Will M&A Get Hot in 2013?

By Brian Beck • Wood LLP • San Francisco

As 2012 limps to a close and many look forward to a more robust 2013, it's time to review what happened and to prepare for the future. A practical update for the current state of affairs is PLI's "Hot Topics in Mergers & Acquisitions 2012." It was held September 6, 2012, in New York and is now available as a webcast. Co-chaired by R. Scott Falk (Kirkland & Ellis) and Sarkis Jebejian (Cravath, Swaine & Moore LLP), the program features a range of perspectives from key figures in the M&A legal world.

Smorgasboord

An overview of the current M&A landscape revealed year-over-year activity that was mostly stagnant despite a recent uptick. LBOs were slow to recover, and hostile bids have generally been unsuccessful. However, many companies appear to be cash-rich and underleveraged, which could indicate the possibility of more deals on the horizon.

Anne Foster (Richards, Layton & Finger, P.A.) and Melissa Sawyer (Sullivan & Cromwell LLP) led a session on Deal Protection, the course materials for which provide especially useful synopses of recent updates and changes. The materials also include a very effective summary and checklist for drafting alternatives.

After a panel on anti-trust developments, John C. Koski (SNR Denton US LLP) provided an entertaining and educational review of ethics, based in part on the classic movie *The Godfather*. Mr. Koski analyzed the Corleone family consigliore Tom Hagen, whose calm demeanor and constant updates to his client, Michael Corleone, are in some ways a depiction of what effective representation should look like.

Mr. Koski also discussed the more recent *Michael Clayton*. The 2007 thriller starring Tilda Swinton and George Clooney raised some issues relevant to all lawyers, Mr. Koski noted. Clooney, as outside counsel, elicited and recorded incriminating statements from Swinton, who played a general counsel for a large multi-national company. An issue cited by Mr. Koski was the ambiguity as to whether Clooney was actually representing the general counsel or the firm.

That issue, in its real-life iteration, has been recently litigated. [*See United States v. Norris*, 722 FSupp 2d 632 (E.D. Pa. 2010), *aff'd*, 2011 U.S. App. LEXIS 5946 (CA-3 2011).] In *Norris,* the CEO made statements to the outside counsel. The outside counsel later testified against the CEO. The district court and the Third Circuit both held that the communication was not protected by attorney-client privilege.

A panel on activists and proxy advisors was helmed by Daniel H. Burch (MacKenzie Partners, Inc.), Phillip R. Mills (Davis Polk LLP) and Chris Young (Credit Suisse Securities LLC). Mr. Burch and Mr. Young discussed how activism is becoming increasingly important in the M&A landscape. On one hand, the actual number of activist fights has been declining. On the other hand, the relative value of each fight is increasing. A recent trend has been to avoid protracted struggle by settling.

Dodd-Frank and More

A number of failed votes relate to Say-on-Pay, a provision of the Dodd–Frank Wall Street Reform and Consumer Protection Act. [*See* 15 U.S.C. § 78n-1 (2011).] Under Say-on-Pay, at least once every three years shareholders of public companies are entitled to an advisory vote to approve compensation packages for top executives. Not surprisingly, the general trend has been that shareholders are more likely to use these votes to hold management accountable for poor stock performance. Companies with well-performing stock tend to obtain approval more easily.

Another recent development is that protestors, loosely organized as "the 99%," have been interfering with shareholder meetings. Often they will buy one share to gain access to a meeting as a way to interrupt it with shouting and chanting.

Daniel F. Duchovny (SEC), William B. Sorabella (Kirkland & Ellis LLP) and Ann Beth Stebbins (Skadden, Arps, Slate, Meagher & Flom LLP) led the discussion on SEC developments. Mr. Sorabella is spearheading Kirkland's effort at establishing the "Burger King structure," an up-and-coming mainstay of private equity. The Burger King structure is a variation of a tender offer.

Of course, tender offers typically occur in two steps. The first is the initial tender, and the second is the squeeze-out of the remaining shares. If the acquirer has control (90-percent ownership in Delaware) after the tender, the squeeze-out does not require the long-form merger with its extensive SEC filings and a proxy statement. On the other hand, if after the conclusion of the tender the acquirer does not meet the control threshold, it may be necessary undergo the long-form merger to consummate the requisite squeeze-out.

In some cases, the time to complete the second step may be materially detrimental to obtaining financing or other deal conditions. In a Burger King structure, the tender is set to a relatively high percentage ownership. If the tender is successful, the acquirer is offered newly issued shares to satisfy the 90-percent control requirement, thus obviating the second step.

