Business and economic conditions are ripe for investments by foreign entities in US companies. The weak US dollar has made the prices of dollar-denominated assets attractive to foreign buyers and the high prices of hydrocarbons, metals and other commodities have created large pools of investment capital which are available for investments in the US. Turmoil in the financial markets has depressed stock prices. Foreign banks that avoided large sub-prime losses may also be in a relatively stronger position to provide acquisition financing than many US financial institutions.

This article provides a high-level overview of a friendly negotiated acquisition of the stock of a US domestic public company (that is, a company organised under the laws of one of the states of the US) by a non-US company. While asset acquisitions are also possible, they are rare because the legal and US tax implications of an asset transaction typically result in a strong bias by the target’s board of directors in favour of a stock-based structure (see box “Asset acquisitions”). Hostile acquisitions are also rare.

This article does not address limits on foreign ownership or other regulatory restrictions that may apply to targets in specific industries.

**GENERAL LEGAL FRAMEWORK**
The laws (including the laws of the State of Delaware, where many large US companies are organised) governing the ac-
public mergers and acquisitions

Merger or tender offer?

Acquisition of the shares of a US public company may be structured as a one-step merger or a tender or exchange offer.

One-step merger

In a one-step merger the buyer and target enter into a merger agreement. To seek the approval of the merger by the seller’s shareholders, the management of the seller must solicit proxies by means of a proxy statement (circulated to shareholders) vetted by the Securities and Exchange Commission (SEC). (Unlike many jurisdictions, the SEC does not concern itself with whether the terms of a transaction (including price) or the procedure being followed are fair. The SEC’s review is completely based on the accuracy and completeness of the disclosure made.) The consideration payable to the seller’s shareholders can consist of cash, securities or a combination of both. If shares are being offered as part of the merger consideration, a prospectus is also required to be filed with the SEC.

Tender or exchange offer

In a cash tender offer, the buyer offers to purchase the target’s shares directly from the target’s shareholders in exchange for cash consideration. When all or part of the consideration consists of securities, the transaction is referred to as an exchange offer.

The cash tender offer commences when the tender offer document is filed with the SEC. Under an exchange offer, the bidder...
may not purchase any shares until a registration statement (with respect to the shares being offered to the target shareholders as consideration) and a tender offer document have been filed with the SEC and a prospectus has been delivered to the target shareholders.

After the completion of the tender/exchange offer, the bidder may complete a second-step merger for the purpose of acquiring any shares that were not tendered in the tender/exchange offer (known as a back-end merger). In some states, a short-form back-end merger may be accomplished without seeking the approval of the target’s remaining shareholders if the buyer owns more than a specified percentage of the target’s shares (usually at least 90%).

Market practice
In recent years, the one-step merger has been the most common structure for acquisitions of US public companies. A principal reason for this stemmed from uncertainty in the application of the “best price rule”, an SEC requirement that all tendering holders be paid the same price for their shares. This had a chilling effect on the use of the tender offer as an acquisition technique because of the potential for litigation surrounding tender offers.

More specifically, decisions by several US courts led to concerns that compensatory and other arrangements with target security holders who are employees or have other relationships with the target could be deemed additional consideration above and beyond the price offered and paid to other target shareholders, in violation of the best price rule.

In 2006, the SEC adopted amendments to the best price rule to clarify that it applies only to the consideration offered and paid for tendered securities, and not to employment compensation, severance or other employee benefit arrangements entered into with the target’s shareholders in connection with a tender offer. In addition, the amendments added a non-exclusive safe harbor applicable to compensatory arrangements approved by the compensation committee or another committee of independent directors of the buyer or target.

The 2006 amendments to the best price rule do not address all the issues that may arise in the context of employees or significant shareholders. For example, the amendments do not cover arrangements to roll over investments by management or large shareholders in the target into shares of the acquisition vehicle. Nor do the amendments address other types of commercial arrangements, such as supply contracts, outsourcing arrangements or agreements for other types of services. Despite these lingering issues, the use of the tender offer has increased significantly since the amendments to the best price rule.

