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Mergers & Acquisitions and Corporate Governance Report

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CLEARY GOTTLIEB IN THE NEWS

CG represented **Bank of America** in its sales of shares of **China Construction Bank** for $8.3 billion and $6.6 billion. CG previously represented Bank of America in its 2005 acquisition of an interest in CCB, which was the single largest foreign investment ever in a Chinese company.

CG is representing **Sony** on its acquisition of **Ericsson**'s fifty percent stake in **Sony Ericsson Mobile Communications AB**, making the mobile handset business a wholly-owned subsidiary of Sony.

CG represented **The Home Depot** in its acquisition of **Redbeacon**.

CG represented a consortium of existing shareholders, including ARCH Digital Holdings, Capital Ally Investments, GM Investment, Sinowill Holdings, Huge Harvest Enterprises, Kingstate Group and Trend Focus, in the going-private transaction of **Funtalk China Holdings**.

CG is representing **The Coca-Cola Company** in connection with its acquisition of **Great Plains Coca-Cola Bottling Company**, and in the restructuring of its joint venture with **Nestlé**, **Beverage Partners Worldwide**.

CG represented **Warburg Pincus** in its purchase of **CFHC Holdings** from a seller group led by Arlington Capital Partners.

CG represented a consortium of existing shareholders in a going-private transaction of **SOKO Fitness & Spa Group**. As a result of the merger, SOKO became a wholly-owned subsidiary of **Queen Beauty and Wellness Group**.

CG represented **Barclays Capital** and **Goldman Sachs** as co-lead financial advisors to **RSC Holdings** in the sale of RSC to **United Rentals**.

CG represented **Sandler O'Neill & Partners** as financial advisor to **BankAtlantic Bancorp**, in connection with the sale of BankAtlantic Bancorp's wholly-owned bank subsidiary, **BankAtlantic**, to **BB&T Corporation**.

Special Committee Review After *Southern Peru Copper*

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Chancellor Strine's latest opus, *In re Southern Peru Copper Corporation Shareholders Derivative Litigation*, includes a number of eye-catching features, including (not least) a $1.2 billion damages award, a potential bring-down requirement for fairness opinions in certain circumstances, clarifications regarding disclosure of the negotiation process, a discussion of the effect of roadshow presentations on the total mix of information available to stockholders, and a particularly intense scrutiny of the work of the financial advisor. Arguably the most interesting aspect of the decision, however, is the Court's finding that to shift the burden of proving entire fairness from defendant to plaintiff, the special committee, in addition to being structurally independent, must also be "effective." In the words of Chancellor Strine, the Court must examine "the substance, and efficacy, of the special committee's negotiations, rather than just look at the composition and mandate of the special committee." **[Read More]**

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Recent Developments in Acquisition Financing Commitments

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Buyers and Sellers Require Certainty of Funds. Although the debt markets have ridden a roller coaster for the last few years, debt commitments for acquisition financings have remained fundamentally unchanged since the credit boom of 2005 through early 2007. Buyers and sellers want deal certainty through firm financing commitments, whereas debt commitment providers want sufficient flexibility to ensure successful syndication even in the face of increased volatility, adverse changes in the market or deterioration of the borrower's financial condition. Parties to M&A transactions remain highly focused on limiting the number and scope of conditions precedent to a lender's obligation to fund and ensuring that there is little-to-no discrepancy between the conditionality in the debt commitment letter and the acquisition agreement. **[Read More]**

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Special Committee Review After *Southern Peru Copper*

BY NEIL WHORISKEY

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Chancellor Strine's latest opus, *In re Southern Peru Copper Corporation Shareholders Derivative Litigation*[1], includes a number of eye-catching features, including (not least) a $1.2 billion damages award, a potential bring-down requirement for fairness opinions in certain circumstances, clarifications regarding disclosure of the negotiation process, a discussion of the effect of roadshow presentations on the total mix of information available to stockholders, and a particularly intense scrutiny of the work of the financial advisor. Arguably the most interesting aspect of the decision, however, is the Court's finding that to shift the burden of proving entire fairness from defendant to plaintiff, the special committee, in addition to being structurally independent, must also be "effective." In the words of Chancellor Strine, the Court must examine "the substance, and efficacy, of the special committee's negotiations, rather than just look at the composition and mandate of the special committee."[2]

