At Forum for Deal Makers, M.&A. Meets the Law

New York Times DealBook
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March 29, 2011

The 23rd annual Tulane Corporate Law Institute, an annual gathering of deal makers in New Orleans, begins on Thursday. It’s not the glittering affair of the World Economic Forum in Davos, Switzerland, but rather a wonky convention of investment bankers, lawyers and others in the takeover business.

A number of roiling issues are at the top of the deal-making agenda. These are some of the likely topics.

STATE OF THE MARKET: The market for mergers and acquisitions has been surging, with domestic activity increasing to $912 billion in 2010, from a low of $799 billion in 2009, according to Dealogic. With the announcement of AT&T’s $39 billion bid for T-Mobile USA, this year is off to a good start.

But all is not well. Strategic bidders remain focused on their businesses, hesitant to engage in risky takeover transactions. The credit market is bubbly, but private equity is still having trouble committing capital.

This is despite having about $540 billion in dry powder to spend, according to Preqin, an independent research firm. The combination of hesitant strategic bidders and private equity’s commitment problems are constraining the growth of the M.&A. market.

International opportunities are looking less promising, with China in an inflationary period, Japan experiencing a terrible natural disaster, Europe struggling with sovereign debt and the Middle East in turmoil. Because of this, the prospects for deals in the United States look better than in many other countries for the first time in years despite the American economy’s problems.

NATIONAL SECURITY REGULATION: Countries are racing to tighten the criteria governing foreign takeovers of domestic companies. In the last year, Canada refused to approve BHP Billiton’s acquisition of the Potash Corporation of Saskatchewan, while the United States forced Huawei, a Chinese telecommunications company, to unwind a small $2 million technology purchase. China has retaliated by adopting its own national security process for foreign investment to go along with its ordinary approval requirements for foreign buyers.

Expect the discussions at Tulane to focus on the kinds of backroom negotiations that are taking place over the national security approval process, particularly when the buyer is Chinese. This is a concern because the United States appears increasingly intolerant of that country’s investments.

INVESTMENT BANKERS: Investment bankers are feeling under siege by the Delaware courts. The most prominent example was in the recent Del Monte case. Barclays, which was representing Del Monte but was also providing financing to the buyers in what is called staple
financing, was accused of having secret contacts with prospective bidders in breach of agreements Del Monte had negotiated. A Delaware court criticized this conduct, though some have called Barclays a hero for obtaining a high-premium offer. The Del Monte opinion comes on the heels of recent Delaware cases finding that investment bankers had inadequately disclosed information about their financial advice.

It all means that bankers are worried that they will make another misstep and come under heavy public criticism. At least one law firm has called into question the continued use of staple financing after Del Monte.

Investment bankers are bound to now rely more heavily on lawyers during the acquisition process. But the Del Monte case may be an outlier where a bank simply did a bad thing. The discussion at Tulane will be about the procedures Del Monte necessitates, but the real debate should be whether all of the additional requirements for investment bank financial advice are really worthwhile or just more process and disclosure without a purpose.

‘LOCK-UP CREEP’: Increasingly in friendly deals, there is what I call lock-up creep. Lock-ups are devices intended to protect a deal from third-party bidders. The best-known type of lock-ups are termination fees payable if the deal is trumped by a third-party bidder. But the trend in recent deals is for enhanced lock-ups, hence, lock-up creep. For example, initial bidders are receiving expansive information rights that entitle them to know about every conversation with a third-party bidder. The issue is whether boards are using this silence to go too far in giving their chosen bidder a sure deal with lock-ups.

MANAGEMENT BUYOUTS: The J. Crew buyout arranged by the private equity firms TPG Capital and Leonard Green showed the problems of management participation unduly affecting the sale process. The talk of Tulane will be about how to prevent management from using its upper hand to buy out the company unfairly. And the focus will again be on more process. But the real solution may simply be for boards to be more vigilant. For example, RAE Systems recently agreed to a buyout by Battery Ventures. When another bidder emerged and the chief executive and significant stockholder refused to endorse a new, higher offer from Battery Ventures, the board took a novel position. It proposed to issue new shares to dilute the manager’s stake and sell the company to Battery Ventures anyway. This is an aggressive response, but it shows that boards can effectively manage the sale process. Following good procedures is merely a sign of this vigilance, a trait shareholders should encourage.

TAKEOVER DEFENSES: The proper balance of takeover defenses will be a topic at Tulane. The Delaware Chancery Court recently allowed Airgas the use of a poison pill to defeat a hostile bid by Air Products. The Airgas decision shows how a poison pill can work effectively with a staggered board, a board in which directors are elected in one-third tranches. Bidders must thus wait two years to elect a majority of the board and force the poison pill to be redeemed. In Airgas’s wake, a pill and staggered board have become a more powerful antitakeover device.

But the decision is spurring shareholder activists to seek work-arounds. Lucian A. Bebchuk, a Harvard Law professor and a leading advocate for shareholders, has written that shareholders
need to increase their lobbying efforts to force corporations to drop staggered boards because of Airgas.

Companies are fighting back. Oklahoma recently adopted a statute requiring all of its companies to have staggered boards on the heels of a similar law in Indiana. The question now is how hard companies will fight to adopt or keep these types of boards and whether they will begin to lobby more widely for laws that support them.

SHAREHOLDER ACTIVISM: Shareholder activism is a perennial discussion at Tulane. Hedge fund activism is likely to surpass precrisis levels in coming years. Companies are increasingly fighting back, and the battle is shifting to the Securities and Exchange Commission over an amendment to the share ownership reporting requirements. The discussion will not focus on meta issues like efforts to work with hedge funds to build better governance, a trend we are seeing in a few particularly troubled companies like St. Joe and Dynegy. Rather and unfortunately, it will focus on the more mundane issues of the tactics to beat activists.