KIRKLAND & ELLIS LLP

KIRKLAND **M&A UPDATE**

December 6, 2011

Forward-Looking Statements — Deal Market Trends for 2012

In this M&A Update, we take a look back at 2011 for lessons learned and implications for the coming year.

With the M&A market recovery losing steam in the second half of 2011, dealmakers are faced with increased global macro-economic jitters, election year incertitude and tightened financing markets. But corporations and private funds still have capital to deploy, leading pundits and practitioners alike to be cautiously hopeful that the M&A market in 2012 may show signs of renewed vitality.

With that in mind, we look back at 2011 for lessons learned in the M&A space with implications for the coming year – from the birth of *Airgas* and further dismantling of staggered boards to the reported (but possibly not exaggerated) death of *Omnicare* and hyperbolized demise of proxy access.

Antitrust Regulators: "Not So Fast"

As we noted in our recent M&A Update, antitrust risk is becoming one of the central topics of discussion among dealmakers. This year, three "3-to-2" combinations faced major opposition from U.S. antitrust agencies. Verifone's acquisition of Hypercom was only cleared after settlement of a DOJ suit requiring divestitures to a financial sponsor (after the regulators rejected a proposed divestiture remedy involving sales to the third strategic player), while H&R Block's acquisition of TaxAct failed after regulators successfully sued to block the merger of the two main rivals to TurboTax. Express Scripts' proposed acquisition of Medco remains under review by the FTC after five months, with opposition to the merger mounting. Similarly, "4-to-3" mergers are meeting with continued skepticism. AT&T's proposed acquisition of T-Mobile faces a February 13, 2012 trial date in the DOJ's suit to block the transaction. The DOJ filing came only five months after the merger was announced, a notably compressed timetable compared to the year-long reviews afforded to the XM/Sirius and Comcast/NBC combinations.

While all four transactions undoubtedly represent significant antitrust gambles in any environment, it is clear that the regulatory environment has shifted to more muscular scrutiny and enforcement than we have seen in recent years, especially at the DOJ. We believe that dealmakers will factor into their decisions about taking (and allocating) antitrust risk their views on the likely impact of the political environment in the run-up to the November elections as well as their best guess as to the outcome thereof.

BRIC by BRIC

With the continuing challenges facing the US and EU economies, 2011 saw growing assertiveness by China and India in various aspects of the M&A market. Chinese and Indian companies have become active participants in the deal market, particularly in segments such as energy, resources and chemicals. Regulators in these countries have substantially overhauled and expanded their merger review processes and, in the case of China, formalized rules on national security review; in some deals, antitrust review in China has unexpectedly become the driver of timetable from signing to closing. It remains to be seen whether these expanded reviews augur further politicization of the regulatory process given that Chinese buyers in particular have faced continued opposition to certain attempted investments in Western countries. Three recent antitrust decisions by the European Commission regarding mergers involving Chinese state-owned enterprises (SOEs) show that the European authorities are questioning whether the SOEs, among the most active Chinese M&A market participants, are sufficiently independent of the Chinese state, with implications for both determining jurisdiction (e.g., should other Chinese government-controlled entities' revenues be aggregated with those of the SOE to determine if a filing is required?) and substantive antitrust review.

Extending Burger King — A "Whopper JR"?

As described in a recent M&A Update, the so-called "Burger King structure" pioneered by Kirkland &

Ellis has been employed in a growing number of private equity as well as strategic acquisitions utilizing a tender offer structure where it is imperative to achieve 100% ownership virtually simultaneously with the closing of the tender, often because of financing constraints. Under this approach, the minimum condition to the front-end tender offer is set at the percentage that, when added to the maximum available top-up option, will ensure that the buyer will cross the 90% short-form threshold; if the tender fails to meet that higher minimum condition (usually measurably higher than 50%), the parties abandon the tender offer and proceed with a one-step merger using a proxy statement that is prepared and filed while the tender offer is pending.

