

# Mergers and Acquisitions Update

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## Mergers and Acquisitions Update

- United Rentals, Inc. and Forthright Negotiating
- Advance Notice Bylaw Developments
- JPMorgan/Bear Stearns

# United Rentals – Factual Background

- United Rentals, Inc.
  - Largest equipment rental company in the world
  - Commenced an auction in Spring 2007
- Cerberus Partners, LP
  - Private Equity Fund
  - Formed shell entity “RAM Holdings” to acquire URI
- Merger Agreement
  - On July 22, 2007 Cerberus, through RAM Holdings, agreed to acquire URI for a transaction value of approximately \$7 billion (including refinanced debt).

# United Rentals – Financing and Guarantee

- Financing
  - \$1.5 billion Equity Commitment Letter from Cerberus
  - Debt Commitment Letter from banks to fund balance of \$7 billion purchase price
  - No third party beneficiaries to equity or debt commitment letter
  - Cerberus guarantee limited to \$100 million “reverse termination fee”

## United Rentals – Specific Performance

- Section 9.10. Specific Performance. The parties agree that irreparable damage would occur in the event that any of the provisions of this Agreement were not performed in accordance with their specific terms or were otherwise breached. Accordingly, (a) Parent and Merger Sub shall be entitled to seek an injunction or injunctions to prevent breaches of this Agreement by the Company and to enforce specifically the terms and provisions of this Agreement, in addition to any other remedy to which such party is entitled at law or in equity and **(b) the Company shall be entitled to seek an injunction or injunctions to prevent breaches of this Agreement by Parent or Merger Sub or to enforce specifically the terms and provisions of this Agreement and the Guarantee to prevent breaches of or enforce compliance with those covenants of Parent or Merger Sub that require Parent or Merger Sub to** (i) use its reasonable best efforts to obtain the Financing and satisfy the conditions to closing set forth in Section 7.1 and Section 7.3, including the covenants set forth in Section 6.8 and Section 6.10 and (ii) **consummate the transactions contemplated by this Agreement**, if in the case of this clause (ii), the Financing (or Alternative Financing obtained in accordance with Section 6.10(b)) is available to be drawn down by Parent pursuant to the terms of the applicable agreements but is not so drawn down solely as a result of Parent or Merger Sub refusing to do so in breach of this Agreement. **The provisions of this Section 9.10 shall be subject in all respects to Section 8.2(e) hereof, which Section shall govern the rights and obligations of the parties hereto (and of the Guarantor, the Parent Related Parties, and the Company Related Parties) under the circumstances provided therein.**

## United Rentals – Limitation on Liability

- Section 8.2(e). In no event, whether or not this Agreement has been terminated pursuant to any provision hereof, shall Parent, Merger Sub, Guarantor or the Parent Related Parties, either individually or in the aggregate, be subject to any liability in excess of the Parent Termination Fee for any or all losses or damages relating to or arising out of this Agreement or the transactions contemplated by this Agreement, including breaches by Parent or Merger Sub of any representations, warranties, covenants or agreements contained in this Agreement, and in no event shall the Company seek equitable relief or seek to recover any money damages in excess of such amount from Parent, Merger Sub, Guarantor or any Parent Related Party or any of their respective Representatives.

# United Rentals – Specific Performance or \$100 Million Liability Cap?

- URI argues for Specific Performance under Section 9.10
  - Section 9.10 provides that URI can specifically enforce the merger agreement and force Cerberus to close the transaction
  - First, Section 8.2(e) “sole and exclusive remedy” applies only if one of the parties terminates the agreement
  - Second, outright prohibition of equitable remedies in the last sentence of Section 8.2(e) is limited to equitable remedies that involve monetary compensation like restitution or rescission, not specific performance
  - Third, “construction of contracts requires harmonization of seemingly conflicting contract provisions” and Cerberus reading of Section 8.2(e) renders Section 9.10 “mere surplusage devoid of meaning”
  - If Cerberus wanted to eliminate specific performance they could have deleted clause (b) of Section 9.10

