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M&A ACADEMY

Current Issues in Acquisitions of Public Companies

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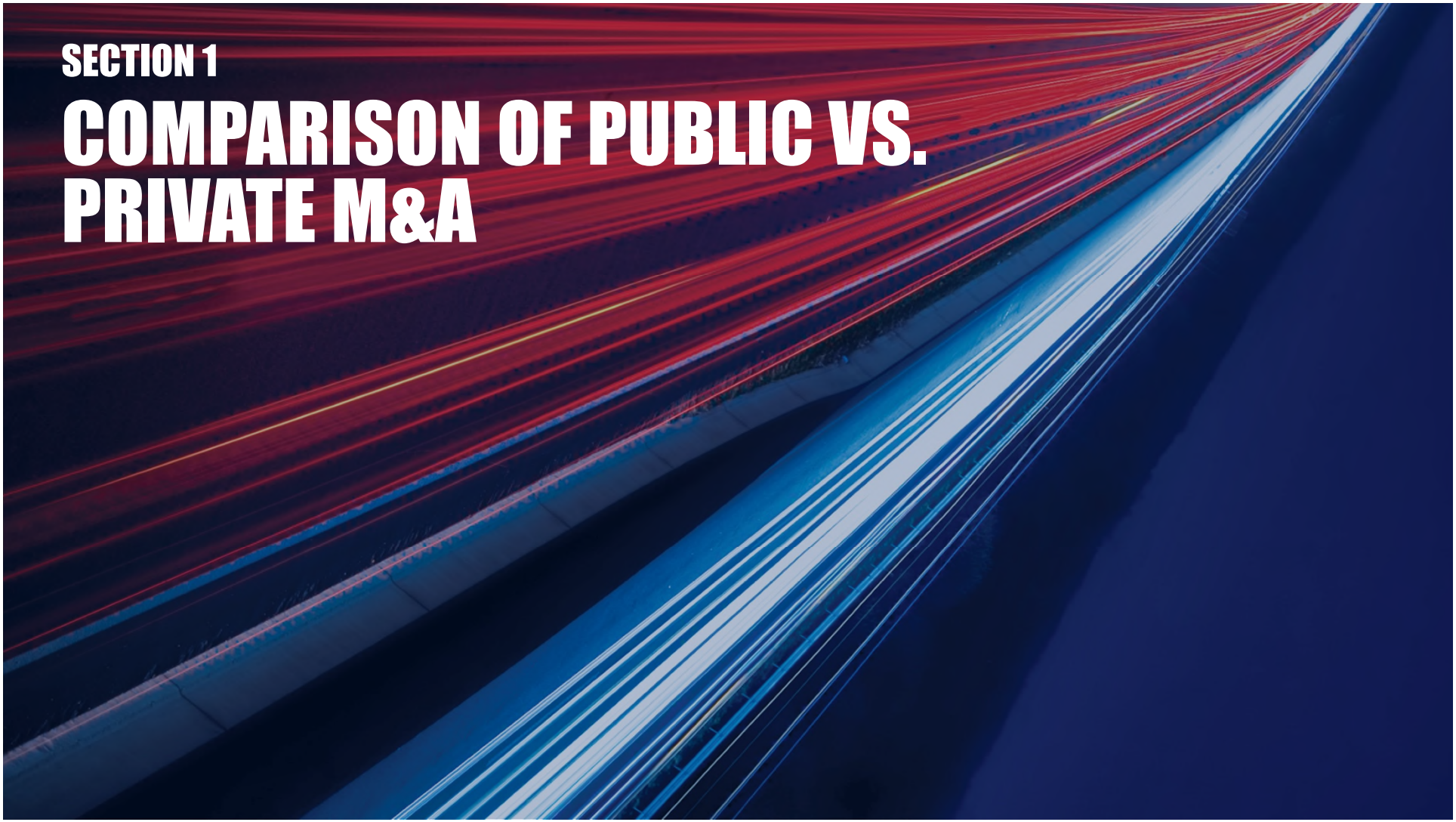
January 8, 2019

