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Statutory Mergers: the US experience

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WACHTELL, LIPTON, ROSEN & KATZ

Topics to Cover

- How Mergers Work in the U.S.
- Benefits of the Merger Structure
- How Various Stakeholders Are Protected

How Mergers Work in the U.S.

1. Principal Types of M&A Agreement
2. Requirements for a Statutory Merger
3. Merger Structures
4. State versus Federal Law
5. One-Step and Two-Step Mergers

Principal Types of M&A Agreement

- | | |
|--|----------------|
| I. Investment Agreement | Private |
| II. Asset Purchase Agreement | |
| III. Stock Purchase Agreement * | |
| IV. Merger Agreement (one-step)** | Public |
| V. Merger Agreement (with tender offer) | |

* On rare occasions, a “public company” can have few enough stockholders to do a stock purchase deal.

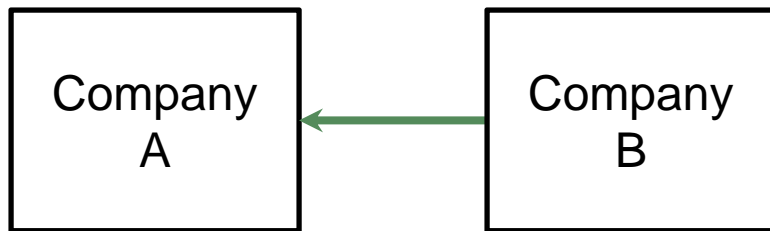
** A private deal might use a merger structure to achieve specific objectives.

Requirements for a Statutory Merger

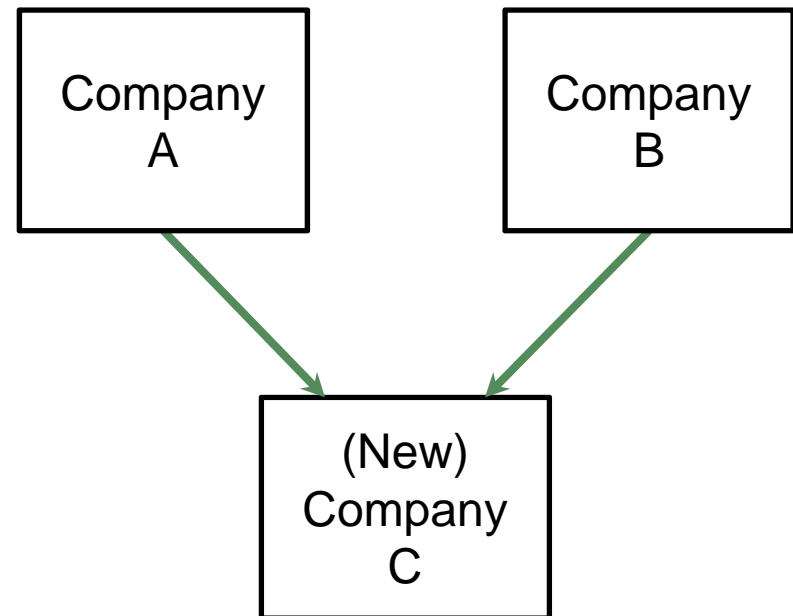
1. Agreement/Plan of Merger
2. Board Recommends to Shareholders
3. Shareholders Vote to Approve Merger
4. File Certificate of Merger

