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Doing Deals 2017: The Art of M&A Transactional Practice

Chair
Igor Kirman

CORPORATE LAW AND PRACTICE
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Doing Deals 2017:
The Art of M&A Transactional Practice

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Igor Kirman

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Prepared for distribution at the
DOING DEALS 2017: THE ART OF M&A TRANSACTIONAL PRACTICE
Program
March 8, 2017

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Program Schedule

Doing Deals 2017: The Art of M&A Transactional Practice
New York City, March 8, 2017
Live Webcast, www.pli.edu, March 8, 2017

Program Schedule: 9:00 a.m. – 5:00 p.m.

Morning Session: 9:00 a.m. – 12:30 p.m.

9:00 **Opening Remarks and Introduction**
Igor Kirman

9:15
The Art of Deal Structuring

- Choosing a structure (merger, stock purchase, asset sale)
- The tender and exchange offer – benefits and traps for the unwary
- Bridging the valuation gap: using contingent value rights (CVRs)
- Special issues in cross-border M&A and "inversions"

Wilson Chu, Raymond O. Gietz, Louis Goldberg

10:45 **Networking Break**

11:00
Getting the Deal Started: Preliminary Agreements and the Role of Financial Advisors

- Confidentiality agreements
- Emerging issues in working with financial advisors
- Effective auction techniques – from bid instruction to closing

Kevin Costantino, Igor Kirman, Kevin Miller

12:30 **Lunch Break**

Afternoon Session 1:45 p.m. – 5:00 p.m.

1:45
The Nuts and Bolts of it: Negotiating Acquisition Agreements

- Representations, warranties, covenants, conditions, and indemnification
- Deal protection and deal jumping- lessons learned from the recent past
- Doing the private equity deal: understanding and dealing with sponsors

Stephen S. Coats, Jane Greyf, Jane Morgan

3:15 **Networking Break**

3:30
It's a Hostile World: Takeover Defense and Hostile Deals

- Strategies for bidder approaches and target responses
- Shark repellants: Effective charter and bylaw provisions
- Case studies on hostile bids

Stephen M. Kotran, Trevor S. Norwitz, Paul J. Shim

5:00 **Adjourn**

Faculty

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IGOR KIRMAN

Igor Kirman is a partner in the Corporate Department at Wachtell, Lipton, Rosen & Katz, where he focuses primarily on mergers and acquisitions, activism and takeover defense, corporate governance and general corporate matters. He has advised public and private companies, as well as private equity funds, in connection with mergers and acquisitions, divestitures, leveraged buyouts, joint ventures, cross-border deals, shareholder activism, takeover defenses and corporate governance matters.

Mr. Kirman is a frequent speaker at professional conferences, and has written articles in numerous professional publications on topics relating to mergers and acquisitions and corporate governance. He recently published a book, "M&A and Private Equity Confidentiality Agreements" (Aspatore). He was named as Dealmaker of the Year by *American Lawyer* for 2006 and also 2015. He is the chair of the Practising Law Institute's annual "Doing Deals" program in New York and teaches a course on mergers and acquisitions as an adjunct at Columbia Law School. He also serves on the Advisory Board of the Practical Law Company and on the Mergers & Acquisitions Advisory Board of Strafford Publications.

Mr. Kirman received a B.A. in Ethics, Politics and Economics *magna cum laude* from Yale University in 1993. He completed his J.D. at Columbia Law School in 1996, where he was notes editor of the *Columbia Law Review*. His student note, "Standing Apart to be a Part: The Precedential Value of Supreme Court Concurring Opinions", 95 Colum. L. Rev. 2083 (1995), was selected as the winner of a national writing competition and awarded the Scribes Law Review Writing Award.

Mr. Kirman is a member of the American Bar Association, where he serves on the Committee on Mergers and Acquisitions (and is a member of its Financial Advisor Task Force) and the Committee on Private Equity and Venture Capital; and is a member of the New York City Bar Association. He is involved in a number of civic institutions, and serves on the Advisory Board of the Mount Sinai School of Medicine and is a Trustee of the Trinity School. He was born in Ukraine and speaks Russian.

Wilson Chu

Wilson Chu is a partner in the Dallas office of McDermott Will & Emery LLP. His practice focuses on M&A, joint ventures, and other strategic transactions, as well as related corporate governance, for clients ranging from Fortune 500 serial acquirers to private equity funds to high-growth, high-profile technology companies in the United States and abroad. While he has experience in a wide range of industries, his practice is heavily-weighted in the technology and healthcare sectors (particularly, healthtech and fintech).

His representative clients include:

- AmerisourceBergen Corporation (NYSE: ABC)
- Renren Inc. (NYSE: RENN)
- Sabre Corporation (NASDAQ: SABR)
- Xerox Corporation (NYSE: XRX)
- Wolters Kluwer N.V. (AEX: WKL)

Wilson created and continues to be the architect of the influential M&A Deal Points Studies published by the Market Trends Subcommittee (which he co-founded) of the ABA's Mergers & Acquisitions Committee (for which he serves as Vice Chair). He is founding co-chair of the University of Texas Mergers & Acquisitions Institute, the country's leading private company M&A conference, and the founding chair of the International Finance Law Review/Inter-Pacific Bar Association's Asia M&A Forum in Hong Kong, Asia's leading M&A law conference. Wilson is also an active leader in broad range of groundbreaking initiatives that promote the business case for diversity, including, Founder, NAPABA Partners Network, Founding Member, Selection Committee for NAPABA's Best Lawyers Under 40, and Founding Co-Chair, Texas Minority Counsel Program.

Stephen S. Coats

Mr. Coats is a Partner of Riverstone, serving as General Counsel. He is based in New York.

Prior to joining Riverstone in April 2008, Mr. Coats was a Partner at Vinson & Elkins L.L.P., a law firm specializing in the energy sector. While at Vinson & Elkins, he focused on domestic and cross-border M&A work in the energy sector. Prior to joining Riverstone, Mr. Coats was outside counsel to Riverstone in several transactions including, among others, Niska Gas Storage, Frontier Drilling, Red Technology Alliance, and Phoenix Exploration Company.

He received his B.A. in Government from the University of Texas at Austin in 1993 and his J.D. from the University of Texas School of Law in 1997. Mr. Coats is licensed to practice law in the states of New York and Texas.

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Mr. Costantino joined Greenhill's investment banking advisory practice in New York in 2005. Since that time, Mr. Costantino has served a number of roles on behalf of the firm, including spending time in the firm's Chicago office following its opening in 2009, assisting with the firm's expansion to Brazil in 2013 and working in the firm's Sydney office, most recently as Co-Head of Greenhill Australia.

Prior to joining Greenhill, Mr. Costantino practiced corporate and securities law at Wachtell, Lipton, Rosen & Katz, where he represented public and private clients in connection with mergers and acquisitions and public and private debt and equity offerings. Mr. Costantino received a B.B.A. with high distinction from the University of Michigan as well as a J.D., *magna cum laude*, from the University of Michigan Law School where he was an Editor of the Law Review.

Raymond Gietz, a partner of Weil since 1989, is a member of the Firm’s Mergers & Acquisitions practice. He represents buyers, sellers, boards of directors, committees of independent directors and financial advisors in connection with complex mergers and acquisitions transactions, including public and private companies, LBOs, asset sales and joint ventures. He regularly advises boards of directors and committees on defense, corporate governance and other matters. Mr. Gietz also has been involved in numerous proxy fights and other contests for corporate control.

Mr. Gietz’s representation involves a range of industries, including healthcare, financial services and steel.

Recent M&A transactions include advising:

- Genworth Financial, Inc. as corporate counsel on its sale to China Oceanwide Holdings Group Company Ltd.
- Centennial Resource Development, Inc. (f/k/a Silver Run Acquisition Corp., a SPAC) in its acquisition of a controlling stake in Centennial Resource Production, LLC and its subsequent acquisition of all of the leasehold interests and related upstream assets in Reeves County, Texas from Silverback Exploration, LLC and Silverback Operating, LLC
- Eli Lilly in its acquisitions of the North American rights to the oncology product Erbitux®, Locemia Solutions ULC, Glycostasis, Novartis Animal Health, Lohmann Animal Health, ChemGen, Agri Stats, Avid Pharmaceuticals and Alzheimer’s imaging agents from Siemens Medical Solutions; and in its sale of veterinary assets to Virbac SA
- QLT Inc. in its acquisition of Aegerion Pharmaceuticals, Inc. and in its minority investment in Aralez Pharmaceuticals Plc
- GECC in the sale of its North American tank car rail assets and railcar repair business to Marmon Holdings, Inc., sale of its remaining North American railcar leasing business to Wells Fargo & Co., investment in and restructuring of the EBX Group and the sale of its Mexican consumer mortgage loan business to Santander Bank
- GE Aviation Systems in its acquisitions of Naverus and Airfoil Technologies
- Ripple Brand Collective, LLC in its sale to The Hershey Company
- Barclays, as financial advisor to Gentiva Health Services, Inc., in Gentiva's sale to Kindred Healthcare, Inc.
- AK Steel Corporation in its acquisition of integrated steelmaking assets in Dearborn, Michigan from Severstal North America and in its joint venture with Magnetation

- Australian biopharmaceutical company Fibrotech in its sale to Shire plc
- Lehman Brothers in the sale of its Archstone business to Equity Residential and AvalonBay Communities
- Magellan Health, Inc. in its acquisitions of Veridicus Holdings, LLC, Armed Forces Services Corporation, 4D Pharmacy Management Systems, Inc., CDMI and Partners Rx
- Costa Inc. in its sale to Essilor International SA
- Franklin Templeton in its acquisition of K2 Advisors, Darby Holdings and Fiduciary Trust
- Citadel Broadcasting in its sale to Cumulus Media
- Safran in its acquisition of L-1
- General Motors in its sale to a government-sponsored entity
- Harbinger in its take-private acquisition of Sky Terra
- Genesis Lease Limited in its sale to AerCap Holdings

Mr. Gietz has been recognized in *Chambers USA*, *Legal 500 US*, *New York Super Lawyers* and has been featured as a "Dealmaker" by *The American Lawyer*. He was also recognized for client service excellence by BTI Consulting Group in its *2012 BTI Client Service All-Stars* survey.

Mr. Gietz received his B.A. from Columbia College, where he was elected to Phi Beta Kappa, and his J.D. from the Columbia University School of Law, where he was a Harlan Fisk Stone Scholar.

Bar Admissions

- State of New York

Education

- LL.B., University of Cape Town, Faculty of Law, 1987
  - magna cum laude
- LL.M., University of Cambridge, 1989
  - First Class Honours

Louis L. Goldberg

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Mr. Goldberg is a partner in Davis Polk's Corporate Department, practicing in the Mergers and Acquisitions Group. He advises major industrial and financial services companies on their most significant public or private mergers and acquisitions transactions and board level matters. His practice also encompasses a full spectrum of corporate, strategic, defensive and crisis assignments ranging from advising on activist situations and unsolicited bids, special committee assignments,board investigations and governance advice, to spinoffs, private equity investments and representing consortia in FinTech and other sectors.

WORK HIGHLIGHTS

Mr. Goldberg's client representations include AgroAmerica, Amdocs, Citigroup, ExxonMobil, Heineken, IHS Markit, Morgan Stanley and Syngenta AG.

Deal Highlights

- Markit on its all-share merger of equals with IHS valued at more than $13 billion
- Syngenta in its:
  - $43 billion pending acquisition by ChemChina in the largest transaction by a Chinese company outside China
  - successful defense against an unsolicited bid by Monsanto
- Citigroup on a series of strategic transactions, including its:
  - $4.25 billion sale of OneMain to Springleaf through a dual-track M&A and IPO process
  - $306 billion loss protection guarantee program with the U.S. government
  - $52 billion capital realignment and its exit from its TARP U.S. government financial assistance
- CVS in its:
  - Contested acquisitions of Caremark and Longs Drugs
  - Acquisition of the Medicare Part D business of Universal American
  - Acquisitions of Eckerd and Albertson's
- Exxon in its acquisitions of Mobil and XTO Energy
- J.P. Morgan in its merger with Chase Manhattan Bank
- Morgan Stanley on its:
  - Sale of its Global Oil Commodities business

    - Sale of TransMontaigne
    - $1.5 billion disposition of its Van Kampen investment management business
    - FrontPoint spinoff
- ABN AMRO, Goldman Sachs and Citigroup on their investment in Digital Asset Holdings, a technology startup company led by former JPMorgan Chase executive Blythe Masters, in a funding round exceeding $50 million with 10 other leading international financial institutions
- Extensive experience in transactions involving forming, buying, selling or divesting “alternatives” asset managers, including several recent transactions in response to the Volcker Rule
-

RECOGNITION

Mr. Goldberg is recognized as a leader in the legal industry:

- *Lawdragon* – **"2016 Lawdragon 500 Leading Lawyer"**

He is consistently recognized as a leading M&A lawyer in various industry publications:

- *Chambers Global*
- *Chambers USA*
- *IFLR1000*
- *Expert Guide to Banking, Finance and Transactional Law (Mergers and Acquisitions)*

PROFESSIONAL HISTORY

- Partner, 1997-present
- Associate, 1989-1997

JANE GREYF

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Jane Greyf, a partner in Goodwin's Private Equity Group and member of the firm's Impact and Responsible Investing Practice, focuses her practice on private equity investments, representing investors, companies and management in private and public leveraged buyouts, and control and minority investment transactions.

Ms. Greyf represents leveraged buyout sponsors, venture capital funds, hedge funds, and other private equity investors and portfolio companies in various acquisitions, dispositions, investments, joint ventures, buyouts, tender offers, co-investments and leveraged finance transactions. She also represents public and private companies in connection with various corporate and securities law issues, including corporate governance, securities law compliance and general corporate matters.

EXPERIENCE

Ms. Greyf's experience includes representing:

- Insight Venture Partners in its $752 million acquisition of iParadigms, a provider of web-based solutions for plagiarism prevention and student feedback
- TA Associates in its recent majority investment in Towne Park, a provider of parking management and hospitality services for the hotel and healthcare industries
- Grubhub in its merger with Seamless.com
- MphasiS Ltd. in its acquisition of Digital Risk, which was recognized as a 2013 Financial Services Deal of the Year by *M&A Advisor*
- GS Capital Partners in the leveraged buyout of Endurance International Group led by Warburg Pincus
- GS Capital Partners and GS Investment Partners in a number of minority investments
- The Carlyle Group in the sale of Schoolnet Inc.
- Ridge Capital Partners in the leveraged buyout of LAT Sportswear Inc.

Professional Activities

Ms. Greyf is a member of the committee overseeing Goodwin's Neighborhood Business Initiative, a pro bono program that offers business and legal services to entrepreneurs and small business owners in underserved neighborhoods.

Professional Experience

Prior to joining Goodwin, Ms. Greyf practiced with Latham & Watkins, Nixon Peabody and Butzel Long.

EDUCATION

- J.D., Columbia Law School, 1998 (Harlan Fiske Stone Scholar)

JANE GREYF

- B.A., New York University, 1995 (*magna cum laude*)

ADMISSIONS

Ms. Greyf is admitted to practice in New York.

STEPHEN M. KOTRAN

Stephen M. Kotran is a partner in the Mergers and Acquisitions and Financial Institutions Groups at Sullivan & Cromwell LLP and a member of the firm's Managing Partners Committee. He represents buyers, sellers, special committees of independent directors and financial advisors in connection with mergers and acquisitions transactions, including negotiated and hostile acquisitions of public companies, negotiated sales of private companies, subsidiaries and divisions, private equity transactions, leveraged buy-outs, formation of joint ventures and asset sales. In recent transactions, his clients have included Acosta, Inc., Bank of America Merrill Lynch, China Oceanwide, Cytec Industries, Inc., Eastman Kodak Company, Evercore Partners, Goldman, Sachs & Co., ING Groep N.V., Ipsen, S.A., Orix, Inc., Platinum Underwriters Holdings, Ltd., Rothschild, Inc., Sprout Pharmaceuticals, Swiss Reinsurance Company Ltd., Wells Fargo Securities LLC and Western World Insurance Group.

Mr. Kotran graduated from Harvard College (A.B., 1985) and the University of Virginia Law School (J.D., 1990) where he was an Editor of the Virginia Law Review and a member of the Order of the Coif. From 1985-1986, Mr. Kotran served as a legislative assistant to U.S. Senator Daniel P. Moynihan (D-NY) and from 1990-1991 he served as a judicial clerk to the Hon. Edward R. Becker (U.S. Court of Appeals, Third Circuit). He has been consistently recognized as a leading M&A, private equity and insurance transactional lawyer by many widely referenced legal guides, including *The Best Lawyers in America, Chambers, IFLR, Lawdragon, New York Super Lawyers, PLC* and *The US Legal 500*. Mr. Kotran is a frequent faculty member on M&A panels for the American Bar Association, the Practising Law Institute, the New York City Bar Association and various other professional organizations. He is a lecturer in Law at Columbia Law School where he teaches a course on M&A transactions and also has guest lectured at numerous other law schools including Fordham, NYU, Stanford, U.Penn and UVa. He is a former co-chair of the Financial Advisors Task Force of the M&A Committee of the Business Law Section of the American Bar Association. He also serves on the M&A Advisory Board of the Practical Law Company.

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Kevin is a frequent author and speaker on M&A topics, including fairness opinions, the role of investment bankers and legal and regulatory developments relating to mergers and acquisitions. Kevin is a member of the Mergers, Acquisitions & Corporate Control Contests Committee of the New York City Bar, as well as the advisory boards of DealLawyers.com and the *DealLawyers* newsletter and a frequent contributor to the DealLawyers.com Blog. Kevin is a graduate of Rutgers University (JD) and the University of Michigan (MA and AB).

Publications

- "*Food for Thought: Conflicting Views on the 'Knowing Participation' Element of Aiding & Abetting Claims,*" Deal Lawyers, March/April 2015.
- "*The Obligation of Financial Advisors—New Decision Upholds Contractual and Other Limitations,*" *Deal Lawyers,* March-April 2008.
- "*A Critique of Pure Reasoning,*" *INSIGHTS*, March 2008.
- "*The Demise of the Broadly Written MAC: Will the Plain Language Standard Replace the Reasonable Acquiror Standard?*" *Deal Lawyers,* Nov.-Dec., 2007.
- "*Unauthorized Management Buyout Proposals: Time to Reappraise Your Corporate Policies,*" *Deal Lawyers,* May/June 2007.
- "*The ConEd Decision - One Year Later: Significant Implications for Public Company Mergers Appear Largely Ignored,*" *The M&A Lawyer,* October 2006.
- "*Gesoff v. IIC: New Guidance Regarding Special Committees, Related Party Transactions and Fair Value,*" *Corporation* (Aspen Publishers) August 1, 2006.
- "*Delaware Court's Criticism of Special Committee in TCI Merger Provides Important Guidance But May Not Be Entirely Fair,*" *The M&A Lawyer,* February 2006.
- "*In Defense of Stapled Finance,*" *The M&A Lawyer,* January 2006.

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PRIMARY FOCUS & EXPERIENCE

Ms. Morgan's practice focuses on the representation of private equity firms and their portfolio companies and financial services companies (including asset managers and hedge funds) in M&A transactions. In addition, she is experienced in the purchase and sale of lending and leasing companies and portfolios of financial assets such as leveraged leases, mortgages, loans and related products.

Her recent private equity transactions include representing Centerbridge Partners, L.P. in its investments in Pocahontas Parkway and the Intrepid Aviation Group and in the consensual recapitalization of $500 million in debt and its acquisition of Wastequip LLC. She has also recently represented Koch Industries, Goldman Sachs and GSO in connection with their acquisition of preferred equity to support private equity-led LBO's and recapitalizations. She currently represents a group of investors in the former Arcapita Bank who are selling stakes in 30 portfolio companies located in the US, Asia, Europe and the Middle East. She represented Irving Place Capital in the $422 million take private of Thermadyne Holdings Corporation and the acquisition of National Specialty Hospitals and represented Culpeper Capital Partners and Fortress Investment Group in the acquisition of Security National Acceptance Automotive Group.

In the asset management industry, her recent transactions include the representation of Man Group plc in its 2014 acquisitions of Numeric Partners (a quantitative hedge fund with $14 billion AUM) and Silvermine Capital (a CLO manager with $3.8 billion AUM) and the sale of Stone Tower Capital to Apollo Global Management. She also represented Man Group plc in its 2011 acquisitions of GLG Partners and Ore Hill Partners.

Ms. Morgan advised Capital Z Investment Partners in the sale of its hedge fund sponsorship business to Paine & Partners and management in 2007 and represented Perella Weinberg Partners in the acquisition of Xerion Capital Partners, an investment manager that focuses on distressed credit and special situations investments. She also advised WL Ross & Co. LLC in connection with its sale of its investment funds to Invesco Ltd. and Lehman Brothers in the sale of numerous GP and LP stakes in a variety of private equity funds.

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TREVOR S. NORWITZ

Trevor Norwitz is a partner in the Corporate Department at Wachtell, Lipton, Rosen & Katz. He has counseled a wide range of corporations and other entities in a variety of industries in connection with mergers, acquisitions, investments, divestitures, hostile takeover bids and defenses, proxy contests, joint ventures, spinoffs, financing transactions, corporate governance matters, and crisis management situations.

Some of Mr. Norwitz's recent representations include: Dollar Tree in its contested acquisition of Family Dollar Stores; eBay in connection with a proxy contest by Carl Icahn, and its spinoff of PayPal, Inc.; Creative Artists Agency LLP in connection with its restructuring and sale of a controlling interest to TPG Group; McGraw Hill Financial in its sale of the McGraw Hill Education business to Apollo Advisers, in its joint venture with CME Group to form S&P/Dow Jones Indices, and in its acquisition of SNL Financial among other companies.

Mr. Norwitz teaches a course in Mergers and Acquisitions at Columbia University School of Law. He is a member of the American Law Institute, the New York City Bar M&A Committee and the International Bar Association Securities Committee and has served on committees of the American Bar Association. He served as a member of an international advisory group to the South African government on company law reform. A regular speaker and panelist at professional conferences, he has chaired and participated in numerous continuing legal education programs and contributes regularly to professional publications on topics relating to M&A and corporate governance. Mr. Norwitz also chairs and serves on a number of non-profit boards of directors, and on the Advisory Board of the Robert L. Bernstein Institute of Human Rights at NYU Law School.

Born in Cape Town, South Africa, Mr. Norwitz received his Bachelor of Business Science (Law) degree with First Class Honors from the University of Cape Town in 1986. On a Rhodes Scholarship to Oxford University, he read law at Keble College, graduating with First Class Honors in 1989, before completing an LLM at Columbia University in 1990.

Paul J. Shim

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Paul J. Shim advises clients on public and private merger and acquisition transactions, with a focus on private equity and other sponsor transactions.

He repeatedly has been recognized by the business and legal press for his work on behalf of clients, including twice being named a "Dealmaker of the Year" by *The American Lawyer*.

Paul joined the firm in 1987 and became a partner in 1996.

1

The Art of Cross-Border Deal Structuring: Debunking Myths for Foreign Acquirors of U.S. Targets

Wilson Chu
Soren Lindstrom

McDermott Will & Emery LLP

Wilson Chu is an M&A and corporate partner in the Dallas office of McDermott Will & Emery LLP and the creator of the American Bar Association's M&A Deal Points Studies. Soren Lindstrom is an M&A and corporate partner in the Dallas office of McDermott Will & Emery LLP. The authors gratefully acknowledge the assistance of our colleagues, Diego Gomez-Cornejo and Thaddeus Chase.

