DEAL LAWYERS

Vol. 8, No. 2 March-April 2014

A History Lesson: The SEC's Office of Mergers & Acquisitions

By David Sirignano, Partner, Morgan Lewis & Bockius LLP & former Chief of the SEC's Office of Tender Offers[1]

It is not unusual for former SEC staff members to have a lasting connection and fondness for the particular group or office they served in while at the SEC. For that reason, I was happy to oblige when Broc Romanek asked me to discuss the evolution of the Office of Tenders Offers of the SEC's Division of Corporation Finance into the its current manifestation as the Office of Mergers and Acquisitions for this publication's 'Looking Forward, Looking Back' series.

I joined the Office of Tender Offers as its Chief in 1986, taking over from Joseph Connelly. Joe had already begun a significant transformation for the office. Before he took over as chief in 1980, most rulemaking related to tender offers was handled by John Huber, either in his role as head of the Office of Disclosure Policy in Corporation Finance or for a while as he served in the Office of General Counsel. At that time the office was known as the Office of Tender Offers and Small Offerings and was headed by Ruth Appelton. Although the office did not handle tender offer-related rule making, it issued significant no-action and interpretive letters under the tender offer, going private and beneficial ownership reporting rules, many of which remain seminal today.

While John Huber created the framework for the modern day tender offers rules and disclosure framework, Joe worked on several key features, such as the All Holder and Best Price Rule, proration and withdrawal rights, Rule 14e-3 insider trading prohibitions, and significant amendments to the going private and beneficial ownership rules, of course with John's continued oversight as Division Director for many of those projects. The Office was now simply known as the Office of Tender Offers or affectionately as "OTO".

I joined the office at a time when the rise of hostile tender offers and billion dollar going private transactions were drawing attention to the SEC's oversight of those transactions. There was significant opposing political pressure to rein in the corporate raiders but also to preserve the neutrality of the Williams Act

[1] Thanks to Dennis Garris for his assistance with this article.

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ISSN 1944-7590

and let the "market for corporate control" take its course. We were very busy writing concept releases, rule proposals and congressional testimony to try to balance these demands, mostly to a stalemate.

Mainly due to developments under Delaware law, the focus eventually changed to the proxy contests as a means for unsolicited changes in corporate control. In response, the duties of the office were significantly expanded when then Corporation Finance Director Linda Quinn gave it primary responsibility for proxy contests and dramatically increased its staffing from 3-4 to 8-10 staff members. Also as part of that shift in focus, OTO was charged with drafting the first significant modernization of the proxy rules to permit communications among shareholders and facilitate solicitations prior to delivery of the proxy statement. Those rules, adopted in 1992, are credited with facilitating the rise of the modern activist investors.

In addition, in order to introduce some uniformity into the review of non-tender offer acquisitions, the office was given an operational role in reviewing the disclosure in Form S-4 registration statements and merger proxies primarily handled by the operational branches. Finally, the office was asked to respond to the internationalization of the securities markets and the rise of cross-border acquisitions. It drafted the tender offer provisions of the MJDS system for U.S./Canadian transactions, and pioneered accommodations for foreign tender offers through no-action and exemptive relief that eventually became the basis for the current cross-border exemptive scheme.

My service as OTO Chief ended in 1993, but Greg Corso continued the broader M&A focus before he joined the staff of Chairman Levitt in 1996. It was while Cathy Dixon was the office head that it received its long sought recognition of its expanded role when it was renamed the Office of Mergers and Acquisitions, a testament to Cathy's persuasiveness. During this period, the Office came under the general oversight and guidance of Associate Director for Regulatory Policy, Mauri Osheroff, a role she continues today but who sadly will be retiring shortly. The Office certainly has benefitted from her rulemaking expertise.

Following Laurie Green's service as acting chief, Dennis Garris took over in 1997 and was one of the office's most prolific rule writers, including additional proxy reforms, Regulation 13D/G reform, cross border acquisitions, and the Mini Tender Offer interpretive release and related enforcement cases. Over this period of time, there was also a shift of interpretive responsibility for issuer tender offers from the Trading Practices Office in the Division of Market Regulation to Office of Mergers and Acquisitions. Perhaps the most significant project was Regulation M-A, on which special counsel Jim Moloney greatly contributed, which developed approaches for deregulating communications under the Securities Act that became the basis for Securities Offering Reform in 2005.

Dennis was followed by Brian Breheny in 2003 after Pamela Carmody served as Acting Chief. Brian revived the tender offer as a viable acquisition method by drafting the amendments to the best price rules to accommodate compensation and severance arrangements that the courts had found ran afoul of those rules.

The office's current head, Michele Anderson took over for Brian in 2008, who became a deputy director of the Division. Over this period of time, the office continued to consolidate authority over tender offer issues, with the shift of responsibility for Rule 14e-5 governing purchases outside of the tender offer from the Office of Trading Practices. The office continues to deal with fundamental tender offer and proxy contest questions given the steady rise in shareholder activism and hostile takeover activity, such as those relating to going private and beneficial ownership reporting, universal ballot and bona fide nominees, the use of social media, disclosure of financing arrangements, and pricing of debt tender offers.

The office has also been fairly busy bringing enforcement cases in these areas. While the Division's rulemaking has been preempted in recent years by legislative mandates, the office will have its hands full in addressing the authority granted the SEC by the Dodd-Frank Act to revamp the filing requirements under Section 13(d). Also the office is working on some long-awaited guidance on debt tender offer practices.

A Look Back: Regulation M-A & The "Five-Business Day" Rule

By Jim Moloney, Partner, and Tim Mullins, Associate, Gibson, Dunn & Crutcher LLP

Looking back some fifteen or twenty years ago when I was working as a young Staff attorney in the SEC's Division of Corporation Finance, things seemed a lot simpler back then. My job was basically to review public company filings, issue comments to counsel around the country who were representing their public company clients, and evaluate the adequacy of their clients' responses and overall compliance with the federal securities laws.

