What’s so Different About a Public M&A Target?

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Today we’ll cover principal considerations that make buying a public company different from buying a private company, including:

• Confidentiality Agreements Material Non-Public Information (MNPI)
• Deal structures & terms
• M&A-Specific Fiduciary Principles
• Litigation profile
• Communications issues
• The opportunity to apply pressure, go hostile or top
Confidentiality Agreements, MNPI & Exclusivity

- **Purpose** – facilitating “negotiated” transaction
- **Standstill Provisions**
  - Purposes
  - Term
  - Fall-away and MFN clauses
  - Going without/MNPI clause as backdoor standstill
- **MNPI**
  - What it is and what it isn’t
  - When can the Company trade?
  - Implications for Acquirer’s Insider Trading Policy; FINRA Investigations
- **Exclusivity periods**
  - Disclosure considerations
- **Target fiduciary considerations/market check**
- **Acquirer considerations in “conflicted” transaction**
Deal Structures & Terms

• “One-step” merger versus “Two-Step” Tender Offer
  – SEC & HSR Processes
  – State merger law
  – Timing implications

• Consideration – unlike private deals, value is expressed per share
  – Cash – fixed priced per share
  – Stock
    • Fixed versus collared exchange ratio
    • Generally tax-deferred
  – Mixed consideration
    • Fixed versus election
    • Tax considerations
Deal Structures & Terms (cont.)

• “Social” issues
  – Target Management – When & how to broach any continuing role
  – Board composition

• Generally no earn-outs, indemnity or other contingencies
  – Contingent Value Rights (or “CVRs”) can serve those functions in some deals

• Closing Conditions

• Deal Protection – Balancing Seller fiduciary concerns versus Acquirer desire for certainty
  – No-shop provisions & Fiduciary outs
  – Go-shop provisions
  – Breakup fees
  – Voting agreements; “Force the vote” provisions

• Litigation profile (see later discussion)
M&A-Specific Fiduciary Principles

Business Judgment Rule

• Some board decisions are covered by the “business judgment rule”
  – Presumption that the directors acted on an informed basis, in good faith and with the honest belief that the action was in the best interests of the company and its stockholders
  – If it applies, a court will not second-guess the board’s decision
  – Two key prerequisites: satisfied duty of loyalty and duty of care

Revlon Duties

• The board’s duty, if it decides to sell the company for cash (or where a material portion of the purchase price is cash) is:
  – To get the highest and best short term value for the stockholders
  – Long term synergies (which might be relevant if stockholders were getting all stock of an acquirer) are not relevant
• Court will apply a higher level of scrutiny to the board’s actions
M&A-Specific Fiduciary Principles (cont.)

- **Entire Fairness**
  - Where the controlling stockholder is on the buy-side of the transaction or is not a buyer but nonetheless has a “disabling conflict,” the courts will consider applying the highest level of scrutiny – entire fairness
  - If entire fairness applies, with a few very important exceptions, the directors have the burden to prove both fair dealing and fair price
  - Delaware law enables boards to move an entire fairness inquiry back to the business judgment rule in the case of a negotiated transaction in which the controlling stockholder is a buyer if:
    - The transaction is approved by a properly functioning special committee; and
    - The transaction is conditioned, *from the outset*, on non-waivable approval of a “majority of the minority.”

A “disabling conflict” would include receiving a personal financial benefit to the exclusion of, and detriment to, the minority stockholders.
M&A-Specific Fiduciary Principles (cont.)

Defensive actions – Unocal Standard

• Any defensive action to resist a takeover bid will be subject to enhanced scrutiny by Delaware courts
• The board of directors must determine that a threat to the company exists and that the response is reasonable in relation to the threat

Independent Board/Special Committee

• In order to obtain any benefit from independent board/a special committee, it must function properly
• Keys to functioning properly include:
  – Ensuring that the members of the board that are making the decisions/the special committee are independent
  – Understanding role/obtaining a proper charter and fully understanding that charter
  – Making sure that the information flow is appropriate
  – Engaging appropriate advisers
Litigation Profile

• The primary litigation risk is on Target & its Board, but ultimately the Acquirer “buys” the litigation. The SEC requires extensive disclosure of the deal history, and the plaintiffs’ bar will scour for hooks on which to hang their claims.

• Key areas of plaintiff allegations are:
  – Conflicts of Interest
    • Management & Board
      – May warrant special committee
    • Financial advisors
  – Failure to meet “Revlon” obligations to obtain highest value
    • Inadequate sale process
    • Preclusive deal protection terms
  – Inadequate disclosure
    • But note recent Delaware decisions on “disclosure-only” settlements
  – Dissenters’ rights

• Buyer has an interest in avoiding needless exacerbation of litigation risk.
Communications Issues

• Pre-signing Leaks
  – Stock run can kill a deal
  – Stock exchange inquiries

• Coordinated Roll-out Plan – Street, employees, the trade
  – Acquirer & Target need to be tightly coordinated
  – Consider engaging communications firm

• SEC filing requirements
  – 8-K’s
  – Roll-out communications
  – Proxy/Tender Offer materials
  – Registration Statement

• Updates
  – Regulation FD
  – Filing requirements
The Opportunity to Apply Pressure, Go Hostile or Top

• For a reluctant Target, start with situation analysis:
  – Contractual restrictions on communications, trading, etc. (eg, NDA)
  – Target defensive profile (eg, poison pill, freeze-out statutes, etc.)
  – Communications channels
  – Acquire’s health

• Escalation Ladder – the goal is to push Target into negotiating, as few deals get completed on a truly hostile basis
The Opportunity to Apply Pressure, Go Hostile or Top (cont.)

• Available tools include, among others:
  – Private “bear hug” letters
    • Addressed to Board to bypass reluctant management team
    • May require a series of communications
  – “Toe-hold” positions in stock
    • MNPI considerations
    • Firebreaks: Schedule 13D; Section 16; HSR, Freeze-out laws
  – Public “bear hug” letters
    • Addressed to Board publicly, but designed to rally stockholder pressure on Board
  – Proxy contest; Tender Offer – Direct appeals to stockholders

• Where Target has signed a deal with another Buyer:
  – Topping bid need not be considered “hostile”
  – Acquisition agreement will provide roadmap for topping (see deal protection above)
  – If tender offer, consider MNPI issues
Questions?

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