

Q&A

Akin Gump's Dooley Says Courts More Likely to Scrutinize Banker Fees



Pat Dooley

Merger deals face intense scrutiny from regulators, analysts, shareholders and courts. Corporate boards must

be prepared to manage a transaction as much as possible to avoid pitfalls that may delay or break a deal, says Pat Dooley, a partner at Akin Gump Strauss Hauer & Feld LLP who provides advice to investment funds and corporate clients on transactional matters. He tells Rob Williams about innovations in deal structures and offers an upbeat outlook for economic conditions.

Q: What effect is the Dodd-Frank Act having on M&A?

A: In general, Dodd Frank has not had a direct impact on M&A activity, though if it eventually raises the costs of borrowing, it could have a depressive effect. One potential effect is the modification of Section 13D of the Exchange Act that allows the SEC to redefine the kinds of disclosures in a Schedule 13D, a form that is required to be filed by anybody who's not a passive investor and holds more than 5 percent of the voting stock of a public company. The SEC has the authority to decide if other financial instruments, such as cash-settled swaps, might "count" for reporting purposes.

Q: Wachtell Lipton wrote a position paper on that issue in March.

A: Wachtell is encouraging the SEC staff to do a couple of things. One would be to consider expanding the scope of what would be considered a security that's required to be re-

ported. The concern from Wachtell's perspective, and from corporate America, is that there's not enough 'early warning' of activists coming in and getting a significant voting or economic position without disclosure to the markets and to the company in question.

Q: What else?

A: Another suggestion is to shorten the filing period after crossing the 5 percent ownership threshold from its current 10 days. A shareholder could actually surface with much more than 5 percent, if it's able to buy very quickly during this 10-day window. There've been suggestions this should be shortened to one or two days, given the advances in electronic communications.

Q: You've advised firms such as Cerberus on transactions. How would the proposed changes affect the private-equity industry?

A: I don't think Dodd-Frank specifically has been top-of-mind for non-bank-owned private-equity funds. On the possible 13D changes, it's probably not meaningful. Generally, private-equity funds are not going to be activist investors. They are interested in doing friendly transactions.

Q: What are the issues facing private equity?

A: The principal concern in terms of deal activity is having financing available to make investments. There's a lot of pent-up demand. In the last six months or so, we've seen very attractive financing terms. You're seeing people willing to use leverage ratios now where you can get between five and six times Ebitda, whereas at the very, very height of the market, you could see as high as seven on occasion. At the nadir, it was closer to four.

Q: What about deal terms?

A: The terms on which banks and other financing sources are willing to provide financing are more favorable to private-equity funds. You're seeing more transactions that have covenant-lite arrangements. Funding sources are willing to put money into these deals, and they're willing to do it on favorable terms.

Q: Do you hear any concerns about QE2 ending in June?

A: Depending on how strong the economy is, the withdrawal of QE2 could result in a rise in interest rates that potentially would put pressure on the cost of financing for M&A transactions. That's really an open question. I don't think anyone has a great sense of what's going to happen if and when QE2 is withdrawn.

Q: What are some of the more common concerns among clients?

A: The sense that I have from talking to people is that there is more of an optimistic perspective about the strengthening of the economy, which I think means people are more willing to make investments in the form of M&A.

Q: What about the use of top-up options to reach the 90 percent threshold to approve a short-form merger?

A: There was always a bit of a question about whether those worked. You've got to be sort of close to the 90 percent threshold, because issuing more shares to reach that level becomes mathematically challenging if you are too far away from 90%. But if you're close, it allows you to close right away rather than wait six or eight weeks for the long-form merger process to go forward. I think you'll continue to see top-up options

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used. It's in everybody's interest because it shortens the process.

Q: Why does it seem like every deal announcement is followed by announcements of possible class actions?

A: There's almost no way to avoid it in any big deal. You just know you're going to get sued. The goal for the lawyers on the transaction is to make sure the process and the record are very good so that you can demonstrate everything's been done appropriately.

