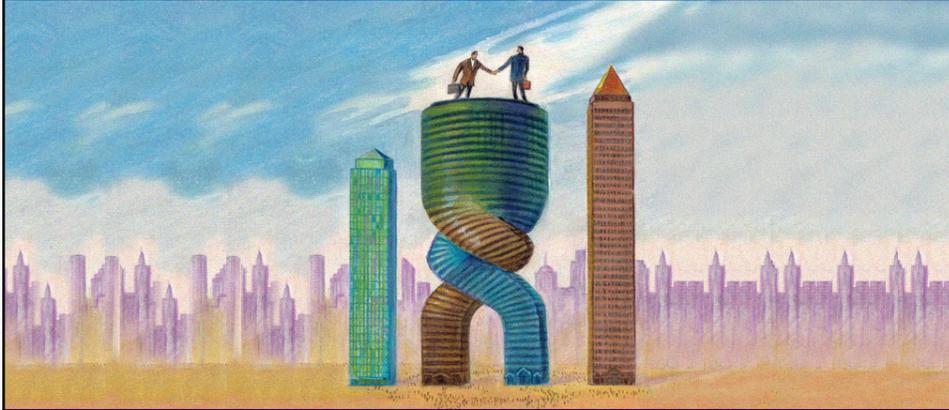


Fusion: A Quarterly Exchange to Power Your M&A Deals



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Fusion: A Quarterly Exchange to Power Your M&A Deals

Public Company M&A Environment: Are You Prepared for Potential Hostility? How Do You Respond?

*Presented by
John K. Wilson, Patrick G. Quick & Matthew Parr*

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Mr. Quick practices corporate law, with an emphasis in securities law compliance, acquisitions, and takeover defense. He regularly counsels several public companies concerning compliance requirements and governance matters and has participated in initial and other public offerings for Wisconsin corporations. Mr. Quick also has participated in many complex acquisition transactions representing both buying and selling parties in a variety of industries. He has been actively involved in the representation of clients doing advance takeover preparedness planning and has counseled clients who have received unsolicited takeover proposals or similar overtures. To contact Mr. Quick send an email to pgquick@foley.com.

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Matthew J. Parr



Matthew J. Parr is a Managing Director in the Mergers & Acquisitions Group of UBS Investment Bank based in Chicago. Mr. Parr has been involved in a wide variety of strategic and capital raising transactions, including corporate acquisitions, mergers, divestitures, minority squeeze-outs, spin-offs, restructurings, leveraged buyouts and defense assignments, as well as leveraged loan, high yield, and equity capital raising for Fortune 500 and middle-market companies. Mr. Parr has advised on a number of M&A transactions including recently the defense of Rinker Group Limited from a hostile tender offer by CEMEX, S.A. de C.V.; the sale of Iscar Metalworking Companies to Berkshire Hathaway, Inc.; the sale of United Rentals' Highway Technology Division to Wynnchurch and Oak Hill; Alamosa's sale to Sprint Nextel; and Alamosa's unsolicited acquisition of Airgate. Mr. Parr received a B.A. in economics from Princeton University where he graduated *magna cum laude*. To contact Mr. Parr send an email to Matthew.Parr@ubs.com.

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Trend: Increased Hostile M&A Activity

- Hostile M&A activity has steadily increased since 2002
- Hostile M&A acquisitions were up 87% in 2006 compared to 2005¹
 - 157 hostile acquisitions worldwide with \$498 billion in value
 - Represented approximately 13% of global announced M&A activity of a record \$3.8 trillion

¹ Data from Thomson Financial

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Trend: Increased Hostile M&A Activity

- Factors contributing to rise in hostile activity
 - High levels of available cash that need to be put to work
 - Relatively cheap and easy to obtain financing
 - Vulnerable targets due to reduced takeover defenses
 - Increasing institutional shareholder and hedge fund activism
 - Industry consolidation
 - Third party breakups of strategic mergers



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Trend: Reduced Takeover Defenses

- While maintaining takeover defenses continues to be a common practice, many companies are abandoning such defenses
- Percentage of S&P 500 companies with:¹
 - Classified boards decreased to 41% in 2006 from 47% in 2005
 - Rights plans decreased to 34% in 2006 from 45% in 2005
- These percentages remain higher at smaller companies whose corporate governance practices are subject to less scrutiny

¹ Data from SharkRepellent.net



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Trend: Continued Institutional Shareholder Activism

- Institutional shareholders continue to object to takeover defenses and make their views known through:
 - Shareholder proposals
 - Withholding votes for directors
 - Corporate governance ratings
- Shareholder proposals to repeal classified boards, eliminate supermajority votes or redeem or vote on rights plans continue to receive high levels of support



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Trend: Increased Hedge Fund Activism