Clearly, I was but one of many hundreds of attorneys, accountants, financial analysts and others working at the SEC who were all acutely focused on protecting investors, keeping order in the securities markets and enforcing the many disclosure requirements on the books. Little did I know that I would get pulled into a rulemaking project that would span three-plus years and would significantly change the manner in which public M&A transactions are structured and carried out today.

At that time, M&A deals seemingly worked just fine. Parties to a business combination would announce their deals. Structuring the transaction as a merger with a vote of security holders would entail the preparation and filing of a preliminary proxy statement that would be reviewed by the Staff in due course, with Staff clearance and mailing of a definitive proxy statement to security holders many months after the merger agreement was first signed.

Structuring the transaction as a tender or exchange offer (without any vote of security holders) required a slightly different protocol. Shortly after the announcement of a cash tender offer, the bidder would need to quickly prepare and file with the SEC a Schedule 14D-1 tender offer statement[1] and commence the offer within *five* business days of the first public announcement of the transaction.[2] Yes, that's right, a hard-and-fast deadline was imposed on the prospective bidder to either "put up" or "shut up." Failure to file and commence was hardly an option as most bidders would not want to risk violating the SEC's tender offer rules and a stern call from Enforcement.

If the tender offer consideration involved securities, generally referred to as a "stock-for-stock" exchange, the parties to the transaction would issue a press release to announce their deal and promptly schedule an investor call within minutes to proudly extol the benefits and synergies associated with their big deal. Interestingly, at the time there was a relatively well-known, but unwritten, rule called the "48-hour rule" under which the SEC Staff would allow the parties to a business combination transaction to communicate freely with investors for up to two days without running afoul of Section 5 despite all the media fanfare.

After the communications bonanza ended, the parties had to go silent in what was known as the "quiet period" during which all public communications about the deal would cease and the advisors would work furiously to pull together a rather lengthy disclosure document (a prospectus) included as part of a registration statement (on Form S-4) that would eventually get filed with the SEC many weeks later.

Once filed, the Staff would generally take up to thirty days to review the registration statement, and after some back-and-forth comments and responses between the Staff and the parties, including their advisors, the disclosure would be finalized, the registration statement would be declared effective, and the exchange offer would then commence. It was not uncommon for the period from first public announcement to commencement to run several months, when security holders would first receive a disclosure document and be given an opportunity to tender their shares, and consummation of the exchange offer and issuance of the consideration offered occurring after one or more months had passed. The drawn out process and timelines were similar to those of mergers that involved a vote of security holders.

To get a better understanding of how this framework came into being, one need only look back to the mid-to-late 1960s when muscle cars such as Mustangs and Camaros were flowing out of Detroit to rule the American roads. In that era, the M&A landscape was much different. Mergers and acquisitions had only recently become "daily fare to readers of the financial pages,"[3] with the markets experiencing a

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[1] 17 C.F.R. § 240.14d-6 (1998) (current version at 17 C.F.R. § 240.14d-6 (2013)).

[2] 17 C.F.R. § 240.14d-2 (1998) (current version at 17 C.F.R. § 240.14d-2 (2013)).

[3] Note, *Cash Tender Offers*, 83 Harv. L. Rev. 377 (1971).

"phenomenal increase" in activity,[4] prompting cries from various constituencies seeking greater regulation and the need for transparency in such transactions. Those cries for protection were not all that dissimilar from the reactions witnessed after the recent frauds and ensuing market volatilities that ultimately led to the enactment of Sarbanes-Oxley[5] and Dodd-Frank[6].

Back in that era, takeover mechanisms such as proxy contests were subject to much more rigid and fulsome disclosure obligations, whereas tender offers received significantly less regulatory oversight.[7] Specifically, for cash tender offers there was no requirement to disclose an offeror's plans following the purchase or for that matter the offeror's identity. Rather, the offeror could simply disclose the bare basics necessary to entice a sufficient number of security holders to sell their shares: the name of the security sought, the price offered, the deadline to sell, the number of shares sought, the number of shares required to obligate the offeror to purchase, and the name and address of the depository.[8]

This technique was used effectively by hostile bidders to implement change of control transactions in a relatively short period of time. Of course, this approach placed extreme pressure on investors to make a hasty and sometimes ill-informed investment decision given the lack of information regarding the offer and the persons and motives behind the offer.

Given the relatively loose regulatory framework, cash tender offers were an appealing takeover mechanism for any would-be acquiror. With little to no mandated disclosure or procedures, offerors could quickly accumulate shares of an issuer preceding a planned tender offer.[9] In some cases, offerors would execute what was referred to as a "Saturday Night Special" where the offeror would make a sudden public tender offer announcement, typically over the weekend, in an effort to surprise the target company and reduce its ability to respond effectively.[10] Offerors could also tip off a few friends to the impending tender offer, enabling them to purchase shares prior to the tender offer only to reap significant profits upon tendering their shares.[11]

The passage of the Williams Act[12] in 1968 led to the SEC's promulgation of the first generation of tender offer rules, mandating minimum tender offer periods, affording investors withdrawal rights (opportunities to change their minds) during certain time periods, and the "five-business" day rule, all of which were designed to address the growing public outcry regarding the many deceptive practices surrounding tender offers.[13] The five-business day rule, previously Rule 14d-2(b)(2), required an offeror to withdraw its offer or provide shareholders with the means to tender their shares within five business days of first announcing a cash tender offer.[14]

The rule hinged on whether there was a public announcement containing certain specified information including: (1) the bidder's identity, (2) the identity of the target company, (3) the amount and class of securities sought and (4) the price offered for the securities sought.[15] Accordingly, any offeror planning to make a tender offer had to be in a position to file a full-blown tender offer statement including not only the identities of the bidder and the subject company, the amount and class of securities being sought, the scheduled expiration date of the tender offer, but also a plethora of other detailed disclosure items

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[4] Patrick J. Griffin, Jr. & J. Richard Tucker, *The Williams Act, Public Law 90-439-Growing Pains? Some Interpretations with Respect to the Williams Act*, 16 How. L.J. 655 (1971).

[5] Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (H.R. 3763) (July 30, 2002).

