

The Coffee War – An Overview of Public Company M&A

Transactional Webinar

February 2013

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This presentation provides a high level overview of the public M&A process while highlighting select areas of interest

It does NOT...

- explain the basics of M&A transactions
- address issues arising in the context of related party or going private transactions
- examine issues that are present in both public and private M&A transactions
- cover hostile M&A transactions

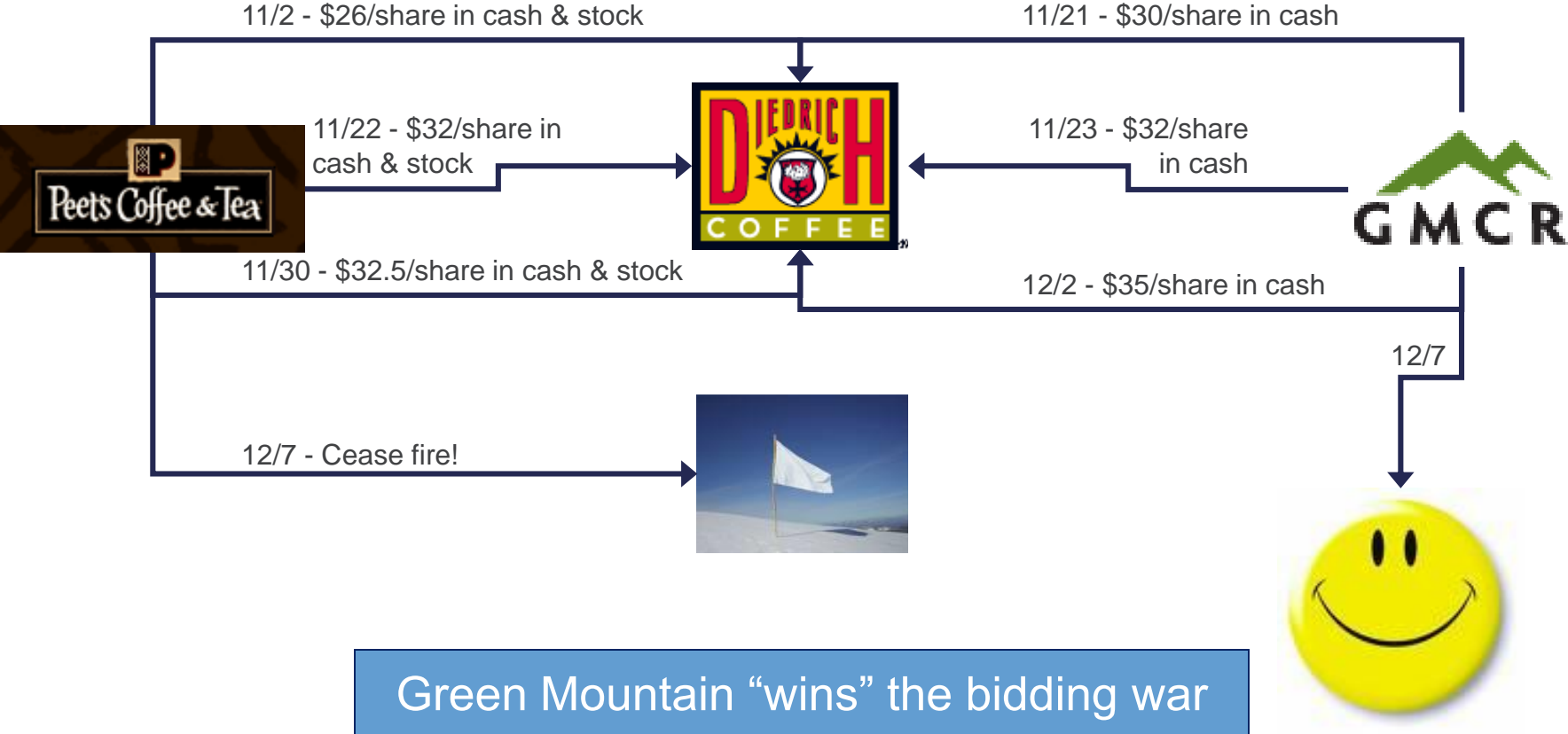
II. The Coffee War

The Players



II. The Coffee War

The War



Green Mountain "wins" the bidding war

Due Diligence

Public Information:

- Availability of public information facilitates preliminary due diligence
- Rule 10b-5 enhances buyer confidence in data, particularly financial statements
- Enables preparation of target defensive profile
- Permits evaluation of shareholder base

For example, Diedrich public filings indicate:

- Target is a Delaware corporation
- Little long-term debt
- Credit Agreement does not restrict changes in control
- Limited exposure to ongoing litigation
- Sequoia Enterprises, LP (controlled by target's Chairman) beneficially owns 58% of the stock



Due Diligence

FCPA Diligence:

- The US Foreign Corrupt Practices Act prohibits bribery payments to foreign government officials and requires public companies to maintain detailed accounting records and adequate internal controls
- DOJ and the SEC expect pre-acquisition FCPA due diligence to be conducted
- Failure to conduct due diligence may be viewed as “willful blindness”
- Buyer will be directly liable for post-closing conduct and may be directly liable for pre-closing conduct
- Target will remain liable for pre-closing conduct



Due Diligence

- The HSR Act, Clayton Act and Sherman Act require that parties to an M&A transaction remain and act like separate entities – and continue to compete – during the pre-closing HSR review process
 - Sherman Act violations expose companies to treble damages claims
- Particular caution is required for “horizontal” transactions
- Pre-closing exchanges of competitively sensitive information and coordinated activities can raise gun-jumping concerns
- Avoid exposure by:
 - designating and insulating a deal team
 - limiting communications regarding pricing, production plans, customers or other competitively sensitive topics to situations where there is a self-evident, deal-related reason for doing so
 - in an all-cash acquisition, ensuring no competitively sensitive information regarding buyer flows to target
 - where appropriate, using a third party to collect and analyze competitively sensitive information

Due Diligence

Employee CIC Rights:

- Public company employees are often parties to agreements, or participants in compensation plans, that provide them with rights triggered by changes in control of the company
 - Rights may include accelerated vesting of equity awards, cash payments or other benefits
 - Parties must consider dilutive effect of equity grants and accelerations
 - Buyers should determine whether additional employee retention incentives will be needed
- Each of Diedrich's CEO and CFO is a party to agreements that provide for (i) immediate vesting and exercisability of all stock options held by him upon a change in control and (ii), if his employment is terminated other than for cause following a change in control, a lump sum cash payment equal to his full annual salary or nine months of his salary, respectively



Target Director Fiduciary Duties

Public company directors are not free to engage in any transaction they choose, but must instead make decisions and take actions consistent with their fiduciary duties, as prescribed by the company's state of incorporation

Delaware Fiduciary Duties:

- Duty of Loyalty
 - Conflicts of interest
 - Good faith
 - Oversight
 - Candor
- Duty of Care
 - Business Judgment Rule
 - Informed action
 - Gross negligence
 - Inaction

Target Director Fiduciary Duties



Delaware Standards of Review in M&A Transactions:

- **Business Judgment Rule** – for a decision to remain independent or to approve a transaction not involving a sale of control
- **Enhanced Scrutiny** – for a decision to adopt or employ defensive measures or to approve a transaction involving a sale of control
- **Entire Fairness** – for a decision to approve a transaction involving management or a principal stockholder or for any transaction in which a plaintiff successfully rebuts the presumptions of the business judgment rule

Target Director Fiduciary Duties

Delaware Standards of Review in M&A Transactions:

- **Enhanced Scrutiny** – for a decision to adopt or employ defensive measures or to approve a transaction involving a sale of control
 - **Revlon Duties** – In *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, the Delaware Supreme Court imposed an affirmative duty on boards to seek the highest value reasonably obtainable to the stockholders when a sale of the company becomes inevitable
 - **The Board's Consideration** – “When a board addresses a pending takeover bid it has an obligation to determine whether the offer is in the best interests of the corporation and its shareholders.” (*Unocal Corp. vs. Mesa Petroleum Co.*)

Target Director Fiduciary Duties

M&A Transaction Process:

Matters Considered:

- In assessing the bid and the bidder's responsibility, a board may consider, in addition to value:
 - the adequacy and terms of the offer
 - its fairness and feasibility
 - the proposed or actual financing for the offer, and the consequences of that financing
 - questions of illegality
 - the impact of both the bid and the potential acquisition on other constituencies, provided that it bears some reasonable relationship to general shareholder interests
 - the risk of nonconsummation
 - the basic stockholder interests at stake
 - the bidder's identity, prior background and other business venture experiences and
 - the bidder's business plans for the corporation and their effects on stockholder interests

Target Director Fiduciary Duties

M&A Transaction Process:

Being
Adequately
Informed:

- Engaging financial advisors
 - Addressing the value of a corporation generally entails obtaining investment banking advice
 - The analysis of value requires the “techniques or methods which are generally considered acceptable in the financial community. . . .” (*Weinberger v. UOP, Inc.*)
 - Fairness opinions are not required (*Smith v. Van Gorkom*)
 - In practice, however, investment banking advice is typically obtained for a decision to sell and often for a decision not to sell
 - Reliance by the target board on expert advice to reach a decision provides strong support that the board acted reasonably (See *Goodwin v. Live Entertainment, Inc.*)
- Diedrich engaged Houlihan Lokey as its financial advisor and received an opinion from them as to the fairness, from a financial point of view, to the holders of Diedrich stock, other than certain affiliated holders, of the Green Mountain offer and the Green Mountain transaction



Target Director Fiduciary Duties

M&A Transaction Process:

Control of the Sale Process:

- In appropriate circumstances, Delaware law permits the board of a corporation that is the target of a takeover bid to employ defensive measures to resist the offer
- Defensive measures can protect stockholders from certain abusive takeover tactics and ensure they receive a fair and adequate price if the company is sold
- They accomplish this by giving negotiating leverage to a company's board and giving the board more control over the timing of responses to unsolicited bids
- Bidders are thus more likely to negotiate with the board, which has the ability to eliminate or mitigate many of the defensive measures

Target Director Fiduciary Duties

M&A Transaction Process:

Control of the Sale Process:

- Defensive measures may include, among other things:
 - Stockholder rights plans (poison pills)
 - Change in control triggers in material contracts, employee benefit plans and employment agreements
 - Standstills in confidentiality agreements
 - Advance notice bylaws
 - Classified board
 - Limitations on director removal
 - Limitations on calling special stockholder meetings
 - Prohibitions on stockholder action by written consent
 - Restrictions on charter and bylaws amendments
 - Supermajority voting requirements
 - DGCL §203

Target Director Fiduciary Duties

What defenses does Diedrich have in place?



Why so few?

Because, as we know, the Chairman controls 58% of the stock

- Stockholder rights plans (poison pills)
- Change in control triggers in material contracts, employee benefit plans and employment agreements
- Standstills in confidentiality agreements
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Structure and Timing

A buyer's advances toward a prospective public company target must be carefully orchestrated to:

- mitigate interloper risk
- otherwise increase deal certainty
- minimize transaction costs
- enhance buyer negotiating leverage and
- promote other buyer priorities

Considerations include:

- tender/exchange offer vs. merger transaction
- Regulation 13D-G

Structure and Timing

Tender Offer vs. Merger

Bottom Line:

Tender offers
are faster

Timing

- Cash Deals – Assuming no SEC review, tender offers can typically be completed approximately 2 weeks faster than mergers due to the requirement that a preliminary proxy statement be filed at least 10 days before a definitive proxy is mailed
 - SEC review of cash merger proxies is rare absent 13E-3 issues
 - HSR waiting period for cash tender offers is only 15 days, rather than the usual 30 days
- Stock Deals – At the time Reg M-A was adopted, the SEC Staff committed to expedite the review of exchange offer S-4's. Thus, an exchange offer S-4 is less likely to be reviewed and any such review should be at a faster pace than a merger proxy
 - No Review – exchange offer should be completed approximately 2 to 3 weeks faster than the merger
 - Review – exchange offer should be completed faster by the same 2 to 3 week period plus any additional advantage attributable to the Staff expediting the exchange offer review

Structure and Timing

Tender Offer vs. Merger

Stockholder Approvals

- Tender offers have certain advantages when obtaining the requisite stockholder support is expected to be challenging:
 - ISS and other proxy advisory services generally have not taken a position in tender offer transactions
 - Tender offer transactions, by their nature, ensure that the person making the final decision is in fact the stockholder at the conclusion of the offer. This contrasts with merger votes, in which the record holder is entitled to vote and may no longer have an economic interest.
- However, if an acquiror wishes to obtain 100% ownership of a target, absent special supermajority voting requirements, this can typically be obtained through majority stockholder vote in the merger context
 - In contrast, in a tender offer scenario, at least 90% of the target shares must be held by the acquiror to effect a back-end merger under Delaware law

Structure and Timing

Tender Offer vs. Merger

Best Price Rule

- Exchange Act Rule 14d-10(a)(2) provides that the consideration offered and paid to any security holder pursuant to a tender offer must be equal to the highest consideration paid to any other security holder during the tender offer
- Only applicable to tender offers
- Can be important if there are potential best price rule issues not related to the executive compensation scenarios ameliorated by the December 2006 Rule 14d-10 amendments (e.g., equity roll-overs in MBO's)

Financing

- One-step merger transactions involve more straightforward acquisition financing structures
- Tender offer structures typically have to provide for the possibility of not being able to get to the short-form merger threshold and thus lending into an acquisition vehicle whose only asset is a majority interest in the still publicly-traded entity for some period

Structure and Timing

Tender Offer vs. Merger

Section 16

- The *Skadden Arps* no action letter sets forth a methodology to exempt acquisitions or dispositions of insider equity interests in merger transactions
- However, *Skadden Arps* is not applicable to tender offers
- Consequently, the tender offer structure should be avoided if there are insider shares that (i) are subject to matching purchases within the 6-month short-swing profit look-back period and (ii) are important to provide comfort that the tender offer will succeed

Rule 14e-5

- Only tender offers are subject to Rule 14e-5, which generally prohibits purchases outside the offer by various transaction-related persons from public announcement until expiration of the tender offer

Both deals structured as exchange/tender offers



Structure and Timing

Regulation 13D-G

The Disclosure Requirement

- Any person or group who, after acquiring beneficial ownership of a class of equity securities, becomes directly or indirectly the beneficial owner of more than 5% of the class must file a Schedule 13D or 13G
- Item 4 of Schedule 13D requires disclosure of the purpose of the transaction, including whether the filer intends to exercise any control over the target company
- Filing must be made within 10 days after the acquisition

Beneficial Ownership

- Under Rule 13d-3(a), includes voting power and/or investment power

M&A Implications

- Restricts an acquiror's ability to accumulate stock in anticipation of a takeover proposal



Peet's Coffee and Green Mountain Both Filed 13D's

Consideration

Public acquirors have more liquid, and hence more attractive, stock to offer as merger consideration than private buyers

Issues include:

- Relative valuations of acquiror and target stock
- Acquiror stock volatility
- Registration requirements
- Target risk tolerance
- Restrictions on issuance, including:
 - availability of authorized stock
 - SRO stockholder approval requirements