Mergers/Amalgamations You (Almost) Never See

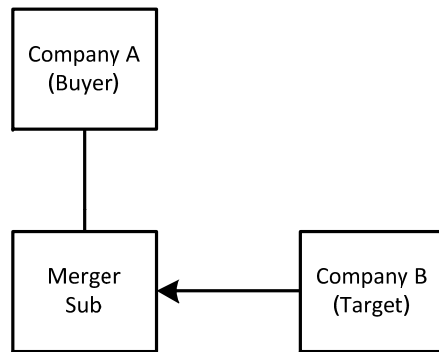
Parent-to-Parent Merger



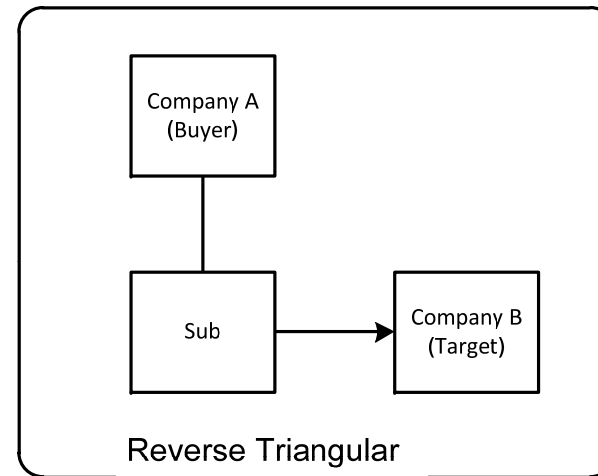
Amalgamation



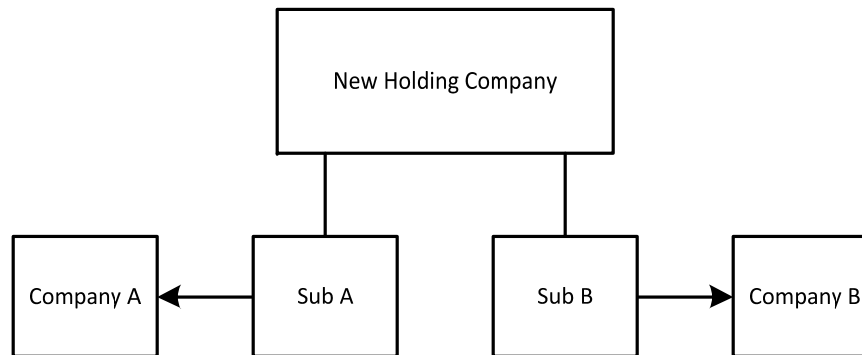
Merger Structures You Do See (A Lot)