[6] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (H.R. 4173) (July 21, 2010).

[7] 83 Harv. L. Rev. at 379.

[8] 16 How L.J. at 659.

[9] 16 How L.J. at 658.

[10] David W. Leebron, *Games Corporations Play: A Theory of Tender Offers*, 61 N.Y.U. L. Rev. 153, 158 n.18 (1986).

[11] 16 How L.J. at 658. Today, Rule 14e-3 protects investors against insider abuses like these. *See* 17 C.F.R. § 240.14e-3 (2013).

[12] The Act was named for Senator Harrison Williams of New Jersey. 83 Harv. L. Rev. at 381.

[13] One peripheral aspect of the new rules was the federal government's desire to preempt state laws seeking to regulate tender offers. *See* W. Brewster Lee, III, *SEC Tender Offer Timing Rules: Upsetting A Congressionally Selected Balance*, 68 Cornell L. Rev. 914, 915 (1983).

[14] *See supra* note 1.

[15] 17 C.F.R. § 240.14d-2(c) (1998). The old rules permitted, without filing with the SEC, communications that identified the bidder and the subject company and included a statement that the bidder intends to make a tender offer but did not specify how many shares were sought or for how much consideration. 17 C.F.R. § 240.14d-2(d) (1998).

on a Schedule 14D-1 that would be disseminated to security holders.[16] In addition, the offer had to be held open for a minimum period of time giving security holders an opportunity to consider the offer and its terms before having to make an investment decision.

The five-business day rule forced offerors contemplating a cash tender offer to stay quiet until they had most of their offer details, including any financing and other terms, worked out. By contrast, the more burdensome Section 5 registration requirements served as the basis to give bidders engaging in stock exchange offers significantly more latitude with respect to the timing of commencement. Clearly the regulatory framework requiring cash tender offers to commence much sooner than exchange offers was designed to protect security holders from many of the abuses detailed above,[17] but at the same time it restricted communications with the marketplace and mandated fixed timetables on parties to a business combination.

Thirty years later, during my tenure at the Commission, I had the pleasure of working with many other SEC Staff members including Brian Lane (then Division Director), Mauri Osheroff (Senior Associate Director), Dennis Garris (then Chief of the Office of Mergers & Acquisitions), Laurie Green (who at the time was working on amending the SEC's Cross Border rules) and P.J. Himelfarb (another Special Counsel working in OM&A with me at the time) in implementing the reforms that have shaped today's regulatory framework for business combinations. During the rulemaking process there were many debates internally as to how the tender offer rules could best be updated and there was no shortage of commentary from outside the Commission as to how the M&A rules could be improved. After all, many of the rules governing tender offers and business combination transactions were almost thirty years old when we first began working on what is now known as Regulation M-A.

It was clear then that the time had come to update the rules. But where to begin? How about that "five-business day" rule which required all bidders to formally commence their cash tender offers by a strictly imposed deadline following the public disclosure of a few basic terms. After all, why did a bidder making a cash tender offer have to commence within five business days while the same bidder making a registered exchange offer received all the flexibility and time in the world to commence? Would the markets fall to their knees if a cash offer commenced six business days after first announcement? And what's wrong with announcing one's plans or intentions to make a tender offer without immediately commencing the offer? Perhaps nothing at all, but at the time there were a few current and former senior Staffers with significantly more familiarity with the rules and experience working on numerous prior rulemakings over the past three decades who were much less optimistic, warning of the inherent dangers that loom large with such rule changes.

Despite the naysayers' concerns, we proceeded to draft proposed rule amendments that incorporated outlandish concepts at the time, concepts such as "early commencement" for exchange offers (permitting exchange offers to commence *before* there is an effective registration statement on file), "subsequent offering periods" (similar to the what the Brits had readily allowed in U.K. deals) and not the least of which was a proposal to eliminate the five-business day rule. To address some of the critics' concerns, the SEC also promulgated Rule 14e-8 which generally prohibits, as deceptive acts, cases where the offeror (1) makes a tender offer announcement without the intention to commence the offer within a reasonable time, (2) makes the announcement with the intention to manipulate the target company's stock price or (3) does not have a reasonable belief that he or she will have the means to complete the offer.[18]

When Regulation M-A went into effect in early 2000 (almost three years after the rulemaking had first begun), tender offers quickly changed and they would never be the same again. The reforms updated the rules governing cash and stock tender offers and significantly deregulated communications in business combination transactions. This came as a rude awakening for some of the '33 Act purists at the time. Along with the changes, the five-business day rule was eliminated, permitting offerors to freely communicate their intentions to the public without having to be ready to launch a tender offer on an accelerated timetable. As a quid pro quo, all written communications relating to potential tender offers had to contain appropriate legends and such communications had to be filed with the SEC on the date

[16] 17 C.F.R. § 240.14d-6 (1998) (current version at 17 C.F.R. § 240.14d-6 (2013)).

[17] 16 How L.J. at 658—60.

[18] 14 C.F.R. § 240.14e-8 (2013).

of their first use.[19] Since that time cash tender offers have become increasingly more common, viewed as the takeover mechanism of choice by many acquirors. Of course, other advances in the law, such as the recently enacted amendments to DGCL § 251(h)[20] have only provided bidders with additional reasons to favor cash tender offers over mergers.

