

THE TOPPS DECISION – ANOTHER TAKE ON STANDSTILLS

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On June 14, 2007, the Delaware Court of Chancery enjoined a shareholders meeting of the Topps Company, Inc. (Topps), at which a vote was to have taken place on its acquisition by private equity co-sponsors Madison Dearborn Partners LLP and an entity controlled by former Disney CEO Michael Eisner (together, the Eisner Group). The meeting was enjoined until (i) potential rival bidder the Upper Deck Company (Upper Deck) was released from its standstill agreement to permit it to publicly comment on the seriousness of its negotiations with Topps and to make a tender offer to shareholders and (ii) Topps made corrective disclosure regarding both the Eisner Group's plan to retain current management and a valuation of the company by Lehman Brothers. The decision serves as an interesting counterpoint to a recent Ontario Court decision on standstills in *Ventas v. Sunrise REIT*.

BACKGROUND

Topps is a Delaware corporation engaged in the business of distributing collectible cards and confectionary items. Topps had struggled with profitability for some time and had recently been the subject of a public proxy battle. In 2006, Michael Eisner, who was familiar with Topps' Chairman and CEO, expressed an interest in taking Topps private, although he was unwilling to negotiate in the context of a public auction. Eisner initially expressed a willingness to offer USD 9.24 per share, which was subsequently increased to USD 9.75 per share following negotiations with the board. Consistent with Eisner's demands, Topps did not publicly announce that it was for sale. Topps and the Eisner Group then entered into a merger agreement, containing a "go-shop" clause that permitted Topps actively to solicit additional bids for a period of 40 days.

During the go-shop period, Topps could seek bids and accept a "Superior Proposal", defined as "a proposal to acquire at least 60% of Topps that would provide more value to Topps stockholders" than the Eisner Group acquisition. Once the 40-day period had expired, Topps could only negotiate with an "Excluded Party", being one whose involvement during the go-shop period was reasonably likely to lead to a Superior Proposal or with other unsolicited bidders themselves making a Superior Proposal. A two-tiered break fee was payable to the Eisner Group if Topps accepted a Superior Proposal: 3.0% of the transaction value during the go-shop and 4.6% of the transaction value thereafter.

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HIGHLIGHTS

- One-size-fits-all analysis again rejected
- Courts will be sensitive to perceived bias in change of control process
- Acceptance of go-shop in lieu of pre-signing market check
- Permissible to run different due diligence processes for different bidders
- Preferential treatment that is given to certain bidders in return for meaningful concessions or deal certainty, and is not incompatible with maximization of shareholder value, is acceptable

A major competitor of Topps' baseball card division, Upper Deck, expressed interest in buying Topps when contacted during the go-shop period. As is common, upon commencing due diligence Upper Deck entered into a standstill agreement that prevented it from disclosing that it had received confidential information or had any intent to bid for Topps. Both before and after the expiry of the go-shop, Upper Deck submitted a bid of USD 10.75 per share, the second time with no financing contingency and with a hell-or-highwater commitment to solve antitrust issues. However, on the basis of Upper Deck's refusal to provide evidence of its ability to finance the offer, antitrust risk and a small reverse termination fee, the Topps board refused to treat Upper Deck's offer as a Superior Proposal or declare Upper Deck an Excluded Party. The board also refused to release Upper Deck from its standstill such that Upper Deck could not publicly comment on its offer or launch a tender offer.

Certain shareholder plaintiffs and Upper Deck together moved for an injunction to delay the vote on the Eisner Group merger, alleging that the board had denied the Topps shareholders an opportunity to select the bid offering the greatest value.

THE COURT'S DECISION

Vice-Chancellor Strine's decision in *Topps* highlights several important points about directors' duties under Delaware law, all of which will likely find resonance with Canadian judges when asked to look at similar issues under Canadian law.

First, courts will be very sensitive to perceived bias in process. In this case, Strine made it clear that a target board may only use a standstill agreement for its proper purpose, which does not include favouring certain bidders because of proposed post-purchase strategies such as management retention. Standstill agreements should be used to maximize, not impair, the value provided to shareholders through an auction. Strine's judgement that there was a "reasonable probability...that the Topps board [was] misusing the standstill" led him to grant the injunction. He praised the Topps board for maintaining the ability to release Upper Deck from the standstill, a right that is often negotiated away during an auction to protect the successful bidder from being outbid by a losing party who "tops up" its offer after the auction has closed (See *Sunrise REIT* discussion below). Given that there was no canvass of the market completed before the Eisner Group merger agreement was executed, it was appropriate for Topps to retain this right. However, once Topps became aware that by releasing Upper Deck it could possibly unlock further value for its shareholders, the board's continued enforcement of the standstill did not, to Strine, serve any apparent legitimate purpose. The board's decision not to declare Upper Deck an Excluded Party was "highly questionable", in particular because it would have cost Topps nothing and would have opened the door to the possibility of greater value for shareholders. In light of the fact that the board had recommended Topps shareholders accept the Eisner Group offer, its focus should have been on "[pursuing] the highest price reasonably attainable".