# United Rentals – Specific Performance or \$100 Million Liability Cap?

- Cerberus argues for capped monetary damages of \$100 million “reverse termination fee” under Section 8.2(e)
  - Section 8.2(e) provides for liquidated damages as “sole and exclusive remedy”
  - Section 9.10 is “subject to” Section 8.2(e)
  - Harmonization is not required because Delaware law permits parties to establish supremacy and subservience where provisions conflict with or nullify each other

# United Rentals – Ambiguous Merger Agreement

- Chancellor Chandler finds:
  - URI’s interpretation of the Merger Agreement is a reasonable harmonization of apparently conflicting provisions
  - Cerberus’ also presents a reasonable interpretation of terms, such as “subject to,” that impose a hierarchy among provisions of the Merger Agreement
  - The Merger Agreement is “ambiguous” as it is susceptible to at least two reasonable interpretations
  - Therefore, the court can not grant summary judgment for either party and a trial is necessary to allow the court to consider extrinsic evidence

# United Rentals – Parol Evidence and the Objective Theory of Contracts

- Where a contract is ambiguous it is appropriate to consider parol evidence
- The introduction of parol evidence does not alter or deviate from Delaware's adherence to the objective theory of contracts
- The private, subjective feelings of the negotiators are irrelevant and unhelpful to the Court's consideration of a contract's meaning

# United Rentals – The Forthright Negotiator Principle

- The Forthright Negotiator Principle
  - Where extrinsic evidence does not lead to a single, commonly held understanding of a contract's meaning, a court may consider the subjective understanding of one party that has been objectively manifested and is known or should be known by the other party
  - The Court considers evidence of what one party *subjectively* believed the obligation to be, coupled with evidence that the other party knew or should have known of such belief

# United Rentals – Parol Evidence and Forthright Negotiator Principle

- First, parol evidence of “deeply flawed negotiation” was not clear enough to conclude that there is a single, shared understanding with respect to the availability of specific performance under the Merger Agreement under this “hopelessly conflicted contract”
- Second, Court applies the Forthright Negotiator Principle to make two findings
  - Even if URI believed the Merger Agreement preserved a right to specific performance, URI’s attorney categorically failed to communicate that understanding to Cerberus during the latter part of the negotiations
  - Although Cerberus could have easily avoided this dispute by deleting Section 9.10(b) from the Merger Agreement, its attorney did communicate to URI his understanding that the Agreement precluded any specific performance rights

# United Rentals – No Specific Performance

- Applying Forthright Negotiator Principle, Court finds that URI knew or should have known that Cerberus believed specific performance was not available under the Merger Agreement and, if URI disagreed with that understanding, it had an affirmative duty to clarify its position in the face of an ambiguous contract with glaringly conflicting provisions
- Because it failed to meet its burden of demonstrating that the common understanding of the parties permitted specific performance of the Merger Agreement, URI's petition of specific performance is denied
- URI subsequently accepts \$100 million break fee from Cerberus as sole and exclusive remedy for failing to consummate merger at \$34.50 per share
- URI stock price today is approximately \$19 for an equity market capitalization of \$1.64 billion

# United Rentals – Lessons for Future Transactions

- Clear drafting
  - Consider deleting unnecessary language rather than relying on a complicated waterfall of “subject to” and “notwithstanding anything to the contract” provisions
  - With clear drafting there is no need for parol evidence
- Focus on what you say in addition to what you draft
  - While the Merger Agreement was ambiguous, counsel for Cerberus was clear that “the deal” was no specific performance while counsel for URI was initially vocal that specific performance was a critical aspect of the construct for the transaction but later dropped the point in discussions
- Private Equity Buyers and Specific Performance

# Advance Notice Bylaws Generally

- Generally, absent any restriction in the Bylaws, a shareholder may nominate directors or present other business at the shareholder meeting without prior notification to the Company or its shareholders
- Advance notice bylaws are permitted in Delaware (and Pennsylvania) so long as generally reasonable
- Court's are deferential to the shareholder franchise and the right of shareholders to nominate dissident directors or bring business before a meeting but also recognize the legitimate interest of the Company in running an orderly meeting with informed shareholders