In certain cases where an acquirer doesn't have secured financing or other needs that necessitate obtaining 100% ownership in one fell swoop, a twist on the structure (a "hybrid Burger King") might prove useful. Take for example a deal where a target only has limited authorized shares available for the top-up option (e.g., only enough to carry the acquirer from an 85% tender level to the 90% short-form threshold) but where a tender offer is still the preferred structure (often for reasons of speed to control). In such a case, the target is unlikely to agree to the very high 85% minimum condition that would be necessary to implement the full Burger King structure. Instead, the target will likely insist on a traditional 50% minimum condition, meaning the buyer would be forced to start a long-form, back-end merger process (which could take months) from scratch after the closing of the tender offer if it fails to attain an 85% tender level, leaving it stranded in majority, but not 100%, ownership position while the merger unfolds. In our proposed "hybrid Burger King" structure, during the pendency of the front-end tender offer the target would file a proxy statement for the possible back-end, long form merger (as compared to the traditional Burger King proxy statement where the long-form merger is an alternative to the tender offer), seeking to advance the clearance of the proxy statement while the tender offer is ongoing. In the event of a failure to obtain the 85% tender level necessary to reach the short-form merger threshold after the top-up option is exercised, the buyer would hopefully be in a position to more quickly finalize its proxy, complete the back-end, long-form merger, and close the deal. Of course, as we noted in our prior memo, this approach is unnecessary for those targets where action by written consent can be used in lieu of a shareholder vote to complete the back-end merger.

Airgas — More Hot Air than Real Impact?

Early in 2011, the Delaware Court of Chancery handed down a ruling decisively reaffirming the validity of the "poison pill" as a defensive tactic. In a much discussed opinion, the court held that target directors may use a poison pill to fend off a hostile suitor for an extended period of time — even if a majority of shareholders want to accept a proposed deal. As a pill would inflict on the would-be acquirer prohibitive dilution and can only be removed by the sitting board, this defensive tactic is viewed as virtually ironclad so long as the target's board is opposed to the transaction.

A poison pill is most effective when, as was the case with Airgas, deployed in conjunction with a staggered board structure, as the classified board prevents an acquirer from waging a proxy contest to replace the whole board (and thereafter the pill) during a single proxy season. However, as a result of a relentless campaign by governance activists, only 15 of the 100 largest U.S. companies still have staggered boards – down from 54 in 2004, a trend replicated across broader cross-sections of the market. In light of this sea change in board structure, the hand-wringing about *Airgas* empowering boards to "just say no" in the face of a premium offer is increasingly unlikely to manifest itself in practice.

Reports of Omnicare's Death May Not Be Exaggerated

As we discussed in a recent M&A Update, the controversial Delaware Supreme Court *Omnicare* decision may be on its last legs. The *Omnicare* decision precludes a target board from agreeing to a merger where a majority shareholder simultaneously signs a binding voting commitment and the board does not have a fiduciary termination right allowing them to accept a superior proposal (i.e., an airtight "lock-up," and therefore in the *Omnicare* court's view, an "impermissible *fait accompli*").

In the meantime, parties have tested various workarounds that largely achieve the same outcome without running afoul of the strict boundaries of *Omnicare*. For example, in *Orman*, the Chancery Court upheld a lock-up agreement with the majority stockholder that survived a fiduciary termination of the merger agreement for 18 months, prohibiting that controlling shareholder from supporting any subsequent alternative transaction. More recently, buyers have replaced the binding voting commitment proscribed in *Omnicare* with the execution of a binding written consent to the merger by the holders of a majority of the shares immediately after the signing of the merger agreement, subject to a token right of the parties to terminate the deal if the written consent is not delivered within 24 hours of signing the merger agreement (in practice, it is delivered immediately). In *OPENLANE*, VC Noble distinguished this structure from *Omnicare* given the absence of a binding commitment to deliver the written consents, although he showed no naivety in understanding that all parties fully and justifiably expected delivery to occur. For targets where written consent by shareholders is permitted (not uncommon for companies with controlling shareholders), *Omnicare* may be dead in practice, even if not in law.

