Vintage Deal Tools Reemerge

In the third quarter of 2012, a number of deals utilized tools not often seen in the current dealmaking environment. These tools include crown jewel lock-ups, force-the-vote provisions and joint public company bids. The appearance (or reappearance) of these tools illustrates the continuing focus of buyers on limiting risks in the context of public company transactions.

Apple’s Asset Lock-up

On July 27, 2012, Apple Inc. agreed to buy AuthenTec, Inc., a fingerprint sensor technology company, for $356 million in cash or $8 per share, representing a 60% premium to market. In connection with the acquisition, the parties entered into an asset lock-up, pursuant to which Apple was granted an option to acquire certain AuthenTec intellectual property for a fee of $20 million in addition to an agreed-upon purchase price. Such an arrangement is intended to prevent a third-party interloper from disrupting Apple’s offer since, in such event, Apple would have the opportunity to purchase the target company’s key assets.

Asset lock-ups generally fell out of use after the late 1980s, when Delaware courts expressed disfavor. Several shareholder suits have been filed in connection with Apple’s acquisition of AuthenTec, and it remains to be seen whether Apple’s use of an asset lock-up in the transaction will ultimately be called into question.

Force-the-Vote Provisions

Force-the-vote provisions require a target company’s board to submit the proposed transaction to a shareholder vote regardless of whether the board continues to recommend the transaction. Although force-the-vote provisions had fallen out of favor for some time, their use has increased in recent years, and the trend
Mergers of Equals: Protecting Against a Post-Closing “Hijacking”

Mergers of equals should, in theory, be the friendliest of friendly merger transactions. In a true merger of equals (as opposed to a combination of two unequally-sized businesses styled as a merger of equals, but where board seats are allocated based on relative size), issues relating to the governance and operations of the combined company, such as corporate name, headquarters location and board of directors makeup, are usually settled through a process of balanced give and take because neither party has ultimate negotiating leverage.

This somewhat genteel view of mergers of equals was, however, upended in the third quarter of 2012 immediately following the closing of the combination of Duke Energy Corporation and Progress Energy, Inc. The merger agreement for that transaction provided that William Johnson, the chairman, president and chief executive officer of Progress, would become the chief executive officer of the combined company. However, within 30 minutes of closing, the newly constituted board, which included a majority of former Duke directors, installed James Rogers, the chief executive officer of Duke, as the chief executive of the combined company.

In a letter to the editors of The Wall Street Journal shortly thereafter, the former lead director of Progress referred to these events as “the most blatant example of corporate deceit that I have witnessed during a long career on Wall Street and as a director of 10 publicly traded companies” and “one of the greatest corporate hijackings in US business history.”

Heated rhetoric aside, the events that transpired following the Duke/Progress transaction illustrate the importance of properly structuring post-closing covenants in merger-of-equals transactions.

In the Duke/Progress transaction, the obligation to cause the Progress chief executive officer to become chief executive officer of the combined company was set forth in the merger agreement but the agreement did not specify that he would continue in such position for any specified period of time. The merger agreement also expressly provided that, other than with respect to certain limited exceptions, there were no third-party beneficiaries to the agreement. Therefore, once the transaction closed, there were no parties with standing to enforce any obligation the combined company may have had to continue to employ Mr. Johnson as chief executive officer and, upon termination, Mr. Johnson was arguably entitled only to the severance specified in his employment agreement. However, some shareholders have brought claims alleging material misstatements and omissions in the registration statement relating to the stock-for-stock transaction, as well as bad faith by the board of directors.

In order to avoid a situation like this, other merger-of-equals transactions have sought to protect the sanctity of these sorts of covenants by including them in either the
charter or bylaws of the combined company. A charter provision is clearly most protective and would typically provide that a supermajority board vote would be required in order to alter agreed-upon governance matters such as board size, composition, or the identity of the chief executive officer or chairman. The number of votes necessary to constitute a supermajority would, at minimum, require that at least some directors from the boards of each of the constituent companies approve of any such change. This type of protection was built into many of the largest merger-of-equals transactions, including the 2002 combination of Conoco and Phillips Petroleum and the 2006 Alcatel/Lucent transaction.