Consideration

Stock Consideration

Revlon Duties

- Delaware “sale of control” cases reduce the board’s *Revlon* duties when stock is the only consideration and the acquiror isn’t controlled by a dominant shareholder

Pre-Closing Fluctuations in Acquiror Stock Price

- Target Viewpoint – key economic measure of the deal is usually its dollar value at the point when the deal becomes fully binding → fixed value preference
- Acquiror Viewpoint – dilution and earnings-per-share calculations usually predominate → fixed ratio preference
- Compromise – collars, which tailor stock consideration arrangements that draw characteristics from either fixed exchange ratio or fixed price deal economics

IV. Negotiations & Signing

Consideration



→ All cash offers



→ All cash & stock offers
Included a cash collar:

0.321 of a share of Peet's common stock plus a cash component in an amount between \$21.265 and \$22.870 such that the value of the total consideration paid per Diedrich Coffee share will be equal to \$32.50, provided that Peet's common stock has a value between \$30 and \$35 per share. If Peet's volume-weighted average stock price over the five trading days prior to the completion of the exchange offer is \$30 or less, the value per share received by Diedrich Coffee's stockholders would be less than \$32.50 and if Peet's volume-weighted average stock price over that same period is \$35 or higher, the value per share received by Diedrich Coffee's stockholders would be greater than \$32.50.

For more on collars, see this nice Factset Merger Metrics post:

https://www.mergermetrics.com/marequest?an=dt.getPage&st=1&pg=/pub/rs_20091103.html&collar_and_walkaway_provisions&rnd=425173

Post-Closing Covenants

Unlike in private M&A transactions, there are typically no seller parties in public M&A deals against which post-closing rights can be enforced

- No indemnification rights
- Limited purpose of representations and warranties
- No post-closing covenants, other than limited covenants benefiting seller stockholders, employees and directors
- Purchase price adjustments and earn-outs are extremely rare



Green Mountain merger agreement contains only one post closing covenant – requiring the parties to provide indemnification to officers and directors of Diedrich for six years post closing (included third party beneficiary rights)

Deal Protections

Generally, public deals face a substantially higher risk of disruption by third party interlopers than private deals as a consequence of:

- Mandatory disclosures of the existence and terms of the deal
- Target directors' fiduciary duties
 - Under *Revlon* and its progeny, directors of a Delaware corporation may be obligated to terminate an existing transaction agreement in favor of a superior alternative

How is this risk mitigated?

Deal Protections



Deal Protections

Mechanisms implemented to balance deal certainty and target directors' fiduciary duties include:

- No-Shops
- Go-Shops
- Lock-Ups
- Force the Vote Provisions
- Limitations on Termination Rights, including
 - Break-Up Fees
 - Reverse Break-Up Fees
 - “Superior Proposal” Requirements
 - Match Rights

Deal Protections

Deal protections in sale of control transactions are analyzed in the context of the target's *Revlon* duties and the enhanced scrutiny of *Unocal*. Consistent with these duties and that scrutiny, the courts will likely permit deal protections that:

- do not preclude a superior proposal
- do not destroy stockholder value
- are not coercive to target company stockholders and
- do not preclude the proper exercise of the target board's fiduciary duties between signing and closing

Deal protections will be evaluated based on the unique facts and circumstances of the deal

- Delaware courts “expect situational thinking”

Deal Protections

- No-Shops
 - Prohibit the target from soliciting acquisition proposals or engaging in discussions that could lead to an acquisition proposal
 - Flat no-shops are prohibited
 - “Window-shop” provisions are required
- Go-Shops
 - Infrequently, target boards will seek to fulfill their *Revlon* duties by means of a post-signing market check
- Lock-Ups
 - Commitments from large target stockholders to vote for, tender shares into or otherwise support the deal
 - Subject to Securities Act gun-jumping risk
 - Schedule 13D may be needed if a proxy is granted
 - Under *Omnicare*, cannot be 100% preclusive