- Estimated global hedge fund assets between \$1.4 and \$2 trillion on which significant returns are expected
- Hedge funds have taken on role as investors, not just traders
- Investment strategies create incentive for hedge funds to be drivers of events at portfolio companies
- Hedge fund activism can take different forms:
 - Challenging management and boards of directors to review business strategy
 - Pursuing increased dividends or stock repurchases or a restructuring, breakup or sale of a company



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Trend: Increased Hedge Fund Activism

- Launching hostile takeovers and proxy contests
- Blocking a sale transaction to force the acquiror to pay a higher price
- Hedge funds often act in parallel using “wolf pack” tactics
 - Not uncommon for a number of hedge funds to acquire over 50% of a company’s shares
 - Takeover defenses and statutes may not be effective as individual hedge funds often stay below 10%
- Hedge funds and other activists no longer viewed as “raiders” but as “corporate activists” promoting shareholder interests

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Preparing for Unsolicited Offers

- Establish takeover defense team and maintain current contact list
 - Key officers: CEO, CFO, CLO, others
 - Financial advisor
 - Legal counsel
 - Investor relations and proxy solicitor
- “No comment” and sole spokesperson policies
 - Avoids duty to disclose third party overtures
 - Ensures company speaks with one voice – through CEO
 - Scripted responses to different approaches

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Preparing for Unsolicited Offers

- Board matters
 - Annual takeover defense and M&A market review, including participation by financial advisor and counsel
 - Consider adopting independence policy – in connection with review of company strategic plan
 - Make clear CEO authority in dealing with unsolicited acquisition proposals and director response if approached
 - Be prepared to call special board meeting on short notice (*i.e.*, 24 hours)



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Preparation – Review and Maintain Takeover Defenses

- Defenses will not prevent a third party from acquiring control of a company
- Instead, defenses provide an informed board the opportunity to control a company's destiny consistent with the board's view of the best long-term interests of shareholders and avoid having an outsider dictate the corporate agenda
- Increased bargaining power of company board can lead to increased takeover premium
- Companies must evaluate and strategize in the face of demands to reduce takeover defenses
 - Prioritize and “choose your battles”



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Preparation – Review and Maintain Takeover Defenses

- Rights plans
 - Strong defense against hostile tender offer
 - But, increasing shareholder activism leading to increased number of companies repealing or letting expire
 - Consider whether “on the shelf” rights plan or shareholder-approved rights plan meeting ISS standards appropriate
 - Is business combination statute a worthy substitute?



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Preparation – Review and Maintain Takeover Defenses

- Classified board
 - Strong defense against proxy contest and end run on rights plan and statutory defenses
 - At a minimum, provides board time to implement strategic alternatives
 - But, increasing shareholder activism leading to increased number of companies repealing
- Board ability to fill vacancies and determine size of board; no removal of directors other than for cause
 - Defense against end run on classified board



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Preparation – Review and Maintain Takeover Defenses

- Advance notice by-laws
 - Restrict activist ability to commence proxy contest
 - Help to eliminate element of surprise with respect to shareholder proposals
 - If shareholders may act by less than unanimous written consent, then advance notice should apply to consent solicitations too
- State statutes
 - Business combination
 - Control share
 - Fair price
 - Anti-greenmail
 - Consideration of other constituencies



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Preparing for Hedge Fund and Other Activist Attacks

- Maintain a response team similar to takeover response team
- Similar to takeover defense review, board should be prepared to deal with an activist situation
 - Board needs to understand strategic plan and potential strategic alternatives
- Although hedge fund attack may be intended to facilitate a takeover or force a sale, takeover defenses of limited use with respect to initial attack
 - Rights plan triggers avoided with hedge fund “wolf pack” tactics



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Preparing for Hedge Fund and Other Activist Attacks

- Investor relations is key
 - Proactively communicate company strategy and explain reasons for any performance shortfall
 - Monitor significant stock holdings and trading
 - Identify potential problematic shareholders
 - Review analysts' reports for opinions that may appeal to hedge funds
 - Understand alternatives that activists may propose so the company can respond accordingly: share buybacks, special dividends, sale of company/division, spin-off or other restructuring
 - Maintain open communication with institutional shareholders and respond to all shareholder inquiries
 - Watch Regulation FD issues



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Director Duties - Takeover Defenses and Offers

- Under Delaware law, there are three standards of judicial review for decisions by directors with respect to adopting and maintaining takeover defenses and responding to hostile offers
 - Business judgment rule
 - Enhanced scrutiny, including Unocal and Revlon
 - Entire fairness



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Director Duties – Business Judgment Rule