## Advance Notice Bylaws – Rule 14a-8

- Rule 14a-8 provides a mechanism for shareholders to access the Company's proxy statement
- Cost of soliciting proxies is a significant deterrent to bringing business before a meeting or nominating directors
- Rule 14a-8 proposals limited by SEC and cannot “relate to election” or the company’s “ordinary business operations,” among other things
- Rule 14a-8 proposals often relate to “good governance” issues (poison pill, separated chairman/CEO, majority voting for directors) or “social issues” (Darfur, environmental concerns)

## Advance Notice Bylaws – Jana v. CNET

- CNET is an interactive media company that owns cnet.com, news.com, gamespot.com, zdnet.com, urbanbaby.com and other Internet assets
- Jana owns 11% of CNET outstanding common stock and is dissatisfied with poor financial performance
- CNET has a staggered eight member board with two members up for election
- Jana launches hostile proxy contest to replace two current directors, expand the board from eight to thirteen and nominate five directors to fill the newly created positions

# Advance Notice Bylaws – Jana v. CNET

- CNET Advance Notice Bylaw
  - Shareholders “may seek” to transact other corporate business at the annual meeting
  - Must own \$1,000 of securities for at least one year
  - Written notice mailed and received at least 120 days in advance of the date of the proxy statement released in connection with the previous year’s annual meeting
  - Such notice must also comply with any applicable federal securities laws establishing the circumstances under which the Corporation is required to include the proposal in its proxy statement or form of proxy

# Advance Notice Bylaws – Jana v. CNET

- Jana argues that the bylaw only applies to nominations and proposals made under Rule 14a-8
  - Because Jana intends to independently finance its own proxy materials to directly solicit from shareholders, the bylaw is inapplicable
- Second, Jana suggests that if the bylaw is read to apply it is invalid under Delaware law as an unreasonable restriction on the shareholder franchise
- CNET argues that, by its terms, the bylaw is not limited to 14a-8 proposals serves a reasonable corporate purpose

# Advance Notice Bylaws – Jana v. CNET

- The Court recognizes that Delaware courts have permitted such bylaws but has warned that when advance notice bylaws unduly restrict the stockholder franchise or are applied inequitably they will be struck down
- In a surprising decision the Court finds that the bylaw applies solely to proposals and nominations that are intended to be included in the company's proxy materials pursuant to Rule 14a-8
  - First, notion that the stockholder “may seek to transact other corporate business” does not make sense outside of 14a-8 context because shareholders do not generally need permission to transact business at an annual meeting
  - Second, deadline referring to prior year proxy statement implies that the bylaw applies only to proposals that a shareholder wants to include in management's proxy statement
  - Third, and most importantly, explicit reference to “federal securities laws” in the final sentence of the bylaw makes clear that the scope of the bylaw is limited to Rule 14a-8 proposals

## Advance Notice Bylaws – Levitt v. Office Depot

- Office Depot is a global supplier of office products and services
- Levitt, historically a real estate development company, looks to expand its range of investments and owns just over 1% of Office Depot outstanding common stock
- Citing “performance problems,” Levitt seeks to nominate a “short slate” of two directors to serve on the twelve member Office Depot board

# Advance Notice Bylaws – Levitt v. Office Depot

- Office Depot Advance Notice Bylaw
  - Notice required not less than 120 calendar days before the date of the Company’s proxy statement released to shareholders in connection with the previous year’s annual meeting
  - Unusual in that it restricts bringing business before the meeting but does not explicitly limit the ability of shareholders to nominate directors at the meeting

# Advance Notice Bylaws – Levitt v. Office Depot

- Levitt argues that the Advance Notice Bylaw does not restrict Levitt’s ability to nominate directors
  - First, there is no express advance notice restriction on director nominations, only on “business”
  - Second, the term “business” does not clearly and unambiguously include the nomination of directors
  - Third, in the alternative if the term “business” does include director nominations, no notice is required because Office Depot has already properly made director nominations an item of business before the Annual Meeting through the proxy statement’s general reference to the election of directors
  - Fourth, if applicable, the 120 day notice requirement prior to the proxy statement date is unreasonably long

## Advance Notice Bylaws – Levitt v. Office Depot

- Court notes that, under Delaware law, no advance notice of a stockholders intent to nominate directors at an annual meeting need be given unless the corporation has imposed such a requirement
- Court agrees with Office Depot that restriction on “business” includes the nomination of directors
- Court considers whether the “business” of electing directors, as set forth in the proxy statement, includes the subsidiary business of nominating directors for election
- Court agrees with Levitt – having properly brought the business of electing and nominating directors before the annual meeting through the proxy statement, the Office Depot board cannot prevent Levitt from nominating candidates for election at the meeting