Forward Triangular



Reverse Triangular

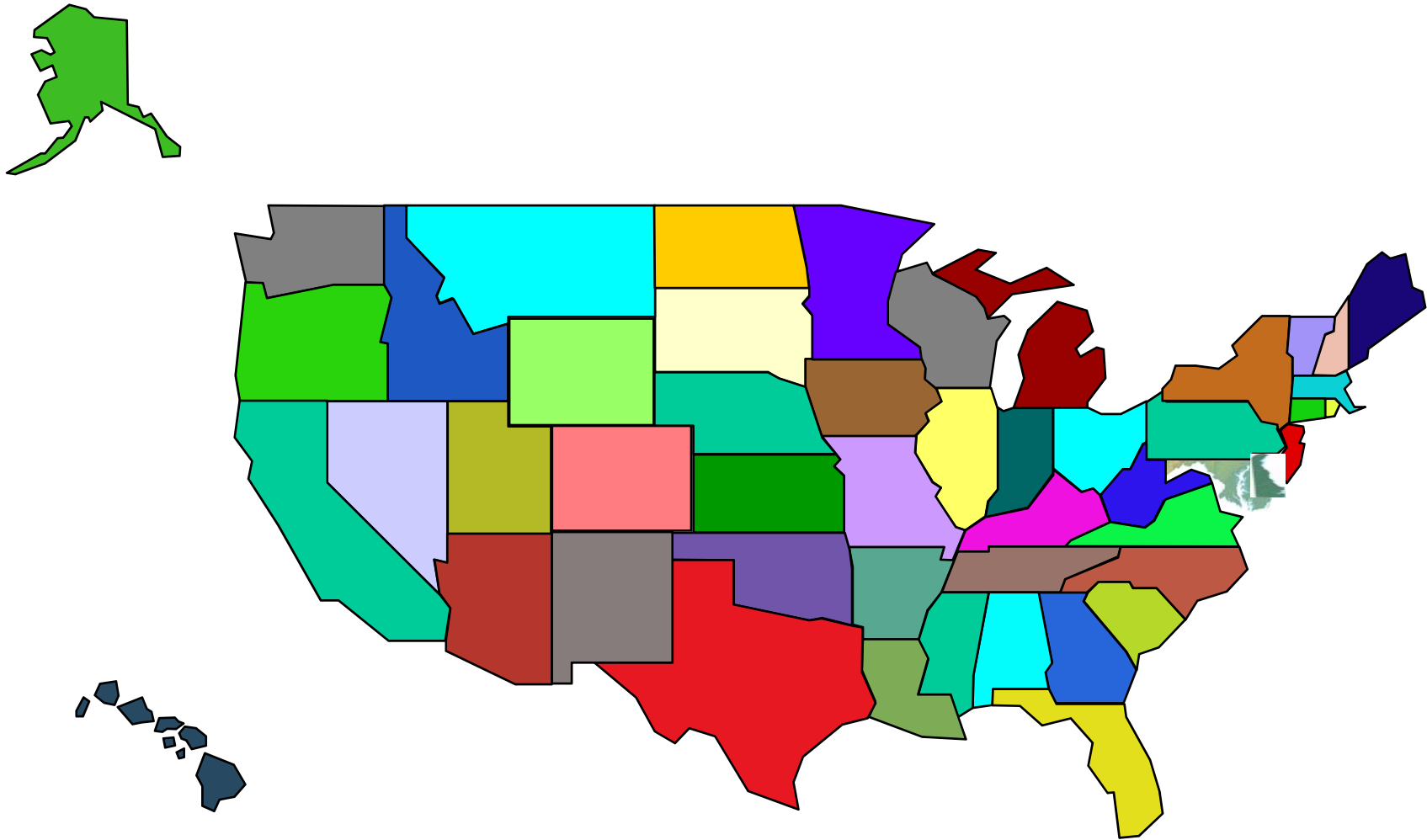


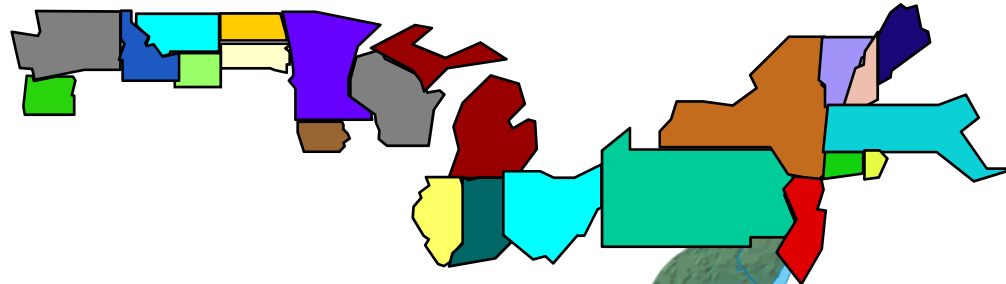
"Top Hat" / "Double Dummy"/351

A Two-Tiered System of Laws Governs US M&A

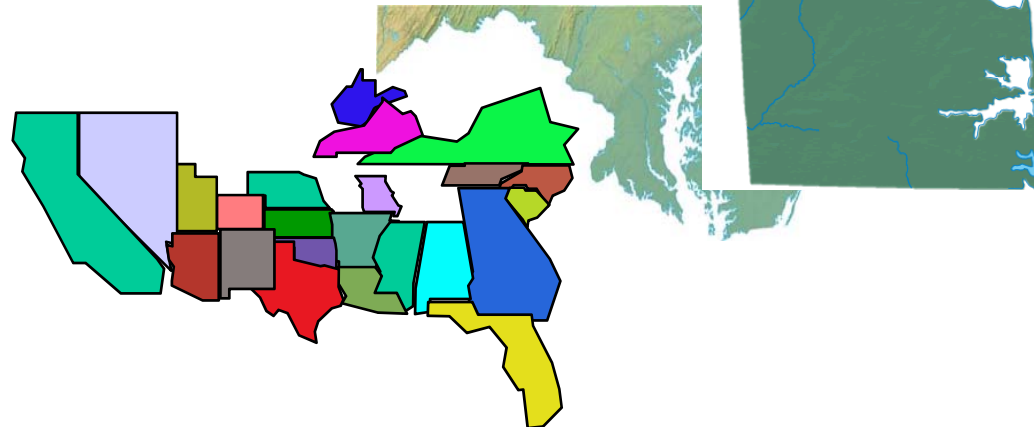
- State Law (statutes and courts) governs
 - Internal workings of companies
 - Duties of directors
 - Ability to adopt and maintain takeover defenses
 - Specific statutory takeover protections
 - Do consider fairness (especially in conflict situations)
- Federal Law (SEC) governs
 - Public offerings of securities
 - Disclosure of information in public companies
 - Some substantive terms of tender offers
 - Solicitation of proxies for public companies
 - *Not* looking at fairness beyond disclosure

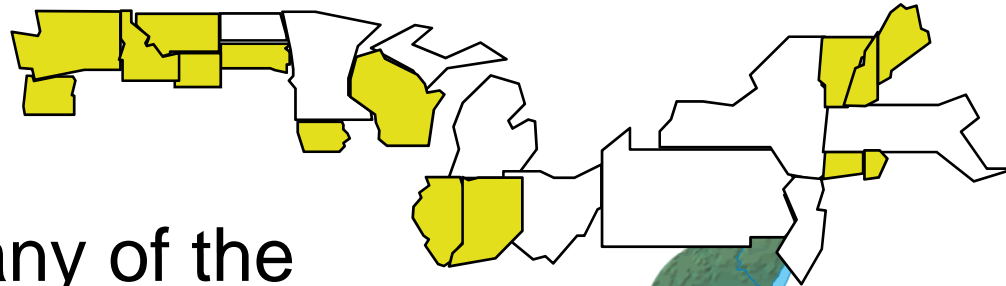
The 50 United States of America . . .



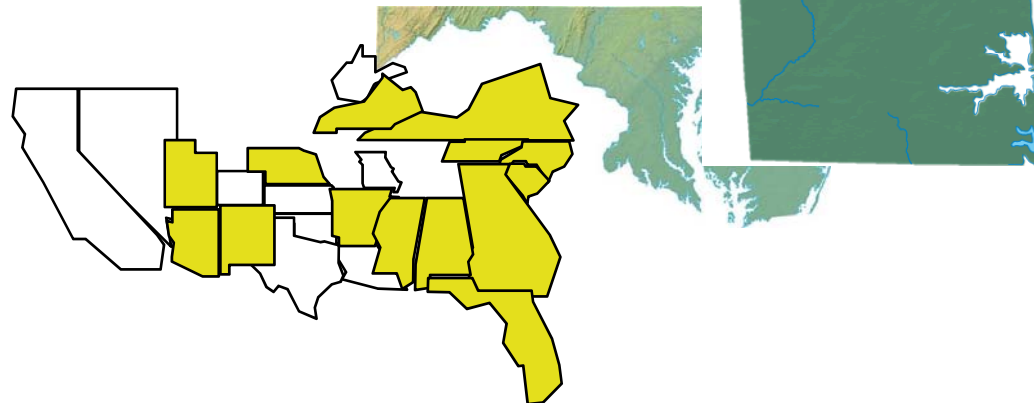


. . . redrawn by popularity as a jurisdiction of incorporation.