While no parade of horribles has ensued since the five-business day rule was eliminated, the SEC has since had the opportunity to use Rule 14e-8 in a handful of instances to combat fraudulent offers, such as:[21]

- In 2003, Ade Ogunjobi, through his company Toks, offered unregistered promissory note securities with the purpose of raising at least one billion dollars to finance tender offer deals for the stock of at least fifteen of the world's largest corporations, a set of transactions claimed to require at least five billion dollars in stock. Subsequently, when the defendants attempted to launch multiple exchange offers, the SEC charged several violations of the Exchange Act as well as a violation of Exchange Act Rule 14e-8, arguing that Toks and Ogunjobi had no reasonable belief they had the means necessary to complete the tender offers they had announced through their offering materials.[22] Toks and Ogunjobi were permanently enjoined by default in March of 2004.[23]
- More recently, in 2011, Allen Weintraub, a convicted felon who was previously barred from serving as an officer or director of a public issuer[24] and owed the SEC a $1.05 million judgment for past tender offer violations, emailed letters to the boards of Eastman Kodak and AMR Corporation, the parent of American Airlines, announcing his intention to make tender offers to purchase all outstanding securities of both companies,[25] at near 50% premiums over their then-current trading prices. In connection with these offers, Mr. Weintraub emailed an announcement to various reporters and later claimed that "several large institutions" backed his plans although he never secured a single financing agreement or letter of credit. In the litigation that followed, the SEC alleged, among other things, a violation of Rule 14e-8, successfully winning summary judgment on the facts.[26]

In retrospect, I think it is safe to say that the Regulation M-A amendments adopted by the Commission in late 1999 and implemented the next year accomplished their intended goals—specifically to free up communications, place stock and cash tender offers on a more equal playing field, facilitate the delivery

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[19] 17 C.F.R. § 240.14d-2(b) (2013).

[20] 79 Del. Laws Ch. 72 (2013).

[21] Several other instances of SEC complaints alleging Rule 14e-8 violations can be found. *See, e.g.*, SEC Sues Global Airlines Corporation and Its Chief Executive Officer Emil Bernard for Securities Fraud, Litig. Release No. 18055, 79 S.E.C. Docket 2862, 2003 WL 1633001 (Mar. 31, 2003) (alleging violations of Rule 14e-8 in connection with tender offer announcements to purchase Trans World Airlines, Inc. and US Airways Group Inc.), *available at* http://www.sec.gov/litigation/litreleases/lr18055.htm; SEC Sues Richard M. Ryan for Fraudulent Tender Offer for Enron Corporation, Litig. Release No. 18124, 80 S.E.C. Docket 449, 2003 WL 21025843 (May 7, 2003) (alleging Rule 14e-8 violations in connection with a tender offer for Enron Corporation), *available at* http://www.sec.gov/litigation/litreleases/lr18124.htm; SEC Charges Treyton L. Thomas and Pembridge Group, Ltd. With Securities Fraud and Stock Manipulation, Litig. Release No. 18957, 84 S.E.C. Docket 263, 2004 WL 2480713 (Nov. 3, 2004) (alleging Rule 14e-8 violations in connection with a tender offer purportedly intended to manipulate the price of Imagis Technologies, Inc. stock), *available at* http://www.sec.gov/litigation/litreleases/lr18957.htm.

[22] Complaint, *Sec. & Exch. Comm'n v. Toks, Inc.*, No. 03-Civ. 01787, (D.D.C. Aug. 25, 2003), *available at* https://www.sec.gov/litigation/complaints/comp18309.htm.

[23] SEC Obtains Permanent Injunction Against Toks, Inc. and Its Chief Executive Officer Ade O. Ogunjobi, Litig. Release No. 18710, 82 S.E.C. Docket 3042, 2004 WL 1091103 (May 13, 2004), *available at* http://www.sec.gov/litigation/litreleases/lr18710.htm. In 2001, Ogunjobi had registered securities as part of a very similar plan, and the SB-2 registration statement was suspended in an earlier Initial Decision on January 8, 2002. *In re* Toks Inc., S.E.C. Release No. 198, 2002 WL 21693 (ALJ Jan. 8, 2002), *available at* http://www.sec.gov/litigation/aljdec/id198bpm.htm. The original SB-2 filed by Toks, Inc. and Ogunjobi is available on the SEC website at https://www.sec.gov/Archives/edgar/data/1158135/000115813501500006/tok3.txt. The Rule 425 free writing prospectuses are also available on the SEC website. The Rule 425 prospectus for AT&T Wireless can be found at https://www.sec.gov/Archives/edgar/data/1138234/000111055001500072/wireless.txt.

[24] SEC Obtains Officer and Director Bar Against Allen Weintraub and Obtains Injunctions Against Florida Stock Transfer, Inc., Vector Holdings Corp. and Allen E. Weintraub, Litig. Release No. 18021, 79 S.E.C. Docket 2333, 2003 WL 896205 (Mar. 7, 2003), *available at* https://www.sec.gov/litigation/litreleases/lr18021.htm.

[25] Weintraub's letters were sent to the board of directors at each of Kodak and AMR, with copies sent to their largest shareholders. *Sec. & Exch. Comm'n v. Weintraub*, No. 11-Civ-21549-CIV, 2011 WL 6935280 at *1 (S.D. Fla. Dec. 30, 2011). Weintraub went so far as to call the press and grant telephone interviews in which he admitted making a tender offer for both AMR and Kodak. *See* Terry Maxon, *We talk about AMR deal with hopeful buyer*, Dallas Morning News (Mar. 29, 2011, 6:42 PM), http://aviationblog.dallasnews.com/2011/03/we-talk-about-amr-deal-with-ho.html/?nclick_check=1.

[26] *Sec. & Exch. Comm'n v. Weintraub*, No. 11-Civ-21549-CIV, 2011 WL 6935280 at *1—*2, *5, *7, *10 (S.D. Fla. Dec. 30, 2011).

of more information to investors and provide bidders and target companies alike with the necessary flexibility to structure their deals and commence their offers in a manner and on a timetable that makes the most sense given the particular circumstances.

While the elimination of the five-business day rule was but one small aspect of the regulatory over-haul, it was nevertheless an important change that many newer lawyers and bankers to the profession may fail to fully appreciate today. And those fears expressed early on that there would be a tidal wave of bogus tender offers along with numerous attempts by state regulators to encroach into this area have all proved to be unfounded. Lucky for us!

Still Risky Business: Unlicensed M&A Advisors After the Six Lawyers Letter

By John Jenkins, a Partner of Calfee, Halter & Griswold LLP

It's pretty hard to spend much time working with small businesses without encountering unlicensed M&A advisors. These people often have a lot of expertise, but their lack of an affiliation with a registered broker-dealer has often sharply limited their role in transactions involving securities. The SEC has recently issued a no-action letter expanding the role that M&A advisors can play without registering as a broker-dealer. However, unlicensed advisors and their clients still need to be cautious, because providing M&A advisory services outside of a registered broker-dealer remains a risky business.

