Remedies for Delayed Closings: The Reappearance of Ticking Fees

“Without interest.” These words are *de rigueur* in merger agreements with respect to the amount of merger consideration payable at the closing of the merger. This fixed purchase price concept is almost always the case without regard to the actual or anticipated length of delay between signing and closing the transaction. Nevertheless, two recent transactions, Thermo Fisher’s acquisition of Life Technologies, announced on April 15, 2013, and Service Corporation International’s acquisition of Stewart Enterprises, announced on May 28, 2013, have included so-called ticking fees, which would increase the merger consideration payable in the event closing is delayed beyond an agreed date.

Under the Life Technologies merger agreement, the US$76 per share in cash consideration will increase by US$0.0062466 (or approximately 0.008%) for each day beginning on the nine-month anniversary of the signing and continuing until and including the closing date, if the closing does not occur within nine months due to the failure to obtain regulatory or other governmental approvals. The outside closing date is 15 months after signing, and so the maximum additional consideration payable would be approximately US$1.137 per share.

Under the Stewart Enterprises merger agreement, the US$13.25 per share in cash consideration will increase by US$0.002178 (or approximately 0.016%) for each day after the seven-month anniversary of the signing and continuing until and including the closing date, if the closing does not occur within seven months. In the event the parties receive a second request under the HSR Act, the number of days used for calculating the ticking fee would be reduced by one day for each day following the later of (i) the 60th day from the date of service of the second request and (ii) the date on which Service Corporation International, but not Stewart Enterprises, has certified substantial compliance until the day on which...
Beginning with 3G’s acquisition of Burger King in 2010, acquirors of public companies have periodically employed an acquisition technique known as the “dual-track” approach. Under this approach, the merger agreement provides that the acquiror will simultaneously pursue both a two-step tender offer and a one-step merger. The dual-track approach is typically used by private equity sponsors and other buyers in debt-financed tender offers, where the financing would only be available upon acquisition of 100% of the target’s outstanding shares. In such a circumstance, a tender offer could only be used to complete the transaction if enough shares are tendered to allow an immediate short-form merger (usually requiring 90%). Otherwise, the transaction would need to be completed pursuant to a shareholder-approved merger.

Under the dual-track approach, an acquiror commences a tender offer for all of the stock of the target and, while the tender offer is pending, the target files with the Securities and Exchange Commission (SEC) a preliminary proxy statement to solicit the vote of its stockholders at a special meeting to approve the merger. If the acquiror does not obtain sufficient shares in the tender offer for a short-form merger, the proxy statement would then already be on file with the SEC, and the review process would have begun.

Since the Burger King transaction, there have been 19 publicly announced transactions that employed the dual-track approach. In 16 of those transactions, the target filed a preliminary proxy statement during the tender offer period, though only one of those companies ultimately filed a definitive proxy statement. Notably, each of those tender offers was completed with sufficient shares to immediately complete the short-form second-step merger, and not one of those transactions resulted in the mailing of a merger proxy.

These statistics suggest that the dual-track approach has been a remedy in search of an illness. The dual-track approach may, therefore, have been fading away based on its record alone. Moreover, we understand from our interactions with, and public comments made by, members of the SEC staff that the SEC was concerned that filing a definitive merger proxy during the tender-offer period could be viewed as violating Rule 14e-5, which prohibits offering to buy the target company’s stock outside the confines of the tender offer. In fact, no transactions announced in 2013 have used this approach, and proposed changes to the Delaware General Corporation Law may hasten the demise of the dual-track structure altogether.

Under the Delaware proposal, Section 251 of the DGCL would be amended to eliminate the requirement for shareholder approval of a second-step merger following most tender offers. Specifically, the amendment would permit companies whose stock is publicly traded to include a provision in a merger agreement eliminating the stockholder-vote requirement as long as several conditions are satisfied, most notably that following the
The Standard of Review in Going-Private Transactions: Delaware’s Long-Awaited Clarification

Due to a jigsaw puzzle of judicial decisions, companies and controlling shareholders have had to deal with continuing uncertainty as to the standard of review that a Delaware court would apply to a going-private transaction with a controlling shareholder. Without certainty as to the applicable standard of review, deal professionals have been left to structure key elements of these transactions based on intuition and “feel” for what will pass scrutiny under the circumstances. In late May, however, Chancellor Strine provided welcome clarity on this process in his decision in the In re MFW Shareholders Litigation action.

