Recent and Developing Issues in M&A-Related NDAs

Moderator:
Michael O'Bryan, Morrison & Foerster LLP

Panelists:
Kevin Costantino, Greenhill & Co.
Igor Kirman, Wachtell, Lipton, Rosen & Katz

April 18, 2013
Agenda

1. Purposes of M&A NDAs
2. Place in the Process
   • including Exceptions for Legal Requirements
4. Standstills
   • including Don’t Ask, Don’t Waive
   • Bios
   • Reference Materials
Intro

• Speakers
• Materials

Questions Invited!
1. Purposes of M&A NDAs

- Protect confidential information
- Comply with regulatory requirements – antitrust, other
- Prevent Target from being put in play (legally or practically)
- Control process to make the most $$
- Some other Buyer purposes, too, even in one-way NDA
2. NDA Place in the M&A Process

• NDAs are important M&A tools
  – Govern a process, setting rules / procedures
  – Powerful signaling device for Buyers and Sellers

• Target controls the draft, Buyer controls the demand
  – Private Company Context
    • Pre-requisite for even basic information
  – Public Company Context
    • More complex issues, but greater flexibility on timing
      – Buyers may “sit out” to avoid restrictions and test a process, or require early to support an informed bid
      – Target may force an indication based on public information prior to receiving an NDA (interjects a “seriousness test”)
Staging Information Strategically

- Targets seek to control sale processes (public or private) to maximize competitive tension and, ultimately, value
- Once under an NDA, the timing of the level of information distributed and to whom is critical

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3. Disclosure and Use Restrictions

• The heart of the NDA
• Disclosure v. Use
• Defining the “Transaction” with respect to which information may be used
• Exceptions for Requirements of Law
• The Backdoor Standstill
• Other Implications
Non-Disclosure and Non-Use

• The basic elements:
  – Non-disclosure (e.g., only to specified individuals, only on a “need to know” basis, etc.)
    • Disclosing party’s confidential info
    • Information about their negotiations
  – Use only for specified purpose (e.g., to consider a specified transaction or kind of transaction)
    • Limit types of permitted uses: evaluation, negotiation, financing, consummation, etc.
    • Some prohibited uses: “detrimental” usage
Use Restrictions: Martin Marietta

- **NDA Use Restriction:**
  - The NDA prohibits any "use" of "Evaluation Material" by either party "for purposes other than the evaluation of a Transaction."
  - A "Transaction" is defined as "a possible business combination transaction between [Martin] and [Vulcan] or one of their respective subsidiaries."

- **JDA Use Restriction:**
  - The JDA required that all "Confidential Materials" be "used ... solely for purposes of pursuing and completing the Transaction."
  - The definition of Transaction was "a potential transaction being discussed by Vulcan and Martin Marietta."
Defining the “Transaction”: Martin Marietta

- Chancellor Strine found Martin used Vulcan’s nonpublic information “in deciding upon, formulating, and selling its Exchange Offer and Proxy Contest”
- Martin Marietta argued such use was justified: Under the NDA, Evaluation Material could be used “for the purpose of evaluation a Transaction,” and Martin claimed “Transaction” included its hostile exchange offer (EO) and proxy contest (PC)
  - Martin argued EO and PC are business combination transactions “between” Martin and Vulcan in the sense that an ultimate combination of the businesses will be “between” the two companies
  - Vulcan argued EO and PC were not Transactions under NDA because “between” is meant to necessitate reciprocal action on the part of both Vulcan and Martin, a requirement not met by an exchange offer (made to Vulcan’s shareholders) and not met by a proxy fight
- Chancellor found both readings plausible and, while he thought Vulcan’s reading was better, he concluded that the definition of “Transaction” was ambiguous
Defining the “Transaction” (cont’d)

• Chancellor Strine looked to extrinsic evidence of what the parties intended the term “Transaction” to mean.

• Conclusion: “a business combination transaction between Vulcan and Martin Marietta means any step or related series of steps leading to a formal mingling of the two companies’ assets that is contractually agreed upon, or consented to, by the sitting boards of both companies at the outset of those steps being taken.”

• Accordingly, use of the Evaluation Materials to decide upon, formulate, and sell its EO and PC “breached the limitations on use of Evaluation Material under the NDA.”