Proxy Access — Not a Dead Letter

Much effort was expended and ink spilled during the raging debate over the SEC's mandatory "proxy access" rules that would have allowed shareholders meeting minimum holding standards to include director nominees in the company's proxy statement. When the D.C. Circuit court vacated the SEC's universal rule, the concurrent SEC amendments to Rule 14a-8 were left untouched. Under these changes, shareholders will be able to propose in the company's proxy statement bylaw amendments which would enact company-specific proxy access frameworks for director nominations (so-called "private ordering").

Activists have already taken up the gauntlet with test-case private ordering non-binding proxy access proposals being submitted thus far at a handful of companies (including Textron, Sprint Nextel and Bank of America). With these proposals seeking significantly lower ownership thresholds for nominations than the now-defunct SEC rules, the celebration of the defeat of the SEC proxy access rules may prove to have been premature and perhaps misguided. The 2012 proxy season will offer the first read on whether the private ordering approach to proxy access will gain traction with the institutional investor community — if it does, proxy access bylaws could, like the majority voting movement, quickly become the norm.

13D Beneficial Ownership Reporting — Changes on the Horizon

The requirement to file a Schedule 13D, or in the case of certain passive or institutional investments a Schedule 13G, within 10 days of exceeding the 5% ownership level has been the predominant early-warning system for accumulations of stock by investors. These SEC rules have come under increasing criticism from some quarters for not adequately adapting to the current trading realities where large stakes can be accumulated over short periods and the creative use of certain derivatives can shield an investor's full holdings from public view. To remedy these issues, proponents of changing the rules are advocating shortening the current 10-day window for investor disclosure (thereby preventing rapid accumulation above the 5% threshold during that period) and expanding the types of holdings which must be disclosed to more clearly encompass modern synthetic and derivative instruments (especially given the lack of clear guidance on these issues in the recent *CSX* litigation). Opponents of these changes point to a lack of evidence that tightening these rules would satisfy requirements that SEC rulemaking protect investors and promote efficiency. The SEC has intimated that its staff is nearing the end of a broad-ranging review of the current ownership disclosure requirements and we expect that some output from these efforts will confront the investor and legal community in 2012.

Dodd Frank — More to Come

During the 2011 proxy season, corporations were forced to adapt to say-on-pay becoming part of the annual governance dance and another avenue of shareholder engagement and discontent — with limited exceptions and some accompanying nuisance litigation, most companies emerged relatively unscathed. The full impact of the new bounty-based whistleblower regime will be closely watched. The upcoming year is likely to feature SEC rulemaking and enactment of other controversial provisions of Dodd-Frank, including the likely unexpectedly broad reach of the disclosure rules around conflict minerals and pay parity, as well as the mandatory clawback policies and tightening of compensation committee and advisor independence requirements. All of these will contribute to the continued ritualization of corporate governance and disclosure, adding fodder for those criticizing the one-size-fits-all approach to these issues.

Disclosure Settlements — A Closing Window?

Following the chilling impact of the mid-1990s litigation reforms on frivolous securities lawsuits, plaintiffs attorneys quickly found a new hunting ground in deal-related litigation — while only 12% of deals

If you have any questions about the matters addressed in this *M&A Update*, please contact the following Kirkland authors or your regular Kirkland contact.

David Fox
Kirkland & Ellis LLP
601 Lexington Avenue
New York, NY 10022
http://www.kirkland.com/dfox
+1 212-446-4994

Daniel E. Wolf
Kirkland & Ellis LLP
601 Lexington Avenue
New York, NY 10022
http://www.kirkland.com/dwolf
+1 212-446-4884

Robert M. Hayward, P.C.
Kirkland & Ellis LLP
300 North LaSalle
Chicago, IL 60054
http://www.kirkland.com/rhayward
+1 312-862-2133

David B. Feirstein
Kirkland & Ellis LLP
601 Lexington Avenue
New York, NY 10022
http://www.kirkland.com/dfeirstein
+1 212-446-4861

Joshua M. Zachariah
Kirkland & Ellis LLP
601 Lexington Avenue
New York, NY 10022
http://www.kirkland.com/jzachariah
+1 212-446-6450

