

Davis Polk

Post de-SPAC M&A and Shareholder Activism

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Your presenters



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Lee has deep experience on a wide variety of public and private M&A transactions. He co-leads the firm's SPAC practice and has advised SPACs and private target companies in numerous de-SPAC transactions, as well as advising recently de-SPAC'd companies on corporate governance, capital raising, shareholder activism and mergers and acquisitions.



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Soren advises clients on a full range of public and private transactions, both U.S. and cross-border. He is also active in transactions involving SPACs, advising SPACs, private equity sponsors of SPACs and private target companies involved in SPAC transactions.



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Derek has deep experience on a wide variety of public and private capital markets transactions, including IPOs, SPACs and other equity offerings, investment-grade and high-yield debt financings, private placements and mandatory and optional convertible securities offerings. In 2021, *Law360* named Derek a "Capital Markets MVP of the Year" and *New York Law Journal* selected him as a "Dealmaker of the Year."

Acquisitions by newly public companies

- In addition to the general issues and challenges associated with completing M&A transactions, newly public companies have new areas of opportunity and new potential issues.
- If using stock as consideration, note the shareholder approval requirements under NYSE/Nasdaq listing rules (issuance of greater than 20% of the shares of the company will generally require shareholder approval) and a general risk of putting yourself “in play” if issuing a substantial amount of equity of the company in connection with an M&A transaction.
 - Also consider potential impacts of anti-dilution or adjustment rights in existing equity instruments issued prior to the acquisition
 - If using stock as consideration in an acquisition of a private target, possible to issue unregistered shares if target equityholders are able to receive shares exempt from registration under applicable securities laws; registration rights may overlap with existing registration rights in the de-SPAC transaction documents
- For companies in most jurisdictions (including Delaware), the usual fiduciary duties of directors will apply to decisions made regarding acquisition transactions, and M&A transaction by public companies are subject to additional public scrutiny.
 - Increased litigation risk associated with such transactions, running the gamut from securities claims to breach of fiduciary duty claims under applicable law
- Careful consideration with the accounting and legal teams should be given to the necessary financial statements that will be required in connection with an acquisition, as public companies are required, depending on the level of significance of an acquisition target, to disclose pro forma financials and historical financials of the target company.

Buying a public company

- Acquisition structure generally
 - *One-step merger*: 3-4 months to close, assuming no regulatory delays; or
 - *Two-step tender offer followed by a merger*: ~45 days to close in that scenario
 - Do not acquire a toehold in target or approach a target without first consulting outside counsel. There can be many traps for the unwary
- Cannot prohibit a topping bid, but can negotiate for some limited protections (e.g., break-up fee (~2.5 to 4% of deal value), non-solicit, last-look rights, voting agreements from key shareholders, force-the-vote provisions)
- Potential to go hostile and risks of doing so
- No indemnification, so diligence is the only way to mitigate and price risks
- Extremely limited conditionality in most instances
- Risk of dissenters' rights has now become real
 - Insist on carefully scrutinizing target projections and be wary of “hockey stick” projections in light of Delaware courts focus on DCF analysis in appraisal actions
- Virtually every public company transaction is challenged in the courts (in most instances, in many different courts in multiple suits)
 - Background of the merger: Every step of the way will be chronicled and carefully reviewed, so keep a high-level calendar of events
 - Conflicts and disclosure claims
 - Change-of-control payments to target insiders

Buying a private company / business

- Structure: Stock Purchase v. Asset Purchase v. Merger
- Greater flexibility on terms and therefore contract protections
 - Price
 - Purchase price adjustments
 - Earn-outs
 - Be sure to discuss the risks and challenges of earn-outs with outside counsel before agreeing to them at termsheet stage
 - Deferred or differential consideration
 - Rollover / retained interests
 - Indemnification for specific matters and for breaches of representations, warranties and covenants
 - Non-competes and non-solicits
 - Various retention tools (e.g., rollovers, earn-outs, deferred comp, etc.) and other provisions (e.g., non-competes / non-solicits) in deals where personnel is key

Buying a private company / business: principal risks in negotiating transaction terms