Q: What's the purpose of these suits?

A: There's two perspectives on this. The first is from corporate America, meaning corporate lawyers. They would say the plaintiffs lawyers are in it to extract a small amount of legal fees. There's an alternative view that even though you'd like to think all transactions are done perfectly, the fact that there are lawyers that routinely look at the process is a mechanism for making sure that buyers and companies continue to focus on making sure they're doing the right thing. My argument would be that it's the job of the corporate lawyer to make sure the process is done properly to protect the board.

Q: How have shareholder suits changed?

A: Claims used to focus on whether the directors had breached their fiduciary duties by selling for too low a price. You still see those claims, but you're also seeing claims that the proxy statement is somehow misleading because it doesn't include certain information. The difference between a breach of fiduciary claim and a disclosure claim is it's more likely that if a court agrees that something is missing from the proxy it will enjoin the transaction until corrective disclosure is made. Moreover, issuers are becoming more focused on trying to make sure lawsuits are heard in the courts of the state of their incorporation because of a belief those suits will be more consistently decided. So issuers are considering "exclusive

venue" clauses in their charters or by laws, though their enforceability is still open to question.

Q: What kinds of disclosures are more significant to courts?

A: A couple of key areas include the disclosure of banker compensation – courts seem to be very focused on that – and what the bankers' relationship is to either the target company or the acquiring company – particularly in an LBO transaction where you may have an investment bank providing advice to the target which has also done work for the private-equity funds or is providing financing for the buyer. Courts are starting to require more and more that those kinds of relationships be disclosed, even though many practitioners probably don't think there's any real conflict. If you don't describe historic relationships, and you don't talk about the specific fees that banks are getting paid, there's a real risk these days that a court will enjoin you until you put that information in.

Q: Are you seeing more 'go-shop' clauses included in transactions?

A: A go-shop is becoming much more common. The situation where you may not see it is in a significant auction process before signing the merger agreement. They're much more common in cases where you haven't had an exhaustive marketing process. It's designed to make sure that a board can properly assert that it's taken all appropriate actions to try to get the highest price, which is its duty when selling the company.

Q: Do boards include a go-shop to actively seek another bidder, or as more of defensive measure to prevent shareholder suits?

A: In the deals that I've been involved in recently, if there's a go-shop, it's a very active process. Putting in a go-shop and not taking advantage of it would run the risk of a court criticizing the board for failing to make sure it maximized value.

Q: How else are courts affecting M&A?

A: Courts are becoming much more focused in making sure that boards of directors are actively involved in the M&A process. There have been cases over the last few years where courts have been critical of a board that was not actively involved and either let management or the investment bank run the process. Courts really want to see the board managing that process. It's particularly true in an LBO situation, where a buyer may be looking to buy a company and have management continue on. There's a view that it is almost an inherent conflict if the management is really running the negotiation process at the same time they're likely to have a job on the other side of the transaction.

Q: Any other innovations in deal structure? In Sanofi-Aventis's takeover of Genzyme, we saw the use of contingent value rights linked to the value of an experimental drug.

A: It's somewhat innovative to use a contingent value right with an experimental drug, although CVRs have been around a long time. CVRs are used to bridge value gaps, sort of like an earnout for a public company. The challenge with CVRs is that it's very hard to come up with milestones that work. For example, what if it's not a gross revenue test, but a net revenue test? If you're the seller, you're worried about whether a bunch of costs will be loaded in to lower the payment amount on the CVR. Most people would prefer not to have to deal with the messiness of trying to figure these things out, or having their lawyers think through every possible contingency that might apply to make sure that the CVR is going to work as intended.

Q: Any final thoughts on the deal landscape this year?

A: It's possible we'll see more activism by hedge funds, who tend not to be acquirers, but catalysts for change. They've shown no signs of slowing down. Additionally, if the economy stays on track, I believe M&A activity will be much stronger this year.