How To Help Clients Guard Against Interloping Bidders

By Benjamin Horney

*Law360 (February 16, 2018, 11:33 AM EST)* -- Though rival bids from third-party suitors rarely succeed, they can be discouraging after attorneys have spent months diligently working on an acquisition. However, there are ways lawyers can make it more likely their client will prevail, including by building protections against so-called interlopers into the original deal agreement.

The moment a merger agreement has been signed by both sides can be a relief, but the drama doesn’t always end there. Even in cases where there was a full-fledged auction prior to the deal being inked — meaning everyone with interest in the target was given a chance to make an offer — you can never be certain that there won’t be an interloper waiting in the wings, ready to swoop in with a rival bid.

“Because third-party bidders know it is an uphill battle to wrest a target away from a committed buyer, they are often prepared for the war and go in with their eyes wide open, armed with the ability to sweeten their deal repeatedly,” said Andrew L. Bab, a corporate partner at Debevoise & Plimpton LLP.

While there’s no way to completely shield a deal from aspiring usurpers, attorneys can help clients guard against them by including certain stipulations in the terms of the original transaction that serve to protect the agreement from potential interceding bidders.

“There is a standard package of deal protection provisions that have withstood scrutiny by the courts over the years and so are used in almost every deal,” said David Shine, a partner at Paul Hastings LLP and chair of the firm’s New York mergers and acquisitions practice. “These include restrictions on the ability of the target to engage in other negotiations, and the requirement that the target pay the original bidder a material breakup fee if an interloper comes in and buys the target.”

That first deal protection Shine refers to, known as a no-shop provision, limits a target from seeking higher bids and curbs its ability to consider unsolicited offers. No-shop provisions stipulate that in order to terminate an already agreed upon deal, the target must conclude that a new offer is financially superior and has a reasonable likelihood of closing, taking into account issues including whether or not the new bidder will be able to procure the necessary financing to fund its proposal, as well as whether the new bid is likely to pass regulatory muster.

No-shop provisions are helpful because even if it is determined that a third-party offer might be superior and has a good chance of closing, the original acquirer is typically given a period of time during which it can attempt to sweeten its offer.
In the event that a third-party bid is deemed superior, no-shop provisions will not protect a client’s original agreement from imploding, but that’s where breakup fees come into play. Breakup fees are paid to the original buyer in order to allow the target to get out of its commitment, and depending on the attorney you ask they are usually worth between 2 and 6 percent of the original deal value.

However, the generally agreed upon value of breakup fees may be evolving, according to Bab.

“Recently, we have seen buyers arguing that for highly leveraged targets, the termination fee should be calculated off of enterprise value rather than purchase price, and the Delaware courts have suggested that in appropriate circumstances that measure may be acceptable,” Bab said.

In addition to no-shop provisions and breakup fees, attorneys can build in so-called go-shop provisions, which actually allow the target to solicit other offers for a set amount of time. That may sound contradictory, but most go-shop provisions give the original buyer a certain amount of time to match any competing offers.

When a target does find a potentially superior offer thanks to a go-shop provision, it makes it far more likely that an interloper will materialize; but it also encourages a bidding war, and the original buyer usually has the upper hand in such situations.

That’s due to a number of reasons, including that there is an already established relationship between the two entities that originally entered into the agreement. Additionally, original offers usually have all of the financing details completely worked out, while third-party offers often do not, meaning they carry with them more risk.

“Most interloper offers are portrayed as being strong and real, but they are usually contingent on things such as due diligence review of target nonpublic information, and sometimes contingent on financing,” Shine said.

Sometimes buyers insist that attorneys include so-called force the vote provisions in deal agreements, a stipulation that denies the target the right to terminate the transaction if it changes its recommendation for the original deal.

“This creates the awkward situation in which the target shareholders are asked to vote for the original deal, even though the target board recommends against it,” Bab said. “The expected delay and uncertainty makes it harder for an interloper to commit the time and resources necessary to steal a deal.”

In addition to providing legal expertise in the form of detailed deal agreements that take into consideration all possible issues that may later arise, attorneys can be of assistance to their clients by being a loyal confidant who is willing to offer other forms of guidance. Lawyers who have experienced situations involving interlopers before can dispense much-needed context to help clients understand when an interceding bidder has a high chance of success, as well as their potential motivations.

For instance, third parties can choose to make an interloping offer in order to gain access to competitively sensitive information, or to simply drive up the price tag.

Robert Townsend, co-chair of Morrison & Foerster’s global M&A practice group, said that he has seen
occasions where a third party makes a bid even though the surrounding circumstances make it highly unlikely they’ll succeed.

Townsend speculates that the intent there is to delay the transaction and create uncertainty in the minds of employees, shareholders, customers and regulators, “presumably with the goal of weakening their competitor, which could be the target or the acquirer.”

Overall, attorneys can help make it less likely that an interloper will enter the fray by advising that their clients run a truly thorough auction process.

“The likelihood of a topping bidder emerging and being successful often depends on how broadly the company was marketed before entering into the original deal,” Townsend said. “The more the market has been tested upfront, the less likely it is a topping bid will emerge.”

--Editing by Rebecca Flanagan and Emily Kokoll.

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