The MFW case arose from the proposed acquisition of M&F Worldwide by its 43% shareholder, MacAndrews & Forbes. In making its initial proposal, the shareholder made clear that it expected the company to establish a special committee of M&F’s independent directors, that it would not proceed with the transaction unless it was approved by a majority of M&F’s minority shareholders, and that it would not bypass the special committee (i.e., the committee had the authority to “just say no”). After negotiating with the special committee, the controlling shareholder raised its price by approximately 4%, ultimately agreeing to pay a 47% premium to M&F’s price before announcement of the offer. Holders of 65% of the shares held by the minority shareholders voted to approve the transaction.
In the MFW decision, Chancellor Strine applied the business judgment rule, rather than the higher-scrutiny “entire fairness” standard, to his review of the transaction. In applying this lower level of scrutiny to the transaction, the Court granted the defendants’ motion for summary judgment and dismissed the plaintiff shareholder claims.

In his decision, Chancellor Strine announced that the following six specific conditions would need to be met in order for the business judgment rule to apply to a controlling shareholder transaction: “(i) the controller conditions the procession of the transaction on the approval of both a special committee and a majority of the minority stockholders; (ii) the special committee is independent; (iii) the special committee is empowered to freely select its own advisors and to say no definitively; (iv) the special committee meets its duty of care; (v) the vote of the minority is informed; and (vi) there is no coercion of the minority.”

The clarity of Chancellor Strine’s holding is refreshing. However, in the law of going-private transactions, like in skydiving, an eye always needs to be kept on the horizon. First, the MFW decision may be subject to further review of the Delaware Supreme Court, and that court could obviously take a different view. Second, since MFW did not involve a tender offer, the case does not decide whether a special committee recommendation is now required in order to obtain the benefits of the business judgment rule in the case of a tender offer structure. Chancellor Strine did not impose such a requirement in the context of a tender offer in his 2002 In re Pure Resources decision. Third, even if the “six-point test” survives Supreme Court review, there is certain to continue to be litigation as to, among other things, the proper mandate that a special committee must have in these circumstances, whether the members of the special committee are appropriately independent, and whether the minority vote is fully informed.

China’s Cresting Going-Private Wave

Though not a tsunami, a powerful wave of going-private transactions involving China-based, US-listed companies has been building over the past several years, with more than 40 going-private proposals having been announced since 2010. Most prominent is the recently consummated US$3.7 billion acquisition of Focus Media, China’s largest out-of-home advertiser, by a Fried Frank-advised consortium consisting of both Chinese and international private equity funds. Focus Media is China’s largest leveraged buyout to date.
China’s Cresting Going-Private Wave (continued from previous page)

One of the key drivers for this going-private trend is the lingering effect of widely reported accounting and fraud scandals involving a number of Chinese companies. These scandals have weighed heavily on market valuations of China-based, US-listed companies since 2011. As a result, many such companies have sought, or are considering, an exit from the US public market, often with an eye towards re-listing in a more favorable market such as Hong Kong or China.

Transactional Considerations

On the surface, these transactions are similar to typical US going-private transactions in that they are generally structured as mergers, and typically constitute 13e-3 “going-private” transactions under the US federal securities laws. However, Chinese market practice in this area is distinct from US practice in several significant ways.