Topics to Be Covered

- Comparison of Public vs. Private M&A
- Due Diligence Considerations
- General Overview of Transaction Structures
- Typical Merger Agreement Provisions
- Litigation Risk / Appraisal Rights
- The *Akorn* Case and Its Impact on the MAE Analysis



SECTION 1

COMPARISON OF PUBLIC VS. PRIVATE M&A

Comparison of Public vs. Private M&A

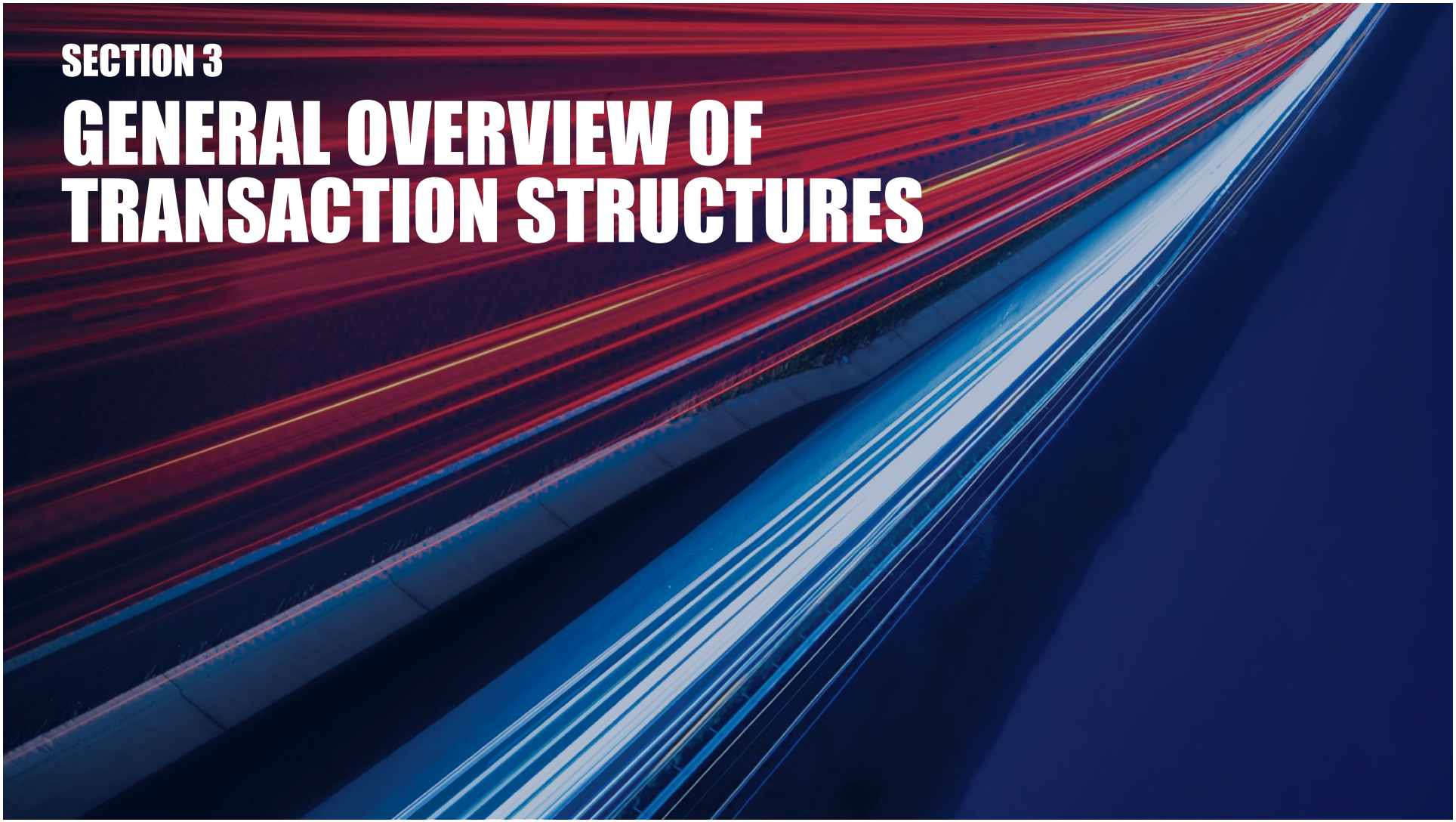
- Buyer's acquisition of publicly traded securities
  - Enhanced pre and post-signing considerations
- Publicly available information
- Privity of contract
  - In general, Buyer does not gain contractual privity with parties that will receive consideration
- Indemnity/post-closing obligations
- Nature of representations and warranties
- Nature of closing conditions
- Public shareholder approval / tender process, filed with SEC
- Application of "fiduciary out"
- Enhanced consideration of potential transaction failure