Deal Protections

Force the Vote Provisions

- Require the target to submit the transaction to a vote of stockholders within a specified timeframe
 - Problematic in Delaware if coupled with a lock-up
 - Must have a fiduciary out

Break-Up Fees

- Termination fee payable to initial acquiror by target
 - Present in virtually all public deals
 - Various triggers
 - Percentage of purchase price depends on total package of deal protections; no *per se* rule

Reverse Break-Up Fees

- Termination fee payable by acquiror to target
 - Only present in a minority of strategic deals
 - Typically address antitrust or financing risk

Deal Protections

“Superior Proposal” Req’ts

- A requirement that the target board determine that a competing transaction is a “superior proposal” before the target can terminate the initial transaction
 - Usually, alternative deal must involve at least 51% of the target stock or assets
 - Target board required to determine that the alternative deal is more favorable to target stockholders (from a financial point of view) and is reasonably capable of being completed

Match Rights

- Give the initial acquiror the right to match other offers
 - Present in most public deals

Deal Protections



- Peet's and Green Mountain signed substantially identical transaction agreements with Diedrich, containing the following deal protections:
 - No-Shop (with window-shop carve-out)
 - 21-Day Go-Shop (in Peet's agreement)
 - Lock-Ups
 - Diedrich's chairman agreed to tender 1,832,580 shares, or 32% of outstanding
 - Less than chairman's full ownership, presumably to address *Omnicare* concerns

Deal Protections



- Peet's and Green Mountain signed substantially identical transaction agreements with Diedrich, containing the following deal protections:
 - \$8.5MM Break-Up Fee (4%)
 - Peet's Agreement – Would have been \$6.388 million (3%) payable to Peet's if Green Mountain offer was accepted during the go-shop period
 - \$8.5MM Reverse Break-Up Fee in Green Mountain deal
 - Fee increases by \$1 million in each 60-day period after Feb. 15, 2010 to compensate Diedrich for antitrust risk
 - “Superior Proposal” Requirement (plus “Intervening Event” termination right)
 - Match Rights

Securities Law Compliance

Public M&A deals implicate a host of federal securities law issues:

- Mergers – must comply with proxy rules, including requirement to deliver proxy statement
- Tender/Exchange Offers – must comply with Williams Act and related tender offer rules, including filing Schedules TO and 14D-9
- Transactions with Stock Consideration – must comply with registration requirements of the Securities Act, including by filing an appropriate registration statement, typically on Form S-4, or qualifying for an exemption
 - Foreign jurisdictions' securities laws in which target stockholders reside must be taken into consideration
- Regulation M and Rule 14e-5 – designed to prevent interested parties in an exchange offer or merger from manipulating the price of the parties' securities during the offer

Securities Law Compliance

Public M&A deals implicate a host of federal securities law issues:

- Regulation FD – generally prohibits selective disclosure of material, nonpublic information by public companies
- Form 8-K – Item 1.01 disclosure required within four business days of signing transaction agreement
 - Material terms must be disclosed, but agreement is not required to be attached
- SRO Rules – NYSE, Nasdaq and other SRO rules address, among other things, requirements for stockholder approval (e.g., NYSE LCM Rule 312.03(c)), proxy solicitations, disclosure obligations and related-party transactions

Minority Stockholders

Although private M&A targets may have minority stockholders, every public M&A target has them

- Often number in the thousands
- Frequently object strongly to the terms of deals
- May:
 - Vote against the merger
 - Refuse to tender in a tender/exchange offer
 - Exercise appraisal rights (DGCL Section 262)
 - Bring derivative actions



In November, a class action law suit was brought against Diedrich and Peet's for breach of fiduciary duties. In December, the complaint was amended to name Green Mountain as a defendant.

Closing Process

Considerations in closing a public M&A deal include:

- Exchange Agent
- DTC book-entry settlement
- Cash in lieu issues at the broker account holder level
- Form 8-K obligations (including *pro forma financials*)
- Public debt indenture supplements
- Form S-8 filings



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