- Be sure that finance, legal and accounting are carefully coordinated on the purchase price adjustment mechanism and definitions, preferably with the help of a transactions solutions specialist from a “Big 4” accounting firm. Price adjustment terms can result in significant value shifts if not properly managed
- Carefully manage retention issues, particularly where management is key
- Closing conditions can be more extensive in the private company context
- Indemnification
 - Need for special indemnities, particularly in connection with tax and environmental matters and known litigations
 - Importance of materiality scrape and indemnity limits
 - Importance of an escrow, even with a creditworthy strategic
 - R&W insurance has become a growing trend, particularly in deals with PE sellers
 - Be sure the business team understand gaps and risks before agreeing to this

Risks that can apply to both public and private deals

- Allocation of any regulatory risks to closing
 - HOHW clauses, other regulatory efforts covenants and importance of being specific (as “best efforts” does not mean what you think it means), reverse break-up fees, etc.
 - Termination date should generally be selected in a manner that leaves ample room to clear any regulatory hurdles even if base case assumes a swift period to closing
- Allocation of any financing risk, particularly in a levered strategic context
 - Financing undertakings, Marketing Period / Required Information definition and use, “reverse break-up fees” and whether the RBF is a cap in all circumstances or just in event of a financing failure, specific performance, etc.
- Preserving target business through careful negotiation of the interim covenants, and allocation of closing risk through careful negotiation of reps and warranties, closing conditions and termination rights

Shareholder activism today

Playbook of activist tactics

Least aggressive

Most aggressive

Initial engagement	Going public	Potential escalation	End game
<ul style="list-style-type: none">— Indirect banker-to-banker (or other intermediary) approach— Engage with company privately— Request meetings or phone conferences with company directors	<ul style="list-style-type: none">— Leak requests/demands to select analysts or other “influencers”— Publish a white paper— Become publicly vocal (e.g., publishing a shareholder letter, making aggressive 13D disclosure)	<ul style="list-style-type: none">— Launch a “vote no” campaign to vote against company board or committee director nominees— Propose bylaw or charter/Articles amendments to remove/replace directors— Shareholder proposal relating to activist agenda (e.g., advocating spin-off)— Use of Environmental, Social Governance (“ESG”) or similar platform to gain support for proposals/board membership— Agitate against board’s preferred strategic alternatives— Vote against board-approved M&A activity	<ul style="list-style-type: none">— Launch proxy contest – often “short slates”— Run full campaign or settle (usually involves board seat(s) for a standstill that is limited in time)— Public “bear hug” to put company in play— A few activists have ability/inclination to launch hostile offer













Evolving activist playbook

Select examples

Driving Portfolio Simplification	— Pushing for portfolio reviews and actions, including divestitures	 (Elliott)	 (Third Point)	 (Elliott)
Targeting Boards	— Targeting tenure, lack of board diversity, and misalignment between director and corporate strategy	 (Elliott)	 (Mantle Ridge)	 (D.E. Shaw / Engine No. 1 / CalSTRS)
Increasing Focus On ESG	— Incorporating ESG into campaigns to gain support and capital of large money managers whose focus on ESG has increased dramatically	<p style="text-align: center;">Latest Campaigns With ESG Demands</p> <div style="display: flex; justify-content: space-around; align-items: flex-start;"> <div style="text-align: center;">  (Elliott) </div> <div style="text-align: center;">  (D.E. Shaw / Engine No. 1 / CalSTRS) </div> <div style="text-align: center;">  (ValueAct) </div> <div style="text-align: center;">  (Third Point) </div> </div> <p style="text-align: center;">Activists With ESG-Dedicated Funds or Professionals</p> <div style="display: flex; justify-content: space-around; align-items: center;">      </div>		
Accumulating Stealth Positions	— Accumulating large stakes quickly through broker-dealers, derivatives and block trades with existing shareholders	 (Senator)	 (Icahn)	 (Starboard Value)
Retaining Financial Advisors	— Engaging financial advisors for advisory services, fundraising and stake building and lawyers, consultants and search firms to bolster credibility	 (Elliott / UBS)	 (Elliott / Greenhill)	 (Corvex / Soroban/ Moelis)
Pursuing Litigation	— Threatening / pursuing litigation to force removal of defenses, gain access to board-related materials or other demands	 (Biglari)	 (Icahn)	 (Hudson Executive)
ISS Supports Activist Campaigns	— Proxy advisors, and particularly ISS, support activists in many proxy contests	 (Land & Buildings)	 (Starboard)	 (Senator / Cannae)