SECTION 2

DUE DILIGENCE CONSIDERATIONS

Due Diligence Considerations

- Utilize SEC filings/public information
  - Review Target charter and bylaws
    - "Poison Pill"; Classified board
    - Supermajority votes; Preferred or "super voting" stock
  - Change of control provisions in material contracts
  - Analyze stockholder base – controlling/large interest holders
  - Share price trading history
  - In transactions involving stock consideration, reverse diligence on Buyer will typically focus on, and often be limited to, Buyer's SEC filings and other public information
- Analyze state law requirements or potential deal impediments



SECTION 3

GENERAL OVERVIEW OF TRANSACTION STRUCTURES

Transaction Structures

Two Primary Acquisition Structures:

- Merger (One Step)
- Tender Offer (Two Step)
  - Negotiated
  - Hostile
  - Followed by second-step "freeze out" merger
- Consideration
  - All cash or all stock
  - Fixed combination of cash and stock
  - Cash and stock election
  - Contingent value or contingent payment rights
- Asset Sales

One-Step Merger vs. Tender Offer

- One-Step Merger Pros and Cons
  - When closed, Buyer owns 100% of Target
  - Target required to convene a stockholder meeting; receive requisite vote
  - Can take longer than tender offer
- Tender Offer Pros and Cons
  - May close more quickly than a one-step merger
  - Second-step merger can be facilitated without a vote
    - "Top up" option
    - 251(h) merger in Delaware (other states following suit)
- Hostile Tender Offer Considerations
  - Does not require Target board approval (absent a poison pill)
  - May be expensive, time consuming, and less certain of success

One-Step Merger vs. Tender Offer (cont.)

Transaction Structure (Assumes All Cash)	Two-Step Tender Offer	One-Step Merger
Approximate Overall Timing	• Two to three month process	• Two to five month process (dependent on SEC review of proxy)
Advantages	• Quicker path to control of Target than one-step (reduces risk of competing offer) • SEC is committed to expedited review • Able to avoid a stockholders meeting and proxy solicitation	• Able to complete transaction in one step with only 51% of Target stockholders voting in favor of transaction • Does not require registration of Buyer shares • Extended period between signing and closing to obtain any required consents (e.g., regulatory approval) or buyer financing
Disadvantages	• Shorter time period between signing and closing to obtain any required consents (e.g., regulatory approval) or buyer financing • Tender can't close until all conditions are satisfied	• Slower path to control of Target (extends risk of competing offer) • SEC is not committed to expedited review
Procedure Weeks 1-3	• Due Diligence and Execution of Merger Agreement	• Due Diligence and Execution of Merger Agreement

Weeks 4-5	• Prepare SEC filings (1-2 weeks)
	  • Schedule TO
	• Parties file HSR materials with DOJ or FCC
		• Prepare SEC filings (1-2 weeks)
		  • Proxy Statement
		• Parties file HSR materials with DOJ or FCC

Weeks 5-9	• Commence Tender Offer (must remain open for longer of 20 business days or SEC approval of filing) • HSR waiting period expires (15 days if no second request) • SEC review process (3-4 weeks) • Close Tender Offer • Close Short-form Merger	• SEC to confirm no review of proxy (2-4 weeks) • If SEC review (add 4-8 weeks) • HSR waiting period expires (30 days if no second request) • If no SEC review, mail proxy statement and solicit proxies (4 weeks) • If no SEC review, conduct Special Meeting and close transaction
Weeks 9-21		• If SEC review, parties reconcile comments and amend proxy (add 4-8 weeks) • Mail proxy statement and solicit proxies (4 weeks) • Conduct Special Meeting and close transaction