SPACs Make the News (Again)

A number of recent transactions suggest that special-purpose acquisition companies (so-called SPACs) have returned to favor with investors and dealmakers. SPACs are “blank check” companies without current operations that raise capital through initial public offerings. The offering proceeds are held to use in connection with a future acquisition and, if the company does not complete an acquisition within a specified period of time, most of the offering proceeds are returned to investors.

Unlike illiquid interests in private equity funds, SPAC shares are publicly traded. However, in order to complete an acquisition, a SPAC must obtain approval from its shareholders, which creates deal risk not present in most private equity acquisitions. In some cases, investors have accumulated large stakes in SPACs at discounts to their cash liquidation value either to wait out the end of the investment period or to vote against a proposed deal in order to receive a distribution of cash proceeds. For example, according to Investment Dealers’ Digest, approximately half of the 40 SPAC acquisitions announced in 2008 failed to obtain shareholder approval. Further, as Universal Business Payment Solutions Acquisition Corporation announced on September 11, 2012, SPACs run the risk of delisting for failure to have at least 300 public stockholders.

Nonetheless, the popularity of SPACs generally rises and falls with M&A activity more generally. Recent SPAC IPOs include offerings by BGS Acquisition Corp. and Andina Acquisition Corp. in March 2012. BGS stated in its prospectus that it intended to focus on operating businesses that have their primary operations located in any of: (a) the Mercosur countries (Argentina, Brazil, Paraguay and Uruguay), (b) associate member countries of Mercosur (Bolivia, Chile, Colombia, Ecuador and Peru), (c) Latin America generally, or (d) the United States in areas principally serving the Hispanic market. Andina disclosed that it would focus on transactions involving the Andean region, particularly Colombia.
Recently announced SPAC acquisitions include:

<table>
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<th>SPAC</th>
<th>Target(s)</th>
<th>Announcement Date</th>
<th>Status as of October 2, 2012</th>
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| Universal Business Payment Solutions Acquisition Corporation | JetPay, LLC  
AD Computer Corporation  
(Payroll Tax Filing Services, Inc.)  
Francis David Corporation  
(d/b/a Electronic Merchant Systems) | July 6, 2012 | Preliminary Proxy Statement filed on September 12, 2012 |
| JWC Acquisition Corp.                    | Tile Shop LLC                                                             | June 27, 2012     | Closed on August 22, 2012                                               |
| Cazador Acquisition Corporation Ltd.     | Net Element, Inc.                                                         | June 12, 2012     | Closed on October 2, 2012                                               |
| Hicks Acquisition Company II Inc.        | Appleton Papers Inc.                                                      | May 16, 2012      | Agreement terminated on July 13, 2012  
Hicks Acquisition Company II announced planned redemption of publicly-held common stock and planned dissolution on July 16, 2012 |
| RLJ Acquisition, Inc.                    | Image Entertainment, Inc.  
Acorn Media Group, Inc.                                                    | April 10, 2012    | Closed on October 3, 2012                                               |
The Hong Kong Legislative Council passed the Companies Bill on July 12, 2012, a major milestone in a comprehensive exercise to rewrite and modernize the Companies Ordinance (Cap. 32) of Hong Kong. The new Companies Ordinance (the “New CO”) is not expected to be operative until 2014. The following is a summary of the major initiatives introduced in the New CO.

Abolition of Headcount Rule for Takeover Schemes

Under the existing regime, a scheme of arrangement requires approval of a majority in number (the “Headcount Rule”) representing at least 75% of the votes present at the meeting. In a takeover context, the Headcount Rule is open to abuse as most shares in Hong Kong listed companies are held in uncertificated form and are typically voted on by the nominee of the clearing system. For schemes of arrangements in a takeover context, the New CO will abolish the Headcount Rule but (tracking the requirement in the Hong Kong Code on Takeovers and Mergers and Share Repurchases) will require that not more than 10% of disinterested votes are cast against the resolution.

Directors’ Duties

The New CO will codify a director’s duty of care, skill and diligence with a view to clarifying the legal position. A mixed objective/subjective standard will be adopted, requiring a director to exercise the care, skill and diligence that would be exercised by a reasonably diligent person with:

(a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company (the objective test); and

(b) the general knowledge, skill and experience that the director has (the subjective test).