Selected examples of shareholder activism

EXAMPLE OF SUCCESSFUL ACTIVISM

	Companies	Typical demands	Specific example	Activist	Outcome
Governance		<ul style="list-style-type: none"> Declassify board/remove pill Add additional independent directors Separation of Chairman/CEO position Management compensation 		GAMCO	<ul style="list-style-type: none"> Shareholders approved GAMCO's board declassification proposal
Alleged under-performance		<ul style="list-style-type: none"> Management change Specific improvement of performance metrics Operational White Papers 		Legion, Macellum and Ancora	<ul style="list-style-type: none"> Company added 4 new independent directors and agreed to explore sale of underperforming businesses
Utilize balance sheet		<ul style="list-style-type: none"> Share repurchases Special dividends 		Elliott	<ul style="list-style-type: none"> Shareholders rejected Elliott's dividend proposal
Corporate clarity		<ul style="list-style-type: none"> Separate non-core businesses Highlight value 		Elliott, Starboard	<ul style="list-style-type: none"> Company sold StubHub for \$4bn
Criticism of announced deals		<ul style="list-style-type: none"> Voting against/public criticism of announced deals 		Starboard	<ul style="list-style-type: none"> Starboard withdrew its campaign after ISS and Glass Lewis announced support for the deal
Sale of company		<ul style="list-style-type: none"> Review strategic alternatives Initiate sale process 		Icahn	<ul style="list-style-type: none"> Company sold to Eldorado Resorts for \$17.3bn

Activists' growing sophistication

- Substantial investment in target due diligence
 - Hire experienced advisors, management consultants and industry experts to supplement internal resources
- Comprehensive analysis / in-depth White Papers
 - Provide strong analytical support for their thesis
- Cultivate relationships with high-quality director candidates
 - Industry expertise, independent from activists with financial backgrounds and strong track records of creating value for shareholders
 - Often, candidates that companies would themselves view as attractive and credible
- Pursue sell-side backing and support from Long-only investors
 - Promote long-term value of campaign ideas
- Innovative mechanisms to target companies
 - Sophisticated IR / PR strategies, including increased use of new media / social media, to maximize impact with shareholder base
- Participate in take-private directly through own / affiliated private equity arm
 - Elliott Management's private equity arm Evergreen Coast Capital recently acquired Gigamon, Athenahealth and Travelport

Activists' traction with “mainstream” investors

- Large cap targets require the support of “vanilla” investors
 - Market cap is no longer a defense
 - Institutional investors (often a small number) and proxy advisory firms are usually outcome determinative
- Activists often curry “mainstream” investor support
 - Invoking corporate governance best practices in campaigns
 - Often (but not always) emphasizing longer-term operational fixes vs. short-term return of cash to shareholders
 - Seeking “influence” rather than “control” (i.e., “short slates”)
 - Running more impressive director slates per above (e.g., more than 75% of board seats won by activists in 2019 went to individuals who were not employees of or otherwise affiliated with the relevant activist)
 - This is important for the relevant issuers as the presence of these candidates is far less disruptive to the board’s proper functioning and process
 - “Taking the high road” and avoiding personal attacks or “poison pen” letters
 - Result: activists increasingly serve as a proxy for mainstream institutions and thus can punch well above their weight
- Mainstream investors are increasingly comfortable informally working with activists behind the scenes in a symbiotic relationship
 - This gives activists increasing leverage, enabling impact even with a relatively small stake
 - Mainstream investors are imposing higher standards, declining to support lazy campaigns and expecting activists to share insightful due diligence publicly