• JDA provisions were also violated; Evidence showed that PC and EO were not “a potential transaction being discussed by Vulcan and Martin Marietta.”
Legally Required Disclosure

• What legal requirements allow Buyer to disclose?
• How should those requirements be expressed to Buyer? Who decides what’s required?
• Can Buyer act in a way that subjects Buyer to the requirements?
Legally Required Disclosure: Martin Marietta

(3) Non-Disclosure of Discussions; Communications. Subject to paragraph (4), each party … will not disclose to any other person, other than as legally required, the fact that any Evaluation Material has been made available hereunder, that discussions or negotiations have or are taking place … or any of the terms, conditions or other facts with respect thereto….

(4) Required Disclosure. In the event that a party … [is] requested or required (by oral questions, interrogatories, requests for information or documents in legal proceedings, subpoena, civil investigative demand or other similar process) to disclose any of the other party's Evaluation Material or any of the facts, the disclosure of which is prohibited under paragraph (3), the party requested or required to make the disclosure shall provide the other party with prompt notice ….

If, in the absence of a protective order or other remedy or the receipt of a waiver by such other party, the party requested or required to make the disclosure … should nonetheless, in the opinion of such party's … counsel, be legally required to make the disclosure, such party … may, without liability hereunder, disclose only that portion of the other party's Evaluation Material which such counsel advises is legally required to be disclosed;

provided, that the party requested or required to make the disclosure exercises its reasonable efforts to preserve the confidentiality ….
Legally Required Disclosure (cont’d)

• Martin Marietta argued that its disclosure was “legally required”
  • To launch a proxy fight and tender offer:
    • Item 1005(b) of Reg. M-A requires disclosure of “any negotiations, transactions or material contacts during the past two years between the filing person ... and the subject company ... concerning any ... [m]erger”
    • Item 6 of Form S-4 requires description of “any past, present or proposed material contracts, arrangements, understandings, relationships, negotiations or transactions during the periods for which financial statements are presented or incorporated by reference ... between the company being acquired ... and the registrant”
    • general anti-fraud provisions prohibit materially misleading disclosures
Legally Required Disclosure (cont.)

• But Chancellor Strine found these provisions did not justify Martin Marietta’s detailed disclosure of the parties’ negotiation history
  – Chancellor Strine concluded “The SEC Rules did not require ... more than the fact that the parties discussed a merger, that they entered into the Confidentiality Agreements, and that they ultimately could not come to terms on the utility of doing a deal.”
Legally Required Disclosure (cont.)

• What about the procedure for what to do if disclosure of Evaluation Material is necessary?
• Martin Marietta argued that the term “legally required” has two meanings:
  – When a party faces an externally driven legal requirement (an external demand) to disclose in the sense of receiving a subpoena or other similar process, that party is subject to the tight restrictions of ¶ 4.
  – But when a party takes discretionary action that triggers a disclosure obligation, that party can make its own determination of what disclosure is required, and not engage in prior consultation or notice to the other party.
• Chancellor found this argument “odd” but gave Martin benefit of doubt and looked to extrinsic evidence, and found in favor of Vulcan’s reading.
Backdoor Standstill

• Drafting disclosure and use restrictions and exceptions for legal requirements in light of *Martin Marietta*
  - Parties may differ as to goal
  - Use of clean teams
  - Can a party put itself in a position where disclosure is legally required (e.g., by filing a tender offer or proxy statement that must meet SEC requirements)?

• Delaware Supreme Court emphasized difference between standstills and confidentiality agreements, but upheld the injunction
Other Implications of Use Restrictions

• Use in Other Contexts
  – Advisor gave information about a potential acquisition by one of its clients to a potential financing source, under NDA; later claims financing source used the information to do another deal without advisor or advisor’s client (and so avoid fee to advisor)
  – Financing source claims broad reading of NDA would effectively prevent it from acting in the industry to which the potential acquisition related
  – Court allows claim for breach to proceed (Goodrich Capital LLC v. Vector Capital (SDNY 6/26/12))
5. Standstills

• What is a standstill?
  – An agreement entered into between target and potential buyers that generally prevents hostile bids, including:
    • Preventing tender offers for the target's securities and other unsolicited proposals for business combination transactions
    • Limiting purchases of securities or assets of the target without the target's prior consent
    • Limiting solicitation of proxies to prevent the replacement of the target's management or from otherwise exercising control over management
  – Generally a NDA provision, but also can be a standalone agreement
Standstills (cont’d)

• Purposes/Uses
  – “Cost of entry” into discussions with a target
  – Serves as a test of whether a bidder is serious
  – Helps targets to control the bidding process
  – Assures bidders that if they ultimately "win" the auction and execute a definitive acquisition agreement with the target, any bidders who "lost" the auction will be contractually bound to not overbid
Standstills - Enforcement