One-Step Merger Approval Procedures

- Similar to a public company's annual shareholder meeting process
  - Convene a meeting (record date, etc.)
  - File Proxy Statement with SEC
  - SEC may review Proxy Statement
- Company recommendation
  - Target board must make recommendation to stockholders
- Approval standard (state law + Target's charter)
- If stockholder approval necessary, generally may require proxy solicitation
- If sufficient share ownership concentration and state law requirements, can approve by written consent

Tender Offer Basics

- Commencing the tender offer
  - Commenced with a "Tombstone Ad" containing material terms
- Buyer Filing: Schedule TO – Tender Offer Statement
  - Includes terms of offer and SEC required disclosures about Buyer, Target, and the offer
  - Incorporates by reference Buyer's "Offer to Purchase"
- Company Filing: Schedule 14d-9 – Solicitation/Recommendation Statement
  - Target board must make recommendation to stockholders within 10 business days
    - Accept, Reject or Unable to Take a Position
  - Typically filed at the same time as Schedule TO in a friendly transaction
- SEC may review tender offer filings

Tender Offer Basics (cont.)

- Tender offer must remain open at least 20 business days
- May offer variety of consideration alternatives: All Cash, All Stock or Fixed Combination or Election
  - If there is a limit on amount of cash or stock, must prorate
- Must offer to all holders of the same class of security at the same price
- If offeror changes percentage of securities sought or consideration offered, offer must be open at least 10 business days after changes
- Other changes (including waiving tender offer conditions) require five business day extension
- Buyer may extend offer period
  - Public announcement on first business day following expiration by earlier of 9:00 a.m. EST or opening of stock exchange
- Buyer must promptly accept and pay for, or return, all securities tendered following termination or expiration of offer
- Subsequent offering period OK if original offer was for all shares and consideration is same type and amount as original offer

Tender Offer — Back End Merger

- Short-Form Merger – if Buyer acquires 90%+ of shares in tender offer (or through a "Top-Up" Option), can complete merger without vote of other shareholders, although still requires Information Statement
- A "Top-Up" Option no longer needed in Delaware if requirements under DGCL 251(h) are satisfied. These include:
  - Target's stock must be listed on national stock exchange or held of record by more than 2,000 holders
  - Merger agreement expressly permits or requires the merger to be effected under 251(h) and provides that the merger will happen as soon as practicable following tender offer completion
  - Tender offer is for "any and all" shares
  - Buyer holds enough stock after the tender offer to adopt the merger

Other SEC Filing Considerations

- If securities are to be issued as consideration, must be registered
  - Form S-4 Registration Statement for registration of securities to be issued in connection with business combination transaction
  - Can combine S-4/Proxy Statement or structure as an exchange offer
  - Contingent value or contingent payment rights may require registration
  - No registration required if (i) integral part of consideration, (ii) no rights of a stockholder like voting or dividend rights, (iii) no minimum payment or interest rate, (iv) not transferable or assignable, or (v) not certificated
- **Plan ahead** if filing a Proxy Statement or Solicitation/Recommendation Statement
  - Organize and maintain record of key communications and developments during the course of negotiations
  - Consider optics of actions

Other SEC Filing Considerations (cont.)

