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Q&A

Stamas Says Exelon Takeover Shows How Deals Can Make Sense to Regulators

George P. Stamas, a partner in the Washington and New York offices of **Kirkland & Ellis LLP**, represented Baltimore, Maryland-based Constellation Energy Group Inc. on its $10.2 billion takeover by Exelon Corp., the largest U.S. nuclear operator, completed last month. That came six years after he advised Constellation on its $16.3 billion sale to FPL Group Inc. (now called NextEra Energy Inc.) – a deal that collapsed in the face of political and regulatory resistance in Constellation's home state of Maryland. Stamas worked with SRA International Inc. on its buyout by Providence Equity Partners LLC for $1.37 billion. He has also advised clients on major sports franchise transactions, including a recent bidder for the Los Angeles Dodgers, and acquired small stakes in the Baltimore Orioles, Washington Wizards and Washington Capitals as a byproduct of his legal work. He spoke with Will Robinson about his deals.

Q: We saw a lot of power industry consolidation in the first half of last year followed by a slowdown. Then the Duke Energy-Progress Energy deal was delayed due to federal regulators in December. Will that have a chilling effect on other deals?

A: People recognize that the FERC is taking up a much more activist stance than it had before, and that's certainly the FERC's prerogative and one has to live with it in the regulatory environment. But Constellation-Exelon is the leading example of how a very complementary deal that makes sense will be recognized by the regulators.

From a purely legal standpoint, I think it was important to both Constellation and Exelon to create a deal that was as binding as possible within the limits of the law. You obviously can't tie up deals, but look at the size of the breakup fees in this transaction in circumstances where either board decided that for fiduciary reasons it that it needed to change its recommendation to its shareholders.

The size of the breakup fee that was being paid would be in the case of Exelon $800 million, and rest assured it raised eyebrows. It was certainly within legal bounds, but it was very much meant to demonstrate it was on the high end.

We also had to think about how the nuclear crisis in Japan, which occurred one month before we signed this deal, could impact the deal. We strategized very carefully and thought through how and whether some of the unintended consequences of the Japan nuclear crisis could or should be addressed by a condition to closing of the transaction. The resolution ultimately was not to address the situation in a specific way in the closing conditions. With respect to each of the closing conditions, we had to balance carefully the tension between having some that were tighter – to protect against undue risk – and some that were more flexible – to promote a closing despite the chance of greater risk.

Q: How did the federal regulatory approval process play out?

A: In Washington, Exelon and Constellation broadly speaking are viewed favorably by regulators.

Dodd-Frank and other regulations have created collateral requirements in the hedging businesses that meant that Constellation really did need to have a bigger partner – it needed a bigger balance sheet. When you are in the business of commercial and retail and you are taking the risks of delivering forward energy to your customers, you've got to have a balance sheet to back that up.

I don't think that agencies necessarily talk to each other, but there is a climate of cooperation that is important overall cutting across the SEC, the CFTC, the NRC and FERC, and I believe Exelon and Constellation were, and going forward will be, viewed as good corporate citizens.

Q: What were the key issues when you were advising on the sale of SRA, where the founder-chairman, Ernst Volgenau, owned 71 percent of its voting stock?

A: For several years, the Delaware courts have been very critical of undue influence by controlled shareholders in transactions, and properly so. When you have taken advantage of the public markets and you have a broad, diverse shareholder base, one must maximize shareholder value. One must do that particularly where you have controlling shareholders and do that in as transparent way as possible. The good thing in the case of SRA is that the controlling shareholder abided by that and encouraged that from day one. We had a special committee that was clearly empowered to take the deal forward without undue influence from Ernst.

We conducted an auction and our timing was very good. We had a number of players who were very interested.

The second legal challenge there was that a number of those players were our competitors. The question became how much information were you providing about your business to the very competitors who are out there every day. On the one hand, you need to show them enough to keep them interested. On the other hand you're not so sure that you can rely entirely on confidentiality agreements and the like. We had to very carefully pick and choose through a very lengthy auction process what we were going to give and how we were going to give it.

The third challenge we had in that transaction was leaks. One of the potential bidders in the middle of the process – [Serco Group Plc, a British defense contractor] – issued a press release saying that they were no longer interested in buying us. Well, the world wasn't aware that we were even for sale. That became a very interesting disclosure challenge from a legal standpoint.

We had to disclose that we were in discussions about a potential transaction but there could not be any assurances as to where it would go. We recognized as well that we would have to start to move very quickly.

Q: Were there a mix of private equity and strategic bidders interested?

A: There was a lot of interest on both sides.

A fourth issue was whether, from a legal standpoint, you sign up a deal fairly early in the process with one of the bidders and then have a go-shop process. Or, do you try to conduct an auction to get further down the line before agreeing to a deal. There's a general view that strategic bidders are not prepared to chase a deal in a go-shop once it has been announced.