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Q&A

Part-Stock Bids, Reverse Break Fees Back in Vogue, Latham's Gerstein Says

As equity markets stabilize, bids with a stock component are becoming more attractive, says **Mark Gerstein**, a partner and global chair of the mergers and acquisitions group at **Latham & Watkins LLP**. Gerstein, who is based in Chicago, spoke with Will Robinson about recent deal work, including his role advising **Energy Transfer Equity LP** on its deal to buy pipeline operator **Southern Union Co.** and the subsequent bidding war with **Williams Cos.**, that ended with ETE paying $5.5 billion. He also represented Illinois utility **Nicor Inc.** on its takeover by **AGL Resources Inc.**, the owner of Atlanta's natural-gas utility.

Q: What was unique about the deal work you did for Nicor on its takeover by AGL?

A: It was a situation in which there were initially a number of bidders but you couldn't determine who was real--where a board had to sit down and be very thoughtful about a notionally higher proposal not being as valuable as the certain and notionally lower proposal. The board was proved right here. The stock currency turned out to be far more valuable at the end of the day.

That was also a strategic-to-strategic transaction with a significant cash component that looked like a private equity transaction in terms of financing termination right in bidder and reverse termination fee structure. If AGL's funding didn't come in due to failure of bank to fund, they could terminate and pay Nicor a substantial fee. There were probably a half dozen strategic transactions that looked like that in 2010 or 2011.

Q: Are you seeing that private equity-like structure more often in deals between two corporate players?

A: Because of 2007 and 2008 financing failures, boards of directors at bidders weren't comfortable going naked and simply committing to buy the company without a financing condition because they were concerned about, "What if my banks folds? What if it walks away? Then I'm bankrupt and I can't pay for the target." It was a combination of the targets wanting cash as opposed to stock, or cash and stock as opposed to just stock, and bidders being unable to bet their entire company on their bank coming to the table with the money when the deal was ready to close. It's derivative of the private equity model that emerged in 2006 and 2007. Private equity sort of plowed that ground. That's what really led to it in 2009 and 2010.

I think you'll continue to see that with companies. They're doing significant cash deals and can't do them clearly off their balance sheets. I think the technology is pretty well accepted in the marketplace now. I think target boards will always resist it. They strongly prefer the certainty. Nicor is a good example of where the transaction was strong enough and the circumstances in which AGL could walk away because the financing failed were so narrow that you basically provided Nicor with a high degree of certainty. For AGL, you assuaged their directors' nightmare concern about the financing source failing.

> *"The challenge with the poison pill right now is that the most significant threat to intelligent long-term management of the corporation for the shareholders' interest is activist hedge funds, who rarely acquire over 10 percent."*

Q: What were the biggest takeaways from the ETE-Southern Union deal?

A: Stock and cash bids can still be a strong currency, opposite a cash bid, particularly where people see upside in the stock. I'm not sure that's something people thought two or three years ago, particularly during the downturn, but that seems that was clearly the lesson of ETE. A stock-cash mix was persuasive.

The Credit Suisse and Latham teams worked together incredibly well on both strategic and financing fronts to allow our client to move extraordinarily quickly every time Williams moved. That, more than anything else, is probably what enabled this. The bankers at CS were very creative. They put their balance sheet behind our bid. We often moved ahead of Williams' bidding. Normally, if you're the primary bidder you wait for the other guy to top you and sign up the agreement. Or, you wait for the target to tell you there's a superior proposal and then you go in and say I'm going to top that. We moved preemptively every time when Williams sought to top and that was very effective.

Q: How was your client ETE able to win out over Williams?

A: A large part of how we won that deal is we also eliminated conditionality in a way that Williams couldn't. We went without financing condition or termination right on a deal where, if the commitments weren't honored, we would've not had the money. That took both a strong commitment from Credit Suisse and a lot of thoughtful documentation in the merger agreement and the finance agreements back to back. It wasn't as if this was a reverse termination fee structure. We were bound to close.

Similarly, on the antitrust side there was a much higher degree of difficulty for Williams to close that transaction from an antitrust perspective than we had. We went both on antitrust and regulatory pretty

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much fully committed with very limited ability to walk away. Antitrust was hell or high water, regulatory was pretty close to that. We couldn't have done it without a high level of confidence in the Latham antitrust team's analysis and equally strong confidence in our regulatory colleagues. The certainty on those fronts both gave the board comfort that we could compete with a fully financed bid relative to what was presumably an all-cash bid with limited financing from Williams. It also gave us a leg up versus Williams, who had some significant antitrust issues they would've had to overcome to close the deal.

Q: What trends are you seeing in the use of poison pills?

A: The vast majority of companies when their pills are expiring do not renew them now. They put them on the shelf, which effectively means they prepare the board of directors for the eventuality that a rights plan might need to be put in place. The challenge with the poison pill right now is that the most significant threat to intelligent long-term management of the corporation for the shareholders' interest is activist hedge funds, who rarely acquire over 10 percent. You've got a few out there that do that, but not many. A pill that's at 10 or 15 percent can be limited as a utility if you're dealing with a single entity.