- Walgreens Settlement in 2018 – Recent SEC Actions continue to focus on misrepresentations in deal disclosures
  - Upon announcement of its agreement to acquire Alliance Boots in 2012, Walgreens disclosed projected pro forma operating income of $9 billion for 2016
  - Walgreens executives continued to support this projection on earnings calls during 2013-14 even after it became clear that this projection was inaccurate
  - Walgreens settled resulting SEC charges for $34.5 million in September 2018

SECTION 4

TYPICAL PUBLIC COMPANY MERGER AGREEMENT PROVISIONS

Consideration; Representations and Warranties

- Consideration
  - Stock consideration generally valued based on a volume weighted average price, and may include collars
  - Payment terms for options, SARs, warrants, and different classes of stock
  - Consideration may include contingent value or contingent payment rights
    - Bridge transaction value gaps – particularly if future events may impact value (e.g., FDA approvals, outcome of pending litigation, etc.)
- Reps and Warranties
  - Typically incorporate information from public filings
  - Don't survive the closing – Useful for disclosure and confirming due diligence, and may allow Buyer not to close if extreme unanticipated problems (i.e. MAC/MAE)
  - Generally "brought down" at closing against an overall "Material Adverse Change"/"Material Adverse Effect" standard
    - *See* discussion herein on the recent *Akorn* decision in Delaware

Covenants

- General "conduct of the business" covenants to operate in the ordinary course and to do or refrain from doing certain specified activities
  - Antitrust "gun jumping" considerations
- Obtain necessary third party consents and approvals
- May require cooperation with Buyer's financing efforts
- Mutual cooperation with proxy and registration statement filings and solicitation of stockholder votes
- May include a "force the vote" provision
  - Target has to put transaction to a stockholder vote, even if another transaction has been proposed or Board recommendation has changed
- May require specific actions to obtain antitrust or other approvals
  - Commercially reasonable efforts
  - "Hell or high water"
- Other covenants specific to the companies/circumstances

Deal Protection; Termination Fees

- Deal protection provisions
  - Target non-solicitation structure
    - "No shop" vs. "go shop" vs. "window shop"
      - Buyer matching rights
    - Intervening event
- Termination fees/expense reimbursement
  - Compensates initial Buyer if another Buyer tops the deal with a higher price offer
  - Reverse termination fee for failures to obtain antitrust or other regulatory approvals or for lack of financing

Deal Conditionality

- Closing conditions (merger closing and tender closing)
  - Stockholder approval (if necessary)
  - Regulatory and third party approvals
    - Typically no required third party contract consents condition
  - No Injunction or other legal impediment to closing
  - Buyer and Target representations and warranties true and correct (usually against an aggregate MAC/MAE standard for Target reps)
  - Buyer and Target covenants performed in all material respects
  - Absence of MAC/MAE
- Tender offer back-end merger usually has minimal conditions

Termination Rights

Termination of Agreement:

- By mutual consent
- By either party if:
  - Merger doesn't close by specific outside closing date (or "drop dead date")
  - Injunction or other legal prohibition on closing
  - Stockholders don't approve merger

Termination Rights (cont.)

- Buyer Termination:
  - Target board changes or fails to reaffirm recommendation of initial Buyer transaction, commencement of a third party tender offer not opposed by Target board, breach of non-solicitation covenants
  - Breach of Target reps, warranties or covenants resulting in failure of closing condition (often subject to a cure right)
- Target Termination:
  - "Fiduciary Out" – Ends at stockholder approval / closing of tender offer
  - Breach of Buyer reps, warranties or covenants resulting in failure of closing condition (may be subject to a cure right)

Effects of Termination

- No termination/break fee paid if:
  - Mutual termination
  - No closing by outside closing date (subject to tail)
- Termination/break fee (which may include expense reimbursement) paid if:
  - Change or failure to reaffirm Target board recommendation
  - Commencement of tender offer not opposed by Target board
  - Breach of non-solicitation covenants
  - Target terminates to accept another deal (typically a reduced fee if termination happens during "go shop" period)
- "Naked No Vote" (more often limited to expense reimbursement)
- Reverse termination/break fee paid for failure of Buyer to close due to absence of financing or if Buyer exercises unilateral termination right