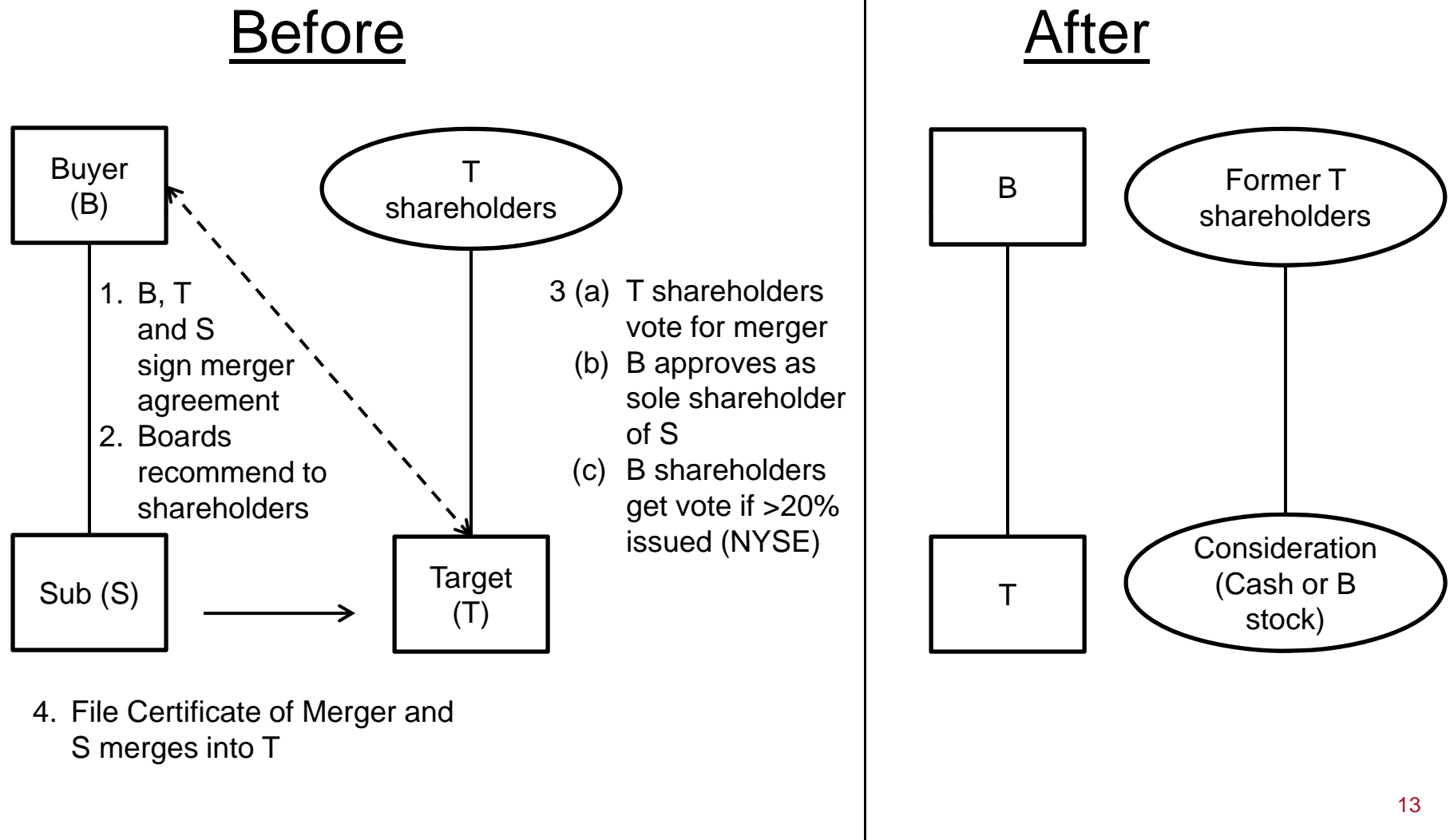
Fortunately, many of the “smaller” corporate jurisdictions follow the Model Business Corporation Act