There has been a significant uptick in U.S.-targeted acquisitions in recent years as foreign buyers set their sights on the United States for growth and diversification. Foreign investors continue to perceive the U.S. economy as strong and stable and U.S. targets are benefitting from the bullish global M&A climate. In spite of the increase of deal flow stateside, there are still many myths about inbound M&A that are believed by even the most experienced foreign buyers around the world. Understanding the intricacies of the U.S. legal landscape, cultural nuances and trends in market practices will help you make your next inbound transaction a successful one. Below we debunk our top ten favorite myths about acquiring a U.S. company.

1. THE U.S. TARGET HAS A STATUTORY DUTY TO DISCLOSE ALL MATERIAL FACTS TO THE BUYER

Generally, there is no statutory duty of the seller to disclose all material facts to the buyer in an acquisition of a private U.S. company for cash. Except for a few limited exceptions, a private U.S. company does not have any statutory duty to disclose material facts to a prospective buyer nor can the buyer rely on statutory implied warranties. For example, there are no implied statutory warranties with respect to any aspect of the business or financial statements of the U.S. target. Since the general U.S. law of contract provides the parties with very generous flexibility to negotiate the terms of the transaction, the buyer, consequently, must seek to cover all material risks by negotiating robust representations and warranties about the target's business, financial statements, legal status, etc. as well as related provisions providing for indemnification by the U.S. target to the extent such representations and warranties turn out to be inaccurate. The buyer could also try to negotiate a "catch-all" representation and warranty by the target providing that neither the representations and warranties nor the related disclosure schedules of the target contain any misstatement of a material fact or omit to state a material fact necessary to make the statements made thereon from being misleading. For obvious reasons, the target will often object to such type of broad "disclosure representation."

2. AS LONG AS WE SECURE A "MATERIAL ADVERSE CHANGE" (MAC) CLOSING CONDITION, WE CAN ALWAYS WALK AWAY IF THINGS GO WRONG

Don't count on it! The U.S. courts have yet to let a buyer in an M&A transaction walk away solely by finding that a "material adverse change" (MAC) to the target and its business had occurred. Accordingly, a typical MAC condition provides little protection for the buyer. Instead, the buyer should seek to negotiate specific thresholds for when a MAC has occurred or, even better, separate closing conditions in addition to the traditional MAC clause. Such specific MAC thresholds or closing conditions could, for example, be a diminution of target's revenue or earnings of more than a certain dollar amount or the loss of three of the target's ten largest customers. The MAC thresholds or closing conditions should be tailored to the deal and to any specific concerns the buyer may have about the target.

3. OF COURSE IT'S CUSTOMARY TO QUALIFY SELLER'S REPS BY EVERYTHING IN THE DATA ROOM

Under more English and continental Europe M&A practice, it is increasingly common for seller to sweepingly qualify its representations and warranties by any information fairly disclosed to buyer in its due diligence and in the due diligence materials in the data room. When counsel for a U.S. target vigorously asserts that such global qualification is also common U.S. practice, you should simply reply: *Au contraire, mon cheri*. Instead, the prevailing U.S. practice formulation is: "Except as set forth in the correspondingly numbered Section of the Disclosure Schedules, seller represents and warrants to buyer that…" Under this framework of specific qualifications, it is common for a U.S. target to attempt "blanket cross-referencing" to expand the scope of a particular disclosure to cover other representations to which its application is, for example, "reasonably apparent." Cross-referencing (deemed or specific) as well as other issues such as disclaimers, materiality and knowledge qualifiers are commonly negotiated. "Whatever's in the data room" notions, however, are not.

4. DON'T WORRY ABOUT WHAT THE AGREEMENT SAYS, YOU CAN ALWAYS SUE FOR FRAUD

Not true, especially if the definitive acquisition agreement contains a non-reliance provision along the lines of: "Buyer has not relied on seller with respect to any matter in connection with buyer's evaluation of the Company other than the representations and warranties of seller specifically set forth in Article [ ] of this agreement." With this type of clause, buyer would be prevented from winning a fraud claim based on statements made by seller that are not contained inside of the four-corners of the written agreement (*i.e.*, no fraud liability for extra-contractual statements). This works because reliance under U.S. law is an essential element of a fraud claim. So when buyer disclaims reliance on extra-contractual statements, then it cannot hold seller liable for them, and buyer would be limited to proving fraud arising from the statements contained within the "four corners" of the agreement. Non-reliance clauses are often the subject of spirited negotiations. Buyers will typically resist giving a non-reliance clause on the grounds that it effectively gives the seller a "license to lie." On the other hand, seller will typically insist on such a clause so it knows for certain that it will be liable only for the representations and warranties within the four-corners of the agreement. Thus, the battle lines are drawn, with buyer forewarned that not all fraud is treated equally.

5. WE CAN'T USE MY COMPANY'S STOCK AS CONSIDERATION TO ACQUIRE A U.S. COMPANY

Not true if the target company is privately held (*i.e.* its stock is not publicly traded), but the use of buyer's stock as consideration in the acquisition will implicate the U.S. federal securities laws (if only cash is used, the U.S. securities laws would not be implicated). To avoid triggering a time consuming and costly registration process with the U.S. Securities and Exchange Commission (SEC) and subsequent SEC reporting obligations, the buyer must issue its stock to the target's stockholders in a "private placement" to "accredited investors" (basically, high net worth and sophisticated investors). If the buyer's stock is issued in a private placement, no SEC filings would be required (other than possibly a post-closing formality notice under Regulation D). However, a private placement will require the buyer to take steps to limit resale in the United States of its stock used in the acquisition and will cause the target's stockholders to be concerned about their ability to sell the stock.

6. YOU DON'T NEED NO STINKIN' PRO-SANDBAGGING PROVISION

Buyer's first draft would typically include a clause providing that buyer's right to seek indemnification for misrepresentations by the U.S. target is not limited by any knowledge of buyer. This clause is commonly referred to as a “pro-sandbagging” clause. The battle lines are drawn when seller insists on an “anti-sandbagging” clause that prevents buyer from seeking indemnification when it closed the deal over a representation that buyer knew was inaccurate. After typically protracted negotiations, the parties sometimes settle by “going silent” and not contractually agreeing one way or another. The question then becomes whether “going silent” is a win for buyer or seller. The answer depends on applicable U.S. state law and, in particular, whether buyer is required to prove reliance. For example, in Delaware (by far the most pervasive state corporate law), silence is generally considered a “buyer win” because buyer is not required to prove reliance on the representation. On the other hand, being silent under California law generally is considered a “seller win” because buyer must prove reliance. Combined with the uncertainty of litigation, buyer is better off insisting on an express pro-sandbagging clause on the basis that buyer is simply seeking to preserve the benefit of the bargain contained in seller’s representations and warranties for which buyer paid a king’s ransom in purchase price.

7. BEING A FOREIGN COMPANY, WE DON’T NEED TO WORRY ABOUT THE U.S. FOREIGN CORRUPT PRACTICES ACT (FCPA) WHEN BUYING A U.S. COMPANY

Wrong. The overarching purpose of the FCPA is to prohibit bribery of foreign officials. The life of the FCPA has over the last decade been marked by a dramatic increase in enforcement actions by the U.S. Department of Justice and the SEC. Violations of the FCPA are punishable by steep civil and/or criminal penalties and can result in severe harm to the reputation of a business. (In 2008, Siemens AG paid a $450 million criminal fine for violating the FCPA and $350 million in disgorgement of profits.) FCPA problems come in many shapes and sizes, but there are common warning signs that should alert a buyer, for example: the U.S. target company (a) conducts business in foreign jurisdictions where corruption is prevalent, (b) operates within an industry that historically is susceptible to corruption or (c) derives a substantial amount of business from government contracting. If a foreign buyer encounters warning signs in connection with a contemplated acquisition of a U.S. target, it should conduct a thorough FCPA due diligence investigation and seek to negotiate adequate protections in the definitive acquisition agreement.

8. IF WE ACQUIRE A U.S. COMPANY, WE WILL BE SUED LIKE THERE'S NO TOMORROW

Not necessarily. In fact, recent studies seem to suggest that is not the case. According to a 2015 study by SRS|Acquiom of 720 M&A transactions, only 9% resulted in arbitrated or court litigated indemnification claims. Proper counseling is key, and it is therefore critical to engage U.S. counsel who understands the custom and practice of U.S. M&A transactions so that the buyer will be afforded proper protections in the definitive acquisition agreement and any related escrow arrangement.

9. YOU MUST DO AN ASSET DEAL IF YOU WANT STEPPED-UP BASIS FOR U.S. INCOME TAX PURPOSES

A basic tenet in U.S. acquisition structuring is "BASS": Buy Assets, Sell Stock. Buyers typically want the step-up in tax basis (for depreciation and other tax deduction expenses) to reflect the purchase price in an asset deal (*i.e*. purchase of substantially all of target's assets). Selling stockholders in an asset deal, however, would be subject to double-taxation (target pays tax on the sale of the assets and its stockholders pay tax on sales proceeds received). One effective method to bridge this buy-asset v. sell-stock gap is through the use of an election under U.S. Internal Revenue Code Section 338(h)(10) in connection with a taxable stock sale. Under a 338 election, the stock transaction is treated as an asset deal for tax purposes, and the buyer's basis is accordingly revalued (*i.e*. stepped-up) to reflect the purchase price. The disadvantage of a 338 election is that it triggers a taxable gain on the deemed asset sale for which target and buyer typically agree to share. Once this sharing is negotiated, the road is paved to with an easier-to-execute stock deal that makes both sides happy.

10. THE ABA'S M&A DEAL POINTS STUDY IS MARKET

Close, but not always. While one of the authors has a proud parent's love for the ABA's M&A Deal Points Studies that benchmark commonly negotiated issues in M&A deals, experienced deal lawyers know that these studies are not all-things-to-all-deals. The studies, which over the years have consistently earned their gold-standard status as the most reliable M&A market-checks, yield varying findings that depend on a variety of factors, including (a) the source of the deals it analyzes (the agreements are publicly available, which means they were filed with the SEC because they meet applicable materiality hurdles for the public buyer), (b) purchase price amount (caps and baskets as percentages of deal size do not necessarily stay the same for every purchase price), and (c) nature of the deal (*e.g.*, leveraged buyout or growth equity). The studies look at each data point but cannot cross-correlate every data point to each other, so they do not depict the inevitable horse-trading that occurs in every deal. The better view of the Deal Points Studies is that they provide a robust and authoritative framework of market practices so a foreign buyer can gain an informed view when tailoring its negotiations to the specifics of the U.S. deal.

NOTES

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Takeover Law and Practice

Igor Kirman

Wachtell, Lipton, Rosen & Katz

This outline describes certain aspects of the current legal and economic environment relating to takeovers, including mergers and acquisitions and tender offers. The outline topics include a discussion of directors' fiduciary duties in managing a company's affairs and considering major transactions, key aspects of the deal-making process, mechanisms for protecting a preferred transaction and increasing deal certainty, advance takeover preparedness and responding to hostile offers, structural alternatives and cross-border transactions. Particular focus is placed on recent case law and developments in takeovers. This edition reflects developments through mid-March 2016.

Takeover Law and Practice

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Takeover Law and Practice

I.

Current Developments

A. Executive Summary

The last several decades have witnessed a number of important legal, financial and strategic developments relating to corporate transactions. Each of these developments has added complexity to the legal issues that arise in connection with mergers and acquisitions, tender offers and other major corporate transactions. Changes in stock market valuations, macroeconomic developments, the financial crisis and domestic and foreign accounting and corporate governance crises have added their own complexities. The substantial growth in hedge funds and private equity, the growing activism of institutional investors and the increased influence of proxy advisory firms have also had a significant impact.

The constantly evolving legal and market landscapes highlight the need for directors to be fully informed of their fiduciary obligations and for a company to be proactive and prepared to capitalize on business-combination opportunities, respond to unsolicited takeover offers and shareholder activism and evaluate the impact of the current corporate governance debates. In recent years, there have been significant court decisions relating to fiduciary issues and takeover defenses. In some instances, these decisions reinforce well-established principles of Delaware case law regarding directors' responsibilities in the context of a sale of a company. In others, they raise questions about deal techniques or highlight areas where other states' statutory provisions and case law may dictate a different outcome than would result in Delaware or states that follow Delaware's model.

Section I of this outline identifies some of the major developments in M&A activity in recent years. Section II reviews the central responsibilities of directors, including basic case law principles, in the context of business combinations and takeover preparedness. Section III focuses on various preliminary aspects of the sale of a company, including the choice of method of sale and confidentiality agreements, while Section IV discusses the various structural and strategic alternatives in effecting takeover transactions, including pricing options available in public company transactions. Section V focuses on the mechanisms for protecting an agreed-upon transaction and increasing deal certainty. Section VI summarizes and updates central elements of a company's advance takeover preparedness, particularly the critical role of a rights plan in preserving a company's long-term strategic plan and protecting a company against coercive or abusive takeover tactics and inadequate bids. Section VII discusses the special considerations that apply to cross-border transactions.

B. M&A Trends and Developments

1. Deal Activity

2015 was a record year for M&A. Global M&A volume hit an all-time high of over $5 trillion, surpassing the previous record of $4.6 trillion set in 2007. U.S. M&A made up nearly 50% of the total. The "mega-deal" made a big comeback, with a record 69 deals over $10 billion, and 10 deals over $50 billion, including two of the largest on record: Pfizer's $160 billion agreement to acquire Allergan and Anheuser-Busch InBev's $117 billion bid for SABMiller. Cross-border M&A reached $1.56 trillion in 2015, the second highest volume ever.

A number of factors provided directors and officers with confidence to pursue large, and frequently transformative, merger transactions in 2015. The economic outlook had become more stable, particularly in the United States. Many companies had trimmed costs in the years following the financial crisis, but still faced challenges generating organic revenue growth. M&A offered a powerful lever for value creation through synergies. Bucking historical trends, in a number of cases, the price of a buyer's stock rose on announcement of an acquisition, as investors rewarded transactions with strong commercial logic,. Equity prices in 2015 were strong, if flat, providing companies with valuable acquisition currency (50% of all U.S. public deals announced in 2015 included equity as a component of the consideration). For at least the first half of the year, strong appetite from debt investors (particularly for quality credits) and low interest rates enabled acquirors to obtain financing on attractive terms, though increasing choppiness in the leveraged finance markets later made high-yield financing of acquisitions more difficult.

Industry trends also played a significant role in M&A activity in 2015. There was consolidation in pharmaceuticals (including the pending Pfizer-Allergan transaction and AbbVie's $21 billion acquisition of Pharmacyclics), technology (including Dell's pending $67 billion acquisition of EMC and Avago's $37 billion acquisition of Broadcom), insurance (including Anthem's pending $54 billion acquisition of Cigna, Aetna's pending $37 billion acquisition of Humana and ACE's $28 billion acquisition of Chubb), and oil and gas (including Energy Transfer Equity's pending $38 billion combination with Williams Companies and Royal Dutch Shell's pending $70 billion acquisition of BG Group).

Continuing a recent trend, tax-free spin-offs remained a popular means to unlock value and restructure operations. A spin-off can create shareholder value when a company's businesses may command higher valuations if owned and managed separately, rather than as part of the same enterprise. These increased valuations can arise from capital markets factors, such as the attraction of investors who want to focus on a particular sector or growth strategy, and from more focused management and corporate initiatives that clarify the business' vision and mission. In addition to the potential for value enhancement, spin-offs also can be accomplished in a manner that is tax-free to both the parent and its shareholders. While the number of announced spin-offs declined in 2015 to 46 from a high of 80 in 2014, 2015 saw record spin-off volume of over $257 billion.

2015 brought important changes to the tax landscape for spin-offs. The IRS will no longer issue rulings as to the tax-free treatment of certain "cash-rich" spin-offs, where a very large percentage of the asset value of the parent or the spun-off corporation consists of cash or a non-controlling stake in another publicly traded entity. The IRS also will no longer rule on whether the "active trade or business" requirement for a tax-free spin-off is satisfied if the fair market value of the gross assets of the active trade or business on which either company is relying is less than 5% of the total fair market value of the gross assets of the company. This appeared to lead Yahoo! to abandon its planned tax-free spin-off of a company that would hold its stake in Alibaba. In addition, Congress amended Section 355 of the Internal Revenue Code in December of 2015 to provide that a spin-off in which only the spun-off company (or the parent company) is a REIT cannot qualify for tax-free treatment. Spin-offs by REITs of other REITs or of certain taxable REIT subsidiaries can still qualify as tax-free, however. As a result, the popular activist tactic of pushing for "OpCo/PropCo" separations—in which an operating company with significant real estate holdings spins its properties off into a separate publicly traded REIT and leases them back—has become less attractive.

Another notable recent trend is a significant increase in outbound investment by Chinese state-owned enterprises and other firms. Significant recent transactions include ChemChina's pending $43 billion acquisition of Syngenta AG, Haier Group's pending $5.4 billion acquisition of GE's appliances business, HNA Group's pending $6 billion acquisition of Ingram Micro, Chongqing Casin Enterprise Group's pending acquisition of the Chicago Stock Exchange and Anbang Insurance Group's $2 billion acquisition of The Waldorf Astoria Hotel. As discussed in Part VII.B.1 below, such transactions may involve review by the Committee on Foreign Investment in the United States, even outside of the defense sector. Successful completion of such transactions (like cross-border transactions more generally) requires thorough consideration of the regulatory implications, as well as an appreciation of different legal regimes and cultural norms as to negotiation and business practices.

2. Hostile and Unsolicited M&A

Hostile and unsolicited M&A have increased dramatically in recent years, from $145 billion of bids, representing 5% of total M&A volume, in 2013 to $577 billion of bids, representing about 20% of total volume, in 2015. Notable recent bids include Anheuser-Busch InBev's unsolicited but eventually agreed $117 billion bid for SABMiller, 21st Century Fox's $80 billion offer for Time Warner, which was ultimately withdrawn; Cigna's bid for Anthem, resulting in an agreed $54 billion merger; Mylan's $35 billion bid for Perrigo, which was defeated; Teva's $40 billion bid for Mylan, which was ultimately withdrawn; DISH Network's $26 billion bid for Sprint Nextel, which was ultimately withdrawn; and Energy Transfer Equity's bid for Williams Companies, resulting in an agreed $38 billion combination.

The Perrigo situation, which involved an inverted target domiciled in Ireland, demonstrates that it is possible for a target board to successfully resist a hostile takeover attempt, even without the ability to use a poison pill or other customary defenses. And where a poison pill is permissible, it can be a powerful means of protecting shareholder value, as illustrated by the Airgas situation: in December 2015, in vindication of the Airgas board's judgment and confirmation of the wisdom of the Delaware case law (particularly the Delaware Chancery Court's 2011 Airgas opinion validating the use of the poison pill), Airgas agreed to be sold to Air Liquide at a price of $143 per share, in cash, nearly 2.4 times Air Products' original $60 offer and more than double its final $70 offer, in each case before considering the more than $9 per share of dividends received by Airgas shareholders in the intervening years.

3. Private Equity Trends

Private equity firms have played a less visible role in the current M&A boom than they did 10 years ago, when PE firms led a number of $10 billion+ leveraged buyouts, sometimes in "club deals" along with other firms. Aside from a few high-profile large PE buyouts (such as the $67 billion acquisition of EMC by Dell Inc., Michael Dell, MSD Partners and Silver Lake, and the acquisition of Kraft Foods by H.J. Heinz, 3G Capital and Berkshire Hathaway), much of 2015's PE buyout activity was in the middle market. This has been driven by a variety of factors, including relatively high public market valuations, which provided strategic bidders competing with PE buyers with a valuable acquisition currency and led sponsors to conclude that targets were richly valued in some cases; strategic bidders' ability to extract synergies, which allowed them to dig deeper when bidding against PE firms; and the leveraged lending guidelines issued by the FDIC, the Federal Reserve and the OCC, which constrained banks' ability to lend into more heavily leveraged transactions.

Despite these factors, PE firms hardly stayed on the sidelines of M&A. In some cases, sponsors teamed with strategics to bid on an asset, bringing together expertise in financial structuring and operational management, as well as the ability to create synergies. Notable examples of such transactions include the Kraft/Heinz/3G Capital/Berkshire Hathaway transaction, and the $9 billion acquisition of Suddenlink by Altice, BC Partners and CPP Investment Board. In other cases, PE firms used portfolio companies as a platform for M&A, again combining the strengths of private equity and strategic firms. PE firms also used creative deal structures, such as a rollover by a PE seller of part of its stake in a portfolio company for the stock of the acquiror, which can help bridge a valuation gap and preserve a portion of the upside for the PE seller. Similarly, a company may sell a business to a PE firm and retain a stake in the divested business, which could ease the sales process, facilitate ongoing relationships and reduce the need for debt financing. With their capital commitment coffers full from the last few years of strong fundraising, PE sponsors can be counted on to continue to seek creative approaches to both deal sourcing and deal structuring to navigate a competitive deal environment where capital nevertheless must be deployed and pulling back is not a viable option.

Private equity exit value and volume grew in 2015 for the sixth consecutive year, resulting in over $550 billion in aggregate value from more than 2,300 deals.[1] Corporate acquisitions remained the primary exit ramp for private equity sellers, accounting for over 54% of total exits and 65% of exit value.[2] Next in line were niche sponsors counting on their operational expertise and sector knowledge to bid aggressively for PE-backed companies in their niche. By contrast, IPO exit volume fell by over about 40% year-over-year in 2015.[3]

a. Fundraising

Fundraising across traditional buyout, infrastructure, real estate and debt funds, among others, continued apace. 2015 saw almost $400 billion of capital raised globally, with 623 funds closing[4]—slightly down from 2014, but nevertheless a robust fundraising performance on par with the years leading up to the financial crisis. U.S. PE fundraising surpassed $185 billion in committed capital, with buyout funds accounting for roughly two-thirds of capital raised.[5] One of the largest post-crisis fund raises was concluded in December when Blackstone's latest flagship PE fund closed on $18 billion in commitments. The overwhelming majority of funds in the market met or exceeded their fundraising targets—and concluded fundraising far more quickly than in previous years—due to pent-up investor demand and sizable cash distributions from funds launched during the pre-crisis market. Although the “flight to quality” among institutional investors seeking to prune their sponsor relationships continued to favor large and established sponsors, middle-market sponsors also had a successful fundraising year as investors sought to put excess and/or recently returned capital to work and diversify their alternative asset portfolios. In 2015, committed capital outstripped contributed capital, adding to what was already a large overhang of “dry powder” (by some estimates exceeding half a trillion dollars in the U.S. alone[6]) and promising intense competition for deals, in an environment in which sponsors may seek an edge through niche strategies, operational excellence and creative dealmaking.

b. Investor and Regulatory Trends

Throughout the private equity world, from sponsors managing single buyout funds to diversified alternative asset management businesses, there continues to be a steady push towards more sophisticated governance structures and greater transparency, spurred by both investor demands and regulatory action. In 2015 both Blackstone and KKR were the target of enforcement actions by the SEC that were focused on the treatment, allocation and disclosure of fees and expenses charged to fund investors, whether directly or through transaction, monitoring and other special fees paid to managers by portfolio companies. Such high-profile enforcement actions, coupled with public calls for greater transparency by large institutional investors such as the California Public Employees’ Retirement System (CalPERS),[7] have led to a revisiting of sponsor procedures as well as fund limited partnership agreements and portfolio company fee arrangements. Many sponsors are more proactive in keeping investors informed about fund and portfolio developments during the entire life cycle of funds, whether through visits to investors, enhanced disclosures or more frequent reporting. Limited partner advisory committees are consulted more frequently, even where such consultation is not contractually required, as a means of managing conflicts and improving transparency. The compliance function at many sponsors has been strenghtened and given greater authority, as all indications are that fees, disclosure, conflicts and controls will remain in the regulatory spotlight in 2016. In addition to enforcement actions, the expanding regulatory landscape affecting funds and their sponsors—such as the European Union’s Alternative Investment Fund Managers Directive (AIFMD) and the U.S. Foreign Account Tax Compliance Act (FATCA)—have also contributed to the need for more sophisticated operational oversight. While these trends play out with differing intensity and speed for different sponsors, they generally have precipitated a shift towards stronger governance, internal control and risk management systems.

