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Event-Driven Investors Don't Always Vote 'Yes'

Law360, New York (May 31, 2013, 10:01 AM ET) -- In recent months, two major M&A transactions, MetroPCS/T-Mobile and Plains Exploration/Freeport McMoRan, were on the verge of being voted down by target company shareholders when the acquiror saved the deal by raising the value of its bid. What made these situations extraordinary was the absence of any competing offer.

Stockholders rarely reject a merger without the expectation of a better offer from someone else, in part because arbitrageurs and other event-driven investors are typically the largest stockholder group in companies that enter into M&A agreements. The event-driven investors buy the target company stock for the purpose of earning the “spread” between the market price and the deal price, and the last thing they want to see is the company choosing to remain independent.

In MetroPCS and Plains, however, event-driven investors actually led the campaigns to vote no on the transactions, convincing other stockholders that they would be better off taking the risks of a standalone strategy for the target company. These developments can be explained in part by the extraordinary circumstances of the MetroPCS and Plains deals, but they also demonstrate that there is more nuance to the event-driven business model than is sometimes recognized.

MetroPCS was a particularly striking example of investment analysis by an event-driven investor changing the outcome of a transaction. When reports circulated in early October that MetroPCS was in talks with Deutsche Telekom about a combination with its subsidiary T-Mobile, arbs piled into the MetroPCS stock, driving up the price from $10 to over $13 a share. But the terms of the deal, announced a few days later, disappointed investors and the stock drifted back to $10 over the next month.

P. Schoenfeld Asset Management (PSAM), a prominent event-driven investor, began a campaign against the T-Mobile transaction in early February with a public letter to the MetroPCS and Deutsche Telekom boards, pointing out the deficiencies in the transaction and urging them to revise the terms to make them more attractive to MetroPCS stockholders. Paulson & Co., MetroPCS’ largest stockholder, endorsed PSAM’s criticism of the T-Mobile deal a week later, and the next day PSAM filed a preliminary proxy statement for a campaign to get MetroPCS stockholders to vote the deal down.

PSAM had little difficulty persuading other stockholders that the terms of the T-Mobile transaction were unfair to MetroPCS stockholders: Deutsche Telekom intended to load up the combined company with $15 billion of intercompany debt; the interest rate on the debt was off market; and the common stock exchange ratio was unfavorable to MetroPCS stockholders.

However, to succeed in its proxy contest, PSAM had to overcome the ingrained tendency of many investors, to vote for a deal, even one with significant shortcomings, if they think there is not going to be a competing offer and the terms being offered are the best they can get from the other party to the acquisition agreement. Investors might daydream that Deutsche Telekom would sweeten the deal if it thought that MetroPCS stockholders were ready to vote against the transaction, but in the end stockholders were unlikely to be the winners in a game of “chicken” with Deutsche Telekom.

PSAM’s successful strategy was to get stockholders and ISS to focus on MetroPCS as a standalone company and persuade them that standalone was not unthinkable: If the deal fell through, stock in a standalone MetroPCS would be worth more than the package of cash and T-Mobile/PCS stock they were being offered by Deutsche Telekom. PSAM accomplished this task through a detailed investor presentation, which identified alternative means by which MetroPCS could acquire additional spectrum and different business models that MetroPCS could follow if it became spectrum constrained, validated MetroPCS management’s projections of strong continued earnings, and explained why MetroPCS should be valued at a higher multiple than T-Mobile.

This white paper was published in late March, and a week later the ISS and Glass Lewis proxy advisory services recommended that MetroPCS stockholders vote against the T-Mobile combination although normally these services do not recommend a negative vote on a business combination in the absence of a superior strategic alternative. By the week of the scheduled stockholders meeting, it was clear that the T-Mobile transaction would fail to receive the necessary shareholder support, and Deutsche Telekom made changes to the amount and terms of the intercompany debt that added approximately $3 a share to the value of the package being offered to MetroPCS stockholders. PSAM and Paulson both supported the revised offer, and it was overwhelmingly approved by MetroPCS stockholders.

Plains Exploration followed a different path to the same result. When Plains’ stock-for-stock merger with Freeport McMoRan was announced in early December, the deal was considered highly favorable to Plains stockholders, but as the date of the May stockholders meeting approached, some Plains stockholders became convinced that Plains stock would be worth more if it continued as a standalone company as a result of developments since the merger agreement had been signed, including the strong stock market performance of other companies in Plains’ peer group, Plains’ operating results since the deal was announced, and recent discoveries in Plains’ Gulf of Mexico drilling program.

CR Intrinsic Investors, an affiliate of SAC Capital, and Arrowgrass Capital, both large Plains stockholders, announced their opposition to the deal in early May; ISS recommended against the transaction and it soon became apparent that Plains’ merger with Freeport, like the original MetroPCS/T-Mobile transaction, would not receive the necessary stockholder support. Freeport followed the course that Deutsche Telekom had taken a month earlier, agreeing that Plains could pay out a $3 a share special dividend before closing, and the merger was then approved by Plains stockholders.

MetroPCS and Plains are likely to remain exceptional situations even if investors become more flexible in their voting on M&A deals. Most acquisitions offer target company shareholders an almost certain premium over the expected market price of the stock if the company remains independent. Stockholders who oppose the deal must be prepared to give up that premium in order to preserve the values that they perceive in the target company stock. Given the arbs’ classic business model, rooted in making the “spread” on the target company stock, event-driven investors can be expected to vote for a deal supported by management, as long as there is a large enough premium, even if they believe that the offer is less than intrinsic value.

Deutsche Telekom and Freeport made it easy for MetroPCS and Plains investors to vote their conviction that MetroPCS and Plains were worth more as standalone companies by offering target company stockholders acquisition packages that had little if any premium over the anticipated market price if the deal was voted down. Once they added a large premium, the event-driven hedge funds and virtually all other stockholders became supporters of the transactions. Nevertheless, the MetroPCS and Plains incidents demonstrated that event-driven investors are not automatic yes votes for M&A transactions and buyers who fail to deliver a premium are at risk of having their proposals voted down.

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Covington & Burling represented P. Schoenfeld Asset Management LP (PSAM) in the MetroPCS proxy contest.