Because of the significant advantages a tender offer may provide to a bidder when compared to a merger transaction, the tender offer should be considered in every transaction. Key benefits include:

- Absent delay due to necessary regulatory or other approvals, the tender offer typically takes the least time to complete, reducing the risk that another bidder presents the target with a superior offer and getting the offer consideration into the hands of the target’s shareholders more quickly (see box “Timelines: cash merger vs cash tender offer”). Once the tender offer is closed, the change of control has been accomplished and a competing bidder cannot buy the control against the wishes of the new owner.

- Earlier completion and reduced completion risk typically increase the appeal of the bidder’s offer to the target’s board members as they consider the offer in light of their fiduciary responsibilities.

Offsetting these benefits are several factors:

- US margin lending rules typically limit the debt financing to 50% of the total offer price where the acquisition financing is secured by the stock of the target, constraining the ability of a buyer to highly leverage its acquisition, at least until a back-end merger has been consummated.

- The timing benefits of the tender offer structure may be reduced if a “short-form” second-step merger is not possible, either because the buyer fails to reach the required threshold or where no “short-form” statutory provisions exist in the particular state. Where a short-form merger is not possible, completion of a two-step process is likely to require more time than a one-step merger.

- The timing benefits of a tender offer may also be illusory where a time-consuming regulatory approval process (that is, in a regulated industry) must be completed before the transaction can proceed.

One-step Merger Structure

The typical transaction takes advantage of the merger statutes available in all US states. The buyer typically establishes a special purpose subsidiary in the same state as the target and that subsidiary is merged with the target, with either the target as the surviving corporation (a reverse triangular merger) or the acquisition subsidiary as the surviving corporation (a forward triangular merger).

Non-US companies prefer these indirect mergers to direct mergers (where the target merges with and into the buyer) as indirect mergers reduce the buyer’s exposure to target company liabilities.

The merger is a flexible tool in the corporate lawyer’s kit. A merger agreement combined with board and shareholder approval allows the conversion of 100% of the outstanding shares into the merger consideration (which is often all cash but
may be securities or a combination of cash and securities).

Entry into the agreement requires only approval by a majority of the target’s directors. The shareholder vote follows, and in most cases requires only a simple majority of the outstanding shares. Shareholder approval is obtained based on a public solicitation by the proxy statement that is reviewed by the SEC for complete disclosure and compliance with applicable rules before being sent to shareholders.

**Merger agreement**

The target and the acquisition vehicle (and, typically, the buyer) enter into a merger agreement which provides for the merger of the target with the acquisition vehicle, subject to the satisfaction of certain conditions precedent, including target shareholder approval.

If not previously made public, the transaction is generally announced at the time the merger agreement is signed.

The representations and warranties about the target contained in the merger agreement are typically less comprehensive (and contain more “materiality” or “material adverse change” qualifiers) than is usual in the acquisition of a private company. Since the target will be owned by the buyer after closing and the buyer’s shareholders are not party to the merger agreement, such representations are of little or no value after closing. Moreover, public companies are subject to the comprehensive disclosure and liability provisions under the US securities laws, giving buyers additional comfort in the absence of effective contractual protections.

The conditions to closing typically include the absence of material adverse changes affecting the target, necessary regulatory approvals having been obtained (including anti-trust clearance and, if applicable, US national security review), the absence of litigation seeking to prevent the transaction and approval of the merger by the target’s shareholders. (Under the laws of many states a so-called “short-form” merger can be effected without shareholder approval if the buyer owns more than a specified percentage of the target’s outstanding shares (90% in Delaware)).

When the merger becomes effective (typically when a certificate of merger is filed with the Secretary of State of the state where the surviving corporation is organised), if the acquisition subsidiary is to be the surviving corporation, the shares of the target corporation are automatically cancelled, and thereafter represent only the right to receive the merger consideration.

**Proxy statement**

After the merger agreement is signed, the target’s management in cooperation with the buyer prepares a proxy statement (similar to a shareholder circular in many other jurisdictions) containing information about the transaction and seeking
proxies from shareholders entitling management to vote their shares in favour of the transaction. The approval threshold is set out in the target’s constitutional documents, but can be (and often is) as low as a simple majority of the outstanding shares entitled to vote at the meeting.