• Fundamental Governing Law
    • Once a change of control becomes inevitable “a board’s primary duty becomes that of an auctioneer responsible for selling the company to the highest bidder.”
    • “no single blueprint exists” for a board to satisfy its *Revlon* duties.
    • Board’s actions must meet a reasonableness standard.
  – *Unocal/Unitrin* Enhanced Scrutiny
    • Applicable to deal protection devices, including standstills
    • An examination of whether the devices are preclusive or coercive and whether the devices and the board’s decision to use them fall within a “range of reasonableness.”
Standstills - Enforcement

_In re Topps Shareholders Litigation_ (Del. Ch. 2007)

— Target may not refuse to waive a standstill to "favor one bidder over another" but may use standstills to “extract reasonable concessions”

— In dicta, Strine suggested that in the context of a well-shopped company, a target might legitimately promise the highest bidder certain deal protection provisions including a promise not to waive the standstill

• Example: Final round of an auction with three bidders remaining. _Topps_, 926 A.2d at 91 n.28.
Standstills - Enforcement

• Topping Bidder Liability: Tortious Interference Against Failed Topping Bidder
  – In auction for Sunrise, HCP and Ventas executed NDAs containing standstills
  – Ventas won auction, at $15 per unit; purchase agreement contained a no-shop provision
  – HCP subsequently announced offer of $18 per unit -- Sunrise's stock price traded to above $18 per unit
  – Sunrise and Ventas go to Ontario Superior Court, which ruled in favor of Ventas, based on HCP’s standstill, the triggers for exceptions to the no-shop, and Sunrise's promise not to waive the standstill
  – Ventas closed acquisition of Sunrise, but first raised price to $16.50 to get equity holder approval
Standstills - Enforcement

- HCP liability for tortious interference
  • Ventas filed suit in the U.S. federal court in Kentucky, which allowed Ventas to proceed with its claim that HCP had tortiously interfered with Ventas' expectancies under the Sunrise-Ventas acquisition agreement
  • Jury awards $101 million as compensation for cost of Ventas' increase in price; HCP also pays punitives
Sample Standstill Clause

For a period of 3 years, neither you nor your affiliates nor any of your Representatives (nor anyone acting on behalf of any of such persons) will, directly or indirectly:

(i) acquire, offer to acquire, or agree to acquire, directly or indirectly, by purchase or otherwise, any securities or direct or indirect rights to acquire any securities of the Company or any assets of the Company,

(ii) make, or in any way participate in, directly or indirectly, any “solicitation” of “proxies” (as such terms are used in the rules of the Securities and Exchange Commission) to vote (or the solicitation of consents), or seek to advise or influence any person or entity with respect to the voting of, or grant of consents with respect to, any voting securities of the Company,

(iii) make any public announcement with respect to, or submit a proposal for, or offer of (with or without conditions) any merger, consolidation, business combination, tender or exchange offer, restructuring, recapitalization or other extraordinary transaction of or involving the Company or its securities or assets,

(iv) form, join or in any way participate in a “group” (as defined in Section 13(d)(3) of the Securities Exchange Act of 1934, as amended) in connection with any voting securities of the Company,

(v) otherwise act, alone or in concert with others, to seek to control or influence the management, Board of Directors or policies of the Company, or

(vi) have any discussions or enter into any arrangements, understandings or agreements (whether written or oral) with, or advise, assist or encourage, any other persons in connection with any of the foregoing.
Standstill Clause (cont’d)

“Don’t Ask, Don’t Waive” Provision

Neither you nor your affiliates, nor any of your respective Representatives, shall directly or indirectly make, in each case to the Company or a third party, any proposal, statement or inquiry, or disclose any intention, plan or arrangement, whether written or oral, inconsistent with the foregoing, or request the Company or any of its Representatives, directly or indirectly, to amend, waive or terminate any provision of this paragraph.

You will promptly advise the Company of any inquiry or proposal made to you with respect to any of the foregoing, including the details thereof.
Standstills - Fall-Away

If at any time during the 12 month period referred to in the preceding paragraph:

i. the Company enters into an agreement or an agreement in principle providing for a Combination or the Company redeems any rights under, or modifies or agrees to modify, a shareholder rights plan to facilitate any Combination,

ii. a tender or exchange offer which if consummated would constitute a Combination is made for securities of the Company and the Board of Directors of Seller either accepts such offer or fails to recommend that its stockholders reject such offer within ten business days from the date of commencement of such offer,

iii. the Board of Directors of the Company resolves to engage in a formal process which is intended to result in a transaction which if consummated would constitute a Combination or