The Licensing Thicket—Ever since the Supreme Court's 1985 decision in the *Landreth Timber* case, it's been well settled that if a deal is structured as a stock purchase, or if the seller receives stock or other securities as consideration for its business, then the transaction involves a "sale" of securities. In turn, federal and state laws define the term "broker" broadly to encompass anyone engaged in the business of effecting securities transactions for another person's account. Since that's the case, if an M&A advisor receives a fee—particularly a transaction-based fee—then that the advisor may well be a "broker" under the Securities Exchange Act of 1934 and applicable state laws.

The need to register as a broker-dealer is often a big problem for M&A advisors. Registration is a major project requiring, among other things, becoming a FINRA member, obtaining appropriate individual licenses, satisfying state-level licensing requirements, and forever after complying with intricate rules relating to the firm's operations, capitalization and business conduct. In order to avoid all this, M&A advisors had to fit their business model into the very narrow role permitted to non-licensed brokers under the SEC's no-action letter guidance.

The Six Lawyers No Action Letter—The SEC has recently issued a no-action letter that substantially increases the scope of activities in which unlicensed M&A advisors may participate in acquisition transactions involving private companies. In the *Six Lawyers* letter (Jan. 31, 2014), the staff of the Division of Corporation Finance went well beyond what it had permitted intermediaries to do in the past. Prior to this no-action letter, staff guidance expressed in the *International Business Exchange Corp.* (Dec. 12, 1986) and *Country Business, Inc*. (Nov. 8, 2006) no-action letters sharply limited advisors' ability to participate in negotiations, assist in structuring the transaction or advise on value. In addition, what relief these no-action letters did provide was limited to engagements involving "small businesses."

In contrast, the *Six Lawyers* letter permits—subject to certain conditions—an unlicensed broker to play an active role in an M&A transaction involving a privately-held company, without regard to size and regardless of whether securities are being sold in the transaction. In fact, what restrictions the *Six Lawyers* letter does impose are unlikely to significantly restrict the ordinary course business activities of an unlicensed M&A intermediary without a history of regulatory problems, so long as the deal doesn't involve a shell company or a public offering of securities. The advisor can't have the authority to bind any parties, finance the deal, handle funds or securities for the account of others, organize a buyer group, or be involved in a deal that results in the sale to a "passive" buyer which isn't going to actively operate the business. However, the unlicensed broker is generally free to solicit interested parties, participate in negotiations, help structure and value securities to be issued in the deal, receive transaction-based compensation, and even represent both sides to the transaction (with appropriate disclosure).

Continuing Risks—While the *Six Lawyers* no-action letter is a helpful development, it does not rise to the level of rulemaking, and the positions expressed in it can change with little notice. The SEC staff has been somewhat mercurial when it comes to no-action letters surrounding broker-dealer licensing issues. For example, the *Paul Anka* (Jul. 24, 1991) no-action letter addressing permissible "finder" arrangements was widely relied upon for more than a decade, but the SEC's staff has backed away from it in recent years. A retreat from the *Six Lawyers* letter may seem unlikely today, but the point is that a no-action letter is an uncertain foundation upon which to build a business. (Although beyond the scope of this brief article, it is worth noting that federal legislation exempting from broker-dealer registration M&A brokers involved with privately held companies meeting certain size standards is currently pending).

Another notable issue is that the *Six Lawyers* letter has no effect on state licensing requirements, which may not necessarily be limited to securities broker licenses. Some states require an M&A broker to obtain a real estate license, if the transaction involves compensation directly (or sometimes indirectly) tied to the sale of real estate. Other states, such as Illinois, subject "business brokers" to independent licensing requirements.

The good news is that some states have provided relief for M&A brokers. For example, the Ohio Securities Act excludes from the statutory definition of the term "Dealer" persons who engage, for the account of another, "in the purchase or sale of securities that are issued and outstanding before such purchase and sale, if a majority or more of the equity interest of an issuer is sold in that transaction." The bad news is that many states do not provide similar relief, and the relief that is provided is not necessarily as broad as that provided in the *Six Lawyers* letter.

Failing to comply with state licensing requirements can have significant consequences to both the broker and others involved in the transaction. For M&A brokers, these consequences may include not only state enforcement actions, but the inability to enforce contractual rights to payment for their services. For companies involved in an M&A deal, use of an unlicensed broker could potentially allow shareholders of the acquired company to rescind their investment in the buyer. Furthermore, use of an unlicensed broker is likely to be regarded as material information, and the failure to disclose that information could expose the issuer to liability under Rule 10b-5 or analogous provisions of state law.

<u>Conclusion</u>—The *Six Lawyers* letter provides welcome relief from a burdensome regulatory scheme, and gives M&A advisors much more latitude to serve their clients, many of whom are in market segments underserved by more established securities firms. But significant risks remain to providing M&A advisory services without licensing, and those risks need to be taken into account by both M&A advisors and the companies involved in transactions in which they participate.

The Board's Evolving Role in Shareholder Communications

By Matthew Sherman, President & Partner of Joele Frank Wilkinson Brimmer Katcher (www.joelefrank.com)

Until recently, investor communications fell solely under the purview of a company's management team. The Investor Relations Officer, working together with the CFO, managed routine interactions with existing and prospective shareholders, and the CEO typically interacted with shareholders during quarterly conference calls and at key industry or investment bank-sponsored conferences. While boards wanted to know that the management team engaged regularly in IR, rarely did they play any role in the effort.

Given the increasing levels of shareholder activism at corporations both large and small and across industries, public company directors are now much more involved in investor relations than ever before.

Shareholder activism is here to stay and boards have taken notice. Boards and management teams are routinely being challenged—both privately and publicly—by investors, sell-side analysts, industry experts and regulators, to name a few. Companies today are finding that every decision is scrutinized—from executive compensation, corporate governance practices and capital allocation to the management team's ability to develop, implement and execute its strategic plan. Boards and management teams that are perceived to be lax or indifferent in addressing these critical, top-of-mind issues often face public opposition and proxy challenges by activist investors.