Briefly, the case involved an offer by Grupo Mexico to sell to its majority-owned subsidiary, Southern Peru Copper, Grupo Mexico's interest in another of its subsidiaries, Minera Mexico. Given that this was a transaction between Southern Peru and its controlling stockholder, a special committee of four independent Southern Peru directors was set up to evaluate Grupo Mexico's offer. Delaware courts will generally review such transactions under an "entire fairness" standard – meaning that the transaction must be entirely fair to minority stockholders, both as to process and as to price. Use of an independent special committee shifts the burden of proof under this standard from defendant to plaintiff. Care is generally taken to assure that the special committee is composed of truly independent directors and that those directors are given a mandate sufficient to allow them to represent the minority stockholders effectively. Here, the Court evaluated not just these structural matters, but also the effectiveness of the special committee in the negotiation process, before determining whether shifting of the burden of proof was appropriate.

Before getting to what makes a special committee "effective," it is worth spending a few paragraphs on the Court's view of the composition and mandate of this special committee. First, as to composition, the Court found that the special committee "members were competent, well-qualified individuals with business experience" and that the special committee "was given the resources to hire outside advisors, and it hired not only respected, top tier of the market financial and legal counsel, but also a mining consultant and Mexican counsel." The Court found that "the members of the special committee met frequently."[3] However, the Court also found that one of the special committee members, appointed by a significant minority stockholder, was "operating under a constraint not shared by all stockholders, which was his employer's desire to sell its holdings in Southern Peru." This meant that the member "may not have been solely focused on paying the best price in the Merger . . . because he had independent reasons for approving the Merger."[4] More pointedly, the Court found that the simultaneous negotiation by this member with the controlling stockholder, seeking registration rights for the minority stockholder which such member represented, and the apparent linking of registration rights with the approval of the merger in draft term sheets, meant that the minority stockholder's "important liquidity concern had the undeniable effect of extinguishing much of the appetite that one of the key negotiators of the Merger had to say no. Saying no meant no liquidity."[5]

It is not difficult to understand the Court's concern with the negotiation by the member for additional liquidity rights in the context of the merger negotiations. The Court cites *Merritt v. Colonial Foods, Inc.,* "The law . . . will accord scant weight to the subjective judgment of an interested director concerning the fairness of a transaction that benefits him."[6] More difficult to understand is the Court's view that the member "was in an odd place to recommend to other stockholders to make a long-term strategic acquisition," given that the minority stockholder he represented "had no intent of sticking around to benefit from the long-term benefits of the Merger".[7] Presumably this will not be read as a requirement that members of special committees must be appointed by minority stockholders with the same investment time-horizon as all other minority stockholders –

that would indeed be a difficult rule to comply with. It may however point to a need to carefully evaluate whether a director holding a material equity interest has an investment horizon — whether long or short — that may strongly influence the director's personal view of the merits of a proposed transaction or otherwise cause a potential misalignment with other stockholders. In the end, the Court found that the member had not "consciously acted in less than good faith."[8] Accordingly, while the member was not subjected to personal liability, the Court clearly did consider his participation in the negotiation of the merger to be less than ideal.

As to the mandate of the special committee, the Court had a number of objections, and pointed to the weak mandate as the root of the problem with the special committee process. The mandate empowered the special committee only to "evaluate" the proposal of the majority stockholder. It did not empower the special committee to engage in negotiations with the majority stockholder. The special committee did in fact engage in such negotiations, but the Court found that the special committee's "approach to negotiations was stilted and influenced by its uncertainty about whether it was actually empowered to negotiate."[9] The mandate did not empower the special committee to evaluate alternatives, and the special committee's failure to insist on this right influenced the Court's "ultimate determination of fairness, as it took off the table other options that would have generated a real market check and also deprived the Special Committee of negotiating leverage."[10]