Two Basic Ways to Structure a Public Company Acquisition

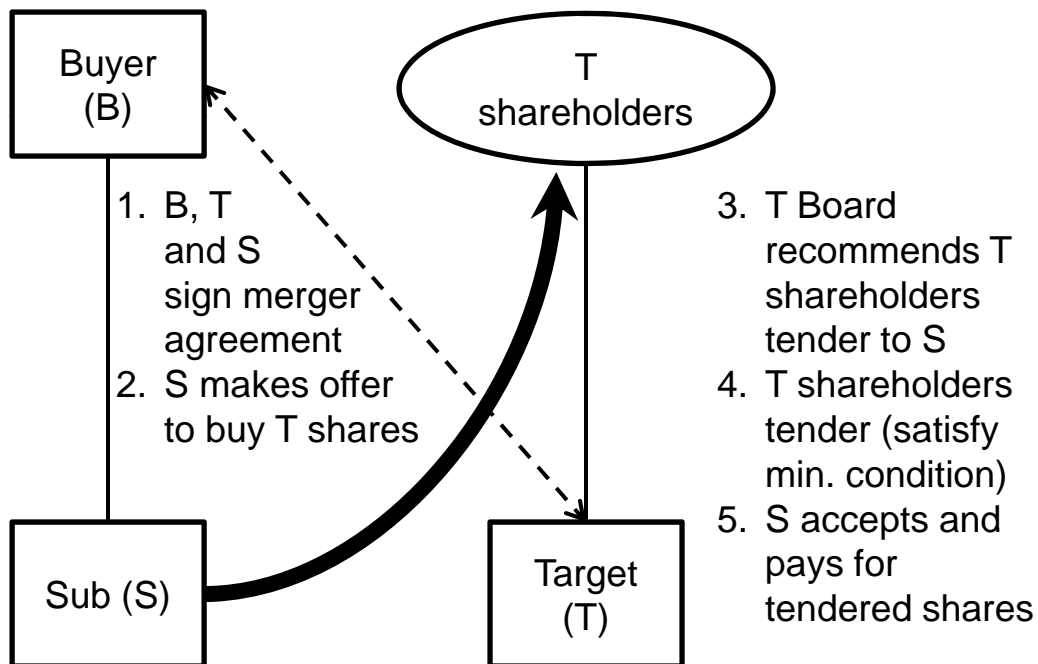
- **One-step merger** in which target shareholders vote to approve transaction
 - Required vote is typically majority of outstanding shares
 - If approved, shareholders receive cash, stock, or a combination upon consummation of the merger
- **Two-step merger** in which acquirer first buys target stock in tender offer, then does statutory “squeeze-out” merger
 - Purchase enough shares to guarantee the required vote for the second-step merger
 - If acquirer gets 90% of shares it may squeeze out minority shareholders at same price in a short-form merger
 - Subsequent offering period, market purchases and top-up option help