Activist investors have been increasingly successful in convincing other mainstream investors and influential proxy advisory services that change is warranted and that "fresh perspectives" are needed in the boardroom to effect such change. With activist investors emboldened by their influence, boards and management teams are taking control, especially on the IR front.

Good companies engage with their shareholders regularly—this is simply good investor relations. Companies must foster and maintain long-term relationships with their top investors so there is a means to communicate directly and effectively and to secure honest feedback that can be used to inform the corporate strategy. Whether a company is facing good times or bad, it would be a mistake for any management team to meet with its institutional shareholders for the first time during an activist campaign.

In this new environment, boards are not only proactively assessing and addressing perceived structural or governance vulnerabilities, but they are devoting more time and resources to investor relations. Directors are developing and nurturing relationships with a broad range of key constituents, especially shareholders. Directors want to understand investors' perspectives and in a number of instances, hear from them directly.

There are a number of scenarios during which direct interaction between board members and shareholders is appropriate and useful. Generally speaking, if a management team is on the road speaking about a board initiative, it can be helpful for investors to hear a director articulate the board's perspective firsthand. In addition, at smaller companies, where the senior leadership team may comprise a smaller group of individuals, having board members speak directly to investors can help showcase the depth of senior-level talent beyond the management team.

In specific scenarios, such as a proxy fight, board members play a critical role in the communications effort with the goal of demonstrating alignment between the management team and the board and support of the overall corporate strategy and direction.

Board engagement with shareholders outside of the proxy process is occurring more frequently due largely to institutional investors becoming more vocal about their own governance guidelines and analysis. These investors often do not rely solely on the recommendations of the proxy advisory services.

When appropriate, we advise clients to support controlled board communications with investors to create relationships that can be leveraged if and when needed. We have found that shareholders are most interested in the board's input when there are substantive issues to discuss and a board-level perspective is warranted.

Ahead of any meeting with investors—activist or otherwise—directors must be fully informed. Board members should be armed with, among other things, details about prior engagement with the shareholder, the shareholder's investment focus and history with the company as well as any public or private statements that the shareholder has made about the company. We advise directors to run through mock Q&As and other role playing exercises to prepare for investor meetings and that all parties agree on the boundaries for a conversation—and how far directors should be willing to go on key topics.

At the end of the day, the management team is in charge of the company's operations and is responsible for implementing and executing the corporate strategy. Providing investors with direct and unfettered access to the board could serve the unintended consequence of undermining management's authority and credibility.

That said, periodically and strategically utilizing a board member in a company's investor relations program can help support that company's effort to build a track record of open and transparent communications with shareholders and analysts. This in turn can provide a board and management team with critical insights into the mindset of its investor base, bolster that company's credibility and corporate governance, and in certain instances, head off any interest or approach from an activist investor.

When You're Selling the Company, Are You Selling the Attorney-Client Privilege Too?

By Dean Hanley, Partner, and Erin Kravitz, Associate, Foley Hoag LLP

Imagine the following scenario. Your law firm is hired to represent a small manufacturing company, ABC, Inc. You've represented ABC on various matters, including environmental compliance, over many years. ABC eventually transitions from having 18 shareholders and five directors to having a single shareholder and sole director, who are the same person. After representing ABC for 23 years, you serve as counsel to both ABC and its sole shareholder in a merger.

The merger closes but a dispute regarding environmental representations made by ABC's sole shareholder soon arises. The shareholder, naturally, retains you to represent him in the action. The buyer of ABC promptly moves to: (1) enjoin you from representing the shareholder in the action (and any other action adverse to ABC's buyer); (2) enjoin you from disclosing to the shareholder any information you obtained from ABC during your prior representation of ABC; and (3) require you to give to the acquiring corporation all of the files in your law firm's possession concerning its prior legal representation of ABC to the extent they relate to the environmental matters at issue.

If this dispute makes its way to the highest court in New York (and it did, in *Tekni-Plex, Inc. v. Meyner and Landis*[1]), the buyer wins, you are disqualified from representing the shareholder and you are ordered to hand over your files to the buyer.

Surprising?

Compare the dispute that landed before Chancellor Strine in the Delaware Court of Chancery in November of 2013 in *Great Hill Equity Partners IV, LP v. SIG Growth Equity Fund I, LLLP*.[2] Chancellor Strine reached conclusions similar to those reached by the court in *Tekni-Plex*, but this time based on a reading of Section 259 of the Delaware General Corporation Law. That section states that, upon the consummation of a merger, "all property, rights, privileges, powers and franchises... shall be thereafter as effectually the property of the surviving or resulting corporation." *Great Hill* turned on the issue of who controlled the attorney-client privilege of the seller post-merger. Chancellor Strine held that the language of the Delaware statute clearly encompasses the attorney-client privilege and that, as such, the privilege passes to the buyer. Strictly speaking, the attorney-client privilege is owned by the acquired company which is now controlled by the buyer in a merger.

This checklist examines some of the issues raised in *Tekni-Plex* and *Great Hill* and proposes some contractual and other practical solutions for the legal practitioner seeking to protect against the outcomes in these cases.[3] The problems in this area are analytically quite complex, but it helps to remember that the attorney-client privilege is intended to enable a lawyer to have communications with her client that will not, and cannot (without client assent) become evidence in a dispute.

A further word of warning. Although Chancellor Strine stated in *Great Hill* that "the answer to any parties worried about facing this predicament in the future is to use their contractual freedom…to exclude from the transferred assets the attorney-client communications they wish to retain as their own," it remains unclear what contractual language would be effective to overcome the Delaware statute. For example, can the agreement state that the privilege is held by the pre-closing shareholders, subject to waiver by their designated representative? If the merger statute essentially transfers everything, must the pre-closing target shareholders create a separate legal entity to somehow "own" the attorney-client privilege? Will a court consider these to be effective and enforceable pre-merger transfers? It's not clear at all.