Given the defects in composition and mandate, perhaps it is an overstatement to say that a Court following Chancellor Strine's decision could never find an effective special committee (and hence determine burden shifting) until after trial. If a Court were presented with a pre-trial record showing that the board was fully independent and had a strong mandate, it might not feel the need to judge how effective the special committee's performance was after a full trial on the subject. But the Court in *Southern Peru* does not leave itself this escape route or shy away from the practical implications of its ruling, acknowledging that "questions of whether the special committee was substantively effective in its negotiations with the controlling stockholder — questions fraught with factual complexity — will, absent unique circumstances, guarantee that the burden shift will rarely be determinable on the basis of the pre-trial record alone."[11]

Chancellor Strine, however, does not necessarily view with consternation the implied requirement that there be a trial to determine burden shifting. In this decision and in *In re Cysive, Inc. S'holders Litig*.,[12] he states that there is little practical benefit to shifting the burden of proof under a preponderance standard, unless the Court is "stuck in equipoise about the issue of fairness."[13] While this is no doubt correct when considering the effect on the Court's decision at trial, it may not be correct to infer that the finding will have little practical effect on settlement. One could argue that the fact that the burden shift may not be determined on the basis of a pre-trial record will mean that defendant's leverage in settlement is reduced, as summary judgment may not be available regardless of how strong the record may seem to be. However, based on a recent (and admittedly limited) survey presented at Widener University School of Law by Cleary Gottlieb[14] of 19 controlling stockholder buyouts involving merger agreements, litigation was pursued in 16 transactions, and only one litigation was dismissed on the pleadings. (The dismissed case was not a Delaware case.) Given the rarity of getting a case dismissed on the pleadings, it would seem that Chancellor Strine may have been correct to minimize the importance of his finding on the dynamics of settlement.[15]

One could also inquire as to whether Chancellor Strine's burden shifting ruling will drive practitioners to recommend using a "majority of the minority" condition — conditioning the transaction on the approval of a majority of the non-controlling stockholders — to shift the burden of proving entire fairness to plaintiffs. While inclusion of a "majority of the minority" condition presumably is still sufficient in itself to result in a burden shift to plaintiff, it has often been viewed as less palatable to the controlling stockholder than use of a special committee — not for any insidious reason regarding suspect loyalties of special committee members, but rather because of the ease with which a number of hedge funds and other stockholders, in certain circumstances, can accumulate a blocking position in the minority shares, thereby facilitating the extraction of an additional premium from the controlling stockholder. Unlike a special committee which must come to terms with the controlling stockholder before signing up and announcing a deal, a hedge fund with a blocking position generally does not have to come to terms with the controlling stockholder at any point before the expiration of the tender offer, potentially leading to an extended period of deal uncertainty after announcement. The use of a tender offer with a "majority of the minority" condition also is more difficult to

coordinate with the settlement process than a special committee process, where negotiations with plaintiff's counsel often proceed simultaneously with negotiations with the special committee. As the goal is typically to avoid litigation altogether, rather than to win at trial, the inclusion of a "majority of the minority" condition in transactions structured as tender offers may continue to be viewed as a less favorable substitute for a special committee process with a simultaneous settlement negotiation, even if the heightened requirements associated with an "effective" special committee process do in fact lead to increased settlement leverage for plaintiffs.

Perhaps even more interesting is the effect the Court's finding is likely to have on the doctrinal framework promoted by Chancellor Strine and Vice Chancellor Laster in *In re Pure Resources*[16] and *CNX Gas Corp. S'holder Litig*.[17] In those cases, the respective Courts advocated that the business judgment rule, rather than entire fairness, be the applicable standard of review for controlled mergers/acquisitions (whether effected by tender offer or merger) if the transaction had been approved by a robust special committee <u>and</u> included acceptance or approval by a "majority of the minority" as a non-waivable condition. Any temptation of a controlling stockholder to follow this paradigm and forego settlement would seem to be greatly diminished by Chancellor Strine's view that the effectiveness of the special committee will "rarely be determinable on the basis of the pre-trial record alone." Given the searching nature of the inquiry as to the "effectiveness" of the special committee, the business judgment rule being applied only after a determination of "effectiveness" has been made will likely not be viewed as a great benefit. In short, we seem to be left where we started, with settlement being the only method of avoiding a trial on entire fairness in a controlled transaction context.

