

KIRKLAND M&A UPDATE

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Are All MOEs Created Equal?

“Merger of equals” is a phrase that is thrown around in deal negotiations and disclosures often without a full appreciation of its meaning, or lack thereof.

With valuations stabilizing and the M&A market heating up, a rebirth of stock-for-stock deals, after a long period of dominance for all-cash transactions, may be in the offing. If this happens, we expect to see renewed use of the term “merger of equals” (MOE) to describe some of these all-equity combinations. As a starting point, it may be helpful to define what an MOE is and, equally important, what it isn’t. The term itself lacks legal significance or definition, with no requirements to qualify as an MOE and no specific rules and doctrines applicable as a result of the label. Rather, the designation is mostly about market perception (and attempts to shape that perception), with the intent of presenting the deal as a combination of two relatively equal enterprises rather than a takeover of one by the other. That said, MOEs generally share certain common characteristics. First, a significant percentage of the equity of the surviving company will be received by each party’s shareholders. Second, a low or no premium to the pre-announcement price is paid to shareholders of the parties. Finally, there is some meaningful sharing or participation by both parties in “social” aspects of the surviving company.

While each of the aspects of an MOE deal will fall along a continuum of “equality” for the shareholders of each party, there are a handful of key issues that require special attention in an MOE transaction:

Social Issues — In pursuit of parity, much time is spent debating and then implementing governance and “people” issues that often do not require similar attention in a true takeover. Among other matters, the parties will need to agree on the name of the combined enterprise, the location(s) of its headquarters, the allocation of board and board committee seats and officer positions, community commitments, retention programs, and allocation of synergistic workforce reductions. In addition, the intended duration and durability of these arrangements will be negotiated, but dealmakers should note that there are challenges inherent in enforcing “social” covenants when there is no longer a separate corporate entity to sue if commitments are breached. The recent controversy surrounding the *Duke/Progress Energy* MOE, where the agreed post-closing CEO from Progress was dismissed minutes after closing by the board which had a small majority of directors from Duke, highlights these challenges. Although awkward to raise while trying to negotiate a happy “marriage”, there are mechanisms designed to enhance the continuity of post-closing arrangements by, for example, enshrining them in organizational documents, requiring super-majorities to change, or even creating a standalone trust that oversees compliance with the covenants (nominally for the benefit of the former stakeholders of the absorbed enterprise). That said, parties to an MOE should balance the desire to preserve their interests with respect to “social” issues (which may have the undesirable effect of perpetuating an “us vs. them” mentality) against the business objective of promptly integrating two enterprises and cultures.

Change of Control — Parties to an MOE will need to pay careful attention to whether change-of-control or similar provisions are triggered under contracts of one or both parties, including debt instruments, benefits plans, licenses, equity awards and employment agreements. In addition to analyzing potential negative consequences, special consideration will need to be given to possible disparities that may result from benefits being triggered on one side of the transaction but not the other. On occasion, we have seen creative use of legal structure (e.g., a “double dummy” or the smaller company being the nominal acquirer) to mitigate or avoid undesirable consequences with respect to these issues. Creative structuring should be handled delicately so as not to create the perception that the deal is an acquisition as opposed to an MOE.

Shareholder Vote/Fiduciary Issues — An MOE will almost invariably require approval by shareholders of both parties. Therefore, the MOE transaction can put one or both companies “in play”, with the particular risk of

an all-cash premium bid topping an all-stock deal struck at or near the market price. While both sides must retain the ability to change their recommendation in appropriate circumstances (with resulting consequences), most MOEs, as all-stock transactions, are subject to tighter deal protections than comparable takeovers. For example, MOEs regularly include explicit “force the vote” provisions (i.e., the parties are required to take the MOE to their shareholders even if a board changes its recommendation following the receipt of a topping bid) in lieu of a fiduciary termination right. These voting and fiduciary provisions are often intensely negotiated in an MOE and the inherent mutuality of an MOE contract requires dealmakers to think through the various consequences of the provisions differently than in a standard acquisition (where they are typically one-sided).

Consideration — In an MOE, it is typical that the consideration is struck as a fixed exchange ratio at signing. This is thematically consistent with the overall picture of a long-term combination as opposed to a premium exit event for shareholders of one party. Similarly, regular dividend timing and amounts are often harmonized at signing, again in the interest of fostering economic equivalency through closing and beyond. Occasionally, in the interest of striking a desired balance in the closing equity allocation, one of the parties will pay a special pre-closing dividend (or receive a relatively small cash component in the merger consideration) to reduce its equity value to conform to the desired allocation. In addition, while often meant to describe a low or no premium stock-for-stock combination of two companies with reasonably balanced value going into the transaction, parties will sometimes instead use the MOE term to highlight the post-closing relatively balanced ownership received by shareholders of the two parties even if the pre-deal values are comparatively unequal. As was the case in the *Sirius/XM* combination, the term can be used to camouflage a premium being paid to the smaller party.

Agreements — Deal documents in MOEs reflect a high degree of reciprocity in legal terms. Representations and warranties, interim operating covenants, financing covenants, deal protections, break-up fees, etc. are largely identical for both parties. Unsurprisingly, allocation of antitrust and regulatory risk is a key negotiating point because, as a baseline matter, stockholders of both parties will suffer the economic consequences of remedies in proportion to their equity allocations. Also, in light of the fact that MOEs inherently involve companies of similar size in the same industry, generally leading to greater regulatory scrutiny, parties to an MOE often need to prepare for a relatively long period between signing and closing. As with any deal that involves a lengthy pre-closing period, the incentives of the parties to an MOE may shift over time, which may be exacerbated by the absence of a premium in an MOE context. Although not every contingency can be anticipated, dealmakers should be aware of this dynamic as it has implications for a number of key contractual provisions.

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“Merger of equals” is a phrase that is thrown around in deal negotiations and disclosures often without a full appreciation of its meaning, or lack thereof (as was laid bare in the acrimonious litigation over the *Daimler/Chrysler* combination). Even though the term may not hold specific legal meaning or carry specific legal consequences (in the words of the then-CEO of Daimler, the term was used only for “psychological reasons”), dealmakers should be aware that use of the label may create certain expectations for parties, shareholders and the market generally, including a certain degree of parity in the contract, economic terms and “social” issues. A careful review of the terms of a self-styled MOE transaction may show that the deal is less “equal” than the name might imply.

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