Termination Fees

- Typically based on a percentage of equity value
- Target termination/break fees
  - Size limited by case law (can't coerce the vote)
  - In 2017, 111 of 173 (64%) surveyed public M&A transactions involved termination/break fees of 3.00-3.99% (per PLC deal points study)
- Reverse termination/break fees
  - More flexibility on size (typically larger than target termination/break fees)
    - In 2017, of 31 surveyed public M&A transactions involving reverse termination/break fee as a cap on damages, average fee was 6.76% of equity value (per PLC deal points study)
  - Financing failures
  - General breaches of reps & covenants
    - Treatment of willful breaches
  - Antitrust failures

Other Transaction Considerations

- Stockholder support/voting agreements
- Post-merger governance considerations
  - Especially meaningful in "merger of equals"
- Regulatory approvals
  - Hart-Scott-Rodino
  - Exon-Florio/CFIUS – If Buyer is a foreign person and the acquisition could implicate national security (broadly construed)
  - SEC
    - Securities registration
    - Tender offer and/or proxy solicitation filings
  - Industry-specific regulatory approvals
  - Foreign regulatory approvals – cross-border transaction

SECTION 5

LITIGATION RISK / APPRAISAL RIGHTS

Litigation Risk / Appraisal Rights

- Buyers can be named on an "aiding and abetting" theory
- Buyer will inherit whatever litigation results from the acquisition
- Target boards in recent years have been sued in overwhelming majority of public company deals:
  - May face lawsuits in jurisdiction of incorporation and in jurisdiction where headquarters or significant operations are located
  - Exclusive forum bylaws – Requires litigation regarding internal affairs/stockholder claims only in one jurisdiction (e.g., Delaware courts). Delaware prohibits litigation fee-shifting bylaws.
- Most litigation settled, sometimes with additional disclosures (but Delaware courts are becoming less willing to go along with "disclosure only" settlements
- Most states include dissenters'/appraisal rights statutes
  - Stockholders who did not vote for a Merger but held shares at the time of the merger can ask a court to determine the "fair value" of their shares
  - Value can be higher, lower or the same as was paid in the acquisition
    - See *Dell* and *SWS Group* Delaware Chancery Court decisions
  - No value is generally attributed to the completion or expectation of the merger (i.e. the value of the stock ignores any effect of the transaction itself)

SECTION 6

THE *AKORN* CASE AND ITS IMPACT ON THE MAE ANALYSIS

Akorn Background

- *Pre-Akorn*, no Delaware decision has ever found an MAE to have occurred. Deal lawyers have generally cautioned clients to assume that invoking an MAE would require a virtually catastrophic event.
- *Akorn, Inc. v. Fresenius Kabi AG*
  - Fresenius to acquire Akorn for $4.75B (agreement signed April 2017)
  - Akorn financial results "fell off a cliff" after reaffirming its full year guidance in April and Akorn's shareholders approved the transaction in July
  - Fresenius receives whistleblower letters detailing regulatory misconduct at Akorn, including submission of fabricated data to FDA and data integrity issues
  - Fresenius conducts independent investigation (Akorn does not conduct investigation)
  - Akorn's financial results continue to decline dramatically through April 2018 (see below chart from opinion)

Year-Over-Year Change In Akorn's Performance					
	Q2 2017	Q3 2017	Q4 2017	FY 2017	Q1 2018
Revenue	(29%)	(29%)	(34%)	(25%)	(27%)
Operating Income	(84%)	(89%)	(292%)	(105%)	(134%)
Earnings Per Share	(96%)	(105%)	(300%)	(113%)	(170%)

Akorn Background (cont.)

- Fresenius provides notice of termination in April 2018 for following reasons:
  - **Breach of representations**, in particular related to regulatory compliance, resulting in failure to satisfy rep bring down closing condition to an MAE standard
  - **Breach of covenants**, in particular the interim covenant to operate in ordinary course of business between signing and closing, resulting in failure to satisfy closing condition to comply in all material respects with covenants
  - **General MAE** at Akorn resulting in failure of condition that no MAE
- Akorn countered that Fresenius had a case of buyer's remorse and had breached its hell or high water covenant and covenant to use reasonable best efforts to close