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1 *In re Southern Peru Copper Corp. S'holder Derivative Litig.*, 30 A.3d 60 (Del. Ch. 2011).

2 *Id* at 89-90.

3 *Id* at 97.

4 *Id* at 99.

5 *Id* at 100.

6 *Id* at 99 and n.139 (quoting *Merritt v. Colonial Foods, Inc,* 505 A.2d 757, 765 (Del. Ch. 1986).

7 *Id* at 100.

8 *Id* at 100.

9 *Id* at 97-98.

10 *Id* at 98.

11 *Id* at 92.

12 *In re Cysive, Inc. S'holders Litig.*, 836 A.2d 531, 548 (Del. Ch. 2003).

13 *Southern Peru*, at 93.

14 As cited in "Putting the law in the back seat" by David Marcus, <u>Corporate Control Alert</u>, May 2011, p.19.

15 These findings would come as no surprise to Chancellor Strine, who has noted that "it was impossible after [*Kahn v. Lynch*] to structure a merger with a controlling stockholder in a way that permitted defendants to obtain dismissal of the case on the pleadings." (*In re Cox Commc'ns, Inc. S'holders Litig.*, 879 A.2d 604, 622 (Del Ch 2005).

16 *In re Pure Resources., Inc. S'holder Litig.,* 808 A2d 421 (Del Ch. 2003).

17 *In re CNX Gas Corp. S'holder Litig.,* 4 A.3d 397 (Del. Ch. 2010).

Liberty Media and the Meaning of "Substantially All" in Indenture Covenants

BY LAURENT ALPERT AND CARINA WALLANCE

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In *Bank of New York Mellon Trust Company, N.A. v. Liberty Media Corp.*,[1] the Delaware Supreme Court recently addressed whether a series of asset dispositions by Liberty Media Corporation constitutes a transfer of "all or substantially all" of the company's assets for purposes of a bond indenture provision. Liberty Media's indenture, as most indentures, includes in the merger covenant a successor obligor clause prohibiting the bond issuer from transferring "all or substantially all" of its assets unless the transferee assumes the issuer's obligations under the bonds. The practical question for both a seller and a buyer of assets is, what constitutes "all or substantially all" of a corporation's assets?

"All or Substantially All" in Bond Indentures

Only a few cases have interpreted "all or substantially all" in the context of bond indentures and their guidance has been limited. A 1964 case concluded that the sale of 75% of a corporation's total assets constituted the transfer of "substantially all" of its assets, particularly because the assets sold generated most of the company's income.[2] The seminal decision on this issue, delivered almost two decades later in *Sharon Steel*, summarily concluded that the transfer of 41% of the company's operating assets and 51% of the book value of its total assets, generating 38% of operating revenue and 13% of operating profit, "in no sense" constituted "substantially all" of that company's assets.[3] However, *Sharon Steel* involved a relatively unusual fact pattern in which (i) a company adopted a plan of liquidation and carried out a series of asset sales to various buyers pursuant to this plan and (ii) the purchaser in the final sale of remaining assets tried to assert that such final sale constituted a transfer of "all or substantially all" of the company's assets so that, as successor, it was free to assume the company's obligations under its indenture without bondholder consent and without triggering a default under the bonds. More recently, two cases addressing this issue have failed to reach the merits of whether a transfer of "substantially all" of a corporation's assets occurred, with one court merely noting that both quantitative factors (percentage of operating revenue, operating profit or book value) and qualitative factors are relevant and citing the parties' failure to disclose any quantitative factors[4] and another court in 2008 declining to come to a conclusion *despite* the fact that all parties agreed that the assets transferred in the corporate spin-offs at issue represented 63.4% of the company's total value.[5] The other few cases analyzing New York and Delaware shareholder approval statutes containing similar language do not provide significant additional guidance.