One Step: Straight to the Merger Vote

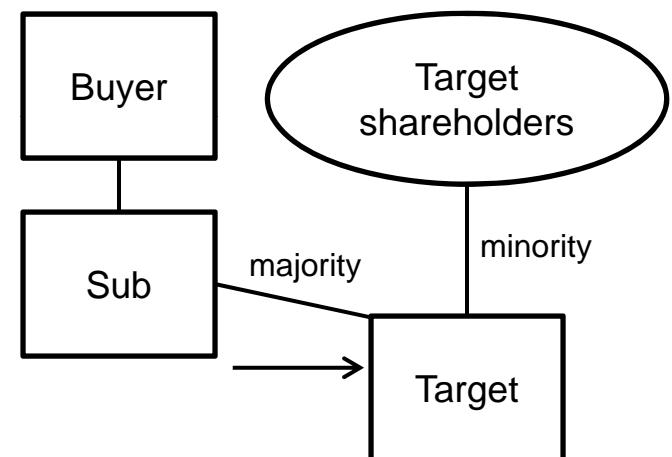


Two Step: Tender Offer, Then Merge

Step 1

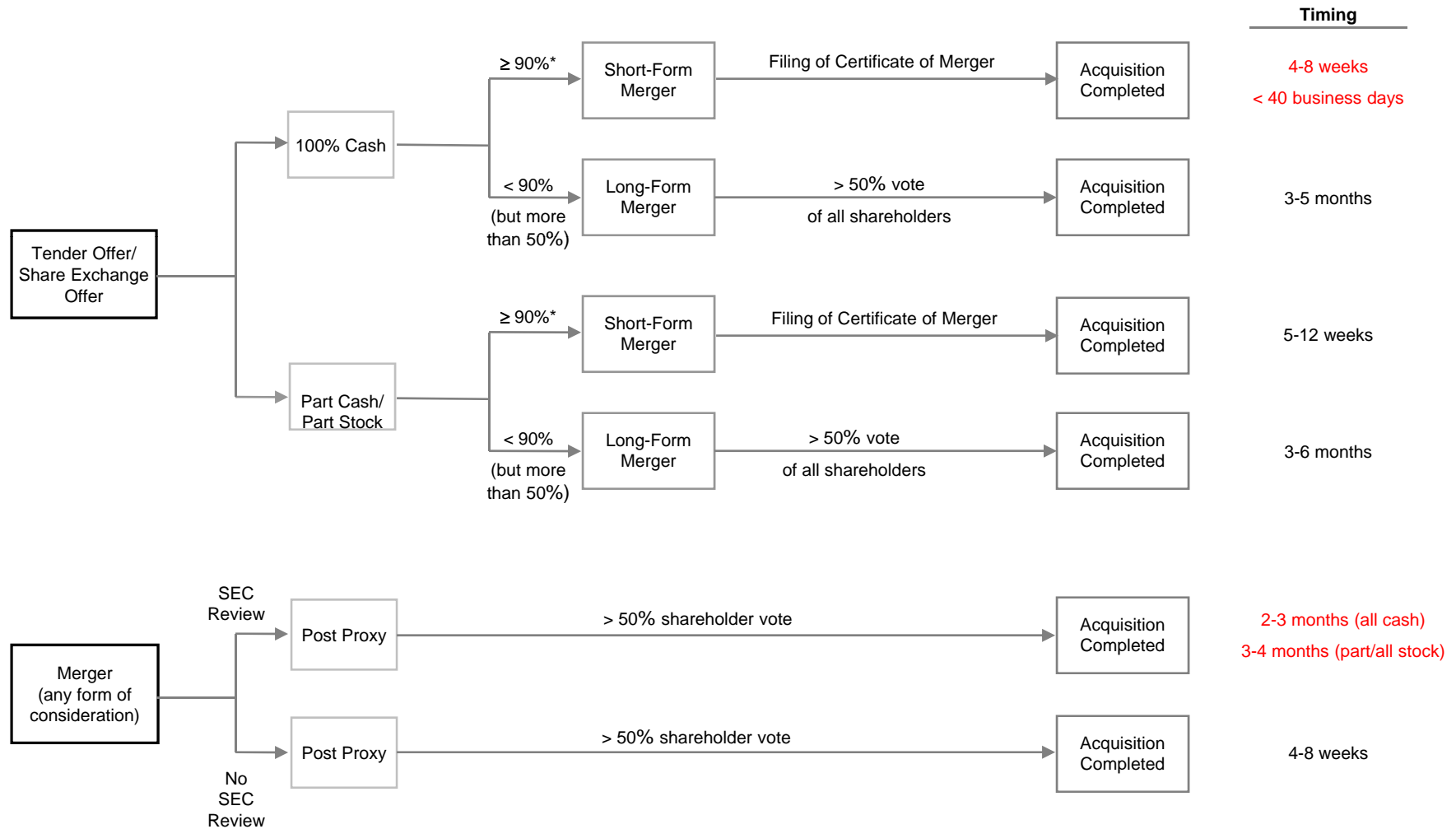


Step 2



- 6 (a) If S owns >90%, does short-form merger into T
- (b) If S owns <90%, S calls share-holder meeting, votes for merger and then merges into T

Timing to Acquire a Public Company



* Including after Subsequent Offering Period and Top-Up Option, if applicable.

Benefits of Tender Offer: Two-Step vs. a One-Step Merger

- No Pre-Clearance: SEC pre-clearance of cash tender offer materials is not required