China-based companies generally obtain a US listing in one of two ways: either through an underwritten initial public offering, which typically involves a holding company incorporated in the Cayman Islands or BVI, or by way of a reverse takeover of an existing US public shell company, which is typically incorporated in Delaware or Nevada. Most of the recent China-based going-private transactions have involved companies that went public through underwritten public offerings and, therefore, most have been subject to the law of the Cayman Islands or BVI. As a result, one key difference in China-based going-private transactions is the typical absence of many customary procedural safeguards for minority shareholders – such as “majority of the minority” shareholder vote requirements, pre-signing market checks or go-shops – that are common features of US going-private transactions involving Delaware companies.

For example, US going-private deals almost invariably feature a “majority of the minority” vote requirement mandating that the transaction be approved by holders of a majority of the shares unaffiliated with the buyer group (in addition to the statutory merger vote) and it is common for US target companies to conduct a pre-signing market check or to negotiate for the right to conduct a post-signing market check (or “go-shop”). However, the Cayman Islands do not have Delaware-style merger-related case law and, consequently, while it has become market practice for the board of directors in a China-based transaction involving a Cayman company to form a special committee of independent directors, none of these other features is prevalent in China-based going-private transactions involving Cayman (or BVI) target companies. Of 14 recent China-based going-private transactions, only three required a “majority of the minority”-type vote, and none featured a “go-shop” provision or market-check process.

China’s Cresting Going-Private Wave (continues on next page)
China’s Cresting Going-Private Wave (continued from previous page)

Second, a Cayman merger requires approval only by a special resolution (which, for most companies, requires at least a two-thirds majority of the shares present and voting at the shareholders meeting, as compared with a majority of outstanding shares as would be required in Delaware). As a result, because the buyer group in China going-private transactions often holds a controlling or significant stake in the target company, the vote in many of these transactions is virtually assured.

Third, while most going-private transactions involving US issuers result in multiple plaintiffs’ lawsuits alleging violations of fiduciary duty or inadequate disclosures, it is rare to see such suits in transactions involving China-based Cayman or BVI issuers.

What Lies Ahead

Since there are about 400 China-based companies with US listings, we expect to see this wave of going-private transactions continue. Also, the complexity and sophistication of these deals should continue to increase. For example, early in the Chinese going-private trend, transactions were largely financed by a single Chinese financing institution, often one of the Chinese “policy banks,” like China Development Bank. However, private equity firms and international banks have begun to play a larger role in these transactions, and along with their participation has come the development of a nascent leveraged buyout market for these transactions. Focus Media, for example, involved an international-style debt financing from a syndicate of international and Chinese banks. So long as market valuations for US-listed Chinese companies remain depressed, and financing is available from banks or private equity firms, going-private transactions will continue to be an appealing option for these companies and their interested stakeholders.

The Delaware Court of Chancery continues to issue decisions of interest that highlight the need for care when undertaking a sale process. While two recent decisions do not break new ground, they affirm two fundamental principles applicable to M&A transactions. First, the court once again reached the conclusion that directors of selling companies continue to enjoy wide latitude in determining the best way to fulfill their
The court concluded that, therefore, plaintiffs were unable to establish a reasonable probability that the Plains board engaged in inadequate or unreasonable decision-making under the circumstances.


In a May 9, 2013, decision, Vice Chancellor Noble refused to enjoin Plains’ merger with Freeport-McMoRan Copper & Gold Inc. In Plains, plaintiffs claimed that the Plains board acted unreasonably by: (1) permitting Plains’ CEO, President, and Chairman of the Board to control the process without appointing a special committee; (2) failing to shop Plains and consenting to onerous deal protection devices; and (3) failing to negotiate a collar, increased exchange ratio, or royalty trust.

Ultimately, Vice Chancellor Noble held that despite not shopping the company, seeking a “go-shop” period, or conducting a market check, the Plains board did not abdicate its Revlon duties by accepting an offer of approximately US$50/share from Freeport, a 39% premium. With respect to the plaintiffs’ arguments regarding the deal terms, the court found that plaintiffs ignored the reality of negotiations that “concessions tend to come at a price,” and were second-guessing the reasonable business judgment of the adequately involved Plains board. The court concluded that, therefore, plaintiffs were unable to establish a reasonable probability that the Plains board engaged in inadequate or unreasonable decision-making under the circumstances.