Liberty Media

In its September 21, 2011 decision of *Liberty Media*, the Delaware Supreme Court addressed whether a proposed split-off by Liberty Media Corporation in June 2010, which would be the company's fourth major distribution of assets since March 2004, should be aggregated with three prior dispositions for purposes of determining whether a transfer of "substantially all" of Liberty's assets had occurred. It was undisputed that in isolation the split-off would not constitute a disposition of "substantially all" of Liberty's assets. The three prior dispositions removed assets from Liberty's balance sheet collectively representing around 52% of its total asset value as of March 2004, while the assets in the proposed spit-off represented an additional 15% of Liberty's total asset value as of that date. The bondholders claimed that the split-off should be aggregated with the three preceding dispositions and all of the assets transferred should be measured collectively against the totality of Liberty's assets at *the inception* of the series of distributions in March 2004.

Relying on *Sharon Steel,* the court declined to aggregate the series of dispositions. In *Sharon Steel*, the Second Circuit found that aggregation was appropriate because the series of asset sales at issue were carried out pursuant to a liquidation plan. In *Liberty Media,* the Delaware Supreme Court concluded that Liberty's transactions were not part of an overall plan to liquidate or to strip its assets from the corporate structure subject to bondholder claims. Rather, each of the four dispositions was the result of a discrete, context-based decision applying Liberty's overarching business strategy of

consolidating ownership of controlling stakes in cash-generating operating companies, while exploring alternatives for its minority investments that did not fit this goal. In fact, since 2004, Liberty Media had engaged in a wide variety of corporate transactions, including not only divestitures but also acquisitions.

The Delaware Supreme Court also noted that the successor obligor clause in Liberty's indenture was a routine, boilerplate provision. Underscoring the importance of uniform interpretation of boilerplate contract provisions, the court refused to interpret the language broadly. In particular, while noting that the "substantially all" test in the indenture applied not only to a transaction but also to a "series of transactions," the court declined to expand the concept of "series of transactions" beyond the narrow construction that a disposition of "substantially all" assets may occur either by way of a single transaction or an integrated series of transactions. The court also noted the absence of restrictive covenants and that, had the draftsmen wanted to be more precise in limiting the company's flexibility to sell off assets, they could have done so. This drafting advice, somewhat unique within a court opinion, may be of particular interest to issuers attempting to clarify that a sale of a certain size is not a sale of "all or substantially all" of their assets.

Implications

The Delaware Supreme Court's decision in *Liberty Media* has not changed the law since *Sharon Steel*, but merely applies the principles adopted by the Second Circuit in aggregating transactions for purposes of a "substantially all" analysis to a narrow set of facts. The lesson from *Liberty Media* is that the final asset sale in a series of divestitures will not likely be aggregated with the preceding transactions where (i) the asset sale alone does not constitute a transfer of "substantially all" of that company's assets, (ii) there is no plan of liquidation, (iii) the transactions occur over the course of a number of years and (iv) they are carried pursuant to a business strategy of divesting a limited number of assets while retaining a viable company. *Liberty Media* is less useful where the fact pattern is more acute —where, for example, even in the absence of a liquidation plan, a series of sales remove a greater percentage of a corporation's asset base and revenues within a significantly shorter time period. In light of the specific facts of *Liberty Media*, the court's conclusion is not surprising. We will need to have further cases for more concrete guidance when the facts are a bit harder.

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1 *Bank of New York Mellon Trust Company, N.A. v. Liberty Media Corp.,* 2011 WL 4376552 (Del. Supreme Ct. Sept. 21, 2011).

2 *B.S.F. Company v. Philadelphia National Bank*, 204 A.2d 746 (Del. Super. Ct. 1964) (interpreting an indenture governed by Pennsylvania law).

3 *Sharon Steel Corp. v. The Chase Manhattan Bank, N.A.,* 691 F.2d 1039 (2d Cir. 1982).

4 *U.S. Bank Nat'l Ass'n v. Angeion Corp.,* 615 N.W. 2d 425, 433 (Minn. Ct. App. 2000).

5 *Bank of New York v. Tyco International Group, S.A.,* 545 F. Supp. 2d 312, 320 (S.D.N.Y. 2008).