The SEC has not moved aggressively enough – and frankly has not kept pace with its peers in my view in Europe – in terms of capturing the more clearly coordinated activities among funds that aren't captured by the definition of group under the Williams Act.

Where we're seeing rights plans going right now is really two-fold. The first is because really following the J.C. Penney situation, boards are much more carefully monitoring share transactions and noise in the marketplace. We're finding them much more willing to drop a rights plan in when there's rumbling rather than wake-up and find out that Pershing [Square Capital] owns 22 percent of their shares. It's sometimes hard to get boards to do that because they have this inclination it's the wrong thing to do to put a rights plan in place. But you talk to any director who has been through a takeover fight and one of the first things they'll tell you is, "We're glad we had the pill." It gives them leverage to work out what's best for shareholders.

Our rights plans all now include triggers for derivative interests. I think you will continue to see that be the case as people implement rights plans going forward because that aspect of the market is really where the action is.

Q: How much of your time are you spending with conflict of interest issues related to investment banks?

A: I think our banking clients are sensitive to both the legal and perception issues associated with conflicts of interest. They were before and it's obviously been a heightened sensitivity following the Del Monte and Kinder Morgan decisions.

I think boards of directors are certainly pressing us as board counsel to ask more directly about the relationships that the bankers have with bidders in an auction, counterparties to the transaction and presumably following Kinder Morgan, although I haven't been asked yet, "Does my banker own any stock in any party to the transaction?"

I think you'll see boards of directors and special committees asking a lot more questions so that they can be comfortable at the end of the day that the relationships that exist aren't going to create a conflict. I think that's probably the right answer as to where it ought to go. There's no one-size-fits-all regulation on this front, but the boards have always been sensitive to it and they're even more sensitized to it now.

DEAL ARBITRAGE

TARGET	ACQUIRER	DEAL SIZE ($M)	ANNOUNCED DATE	EXPECTED COMPLETION DATE	OFFER PER SHARE	ANNOUNCED PREMIUM IN %	LAST TARGET PRICE	CURRENT PREMIUM %	SPREAD	LAST SPREAD MOVE
AboveNet Inc	Private	2,147	03/19/12	06/30/12	84.00	18.32	83.11	1.07	0.89	0.29
Astral Media Inc	BCE Inc	3,157	03/16/12	-	50.00	37.22	48.32	3.48	1.68	0.03
CVR Energy Inc	Icahn Enterprises LP	1,914	02/16/12	04/02/12	30.00	15.38	26.77	12.07	3.23	-0.71
Georgia Gulf Corp	Westlake Chemical Corp	1,853	01/13/12	-	35.00	75.48	33.46	4.60	1.54	-0.17
Goodrich Corp	United Technologies Corp	17,975	09/21/11	06/30/12	127.50	43.57	124.95	2.04	2.55	0.15
Illumina Inc	Roche Holding AG	5,386	01/25/12	03/23/12	44.50	33.73	50.46	-11.81	-5.96	-0.24
Medco Health Solutions Inc	Express Scripts Inc	34,322	07/21/11	-	71.50	30.72	68.49	4.39	3.01	0.09
Motorola Mobility Holdings Inc	Google Inc	9,813	08/15/11	-	40.00	72.94	39.26	1.88	0.74	0.01
Novellus Systems Inc	Lam Research Corp	2,831	12/14/11	06/30/12	49.30	32.57	48.86	0.90	0.44	0.08
Provident Energy Ltd	Pembina Pipeline Corp	3,963	01/16/12	-	11.73	27.84	11.69	0.38	0.04	-0.01
Quest Software Inc	Private	1,860	03/09/12	09/30/12	23.00	12.55	24.02	-4.25	-1.02	0.03
RSC Holdings Inc	United Rentals Inc	1,912	12/16/11	06/30/12	22.32	59.76	22.22	0.44	0.10	-0.04
Solutia Inc	Eastman Chemical Co	4,501	01/27/12	06/30/12	28.15	49.82	27.81	1.21	0.34	-0.03
Southern Union Co	Energy Transfer Equity LP	9,331	06/16/11	03/27/12	43.36	48.34	42.40	2.28	0.96	0.15
Taleo Corp	Oracle Corp	1,838	02/09/12	06/30/12	46.00	24.73	45.93	0.15	0.07	-0.01
Thomas & Betts Corp	ABB Ltd	3,867	01/30/12	06/30/12	72.00	26.88	71.65	0.49	0.35	0.05
TMX Group Inc	Maple Group consortium	3,732	05/13/11	03/30/12	50.00	24.77	44.66	11.96	5.34	1.06
Viterra Inc	Glencore International PLC	7,432	03/20/12	07/31/12	16.25	33.41	15.91	2.14	0.34	0.00
Vulcan Materials Co	Martin Marietta Materials Inc	7,474	12/12/11	05/18/12	43.79	17.14	44.16	-0.83	-0.37	0.22
Zoll Medical Corp	Asahi Kasei Corp	1,967	03/12/12	06/30/12	93.00	26.46	92.75	0.27	0.25	-0.02

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