As to the plaintiffs’ arguments that the CEO improperly controlled the sale process, the court found it pivotal that plaintiffs offered no explanation as to why the disinterested and independent directors, representing seven-eighths of the board, would disregard their fiduciary duties “to help Flores achieve his [allegedly] self-interested objectives.” The court found that, in addition to their independence, the directors’ relevant expertise and experience supported a “reasonable inference that they were informed and competent to make an appropriate decision,” even without shopping Plains to other potential buyers.

Plains again illustrates that while the Delaware Courts continue to hold corporate directors to a high standard under Revlon, Revlon does not prescribe a single course of conduct a board must undertake when selling the company, so long as it acts on a reasonable and informed basis.
Anvil Holding Corp. v. Iron Acquisition Co.

Shortly after Plains was decided, Vice Chancellor Parsons concluded that fraud allegations made against a private equity firm and others in connection with the US$175 million sale of a software company were actionable. The plaintiff-buyers claimed that defendants overstated the company’s value because they allegedly knew that one of the company’s most important contracts would materially change soon after closing, and purposely concealed knowledge of this fact during negotiations. In particular, the contract’s pricing was changing from firm fixed pricing to time and materials pricing, which would be far less lucrative for the company.

In refusing to dismiss these allegations of fraud, the court found that it was “reasonably conceivable” that plaintiffs could prove that defendants made a false representation that each of the defendants knew was false at the time made, and, moreover, “that the individual defendants . . . actively concealed from the buyer information that made those representations false.”

Defendants argued that there was no basis to hold the individual defendants liable for statements made by the company. However, the court rejected this argument because the individual defendants were both sellers and managers of the company, and were each linked to the false representations. The court also rejected the defendants’ argument that claims based on “off-contract” representations were invalid due to a provision in the purchase agreement stating that the parties were not making representations or warranties outside of those contained in the agreement, and on another provision stating that the agreement superceded any prior understandings between the parties. While the court noted that “Delaware courts will honor clauses in which sophisticated parties disclaim reliance on extra-contractual representations,” it found that the purchase agreement did not reflect a clear promise by the buyer that it was not relying on statements made to it outside of the agreement, because the agreement did not specifically state that the parties disclaimed reliance upon extra-contractual statements.

Anvil thus provides an important reminder that, whether or not a buyer specifically asks, a selling company must carefully consider all information that may be material to a buyer, as well as the accuracy of any representations it does make. In addition, it cautions that Delaware courts will only find that a party has disclaimed reliance on representations made outside of the contract if the contract contains an express promise to that effect.
Rural/Metro: Possible Life for Stapled Financing?

The shareholder litigation over Rural/Metro Corporation’s US$438 million sale to Warburg Pincus in 2011 started in a typical fashion. The progress of the litigation, however, was anything but ordinary. In the end, one of two financial advisors to Rural/Metro opted to proceed to trial, while the company itself and the other financial advisor settled.

Rural/Metro, a medical transport company, began investigating a potential sale of the company in December 2010 after receiving an unsolicited acquisition offer in late September 2010. The Board formed a special committee and hired RBC Capital Markets LLC and Moelis & Co. LLC as its financial advisors. RBC and Moelis ran an auction that involved contacting 28 potential buyers (21 of whom signed confidentiality agreements). Ultimately, Warburg agreed to pay US$17.25 per share, a 37% premium to Rural/Metro’s price prior to announcement of the transaction.

As expected, shortly thereafter, multiple shareholder complaints were filed. The plaintiffs alleged that the Rural/Metro Board of Directors breached its fiduciary duties and that its financial advisors, RBC and Moelis, aided and abetted those breaches. As to the financial advisors, the plaintiffs alleged that RBC and Moelis provided flawed financial analyses and advice at the eleventh hour – failing to give the Board enough time to synthesize this information – and that the Board accepted this advice without question despite what the plaintiffs characterized as obvious flaws.