4. Acquisition Financing

Last year's robust acquisition financing market helped drive the headline-grabbing deals and record volume of M&A in 2015. At the same time, credit markets were volatile in 2015 and appeared to have shifted fundamentally as the year went on—and with them, the types of deals that could get done and the available methods of financing them. U.S. and European regulation of financial institutions, monetary policy, corporate debt levels and economic growth prospects have coalesced to create a more challenging acquisition financing market than has been seen in many years. As a result, 2016 is likely to be a year in which financing costs, availability and timing have significant influence over the type, shape and success of corporate deal-making.

a. Investment Grade Acquisition Financing

Investment grade acquisition financing activity showed continued strength in 2015, with bridge commitments for "mega-mergers" leading the way. In March, Morgan Stanley and The Bank of Tokyo-Mitsubishi UFJ provided an $18 billion bridge commitment to backstop AbbVie Inc.'s acquisition of Pharmacyclics. In November, AB InBev announced the largest corporate loan on record when it obtained commitments for $75 billion in connection with its acquisition of SABMiller.

In prior credit cycles, deterioration in acquisition financing markets has tended to creep up the ratings scale, with bank risk management during a persistent downturn resulting in changes to pricing, terms, and permanent financing take-out methods for not only high-yield but also cross-over and low investment grade acquirors. Moreover, as equity and credit investors become increasingly concerned with business risks attendant to higher corporate leverage, it may become less desirable to use cash to finance M&A activity. Combined with lower equity valuations, these dynamics could negatively affect deal activity, particularly for acquirors at the lower end of the investment grade range, many of whom have added significant leverage to their balance sheet over the past couple of years.

b. Leveraged Acquisition Financing

In the high-yield financing market, challenging conditions in the first half of 2015 worsened after August, and weakness previously limited to certain sectors (oil and gas, mining and retail) could be seen among lower-rated borrowers generally. High-yield bank loan and bond mutual funds and ETFs experienced substantial outflows during the year, which accelerated at year-end. These trends persisted, and continued to worsen, into the start of 2016. Market volatility and investors' flight to safety tend to exert their greatest pressure on high-yield issuers—absent significant market changes, leveraged borrowers should expect to face a dramatically different financing landscape in 2016 than at any time since the mid- to late- 2000s.

Critically, for the first time since 2008, banks are facing the prospect of taking significant losses on a large backlog of leveraged buyout loans (by some accounts reaching as high as $15 billion). Garnering headlines, a $5.5 billion bank and bond deal to finance Carlyle's takeover of Symantec Corp.'s data-storage business, Veritas, was pulled in November 2015, leaving the commitments on the books of the lead banks. Other deals that got done in late 2015 were restructured, and many priced well outside their anticipated range. Accordingly, financing sources have begun insisting on a broader toolkit for exiting their bridge commitments, including expanding the types of markets they could require borrowers to use to permanently refinance a commitment as well as wider rights to "flex" pricing, structure and other terms. Not surprisingly, upward pricing flexes outnumbered downward pricing flexes 3:1 in fourth-quarter 2015 syndications. In rapidly changing financial markets, where conditions, terms and pricing available to support deals may change on a weekly basis, careful and creative construction of the financing plan early in a transaction process will increase the likelihood of success and allow acquirors to seize on optimal market conditions when they arise. Advance planning for deals with experienced and thoughtful legal and financial advisors will be increasingly important in meeting the challenges of the year ahead.

5. Shareholder Litigation

Over the past several years, there has been a dramatic rise in stockholder litigation challenging mergers. Multiple stockholder lawsuits are commonly filed shortly after the announcement of major transactions. Such suits commonly contained rote allegations that the selling corporation's directors breached their fiduciary duties by agreeing to a deal at an inadequate price following an inadequate process and with inadequate disclosure. Stockholder lawsuits were filed to challenge 92% of deals with a transaction value greater than $100 million in 2014 and those deals were each subject to an average of 4.3 different lawsuits.[8] In over 30% of those transactions, lawsuits were filed in more than one jurisdiction, thereby forcing the merging corporations and their directors to defend against substantially the same claims at the same time in multiple courts with no guarantee of coordination.[9] Until recently, the vast majority of these merger objection lawsuits were settled, typically for nonmonetary consideration such as additional disclosures or minor amendments to deal terms (like the lowering of a termination fee).[10] In the last two years, however, the Delaware and New York courts have announced in a series of decisions that "disclosure only" settlements will rarely, if ever, pass muster in the courts, and that "disclosure light" settlements (ones that combine disclosure with some non-price deal-term alteration or prospective corporate governance change) will be subject to far greater scrutiny.[11] In adopting these changes in approach, the Delaware (and New York) courts believe they are serving stockholder interests by reducing the incentives to plaintiff-side law firms to bring cookie-cutter challenges to arm's-length mergers. Whether the new approaches will have their intended effects remains to be seen, but the early data suggests that fewer suits are being filed in the wake of these decisions.

Additionally, there has been a drop in the amount of multijurisdictional litigation. In 2013, the Delaware Court of Chancery upheld the legality of "exclusive forum" bylaw provisions that bar stockholder challenges to mergers from being filed in courts outside of Delaware.[12] In 2015, Delaware's legislature specifically authorized such provisions by statute. Such bylaws have become an increasingly common tool to fight against multijurisdictional litigation. Courts throughout the country—including state and federal courts in California, Illinois, Louisiana, Ohio, Oregon, New York and Texas—have enforced exclusive forum bylaws and dismissed or stayed litigation filed in violation thereof.[13] Such exclusive forum bylaws are beginning to reduce multijurisdictional litigation and we expect this will continue.[14]

Another notable recent development in shareholder litigation is Delaware's 2015 amendment of the Delaware General Corporation Law to provide that no certificate of incorporation of a Delaware corporation may contain a provision shifting fees on to a stockholder for bringing an unsuccessful fiduciary action against a director.[15]

C. Shareholder Activism and Engagement

1. Hedge Fund Activism

Recent years have seen a resurgence of raider-like activity by activist hedge funds, both in the U.S. and abroad, often aimed at forcing the adoption of policies with the aim of increasing short-term stock prices, such as increases in share buybacks, the sale or spin-off of one or more businesses of a company or the sale of the entire company. Matters of business strategy, capital allocation and structure, CEO succession, options for monetizing corporate assets and other economic decisions have also become the subject of shareholder referenda and pressure. Hedge fund activists have also pushed for governance changes as they court proxy advisory services and governance-oriented investors and have run (or threatened) proxy contests, usually for a short slate of directors, though increasingly for control of the board. Activists have also worked to block proposed M&A transactions, mostly on the target side but also sometimes on the acquiror side.

a. Large Companies and New Tactics

In recent years, it has become clear that even household-name companies with best-in-class corporate governance and rising share prices are liable to find themselves targeted by shareholder activists, represented by well-regarded advisors. Shareholder activism, in its latest incarnation, is no longer a series of isolated approaches and attacks; instead, it is creating an environment of constant scrutiny and appraisal requiring ongoing monitoring, awareness and engagement by public companies. The trend of targeting (and sometimes achieving settlements at) mega-cap, high-profile companies in diverse industries continued from 2014, through 2015 and into 2016, as illustrated by campaigns at Apple, General Electric, PepsiCo, Qualcomm, Yahoo!, eBay and DuPont, among others.

Campaigns by large institutional investors and asset managers that are not dedicated activist funds have also burst onto the activism scene, as illustrated by Artisan Partners' campaign against $280 billion Johnson & Johnson and the efforts by PAR Capital Management and Altimeter Capital Management to install former Continental CEO Gordon Bethune as Chairman of United Continental Holdings' board and replace six incumbent nominees, and Relational Investors' partnership with the California State Teachers' Retirement System (CalSTRS) to pressure Timken to break up the company.

Against this backdrop, however, there have recently been signs of a growing recognition that the excesses of shareholder activism threaten the sustainability and future prosperity of the American economy; for example, several major institutional investors have gone on the record to criticize—and have voted against—the typical activist playbooks, and have sought to establish and publicize their long-term mindset. DuPont's 2015 defeat of Trian Partners' proxy fight to replace four DuPont directors provided an important reminder that well-managed corporations executing clearly articulated strategies can still prevail against an activist, even in the face of pro-dissident recommendations by the major proxy advisory services and a campaign by a well-credentialed activist. Notable features of the DuPont-Trian campaign include the parties having engaged for nearly two years before the election contest commenced, DuPont implementing substantive business change (including active portfolio management, cost-cutting acceleration, and increased return of capital) and board refreshment, aggressive use of rapid response online, hardcopy and media communication tools by both sides (including dedicated "fight" websites, videos and newspaper advertisement), and several key institutional shareholders being willing to publicly announce their positions for or against the company in advance of the vote. Additionally, retail shareholders—who represented over 30% of DuPont's shareholder base—played a major role in determining the outcome of the proxy fight. DuPont used a variety of creative methods to reach this constituency. The aftermath of the DuPont battle nevertheless featured a subsequent change in CEO and announcement of a combination with Dow Chemical that was supported by Trian.

In addition to becoming more ambitious, activists have become more sophisticated, hiring investment bankers and other seasoned advisors to draft sophisticated "white papers," aggressively using social media and other public relations techniques, consulting behind the scenes with traditional long-only investment managers and institutional shareholders, nominating director candidates with executive experience and industry expertise, invoking statutory rights to obtain a company's non-public "books and records" for use in a proxy fight, deploying precatory shareholder proposals, and being willing to exploit vulnerabilities by using special meeting rights and acting by written consent. Special economic arrangements among hedge funds have also become more common, such as Pershing Square and Sachem Head's profit-sharing arrangements involving Zoetis and the arrangements the four hedge funds targeting General Motors entered into with their consultant and director nominee Harry Wilson.

Economic activists have also deployed non-binding shareholder proposals to seek to force corporate change. While shareholder proposals were historically the domain of governance activists (under the Rule 14a-8 proposal framework), in 2013 activist shareholder Relational Investors teamed up with CalSTRs to pressure Timken to break up the company by submitting to a shareholder vote a successful and ISS- and Glass Lewis-supported Rule 14a-8 shareholder proposal calling for a spin-off. In 2014, Carl Icahn deployed shareholder proposals in pursuit of economic agendas at both Apple and eBay, with such proposals to be considered at the companies' regularly scheduled annual meetings. After arguing for a \$150 billion buyback by Apple, Icahn presented a precatory proposal to be voted on by shareholders requesting a \$50 billion buyback. At eBay, Icahn sought to increase pressure on the company to separate its PayPal business by, in addition to running two of his employees as alternative director candidates in an election contest, submitting a non-binding proposal for a spin-off of the PayPal business (after preliminary proxy materials had been filed by both parties, Icahn ultimately withdrew his proposal following a negotiated settlement in which eBay appointed a mutually agreed independent director to its board and entered into a confidentiality agreement with Icahn; eBay later announced a separation of PayPal).

The successful "withhold the vote" campaign launched by hedge fund H Partners Management against Tempur Sealy in May 2015 was also notable for its use of majority voting to advance hedge fund activism. Having missed the advance notice deadline for director nominations, H Partners, a 10% shareholder, nevertheless waged an economic-based campaign to get shareholders to withhold votes from three sitting directors, specifically the CEO, the Chairman of the Board, and the Chair of the Nominating and Corporate Governance Committee, and argued that the CEO should be replaced and that the hedge fund's founder should be appointed to the board. ISS ultimately backed H Partners' campaign and the targeted directors failed to receive majority support. In accordance with the company's majority vote resignation policies, the directors tendered their resignations for the board to consider. A few days after the annual meeting had concluded, the board ultimately accepted the resignations, announced a settlement with H Partners in which its founder joined the board, and started a CEO search.

b. M&A Activism and Appraisal Arbitrage

Aside from activism pushing for a sale of the company, M&A deal activism should be anticipated in which, after a deal is announced, activists may seek a higher price, encourage a topping bid for all or part of the company, dissent and seek appraisal, try to influence the combined company and its integration, or even try to scuttle a deal entirely, leveraging traditional disruptive activist campaign tactics in their efforts. Deal activists may have little to lose, particularly when they exploit inherent deal uncertainty to buy the target's stock at a discount to the deal price and agitate for additional consideration. Even if there is no bump in transaction consideration for all shareholders, activists may still seek to profit from hold-up tactics and extract private benefits that may come at the expense of other shareholders. And just as U.S. investors have exported general activism abroad, U.S. hedge funds increasingly consider agitating against non-U.S. deals, often leveraging the idiosyncrasies of local laws to seek special benefits while deploying other U.S.-style tactics.

Additionally, M&A activism increasingly involves appraisal arbitrage, where hedge funds invoke (or buy claims giving them the right to invoke) statutory rights giving shareholders who object to a cash offer the right to dissent and seek a higher price through litigation, at the cost of not receiving the merger consideration.

In particular, stockholders of Delaware corporations acquired in merger transactions in which the consideration consists of cash, or a mix of cash and stock (unless all stockholders are entitled to receive only stock consideration at their election), are entitled to seek a judicial appraisal from the Delaware Court of Chancery of the fair value of their shares rather than accept the merger consideration. Most other jurisdictions also have some form of appraisal rights available, although the details vary from state to state. In order to perfect appraisal rights in Delaware, stockholders much comply with various procedural requirements, including not voting in favor of the merger and delivering a written demand to the company by the applicable statutory deadline (generally, before the vote is taken regarding a merger or before the consummation of a tender offer). The Court of Chancery appraises the shares by determining their fair value exclusive of any element of value arising from the accomplishment or expectation of the merger, plus interest which is generally computed from the closing date of the merger through the date of payment of the judgment based on 5% over the Federal Reserve interest rate.

The fundamental dynamic driving the phenomenon of appraisal arbitrage is that under current law, the worst-case scenario for appraisal arbitrageurs is that they will receive the deal value (assuming that the court views the deal value as the appropriate metric of fair value) plus the generous Delaware statutory interest rate, and studies indicate that billions of dollars in capital have been allocated to appraisal arbitrage strategies. Appraisal petitions were filed following 33 mergers in the Delaware Court of Chancery in 2015, compared with 24 in 2014.

Recent developments in the appraisal area have involved three questions: Can the appraisal court rely on the "M&A market" driving a robust sales process to help establish that the merger price was fair? Will Delaware amend its appraisal statute to provide that companies will no longer have to pay the statutory pre-judgment interest rate of 5% over the Federal Reserve discount rate on appraisal awards, which increases the potential returns of appraisal? And, can a stockholder who cannot demonstrate that the shares it owns were voted against the merger nonetheless pursue appraisal?

In several cases decided in 2014 and 2015, the Court of Chancery has shown itself increasingly willing to rely on market processes as an indication that stockholders received fair value, provided that a third party was not prevented from making a higher offer.[16] Not every appraisal case will be appropriate for the application of this approach (for example, cash-out mergers by controlling stockholders may not fit the mold), but where the facts support an inference of a robust market-derived price, plaintiffs will find it difficult to argue that fair value exceeds the merger consideration. Further, the Court of Chancery has also shown itself willing to deduct the value of synergies from the merger price, on the ground that the value attributable to synergies is not part of the fair value of the company as a stand-alone entity.[17] These decisions confirm that the market still matters in appraisal proceedings, sometimes conclusively, and that appraisal arbitrage is not without risk.

In 2015 and again in 2016, amendments to the appraisal statute were proposed that would affect the amount of interest owed on any appraisal award; to date, however, these amendments have not been adopted. Finally, the Delaware courts reaffirmed in 2015 that an appraisal plaintiff is not required to show that the shares as to which appraisal is sought were shares that were not voted in favor of the merger.[18] This result arises out of the difficulty of applying the language of the appraisal statute itself to the typical pattern of current share ownership involving the Depository Trust Company and, thus, a stockholder not only can purchase shares after the announcement of the transaction and pursue appraisal claims, but is not even required to hold shares on the record date for the vote on the transaction.

In this environment of hedge fund activism, including activism against some of the largest and most well-known U.S. companies, advance preparedness for activist pressure as well as for unsolicited takeovers is critical to improving a company's ability to create sustainable value over the long term and control its corporate destiny, deter coercive or inadequate bids, secure a high premium in the event of a sale of control of the corporation and otherwise ensure that the company is adequately protected against novel takeover tactics. Advance preparation for defending against shareholder opposition or an unsolicited takeover also may be critical to the success of a preferred transaction that a company has determined to be part of its long-term plan. Companies that build and maintain constructive engagement with shareholders, including shareholder activists, are better able to diffuse potentially confrontational situations before they become public, bloom into a full-fledged fight or result in the company being put "in play."

2. Governance Activism

Companies face a rapidly evolving corporate governance landscape defined by heightened scrutiny of a company's articulation of long-term strategies, board composition and overall governance *bona fides*, frequent implementation by companies of shareholder proposals and increasing direct shareholder engagement. As many companies have, in recent years, taken steps such as instituting majority voting, declassifying their boards of directors, eliminating takeover defenses, granting special meeting rights and, in certain cases, splitting the roles of chairman and chief executive officer, there are fewer targets for shareholder proposals on such topics. The potential for "withhold the vote" recommendations against directors has also emerged as an important consideration impacting boardroom decision-making, and majority shareholder support is increasingly common for certain shareholder proposals. One of the explanations for increasing shareholder support of governance changes is voting by institutional shareholders in accordance with recommendations of shareholder advisor services, such as ISS and Glass Lewis, which provide analysis or advice with respect to shareholder votes. These shareholder advisory services publish proxy voting guides setting forth voting policies on a variety of common issues that are frequent subjects of shareholder proposals. By outsourcing judgment to consultants or otherwise adopting blanket voting policies on various governance issues, institutional shareholders increasingly do not review individual shareholder proposals on a company-by-company basis and are thereby ignoring an individual company's performance or governance fundamentals. As a result, many shareholder votes may unfortunately be preordained by a blanket voting policy that is applied to all companies without reference to the particulars of a given company's situation. Notable exceptions to this general trend involve some large funds, such as BlackRock, State Street and Vanguard, which have formed their own large internal governance departments and have been more proactive in engaging directly with companies. Major institutional investors are feeling increasing pressure to avoid rote reliance on advisory firm recommendations and instead engage in case-by-case, pragmatic assessment of governance issues. Proxy advisory firms themselves have become subject to heightened scrutiny, with the SEC issuing regulatory guidance in June 2014 concerning the proxy voting responsibilities of investment advisors and their use and oversight of proxy advisory firms, and the SEC's Office of Compliance Inspections and Examinations specifically including in its 2015 National Examination Program Priorities plans to "examine select proxy advisory service firms, including how they make recommendations on proxy voting and how they disclose and mitigate potential conflicts of interest" and "examine investment advisors' compliance with their fiduciary duty in voting proxies on behalf of investors." In July 2015, the chair of a U.S. Senate economic policy subcommittee formally asked the U.S. Government Accountability Office to examine proxy advisory firms, and NASDAQ and the U.S. Chamber of Commerce have also launched initiatives focused on the use and impact of proxy advisory firms and their recommendations.

Proxy Access. Over the past decade, expanding shareholders' ability to nominate their own director candidates by permitting them to do so using the company's own proxy statement and proxy card rather than using their own proxy materials has been a fertile area for activism, discussion, rule-making and litigation. Although the SEC's mandatory proxy access rule was struck down, amendments to Rule 14a-8 have facilitated private ordering by permitting shareholders to submit proxy access proposals to individual companies. In the 2015 proxy season, a coordinated "Boardroom Accountability" campaign by the New York City Comptroller and various pension funds led to the filing of precatory shareholder proposals seeking proxy access at over 100 companies. While a majority of companies recommended that shareholders vote against these precatory proposals at their 2015 annual meetings, most, though by no means all, nevertheless passed at large-cap companies, gaining the support not only of the pension funds but also of many mainstream institutional investors, with targeted companies subsequently implementing proxy access provisions. Some major institutions like TIAA-CREF pursued private engagement in 2015, encouraging companies to adopt proxy access unilaterally even if they did not receive a shareholder proposal, and later began filing formal shareholder proposals themselves. Proxy access efforts by shareholders continued into the 2016 proxy season, and by early 2016, over 200 U.S. companies had implemented proxy access, often through negotiations with shareholder proponents or even proactively in advance of receiving a shareholder proposal. While some companies that had previously adopted proxy access bylaws received a second round of shareholder proposals asking for revisions, the proxy access "market" has now appeared to coalesce around "3/3/20/20" headline formulations requiring eligible shareholders to have continuously owned at least 3% of the company's outstanding stock for at least 3 years, limiting the maximum number of proxy access nominees to 20% of the board with appropriate crediting of previously elected nominees and permitting reasonable levels of aggregation and grouping (e.g., up to 20 shareholders) to meet the 3% threshold; treatment of other terms varies by company.

Defensive Provisions. Shareholder proposals requesting companies to repeal staggered boards continue to be popular, and such proposals have passed 86.4% of the time since 2005 at S&P 500 companies. However, some institutional investors are evaluating whether "one-size-fits-all" objections to classified boards have been overdone, especially in light of recent, well-regarded econometric studies showing that classified boards can promote long-term value creation. At year-end 2015, approximately 10% of S&P 500 companies had a staggered board, according to SharkRepellent figures, down from 47% as recently as 2005. Staggered boards are more prevalent among smaller companies, with 31.52% of the companies in the S&P 1500 having a staggered board at the end of 2015. As distinct from rights plans, a company that gives up its staggered board cannot regain a staggered board when a takeover threat materializes because it cannot be adopted unilaterally without shareholder approval, which would be difficult to obtain.

Over the past ten years, governance activists have sponsored precatory resolutions seeking repeal of or a shareholder vote on shareholder rights plans, also known as "poison pills." One result of this activism has been a dramatic decline in the proportion of large public companies that have rights plans in place, and an increase in the number of companies choosing instead to have "on-the-shelf" rights plans ready to be adopted promptly following a specific takeover threat. According to SharkRepellent, at year-end 2015, only 4% of S&P 500 companies had a shareholder rights plan in effect, down from approximately 45% as recently as the end of 2005. Shareholder rights plans are somewhat more prevalent for smaller companies, with 6.2% of the companies in the S&P 1500 having a rights plan in effect at the end of 2015 (a decline from 8.87% at the end of 2014). As discussed in Section VI.A, a number of companies have adopted rights plans with 4.9% triggers intended to protect valuable tax assets. Importantly, unlike a staggered board, a company can adopt a rights plan quickly if a hostile or unsolicited activist situation develops. However, ISS recommends an "against" or "withold" vote for directors who adopt a rights plan with a term of more than 12 months or renew any existing rights plan (regardless of term) without a shareholder vote. ISS also recommends voting on a case-by-case basis for boards adopting a rights plan for less than 12 months without shareholder approval.

Additionally, governance advisors have increased their focus on defensive charter and bylaw provisions adopted by newly public companies. For the 2016 proxy season, ISS issued new voting guidelines under which it generally will make adverse recommendations for directors at the first shareholder meeting of a newly public company if that company has bylaw or charter provisions that are "materially adverse to shareholder rights." Unless an adverse provision is reversed or submitted to a vote of public shareholders, ISS will make voting recommendations on a case-by-case basis on director nominees in subsequent years. Glass Lewis' guidelines provide for a one-year grace period for companies that have recently completed an IPO in which Glass Lewis refrains from issuing voting recommendations on the basis of corporate governance best practices, except in egregious cases. However, Glass Lewis will consider recommending to vote against the members of the board who served when an antitakeover provision such as a shareholder rights plan or a classified board was adopted if the board (i) did not also commit to submit such provision to a shareholder vote within 12 months of the IPO or (ii) did not provide a sound rationale for adopting such provision. The Council of Institutional Investors issued a draft statement laying out investor expectations as to various governance features of newly public companies. In addition, shareholder activists have pressured companies to remove, or agree not to include, several antitakeover defenses in spin-off companies' governance documents. After DuPont announced that its performance chemicals spin-off company, Chemours, would have a classified board and several other customary antitakeover protections for a spin-off or IPO company, Trian Fund Management criticized the DuPont board and subsequently launched a proxy fight. DuPont later revised Chemours' governance so that the classified board would be subjected to approval by the Chemours shareholders at the first annual meeting of Chemours stockholders. Carl Icahn has also entered into agreements with eBay, Manitowoc and Gannett that require their respective spin-off companies to, for a period of time after the spin-off, have an annually elected board, permit shareholders to call special meetings, and refrain from adopting a shareholder rights plan with a threshold below approximately 20% or a duration of more than a specified number of days without stockholder ratification.