Being ready before an activist campaign begins

- Undertake a rigorous analysis of possible activist “attack vectors” (i.e., vulnerabilities) against the company
- Develop Messaging, Communication and Response Plan in light of vulnerability assessment
 - Content and detail of the Plan varies by company
- Continued communication and relationship building with shareholders are key:
 - Need to assess the company’s vulnerabilities, strengths and strategies.
 - Important on an ongoing basis to build relationships with key shareholders and communicate the company’s strategies and plans to them – both the analysts and the proxy advisory side of the institutional shareholders. (The activists are building those relationships!).
 - Develop communication plan – the company will need to respond to activist attacks, but also needs to look pro-active and not just reactive in communicating its strategies and plans and why and where the activist has it wrong.
- Maintain a response team that includes key employees, outside counsel, bankers, proxy solicitors and public relations firm and maintain a working group list
- Effective business plan and periodic board strategy discussions should identify potential issues and vulnerabilities and forestall potential shareholder activism by addressing and defusing concerns before they reach a boiling point
 - Consider an acceptable level of ongoing disclosure of “issues” under consideration to keep shareholders informed and “defuse” activists
- Watch the shareholder base – have a “state of the art” stock watch program
- Review structural defenses on at least an annual basis

Some suggestions on company response playbook when an activist emerges

- The board and management need to be fully aligned throughout the process, as the activist will be seeking to “drive a wedge” between the board and management. The board therefore needs to be fully updated and well prepared on an ongoing basis.
- **Speak as one voice through the CEO/CFO.** Avoid letting activist divide and conquer by having one-on-ones with board members or prematurely coming before the board.
- Prepare thoroughly for meetings and discussions with the activist (including responses; Q&A; and practice “role play” sessions).
 - Different companies take different approaches on core response team of internal management and outside advisers.
- For meetings/calls with the activist: the playbook and approach will need to be tailored to the stage you are at and the context.
 - Typically: engage as appropriate; think about who should attend meetings; avoid getting into confrontational back and forth; but be firm and ready to push back when the company believes its plan is right – need to show that board and management will do what is best for the shareholders overall and not be intimidated by the activist.
- Be mindful of insider trading and Reg FD limitations – absent an NDA (which most activists will decline to sign), cannot share MNPI with activists
- There is no set process. This is like a chess match and the company needs to try to change the agenda.
- In responding to an activist, for Delaware companies, the usual duties of directors of a Delaware company continue to apply

Take-private transactions

- Have proper response to inbound call ready for your senior management (see the following slides)
- Be sure that your Board and senior management are aware of their fiduciary duties and process is managed carefully with those in mind
 - Be wary of actual or perceived conflicts of interests, particularly within senior management (in particular if significant management roll-over or re-investment is contemplated)
 - Obligation to get the highest price reasonably available and not to prefer one bidder over another (e.g., cannot agree to anything that precludes possibility of competing bid or coerces shareholders)
- Manage the process throughout and identify potential conflicts early with the help of outside counsel
- Be sure that everyone knows that all material steps will need to be disclosed
- Make sure that everyone understands that the deal will be challenged in court by multiple lawsuits, and that the process will be carefully picked over by the SEC and the plaintiffs with extensive discovery of emails and other documents
- Understanding when a Special Committee is needed
- Consider how the transaction would affect the company's existing capital structure, in particular:
 - the effect on any outstanding warrants, preferred equity or convertible securities, some of which may have anti-dilution or adjustment provisions in the event of a change of control
 - the effect on any earnouts or contingent rights of the existing equityholders under the de-SPAC transaction documents

Talking points for inbound calls offering to buy the company

Chairman / CEO

- The company is not for sale.
- **If the offer is from a credible counterparty:** However, I am obligated to report your interest to the members of the Board, and I will do so.
- **Note:** Do not offer a substantive response, agree to meet or commit to a future response to the call. If pressed, state “After I have discussed this call with other members of the Board, I will be back to you if and when appropriate.” (Avoid any further conversation.)
- **Note:** It is advisable to note as precisely as possible exactly what was said during the conversation. The individual making the call will likely have been carefully scripted and thorough notes will ensure that the intended meaning is not lost.

Talking points for inbound calls offering to buy the company (cont.)

Directors and Officers

- It is not appropriate for me to discuss any potential transaction involving the sale of the company.
- The appropriate spokesperson for our company on these matters is our Chairman and CEO. You should contact him directly. (Avoid any further conversation.)
- **Note:** If the counterparty insists on delivering a particular message, note as precisely as possible exactly what the message is so that it may be promptly related to the Chairman and CEO, but do not respond or agree to respond to the message or commit the company to responding. If pressed, state “The company will be back to you if and when appropriate.”