Maintenance of Share Capital

Under the existing regime, a reduction of share capital requires a special resolution and a court order confirming the reduction. The New CO will introduce an alternative court-free procedure where the special resolution is supported by a solvency statement made by each director confirming the director’s opinion that the company will be cashflow solvent immediately after the transaction and for a period of 12 months thereafter.

Under the existing regime, a reduction of share capital requires a special resolution and a court order confirming the reduction. The New CO will introduce an alternative court-free procedure where the special resolution is supported by a solvency statement.
The New CO will also allow companies (not just private companies, as is the case currently) to purchase shares out of capital, subject to meeting the solvency test described above.

**Financial Assistance**

Under the existing regime, subject to certain exceptions, companies are prohibited from giving financial assistance to third parties who are purchasing the company’s shares. Private companies may seek a “whitewash” approval by special resolution from shareholders to permit financial assistance. The New CO will allow companies (whether listed or unlisted) to provide financial assistance, subject to the satisfaction of the solvency test and either (a) board approval only, if the aggregate amount of the assistance does not exceed 5% of shareholders’ funds; (b) board approval and unanimous approval of shareholders; or (c) board approval and approval by ordinary resolution of shareholders, with notice given to shareholders of the assistance and subject to a right of dissenting shareholders representing 5% or more of the votes to petition the court for a restraining order. The outright abolition of the financial assistance restrictions for private companies was proposed, but not adopted, as it was considered premature until Hong Kong implemented measures to prohibit insolvent trading. If rules on insolvent trading are eventually adopted in Hong Kong, it is possible that the restrictions on financial assistance by private companies could be further relaxed.

Other important measures in the New CO include:

**Enhancing Corporate Governance**

- requiring every private company to have at least one natural person to act as a director;
- improving the procedures for written resolutions, including procedures for shareholders to propose resolutions;
- reducing the threshold requirement for members to demand a poll from 10% to 5% of voting rights;
- requiring public companies and larger private companies to prepare a more comprehensive directors’ report which includes an analytical and forward-looking business review;
- improving the procedures for dealing with directors’ conflicts of interests, including expanding the requirement to seek shareholders’ approval to cover service contracts which exceed three years, and requiring ratification of director conduct by disinterested shareholders only;
requiring disinterested shareholders’ approval in cases where shareholders’ approval is required for transactions of public companies and their subsidiaries;

- extending the scope of unfair prejudice to cover “proposed acts and omissions” so that the remedy is potentially available before the act or omission occurs;

- empowering auditors to require a wider range of persons (such as officers of a company’s Hong Kong subsidiaries and any person holding or accountable for the group’s accounting records) to provide information and explanation required for the performance of the auditor’s duties and extending the offense of failing to provide the information or explanation to the auditors to cover such persons;

Ensuring Better Regulation

- introducing new secrecy rules which will make it an offense for persons involved in an investigation to disclose particulars of such investigation;

- strengthening the enforcement regime in relation to liabilities of officers for contravention of the New CO, including lowering the threshold to include reckless acts or omission, and introducing a new definition of “responsible persons” which includes officers, shadow directors and persons who authorize or permit or participate in the contravention or failure;

Facilitating Business

- allowing companies to dispense with annual general meetings by unanimous shareholder consent;

- introducing a new court-free statutory amalgamation procedure for wholly-owned group companies;

- facilitating simplified financial reporting by small and medium sized enterprises;

- allowing companies to execute deeds without the common seal, with the signature of two directors or a director and the secretary;

Modernizing the Law

- adopting a mandatory no-par value system for companies with share capital; and

- clarifying the rules on indemnification of directors against liabilities to third parties.
Proxy Access Update and SEC Rule Changes

Update on Proxy Access Proposals

In our M&A Quarterly for the Second Quarter of 2012, we reported on proxy access proposals that had been submitted during the main proxy season. We described two such proposals that were adopted by shareholders of Nabors Industries and Chesapeake Energy, both of which requested that the company’s board adopt a bylaw allowing shareholders who have owned at least 3% of the company’s stock continuously for at least three years to have their candidate nominations included in the company’s proxy materials (not to exceed one quarter of the number of directors). This ownership threshold and holding period are identical to those which had been included in the proposed, and now invalidated, SEC Rule 14a-11.