# Advance Notice Bylaws - Lessons

- Jana case was appealed to the Delaware Supreme Court
- Companies should consider modifications to the bylaws to clarify that advance notice bylaws are not limited to Rule 14a-8 shareholder proposals
- If advance notice bylaw is limited to “business” companies should amend bylaws to expressly include nominations
- Modernization of advance notice bylaw – consider requiring disclosure regarding ownership of derivative positions in the company

# JPMorgan and Bear Stearns – Background of the Merger

- During the week of Monday March 10, Bear Stearns, facing a “run on the bank” and potential bankruptcy, entered into discussions with regulators regarding liquidity concerns
- On the evening of Friday March 14<sup>th</sup> the Fed informed Bear that it was pulling a secured lending facility agreed to earlier that day
  - Bear needed to enter into a deal before Monday morning or faced potential bankruptcy
- “Bidder A”, reported to be private equity group J.C. Flowers & Company, did not receive Fed support and could not finance a transaction
- JPMorgan lowered initial \$10 to \$12 range to \$2

# JPMorgan and Bear Stearns – Fed and JPMorgan Guarantees

- Fed guarantee of a \$30 billion line of credit secured by Bear assets
- JPMorgan guarantee of Bear obligations extending for one year, even if Bear shareholders voted down the deal
  - JPMorgan power to direct Bear operations in its reasonable discretion
- If Bear shareholders voted down the deal, Merger Agreement provided for renegotiation and revoting for a one year period
- Crown jewel provision – Option to purchase Bear headquarters for \$1.1 billion

# JPMorgan and Bear Stearns – Renegotiated Deal

- Price increased from \$2 per share to \$10 per share (currently trading at approximately \$10.50)
- Initial JPMorgan option for 19.9% of Bear rescinded in exchange for option to purchase 39.5% of Bear
- JPMorgan guarantee terminates 120 days following a no vote by Bear shareholders
- On March 24, JPMorgan acquired another 8.9% of Bear at \$12.24 per share
- JPMorgan 13D filed earlier this week reports ownership of 49.73% of Bear

# JPMorgan and Bear Stearns – NYSE Issue

- New option for 39.5% of Bear outstanding common stock
- NYSE Rule 312
  - Requires shareholder approval for issuance of 20% of the voting power of a listed company
  - NYSE Enforcement – Delisting
  - Exception when “(1) the delay in securing stockholder approval would seriously jeopardize the financial viability of the enterprise and (2) reliance by the company on this exception is expressly approved by the Audit Committee of the Board.”
  - NYSE approved the 39.5% issuance

# JPMorgan and Bear Stearns – Litigation

- Omnicare and Delaware Law
  - Agreement from over 50% of the shareholders to vote for the transaction
  - Force the vote provision requiring a shareholder vote regardless of whether the Board changes its recommendation of the deal
  - No fiduciary out ability to terminate the merger agreement
- Completely Locked-up Deal violates Unocal
  - Enhanced scrutiny of defensive measures
    - reasonably grounds for believing there is a danger to corporate policy and effectiveness
    - defenses must be reasonable in relation to the threat posed
  - Predetermined outcome is preclusive and coercive

# JPMorgan and Bear Stearns – Litigation

- Orman v. Cullman (General Cigar)
  - Limited Omnicare where there was a majority of the minority requirement and an 18 month bar on other deals through majority voting agreement
- Force the Vote
  - Bear Stearns Board can change recommendation but must hold shareholder vote
  - Loss of JPMorgan and Fed guarantees
  - Unlikely that Bear Stearns would find a superior alternative without Fed involvement

# JPMorgan and Bear Stearns – Litigation

- Class Action Lawsuits filed in New York and Delaware
- On April 9<sup>th</sup>, Delaware stayed proceeding in deference to New York litigation
- Plaintiffs Arguments
  - Merger Consideration is too low and the merger process was unfair
  - Bear Stearns directors breached their fiduciary duties
  - Option sale preclusive and coercive