Majority Voting. Beginning mostly in 2004, in the face of then-stalled efforts to provide investors with "proxy access," shareholder activists began to agitate against the traditional plurality voting standard, under which the director nominees receiving the highest number of votes are elected as directors, without regard to votes "against" or "withheld." Shareholder activists called on companies to instead adopt majority voting, under which a director nominee is elected only if the votes for his or her election exceed votes against or withheld. While majority voting remains a shareholder activist concern, hundreds of public companies have adopted a true majority voting standard for the election of directors in uncontested elections and a resignation policy for directors receiving less than a majority vote (often contained in the bylaws). Today, majority voting is on a path to becoming universal among large companies, as over 88% of S&P 500 companies currently have a majority voting policy in place.

Action by Written Consent. Governance activists have been seeking to increase the number of companies that may be subject to consent solicitations. 70% of S&P 500 companies prohibit shareholder action by written consent as of the end of 2015 (or require such consent to be unanimous). During 2005-2009, only one Rule 14a-8 shareholder proposal was reported to have sought to allow or ease the ability of shareholders to act by written consent. From 2010 to 2015, however, there were just over 160 such proposals (Approximately 20% of which passed). Hostile bidders and activist hedge funds have effectively used the written consent method to facilitate their campaigns, and companies with written consent provisions should carefully consider what safeguards on the written consent process they can legally and appropriately put in place.

Special Meetings. Institutional shareholders have also been pushing for the right of shareholders to call special meetings in between annual meetings, and shareholder proposals seeking such a right can generally be expected to receive significant support, depending on the specific threshold proposed by the shareholder and the company's governance profile. Over 60 percent of S&P 500 companies now permit shareholders to call special meetings in between annual meetings. Among the companies that permit shareholders to call special meetings, there remains significant variation with respect to the minimum threshold required to call a special meeting and as to the procedural requirements and substantive limitations on the exercise of this right. Economic activists and hostile bidders have been able to use the special meeting right to great effect to increase pressure on target boards, including by seeking to remove directors or submit precatory economic proposals. Care should be taken in drafting charter or bylaw provisions relating to special meeting rights to ensure that protections are in place to minimize abuse while avoiding subjecting institutional shareholders who wish to support the call of a special meeting to unduly onerous and unnecessary procedural requirements.

Say on Pay. Since the implementation of the mandatory say-on-pay vote, it has become increasingly important for companies to consider proactive outreach to shareholders regarding executive compensation. Now, more than ever, shareholder perception of company performance drives say-on-pay recommendations and voting at least as much as actual pay practices. Consequently, all companies are susceptible to a "no" recommendation or vote based on a perceived disconnect between pay and stock price performance, regardless of how carefully they adhere to so-called "best practices" in matters of compensation. In 2016 and the years ahead, well-established relationships with significant investors can be outcome-determinative when it comes to the mandatory say-on-pay vote.

3. Shareholder Engagement

Given the current hedge fund and governance activist environment discussed above, it has become very important for companies to nurture relationships with long-term shareholders and cultivate their understanding of the company's point of view, especially with respect to investments that have a long-term horizon. Leading institutional investors have also been developing a new paradigm for corporate governance in which these institutions would engage with a company and its independent directors to understand its long-term strategy and ascertain that the directors participated in the development of the strategy, were actively monitoring its progress and were overseeing its execution. The value of shareholder engagement has been recently endorsed by entities as diverse as the SEC, BlackRock, Vanguard, State Street, the Council of Institutional Investors, ISS and Glass Lewis, as well as by a host of corporate executives and board members, lawyers and commentators. Companies often engage with major shareholders in order to make the case for the corporate strategy, respond to shareholders' concerns and avoid capitulation to harmful demands from shareholder activists. The evolving trend is not only an increase in the frequency and depth of engagement, but also a more fundamental emphasis on the roles and responsibilities of both companies and shareholders in facilitating thoughtful conversations instead of reflexive, off-the-shelf mandates on corporate governance issues, and cultivating long-term relationships that have the potential to curb short-term pressures in the market. While corporate governance debates in the last decade or so have largely been framed oppositionally in terms of board/management versus shareholders, it may be that the next phase in corporate governance evolution features more debates between different types of shareholders—for example, activist hedge funds versus index funds or other large mutual fund groups. In some cases, activist funds have opposed each other's agendas. In short, shareholder engagement is no longer limited to the "proxy season" or special situations, and has become a regular, ongoing initiative of corporate governance and investor relations teams at public companies, with direct engagement with portfolio managers and governance professionals of key shareholders increasingly a year-round effort. In appropriate cases, director-level shareholder engagement may also serve to enhance credibility, preempt shareholder resolutions/contests and defuse contentious situations.

D. Regulatory Trends

The U.S. antitrust agencies continue to actively investigate and pursue enforcement actions involving transactions in many sectors of the economy. The overall level of merger enforcement during 2015 was roughly in line with the aggressive levels of the past few years, with the Federal Trade commission ("FTC") and U.S. Department of Justice's Antitrust Division ("DOJ") on a combined basis initiating court challenges to block seven proposed transactions and requiring remedies in 23 additional transactions. In addition, companies abandoned four transactions due to opposition from the antitrust agencies.[19]

Enforcement Trends and Issues

Enforcement activity in 2015 shows that the FTC and DOJ are prepared to pursue aggressive theories with respect to market definition and competitive effects. In a number of cases, the agencies defined product markets based on narrow customer groups that purportedly have different requirements that only a few suppliers can satisfy and that may be vulnerable to discriminatory treatment. This approach substantially limits the number of competitors that the agency counts as being in the relevant market and increases the competitive significance of the merging parties, thereby supporting a claim of competitive harm. The agencies have also shown a willingness to shift the focus of their competitive analysis away from local overlaps between the parties, focusing instead on a merger's effects at the national level. While in 1997 the FTC alleged that the merger of Staples and Office Depot would harm local competition, this year's suit alleges that the transaction will reduce competition across the U.S. Similarly, in the Comcast situation, the DOJ focused on Comcast's "control" of access to a large share of broadband customers nationally. This approach has important implications for the parties' ability to identify remedies that are sufficient to address the agencies' concerns.

During 2015, the agencies continued to be stringent in their approach to merger remedies, increasingly requiring that the parties identify an acceptable "upfront buyer" before accepting divestiture packages. This requirement can add months to the review process, as the merging parties need to identify a buyer, negotiate a divestiture agreement, and have the proposed divestiture buyer and package vetted by the agencies before the main deal can proceed. The agencies also continued to require broad divestiture packages, which in some recent cases included assets outside the relevant market of concern. For example, the FTC conditioned clearance of the merger of Holcim and Lafarge on the divestiture of several cement plants and terminals, including a plant and a terminal in Canada, which the FTC alleged were necessary to remedy competitive concerns in northern U.S. markets.

The recent "failed" divestiture in connection with Albertsons' acquisition of Safeway is likely to prompt even more scrutiny of proposed remedies. In January 2015, Albertsons agreed to sell 146 supermarkets to Haggen Holdings, a small regional supermarket chain, to obtain FTC's approval to acquire Safeway. In September, a few months after it acquired the stores, Haggen filed for bankruptcy, announcing a plan to reorganize with only 37 stores. Numerous store closures will likely result in a loss of competition, frustrating the FTC's efforts to maintain competition at the pre-merger level. Following the Albertsons situation and a similar failed divestiture in connection with Hertz's 2012 acquisition of Dollar Thrifty, merger parties should be prepared for a thorough review of divestiture buyers and protracted consent negotiations in transactions that raise concerns requiring relief.

Yet even in this atmosphere of vigorous antitrust enforcement, a number of difficult transactions were approved either unconditionally or with remedies. In September, the DOJ announced that it would not challenge Expedia's acquisition of Orbitz, a transaction that faced significant opposition from the hotel industry. The DOJ found that the acquisition was unlikely to harm competition because Orbitz only constitutes a small source of bookings for hotels, airlines and car rental companies, and the online travel business is rapidly evolving with several new services being launched to compete with the existing providers. In February, the FTC approved Zillow's proposed acquisition of Trulia, respectively the first and second largest web portals for home buying that sell advertising space to real estate agents. Although the parties' internal documents showed that "Zillow and Trulia compete closely with one another for consumer traffic and for real estate agent advertising dollars," the evidence also showed that real estate agents use numerous methods in addition to the parties' platforms to attract customers. The FTC found insufficient evidence that real estate agents would face higher prices post-merger, or that the combined company would have a reduced incentive to innovate.

Most enforcement actions in 2015 were resolved through consent orders requiring remedial action. Notable cases include Dollar Tree's acquisition of Family Dollar Stores and the merger of RJ Reynolds and Lorillard. In Dollar Tree, the FTC asserted that the two chains competed head-to-head in terms of price, product assortment and quality as well as location and customer service in local markets across the country. The agency required divestiture of 330 Family Dollar stores to resolve competitive concerns. The FTC's clearance of the merger of Reynolds and Lorillard, respectively the second and third largest U.S. cigarette manufacturers, was subject to the divestiture of four cigarette brands to Imperial Tobacco. The FTC alleged that, absent the divestiture, the merger would have raised significant concerns by eliminating current and emerging head-to-head competition between the parties in the highly concentrated cigarette market, thereby increasing the chances of unilateral price hikes as well as coordinated interaction between Reynolds and Altria, the industry leader.

The U.S. competition authorities also continue to vigorously enforce compliance with the HSR pre-merger notification requirement and waiting periods, including taking action with respect to both failures to file and so-called "gun-jumping" violations. For example, in August 2015, the FTC announced that Third Point LLC and three Third Point funds had agreed to settle charges that it had violated the HSR Act in connection with purchases in 2011 of Yahoo! stock. The HSR Act and Rules provide an exemption for acquisitions of up to 10% of a company's voting stock if the acquisitions are made solely for the purpose of investment and the acquirer "has no intention of participating in the formulation, determination or direction of the basic business decisions of the issuer." According to the FTC's complaint, the funds acquired voting securities in Yahoo! in excess of the $66 million (the 2011 HSR threshold) in August 2011 and continuing through September 8, 2011, when Third Point filed its Form 13D with the U.S. Securities and Exchange Commission, without having filed its HSR notification and observed the HSR waiting period. Although Third Point claimed that these purchases occurred when it had only investment intentions, the FTC found that Third Point "took actions that belied an investment-only intent." Specifically, Third Point had contacted third parties to determine their interest in replacing the current Yahoo! CEO or serving as a director of Yahoo!, internally considered launching a proxy fight, and made public statements concerning an alternative board slate.

The FTC's Bureau of Competition issued a blog post the same day explaining the long FTC history in narrowly construing the "investment only" exemption. The FTC construes the term not to apply should the company even be seriously considering a takeover, including possibly nominating someone for a seat on the board of directors. Similarly, the Premerger Office has indicated that the exception is unavailable if the acquirer attempts to influence the management's decisions.

Since the actions cited in the FTC's complaint were deemed by the FTC to be Third Point's first violation of the HSR Act, the Commission decided not to seek civil penalties. Rather, the order expressly prohibits Third Point from making acquisitions in reliance on the investment-only exemption if Third Point has engaged in certain enumerated conduct. The FTC's blog makes clear that while "activist investor conduct can be—but is not inevitably—beneficial," requiring compliance with the HSR Act does not inhibit activist conduct itself.

State attorneys general also continue to play a role in certain high-profile merger reviews, raising both strictly local as well as national concerns. In addition, in regulated industries (*e.g.*, energy, public utilities, gaming, insurance, telecommunications, financial institutions and defense contracting), state and federal regulatory agencies also have separate jurisdiction to review transactions.

The U.S. is not alone in its careful review of M&A transactions as further discussed in Section VII. For instance, in December 2015 the Canadian Competition Commission also brought an action before the

Tribunal to block the Office Depot/Staples transaction. In addition, in September 2015, telecom providers TeliaSonera AB and Telenor Group abandoned their proposed combination to create Denmark's largest mobile phone operator, citing as the cause the failure to reach an agreement with the European Commission on acceptable conditions. With pre-merger notification regimes in nearly 100 jurisdictions, it is not unusual for a multinational transaction to require a dozen or more notifications. In large transactions, competition authorities in the U.S., Europe and Canada frequently coordinate their investigations of transactions, and even the remedies they might require before granting clearance.

Getting the Deal Done

In light of the heightened global emphasis on antitrust enforcement, even more attention must be paid to the antitrust-related provisions contained in transaction agreements, including so-called "efforts" clauses, cooperation obligations, termination provisions and reverse termination fees. The trend toward sizeable antitrust-related termination fees in strategic transactions, such as the $2.5 billion reverse termination fee in 2011's Google—Motorola Mobility transaction and the $3 billion reverse termination fee in AT&T—T-Mobile (coupled with significant spectrum transfers), continued in 2014 and 2015. In the Electrolux/GE transaction, which GE terminated during the antitrust trial, the break up fee paid to GE was $175 million, and the Office Depot/Staples deal currently in litigation has a $250 million termination fee. The pending Charter/Time Warner Cable transaction includes a $2 billion reverse termination fee.

Looking forward, with many industry-shaping mergers still under review this year—the Obama Administration's last year—is likely to continue to be a period of vigorous antitrust enforcement. As in 2015, the agencies are likely to continue to pursue new theories of competitive harm, take a tough approach to merger remedies, and subject difficult transactions to lengthy reviews. In this enforcement environment, careful analysis and planning will remain important for parties considering potential transactions. Merger partners should thoroughly evaluate the substantive antitrust issues raised by the transaction, considering both traditional and alternative theories of competitive harm, and develop an effective remedy strategy early on. Finally, risk allocation and other antitrust-related provisions in transactions agreements will continue to be critical and will need to reflect the increased risk of protracted investigations and potential litigation.

II.

Board Considerations in M&A

The basic duties of corporate directors are to act with care and loyalty. But the level of scrutiny with which courts will review directors' compliance with their duties varies with situation and context. The default rule is the business judgment rule, which holds that directors' business decision-making generally will not (absent a personal conflict of interest) give rise to personal liability. Certain contexts, including when directors defend against a threatened change to corporate control or policy or engage in a sale of control of a company, invoke a heightened level of scrutiny under the *Unocal* and *Revlon* doctrines. Finally, in transactions involving a conflict of interest, an "entire fairness" standard may apply.

A. Directors' Duties

Directors owe two fundamental duties to shareholders: the duty of care and the duty of loyalty. Simply put, a director satisfies his duty of care if he has sufficient knowledge and data to make a well-informed decision. A director satisfies his duty of loyalty if he acts in good faith and in the interests of the shareholders and the corporation (rather than in his own personal interest).

1. Duty of Care

To demonstrate that a board has not met its duty of care, a plaintiff must prove that directorial conduct has risen to the level of "gross negligence," measured under the standard announced in 1985 by the Delaware Supreme Court in *Smith* v. *Van Gorkom* (the "*Trans Union*" case).[20] Delaware statutory law permits directors in exercising their duty of care to rely on advice from experts such as financial and legal advisors:

> A member of the board of directors, or a member of any committee designated by the board of directors, shall, in the performance of such member's duties, be fully protected in relying in good faith upon the records of the corporation and upon such information, opinions, reports or statements presented to the corporation by any of the corporation's officers or employees, or committees of the board of directors, or by any other person as to matters the member reasonably believes are within such other person's professional or expert competence and who has been selected with reasonable care by or on behalf of the corporation.[21]

At its core, the duty of care may be characterized as the directors' obligation to act on an informed basis after due consideration of relevant information and appropriate deliberation. Due care means that directors should act to assure themselves that they have the information required to take, or refrain from taking, action; that they devote sufficient time to the consideration of such information; and that they obtain, where useful, advice from counsel, financial advisors and other appropriate experts.[22]

Directors who act without adequate information, or who do not adequately supervise a merger sales process, risk criticism from the courts. Regardless of whether a transaction is a "change in control," directors should take an active role in the decision-making process and remain fully informed throughout that process.[23]

Because a central inquiry in a duty of care case is whether the board acted on an informed basis, a board should carefully document the basis for its decisions. While the use of competent advisors will generally protect directors from potential liability and help a board demonstrate that its decisions should not be set aside by the courts, ultimately business decisions must be made by directors—they cannot be delegated to advisors, and the Delaware Supreme Court has recently emphasized that advisors are not "gatekeepers" responsible for the overall adequacy of board process.[24]

Importantly, Section 102(b)(7) of the Delaware General Corporation Law allows corporations to include in their certificates of incorporation a provision to exculpate directors (but not officers) from monetary liability for breaches of the duty of care. Section 102(b)(7) provisions cannot, however, exculpate breaches of the duty of loyalty (including breaches arising from bad faith conduct), and they do not prevent a court from ordering equitable relief against violations of any duty.[25] In addition, even an exculpated breach of the duty of care can form the basis of a claim against a non-exculpated party (a financial advisor or officer, for example) for aiding and abetting the breach.

2. Duty of Loyalty

Every director has a duty to act in what he or she believes to be in the best interests of the corporation and its stockholders. This includes a duty *not* to act in a manner adverse to those interests by putting a personal interest or the interests of someone to whom the director is beholden ahead of the corporation's or the stockholders' interests.[26] The classic manner of showing that a director has not met his or her duty of loyalty involves proof that the director has engaged in a "self-dealing" transaction. However, any time a majority of directors are either (a) personally interested in a decision before the board or (b) not independent from or otherwise dominated by someone who is interested, courts will be concerned about a potential violation of the duty of loyalty and may review the corporate action under the "entire fairness" level of scrutiny, described more fully below.[27]

The duty of loyalty also encompasses the concept of good faith. In its 2006 decision in *Stone* v. *Ritter*, the Delaware Supreme Court clarified that "the obligation to act in good faith does not establish an independent fiduciary duty that stands on the same footing as the duties of care and loyalty."[28] Instead, the traditional duty of loyalty "encompasses cases where the fiduciary fails to act in good faith."[29] A director violates his or her good faith obligations where the fiduciary "intentionally acts with a purpose other than that of advancing the best interests of the corporation, where the fiduciary acts with the intent to violate applicable positive law, or where the fiduciary intentionally fails to act in the face of a known duty to act, demonstrating a conscious disregard for his [or her] duties."[30]

Understanding what rises to a duty of loyalty violation is especially important in light of Section 102(b)(7), because corporations may not exculpate their directors for breaches of the duty of loyalty (in contrast to breaches of the duty of care). The Delaware Supreme Court has held that if a plaintiff has failed to plead a duty of loyalty claim against a director, that director may be dismissed from the litigation, even where the plaintiff may have adequately pleaded loyalty claims against other members of the board.[31]

In *Lyondell Chemical Co.* v. *Ryan*, the Delaware Supreme Court rejected stockholder claims that directors had breached their duty of loyalty and good faith in selling the company. The *Lyondell* Court assumed that the directors did nothing to prepare for an impending offer and did not even consider conducting a market check before entering into a merger agreement containing a no-shop provision and a 3.2% break-up fee.[32] The Court stated that in order to show a lack of good faith, the plaintiffs would need to show that the board "utterly failed" to try to meet its obligations or otherwise acted for some purpose other than advancing the best interests of the corporation.[33] Because the board had engaged in some level of negotiation and pushed back (albeit unsuccessfully) on the acquiror, the Supreme Court reversed the Court of Chancery, noting that the directors needed only to make decisions that were "reasonable, not perfect."[34] *Lyondell* is a powerful statement that courts appreciate the complex decisions directors must make in selling the company, and will not treat all attacks on board process as raising issues of good faith.[35]

B. The Standards of Review

The fiduciary duties of care and loyalty are standards of conduct describing a director's obligations to the corporation.[36] Whether a court determines that directors breached their fiduciary duties can depend heavily on the standard of review the court applies to the directors' decision-making.

1. Business Judgment Rule

The traditional business judgment rule is the default standard of review applicable to directors' decisions. Under the business judgment rule, "directors' decisions are presumed to have been made on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company."[37] In other words, the business judgment rule is a presumption that directors are complying with their fiduciary duties. The purpose of the rule is to "encourage[] corporate fiduciaries to attempt to increase stockholder wealth by engaging in those risks that, in their business judgment, are in the best interest of the corporation 'without the debilitating fear that they will be held personally liable if the company experiences losses.'"[38] In the case of a Delaware corporation, the statutory basis for the business judgment rule is Section 141(a) of the Delaware General Corporation Law, which provides that "[t]he business and affairs of every corporation . . . shall be managed by or under the direction of a board of directors."[39]

In cases where the traditional business judgment rule applies, directors' decisions are protected unless a plaintiff is able to plead facts showing that a board has in fact acted disloyally, in bad faith, or with gross negligence.[40] This rule prevents courts and stockholders from interfering with managerial decisions made by a loyal and informed board unless the decisions cannot be "attributed to any rational business purpose."[41] Indeed, the Court of Chancery has described business judgment review as a "bare rationality test."[42] If a plaintiff is able to rebut the presumptive protections of the business judgment rule, the court will review the action or decision for entire fairness.[43]

2. Enhanced or Intermediate Scrutiny

There are certain situations in which Delaware courts will not defer to board decisions under the traditional business judgment rule. These include a board's (a) adoption of defensive mechanisms in response to an alleged threat to corporate control or policy,[44] and (b) approval of transactions involving a sale of control.[45]

In these circumstances, board action is subject to judicial review under an "enhanced scrutiny" standard, which examines the substantive reasonableness of both the board's process and its action. The Court of Chancery has explained that "[e]nhanced scrutiny applies when the realities of the decision-making context can subtly undermine the decisions of even independent and disinterested directors."[46] The decision-making process, including the information relied on, must satisfy the court's enhanced, or intermediate, standard. In addition, under the enhanced scrutiny tests, unlike under the traditional business judgment rule, the court will need to be satisfied that the directors' decisions were objectively *reasonable* rather than merely rational.[47] It is important to note that these tests have most application before a stockholder vote and when a third-party bidder or other plaintiff is seeking injunctive relief.[48] The Delaware Supreme Court has recently confirmed that when a board decision that would otherwise be subject to enhanced scrutiny is approved via a fully-informed, uncoerced vote of a majority of the disinterested stockholders, the standard of review is business judgment.[49]

a. *Unocal*

Directors who adopt defensive measures against a potential threat to control carry the burden of proving that their process and conduct satisfy the enhanced standard established in 1985 by *Unocal Corp*. v. *Mesa Petroleum Co*.[50] This standard requires that the board meet a two-pronged test:

- first, the board must show that it had "reasonable grounds for believing that a danger to corporate policy and effectiveness existed," which may be shown by the directors' reasonable investigation and good faith belief that there is a threat; and

- second, the board must show that the defensive measure chosen was "reasonable in relation to the threat posed," which in *Unitrin, Inc.* v. *American General Corp.* the Delaware Supreme Court defined as being action that is not "coercive or preclusive" and otherwise falls within "the range of reasonableness."[51]

Under the first prong of this test, a court may take issue with defensive action when a board is unable to identify a threat against which it may justifiably deploy anti-takeover efforts. For example, in *Unitrin*, the Court viewed the first prong of *Unocal*—whether a threat to corporate policy exists—as satisfied based on the board's conclusion that the price offered in an unsolicited takeover bid was inadequate, although it described the threat as "a mild one."[52] *Unitrin* also made clear that a board has discretion to act within a range of reasonably proportional responses to unsolicited offers,[53] *i.e.*, not limited by an obligation to act in the least intrusive way.