- Directors' decisions presumed to have been made on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company
- Board decisions protected unless plaintiff carries burden of proof to show that a board did not meet duty of care or loyalty
 - Duty of care: Directors must make decisions on a fully informed basis after appropriate consideration of relevant information
 - Duty of loyalty: Directors cannot engage in self-dealing
- Business judgment rule would generally apply to a target board decision not to accept an unsolicited offer



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Director Duties – Enhanced Scrutiny

- Delaware courts will not defer to the board under the business judgment rule and will instead apply enhanced scrutiny standard in certain circumstances:
 - Board decision to undertake defensive action in response to a threat to corporate control
 - Unocal: Board must show that (1) it had reasonable grounds to believe that a danger to corporate policy and effectiveness existed and (2) the defensive measure was reasonable in relation to the threat posed
 - Board decision to approve a sale of control or break-up of the company
 - Revlon: Once the board has decided to sell the company, the board must achieve the highest value reasonably available for stockholders



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Director Duties – Enhanced Scrutiny / Entire Fairness

- If the enhanced scrutiny standard is applicable, the court will:
 - Review the board’s decisional process
 - Examine the reasonableness of the board’s decision
- Entire fairness: If a majority of the board has a conflict of interest, then the court will determine if the transaction is entirely fair to stockholders
 - The court will consider both fair dealing and fair price by examining the board process, quality of result achieved and quality of disclosures to shareholders



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Responding to Unsolicited Inquiries and Offers

- Informal approach – call to CEO or director
 - No duty to discuss, negotiate or meet
 - If CEO contacted, response is that the company is not for sale and plans to remain an independent company
 - If director contacted, referred to CEO for response
 - Board not required to consider if not a firm offer (written proposal at stated price), but management should inform board of serious approaches so that board is prepared
 - No duty to disclose unless leak of information by company personnel



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Responding to Unsolicited Inquiries and Offers

- Non-public firm offer or “bear hug”
 - No duty to discuss, negotiate or meet
 - Takeover defense team to consider response to bidder
 - Inform directors and call special board meeting to consider offer
 - Board has no duty to accept an offer because a third party offers to acquire the company at a price in excess of the market price if the board determines the offer is not in the best interests of stockholders
 - No duty to disclose unless leak of information by company personnel
 - Monitor stock activity



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Responding to Unsolicited Inquiries and Offers

- Public firm offer or “bear hug”
 - Response to bidder is simply “we will call you back”
 - Takeover defense team to consider whether to meet with bidder
 - Inform directors and call special board meeting to consider offer
 - Board has no duty to accept an offer because a third party offers to acquire the company at a price in excess of the market price if the board determines the offer is not in the best interests of stockholders
 - No public statement other than “stop-look-and-listen”
 - in tender offer, the company must file Schedule 14D-9 within 10 business days
 - Monitor stock activity



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Special Board Meeting to Consider Firm Offer

- If majority independent directors, no need for a special committee
- Presentations by management, financial advisor and legal counsel
- Board should be informed of:
 - Fiduciary duties of care and loyalty
 - Application of business judgment rule or enhanced scrutiny, as applicable
 - Board must act in good faith and on reasonable basis, with defensive action proportional to threat posed
 - Board has duty to prevent transfer of control without premium; premium over market not necessarily a fair price
 - Unless Revlon duties present, no duty to accept or negotiate offer



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Special Board Meeting to Consider Firm Offer

- Board may consider:
 - Anticipated effect on stockholder value of remaining independent and executing strategic plan
 - Inadequacy of offer price or form of consideration or structure of offer
 - Other terms, conditions and contingencies of offer
 - Timing of the offer
 - Risk of non-consummation or illegality of the offer
 - Impact of the offer on constituencies other than stockholders



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Special Board Meeting to Consider Firm Offer

- Strategic alternatives, defenses and responses for board to consider:
 - “Just say ‘no’” or “just say ‘more’” defenses
 - Litigation against bidder
 - Proxy fight to keep control of board
 - Implementation of additional takeover defenses (e.g., if company does not have in place a rights plan)
 - Strategic divestitures, spin-offs, recapitalizations, stock repurchases, acquisitions or other actions that decrease likelihood of takeover
 - Strategic alliance or “white knight” transaction
 - Auction of company
 - Negotiate with bidder, including standstill agreement and “greenmail”

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Responding to Hedge Fund Activist Approach

- Approaches typically private, but can be public through Schedule 13D
- Assemble defense team to determine appropriate response and develop investor relations strategy
- Advise board so it is prepared and call special meeting if appropriate
- Similar to takeover offer, generally no duties to discuss, negotiate, meet or disclose
- Decision of whether to meet with activist made based on case-by-case basis; consider confidentiality and standstill agreement if meeting with activist
- Monitor stock activity and maintain contact with large institutional investors and proxy advisory firms
- Goal to avoid public announcement or “wolf pack” attack that puts company “in play”

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