iv. a person or “group” (as defined in Section 13(d)(3) of the Securities Exchange Act of 1934, as amended) enters into an agreement or commences a proxy solicitation in which the person or “group” would, if successful, elect or acquire the ability to elect a majority of the Board of Directors of the Company,

then the restrictions set forth in the preceding paragraph shall terminate and all other provisions of this agreement shall continue to be in full force and effect in accordance with the terms hereof.
A “Combination” shall mean a transaction in which

i. a person or “group” (within the meaning of Section 13(d) under the Exchange Act) acquires, directly or indirectly, securities representing 20% or more of the voting power of the outstanding securities of the Company or properties or assets constituting 20% or more of the consolidated assets of the Company and its subsidiaries or

ii. in any case not covered by (i), (A) the Company issues securities representing 20% or more of its total voting power, including in the case of (i) and (ii) by way of a merger or other business combination with the Company or any of its subsidiaries or (B) the Company engages in a merger or other business combination such that the holders of voting securities of the Company immediately prior to the transaction do not own more than 80% of the voting power of securities of the resulting entity.
Don’t Ask, Don’t Waive

• Combination of:
  – NDA prohibition on bidder asking for waiver of standstill, and
  – Acquisition Agreement prohibition on target soliciting or facilitating bids

• Highlighted in recent litigation
Don’t Ask, Don’t Waive

*Complete Genomics*, Del. Ch., Nov. 27, 2012

• VC Laster enjoins enforcement of standstill with DADW

• Problem of “willful blindness”
  – DADW “resembles a bidder-specific no-talk clause....”
  – “Unlike a traditional no-shop clause, which permits a target board to communicate with acquirors under limited circumstances, a no-talk clause ... ‘not only prevents a party from soliciting superior offers..., but also from talking to or holding discussions with third parties.’”
  – “impermissibly limited its ongoing statutory and fiduciary obligations to properly evaluate a competing offer, disclose material information and make a meaningful merger recommendation to its shareholders.”
Don’t Ask, Don’t Waive (cont’d)


• NDAs initially had DADW, but Company waived “don’t ask” after deal announced and litigation commenced

• C Strine requires disclosure, saying shareholders should know about DADWs, even if waived
  – Company is saying the merger is open to topping bids, and this covers the most likely bidders

• Acknowledges potential use as “gavel” in auction by well-motivated seller:
  – “…to impress upon the people that it has brought into the process that the process is meaningful; that if you’re creating an auction, there is really an end to the auction for those who participate. And therefore, you should bid your fullest because if you win, you have the confidence of knowing you actually won that auction at least against the other people in the process.”
Don’t Ask, Don’t Waive (cont’d)

Ancestry.com (cont’d)
• Sees potential duty of care violation in Board:
  – not understanding effect of provisions, and
  – not considering waiver when they had the chance

Intermec, WA, March 15, 2013 (Del. corp.)
• Declines to enjoin shareholder vote on merger despite presence of DADW provisions in several bidder NDAs
  – “[T]he biggest problem for the plaintiffs is ... factual. Only 3 of the 12 possible suitors had [DADWs] ..., but none of these 3 can be characterized as serious contenders”
Don’t Ask, Don’t Waive (cont’d)

• Delaware Supreme Court has yet to address directly

• So what to do?
  – Consider context in which you’re signing – usually beginning of process, before there’s a deal, but may be hard to change later
  – Discuss impact with Board – purpose, effect, etc.
  – Consider how best to use – fall-away, waiver, assignment to buyer
  – Consider covenant lite – allow private, but not public, requests
  – If you keep them, disclose to shareholders
Conclusion

- Always signed at the beginning – you don’t know where you’ll end up
- Post-breach remedies may be difficult
- Drafting matters
- Watch for back-door covenants with potentially broad consequences
- For Target: Some points may rise to Board level, even if agreed between Target and Buyer teams

Any Questions?
Michael G. O'Bryan
Morrison & Foerster LLP
San Francisco
(415) 268-6352
mobryan@mofo.com

Michael O’Bryan is a partner in MoFo’s global M&A practice. He focuses on U.S. and international mergers, acquisitions, divestitures and other strategic transactions, including “going private” and other related party transactions. He has been involved in more than 350 M&A transactions, advising companies, boards and special committees, as well as investment banks, in negotiated and contested transactions.

Mr. O’Bryan has worked extensively with clients across a variety of industries, including in technology, software, telecommunications, internet, consumer, and healthcare / life sciences sectors.