However, board discretion under the *Unocal* standard is not unlimited. In the 2000 case *Chesapeake Corp.* v. *Shore*, the Delaware Court of Chancery invalidated the adoption of a supermajority voting bylaw by a board confronted with a combined consent solicitation and tender offer.[54] Applying *Unocal,* the Court found that the only threat the board met its burden to show—price inadequacy—was "mild."[55] The Court then examined the board's response to this threat, and found that the target board failed to demonstrate that the supermajority voting bylaw was not preclusive in light of such factors as the target management's control of nearly 24% of the voting power and the probable percentage of stockholders who would vote in the consent solicitation. The Court noted that the target company's other defensive provisions, such as its rights plan, the inability of its shareholders to call a special meeting and the board's power to set the record date for consent solicitations, provided protection against coercion by the bidder and gave the board time to consider other alternatives. The Court recognized that "*Unitrin* emphasized the need for deference to boards that make reasoned judgments about defensive measures," but stated that "[i]t in no way suggests that the court ought to sanction a board's adoption of very aggressive defensive measures when that board has given little or no consideration to relevant factors and less preclusive alternatives."[56]

The landmark 2011 decision in *Air Products & Chemicals, Inc.* v. *Airgas, Inc.*, upholding the Airgas board's refusal to accept a premium cash bid from Air Products, is the most important recent decision reviewing the law applicable to board responses to unsolicited takeover efforts.[57] The Delaware Court of Chancery upheld under *Unocal* the Airgas directors' decision to block a hostile tender offer by refusing to redeem its "poison pill" shareholder rights plan. In ruling for the Airgas board, the Court found that the directors had acted in good faith in determining that Air Products' "best and final" tender offer was inadequate. In making this finding, the Court relied on the fact that the board was composed of a majority of outside directors, that the board had relied on the advice of outside legal counsel and three separate financial advisors, and that the three Airgas directors nominated to the Airgas board by Air Products (and elected by the stockholders) had sided with the incumbents in concluding that Air Products' offer should be rejected. The Court's opinion held that "in order to have any effectiveness, pills do not—and cannot—have a set expiration date."[58] The Court continued that while "this case does not endorse 'just say never.' . . . it does endorse . . . Delaware's long understood respect for reasonably exercised managerial discretion, so long as boards are found to be acting in good faith and in accordance with their fiduciary duties (after rigorous judicial fact-finding and enhanced scrutiny of their defensive actions). The Airgas board serves as a quintessential example."[59]

Even in the absence of a hostile bid, deal protection devices included in friendly merger transactions such as termination fees, force-the-vote provisions, expense reimbursements and no-shop provisions generally are reviewed under the *Unocal* standard. This is because, as one Delaware Court of Chancery case put it, "[w]hen corporate boards assent to provisions in merger agreements that have the primary purpose of acting as a defensive barrier to other transactions not sought out by the board, some of the policy concerns that animate the *Unocal* standard of review might be implicated."[60] Generally, Delaware courts will consider the effect and potentially excessive character of "all deal protections included in a transaction, taken as a whole," in determining whether the *Unocal* standard has been met.[61]

Further, limits on the board's discretion under the Unocal standard are especially relevant where "defensive conduct" impacts the shareholder franchise or a proxy contest. In such situations the *Unocal* standard will often be applied with particular acuity and reference to *Blasius Industries, Inc.* v. *Atlas Corp.*[62] In *Blasius*, the directors of the target increased the size of the board so that a proxy insurgent, which was running a short slate, could not have a majority of the board even if all of its candidates won. The Delaware Court of Chancery invalidated the bylaw as impermissible interference with the stockholder franchise. In *Blasius*, the court held that a board must show "compelling justification" for any conduct whose primary purpose is to thwart effective exercise of the franchise. Subsequent decisions have clarified that this "non-deferential" standard is "rarely applied," and, when it is applied, it should generally be done as part of a *Unocal* analysis.[63]

In *MM Companies Inc.* v. *Liquid Audio, Inc.*,[64] the Delaware Supreme Court applied *Blasius* scrutiny within a *Unocal* framework to a board's appointment of two new directors immediately prior to a contested election, because such appointments were done for the purpose of frustrating stockholder attempts to gain influence on the board. MM sought to replace the two members of Liquid Audio's five-person staggered board up for re-election that year. The record reflected that the decision was "taken for the primary purpose of impeding the shareholders' right to vote effectively in an impending election."[65] The Court explained that *Blasius* scrutiny may apply even where defensive actions do "not actually prevent the shareholders from attaining any success in seating one or more nominees in a contested election" and where an "election contest [does] not involve a challenge for outright control of the board."[66]

However, more recently, Delaware courts have stressed that "the reasoning of *Blasius* is far less powerful when the matter up for consideration has little or no bearing on whether the directors will continue in office."[67] Thus, in *Mercier* v. *Inter-Tel*, the Court of Chancery expressed doubt that *Blasius* review should apply to a board's decision to adjourn a stockholder meeting to solicit additional support for a proposed merger transaction, even where the board knew that the transaction would be voted down if the meeting went forward and even in the midst of a proxy fight. But, in any event, the court was satisfied that the board satisfied the "compelling justification" standard, because directors "act for a compelling reason in the corporate context" when they "act for the purpose of preserving what the directors believe in good faith to be a value-maximizing offer."[68]

b. *Revlon*

Transactions involving a "sale of control" or "change of control" of a corporation (*i.e.*, a merger in which all or a preponderant percentage of the consideration is cash, or in which there will be a controlling shareholder post-merger) will also be subject to enhanced judicial review.[69] In *Revlon, Inc.* v. *MacAndrews & Forbes Holdings, Inc.*, the Delaware Supreme Court held that in a sale of control context, directors must attempt to achieve the highest value reasonably available for shareholders.[70]

When *Revlon* review is triggered, "[t]he directors' role change[s] from defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders at a sale of the company."[71] Under this conception of *Revlon*, provided a board is choosing between two or more capable bidders presenting transactions that are comparable in terms of timing and likelihood of consummation, it must look solely to price. Specifically, a board comparing two or more cash offers cannot, for example, choose the lower one because it has advantages for "constituencies" other than common shareholders, such as employees, customers, management, and preferred shareholders.

However, it is also true that "there is no single blueprint that a board must follow to fulfill its duties" in the *Revlon* context.[72] The Delaware Supreme Court has held that "[i]f a board selected one of several reasonable alternatives, a court should not second-guess that choice even though it might have decided otherwise or subsequent events may have cast doubt on the board's determination."[73] This flexibility is particularly significant in determining a board's *Revlon* obligations when it is considering a friendly merger for cash but does not wish to engage in pre-signing negotiations with more than one partner. The Court has recently stressed that "[w]hen a board exercises its judgment in good faith, tests the transaction through a viable passive market check, and gives its stockholders a fully informed, uncoerced opportunity to vote to accept the deal," the board's *Revlon* obligations are met.[74]

1. When does *Revlon* apply?

The *Revlon* "duty to seek the best available price applies only when a company embarks on a transaction—on its own initiative or in response to an unsolicited offer—that will result in a change of control."[75] The most common example of this is where the board of a non-controlled company decides to enter into a definitive agreement to sell the company in an all-cash deal. But, where the board does not embark on a change-of-control transaction, such as when it is arguably put "in play" by the actions of outsiders,[76] *Revlon* review will not apply. Accordingly, enhanced scrutiny is not triggered by a board's refusal to engage in negotiations where an offeror invites discussion of a friendly (or unfriendly) deal.[77] Nor will *Revlon* apply to a merger transaction in which there is no change of control, such as in a purely stock-for-stock merger between two non-controlled companies. The Delaware Supreme Court held in its seminal 1989 opinion in *Time-Warner* that in stock-for-stock mergers with no sale of control, the ordinary business judgment rule applies to the decision of a board to enter into a merger agreement.[78] But a stock-for-stock merger is considered to involve a sale of control when there would exist a post-merger controlling shareholder. This was the case in *Paramount Communications, Inc.* v. *QVC Network Inc.*, where Viacom had a controlling shareholder who would have had voting control of the post-merger combined company.[79] The reason that pure stock-for-stock mergers between non-controlled entities do not result in a *Revlon*-inducing "change of control," is that such combinations simply shift "control" of the seller from one dispersed generality of public shareholders to a differently constituted group that still has no controlling shareholder. Accordingly, the future prospect of a potential sale of control at a premium is preserved for the selling company's shareholders. This principle applies even if the acquired company in an all-stock merger is very small in relation to the buyer. Despite the formal difference between the standards of review applicable to stock-for-stock transactions, the Delaware courts have indicated in recent decisions that the doctrinal distinction is not absolute, and, even in all-stock transactions, directors are well advised to consider means of maximizing stockholder value.

Nor is there a "change of control" in the cash (or stock) sale of a company with a controlling shareholder to a third party.[80] Where a company already has a controlling shareholder, "control" is not an asset owned by the minority shareholders and, thus, they are not entitled to a control premium. The Court of Chancery has expressly held, therefore, that the sale of controlled companies does not invoke *Revlon* review.[81]

Though, as discussed, it is clear that all-cash deals invoke *Revlon* review and all-stock deals do not, the courts are still struggling with situations in which the consideration is mixed. In *In re Santa Fe Pacific Corp.*, the Delaware Supreme Court held that a transaction in which cash represented 33⅓% of the consideration would not be subjected to *Revlon* review.[82] However, more recently, the Delaware Court of Chancery ruled that the *Revlon* standard would likely apply to half-cash, half-stock mergers, reasoning that enhanced judicial scrutiny was in order because a significant portion "of the stockholders' investment [] will be converted to cash and thereby be deprived of its long-run potential."[83]

Revlon applies only once the board actually makes the decision to embark on a change of control transaction and not while it is exploring whether or not to do so.[84] Accordingly, the board may change its mind at any time before making the decision to enter into a transaction. However, once a board makes a decision that attracts the heightened *Revlon* level of scrutiny, courts may look back at the board's behavior during the exploration process and may be critical of actions taken that appear unreasonable and inconsistent with the board's duty to maximize stockholder value.[85] For this reason, it is important for boards and their advisors to keep a good record of their reasons for taking the actions they did.

2. What is maximum value?

Revlon does not require boards to simply accept the highest nominal offer for a company. A board may conclude that even a cash offer, although "higher" in terms of price than another cash offer, is substantially less likely to be consummated; the risk of non-consummation is directly related to value. And the difficulties that may arise in valuing stock and other consideration are discussed in Section IV.B.4; the related board decisions require the exercise of informed judgment. Directors "should analyze the entire situation and evaluate in a disciplined manner the consideration being offered. Where stock or other non-cash consideration is involved, the board should try to quantify its value, if feasible, to achieve an objective comparison of the alternatives."[86] In the context of two all-cash bids, under certain circumstances a board may choose to take a bid that is "fully financed, fully investigated and able to close" promptly over a nominally higher, yet more uncertain, competing offer.[87] Bids that present serious issues concerning regulatory approval or the buyer's ability to close may be viewed as less attractive, although nominally higher, than offers that are more certain of consummation.

An example of judicial deference to a board's strategic decisions when conducting a sale of control is *In re Dollar Thrifty Shareholder Litigation*,[88] where the Delaware Court of Chancery denied a motion to enjoin the completion of Dollar Thrifty's merger with Hertz, finding that the Dollar Thrifty board had not violated its *Revlon* duties in declining a higher bid from Avis. From 2007 through 2009, Dollar Thrifty had engaged in unsuccessful negotiations with both Hertz and Avis. Following a turnaround effort led by a new CEO, the Dollar Thrifty board decided to reengage with Hertz, and, after months of bargaining, Dollar Thrifty agreed to be acquired by Hertz for $41 per share. The merger agreement also included a robust reverse termination fee, a no-shop provision, matching rights, and a provision requiring Hertz to make substantial divestitures if necessary to secure antitrust approval of the merger. Following the announcement of the Hertz deal, Avis made an offer at $46.50 per share, although its offer lacked the certainty of the merger agreement with Hertz. The Dollar Thrifty board rejected the Avis bid in favor of the deal with Hertz. The Court wrote that "directors are generally free to select the path to value maximization [under *Revlon*], so long as they choose a reasonable route to get there."[89] The Court concluded that the board acted reasonably in rejecting the Avis offer in light of the facts that Avis lacked the resources to finance the deal and that a deal with Avis was subject to greater antitrust risk. As the Court noted, "[v]alue is not value if it is not ultimately paid."[90] Similarly, the Court of Chancery refused to enjoin a stockholder vote on a proposed merger between Family Dollar Stores, Inc. and Dollar Tree, Inc. when the Family Dollar board turned down a facially higher bid from Dollar General, Inc.[91] The Court held that the independent directors properly complied with their fiduciary duties and were justified in concluding that "a financially superior offer on paper does not equate to a financially superior transaction in the real world if there is a meaningful risk that the transaction will not close for antitrust reasons."[92]

3. What sort of sale process is necessary?

Boards have substantial latitude to decide what tactics will result in the best price. As the Delaware Supreme Court recently reaffirmed, "*Revlon* and its progeny do not set out a specific route that a board must follow when fulfilling its fiduciary duties, and an independent board is entitled to use its business judgment to decide to enter into a strategic transaction that promises great benefit, even when it creates certain risks."[93] Directors are not required "to conduct an auction according to some standard formula" nor does *Revlon* "demand that every change of control of a Delaware corporation be preceded by a heated bidding contest."[94] Courts have recognized that, in general, disinterested board decisions as to how to manage a sale process are protected by the business judgment rule. In *Mills Acquisition Co.* v. *Macmillan, Inc.*, the Delaware Supreme Court stated that "[i]n the absence of self-interest . . ., the actions of an independent board of directors in designing and conducting a corporate auction are protected by the business judgment rule."[95] The Court continued that "like any other business decision, the board has a duty in the design and conduct of an auction to act in 'the best interests of the corporation and its shareholders.'"[96] A board approving any sale of control must also be fully informed concerning the development of the transaction, alternatives, valuation issues and all material terms of the merger agreement. Thus, even in the change-of-control context reviewed under *Revlon*'s enhanced scrutiny, a board retains a good deal of authority to determine how to obtain the best value reasonably available to shareholders.

In *In re Toys "R" Us, Inc. Shareholder Litigation*, the Delaware Court of Chancery strongly endorsed the principle that well-advised boards have wide latitude in structuring sale processes.[97] The Court's noteworthy holdings included, among others: (1) rejection of the plaintiffs' claims that a 3.75% break-up fee and matching rights unreasonably deterred additional bids; (2) approval of the board's decision to permit two of the competing private equity firms in the deal to "club" together, which potentially reduced the number of competing bidders in later rounds but was designed to facilitate bidding; (3) the rejection of allegations of a conflict of interest on the part of the CEO arising out of his stock and option holdings; and (4) the rejection of claims that the board's financial advisor's advice was tainted by the terms of its engagement letter, which provided for greater fees in the event of a sale of the whole company versus some smaller transaction. The Court's opinion reaffirmed the principle that courts will not second-guess well-informed, good faith decisions that need to be made to bring a sale process to successful conclusion.

Similarly, in *In re Topps Co. Shareholders Litigation*, the Court endorsed the Topps board's decision not to conduct a public auction but instead to negotiate, essentially on an exclusive basis, with a particular buying group.[98] The Court also approved the array of deal protection terms in the Eisner agreement (including matching rights and a 4.3% break-up fee). The Court found that the Topps board was justified in signing the deal at a time when Topps' chief competitor, Upper Deck, had already communicated its interest in a transaction. However, the Court found that the Topps board had erred in failing to conduct serious negotiations with Upper Deck during the "go-shop" period prescribed under the merger agreement, clarifying that (if *Revlon* duties apply) once a premium price is put on the table by a *bona fide*, financially capable overbidder, the target board must fully engage on both price and non-price terms to determine if a truly "superior" transaction is available. As a result, the Court entered an injunction requiring a waiver of the standstill with Upper Deck during the "go-shop" period to permit Upper Deck to make an "all shares, non-coercive tender offer" at a price no less than its most recent proposal.

In *In re Smurfit-Stone Container Corp. Shareholder Litigation*, the Court rejected plaintiffs' contention that the Smurfit-Stone board had improperly failed to conduct an auction and that the deal protection provisions in the merger agreement with Rock-Tenn Corporation—including a 3.4% termination fee, customary no-shop provisions with a fiduciary out and standard matching rights—were impermissible under Delaware law. The Court noted that a board could forego a pre-signing market check if the merger agreement permitted the emergence of a higher bid after signing, and it upheld the deal protection measures as standard in form. The Court also noted with approval that the Smurfit-Stone board "took firm control of the sales process," "asserted its control over the negotiations" with multiple bidders and "engaged in real, arm's-length dealings with potential acquirors."[99] Similarly, in *In re Plains Exploration & Production Co. Stockholder Litigation*, the Court of Chancery rejected claims challenging the reasonableness of a board's single-bidder sales strategy, holding that "there is no bright-line rule that directors must conduct a pre-agreement market check or shop the company."[100] *Plains* explained that "as long as the Board retained 'significant flexibility to deal with any later-emerging bidder and ensured that the market would have a healthy period of time to digest the proposed transaction,' and no other bidder emerged, the Board could be assured that it had obtained the best transaction reasonably attainable."[101] The Court there also upheld the board's decision to leave day-to-day negotiations to the company's CEO, even though the CEO was "interested" in the transaction by virtue of future employment with the post-transaction company, in part because this conflict was fully disclosed to the board, and the board believed that the CEO was best-positioned to advance the company's interest.[102]

The key thread tying these cases together is that compliance with *Revlon* requires the board to make an informed decision about the path to maximizing stockholder value. As one Delaware Supreme Court case explained, "[w]hen the board is considering a single offer and has no reliable grounds upon which to judge its adequacy, [the] concern for fairness demands a canvass of the market to determine if higher bids may be elicited. When, however, the directors possess a body of reliable evidence with which to evaluate the fairness of a transaction, they may approve that transaction without conducting an active survey of the market."[103]

A case where the board was held to be inadequately informed is *In re Netsmart Technologies, Inc. Shareholders Litigation*, wherein the Court of Chancery temporarily enjoined the acquisition of Netsmart Technologies, Inc. by two private equity funds, in part because the board failed to fully inform itself about all possible bidders in its auction process.[104] While Netsmart's advisors contacted a number of potential private equity buyers, the company failed to contact any potential strategic buyers because its management and investment bankers believed that no such buyers would be interested. The Court found a likely fiduciary violation because of this tactical decision, in part because of the concern that "[t]he private equity route was . . . a clearly attractive one for management" due to the likelihood that management would retain control and receive equity in a private equity deal but not in a strategic deal.[105] While the Court refused to permanently enjoin the transaction on this basis, it did require more accurate disclosure of the board's decision-making process, including its failure to contact potential strategic buyers. The *Netsmart* decision may be unusual, in part because it seemed to be influenced by the fact that the target was a micro-cap company, but it emphasizes the importance of conducting a process that allows the board to be fully informed of all reasonable options.

The Court of Chancery also strongly criticized a board's sales process even while refusing to enjoin the transaction in *Koehler* v. *NetSpend Holdings Inc*.[106] There, the Court expressed concern about the board's decision to forego a market check where the deal price was well below the low end of the share price implied by its bankers' discounted cash flow analysis and two private equity firms that had previously considered investing in the company had signed standstill agreements that barred them from requesting a waiver (so-called "don't ask, don't waive" provisions). Nevertheless, the Court declined to issue an injunction because the risk of scuttling the premium transaction outweighed the potential benefit of putting off the deal in the faint hope of a higher bidder (especially as the two potential private equity bidders did not show any interest once the "don't ask, don't waive" provisions were withdrawn).[107] The *NetSpend* decision serves as a reminder that boards engaging in single-bidder sales strategies and deploying contractual features such as "don't ask, don't waive" standstills must do so as part of a robust and carefully designed strategy.

The Delaware Supreme Court recently upheld the decision of the Court of Chancery to impose substantial aiding-and-abetting liability on the lead financial advisor of the Rural/Metro ambulance company in that company's sale to a private equity firm.[108] The sales process was found to be flawed because the company's lead financial advisor (a) deliberately timed the sales process to coincide with a strategic process involving another ambulance company in order to try to obtain lucrative financing work, (b) attempted to provide stapled financing to whoever bought Rural and (c) presented flawed valuation materials.[109] The advisor did not disclose these conflicts to the board. Indeed, the board was not aware of the financial advisor's efforts to provide buy-side financing to the buyer, had not received any valuation information until a few hours before the meeting to approve the deal and did not know that the advisor had manipulated the valuation metrics.[110] Applying enhanced scrutiny under *Revlon*, the Court of Chancery found that the directors had acted unreasonably and therefore violated their fiduciary duties. The Court then held that the financial advisor had aided and abetted this fiduciary breach and was liable for almost $76 million in damages to the shareholders, even though the company that was sold entered bankruptcy shortly afterward.[111] On appeal, the Supreme Court affirmed and ruled that the presence of a secondary financial advisor did not cure the defects in the lead advisor's work, and that the post-signing market check could not substitute for the board's lack of information about the transaction.[112] The Rural/Metro case is further discussed in Section III.C.

The Court of Chancery also preliminarily enjoined the private equity buyout of the Del Monte Foods Company because of an apparent *Revlon* violation by its board of directors, aided and abetted by the buyer.[113] There, the Del Monte board engaged Barclays to oversee a limited, non-public auction of the company. Potential financial bidders all signed confidentiality agreements with "no-teaming" provisions that prevented the bidders from forming clubs. Dissatisfied with the offers it received, the Del Monte board told Barclays "to shut [the] process down and let buyers know the company is not for sale."[114] But Barclays, unbeknownst to the board, encouraged several of the bidders to work together, in violation of the "no teaming" provisions, to submit a joint bid. Several private equity buyers, led by KKR, joined together and made a bid. Despite the apparent violation of the "no teaming" provisions, the board asked no questions and decided to engage in one-on-one negotiations with the KKR-led group. Later, having never uncovered Barclays' behind-the-scenes efforts to cobble together a bid, the board also allowed Barclays to participate in buy-side financing. The Court found that the plaintiffs were likely to succeed on their claim that the board had acted unreasonably in the sales process by failing to oversee its advisors and the process and therefore committed a fiduciary breach, and that KKR had likely aided and abetted this conduct. As a remedy, the Court granted an injunction effectively requiring Del Monte to run a go-shop process.[115]

c. Third-Party Overbids

Announcement of a merger agreement may provoke an unsolicited competing bid by a third party. Since such a third-party bid could represent a threatened change of control, a target's directors' actions with respect to that bid, including any changes to the original merger agreement, will be governed by the enhanced-scrutiny *Unocal* standard. The *Time-Warner* decision makes clear, however, that so long as the initial merger agreement did not itself involve a change-of-control transaction, the appearance of an unsolicited bid (whether cash or stock) does not in and of itself impose *Revlon* duties on the target board. Rather, the seller in a strategic stock-for-stock deal, as a matter of law, is free to continue to pursue the original proposed merger, assuming it has satisfied the applicable standard. As the Court said, "Directors are not obliged to abandon a deliberately conceived corporate plan for a short-term shareholder profit unless there is clearly no basis to sustain the corporate strategy."[116] In other words, a *Revlon* situation cannot be unwillingly forced upon a board that has not itself elected to engage in a change-of-control transaction. Absent the circumstances defined in *Revlon* and its progeny, a board is not obligated to choose short-term over long-term value and, likewise, "is not under any *per se* duty to maximize shareholder value in the short term, even in the context of a takeover."[117] Thus, even if an unsolicited bid provides greater current value and other short-term value than a stock-for-stock merger, the target's board may attempt to preserve or achieve for its shareholders the business benefits of the original merger transaction so long as the original merger does not itself constitute a change of control. (Of course, if the original transaction requires stockholder approval, the board's preference may not prevail.)