Recent Developments in Acquisition Financing Commitments

BY MEME PEPONIS, AMY SHAPIRO, CARLO DE VITO PISCICELLI AND JUSTINE PASNIEWSKI

Ms. Peponis and Ms. Shapiro are partners, Mr. de Vito Piscicelli is counsel, and Ms. Pasniewski is an associate at Cleary Gottlieb Steen & Hamilton LLP.

Buyers and Sellers Require Certainty of Funds

Although the debt markets have ridden a roller coaster for the last few years, debt commitments for acquisition financings have remained fundamentally unchanged since the credit boom of 2005 through early 2007. Buyers and sellers want deal certainty through firm financing commitments, whereas debt commitment providers want sufficient flexibility to ensure successful syndication even in the face of increased volatility, adverse changes in the market or deterioration of the borrower's financial condition. Parties to M&A transactions remain highly focused on limiting the number and scope of conditions precedent to a lender's obligation to fund and ensuring that there is little-to-no discrepancy between the conditionality in the debt commitment letter and the acquisition agreement.

SunGard Provisions Continue to Be Common

The so-called "SunGard" provisions in debt commitment letters were one of the main mechanisms developed during the credit boom to limit conditionality relating to the target company and its business. They essentially provide that, so long as the conditions to closing under the acquisition agreement relating to representations and warranties about the target company are satisfied, such that the buyer is not permitted to walk away from the acquisition, the lenders are obligated to fund, subject to a narrow set of conditions expressly set forth in the debt commitment letter, including the accuracy of a very limited set of additional specified representations as to matters that are within the control of the buyer. In the case of secured financings, these provisions also limit the actions that are required as of the closing to perfect the lenders' security interest in the collateral to those that can be easily satisfied. Despite post-credit crunch scrutiny of borrower-favorable provisions, the SunGard provisions continue to be an ever-present feature of debt commitment letters.

No MAE and No Market MAC Conditions

The inclusion of identical conditions regarding no material adverse effect with respect to the target company (a "no MAE condition") in the acquisition agreement and the debt commitment letter (either by restating or cross-referencing) continues to be common. Lenders focus on the scope of, and exceptions to, the no MAE condition. On the other hand, despite recent volatility in the debt markets, debt commitment providers still have been willing to forgo a condition as to material adverse change in the financial or debt markets (a "no MAC condition"). Lenders remain acutely aware of market volatility and risk, but are often open to addressing those concerns through the ability to adjust pricing and other terms (including "syndication flex" rights), to the extent necessary, and timing limitations discussed below.

Length of Commitments

Obtaining debt financing commitments in excess of six months can be challenging, which is an important fact to keep in mind in structuring acquisitions for which a longer lead time is necessary. Lenders may agree to longer periods if necessary due to regulatory or other transaction-specific requirements, but because an extended commitment period will impact lenders' risk, it will have pricing and pricing-related flex implications. For financings that rely on a high-yield bridge loan commitment, taking into account what financial statements are or will be available during the commitment period is especially important.

Governing Law of Agreements

The governing law provision is another area that affects the relationship between the acquisition and financing agreement. If the debt commitment letter is governed by the laws of one jurisdiction (typically New York) and the acquisition agreement is governed by the laws of a different jurisdiction (e.g., Delaware), the interpretation of some provisions that are intended to be identical (most importantly, the no MAE condition) could differ. To avoid this disconnect, it has become common to specify in the debt commitment letter that the definition of "Material Adverse Effect" and sometimes other provisions are governed by the law that applies to the acquisition agreement.

"Xerox" Provisions

Finally, lenders continue to request that so-called "Xerox" provisions be included in acquisition agreements to give lenders the benefit of certain provisions protecting the buyer. Specifically, these provisions include an agreement by all parties as to the exclusive jurisdiction of New York courts , the waiver of jury trial and unavailability of injunctive relief in any action against the lenders, with monetary damages (typically limited to the amount of the reverse break-up fee payable by the buyer) being seller's sole remedy against the buyer and lenders.

* * *

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