An advantage of the Burger King structure is its tandem, rather than two-step, approach. From the start, the acquirer begins the process of obtaining approval for the long-form merger. If the tender does not result in sufficient ownership and a long-form merger is required, the acquirer has already eliminated much of the wait by beginning the long-form merger process.

This kind of structure may be soon accepted as the new normal, having already been used at least 15 times. However, as the transaction is still relatively new, there is little formal SEC guidance. The SEC may inquire into the effects Rule 14e-5 of the Exchange Act (regarding forward looking statements during a tender offer). Given this uncertainty, care is recommended in establishing timing triggers.

Ms. Stebbins also discussed the 2012 proxy season and made forecasts for the 2013 season. The new Rule 14a-11 was vacated the U.S. Court of Appeals for the D.C. Circuit. [*See Business Roundtable v. SEC*, 647 F3d 1144 (CA-DC 2011).] Amendments to Rule 14a-8, relating to proxy access, were not discussed. More than 20 companies voted on proxy access procedures in 2012. In 2013, similar votes on proxy access are expected.

Divestiture Fest

Arguably saving the best for last, PLI's final presentation topic was led by Carmen M. Molinos (Morgan Stanley), Eric L. Schiele (Cravath, Swaine & Moore LLP) and Paul J. Shim (Cleary Gottlieb Steen & Hamilton LLP) on corporate divestitures. Impressively, a record 43 percent of M&A volume occurred in corporate separations. Given the current state of the market and the levels of shareholder activism, spinoffs and break-ups will surely continue to play a major role in the M&A landscape in the foreseeable future.

Five main types of divestitures were discussed (beyond these, other potential divestiture strategies include a sub-IPO, a structured sale, a joint venture and a strategic sale):

- **Spin-off.** A spin-off structure entails the transfer of a subsidiary's (S) stock to the parent's (P) shareholders. S is no longer a subsidiary of P, and the historic P shareholders control both P and S.
- **Sponsored Spin-off.** In a sponsored spin-off, a third-party sponsor (3S) acquires an interest in S for consideration. P shareholders remain in control of P, and both P shareholders and 3S own the outstanding stock of S.
- **Split-off.** In a split-off, some P shareholders exchange their shares for S stock. Nonexchanging P shareholders own P but not S. Exchanging P shareholders own S but not P.
- **Equity Carve-Out.** In an equity carve-out, S makes a public offering. P shareholders' ownership of P is unchanged. S is now owned by P and public shareholders.
- **Reverse Morris Trust.** In a Reverse Morris Trust structure, there are two steps. The first step involves a spin-off. In the second step, P shareholders exchange S shares with a counterparty (C) in a standard merger. P shareholders own P and also have an interest in C. C owns the stock of S.

The presenters also discussed the board considerations—something tax professionals often do not stop to consider. Board members are protected by the business judgment rule. However, they are also bound by the duty of care and the duty of loyalty.

In the case of bankruptcy and insolvency, directors should be careful not make fraudulent conveyances in corporate divestitures. In a situation where the transferor incurs debts beyond its ability to pay, the spun-off entity or the parent may be subject to the historic creditors. Moreover, the directors may be subject to derivative claims for breach of fiduciary duty. Consequently, it is customary—and advisable—for solvency opinions to be obtained by counsel in divestitures.

Tax consequences are paramount to tax professionals, and the tax consequences of divestitures can literally make or break the deals. Generally, a tax opinion will be obtained in addition to a solvency opinion. The days of private letter rulings for every spinoff may be gone, but that is not the case for tax opinions. The goal, of course, is for the distribution of stock not to incur recognition of income under Code Sec. 355, either to the parent company or the parent's shareholders.

Of course, many complicated issues can arise between the parent and the spun-off company. They could have been integrated so that they shared space. They could have overlapping payroll and IT contracts. Spin-offs may trigger change of control and other events under debt agreements. Moreover, ownership of intellectual property, including trademarks, can lead to complications.

As lawyers, accountants, bankers and executives look towards 2013, PLI's seminar, "Mergers & Acquisitions 2013: Trends and Developments," scheduled for January 17, 2013, is worth considering. For details, you can visit the PLI website at *www.pli.edu/Content/Seminar/Mergers_Acquisitions_2013_Trends_and_Developments/_/N-4kZ1z12p5z?No=25&ID=157099*.

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