In these circumstances, actions taken defensively against the potential change-of-control overbid will be evaluated under the *Unocal* standard. The Delaware Supreme Court in *Time-Warner* allowed directors great latitude in determining when a threat to a previously agreed merger exists. The Time board was permitted to act based on: (1) the "concern . . . that Time shareholders might elect to tender into Paramount's cash offer in ignorance or a mistaken belief of the strategic benefit which a business combination with Warner might produce"; (2) its view of whether the conditions attached to Paramount's offer introduced "a degree of uncertainty that skewed a comparative analysis"; and (3) the issue of whether the "timing of Paramount's offer to follow issuance of Time's proxy notice was . . . arguably designed to upset, if not confuse, the Time stockholders' vote."[118]

Notably, more than one standard of review can apply to directors' decisions during the same transaction. For example, the approval of a friendly stock-for-stock merger may be governed by the traditional business judgment rule, but modifications of that transaction after the appearance of a third-party hostile bidder may be subject to the *Unocal* standard.[119] Similarly, the *Unocal* standard will continue to apply so long as a board's response to a third-party bid is defensive in an effort to keep the company independent, but once a board pursues an alternative transaction that constitutes a change of control, the board's decision will generally be subject to *Revlon* scrutiny.

3. Entire Fairness

The "entire fairness" standard is "Delaware's most onerous standard [of review]."[120] It imposes the burden of proof upon directors to show the fairness of both the price and process of the transaction they approved. A court will review a board's actions under the entire fairness standard in the following situations:

- when a majority of the board has an interest in the decision or transaction that differs from the stockholders in general;[121]
- when a majority of the board lacks independence from or is dominated by an interested party;[122] or
- when the transaction at issue is one where the directors or a controlling stockholder "stand[] on both sides" of a transaction.[123]

There is no bright-line test to determine whether an individual director is conflicted, or a majority of directors are conflicted, for purposes of determining whether the entire fairness standard will be applied. A conflict must be "material" if it is to be considered disabling.[124] Potential conflicts can take many shapes, including when a director receives certain payments,[125] has certain family relationships with,[126] or has certain significant prior business relationships with, a party to the transaction,[127] and other instances where a director will benefit or suffer a detriment in a manner that is not aligned with the interests of the public stockholders. A key consideration is whether the director can be said to stand on both sides of the transaction in question, or whether he or she has obtained some benefit not ratably shared with public stockholders.

Entire fairness review can be triggered even though a majority of directors are disinterested:

> [A] financial interest in a transaction that is material to one or more directors less than a majority of those voting is "significant" for burden shifting purposes . . . when the interested director *controls* or *dominates* the board as a whole or when the interested director *fails to disclose his interest* in the transaction to the board *and* a reasonable board member would have regarded the existence of the material interest as a significant fact in the evaluation of the proposed transaction.[128]

The entire fairness standard is also frequently applied in a "squeeze-out" merger in which a controlling stockholder buys out the public minority stockholders. The entire fairness standard of review may even apply in the context of a transaction ostensibly with an unaffiliated third party. The cases where this occurs typically involve situations where different groups of stockholders arguably are not treated equally in connection with the transaction. In these controlling stockholder situations, certain procedural protections (*e.g.*, the use of a special committee of disinterested, independent directors; a nonwaivable majority-of-the-minority approval condition) may help avoid entire fairness review or at least shift the burden of disproving entire fairness to the plaintiffs.[129]

Since the 2014 decision in *Kahn* v. *M&F Worldwide Corp.*, a controlling stockholder has been able to obtain business judgment review treatment if it and the board follow specific guidelines. To qualify for such treatment, the following conditions must be satisfied: "(i) the controller conditions the procession of the transaction on the approval of both a Special Committee and a majority of the minority stockholders; (ii) the Special Committee is independent; (iii) the Special Committee is empowered to freely select its own advisors and to say no definitively; (iv) the Special Committee meets its duty of care in negotiating a fair price; (v) the vote of the minority is informed; and (vi) there is no coercion of the minority."[130] The Court also noted that the proper use of *either* special committee *or* majority-of-the-minority approval alone "would continue to receive burden-shifting within the entire fairness standard of review framework."[131] In *Swomley* v. *Schlecht*, the Court of Chancery, in a bench ruling, applied the *M&F Worldwide* standard to dismiss a challenge to a squeeze-out merger involving SynQor led by the company's managers and employees, who held 46% of the stock.[132] The Court noted that a plaintiff that wished to plead that a special committee had not satisfied its duty of care would need to show gross negligence or even recklessness, which was a "very tough standard to satisfy."[133] The Supreme Court summarily upheld this decision in a unanimous *en banc* order.[134]

When analyzing a transaction to determine whether it satisfies the entire fairness standard, a Delaware court will consider both process ("fair dealing") and price ("fair price")although the inquiry is not a bifurcated one; rather, all aspects of the process and price are considered holistically in evaluating the fairness of the transaction.[135] As the Delaware Court of Chancery stated in *In re John Q. Hammons Hotels Inc. Shareholder Litigation*:

> The concept of entire fairness has two components: fair dealing and fair price. These prongs are not independent, and the Court does not focus on each of them individually. Rather, the Court determines entire fairness based on all aspects of the entire transaction. Fair dealing involves questions of when the transaction was timed, how it was initiated, structured, negotiated,

> disclosed to the directors, and how the approvals of the directors and the stockholders were obtained. Fair price involves questions of the economic and financial considerations of the proposed merger, including all relevant factors: assets, market value, earnings, future prospects, and any other elements that affect the intrinsic or inherent value of a company's stock.[136]

A "fair price" has been described as follows:

> A fair price does not mean the highest price financeable or the highest price that fiduciary could afford to pay. At least in the non-self-dealing context, it means a price that is one that a reasonable seller, under all of the circumstances, would regard as within a range of fair value; one that such a seller could reasonably accept.[137]

With respect to process, the Delaware Supreme Court has long encouraged boards to utilize a "special committee" of independent directors when a conflict transaction is proposed. As discussed at greater length below, a special committee attempts to reproduce the dynamics of arm's-length bargaining. To be effective, a special committee generally should: (1) be properly constituted (*i.e.*, consist of independent directors); (2) have an appropriately broad mandate from the full board (*e.g.*, not be limited to simply reviewing an about-to-be-agreed-to transaction); and (3) have its own legal and financial advisors.[138] As noted above, the use of a well-functioning special committee can shift the burden of proof to the plaintiff. Approval of a take-private merger with a controlling shareholder by a majority of the minority shareholders also shifts the burden, provided the disclosures to the shareholders are deemed sufficient.[139] The quantum of proof needed under entire fairness is a "preponderance of the evidence," which has led the Delaware Supreme Court to note that the effect of a burden shift is "modest," as it will only prove dispositive in the rare instance where the evidence is entirely in equipoise.[140] Nevertheless, the Supreme Court has also stressed that it views the use of special committees as part of the "best practices that are used to establish a fair dealing process," and thus, in spite of the only "modest" benefit from a burden standpoint, special committees remain important in conflict transactions.[141] And, in light of *M&F Worldwide*, a controller's agreement in advance to "voluntarily relinquish[] its control" by conditioning a transaction "upon the approval of both an independent, adequately-empowered Special Committee that fulfills its duty of care, and the uncoerced, informed vote of a majority of the minority stockholders" will result in the achievement of business judgment review rather than entire fairness review.[142]

Decisions of the Delaware courts have repeatedly emphasized the need for the members of a special committee to be independent of the transaction proponent, well informed, advised by competent and independent legal and financial advisors, and vigorous in their negotiations of the proposed transaction.[143]

C. Controlling Stockholders, Conflicts and Special Committees

Conflict transactions (such as those involving controlling stockholders), and the closely related issues of how to structure special committee processes have received a lot of judicial attention in recent years.

1. Controlling Stockholders

Any stockholder controlling a majority of a company's voting power is a controlling stockholder. A minority stockholder will also be considered a controlling stockholder if it exercises "a combination of potent voting power and management control such that the stockholder could be deemed to have effective control of the board without actually owning a majority of stock."[144] For a minority stockholder to be considered a controlling stockholder, a plaintiff must allege well-pled facts showing "actual domination and control" over the board by the minority stockholder.[145]

"Control" is a complex and fact-intensive concept under Delaware law, which can make it difficult to predict with confidence whether certain influential stockholders could be deemed to be "controlling stockholders" either generally or with respect to a particular transaction. Although voting power is a critical component in the control analysis for non-majority stockholders, it is not outcome-determinative. Instead, the Court will focus on the stockholder's influence and authority over board action. Thus, in *In re Western National Corp. Shareholders Litigation*, the Court of Chancery held that a 46% stockholder was not a controller as the plaintiffs could not show that the large stockholder took steps to dominate or interfere with the board of directors' oversight of the company.[146] In contrast, the Court denied a motion to dismiss in *Williamson* v. *Cox Communications, Inc.* where the complaint alleged that a group of stockholders with a combined 17.1% voting power was a control group in light of its board-level appointment and veto power over major corporate actions.[147] In litigation concerning the merger of KKR Financial Holdings with KKR, the Delaware courts put an even greater emphasis on the importance of the board of directors in the control analysis. Plaintiffs alleged that a 1% stockholder who, pursuant to a management agreement, supplied the company with all of its employees and "managed the day-to-day operations of the company" should be deemed a controlling stockholder. However, the Supreme Court disagreed and affirmed the Court of Chancery's ruling that such a minority stockholder could not be deemed a controlling stockholder unless it could exercise actual control over a majority of the board. The Court held that there was no indication that the directors "could not freely exercise their judgment in determining whether or not to approve and recommend to the stockholders" the transaction at issue, or, put differently, that the managing minority stockholder would be able to take retributive action by removing the directors if they failed to approve the merger.[148]

2. Conflicts and Director Independence

Where a corporation engages in a transaction with a controlling stockholder, the use of an independent special committee can affect the judicial scrutiny applied to the ultimate transaction by shifting the burden of proving unfairness to the plaintiff. However, such committees are only effective when their members are disinterested and independent. In determining director independence and disinterestedness, a board should have its directors disclose their compensatory, financial and business relationships, as well as any significant social or personal ties that could be expected to impair their ability to discharge their duties. The Delaware Supreme Court has stressed that all these factors must be considered "in their totality and not in isolation from each other."[149] Paying close attention to which directors are selected to serve on a special committee is important, and care should be taken to vet the true independence of those selected.[150] The use of a special committee will not shift the burden of proving unfairness to the plaintiffs if the directors on the committee are viewed as "beholden" to a controlling stockholder.[151] Even if a director does not have a direct personal interest in the matter being reviewed, the director will not be considered qualified if he or she lacks independence from the controlling stockholder or some other person or entity that is interested in the transaction. Certain compensatory relationships can lead to independence concerns. For example, in the 2004 case *In re Emerging Communications, Inc. Shareholders Litigation*, the Court questioned the independence of a member of a special committee because he was a paid consultant of an affiliate of the controlling stockholder.[152] Familial relationships may also be disqualifying. In *Harbor Finance Partners* v. *Huizenga*, the Court of Chancery held that a director who was the brother-in-law of the CEO and involved in various businesses with the CEO could not impartially consider a demand adverse to the CEO's interests.[153] And the confluence of business and social relationships may together compromise a director's independence. Thus, in *Delaware County Employees' Retirement Fund* v. *Sanchez,* the Supreme Court ruled that allegations that a director had "a close friendship of over half a century with the interested party" and that "the director's primary employment . . .

was as an executive of a company over which the interested party had substantial influence" adequately raised a doubt that the director was not independent.[154]

Not all relationships between special committee members and management or controlling stockholders will give rise to independence concerns, and Delaware courts have offered broad guidance on this topic. For example, the Delaware Supreme Court has rejected the concept of "structural bias," *i.e.*, the view that the professional and social relationships that naturally develop among members of a board impede independent decision-making.[155] In *Yucaipa American Alliance Fund II, L.P.* v. *Riggio*, the Court of Chancery found a director independent despite her having previously served as an executive under the company's founder and former CEO 10 years prior.[156] Nor is the fact that a stockholder had elected a director a sufficient reason to deem that director lacking independence.[157] The Court of Chancery has also refused to accept a "transitive theory" of conflict, rejecting the argument that a director lacks independence from an alleged controller because the director is allegedly beholden to someone else who, in turn, is allegedly beholden to the controller.[158] In *M&F Worldwide*, the Delaware Supreme Court reinforced that "[a] plaintiff seeking to show that a director was not independent must satisfy a materiality standard" and that neither "the existence of some financial ties between the interested party and the director" nor "allegations that directors are friendly with, travel in the same social circles as, or have past business relationships with the proponent of a transaction" are sufficient to rebut the presumption of independence.[159] Notably, the Supreme Court approved then-Chancellor Strine's finding that the directors' satisfaction of the NYSE independence standards was informative, although not dispositive, of their independence under Delaware law.[160]

3. The Special Committee's Procedures and Role

The purpose for which the special committee is created may also be relevant in determining whether its directors are independent. As the Delaware Supreme Court said in *Beam ex rel. Martha Stewart Living Omnimedia, Inc.* v. *Stewart*, "[i]ndependence is a fact-specific determination made in the context of a particular case. The court must make that determination by answering the inquiries: independent from whom and independent for what purpose?"[161] For example, special litigation committees are analyzed differently from transactional special committees because, as a defendant in a lawsuit, the board itself is interested in the outcome of the litigation and whether it should be pursued. In *Stewart*, the Delaware Supreme Court explained that a personal friendship or outside business relationship, standing alone, is insufficient to raise a reasonable doubt about a director's independence in the context of pre-suit demand on the board.[162]

The function of a special committee is to protect stockholder interests in cases where the interests of certain directors (such as directors participating in a management buyout or representing a controlling stockholder) differ significantly from those of the public stockholders by delegating a decision to a group of independent, disinterested directors. The influence (and number) of interested directors on a board may be relevant in determining the desirability of forming a special committee. For example, a board consisting of a majority of independent directors may not be significantly affected by management directors promoting a leveraged buyout. It may be sufficient for interested directors to recuse themselves from any deliberations and votes in connection with a proposed transaction. As the Court of Chancery has explained, "[t]he formation of a special committee can serve as 'powerful evidence of fair dealing,' but it is not necessary every time a board makes a decision."[163]

If directors who have a personal interest conflicting with those of the public stockholders constitute a minority of the board, the disinterested majority can act for the board, with the interested members abstaining from the vote on the proposal. But if a majority of the board is not disinterested, under Delaware law, absent appropriate procedural protections, the merger will be reviewed under the "entire fairness" standard, with the burden of proof in any stockholder litigation placed on the board.[164]

The need for a special committee may shift as a transaction evolves. Acquirors that begin as third-party bidders may become affiliated with management directors, or management may organize and propose a management buyout in response to an unsolicited bid from a third party. Throughout a sale process, the board and its advisors must be aware of any conflicts or potential conflicts that arise. Failure to disclose such conflicts may result in substantial difficulties in defending the board's actions in court.[165]

Even where a majority of directors are independent, delegation of negotiation or review functions to a special committee may be appropriate or expedient in certain contexts; however, there is no automatic need to create a special committee of directors, or to layer on separate newly retained advisors (legal or financial) in every instance where there may potentially be conflicts.

Delaware courts closely review the conduct of parties in controlling stockholder transactions and have in several cases been skeptical of processes that did not involve the active participation of a special committee. In 2000, the Delaware Court of Chancery held in *In re Digex, Inc. Shareholders Litigation* that the conflicted directors on a board controlled by a majority stockholder had likely breached their fiduciary duties by agreeing to waive the protections of the Delaware business combination statute in favor of the acquiror of that majority stockholder over the opposition of the independent directors.[166] The same year, in *McMullin* v. *Beran,*[167] the Delaware Supreme Court reversed a dismissal of a challenge to the directors' conduct where, in connection with the approval of a merger agreement between a controlled subsidiary and a third party, an already established special committee was not empowered to participate in the sale process and the majority stockholder controlled the process and allegedly had interests divergent from those of the public stockholders.[168]

In order for use of a special committee to shift the burden of proof to the plaintiff, the special committee must follow proper procedures. For example, in the context of a transaction with a majority stockholder, "the special committee must have real bargaining power that it can exercise with the majority stockholder on an arm's length basis."[169] The special committee should receive independent financial and legal advice, negotiate diligently and without the influence of the controlling stockholder and possess all relevant material information.[170] In *Kahn* v. *Lynch Communication Systems, Inc.*, the Delaware Supreme Court suggested that even where a special committee obtains independent legal and financial advice and negotiates diligently, the requisite degree of independence may still be lacking if the committee and controlling stockholder fail to establish that the committee has the power to negotiate independently.[171]

The special committee should have a clear conception of its role, which should include a power to say no to the potential transaction.[172] In the 2011 *Southern Peru* case,[173] the Delaware Court of Chancery criticized the role of the special committee in reviewing a merger proposal from a controlling stockholder. The Court stated that the special committee's "approach to negotiations was stilted and influenced by its uncertainty about whether it was actually empowered to negotiate" and that the special committee "from inception . . . fell victim to a controlled mindset and allowed [its controlling stockholder] to dictate the terms and structure of the [m]erger."[174] The Delaware Supreme Court affirmed the Court of Chancery's rulings and adopted its reasoning.[175] Indeed, the Delaware Court of Chancery has held, on a motion to dismiss, that, although there is no "*per se* duty to employ a poison pill to block a 46% stockholder from engaging in a creeping takeover," the failure to employ a pill, together with other suspect conduct, can support a claim for breach of the duty of loyalty.[176] A special committee that does not recognize, even in the context of a takeover bid by a controlling stockholder, that it may refuse to accept the offer might bear the burden of proving the entire fairness of the transaction in court.[177] The ability to say no must include the ability to do so without fear of retaliation. In *Lynch*, the Court was persuaded that the special committee's negotiations were influenced by the controlling stockholder's threat to acquire the company in a hostile takeover at a much lower price if the committee did not endorse the controlling stockholder's offer.

Special committees and their advisors should be proactive in seeking all relevant information (potentially including valuation information and information held by management or the transaction proponent) and in negotiating diligently on behalf of stockholders.[178] The records of the deliberations of a special committee and the full board should reflect careful and informed consideration of the issues.[179]

4. Selecting Special Committee Advisors

The best practice is for the special committee itself, rather than management or a controlling stockholder, to choose its own financial and legal advisors. In *Macmillan*, the Delaware Supreme Court was critical of the conduct of an auction to sell the company in which a financial advisor selected by the company's CEO, rather than by the special committee, played a dominant role.[180] In *TCI*,[181] Chancellor Chandler found that the special committee's decision to use TCI's legal and financial advisors rather than retaining independent advisors in itself "raise[d] questions regarding the quality and independence of the counsel and advice received." And in 2006 in *Gesoff* v. *IIC Industries Inc.*,[182] Vice Chancellor Lamb strongly criticized a special committee's use of advisors who were handpicked by the majority stockholder seeking a merger.

Whether the special committee should retain advisors with a previous corporate relationship is a context-specific decision. While having a special committee advised by firms that have close ties to the company may raise independence concerns, it is not in all cases better for the special committee to choose advisors who are unfamiliar with the company or to avoid hiring advisors who have done prior work for the company. In one case, Justice Jacobs (sitting as a Vice Chancellor) criticized a process in which the company's historical advisors were "co-opted" by the majority stockholder, leaving the special committee with independent advisors who did not know the company well and who lacked the information available to the majority stockholder's advisors.[183]

As a practical matter, some companies may have had at least some prior dealings with close to all of the financial or legal advisors who would have the relevant experience and expertise to advise a special committee on a transaction that is particularly complicated or of a certain size. If the special committee chooses to engage an advisor with such prior dealings, it should carefully document any potential conflict, the reasons the special committee considered it important to engage the advisor, and the measures the special committee took to mitigate any such conflict. Such measures may include negotiating carefully worded confidentiality provisions and structuring the advisor's fee to prevent any misaligned incentives. The committee may also choose to hire a second advisor for a particular role, although it should take care to ensure that the second advisor's presence will successfully mitigate the conflict that has been identified—for example, by ensuring that the new advisor is not merely a "secondary actor," and by not compensating it on a contingent basis.[184] Interviewing several advisors will also help to show that a special committee was aware of its options and made an informed decision in hiring its advisors, without delegating the decision to management.

5. Transactions Involving Differential Consideration

Transactions that provide different consideration to different stockholders—whether it be different consideration to a controlling stockholder or different consideration for different series or classes of stock—can be subject to entire fairness review as well. For example, in *TCI*, AT&T acquired TCI in an arm's-length all-stock merger in which the holders of TCI's high-vote shares—including TCI's controlling stockholder—received an approximate 10% premium over the consideration received by the low-vote holders.[185] The Court concluded that, although AT&T was a third-party buyer, the transaction would be subject to entire fairness review because a majority of the TCI directors held high-vote shares that received a premium relative to the low-vote shares. And, in *In re Trados Inc. Shareholder Litigation*, the Delaware Court of Chancery held that a common stockholder's allegations were sufficient to rebut the business judgment presumption with respect to a board's decision to approve a merger, where the merger triggered the preferred stockholders' large liquidation preference and allowed them to exit their investment while leaving the common stockholders with nothing, and a majority of the board was designated by preferred stockholders and had other alleged relationships with those preferred stockholders.[186]

Even in the absence of director affiliations with a certain class of stock, differential consideration in a merger can give rise to entire fairness review absent certain procedural protections. In *In re John Q. Hammons Hotels Inc. Shareholder Litigation*, the Delaware Court of Chancery held that entire fairness applied to a merger where the controlling stockholder and the minority stockholders received slightly different consideration, noting that they were "in a sense 'competing'" for portions of the consideration offered by an unaffiliated third-party buyer, and the procedural protections employed were insufficient to invoke the business judgment rule.[187] As part of its analysis, the Court made clear that, generally, the *Lynch* line of cases does not mandate entire fairness review of a sale of a company where minority stockholders were cashed out but the controlling stockholder received a continuing interest in the surviving company.[188] The Court concluded that all defendants would be protected by the business judgment rule "if the transaction were (1) recommended by a disinterested and independent special committee, *and* (2) approved by stockholders in a [fully informed and] non-waivable vote of the majority of all the minority stockholders."[189] The Court went on to rule, however, that for business judgment review to apply, "there [must] be robust procedural protections in place to ensure that the minority stockholders have sufficient bargaining power and the ability to make an informed choice of whether to accept the third party's offer for their shares." The protections actually employed in *John Q. Hammons* did not qualify "both because the vote could have been waived by the special committee and because the vote only required approval of a majority of the minority stockholders voting on the matter, rather than a majority of all the minority stockholders."[190] Nevertheless, in a post-trial opinion, the Court of Chancery found that the transaction was entirely fair.[191]

In the 2012 *In re Delphi Financial Group Shareholder Litigation*[192] decision, the special committee approved a merger that paid the founder, CEO and controlling stockholder an additional premium for his high-vote shares, even though the company's charter prohibited holders of such high-vote shares from receiving disparate consideration in any merger. The special committee had formed a special sub-committee to act on its behalf "with respect to any matters related to [the founder] and differential merger consideration."[193] Although the special committee attempted to persuade the founder to accept the same price as the low-vote stockholders, the founder "remained obstinate, refusing to back down on his demand for some level of disparate consideration."[194] The record showed that the special committee members believed that the founder would "jettison" the deal and deprive the low-vote stockholders of the opportunity to realize a "circa-100%" premium on their shares.[195] The special committee therefore approved the differential merger consideration. Applying entire fairness review (on account of the differential merger consideration paid), the Delaware Court of Chancery refused to enjoin the vote on the merger. Vice Chancellor Glasscock reasoned that because of the high premium offered to the low-voting stock, the fact that there were no other potential topping bidders and the fact that damages against the founder were an available remedy, stockholders should "decide for themselves" whether to accept the merger consideration.[196] The Court did, however, conclude that plaintiffs were likely to demonstrate at trial that the founder violated his fiduciary duties, largely because he had already "sold his right to a control premium" to the low-vote stockholders via the charter (even though stockholders approved an amendment of this provision in connection with the deal).[197]

III.