The proxy solicitation process typically takes three to four months to complete. The Exchange Act and the regulations thereunder prescribe the contents of the proxy statement. The proxy statement must be filed with, and typically reviewed by, the SEC. The initial SEC review takes about four weeks, and responding to SEC comments and receiving SEC clearance can take an additional two to three weeks. Once the proxy statement has been cleared by the SEC, it is distributed to the target’s shareholders. The target shareholder meeting is normally held about five weeks after the proxy materials are distributed.

Disclosures made in a proxy statement (as well as other solicitations, even if not contained in the definitive proxy statement) are subject to anti-fraud provisions in the Exchange Act and rules adopted thereunder, and may not be false or misleading (see box “Proxy statement disclosure requirements: cash merger”).

If the merger consideration includes securities, the issuance of those securities in the merger must be registered under the Securities Act. Registration is typically accomplished by combining the proxy statement with a prospectus meeting the requirements of the Securities Act. In addition to the information required to be included in a proxy statement, the proxy statement/prospectus must contain the information that is required to be included in a prospectus in a public offering of the securities. This includes:

- A description of the business of the issuer of the securities.
- Risk factor disclosure.
- Historical US generally accepted accounting principles (US GAAP) or International Financial Reporting Standards (IFRS) (if the issuer is a foreign entity) financial statements of the issuer (and likely pro forma financial statements of the merged entity).
- A discussion (from management’s perspective) of the financial results and liquidity of the issuer of the securities (the management discussion and analysis (MD&A) section).

The disclosures in the proxy statement/prospectus are subject to the strict liability provisions of the Securities Act.

An issuer of securities in a merger becomes subject to the periodic reporting requirements under the Exchange Act and certification, corporate governance and other obligations under the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley). In order to make the securities attractive as merger consideration, it is usually necessary to list them on a securities exchange.

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Proxy statement disclosure requirements: cash merger

Schedule 14A under the Securities Exchange Act of 1934 mandates that proxy statements contain the following disclosure:

- A summary of the terms and conditions of the transaction.
- The time and place of the target shareholder meeting.
- The identity of the person(s) soliciting proxies and a description of their interest in the matters to be tabled at the shareholder meeting.
- A description of any applicable dissenters’ appraisal rights.
- A description of target’s voting securities and the principal holders thereof and any known arrangement that may result in a change of control of the target.
- Information about the target’s directors and management, including information on compensation.
- A description of the proposed merger and the terms of the merger agreement.
- A discussion of necessary regulatory approvals and their status.
- A description of the past contacts, transactions and negotiations between the buyer and the target.
- A description of any proposed amendments to the target’s charter documents and other actions proposed to be taken at the shareholder meeting.
- A description of voting procedures.

For a cash merger, historical or pro forma financial information on the buyer is normally not required. A description of the business and discussion of the financial position of the buyer may be required if such information would be material to a voting decision (for example, if the merger agreement contains a financing condition).
Where a buyer’s securities are already listed on a major foreign exchange (for example, London or Hong Kong) this may be sufficient, particularly if the target’s shareholder base is largely institutional.

**TENDER AND EXCHANGE OFFER STRUCTURE**

As stated above, in the context of negotiated transactions in the US involving a tender offer, transactions are invariably structured as two-step transactions. A buyer conditions the tender offer on its acquisition of a majority of the target’s outstanding shares to ensure that the second-step merger is approved.

The first step is a tender offer in which the prospective buyer offers to acquire the target’s shares directly from the target’s shareholders. Once the tender offer closes successfully, the buyer takes control of the board of directors and runs the company.

The second step involves the merger that deals with all remaining public shares of the target (back-end merger).

Following the completion of a tender offer, the laws of many states permit the buyer, if it holds more than a specified percentage of the target’s shares (90% in Delaware), to merge the target with the bidder without the need to obtain the approval of the target’s other remaining shareholders (a short-form merger or squeeze out transaction).

The target’s certificate of incorporation may also permit target shareholders to take action by written consent, in lieu of a shareholder meeting. In such a case, the buyer is also able to quickly consummate a merger, perhaps with as little as a simple majority of the outstanding shares. In either case, the merger consideration is the same as was paid in the tender offer.

