July 23, 2007

The Return of the Tender Offer

Unused in friendly transactions for many years, the tender offer has made its return as a viable – and in many cases superior – alternative to the single-step merger for both strategic and private-equity acquisition structures. Indeed, the first six months of 2007 have seen at least 29 tender offers for U.S. targets having a market cap in excess of $200 million, compared with 5 for the same period in 2006.

This resurgence was made possible by amendments to Rule 14d-10 last fall which largely resolved the so-called "best-price" problem (see our memo entitled SEC Adopts Amendments to Best-Price Rules to Exempt Compensatory Arrangements, dated November 2, 2006), and has been helped along by other factors, including (1) the now-demonstrated availability of financing for tender offer structures, which can be more complex than standard merger financings, especially for financial buyers, and (2) the successful use in several recent tender offers of so-called "top-up" options, which significantly increase the likelihood that the buyer will be able to close the tender offer and short-form merger on the same day or within a few days, and therefore reduce the risk that the buyer will be stuck for several weeks or months owning a majority, but less than all, of the target.

With these factors making the tender offer viable again, dealmakers have found ways to utilize the advantages of the tender offer structure to address deal problems that could not be resolved in the traditional merger structure. Examples include using a tender structure to obtain a timing advantage in a topping bid situation (ElkCorp, Mills); to reduce the ability of dissident stockholders to engineer "no" votes against the transaction (Biomet, Laureate Education); and to acquire a company that was not current in its financial reporting (for example, due to an options backdating problem) where an esoteric SEC interpretation of the proxy rules may have prevented the target company from holding a shareholder vote on a merger (SafeNet).

The specific potential advantages of a tender offer over a one-step merger structure include:

- Speed. A tender offer can be completed in as quickly as 20 business days from launch (or about five to six weeks from deal signing), compared to four months or more for a merger, which must be approved by shareholders at a special meeting following an SEC proxy review process.

- Risk Reduction. The greater potential speed of the tender offer means a shorter period during which the target is exposed to market-risk, MAC (material adverse change) risk and other non-consummation risks and during which the buyer is exposed to third-party topping bid risk.

- Potentially Improved Chances of Obtaining Shareholder "Approval". Attempts by dissident shareholders to "hold up" friendly merger transactions by engineering "no" votes has been one of the major M&A developments of 2007, and the tender offer structure offers some advantages that may be useful in these situations, including that (1) the tender offer does not suffer from the so-called "dead vote" problem that arises in contested merger transactions when a substantial number of shareholders sell their shares after the record date and then do not vote their shares, or do not change an outdated vote, after they have sold their economic interest; (2) ISS and other proxy advisory services generally do not currently make recommendations with respect to tender offers, leaving shareholders to make up their own minds based on economic interest rather than on ISS's perception of process or other non-price factors; and (3) recent experience indicates that dissident shareholders may be less likely to try to "game" a tender offer than a merger vote, and therefore the risk of a "no" vote (less than 50% tender) may be lower than for a traditional voted merger.

- Securities Law Benefits. A company that is not current in its financial reporting (such as a company with an options backdating problem) can be the subject of a tender offer but, because of an SEC staff interpretation of the proxy rules, there is concern among M&A and securities lawyers that such a company cannot issue a merger proxy and therefore cannot hold a proper shareholder vote on the merger. The SEC staff has indicated an intent to alleviate this concern, but has not done so formally.

Of course, a tender offer is not appropriate for every acquisition. Margin rules, financing and regulatory considerations, and other factors may in many cases favor the traditional merger structure. (For example, in situations where it may take substantially longer to obtain antitrust or other regulatory approvals than to obtain shareholder approval, a single-step merger may be the preferred approach because the transaction will not be subject to third-party topping bid risk during the period from receipt of shareholder approval until receipt of regulatory approval. In the tender structure, the deal remains exposed to topping risk until the tender offer closes after all regulatory approvals have been obtained). But the speed and flexibility of the tender offer will often make possible deals that might otherwise have stalled, and most certainly should be considered by both buyers and sellers alike as something much more than the structure of last resort.

Mark Gordon