Mr. O’Bryan is active in the ABA’s M&A Committee, where he chairs a task force preparing a model Tender Offer Agreement and a task force reviewing M&A cases.
Kevin M. Costantino
Managing Director

- Joined Greenhill in 2005, and is a member of the firm’s Merger Leadership Group
- At Greenhill, Mr. Costantino helped establish the firm’s Chicago office and Australian operations
- Prior to joining the firm, Mr. Costantino practiced law at Wachtell, Lipton, Rosen & Katz, where he represented public and private clients in connection with M&A, debt and equity offerings
- Mr. Costantino received a B.B.A. with high distinction from the University of Michigan, as well as a J.D., magna cum laude, from the University of Michigan Law School, where he was an Editor of the Law Review

Selected Transaction Experience

- SUPervalu on its sale of its New Albertsons subsidiary to an investor group led by Cerberus Capital Management as well as a simultaneous equity tender offer by Cerberus for up to a 30% stake in pro forma SUPervalu (US$3.3bn)
- The Affiliated Transactions Committee of the Board of Directors of Coca-Cola Enterprises, Inc. on the sale of its North American operations to, and purchase of the Nordic operations of, The Coca-Cola Company (US$14.4bn)
- The Special Committee of the Board of Directors of Barnes & Noble on its acquisition of Barnes & Noble College Booksellers (US$596m)
- The Special Committee of Wendy’s International on its defense against Nelson Peltz, and subsequent sale to Arby’s
- Ceridian on its defense against Pershing Square Capital, and subsequent sale to Thomas H. Lee Partners and Fidelity National Financial (US$5.3bn)
- Nikko Cordial on its US$4.6bn acquisition by Citigroup
- 7-Eleven, Inc. on its US$1.0bn acquisition by Seven-Eleven Japan
IGOR KIRMAN

Igor Kirman is a partner in the Corporate Department, where he focuses primarily on mergers and acquisitions, corporate governance, and general corporate and securities law matters. He has advised public and private companies, as well as private equity funds, in connection with mergers and acquisitions, divestitures, leveraged buyouts, joint ventures, cross-border deals, financing transactions, takeover defenses and corporate governance matters.

Mr. Kirman is a frequent speaker at professional conferences, and has written articles in numerous professional publications on topics relating to mergers and acquisitions and corporate governance. He recently published a book, "M&A and Private Equity Confidentiality Agreements Line by Line" (Aspatore). He was selected to be included in The Deal's "Movers & Shakers" issue in 2006 and was named as one of the "Dealmakers of the Year" by American Lawyer for 2006. He is the Chair of the Practicing Law Institute's annual "Doing Deals" program in New York and teaches a course on mergers and acquisitions as an adjunct at Columbia Law School. He also serves on the Advisory Board of the Practical Law Company and on the Mergers & Acquisitions Advisory Board of Strafford Publications.

Mr. Kirman received a B.A. in Ethics, Politics and Economics, magna cum laude, from Yale University in 1993. He completed his J.D. at Columbia Law School in 1996, where he was Notes Editor of the Columbia Law Review. His student note, "Standing Apart to be a Part: The Precedential Value of Supreme Court Concurring Opinions", 95 Colum. L. Rev. 2083 (1995), was selected as the winner of a national writing competition and awarded the Scribes Law Review Writing Award in 1996.

Mr. Kirman is a member of the American Bar Association, where he serves on the Committee on Mergers and Acquisitions (and is a member of its Financial Advisor Task Force) and the Committee on Private Equity and Venture Capital; and is a member of the New York City Bar Association, where he serves on the Mergers, Acquisitions & Corporate Control Contests Committee. He was born in Ukraine and speaks Russian.
Reference Materials

• Delaware Court Provides Further Guidance on Enforceability of “Don’t Ask, Don’t Waive” Standstills (Morrison & Foerster, Jan. 2013)
• “Don’t Ask, Don’t Waive Standstills” and the Auction Problem (Wachtell, Lipton, Nov. 30, 2012)
• “Don’t Ask, Don’t Waive Standstills” Revisited (Rapidly) (Wachtell, Lipton, Dec. 28, 2012)
• In re: Complete Genomics, Inc., Transcript Rulings, Del. Ch., Nov. 27 and Nov. 9, 2012
• In Re Intermec, Inc., Transcript, March 15, 2013
• Promises Made to be Broken? Standstill Agreements in Change of Control Transactions (Christina M. Sautter, forthcoming in Delaware Journal of Corporate Law)
• Auction Theory and Standstills: Dealing with Friends and Foes in a Sale of Corporate Control - Abstract (Christina M. Sautter)
• Goodrich Capital, LLC v. Vector Capital Corp. (SDNY 6/26/12)
• RAA Management v. Savage Sports Holdings (Del. 2012)