Until the tender offer closes, the target board’s fiduciary obligations to the other remaining shareholders force the buyer to be careful about any related party transactions (including financing support) involving its new subsidiary. If a short-form back-end merger is not available, the second step back-end merger typically requires the consent of shareholders representing a majority of the outstanding shares.

Unlike many jurisdictions (for example, the UK and Hong Kong), US law does not require a prospective buyer to conduct a tender offer when it crosses specified ownership thresholds. The Exchange Act does impose detailed requirements regarding disclosure and conduct in effecting a tender offer. In addition, if securities are offered as part of the tender offer consideration, those securities usually need to be registered under the Securities Act.

**Tender offer document**

As with a merger proxy statement, the form and content of the tender offer document depends on whether securities are being offered as part of the tender offer consideration.

In a cash tender offer, the document and certain additional information and documents must be filed with the SEC under Schedule TO. The document is not subject to SEC approval, and the tender offer can commence once the document is filed. The SEC can, however, review and comment on the filed document. If the SEC comments necessitate material changes to the tender offer document, recirculation may be required.

The requirements for Schedule TO are set out in rules adopted under the Exchange Act (see box “Cash tender offer disclosure requirements”).

**Exchange offers**

A bidder may offer securities as a part or all of the tender offer consideration. However, those securities usually need to be registered under the Securities Act. Before commencing a tender offer that includes securities as consideration, the bidder must file with the SEC a registration statement with respect to such securities. The bidder may not purchase any shares in the tender offer until the SEC has declared the registration statement effective and a prospectus has been delivered to target shareholders. In the case of a merger in which securities form part of the merger consideration, additional disclosures about the issuer of those securities and its business are required.

For foreign bidders that are not already US reporting companies, the requirement that any securities consideration be registered has important timing implications. The bidder may commence a tender offer subject to the filing of a registration statement, disseminating a preliminary prospectus and exchange offer statement to all target shareholders (usually in practice a combined document) and filing a tender offer statement on Schedule TO with the SEC.

As a practical matter, however, the potential for delay arising from the SEC review process, and the fact that the bidder could be required to recirculate the prospectus and offer documentation if the SEC comments result in material changes, have in many cases made bidders which are not already reporting companies reluctant to commence an offer, at least until initial SEC comments on the securities registration statement have been received.

**Partial acquisitions**

The tender offer structure also leaves open to the buyer the possibility of acquiring less than 100% of the target’s shares. In practice, most buyers of US public companies seek to acquire all of the outstanding shares.

There are several reasons for this. A buyer typically acquires control of a public company with a view to making changes designed to increase its value. In addition, the buyer may want to combine the target with an existing business owned by the buyer or sell off parts of the target’s business. The disclosure, fiduciary and corporate governance considerations that arise where the subject of these actions remains a public company can complicate and de-
lay the restructuring process, and expose the new owner to potential liability to the public shareholders. In addition, the expense of continuing compliance with public company obligations may be burdensome.

In some cases, it may be desirable to retain the target as a public company. Benefits often cited by potential foreign buyers include the ability to raise additional equity by virtue of the existing listing and status as a public company and the prestige of controlling a US company.

In practice, however, the target’s ability to raise additional equity capital may be limited where the existing shareholder base is small. More importantly, in a competitive situation, a target’s board of directors is unlikely to favour proposals to acquire less than all of the target’s shares, since post-transaction holders of the target’s shares will not be able to capture any control premium with respect to their remaining interests in the target.

**Conduct of tender offer**

The SEC has adopted rules that govern the manner in which all tender offers for equity securities must be conducted. The key rules are summarised below:

**Offer period.** A tender offer must be held open for at least 20 business days. The offer must be extended for at least an additional ten business days after any change in the tender offer consideration or change in the percentage of securities sought (other than increases of 2% or less in the percentage sought). The offer must be extended for at least five business days after the waiver of a condition and in the case of certain other material changes. There is no maximum offer period.

**Withdrawal rights.** Holders must have the right to withdraw their tenders at any time that the offer period is open.

**All holders rule.** A tender offer must be made to all holders of the class of securities being sought.

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**Cash tender offer disclosure requirements**

Regulation M-A sets out the disclosure obligations for tender offer documents. In an all-cash tender offer for equity securities of a US public company the following information must be filed with the SEC on Schedule TO:

- Information about the target (including name and contact information, the title and amount of target’s securities which are the subject of the tender offer, trading market and trading price information, information about dividends and prior public offerings and information about purchases by the buyer of the target’s stock in the past two years).