- Speed: a cash tender offer can be completed relatively quickly – 20 business days in the case of a friendly deal not involving any regulatory issues
- Direct: a tender offer is made directly to shareholders and does not require a shareholder meeting or board approval (so useful/necessary for a hostile takeover bid)
- Freeze-out: a tender offer between parent/subsidiary can avoid entire-fairness heightened review so long as certain conditions (e.g., majority of minority) are met

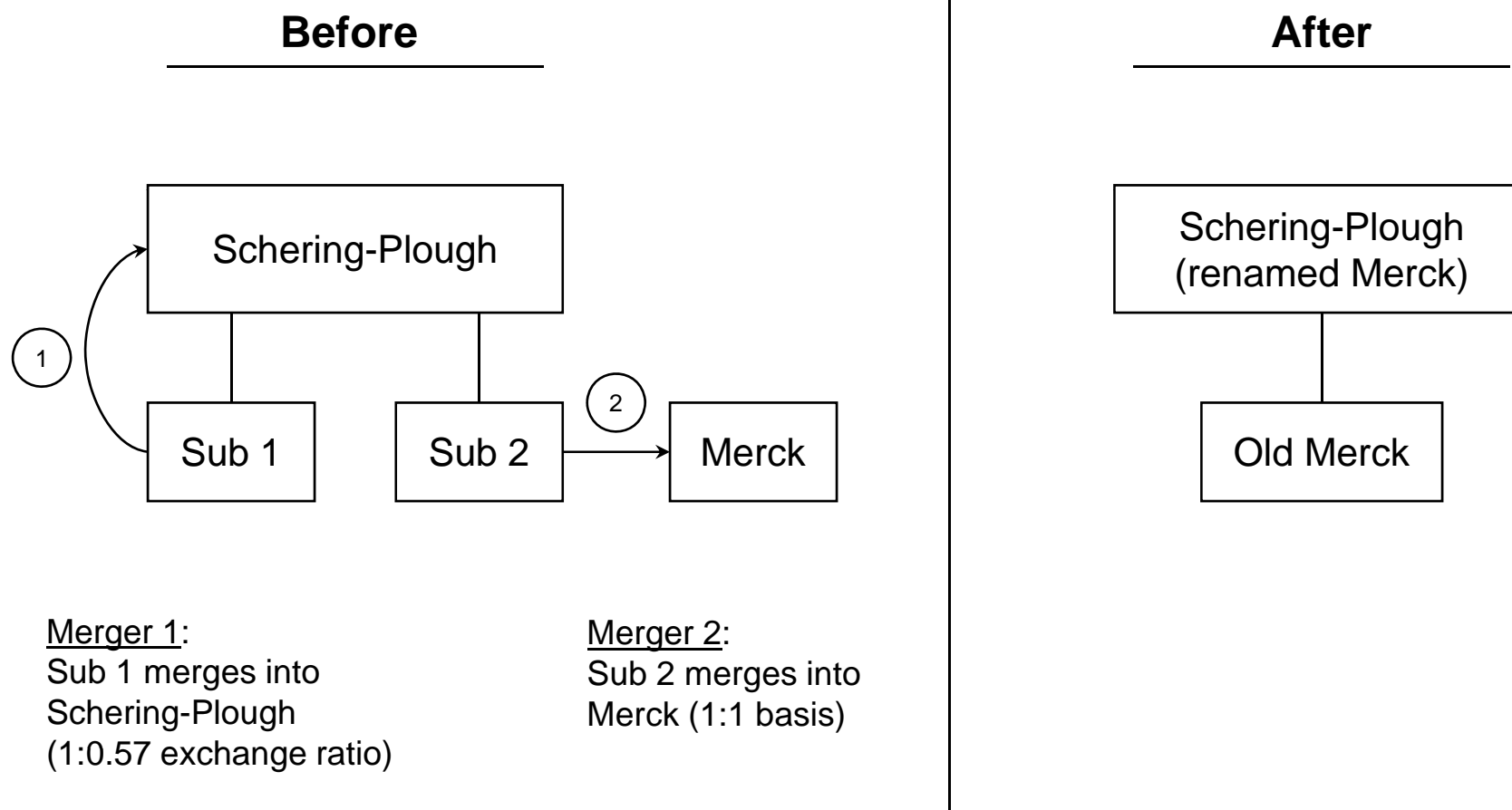
Benefits of One-Step Merger vs. Tender Offer (Two-Step Merger)