The M&A Deal-Making Process

A. Preliminary Agreements: Confidentiality Agreements and Letters of Intent

Companies considering M&A transactions should be cognizant of certain risks arising from negotiations that take place and agreements that are entered into before the execution of definitive transaction agreements. Preliminary agreements, such as confidentiality agreements and letters of intent, are sometimes seen as routine or relatively inconsequential. Because of this, parties sometimes enter into these agreements without sufficient consideration of their provisions, sometimes without involving counsel at all, only to later find themselves restricted or obligated in ways they had not anticipated. It is important to appreciate that the merger process begins with (or even before) the first discussions and that each step in the process may have significant consequences.

1. Confidentiality Agreements

Often, the first legally binding undertaking in a merger negotiation is the execution of a "confidentiality agreement," which is sometimes referred to as a "Non-Disclosure Agreement" or "NDA." It is entirely understandable that a company providing its proprietary or nonpublic information to another company would want to protect its confidentiality; however, this seemingly innocuous document often includes important substantive agreements. For example, a confidentiality agreement will often contain an express "standstill" provision restricting the ability of the party (or parties, if it is mutual) receiving information from taking various actions with respect to the other party, including commencing a takeover bid, buying shares, participating in proxy contests and engaging in other acts considered "unfriendly" to the party providing the information. This standstill agreement will continue for a set period or until a specified "fall-away" event, such as the announcement of a transaction with a third party. Even in the absence of an explicit standstill provision, a confidentiality agreement may give rise to claims that the agreement acts as an implied "standstill" barring unsolicited bids. Such agreements should be carefully reviewed by counsel before execution.

In addition to requiring that information provided be kept confidential, confidentiality agreements typically restrict the use of the information provided for the purpose of evaluating and negotiating a transaction (sometimes a specifically contemplated transaction) between the parties. Until *Martin Marietta Materials, Inc.* v. *Vulcan Materials*

Co.,[198] Delaware courts had not considered whether a violation of disclosure and use restrictions would be a basis for blocking a takeover bid. The Delaware Court of Chancery's May 2012 decision, which subsequently was affirmed by the Delaware Supreme Court, determined that Martin Marietta breached both the use and disclosure restrictions in two confidentiality agreements. Although then-Chancellor Strine found the wording to be ambiguous (but more consistent with Vulcan's reading), after an exhaustive interpretive analysis of the language of the agreements and parsing of whether a business combination "between" the parties applies to a hostile takeover and proxy contest, he concluded that the parties—especially Martin Marietta—intended the agreement to preclude use of the information exchanged in a hostile transaction. He also held that Martin Marietta had willfully breached its nondisclosure commitments by disclosing details of the parties' confidential negotiations in tender and other materials, without complying with the required procedures under the agreements. Consequently, the Court enjoined Martin Marietta's unsolicited takeover bid for four months, which effectively ended its hostile bid.

More recently, a California court in *Depomed Inc.* v. *Horizon Pharma, PLC*[199] preliminarily enjoined a hostile bidder on the ground that it misused information in violation of a confidentiality agreement, effectively ending the hostile takeover attempt. Unlike in *Vulcan*, the confidentiality agreement at issue was not even signed directly between acquirer and target. In 2013, Horizon, while pursuing a co-promotion arrangement concerning a particular drug asset owned by Janssen Pharmaceuticals, Inc. ("Janssen"), signed a confidentiality agreement with Janssen containing customary provisions limiting the use of Janssen proprietary information solely to evaluate Horizon's interest in pursuing a business relationship with Janssen. Without signing a new confidentiality agreement, Horizon later participated in an auction process that Janssen ran for the drug asset. Depomed also participated, winning the auction and acquiring the U.S. rights to the drug asset. Two years later, Horizon launched a hostile bid for Depomed, which sued for injunctive relief, asserting that Horizon was improperly using information relating to the drug asset in evaluating and prosecuting its hostile bid. In a ruling applying the plain terms of the agreement, the court rejected arguments that the confidentiality agreement only applied to the earlier co-promotion transaction structure, and concluded that it was likely Depomed had acquired the right to enforce the confidentiality restrictions against Horizon "because a different conclusion would be illogical" as it would mean that Depomed could not protect the confidential information about its asset.[200] The court held that Horizon had misused confidential information in formulating its takeover proposal, and Horizon withdrew its bid the following day.

Since *Vulcan*, parties have generally focused more on making clear the extent, if any, to which the confidentiality agreement should be interpreted to prevent a hostile bid. *Depomed* is a further reminder that parties should beware of the serious obligations attendant to confidentiality agreements, especially where the possibility of assigning such agreements can transform the nature of the original obligation and cause unanticipated limitations on future strategic opportunities.

When they are included, standstill provisions are typically worded very tightly to prevent a party that has obtained confidential information about a company from making an unsolicited bid or otherwise taking harmful action against the disclosing party. To prevent evasion of the standstill, these provisions typically specify that the bound party may not even request a waiver lest that result in the disclosing company being put "in play." Delaware courts have in recent years focused on these provisions, which they call "don't ask, don't waive" clauses, to ensure that they do not unduly restrict a board of directors from complying with its *Revlon* duties to maximize shareholder value once a decision is made to sell the company. The courts have recognized, however, that a "don't ask, don't waive" provision may sometimes be appropriate. For example when conducting an auction to sell the company, the board may decide to include a "don't ask, don't waive" provision to incentivize bidders to put their best foot forward in the auction rather than holding back, knowing they can overbid the auction winner later. These provisions and the developments in Delaware case law on this issue are discussed in Section V.A.2.

Other typical provisions in confidentiality agreements have also had far-reaching consequences for the parties to a potential transaction. For example, a party providing confidential information often insists that the confidentiality agreement contain broad disclaimer and non-reliance language making clear that the providing party has not made any representation or warranty to the receiving party as to the accuracy or completeness of the information provided, and that the providing party will not have any liability to the receiving party arising from the use of the information. Delaware courts have enforced broad disclaimer and non-reliance language that effectively allocates to the potential buyer the risk that information provided by the potential seller may be inaccurate until a definitive transaction agreement is entered into, even in the case of allegations of fraud.

2. Letters of Intent

Another common preliminary agreement is the letter of intent, sometimes referred to as a "memorandum of understanding" or "MOU." Letters of intent are more common in private transactions than in public company deals, although it is not uncommon even in public deals for parties to negotiate term sheets, which are similar in that they spell out the most critical terms of a proposed transaction but are typically unsigned. Even when executed by the parties, a letter of intent usually is mostly (but not entirely) a nonbinding agreement to agree.[201] Letters of intent can identify any deal-breakers early on in negotiations, saving the parties from unfruitful expenditure of time and money. While most provisions included in letters of intent typically are intended to be nonbinding, some provisions are expressly intended to be binding (for example, the grant of an exclusivity period or an expense-reimbursement provision).

Whether to negotiate a letter of intent or proceed straight to definitive documentation is dependent upon the facts in each case. Letters of intent can serve several purposes at the outset of negotiations, including demonstrating both parties' commitment to the possible transaction, allocating responsibility for certain documents, establishing a timeframe for executing definitive agreements, allocating responsibility for expenses, and serving to provide preliminary documentation to third parties requesting it (such as lenders). A letter of intent can also be used to make a Hart-Scott-Rodino antitrust filing so as to commence the requisite waiting period even if it is not binding. On the other hand, letters of intent can take time to negotiate, leading to the possibility of leaks, might impact the dynamics between the parties, and can raise disclosure questions in the case of public companies.

It is essential that the parties are clear as to whether, and to what extent, a letter of intent is intended to be binding and enforceable. The enforceability of a letter of intent typically turns on two questions: "(1) whether the parties intended to be bound by the document; and (2) whether the document contains all the essential terms of an agreement."[202] Because they are cursory in nature, letters of intent typically state that the document is meant to be nonbinding in nature and that the parties will only be bound upon execution of definitive agreements. The absence of such language could lead a court to hold the letter of intent enforceable. For example, the Delaware Court of Chancery ruled in a 2009 bench decision on a motion for a temporary restraining order that a jilted bidder had asserted colorable claims that a target had breached the no-shop/exclusivity and confidentiality provisions of a letter of intent, as well as its obligation to negotiate in good faith.[203] In reaching its decision, the Court stated that parties that wish to enter into nonbinding letters of intent can "readily do that by expressly saying that the letter of intent is nonbinding," and that contracts "do not have inherent fiduciary outs"—points that practitioners representing sellers should keep in mind from the outset of a sale process.

In *SIGA Technologies, Inc.* v. *PharmAthene, Inc.*, SIGA and PharmAthene negotiated a licensing agreement term sheet (the "LATS") that was unsigned and had a footer on both pages stating "Non-Binding Terms."[204] The LATS was later attached by the parties to a merger agreement and loan agreement, both of which provided that if the merger agreement was terminated, the parties would nevertheless negotiate a licensing agreement in good faith in accordance with the terms of the LATS. After terminating the merger agreement, SIGA claimed that the LATS was nonbinding and attempted to negotiate a licensing agreement with economic terms drastically different from those in the LATS. In 2013, the Delaware Supreme Court affirmed the Court of Chancery's finding that the parties intended to negotiate a license agreement on economic terms substantially similar to those in the LATS and that SIGA's failure to so negotiate was in bad faith. The Court ruled that the LATS was not a mere "jumping off point," but rather the parties had agreed to an enforceable commitment to negotiate in good faith.[205] Turning to the remedy, the Court held that, where the parties would have reached an agreement but for the defendant's bad faith negotiations, the plaintiff may be awarded expectation damages.[206] After further proceedings in the Court of Chancery and another appeal, the Delaware Supreme Court held that when a contract is breached, expectation damages can be established as long as the plaintiff can prove the *fact* of damages with reasonable certainty.[207]

By contrast with *SIGA*, the Delaware Supreme Court held in *Ev3, Inc.* v. *Lesh* in 2014 that a nonbinding provision of a letter of intent does not become binding simply because the merger agreement contains an integration clause providing that the letter of intent is not superseded.[208] The parties in *Ev3* had negotiated a nonbinding letter of intent that included a "Funding Provision" under which the acquiror committed to providing capital to help the target achieve certain development milestones, which were conditions to the payment of the merger consideration. Though the integration clause of the merger agreement provided that the letter of intent was not superseded, the merger agreement also provided that the acquiror could fund and pursue the milestones in its "sole discretion, to be exercised in good faith" and that such provision would override any other provision in the merger agreement to the contrary.[209] The Supreme Court held that the nonbinding nature of the Funding Provision and the direct conflict between the Funding Provision and the provision in the merger agreement meant that the selling stockholders were not able to rely on the Funding Provision to argue that the acquiror had failed to perform its contractual duties.[210]

Parties that do not wish to be bound by provisions of a letter of intent should avoid statements or actions that may indicate that a letter of intent was understood by the parties to be binding. Parties that desire maximum flexibility to not be bound by a letter of intent should also consider expressly disclaiming an obligation to negotiate in good faith and making clear that negotiations may be terminated without liability at any time until a definitive agreement has been entered.

B. Techniques for a Public Sale

A merger transaction may impose special obligations on a board. But every transaction is different, and courts have recognized that a board should have significant latitude in designing and executing a merger process. As the Delaware Supreme Court recently reiterated, there is "no single blueprint" that directors must follow in selling a company.[211] This is true even if *Revlon* applies: directors are not guarantors that the best price has been obtained, and Delaware case law makes clear that "[n]o court can tell directors exactly how to accomplish that goal [of getting the best price in a sale], because they will be facing a unique combination of circumstances, many of which will be outside their control,"[212] and thus *Revlon* "does not . . . require every board to follow a judicially prescribed checklist of sales activities."[213] Rather, the board has reasonable latitude in determining the method of sale most likely to produce the highest value for the shareholders. As a result, even in a change-of-control setting, a board may determine to enter into a merger agreement after an arm's-length negotiation with a single bidder, as opposed to putting the company up for auction or conducting a market canvass, if it determines in good faith that a single-bidder strategy is the most desirable. Even after a competitive bidding process has begun, a board may, under proper circumstances, favor one bidder over another "if in good faith and advisedly it believes shareholder interests would be thereby advanced."[214]

1. Formal Auction

In a "formal" auction, prospective acquirors are asked to make a bid for a company by a fixed deadline, in one or several "rounds" of bidding. A company, usually with the assistance of an investment banker, may prepare a descriptive memorandum, known as a "confidential information memorandum" or an "offering memorandum" (or just a short "teaser" since, in a public company sale, the material information is already public) that is circulated to prospective bidders. Prior to the bidding, a company will typically send a draft contract and related documentation, along with a bid letter setting forth the auction process, to multiple parties. Interested bidders are allowed to engage in due diligence (subject to entering into a confidentiality agreement) and then submit their bids, together with any comments on the draft contract. A formal auction often has more than one round and typically involves simultaneous negotiations with more than one bidder.

A significant advantage of a formal auction is that it can be effective even if there is only one bidder. Absent leaks, a bidder has no way of being certain whether there are other bidders, and this will create an incentive to put forward its best bid. In addition, the seller in a formal auction can negotiate with bidders to try to elicit higher bids. A formal auction may be conducted openly (typically by announcing that the company has hired an investment bank to "explore strategic alternatives") or conducted without an announcement. Even without an announcement, however, it is difficult to conduct a formal auction without rumors of a sale leaking into the marketplace. Companies may also engage in a limited or "mini-auction," in which only the most likely bidders are invited to participate. One difficulty in any auction process is that the true "value" of a bid, which must take into account not only the price to be paid but also the likelihood and timing of consummation and the related financing and regulatory approval risks, may be difficult to discern with certainty (and some bidders may propose stock or part-stock deals, which implicate considerations regarding valuation and pricing mechanisms, as further discussed below in Section IV). The optimal sale process to be employed depends on the dynamics of the particular situation and should be developed in close consultation with financial and legal advisors.

2. Market Check

An alternative to the auction technique is a "market check," whereby the seller gauges other potential buyers' interest without conducting a formal bidding process. A market check may be preferable to an auction for a number of reasons, including a reduced likelihood of leaks and a shortened negotiating timeframe. A seller may also forgo an auction because it determines that an auction is unlikely to yield other serious bids or because it strategically accedes to an attractive bidder's refusal to participate in an auction. It is important to note that a seller may appropriately conclude, depending on the circumstances, that it should negotiate only with a single bidder, without reaching out to other potential bidders pre-signing. A market check may occur either before or after the signing of a merger agreement, and may be active or passive.

In a pre-signing market check, a company, usually through its financial advisors, attempts to determine which parties may be interested in acquiring the company at the best price prior to signing an agreement without initiating a formal auction. A pre-signing market check may occur even if not initiated by the company, for example, when there are public rumors that the company is seeking an acquiror or is the subject of an acquisition proposal (*i.e.*, is "in play").

In a post-signing market check, provisions in the merger agreement provide an opportunity for other bidders to make competing offers after execution of the agreement.[215] An advantage of a post-signing market check is that it ensures that the seller may secure the offer put forth by the first bidder while leaving the seller open to considering higher offers. Acquirors, of course, will typically seek to limit the market check and will negotiate for so-called "deal protections" such as a "no-shop" covenant, restricting the seller's ability to solicit or discuss alternative transactions, and termination or "break-up" fees, in the event that the initial transaction is not consummated due to the emergence of a superior proposal. For a post-signing market check to be effective, potential bidders must be aware of the opportunity to bid, have sufficient information and time to make a bid, and not be unduly deterred by unreasonable break-up fees or deal protections afforded to the first bidder.

Post-signing market checks may either be active, where the seller actively seeks out new bidders—through a so-called "go-shop" provision—or passive, where new bidders must take the first step of declaring their interest after hearing about the transaction (and knowing that the target company would have a "fiduciary out" to consider higher bids), which is sometimes referred to as a "window shop" form of market check.

Go-shop provisions became a popular feature of financial sponsor and management buyouts in the last buyout boom, although they have been used less in the last few years. Go-shop provisions offer buyers (often financial buyers) the benefit of avoiding an auction and the assurance of a break-up fee if a deal is topped (which is usually an acceptable outcome for financial buyers). On the other hand, a go-shop enables a company being sold to a private equity firm to "lock-in" an acceptable transaction without the risks of a public auction, while mitigating the potentially heightened fiduciary concerns that can arise in such deal settings. These provisions allow the target to solicit competing offers for a limited time period (typically 30 to 50 days) after signing an acquisition agreement—permitting the target during that interval to, in the words of then-Vice Chancellor Strine, "shop like Paris Hilton."[216] They also often provide for a lower break-up fee if the agreement is terminated to accept a superior proposal received during the go-shop period. For example, the agreed-upon break-up fee in the 2013 buyout of Dell Inc. by Michael Dell and Silver Lake Partners was 60% lower for bids received during the 45-day go-shop period. Similarly, in Lone Star Funds' 2015 buyout of Home Properties, Inc., the agreed-upon break-up fee was 66% lower for bids received during the 30-day go-shop period. Other recent buyouts that have made use of a go-shop provision include those of EMC Corporation, Solera Holdings, Dole Food Company, BMC Software, Duff & Phelps Corporation, Safeway Inc. and CEC Entertainment, Inc.

Delaware courts have generally found go-shops to be a reasonable, but not mandatory, approach to satisfying *Revlon* duties.[217]

To date, go-shops have not become commonplace in strategic deals (although they have perhaps become somewhat more common in recent years). This is because corporate acquirors have strategic interests in their targets and receiving a break-up fee is usually a suboptimal outcome for them. They understand that the directors of their target must satisfy their fiduciary duties but do not like to affirmatively invite their competitors to consider interloping. There have also been some tailored variations on the go-shop theme, like the "qualified pre-existing bidder" provision that U.S. pork processor Smithfield and Chinese meat processor Shuanghui employed in their 2013 combination. The agreement for that transaction carved out two pre-existing bidders from the no-shop provision and provided for a reduced break-up fee ($75 million, versus $175 million in other scenarios) for 30 days following execution of the agreement with respect to deals pursued with these bidders. Along these lines, an alternative approach to the standard go-shop that some strategic deals have taken has been to more broadly couple a no-shop with a lower break-up fee for a specified period of time (for example, the Pfizer/Wyeth deal).

When a go-shop provision is employed to satisfy the board's fiduciary duty, it is important that there be an active and widespread solicitation. The requisite information must be made available to competing bidders who emerge, even though they may be competitors and the buyer and management may not want to provide sensitive information to them. In rare cases, where the seller's investment bank may have an incentive to support the transaction with the original buyer because of relationships or because they are providing financing for the transaction (which can raise its own conflict concerns), it may be appropriate to bring in another bank to run the go-shop process.[218]

A board may sell a company through a single-bidder negotiation coupled with a post-signing, passive market check. Although this method is more likely to be closely scrutinized by courts than those previously described, it is permissible so long as the board is informed of the downsides of this approach and has an appropriate basis for concluding that they are outweighed by the benefits, and the transaction provides sufficient opportunity for competing bids to emerge. In the *Fort Howard* case in 1988, which has recently been reaffirmed by the Delaware Supreme Court, Chancellor Allen ruled that the company's directors had satisfied their fiduciary duties in selling the company by negotiating for an approximately month-and-a-half-long period between the announcement of the transaction and the closing of the tender offer in which new bidders could express their interest.[219] The Chancellor ruled that the market check was not "hobbled" by deal protection measures and noted that he was "particularly impressed with the announcement [of the transaction] in the financial press and with the rapid and full-hearted response to the eight inquiries received."[220] Similarly, in 2011, Vice Chancellor Parsons ruled in *In re Smurfit-Stone* that an active market check was unnecessary because the selling company had been "in play" both during and after its bankruptcy, yet no competing offers were made.[221]

The Delaware Court of Chancery has provided valuable guidance for sellers considering forgoing an active market check. In *In re Plains*, Vice Chancellor Noble found that the directors were experienced in the industry and had "retained 'significant flexibility to deal with any later-emerging bidder and ensured that the market would have a healthy period of time to digest the proposed transaction.'"[222] When no competing bids surfaced in the five months after the merger was announced, the Plains board could feel confident it had obtained the highest available price. In contrast with *Plains*, in *Koehler* v. *NetSpend*, Vice Chancellor Glasscock criticized the NetSpend board's failure to perform a market check, given the other facts surrounding the merger.[223] NetSpend's suitor entered into voting agreements for 40% of the voting stock and bargained for customary deal protections in the merger agreement, including a no-shop, a 3.9% termination fee and matching rights. Most critically, the merger agreement also prohibited the NetSpend board from waiving "don't ask, don't waive" standstills that NetSpend had entered into with two private equity firms that had previously expressed an interest in investing in the company, but had not been part of a pre-signing auction or market check. Even though the record showed that the investment bank advising NetSpend's board had advised that a private equity bidder was unlikely to match the buyer's offer, Vice Chancellor Glasscock found that, by agreeing to enforce the "don't ask, don't waive" standstills, the NetSpend board had "blinded itself" to the two most likely sources of competing bids and, moreover, had done so without fully understanding the import of the standstills.[224] This, combined with reliance on a "weak" fairness opinion and an anticipated short period before consummation, led Vice Chancellor Glasscock to conclude that the sales process was unreasonable.[225] *Plains* and *NetSpend* reinforce that the terms of a merger agreement and its surrounding circumstances will be viewed collectively, and, in the *Revlon* context, the sales process must be reasonably designed to obtain the highest price.

C. Investment Bankers and Fairness Opinions

The board, in exercising its business judgment as to the appropriate form and valuation of transaction consideration, may rely on experts, including counsel and investment bankers in reaching an informed view.

In merger transactions, an investment banker's unbiased view of the fairness of the consideration to be paid and the related analyses provide a board with significant information with which to evaluate a proposed transaction. Since Delaware's 1985 *Smith* v. *Van Gorkom* decision, it has been common in a merger transaction involving a public company for a fairness opinion to be rendered to the board of the seller (and, sometimes, to the buyer). In Delaware, Section 141(e) of the DGCL provides protection from personal liability to directors who rely on appropriately qualified advisors. A board is entitled to rely on the expert advice of the company's legal and financial advisors "who are selected with reasonable care and are reasonably believed to be acting within the scope of their expertise," as well as on the advice and analyses of management.[226] The analyses and opinions presented to a board, combined with presentations by management and the board's own long-term strategic reviews, provide the key foundation for the exercise of the directors' business judgment.[227] Courts reviewing the actions of boards have commented favorably on the use by boards of investment bankers in evaluating merger and other transaction proposals (although generally receipt of a fairness opinion by independent investment bankers is not required as a matter of law).[228]

Particularly in situations where directors are choosing among competing common stock (or other non-cash) business combinations, a board's decision-making may be susceptible to claims of bias, faulty judgment and inadequate investigation of the relative values of competing offers. Because the stock valuation process inherently involves greater exercise of judgment by a board than that required in an all-cash deal, consideration of the informed analyses of financial advisors is helpful in establishing the fulfillment of the applicable legal duties.

In a stock-for-stock fixed exchange ratio merger, the fairness of the consideration often turns on the relative contributions of each party to the combined company in terms of revenues, earnings and assets, not the absolute dollar value of the stock being received by one party's shareholders based on its trading price at a particular point in time. Parties to a stock-for-stock merger customarily opt to sign a merger agreement based on the fairness of the exchange ratio at the time of signing, without a bring-down. This structure enhances the probability of consummating the merger by not giving either party a right to walk away if the fairness opinion would otherwise have changed between signing and closing.