At the same time, plaintiffs took issue with RBC’s attempts to offer Warburg stapled financing and other financial products which, if utilized, would possibly double the amount RBC would be paid on the deal. Although Warburg did not take RBC up on any of its offers for financing, the plaintiffs believed that given the “widespread availability of acquisition financing at the time, allowing RBC to offer stapled financing served no useful purpose, and only created a huge financial incentive for RBC to consummate a sale transaction, and compromise the integrity of its advice.”

Ultimately, the lead plaintiff and the Rural/Metro defendants reached a disclosure-only settlement. However, one of the shareholder plaintiffs challenged the settlement, and Vice Chancellor Laster rejected the settlement in January 2012 (nearly seven months after closing) based on his belief that the confirmatory discovery conducted by lead counsel was insufficient.

After several more months of discovery, Moelis agreed to a settlement pursuant to which Moelis paid US$5 million (without admitting any wrongdoing). Five days later, on April 30, 2013, Rural/Metro and its directors settled for an additional US$6.6 million (also without admitting wrongdoing). Both Moelis and the directors will be indemnified.
Prior to Life Tech and Stewart Enterprises, there were only about a dozen examples in recent years of consummated public merger transactions that employed an increasing purchase price as part of the merger consideration.

the company certifies substantial compliance with such second request. The extended outside closing date is 60 days after the seven-month anniversary of signing, and so the maximum additional consideration payable would be approximately US$1.31 per share.

Prior to Life Tech and Stewart Enterprises, there were only about a dozen examples in recent years of consummated public merger transactions that employed an increasing purchase price as part of the merger consideration. In most of these transactions, the increase was to be applied in the event of any delay in closing the transaction, but a few were linked to specific conditions, such as the ability to obtain regulatory and antitrust approvals or the ability to complete internal arrangements to effectively take control of the target business. This feature was generally structured either as an interest rate adjustment or as a per-share cash adjustment. In one transaction, the feature was to be

* * * *

Remedies for Delayed Closings: The Reappearance of Ticking Fees (continued from previous page)

Even though RBC would likely be entitled to similar indemnification rights as Moelis, RBC opted to proceed to trial. The trial focused not only on RBC’s fairness opinion and its role in the auction process, but also on RBC’s repeated efforts to offer Warburg stapled financing and several other financial products in connection with the deal.

Assuming the parties do not settle prior to the issuance of a decision, Vice Chancellor Laster will have an opportunity not only to address issues related to the disputed financial analyses, but also to revisit his 2011 decision in Del Monte Foods, which substantially limited the willingness of investment banks to offer (or companies to allow) stapled financings for public company sales in most circumstances. Here, unlike in Del Monte Foods, the plaintiffs have not alleged that the investment bank violated confidentiality agreements, steered the sale to a favored client, or acted without the full knowledge of the board. Moreover, Rural/Metro had a second financial advisor, Moelis, actively engaged in the sale process from the very beginning.

A decision favorable to RBC could roll back some of the fear and hesitancy on the part of companies and investment banks in allowing a sell-side financial advisor to provide buy-side financing. Any such decision would likely address limitations and conditions on when this would be appropriate, including with respect to board decision-making and the requirement to have a second “independent” financial advisor. On the other hand, an unfavorable decision would likely further chill the market in this regard. ■

Remedies for Delayed Closings: The Reappearance of Ticking Fees (continued from cover)
a fixed fee applied for each month that the closing was delayed, ranging from US$75,000 for the first month of delay to US$3 million for the third month of delay onward. Only three of these transactions were delayed long enough such that the increasing purchase price feature became effective.

Of these three transactions, two (Dow Chemical’s 2009 acquisition of Rohm & Haas and Boston Scientific’s 2006 acquisition of Guidant) closed not long after the proposed closing dates, and resulted in the payment of only modest additional per-share consideration. However, due in part to antitrust issues, the third transaction (DaVita’s 2005 acquisition of Gambro Healthcare) did not close until 10 months after signing. The adjustment feature in that transaction provided for the purchaser to pay 4% annual interest on the purchase price for the first 90 days following signing and 8% annual interest from the 91st day following signing until the closing. As this was an acquisition of a private company, it is unclear what adjustment was actually applied to the purchase price.