Second, the use of go-shops to canvass the market for a better price post-signing may be a valid way for target directors to discharge their duty to seek the best price for shareholders in a change of control, depending on the circumstances. Go-shops have become more common in the U.S., in particular in private equity led deals, (and are occasionally used in Canada) as target boards seek to ensure satisfaction of their fiduciary duties while avoiding a public pre-signing market check, often strenuously resisted by potential buyers and potentially competitively damaging. The use of go-shops may also reflect recognition of the fact that pre-signing auctions can be inefficient where management may have cause to favour a particular bidder. Strine suggested that go-shops may be an efficient way of encouraging other potential bidders to pay a higher price, because the knowledge that a credible buyer is willing to pay a certain price provides "some form of sucker's insurance" validating the consideration of higher offers by others. Although Strine found occasion to criticize a post-signing market check in his earlier *Netsmart* decision (see our June 2007 *Blakes Bulletin* on M&A), in Strine's view in *Topps*, the market should have been aware well before the deal was announced that the company was ripe for reorganization or sale. This again underscores the fact and context specific nature of these decisions. It is clear that if a go-shop is accepted, there must be real solicitation efforts made post-signing and in this case Topps met that obligation.

Strine also took no issue with the break fee that the Eisner Group would receive if Topps accepted another offer during or after the go-shop, stating that "the advantage given to Eisner over later arriving bidders is difficult to see as

unreasonable". Preferential treatment that is given to certain bidders in return for meaningful concessions or deal certainty, and is not incompatible with maximization of shareholder value, is acceptable to the Delaware court.

Because of the relative novelty of go-shops, it is difficult to know how their use affects deal value. Although agreements subject to a go-shop are typically evaluated by financial advisors for fairness, the low number of jumped deals indicates that the locked-in price is most likely the final price that shareholders will receive. Matching rights that typically accompany go-shop provisions may also discourage competitive bidders.

Third, Strine was sympathetic to the suggestion that it may be necessary to proceed more cautiously in negotiations and due diligence with strategic buyers, particularly in industries where there are few players. He acknowledged that Topps had good reason to be suspicious of Upper Deck's motives, as Upper Deck had not acted quickly to indicate genuine interest and had also proposed to limit its liability to a USD 12 million reverse break fee if it were unable to consummate the deal. Topps' worry that Upper Deck, a major competitor of its baseball card division, would pay USD 12 million for no reason other than to stop the potentially threatening Eisner Group merger and to gain access to Topps' confidential information was not entirely unrealistic according to Strine. However, if the Topps board was acting in good faith, it could have negotiated a higher reverse break fee to test Upper Deck's commitment to the deal before declaring Upper Deck an Excluded Party.

Finally the Delaware courts and U.S. regulators have shown a willingness to second guess non-disclosure of material information in proxies. In this case, Strine was critical of the failure to disclose assurances made by the Eisner Group to top management about continued employment (which again would underscore perceived bias in the sale process) and a significant change in the assumptions underlying the valuation of the target company, which resulted in a change in the valuation range.

CANADIAN IMPLICATIONS

With consistent strong affirmations of the business judgment rule in Canada, it is unlikely that a Canadian court would have been as willing as Vice-Chancellor Strine to second guess a board's decision-making, however, the *Topps* decision is noteworthy for Canadian transactions.

Although Canadian courts have not adopted the Revlon standard applied by Delaware, there is an expectation among investors and regulators generally in Canada that an issuer in a change of control scenario will act in a manner to maximize shareholder value. In this context, it is useful to see judicial sanction of the go-shop as a viable alternative to a pre-signing market check. It is also useful to see judicial sanction of an unequal diligence process when dealing with direct competitors.

Interestingly, notwithstanding the different outcome, this decision is arguably consistent with the recent Ontario court decision in which the enforceability of an agreement to enforce a standstill agreement was upheld. In *Sunrise REIT*, the Ontario court gave primacy to a commercial bargain and confirmed that an Ontario board can place limits on its rights to consider superior offers. In Ontario, such an agreement is not by definition invalid or unenforceable as long as the board has acted reasonably in creating a value maximizing process. See our March 2007 *Blakes Bulletin on Securities Law*. This is consistent with Vice-Chancellor Strine's view that preferential treatment that is given to certain bidders in return for meaningful concessions or deal certainty, and is not incompatible with maximization of shareholder value, is acceptable. In *Sunrise REIT*, the trustees in good faith, and to conclude a transaction, had bargained away their right to waive the third party standstill. In *Topps*, the boards had maintained the ability to waive the standstill but, as Strine notes, were bound to use that contractual power only for proper purposes.

POST SCRIPT

On June 25, 2007, Upper Deck commenced an unsolicited take-over bid to purchase the Topps common shares at USD 10.75 per share.

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