- The bidder’s identity and background information about the bidder.

- The terms of the tender offer.

- A discussion of past contacts, transactions and negotiations between the bidder and the target or the target’s officers, directors and affiliates.

- A discussion of the purposes of the tender offer and any plans, proposals or negotiations for extraordinary transactions, material asset transfers, changes in dividend policy, indebtedness or capitalisation or changes in the management, corporate structure or business of the target.

- A discussion of the source and amount of the bidder’s funds, including any financing conditions to which the tender offer is subject.

- Disclosure of the bidder’s beneficial interest in the securities which are the subject of the offer and any transactions in such securities in the 60 days leading up to the offer.

- The identities of any persons paid to assist in the solicitation, and the terms of their compensation.

- Historical financial statements of the bidder (two years audited and the most recent unaudited stub period, prepared under US generally accepted accounting principles or, if the bidder is a foreign private issuer, International Financial Reporting Standards may be used) must be included unless:

  - the tender offer consideration consists solely of cash;

  - the offer is not subject to any financing conditions; and

  - the offer is either for all of the outstanding securities of the class being sought or the bidder is subject to the periodic reporting requirements of the Securities Exchange Act of 1934 (that is, a public company).

*Pro forma* financial information is generally not required where the tender offer consideration is all cash.

- Disclosures regarding regulatory approvals and compliance, litigation and anti-trust laws.

Certain additional documents, including tender offer materials, agreements relating to any tender offer financing and contracts and other arrangements between the target and the bidder, must be filed as exhibits to the tender offer document.
Best price rule. The consideration paid to any holder of target shares, pursuant to a tender offer, must be the highest consideration paid to any other holder during the tender offer. If the tender offer consideration is increased, all tendering holders are entitled to the higher price. Uncertainties regarding the application of the best price rule to employment, severance and other arrangements may cause complications in some tender offer transactions.

Proration. Where an offer is oversubscribed (that is, more shares have been tendered than the maximum number of shares that the bidder has offered to purchase), the bidder must acquire shares from all tendering holders on a pro rata basis. A consequence of this rule is that there is no benefit to tendering early; as a result, it is typical for few shares to be tendered until the very end of the tender offer period. In addition, proration has the effect of reducing the attractiveness of offers for less than all of a class of securities, since tendering holders may not be able to dispose of all of their holdings in the tender offer.

Subsequent offer period. If announced during the course of the initial tender offer, a bidder may, after completion of a tender offer, commence a subsequent offer to acquire the target securities on the same terms for a period of three to 20 business days. The bidder must accept all valid tenders during the subsequent offer period, and the tendering holders are not entitled to withdrawal rights.

Tender offer liability
Material misstatements and omissions, as well as fraudulent, deceptive or manipulative acts or practices in connection with the conduct of a tender or exchange offer are prohibited under the Exchange Act. Rules adopted under the Exchange Act also bar specific practices by bidders, including purchasing securities outside the tender offer or announcing a tender offer without the intent or means to complete the offer with an intent to manipulate the share prices of the target or the bidder. Certain other practices, such as “short tendering” (tendering shares that one neither owns nor has the right to obtain) and “multiple tendering” (tendering shares into multiple competing offers) are also proscribed.

Target duties in a tender offer
Exchange Act rules require the target of a tender offer to take certain actions in connection with a tender offer.

The target company must, within ten business days after a tender offer for its shares is commenced, advise the shareholders of its position with respect to the tender offer, or advise that it is unable to express a position. This is accomplished by disseminating a Schedule 14D-9 to the target’s shareholders. Schedule 14D-9 must also be filed with the SEC before the target, its management or any other person may solicit or make any recommendation with respect to the tender offer.

Information required to be included in the Schedule 14D-9 includes:

- A description of any agreements with the bidder or its affiliates.
- The recommendation (or inability to express a recommendation) and the reasons behind such position.
- The identity and compensation of persons retained to solicit for the target.
- A description of any negotiations by the target in respect of significant transactions in response to the tender offer.