Since that time, precatory proxy-access proposals have been presented to shareholders at Forest Laboratories, Medtronic and H&R Block. Each of these proposals required the nominating shareholder hold just a 1% ownership interest for a two-year period (or a group of 50 or more shareholders each holding $2,000 worth of stock for one year), which are significantly lower eligibility requirements than those approved by the shareholders of Nabors Industries and Chesapeake Energy. The stated aim of these new proposals was to ensure that long-term shareholders have a reasonable, but not necessarily easy, means for including board nominations in the companies’ proxy materials. Based on the outcome of the votes, it appears that the hurdles were set too low: none of these proposals obtained the support of even 10% of the shares voted. It is notable that both Institutional Shareholder Services (ISS) and Glass Lewis declined to support the proposals.

SEC Rule Changes


- Listing Standards for Compensation Committees: Under new Rule 10C-1 of the Securities Exchange Act of 1934 (the “Exchange Act”), each national securities exchange must establish listing standards that, among other things, require each member of a listed company’s compensation committee to be a member of the board of directors and to be “independent” (as defined in the listing standards of the applicable stock exchange). Compensation committees must also have authority to retain independent advisors and they will be required to consider independence factors in selecting these advisors. Each national securities
exchange and national securities association must have final rules in place that comply with Rule 10C-1 and have been approved by the SEC no later than June 27, 2013. Once an exchange’s new listing standards are in effect, a listed company must meet the standards in order for its shares to continue trading on that exchange.

- Compensation Consultant Conflicts of Interest Disclosure: The SEC adopted amendments to its proxy disclosure rules to require new disclosures from companies about their use of compensation consultants and conflicts of interest. Specifically, with respect to any compensation consultant that has played a role in determining or recommending the amount or form of executive and director compensation and whose work has raised any conflict of interest, companies will be required to disclose the nature of the conflict and how the conflict is being addressed. Companies must comply with these disclosure rules in any proxy or information statement for an annual or special meeting of shareholders at which directors will be elected occurring on or after January 1, 2013.

- Conflict Minerals Rules: Under new Rule 13p-1 of the Exchange Act, companies must publicly disclose their use of conflict minerals (including tantalum, tin, gold and tungsten) that originated in the Democratic Republic of Congo or adjoining countries. Companies will be required to provide this disclosure by filing a specialized report on new Form SD beginning on May 31, 2014 (for the 2013 calendar year) and annually on May 31 every year thereafter.

- Payment Disclosure Rules for Resource Extraction: Under new Rule 13q-1 of the Exchange Act, resource extraction issuers (companies engaged in the development of oil, natural gas or minerals) must file annual reports disclosing certain payments made to the US government or foreign governments for the purpose of commercial development of oil, natural gas or minerals. Companies must comply with the new rule for fiscal years ending after September 30, 2013 by filing a Form SD no later than 150 days after the end of their fiscal year.

Affected companies should consider whether new internal policies or procedures should be adopted in order to implement and comply with these new rules.
has continued in 2012. At about the midpoint of the third quarter of 2012, approximately 44% of transactions in 2012 valued at over $100 million featured a force-the-vote provision.

Buyers utilize force-the-vote provisions to provide an additional measure of deal protection. Third-party bidders contemplating a superior offer may be deterred if they know that a solicitation process must occur before the existing merger agreement can be terminated.

**Bristol-Myers’ and AstraZeneca’s Joint Bid**

On August 9, 2012, Bristol-Myers Squibb Company acquired Amylin Pharmaceuticals, Inc. for $31 per share. The transaction price represented a 10% premium to market and an increase of 51% over Bristol-Myers’ original bid for Amylin in February 2012, which had been rejected by Amylin’s board. The Amylin acquisition was, in effect, a joint bid of Bristol-Myers and AstraZeneca plc. As structured, Bristol-Myers first paid $5.3 billion in cash to Amylin stockholders and also assumed another $1.7 billion in debt and other liabilities. Bristol-Myers then contributed the company to a joint venture with AstraZeneca, in exchange for approximately $3.4 billion in cash. Through the joint venture, each of Bristol-Myers and AstraZeneca will have an interest in profits from Amylin’s future sales. AstraZeneca also intends, subject to the receipt of applicable antitrust approvals, to pay Bristol-Myers an additional $135 million to exercise an option to acquire additional governance rights over key strategic and financial decisions regarding Amylin’s portfolio.
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