

An Expert's View



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Richard examines recent developments in public M&A and offers projections for 2014:

What trends in deal structure and other negotiated provisions in public M&A did you observe during 2013?

The most significant trend in deal structuring in US public company M&A in 2013 was the effectiveness in August 2013 of new Section 251(h) of the DGCL. Section 251(h) was enacted to facilitate two-step transaction structures consisting of a first-step tender offer followed by a second-step merger.

For transactions in which it is available, Section 251(h) will eliminate the need for approval of the stockholders of the target for the second-step merger (provided that the tender offeror owns at least the number of shares of target common stock that would be necessary to approve the second-step merger). As a result, it will:

- Shorten the time period between consummation of a first-step tender offer and completion of the second-step merger.
- Reduce the costs associated with two-step transactions.
- Reduce the risk that an acquirer will not be able to complete the second-step merger after having consummated the first-step tender offer.

A number of market commentators predict that Section 251(h) will lead to an increase in two-step transactions relative to acquisitions structured as single-step mergers, particularly for highly leveraged acquirers. I do not expect a significant increase in two-step transaction structures. I do anticipate, however, and we have already seen, a reduction in the use of other deal technologies that have been developed to manage the risks with two-step transaction structures. These other technologies include:

- Top-up options, which permit a tender offeror to purchase additional shares following successful completion of a tender offer so as to commit the offeror to cross the 90% threshold necessary for a short-form merger under Delaware law.
- The so-called "Burger King" or "dual-track" structure, in which an acquirer proceeds simultaneously down the path of a cash tender offer as well as a single-step merger.
- Subsequent offering periods.

Negotiated provisions in US public company M&A in 2013 have continued to show the normal range of terms regarding deal-protection provisions, material adverse change clauses and antitrust commitments.

One feature that has become much more common is the concept of the "Intervening Event." Most US public company

M&A agreements include a covenant on the part of the board of directors of the target company to recommend the transaction to target stockholders. This covenant is usually subject to a negotiated fiduciary exception. Increasingly, the scope of this fiduciary exception is being limited to circumstances in which there is a superior proposal or an Intervening Event. An Intervening Event is basically a change in circumstances not involving a superior proposal or other event contemplated by the agreement. The concept of the Intervening Event is being developed to alleviate concerns on the part of the buyer that the target board might simply change its mind.

Apart from acquisition activity, have you noticed any other significant developments impacting M&A practice recently?

There have been two significant factors affecting US public company M&A practice in 2013. The first is the increased level of shareholder activism, which is influencing M&A practice through a variety of channels. Many boards of directors and management teams have become more proactive in considering M&A transactions (particularly divestitures and spin-offs) as preemptive measures to keep activists at bay. Business rationalization is a frequent declared objective of shareholder activists, so boards of directors and management are seeking to get ahead of the activists.

In addition, for those companies that have actually been targeted by activists, significant M&A (again, primarily divestitures or sale of the company) may be a response to the activism. Both of these are somewhat conducive to increased M&A activity. A countering effect of shareholder activism, however, is greater concern on the part of buyers regarding whether a particular acquisition will be well-received by its stockholders and greater concern on the part of the target board of directors about the possibility of activists opposing a proposed sale of the company.

The second significant development is the continuing improvement in the US market for acquisition financing. While the US M&A market in 2013 is well below the boom years of 2006 to 2007 for leveraged activity, it is clear that bank and debt capital markets capacity has increased and firmed up for significant leveraged acquisitions by strategic acquirers and private equity funds. There is heightened confidence across the acquirer universe, ranging from blue-chip corporate borrowers to private equity acquirers, that debt is available at signing and at closing to execute highly leveraged acquisitions.

2013 did not see the hoped-for rebound in US public M&A activity. What drives the public M&A market and what do you think are the prospects for increased deal activity in 2014?

In the medium to long term, US public M&A activity is driven by real economic activity and by rising stock market values, partly offset by regulatory constraints. Over the short term, however, M&A activity can be enhanced by irrational exuberance or retarded by excessive pessimism or stock market volatility. For these reasons, I am generally optimistic about the prognosis for US public M&A, particularly if the US stock market does not quickly surrender a significant portion of its gains from 2013.

M&A activity in a number of sectors, including financial institutions and the energy sector, remains subject to significant regulatory headwinds, and I expect those sectors to continue to underperform from an M&A perspective relative to their contribution to the US macro economy. I see the most significant risks to US public M&A in 2014 as coming from external factors, such as renewed political uncertainty in Washington, further negative news regarding economic recovery in Europe and negative news relating to political developments in the Middle East.