The terms of any proposed significant transaction and the identities of the parties, need not be disclosed if no agreement in principle has been reached and the board concludes that disclosure would jeopardise the negotiations, although the fact that negotiations have begun must nonetheless be disclosed.

OTHER PRE-TRANSACTION CONSIDERATIONS
Other factors that should be considered before significant work on a transaction commences include:

Preventing leaks
Premature disclosure of the buyer’s interest or that a possible transaction is under consideration creates significant risk to a successful transaction. Typically, a transaction is not announced until due diligence has been completed and a binding acquisition agreement signed. Possible adverse consequences of a leak include:

- Regulatorily mandated early disclosure of a transaction (before an agreement is signed) in response to increased trading.
- Reduction in the premium the buyer can claim to be paying over pre-announcement market value.
- Increases in the target’s stock price to unattractive levels.
- The arrival on the scene of unwanted competing bidders.
- Increased movement of the shares into the hands of hedge funds and other arbitrageurs (who are likely to pressure the target to aggressively explore other transactions or take other steps such as conducting an auction for the target).
- Possible investigation by the SEC or other regulators.

The risk of a leak can be reduced by keeping the group of people who know about the transaction small, using code names, and stressing the need for secrecy.

The written record
The buyer and its advisors should also be mindful when creating written documents (including e-mails) relating to the transaction. In US litigation, the discovery rules are broad, and discovery can be compelled for documents which the au-
Any documents prepared by or for the buyer’s management discussing factors such as markets, market share and the competitive environment must be included in the buyer’s anti-trust filing under the Hart-Scott Rodino Antitrust Improvements Act of 1976 (HSR). HSR generally requires filing with the US anti-trust agencies before a buyer can acquire more than $63.1 million (in 2008) of a target’s stock (see “Hart-Scott Rodino” below).

Pre-transaction stock purchases
Under Section 13(d) of the Exchange Act, any person who acquires beneficial ownership of more than 5% of the outstanding shares of a US public company is required to file a Schedule 13D with the SEC within ten days of such acquisition. The purpose of the Schedule 13D requirement is to notify the public of actual or potential changes in or influences on the control of an issuer by mandating the disclosure of the background and identity of the purchaser, the purpose of the acquisition (that is, to seek control of a target company) and any plans with respect to the acquisition or disposition of the acquired securities.

Violation of the reporting requirements under Section 13(d) (such as the failure to file or the filing of a false Schedule 13D), may subject the violator to sanctions, including an injunction to comply with the disclosure requirements and to bar such person from future purchases of the target’s shares. Monetary damages and a remedy of rescission have also been granted for violations of Section 13(d).

Fiduciary obligations of the target board
The target’s board of directors play a central role in any transaction that involves a change of control of the target (a control transaction). While management may in practice have some role to play, the company’s officers, who are appointed by the board, are usually seen to have conflicts of interest (particularly where they expect to play a role in the target post-transaction), and may well breach their obligations to the target if they take sides. In any case, management is generally required by the board to remain neutral in the evaluation of alternative transactions or courses of action.

The US states (Delaware in particular) have a complex and well developed body of law governing the fiduciary obligations of directors in connection with control transactions. In most states, control transactions do not have the protection of the business judgment rule (which shields directors from liability as long as they have carried out their duties with due care and loyalty). Instead, when considering a sale of a target, the directors have the duty to achieve the best price reasonably available for the shareholders.

The board’s obligations in this regard are often referred to as “Revlon duties”, because the standard was articulated in a Delaware case involving the acquisition of Revlon Corporation. The practical impact of these obligations is that, unless an auction has been conducted, a target’s board generally will not agree to enter into a binding control transaction without reserving the right to entertain and agree to superior competing proposals after the transaction has been announced.

The need for these so-called “fiduciary outs” is a key driver of the deal protection mechanisms (see “Deal protections” below). Potential buyers of a US public company should seek the advice of experienced counsel in seeking to understand how the target board’s fiduciary obligations affect the target board’s decision-making in the context of any particular set of facts.

When evaluating a proposal for a transaction, the principal factors that the target’s board focuses on are the offer price, the nature of the consideration (cash is preferable to securities and among securities, greater liquidity is preferable) and completion risk (fully funded offers are preferable to those with financing conditions).