Until courts squarely address some of the possible solutions to this problem, suggestions like those offered here are no doubt better than nothing, but the area of practice is surprisingly unsettled considering the age of the

[1] *Tekni-Plex, Inc. v. Meyner and Landis*, 89 N.Y.2d 123 (1996).

[2] *Great Hill Equity Partners IV, LP v. SIG Growth Equity Fund I, LLLP*, C.A. No. 7906-CS (Del. Ch. Nov. 15, 2013).

[3] Some of the suggested language in this list is based on or derived from Bryans, *Business Successors and the Transpositional Attorney-Client Relationship*, 64 Bus. Law. 1039 (August 2009).

problem and how fundamental attorney-client principles are supposed to be—is not settled. *Great Hill* points toward some solutions, but it does not really get practitioners to the destination.

Other unresolved issues are noted below.

1. Basic legal principles: As an initial (and fundamental) matter, when a lawyer or law firm undertakes to represent a corporation, the relationship, confidentiality and (if carefully protected) attorney-client privilege exists between the lawyer and the corporation as an entity, despite the fact that the corporation acts through individual representatives. Additionally, and crucially in *Tekni-Plex*, when control of a corporation passes to new management and efforts are made to continue the business of the corporation, an attorney-client relationship exists between the buyer (strictly speaking, the acquired corporation now controlled by the buyer) and seller's counsel; it is the relationship between an attorney and his former client.

   As such, buyer's (new) management may assert or waive the attorney-client privilege, even with respect to communications made by former officers and directors, and is in principle entitled to access confidential information disclosed during the course of the representation of seller. (Note, of course, that a mere transfer of assets, without an attempt to continue the original business of a company, may not result in such a transfer of the attorney-client privilege. The question often turns on whether the buyer is the "successor" to the target's business.)

2. Post-transaction conflict/disqualification:

   a. *Problem*: As in *Tekni-Plex*, a lawyer may want to represent selling shareholders in litigation adverse to buyer.

   b. *Possible Contractual Solution*: "Buyer consents to Seller Law Firm's representation of Seller and/or Shareholders in any post-closing matter in which the interests of Buyer, on the one hand, and Seller and/or Shareholders, on the other, are adverse, even if the matter is one in which Seller Law Firm may have previously advised Seller."

3. Disclosure to selling company and stockholders:

   a. *Problem*: A lawyer may want or need to make certain disclosures relating to its representation of the selling company to the selling company's shareholders or the selling company itself in connection with a post-closing dispute.

   b. *Possible Contractual Solution*: "Buyer consents to the disclosure by Seller Law Firm to Seller and/or Shareholders of any information learned by Seller Law Firm in the course of its representation of Seller, regardless of whether such information is subject to the attorney-client privilege and/or Seller Law Firm's duty of confidentiality and whether or not such disclosure is made before or after the closing of the transaction."

4. Access to files:

   a. *Problem*: In the event of a dispute with buyer, seller will likely want to keep or obtain access its own files, which now belong to the buyer (again, strictly speaking, these are files which now are owned by the acquired corporation that is under buyer's control).

   b. *Possible Contractual Solution for Retention of Files*: "Buyer agrees that Seller may retain copies of such of its files as Seller reasonably determines may be necessary or desirable to assist it in connection with any potential post-closing disputes."

   c. *Possible Contractual Solution for Access to Files*: "Buyer agrees that Seller shall have the right to access and copy such of Seller's files now in Buyer's possession, during normal business hours and on at least 24 hours prior written notice, as it reasonably determines may be necessary or desirable to assist it in connection with any potential post-closing dispute."

5. Access to transaction-related information:

   a. *Problem*: A buyer may want access to information relating to a lawyer's representation of seller in the sale transaction itself. (How was the purchase price agreed on? What information was not included in the disclosure schedule?)

b. *Possible Contractual Solution*: "Buyer irrevocably waives any right it may have to discover or obtain information or documentation relating to the representation of Seller and Shareholders by Seller Law Firm in the transactions provided for herein and contemplated hereby."

c. *Practice points*:

   i. In order to prevent confidential or privileged information relating to a transaction from ending up on the servers of or in the files of a buyer (that is, the acquired corporation controlled by buyer), counsel and seller management may consider "quarantining" such information by using a web-based email service to communicate about the transaction. Accounts can be closed once the transaction is complete and any backups of emails will not be retrievable from the seller's servers or files, ownership of which has passed to buyer. Alternately, use the company's servers but "tag" all communications about the transaction with a special email account called privilege@company.com. Later, those tagged emails can be purged or quarantined.

   ii. Which communications relate to the transaction may not be as clear as one might hope. Careful thought should be given as to whether specific reports or other information tangentially related to the transaction are covered.

d. *Case Note*: The court in *Tekni-Plex* held that transaction-related communications were the exception to its general rule that a buyer gains control of the seller's attorney-client communications upon consummation of a merger. Chancellor Strine in *Great Hill*, however, saw no reason to exclude such communications, stating, "[M]embers of the Delaware judiciary have no authority to invent a judicially-created exception to the plain words 'all…privileges' and usurp the General Assembly's statutory authority."

6. <u>Attorney-Client Privilege:</u>

   a. *Problem*: As discussed in *Tekni-Plex*, not only does a buyer (as controller of the acquired corporation) have an attorney-client relationship with seller's former counsel, but, as a result, its management has the ability to waive the attorney-client privilege in any post-closing disputes.

   b. *Possible Contractual Solution*: "Whenever, at any time subsequent to the closing of the transaction, Buyer shall have the right to assert or waive an attorney-client privilege with respect to any communication between Seller and any person representing or formerly representing it, Buyer shall not waive such privilege without the prior written consent of Seller and/or Shareholders."

   c. *Practice Point*: Another possible solution here is for the target's shareholders (or a representative thereof) to enter into a common interest agreement with the target company and its attorneys before closing. A typical feature of a common interest agreement is a provision stating that the parties thereto cannot use privileged communications against each other if their interests diverge, as could be the case in a post-closing dispute. Significant target shareholders can strengthen this position by engaging separate counsel distinct from Seller company's counsel.