- 100% Ownership: get to 100% ownership in a single step, which may be important for financing the transaction.
- Possible Timing Advantage: if regulatory or other conditions delay closing tender offer for more than three to four months, the interloper risk can be eliminated (by securing shareholder approval) more quickly in a one-step merger than in a two-step tender offer.
- Flexibility in Structuring Consideration: Simpler to provide for cash-stock elections, collars, etc.
- Flexibility to Buy Target Shares in the Market: Can buy target shares during deal pendency (subject to any applicable restrictions), which cannot in a tender offer.

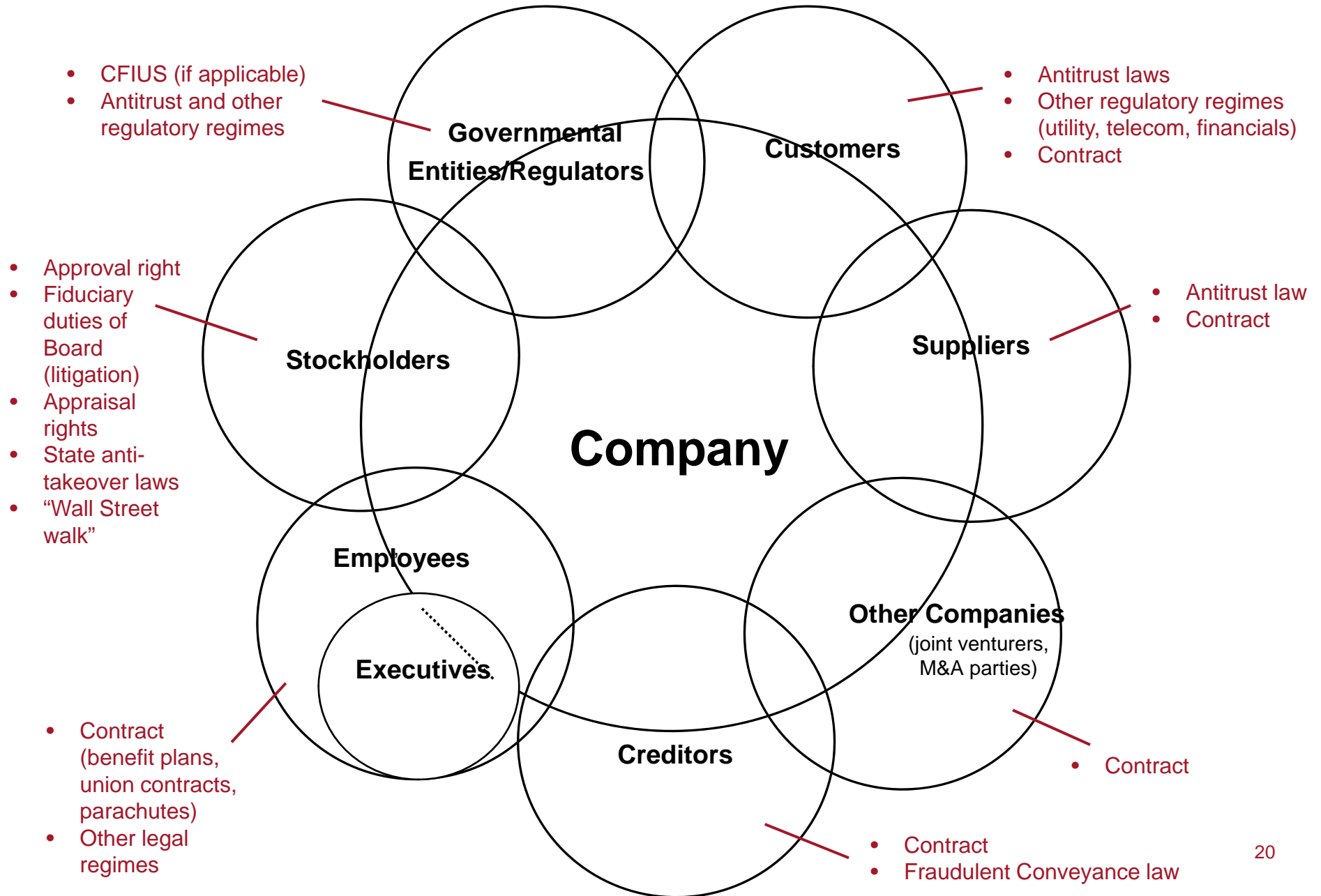
Benefits of Using a Merger

- Eliminate judicial approval requirement
- Eliminate Buyer shareholder vote for small stock-for-stock acquisitions
 - Speed
 - Efficiency
 - Certainty
- Flexibility in structuring
 - Form of consideration
 - cash/stock/blend/cash election
 - collars, caps, and walk-aways
 - Optimal considerations
 - Structuring around hurdles

Example: The Merck/Schering-Plough Merger “Modified Top-Hat/Double Dummy”



How Are All Stakeholders Protected?



How Are Shareholders Protected?

- Shareholder vote requirement
 - Target company's shareholders must approve a merger
 - SEC polices disclosure (also state courts)
- Strongest protection is directors' fiduciary duties
 - Actively policed by litigious plaintiffs bar and sophisticated judiciary (especially in Delaware)
- State law anti-takeover statutes
 - Business Combination; Control Share Acquisition statutes
- Dissenters' Appraisal Rights

Appraisal Rights

- Important theoretical protection for minority shareholders (given the law's deference to majority shareholders) but not often invoked in practice
- **How do buyers achieve certainty?**
 - Statute specifies fair value is standalone and without synergies
 - Judges recognize value of arm's-length sale process
 - Risk of lower value, long wait and legal fees deter opportunism
 - Buyers can also build in self-help (5% assertion condition)
- Potential risks under Section 164:
 - Judge interpreting "fair value" could consider sale premium
 - What is a "reasonable interest rate"?

State Law on Takeover Bids

- Directors owe shareholders duties of care and loyalty
- Three standards of judicial review
 - Business Judgment Rule generally recognizes Board's prerogative to manage the company acting loyally and with due care
 - Enhanced Scrutiny in takeover defenses
 - Unocal – reasonable response to perceived threat to company
 - Unitrin – defense must not be preclusive
 - Household to Airgas – upholds “poison pill” defense
 - Entire Fairness Standard applies if conflict of interests
 - Increasing reliance on Special Committees/Majority-of-Minority
- Revlon Rule – If selling control, get best available price
- Blasius Rule – May not mess with the shareholder franchise
- Specific state takeover statutes apply

US Takeover Response Approach Differs from SA/UK/European Model

- Gives more leeway to Board of Directors
- “Nuanced” approach that avoids specific rules
- SEC’s role is primarily to ensure full disclosure and compliance with federal tender offer and proxy rules
- No rule against “frustrating actions” (as in S. 126)
- No mandatory offer requirement (as in S. 123)
- No rule against squeeze-out (expropriation) of minority; general rule is that majority controls, but must treat fairly
- More litigious environment (class actions, plaintiff’s bar, contingency fees)
- Board can “JUST SAY NO” (up to a point)

Trevor Norwitz is a partner in the Corporate Department at Wachtell, Lipton, Rosen & Katz where he focuses primarily on mergers and acquisitions, corporate governance and securities law matters. He has advised a range of public and private entities in a variety of industries in connection with mergers, acquisitions, divestitures, hostile takeover bids and defenses, proxy contests, joint ventures, financing transactions and corporate governance matters.

Born in Cape Town, South Africa, Mr. Norwitz received his Bachelor of Business Science with first class honors from the University of Cape Town in 1986. On a Rhodes Scholarship to Oxford University, he read law at Keble College, graduating with first class honors in 1989, and then completed an LL.M. at Columbia University in 1990. He joined the firm in 1994 and was named partner in 1998.

Mr. Norwitz teaches a course in mergers and acquisitions at Columbia University School of Law. A member of the American Law Institute and active in the American Bar Association and the New York City Bar Association, he is a regular speaker and panelist at professional conferences, has chaired and participated in numerous advanced legal education programs and contributes regularly to professional publications on topics relating to M&A and corporate governance. He also served on an international advisory group to the South African government on their company law reform. Mr. Norwitz serves on a number of nonprofit boards, including The University of Cape Town Fund, Friends of Ikamva Labantu, both of which he chairs and Advancing Human Rights and Friends of the Mandela-Rhodes Foundation.



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