Christine Wilson
Kirkland & Ellis LLP
655 Fifteenth Street, N.W.
Washington, D.C. 20005-5793
http://www.kirkland.com/cwilson
+1 202-879-5011

Timothy Muris
Kirkland & Ellis LLP
655 Fifteenth Street, N.W.
Washington, D.C. 20005-5793
http://www.kirkland.com/tmuris
+1 202-879-5200

Yosef Y. Riemer
Kirkland & Ellis LLP
601 Lexington Avenue
New York, NY 10022
http://www.kirkland.com/yriemer
+1 212-446-4802

Todd F. Maynes, P.C.
Kirkland & Ellis LLP
300 North LaSalle
Chicago, IL 60054
http://www.kirkland.com/tmaynes
+1 312-862-2485

faced shareholder suits in 1999, around 85% were plagued by such suits by 2010. With this weed-like growth, a popular fee-maximizing tactic for plaintiffs counsel has been the quick resolution of the cases with "disclosure-only" settlements. In such cases, target shareholders get a bit of additional disclosure, often of questionable value, while the only monetary payment is attorneys' fees.

Delaware courts, in particular, have raised the standard for disclosure by public companies in deal-related SEC filings by providing guidance in those cases that do go to trial. In doing so, they have narrowed the window for disclosure claims and concessions — i.e., as proxy disclosure has evolved and improved with court guidance, often with the intent to head off lawsuits, the enhanced disclosure has left less room for substantive disclosure-only settlements when the inevitable suits are nevertheless filed. Chancellor Strine, in a recent hearing, noted that the target for disclosure-only settlements has narrowed, which may force the plaintiffs bar to seek remedies and fees in other jurisdictions.

Multi-Jurisdictional Deal Litigation — Forum Shopping?

For various reasons, including the narrowing Delaware disclosure settlement window described above and competing perceptions of more favorable venue and litigation conditions, post-announcement deal litigation has seen increasing incidence of competing cases filed in multiple jurisdictions, with the litigants, and sometimes even the courts, fighting over the appropriate jurisdiction to resolve the dispute. This development complicates efforts to resolve these suits (whether by dismissal or settlement), often to the detriment of the shareholders of the target company. Courts, especially those in Delaware, are increasingly sensitive to the risks posed by this seeming forum-shopping and the need for a more effective mechanism to centralize deal litigation in one (most appropriate) forum. In April 2011, then Delaware Chancellor Chandler encouraged defense counsel to file motions in each relevant jurisdiction asking the judges to confer and decide the more appropriate jurisdiction to proceed. However achieved, a rational and consistent resolution to this issue is needed to ensure that the epidemic of M&A suits does not deteriorate beyond its current largely nuisance impact.

In fact, following a suggestion by VC Laster, some companies have sought to mitigate forum shopping issues by adding exclusive jurisdiction provisions into their bylaws or charter requiring that certain types of litigation (including deal-related claims) be brought exclusively in the courts of the state of incorporation (usually Delaware). Bylaw provisions are the most expedient, as boards can adopt them unilaterally, but as we noted in an earlier M&A Update it is unclear whether these provisions will be respected when evaluated by courts outside of Delaware. Charter amendments provide a shareholder-approved alternative to a director-adopted bylaw and seem more likely to garner respect in out-of-state courts, but are subject to the uncertain prospects of achieving stockholder approval.

NOL Ownership Changes — Not So Lost?

Code Section 382 currently applies formulaic limitations on the ability of a company to utilize its net operating losses (NOLs) in future years if it undergoes an "ownership change". In simplified form, the existing regulations have provided that any purchase or sale by a 5+% shareholders counts towards determining whether an aggregate shift of 50% ownership has occurred. Under recently proposed IRS regulations certain sales in the market by 5+% shareholders of public companies would not count as an ownership shift. While these regulations are only proposed and a full explication of the extremely complex Section 382 rules is well beyond the scope of this note, it is clear that, if implemented, these changes could have a significant impact on the availability of NOLs for certain public companies and may require a revisiting of the necessity and propriety of at least certain elements of NOL poison pills with a 5% trigger that have been adopted by many companies to reduce the likelihood of an ownership change.