It is obviously too early to tell whether seller purchase-price protections for delayed closings (in the form of ticking fees) will become more regular features of the deal landscape. However, in the event such a structure is being contemplated, deal professionals should take into account several considerations. First, the structure has typically been used only in one-step transactions. If the transaction were to be structured as a tender offer followed by a second-step merger (which may be less likely in situations where the parties anticipate a long delay between signing and closing), the additional consideration would need to be frozen at the closing of the tender offer in order to assure that all holders (including those who do not receive payment until completion of the second-step merger) receive the same consideration. Second, the structure has also typically been used only in cash transactions. However, in theory, it could be used in a stock-for-stock transaction, as long as the maximum additional amount of issuable shares is properly treated (for purposes of shareholder voting requirements, etc.). Finally, in light of the increased activity of the public merger plaintiffs’ bar, a transaction with an unusual feature, like an upward purchase price adjustment, is likely to attract greater attention from plaintiffs’ lawyers. Accordingly, boards and their advisors should be diligent in considering the risks of delayed closing and the manner in which the adjustment feature is calculated in order to minimize the risk that this feature, which should generally be viewed as favorable to shareholders, could be used against the company in any shareholder litigation.
M&A/Private Equity Group

Partners

New York
Jeffrey Bagner
jeffrey.bagner@friedfrank.com
Abigail Pickering Bomba
abigail.bomba@friedfrank.com
Andrew J. Colosimo
andrew.colosimo@friedfrank.com
Aviva F. Diamant
aviva.diamant@friedfrank.com
Steven Epstein
steven.epstein@friedfrank.com
Christopher Ewan
christopher.ewan@friedfrank.com
Arthur Fleischer, Jr.*
arthur.fleischer@friedfrank.com
Peter S. Golden
peter.golden@friedfrank.com
Tiffany Pollard
tiffany.pollard@friedfrank.com
Paul M. Reinstein
paul.reinstein@friedfrank.com
Philip Richter
philip.richter@friedfrank.com
Steven G. Scheinfeld
steven.scheinfeld@friedfrank.com
Robert C. Schwenkel
robert.schwenkel@friedfrank.com
David L. Shaw
david.shaw@friedfrank.com
David N. Shine
david.shine@friedfrank.com
John E. Sorkin
john.sorkin@friedfrank.com
Steven J. Steinman
steven_steinman@friedfrank.com

Washington, DC
Jerald S. Howe, Jr.
jerry.howe@friedfrank.com
Mario Mancuso
mario.mancuso@friedfrank.com
Brian T. Mangino
brian.mangino@friedfrank.com
Richard A. Steinwurzel**
richard.steinwurzel@friedfrank.com
Andrew P. Varney
andrew.varney@friedfrank.com
Michael A. Yuffee
michael.yuffee@friedfrank.com

London
Laura Brunnen
laura.brunnen@friedfrank.com
Richard May
richard.may@friedfrank.com
Robert P. Mollen
robert.mollen@friedfrank.com
Jerry Walter
jerry.walter@friedfrank.com

Paris
Eric Cafritz
eric.cafritz@friedfrank.com
David Chijner
david.chijner@friedfrank.com

Frankfurt
Dr. Juergen van Kann
vankann@friedfrank.com

Hong Kong
Victor Chen
victor.chen@friedfrank.com
Douglas Freeman
douglas.freeman@friedfrank.com
Carolyn Sng
carolyn.sng@friedfrank.com

A Delaware Limited Liability Partnership.
The articles included in Fried Frank M&A Quarterly are general in nature and are not intended to provide legal advice with respect to any specific situation confronted by our clients or other interested persons. Please consult with counsel before taking any action with respect to any matters discussed in Fried Frank M&A Quarterly.