Approaching the target
In light of the target board’s fiduciary obligations, careful thought should be given up front to the manner in which the target is approached. Generally speaking, where the buyer hopes to proceed with a friendly transaction, a non-threatening initial approach is preferable. Since the buyer wishes to come to a binding agreement with the target, without the target soliciting competing offers, the buyer wants to avoid putting the target in a position where management feels the need to disclose that a transaction is under discussion.

Such approaches can take many forms, including a written letter (usually without price), a phone call to the CEO or an indirect approach through an independent director or other suitable intermediary. More aggressive approaches, such as the so-called “bear hug” letter (which proposes a friendly transaction but threatens a hostile one or a proxy contest for election of directors if the offer is rebuffed), are more likely to result in public disclosure of the offer by the target.

Negotiations with management
Reaching an understanding that results in the retention of the target’s key managers is often an area of critical importance. This is particularly the case for foreign buyers for whom the management’s expertise and experience in the US operating and regulatory environment maybe a key element of value in the transaction.

Pre-transaction dealings with the management may present challenges. The management’s position is conflicted, and it should remain neutral with regard to the evaluation and negotiation of competing proposals. As a consequence, buyers should not expect to win management
support for a transaction by offering attractive employment or severance terms to management.

Schedule TO requires disclosure of arrangements between the bidder and the target’s management. Since material changes to such arrangements also need to be reported on Schedule TO (and could necessitate the extension of the tender offer), the buyer cannot enter into any undisclosed agreement or understanding with the target’s management team before the tender offer closes. This presents the buyer with a real risk that it will not get the terms it expects from the target’s management. In addition, any arrangements with management need to be structured in a way that does not violate the best price rule. In the context of a merger, agreements or understandings with the target’s management must be disclosed in the proxy statement.

**Deal protections**

Whether the transaction is structured as a merger or a tender offer, the buyer typically wants to ensure that the deal is not trumped by a superior offer. Unless an auction has been conducted, the transaction documents typically contain “fiduciary out” clauses, both with respect to any merger and with respect to the target board’s endorsement of the merger or tender offer terms, and the right to terminate the agreement if the board endorses a superior offer. To mitigate the risk of a superior offer, buyers have developed a number of deal protection mechanisms.

“No shop” covenants. These are provisions included in definitive transaction documents which prohibit the target from soliciting competing offers. Generally, the target is permitted to entreat superior *bona fide* unsolicited proposals and to terminate the first deal if the superior proposal results in an agreement with better terms.

**Termination fees.** Where a transaction agreement provides that the transaction may be terminated in the event of an agreement reflecting a superior proposal, the buyer often seeks to include a provision requiring the target to pay a termination fee to the buyer upon the signing of the superior transaction.

The size of the fee is typically in the range of 2% to 5% of the price to be paid for the target’s equity, plus the buyer’s expenses (fees at higher levels run a higher risk of being invalidated by a court). The percentage is typically higher in the case of smaller transactions. The obligation to pay the termination fee is intended to ensure that the target board only accepts a competing proposal which it believes is superior by more than the amount of the termination fee.

**Agreements with significant shareholders.** The buyer may seek to enter into agreements with significant shareholders of the target, under which they agree to tender their shares in a tender offer or vote their shares in favour of a merger. A well advised controlling shareholder may be unwilling to enter into such arrangements without a fiduciary out, out of concerns that such arrangements may interfere with the target’s ability to obtain the best price for all shareholders.

**Option agreements with the target.** A buyer may seek to obtain option agreements entitling it to purchase new shares or assets of the target. A share option may not prevent a competing bid, but can provide value to the buyer if a competing bidder offers a higher price, and increases a competing bidder’s acquisition costs. An option on an important asset (or “crown jewel”) may also serve to deter would-be bidders. However, courts generally invalidate such arrangements if they serve to preclude or impair a competitive bidding process.

**REGULATORY MATTERS**

A number of regulatory matters must be considered in connection with any proposed acquisition. Two regulatory regimes in particular merit further discussion: the national security review process and the US anti-trust review process.