Akorn Holding

- Delaware Chancery Court Ruling
  - Court held Fresenius was justified in its termination of merger agreement in three key ways:
    - Breach of regulatory compliance rep to an MAE standard resulting in failure to satisfy rep bring down condition
      - Overwhelming evidence of widespread regulatory violations and pervasive compliance problems
    - Material breach of interim covenant to carry on business in ordinary course
      - Fresenius changed its quality and audit function, mislead FDA by using fabricated data, did not investigate credible whistleblowers and did not remediate deficiencies
    - General MAE had occurred
      - Sudden decline which was unexpected and durationally significant; remedy of compliance issues would require cost equal to 20% Akorn's standalone value; 86% drop in EBITDA from 2017 to 2016 (51% of adjusted EBITDA)
      - Performance contrasted markedly with that of Akorn's peers and Akorn's prior record of growth
  - While Fresenius did breach its hell or high water covenant, it was not a material breach as it quickly corrected its conduct

Akorn Takeaways

- Takeaways
  - No bright line test and standard is still very high – Akorn is a perfect storm of dramatic post-signing decline plus shocking regulatory misbehavior
  - Court will respect allocation of risk
  - Words Matter: "In all material respects"
  - Actions Matter:
    - Court put great weight in Fresenius's actions following the emergence of the MAE (i.e. continuing to seek antitrust approval, making public comments supportive of deal, continuing to evaluate how to make numbers work), which outweighed internal emails suggesting buyer's remorse and that it began evaluating its ability to terminate the agreement early in the process
  - Effort Standards:
    - The court analyzed the difference between effort standards, and explained that while business teams and even the ABA suggest a hierarchy of effort standards (i.e. reasonable best efforts requires more than commercially reasonable efforts), the court suggested that there is little case law to suggest such a distinction and even "best efforts" implicitly includes a reasonableness standard.

Biographies

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Our Global Reach

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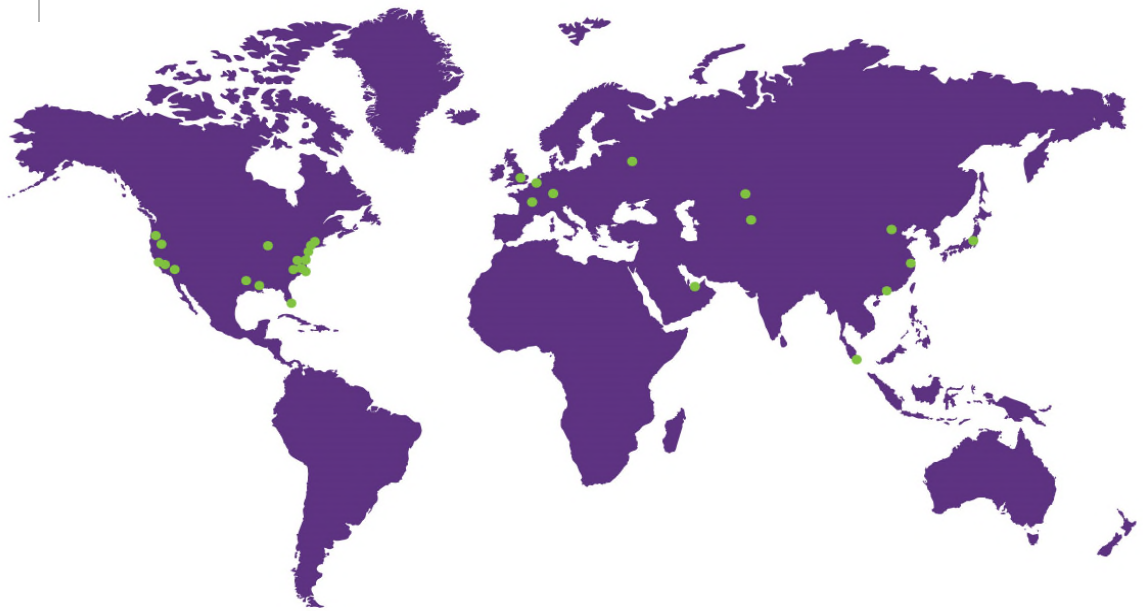

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