7. <u>Malpractice:</u>

   a. *Problem*: A lawyer that represented a seller before a sale will want to avoid malpractice claims being brought against it by a buyer (asserting its rights as a former client).

   b. *Possible Contractual Solution*: "Buyer covenants that it shall not assert any claim against Seller Law Firm in respect of legal services provided to Seller by such firm, whether or not such services relate to the business or the assets of Seller to be acquired by Buyer pursuant to the terms hereof."

"Dual Track" Structure Remains Useful to Strategic Acquirors: Even After DGCL §251(h)

By Paul Scrivano & Noah Kornblith of O'Melveny & Myers LLP

In the wake of the adoption of Section 251(h) of the Delaware General Corporation Law, numerous commentators have suggested that the "dual track" acquisition structure is no longer needed for deals with targets that are Delaware corporations. We are of the view that, to the contrary, the dual track structure is still a useful tool in the M&A toolbox for strategic acquirors in Delaware deals, and it can even be combined with Section 251(h) in a transaction.

In a dual track structure, the parties will initially utilize a two-step deal to effect an acquisition, with the first step being a tender offer, and the second step being a merger to squeeze out non-tendering stockholders. However, in the event the tender offer does not close (in many cases due to the failure of a high minimum tender condition that, when combined with shares issued pursuant to a "top-up option," would require ownership of at least 90% of the target shares to permit a short-form merger to occur after the closing of the tender offer), the parties will terminate the tender offer and fall back to effecting the acquisition as a one-step deal consisting of a long-form merger. The principal aim of the original dual track structure was to avoid the acquiror becoming a majority owner of a publicly traded subsidiary after the closing of the first-step tender offer and before the closing of the second-step merger. Under a dual track structure, during the pendency of the tender offer, the target prepares and files a preliminary proxy statement to mitigate any timing delay should the transaction fall back to a one-step deal utilizing a long-form merger.

Delaware enacted Section 251(h) to eliminate the need to comply with the short-form merger statute (with a threshold of 90% ownership) in certain circumstances. Section 251(h) provides that if an acquiror purchases through the tender offer a sufficient percentage (typically a majority) of the outstanding shares of the target necessary to deliver the requisite stockholder approval in a merger vote, then the acquiror may consummate the second-step merger without stockholder approval even though the percentage of shares purchased in the tender offer is less than the 90% short-form merger threshold. This means that the ubiquitous top-up option used in two-step deals is, in many cases in Delaware deals, no longer needed, and that the delay of a long-form merger (if the short-form threshold is not achieved in the tender offer) can be avoided. In effect, the acquiror can close the transaction as if it were a short-form merger so long as the acquiror purchases in the tender offer the requisite percentage of shares to deliver the stockholder approval in a long-form merger.

Since Section 251(h) became effective, numerous commentators have prophesized the death of the dual track structure in Delaware deals. The reasoning is that Section 251(h) effectively lowered the "minimum tender" threshold to effectuate a short-form merger from 90% of the target's shares to a majority of the target's shares (or such higher threshold as set forth in the target's governing documents). This in turn eliminates the concern of the acquiror having to abandon the tender offer if the 90% threshold was not reached and falling back to a long-form merger so as to avoid becoming a majority owner of a publicly traded subsidiary until the close of the second-step merger. That theory, however, may be too simplistic in its analysis, depending on the deal.

The dual track structure remains a valuable option in deals undertaken by strategic acquirors where there may be a potentially long interim period between signing and closing, typically due to regulatory approvals. In these deals, the timing advantage of a tender offer is lost because the acquiror cannot close the tender offer and purchase shares tendered until all regulatory approvals have been obtained. That is an important limitation—in deals with a long interim period, the tender-offer structure actually backfires against the acquiror because a Delaware target's "fiduciary out" is not extinguished until the acquiror closes the tender offer and purchases the tendered shares. Section 251(h) does not eliminate this problem for the acquiror—the target's fiduciary out continues until shares are purchased in the tender offer. By contrast, with a long-form merger, once the target's stockholders approve the merger (generally, two to four months after signing), a Delaware target's fiduciary out is extinguished.

One example of a situation where the dual track structure would be preferable over Section 251(h) alone would be a deal where there is a meaningful likelihood that a "second request" under the HSR

Act may be issued by the DOJ or the FTC. Assume that the second request would result in the interim period between signing and closing being six months, a reasonable period of time to address a second request. Even if a majority of the target's shares are tendered by the 20th business day after the tender offer was commenced, the acquiror could not close the offer and purchase the target shares, and the target's fiduciary out would continue until the second request was substantially complied with at the end of the sixth month. As a result, the acquiror is vulnerable to six months of topping bid risk. Section 251(h) does not change that outcome.

However, if the transaction described above utilized a dual track structure instead, that same topping bid risk is minimized. After the parties received that second request from the DOJ or FTC, the parties could abandon the tender offer and revert to the long-form merger. This would enable the merger vote to be held within two to four months after signing, the target's fiduciary out would be extinguished upon receipt of stockholder approval, and the acquiror would not be susceptible to topping bid risk after that time. Accordingly, the dual track structure significantly shortens the period of topping bid risk. Georgia-Pacific's recent acquisition of Buckeye Technologies utilized a dual track structure with this very issue in mind. When the parties to that transaction received a second request, the tender offer was abandoned, and the transaction proceeded with a long-form merger. Section 251(h) would not provide similar protection.

Of course, the best of all worlds approach for a strategic acquiror in a Delaware deal would be to utilize a dual track structure that also incorporates Section 251(h). If the closing of the tender offer was not delayed due to regulatory or other reasons, then the second-step merger would be completed via Section 251(h); if there was a delay, then the deal would fall back to the one-step structure using a long-form merger.

Even after the enactment of Section 251(h), the dual track structure is still a valuable mechanism to mitigate a strategic acquiror's exposure to topping bid risk during the pendency of a lengthy regulatory approval process, and therefore increases deal certainty for a strategic acquiror.

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