**National security review**

The Committee on Foreign Investment in the United States (CFIUS) is an interagency committee that reviews the national security implications of foreign investment in the US economy. The review undertaken by CFIUS applies to proposed or completed transactions that would give a foreign person “control” over a US business. Transfers which CFIUS does not approve can be blocked or unwound.

Filing for CFIUS review of a transaction is voluntary but has the effect (subject to certain exceptions described below) of protecting a transaction from future scrutiny.

An ordinary transaction may receive clearance after a 30-day initial review period or be subject to an additional 45-day national security investigation. A full 45-day national security investigation is required for transactions involving an acquirer that is controlled by or acting on behalf of a foreign government and is an acquisition that could affect US national security.

In 2007, President Bush signed into law the Foreign Investment and National Security Act of 2007 (FINSA), revising the process for US national security reviews of foreign investments in US-based entities. FINSA has made the reviews more rigorous, particularly for transactions in certain sensitive sectors and for transactions involving entities controlled by foreign governments.

The amendments also gave CFIUS the authority to negotiate, impose, and enforce conditions necessary to mitigate any threat to national security arising from a transaction and narrowed the safe harbor that protects transactions cleared by CFIUS from future scrutiny (and potential unwinding). The safe harbor no longer applies if the parties to a transaction intentionally and materially breach any term of a mitigation agreement and CFIUS determines that no other remedies are available to remedy such breach.
FINSA increases the importance of managing the pre-filing CFIUS period to ensure that the filing contains all of the information necessary for CFIUS to complete a timely review. Parties to a transaction subject to CFIUS review should factor this pre-filing period into their contemplated closing schedule. Typically, the total time required to obtain CFIUS clearance ranges from three to six months. For politically-sensitive transactions, CFIUS planning should be integrated into an overall transaction lobbying strategy from the outset.

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HSR provides the Federal Trade Commission and the Anti-trust Division of the US Department of Justice (the anti-trust agencies) with an opportunity to review an acquisition for potential anticompetitive effects in the event that a bidder intends to purchase a certain amount of a target’s shares. Generally, a bidder is required to make a filing under HSR and to comply with certain waiting period requirements if it intends to effect an acquisition that exceeds certain thresholds.

An HSR filing is required in an acquisition transaction when:

- One party has total assets or annual net sales of $126.2 million (in 2008) or more and the other party has total assets or annual net sales of $12.6 million (in 2008) or more, and more than $63.1 million (in 2008) of securities (and/or assets) is to be acquired; or
- The acquiring person would, as a result of the acquisition, hold an aggregate total amount of voting securities (and/or assets) of the target in excess of $252.3 million (in 2008).

In the event that the acquisition does not meet either of the two tests set out above, HSR does not apply and the buyer is not subject to the waiting period requirements and may immediately consummate an acquisition transaction.

If HSR applies, a 15-day (cash tender offers) or a 30-day (exchange offers and mergers) waiting period begins on filing with the anti-trust agencies. During the waiting period, the buyer is prohibited from consummating an acquisition.

The anti-trust agencies may extend the waiting period by requesting additional information (known as a second request), until 30 days (ten days for a cash tender offer) after “substantial compliance” with the request(s). The anti-trust agencies have the power to grant early termination of the waiting period and are generally willing to do so if no substantive anti-trust issues are raised by the proposed transaction. (For further information on the anti-trust process, see Article, “Merger control: the competitive implications of transactions”, page 207.)

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While the legal landscape for acquisitions of US public companies is complex and can at times seem daunting, the US is the most active market for mergers and acquisitions in the world. There is a great deal of institutional experience with such transactions and the certainty that results from this makes the risks that remain manageable.

Following the adoption of amendments to the best price rule in 2006, the tender offer has been experiencing something of a comeback as an acquisition method in the cases where it is appropriate. Generally speaking, a fully financed, all-cash tender offer for 100% of a target’s shares provides the greatest likelihood of a successful transaction, although other structures can succeed and are in fact preferable in some circumstances.

Transactions in which shares of the buyer are used as acquisition currency present particular challenges, as the buyer needs to register the offer and sale of those securities in the US and becomes subject to the periodic reporting requirements and other provisions of the US securities laws (including Sarbanes-Oxley).

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