Great care should be exercised by investment bankers in preparing the analyses that support their opinions and in the presentation of such analyses to management and the board. The wording of the fairness opinion and the related proxy statement disclosures must be carefully drafted to accurately reflect the nature of the analyses underlying the opinion and the assumptions and qualifications upon which it is based.[229]

Courts and the SEC will scrutinize perceived conflicts of interest by the investment bank giving the fairness opinion. Since 2007, FINRA's rules require specific disclosures and procedures addressing conflicts of interest when member firms provide fairness opinions in change-of-control transactions.[230] FINRA requires disclosure in the fairness opinion as to, among other things, whether or not the fairness opinion was approved or issued by a fairness committee, whether or not the fairness opinion expresses an opinion regarding the fairness of the amount or nature of the compensation to be received in such transaction by the company's officers, directors, employees or class of such persons, relative to the compensation to be received in such transaction by the shareholders, and disclosure of whether the compensation that the member firm will receive is contingent upon the successful completion of the transaction, for rendering the fairness opinion and/or serving as an advisor, as well as whether any other "significant" payment or consideration is contingent upon the completion of the transaction, and any material relationships that existed during the past two years or that are mutually understood to be contemplated in which any compensation was received or is intended to be received as a result of the relationship between the member and any party to the transaction that is the subject of the fairness opinion.[231]

The SEC Staff also requires, in transactions subject to the proxy rules, detailed disclosure of the procedures followed by an investment banker in preparing a fairness opinion, including a summary of the financial analyses underlying the banker's opinion and a description of any constraints placed on those analyses by the board. Detailed disclosure about previous relationships between the investment banker and the parties to the transaction is also required.

The courts have also had a voice in deciding what constitutes a conflict of interest on the part of financial advisors to a transaction. For example, although FINRA does not ban the practice of contingent fee arrangements for financial advisors, in some circumstances, certain contingent fee arrangements will cause Delaware courts to find triable issues of bias. In *TCI*, the Court held that the fact that the fairness opinion rendered by a special committee's financial advisor was given pursuant to a contingent fee arrangement—$40 million of the financial advisor's fee was contingent on the completion of the transaction—created "a serious issue of material fact, as to whether [that advisor] could provide independent advice to the Special Committee."[232] Although certain contingent fee arrangements in specific factual contexts have been questioned by the Delaware Court of Chancery, contingent fee arrangements "ha[ve] been recognized as proper by [the] courts,"[233] as *Toys "R" Us* acknowledged.

Disclosure of contingent fees may also be required.[234] For example, in *Crawford*,[235] the bulk of the investment bankers' compensation was contingent on either the completion of the Caremark/CVS transaction or on the completion of an alternate transaction *after* the announcement of the CVS deal. Because this fee would only be payable if Caremark announced the CVS deal (which would be unlikely unless the investment bankers provided a fairness opinion in favor of that transaction), the Court found that the particulars of the fee arrangement had to be disclosed so that shareholders could consider the bankers' potential conflict of interest in recommending the deal. Similarly, in *In re Atheros Communications, Inc.*, the Court held that where 98% of the financial advisor's fee was contingent on the closing of the transaction which, as a "practical matter," the financial advisor would receive only if it rendered a fairness opinion in favor of the transaction, the portion of the fee that was contingent had to be disclosed to shareholders.[236]

In an important decision concerning the role played by outside financial advisors in the board's decision-making process, the Delaware Court of Chancery held in 2011 that a financial advisor was so conflicted that the board's failure to actively oversee the financial advisor's conflict gave rise to a likelihood of a breach of fiduciary duty by the board. In *In re Del Monte Foods Co. Shareholders Litigation*,[237] the Court found that after the Del Monte board had called off a process of exploring a potential sale, its investment bankers continued to meet with several of the bidders—without the approval or knowledge of Del Monte—ultimately yielding a new joint bid from two buyout firms. While still representing the board and before the parties had reached agreement on price, Del Monte's bankers sought and received permission to provide financing to the bidders. The financial advisor was then tasked with running Del Monte's go-shop process, even though the financial advisor stood to earn a substantial fee from financing the pending acquisition. The Court stated that, although "the blame for what took place appears at this preliminary stage to lie with [the bankers], the buck stops with the Board," because "Delaware law requires that a board take an active and direct role in the sale process."[238] The Court also faulted the board for agreeing to allow the competing bidders to work together and the bankers to provide buy-side financing without "making any effort to obtain a benefit for Del Monte and its stockholders."[239] The case ultimately settled for $89 million, with the investment bank bearing roughly a quarter of the cost.

In 2014, in *In re Rural Metro Corporation Stockholders Litigation*,[240] the Delaware Court of Chancery found that Royal Bank of

Canada aided and abetted fiduciary duty violations of the board of directors of Rural/Metro Corporation in its sale of the company to a private equity firm. The Court noted that, although RBC did tell the board upfront it was interested in providing staple financing, RBC never disclosed to the Rural board of directors that it was lobbying the private equity firm to participate in buy-side financing, even as the board sent RBC to negotiate against the private equity firm on behalf of the company. RBC was found to have failed to disclose certain critical information to the board "to further its own opportunity to close a deal, get paid its contingent fee, and receive additional and far greater fees for buy-side financing work."[241] The Court concluded that "RBC knowingly participated in the Board's breach of its duty of care by creating the informational vacuum that misled the Board," in part by revising its valuation of Rural downward so as to make it appear that the private equity firm's offer was fair to and in the best interests of Rural's shareholders.[242]

In 2015, the Delaware Supreme Court affirmed the Court of Chancery's ruling in *Rural Metro*, but emphasized its narrow nature and provided clarification on the practical steps boards and their financial advisors can take to manage potential conflicts.[243] The Court refused to adopt the Chancery Court's *dictum* describing the financial advisors role as a "gatekeeper," stating that its holding was "a narrow one that should not be read expansively to suggest that any failure on the part of a financial advisor to prevent directors from breaching their duty of care gives rise to a claim for aiding and abetting a breach of the duty of care."[244] The Court accepted the practical reality that banks may be conflicted, but put the onus on directors to "be especially diligent in overseeing the conflicted advisor's role in the sale process" and explained that "because the conflicted advisor may, alone, possess information relating to a conflict, the board should require disclosure of, on an ongoing basis, material information that might impact the board's process."[245]

Del Monte and *Rural Metro* are examples of cases where, based on the records before them, the courts found serious improper behavior by the investment banks. Such cases are rare and, moreover, the Court of Chancery has also ruled that a fully informed stockholder vote may effectively insulate a financial advisor from aiding and abetting liability, just as it may insulate directors.[246] It is nonetheless important that banks and boards take a proactive role in encouraging the disclosure and management of conflicts. Banks should faithfully represent their clients and disclose fully any actual or potential conflicts of which they are aware so that such conflicts can be managed appropriately.[247] Though boards cannot know and do not have a responsibility to identify every conflict their financial advisors may have, they should seek to ensure that these conflicts are brought to light as they arise throughout the transaction process, and to appropriately manage any such conflicts.

Transactions involving a target with different classes of stock that receive differential consideration present special issues regarding fairness opinions. In the *TCI* decision, the special committee's financial advisor rendered an opinion concluding that the consideration to be received by holders of low-vote shares was fair and, separately, that the same was true as to holders of high-vote shares. But the Court indicated that the financial advisor should also have opined that the premium to be received by the holders of the high-vote shares was fair to the low-vote holders—a so-called "relative fairness" opinion.[248] However, it may be difficult in practice to render a "relative fairness" opinion, and major investment banks, in contrast to certain boutique banks, historically have resisted giving such opinions, a trend that generally has continued with few exceptions even in the 10 years since *TCI*.

D. Use and Disclosure of Financial Projections

Financial projections are often prepared by the management of the target company (or both companies in a stock-for-stock deal) and can play a critical role in the decision-making process of both the acquiror and target boards with respect to the amount and nature of consideration. These projections may also serve as the foundation for certain analyses supporting a fairness opinion given by a financial advisor. Despite their usefulness, the creation of and reliance on financial projections may trigger certain disclosure obligations under both Delaware law and SEC rules. Failing to understand and follow the disclosure requirements may result in costly shareholder litigation claiming that the company's disclosure to shareholders was inadequate and misleading, which could lead to delay in completing a transaction.

As it did in the *Netsmart* decision, the Delaware Court of Chancery often requires disclosure of management projections underlying the analyses supporting a fairness opinion.[249] Courts have also indicated that partial or selective disclosure of certain projections can be problematic.

Not all projections will be deemed sufficiently material or reliable as to require proxy disclosure. Nor is the mere receipt or review of certain projections by parties or advisors to a transaction enough to require disclosure.[250] For one thing, the development of financial projections is an iterative process, which often involves deliberation between the board (or special committee), the financial advisors and management as to which assumptions are reasonable. Additionally, financial projections often contemplate a base case, an upside case and a downside case, not all of which are necessarily material and required to be disclosed.[251] As explained in *In re Micromet, Inc. S'holders Litig.*, "Delaware law does not require disclosure of inherently unreliable or speculative information which would tend to confuse stockholders or inundate them with an overload of information."[252]

In *In re BEA Systems, Inc. Shareholders Litigation*, the plaintiffs argued that certain financial data considered by BEA's financial advisor had been presented to the board and thus had to be disclosed.[253] The Delaware Court of Chancery found that neither the financial advisor nor the board considered the contested data reliable or actually relied upon that data in forming their views on valuation and that the information did not have to be disclosed, noting that disclosure of such unreliable information "could well mislead shareholders rather than inform them."[254] The *BEA* case indicates that Delaware courts have not imposed *per se* disclosure standards for financial projections or other aspects of a financial advisor's work; case-specific materiality is the touchstone for disclosure.

The SEC also imposes its own disclosure requirements. For example, the SEC typically requires disclosure of a target company's projections that were provided to the acquiror or its financial advisors, or the target's own financial advisors for purposes of giving a fairness opinion. While the SEC is receptive to arguments that certain projections are out of date or immaterial, it is normally the company's burden to persuade the SEC that projections that were provided to certain parties should not be disclosed. In light of the timing pressure facing many transactions, where even a few weeks' delay may add unwanted execution risk, companies may prophylactically disclose projections that they would have otherwise kept private. Such prophylactic efforts help accelerate the SEC review process and also help to minimize the likelihood that a successful shareholder lawsuit will enjoin a transaction pending further disclosure found to be required by a court. Nevertheless, a company must take heed not to include so many figures in its disclosure so as to be confusing or misleading to shareholders. Companies should consult with their legal and financial advisors well in advance of a filing to ensure that they are well informed of how to strike the delicate balance between under- and over-disclosure of projections.

Delaware law and the views of the SEC Staff on how much disclosure to require (both of target projections and, in the case of transactions involving stock consideration, buyer projections) continue to develop, however, and parties should consider at the outset of their negotiations the possibility that such disclosure may be required in the future.

IV.

Structural Considerations

A. Choosing a Transaction Form

The legal form of an M&A transaction is a critical initial structuring consideration. The legal structure may have important consequences for the deal, including the tax treatment of the transaction, the speed at which the transaction will be completed, and the standard of review the transaction will receive in litigation. Parties to a transaction should be mindful of the consequences of the transaction structure they select.

1. Federal Income Tax Considerations

As a result of both an acquiror's need to conserve cash and the desire of shareholders of the target to have the opportunity for tax deferral (and/or to participate in future value creation by the combined company), the consideration paid by the acquiror in many mergers includes acquiror stock that is intended to be received on a tax-free basis by the target shareholders. For tax-free treatment to apply, a number of requirements must be met, as described below. The requirements vary depending on the form of the transaction. For all forms of transaction (other than the so-called "double-dummy" structure) a specified minimum portion of the consideration must consist of acquiror stock.

a. Direct Merger

In this structure, the target merges with and into the acquiror. It is also possible for the target to merge into a wholly owned limited liability company that is a direct subsidiary of the acquiror. This will generally be nontaxable to the target, the acquiror and the target's shareholders who receive only stock of the surviving corporation (excluding "nonqualified preferred stock" as described below), provided that acquiror stock constitutes at least 40% of the total consideration. For these purposes, stock includes voting and non-voting stock, both common and preferred. Target shareholders will be taxed on the receipt of any cash or "other property" in an amount equal to the lesser of (1) the amount of cash or other property received and (2) the amount of gain realized in the exchange, *i.e.*, the excess of the total value of the consideration received over the shareholder's adjusted tax basis in the target stock surrendered. For this purpose, "other property" includes nonqualified preferred stock. Nonqualified preferred stock includes any class of preferred stock that does not participate in corporate growth to any significant extent and:

(1) is puttable by the holder within 20 years, (2) is subject to mandatory redemption within 20 years, (3) is callable by the issuer within 20 years and, at issuance, is more likely than not to be called or (4) pays a variable rate dividend. However, if acquiror nonqualified preferred stock is received in exchange for target nonqualified preferred stock, such nonqualified preferred stock is not treated as "other property." Any gain recognized generally will be capital gain, although it can, under certain circumstances, be taxed as dividend income.

Historically, the requirement that acquiror stock constitute at least 40% of the total consideration was, in all cases, determined by reference to the fair market value of the acquiror stock issued in the merger (*i.e.,* on the closing date). Treasury regulations issued in 2011 permit the parties, in circumstances where the consideration is "fixed," to determine whether this requirement is met by reference to the fair market value of the acquiror stock at signing rather than at closing, adding flexibility and certainty on an issue essential to achieving tax-free treatment. The regulations also clarify that this signing date rule is available in certain variable consideration transactions with collars.

b. Forward Triangular Merger

In this structure, the target merges with and into an at least 80% owned (usually wholly owned) direct subsidiary of the acquiror, with the merger subsidiary as the surviving corporation. The requirements for tax-free treatment and the taxation of non-stock consideration (including nonqualified preferred stock) are the same as with a direct merger. However, in order for this transaction to be tax-free, there are two additional requirements. First, no stock of the merger subsidiary can be issued in the transaction. Thus, target preferred stock may not be assumed in the merger but must be reissued at the acquiror level or redeemed prior to the merger. Second, the merger subsidiary must acquire "substantially all" of the assets of the target, which generally means at least 90% of net assets and 70% of gross assets. This requirement must be taken into account when considering distributions, redemptions or spin-offs before or after a merger.

c. Reverse Triangular Merger

In this structure, a merger subsidiary formed by the acquiror merges with and into the target, with the target as the surviving corporation. In order for this transaction to be tax-free, the acquiror must acquire, in the transaction, at least 80% of all of the target's voting stock and 80% of every other class of target stock in exchange for acquiror voting stock. Thus, target non-voting preferred stock must either be given a vote at the target level and left outstanding at that level, exchanged for acquiror voting stock or redeemed prior to the merger. In addition, the target must retain "substantially all" of its assets after the merger.

d. Section 351 "Double-Dummy" Transaction

An alternative structure is for both the acquiror and the target to be acquired by a new holding company in a transaction intended to qualify as a tax-free exchange under Section 351 of the Internal Revenue Code. As a corporate matter, this would be achieved by the holding company creating two subsidiaries, one of which would merge with and into the acquiror and the other would merge with and into the target in two simultaneous reverse triangular mergers. In addition to each merger potentially qualifying as a tax-free reverse triangular merger, shareholders of the acquiror and the target would receive tax-free treatment under Section 351 to the extent that they received holding-company stock, which may be common or preferred (other than nonqualified preferred stock), voting or non-voting, provided that the shareholders of the acquiror and the target, in the aggregate, own at least 80% of the voting stock and 80% of each other class of stock (if any) of the holding company immediately after the transaction. Unlike the other transaction forms discussed above, there is no limit on the amount of cash that may be used in this transaction as long as the 80% aggregate ownership test is satisfied. Cash and nonqualified preferred stock received will be taxable up to the amount of gain realized in the transaction.

e. Multi-Step Transaction

A multi-step transaction may also qualify as wholly or partially tax-free. Often, an acquiror will launch an exchange offer or tender offer for target stock to be followed by a merger that forces out target shareholders who do not tender into the offer. Because the purchases under the tender offer or exchange offer and the merger are part of an overall plan to make an integrated acquisition, tax law generally views them as one overall transaction. Accordingly, such multi-step transactions can qualify for tax-free treatment if the rules described above are satisfied. For example, an exchange offer in which a subsidiary of the acquiror acquires target stock for acquiror voting stock followed by a merger of the subsidiary into the target may qualify for tax-free treatment under the "reverse triangular merger" rules described above. These multi-step transactions provide an opportunity to get consideration to target shareholders more quickly than would occur in single-step transactions, while also providing tax-free treatment to target shareholders on their receipt of acquiror stock.

f. Spin-Offs Combined with M&A Transactions

A tax-free spin-off or split-off that satisfies the requirements of Section 355 of the Internal Revenue Code can be used in combination with a concurrent M&A transaction, although there are limitations on the type of transactions that could be accomplished in a tax-free manner as described in more detail below. For example, "Morris Trusts" and "Reverse Morris Trusts" transactions effectively allow a parent corporation to separate a business and combine it with a third party in a transaction that is tax-free to parent and its shareholders if certain requirements are met. In a traditional Morris Trust transaction, all of the parent's assets other than those that will be acquired by the third party are spun off or split off into a new company and then the parent immediately merges with the acquiror in a transaction that is tax-free to parent stockholders (*i.e.*, involving solely stock consideration). By contrast, in a Reverse Morris Trust transaction, all assets to be acquired by the third party are spun off or split off into a new company and then the new company immediately merges with the acquiror in a transaction that is tax-free to parent stockholders.

In order to qualify as tax-free to parent, the Morris Trust and Reverse Morris Trust structures generally require, among other things, that the merger partner be smaller (*i.e.*, that the shareholders of parent own more than 50% of the stock of the combined entity). Recent examples of Reverse Morris Trust transactions include the announced spin-off of Lockheed Martin's Information Systems & Global Solutions business and merger of such businesses with Leidos Holdings, the acquisition by Olin Corporation of the chlor-alkali and downstream derivatives businesses that was split off by The Dow Chemical Company, and PPG Industries' 2013 split-off of its commodity chemicals business and merger of such business with Georgia Gulf (since renamed Axiall Corporation).

A tax-free spin-off also can be combined with a significant investment transaction in a so-called "sponsored spin-off." In this type of transaction, the parent distributes the shares of the subsidiary in a tax-free spin-off that is immediately followed by the acquisition by a sponsor of less than 50% of either the parent or the company being spun off. The sponsor's investment allows the parent to raise proceeds in connection with the spin-off without having to first go through an IPO process, and can help demonstrate the value of the target business to the market. Sponsored spin-offs raise a number of complexities, including as to valuation, capital structure and governance.

Certain requirements for tax-free treatment under Section 355 of the Internal Revenue Code are intended to avoid providing preferential tax treatment to transactions that resemble corporate-level sales. Under current law, a spin-off coupled with a tax-free or taxable acquisition will cause the parent to be taxed on any corporate-level gain in the spun-off company's stock if, as part of a plan (or series of related transactions) that includes the spin-off, one or more persons acquire a 50% or greater interest in the parent or the spin-off company.

Acquisitions occurring either within the two years before or within the two years after the spin-off are presumed to be part of such a plan or series of related transactions. Treasury regulations include facts and circumstances tests and safe harbors for determining whether an acquisition and spin-off are part of a plan or series of related transactions. Generally, where there have been no "substantial negotiations" with respect to the acquisition of the parent or the spin-off company or a "similar acquisition" within two years prior to the spin-off, a post-spin acquisition of the parent or the spin-off company solely for acquiror stock will not jeopardize the tax-free nature of the spin-off.

As described above, post-spin equity transactions that are part of a plan remain viable where the historic shareholders of the parent retain a greater-than-50% interest (by vote and value) in the parent and the spin-off company after the merger transaction. Where the merger partner is larger than the parent or spin-off company to be acquired, it may be possible to have the merger partner redeem shares or pay an extraordinary distribution to shrink its capitalization prior to the merger transaction.

Additional rules apply when the post-spin-off transaction is taxable to the former parent shareholders (*e.g.,* acquisitions involving cash or other taxable consideration). Because post-spin transactions can cause a spin-off to become taxable to the parent corporation (and, in the case of a taxable acquisition, its shareholders), it is customary for the tax matters agreement entered into in connection with a spin-off to impose restrictions with respect to such transactions and to allocate any tax liability resulting from the spin-off to the corporation the acquisition of whose stock after the spin-off triggered the tax.

2. Tender Offers

A tender offer involves the acquiror making a direct offer to the target's public shareholders to acquire their shares, commonly conditioned on the acquiror holding at least a majority of each class of target stock upon the close of the tender offer. Usually, following the tender offer, the acquiror and the target merge pursuant to a previously signed merger agreement, ensuring the completion of the transaction. In cases where, upon consummation of the offer, the acquiror holds at least the statutorily prescribed percentage (usually 90%, or 50% in the case of a transaction effected pursuant to Section 251(h) of the DGCL, as discussed below) of each class of target stock entitled to vote on the merger, the acquiror can complete the acquisition by a short-form merger,[255] thereby avoiding the need to solicit proxies or hold a shareholders' meeting. In order to overcome shortfalls in reaching the short-form merger threshold in non-DGCL 251(h) transactions, the market has relied upon workarounds that have become commonplace features of merger agreements contemplating such tender offers. Namely, the merger agreement may provide for a "subsequent offering period" during which the acquiror may purchase additional tendered shares following the close of the initial tender period and for a "top-up option" (discussed further below), which permits the acquiror to purchase newly issued shares directly from the target in order to reach the requisite threshold. As discussed further below, to hedge against the risk of delays from not acquiring sufficient shares for a short-form merger in a non-DGCL 251(h) transaction even with the aforementioned features, or from an extended regulatory approval process, acquirors in recent years occasionally have pursued a "dual-track" process (or "Burger King" structure after a 2010 namesake buyout) by beginning the process for a one-step merger in conjunction with that of a two-step tender offer followed by a merger.

Section 251(h) of the DGCL, effective August 1, 2013 and amended as of August 1, 2014, has had a significant impact on the use of tender offers. As described below, Section 251(h) permits, in certain cases, a merger agreement to eliminate the need for a stockholder meeting to approve a second-step merger following a tender offer, so long as the buyer owns sufficient stock following the tender offer to approve the merger. Where applicable, Section 251(h) diminishes the need for a top-up option, or for a dual-track approach where the threshold for exercising the top-up option exceeds the threshold for a short-form merger. The provision also adds speed and certainty to some acquisitions by allowing them to close upon completion of the tender offer without having to wait for a shareholder vote, the result of which—because the acquiror already holds sufficient shares to approve the merger—is a foregone conclusion.

a. Advantages of the Tender Offer Structure

1. Speed

Amendments to the tender offer rules effective in 2000 reduced the timing disparity between all-cash tender offers and tender offers with consideration including securities (or "exchange offers") by allowing the 20-business-day time period for certain exchange offers to begin as early as upon filing of a registration statement, rather than upon effectiveness of the registration statement. The SEC typically will endeavor to work with an offeror to clear a registration statement in time for the exchange offer to be completed within 20 business days, although this outcome is not assured.

A two-step structure involving a tender offer is not always preferable to or faster than a one-step merger; the decision of which structure to employ must be made in light of the particular circumstances of the transaction. For example, in a transaction that involves a lengthy regulatory approval process, the tender offer would have to remain open until the regulatory approval was obtained, and if the tender offer did not result in the acquiror holding sufficient shares to effect a short-form merger, additional time would be needed to effect the back-end merger. On the other hand, structuring such an acquisition as a one-step merger would permit the parties to obtain shareholder approval during the pendency of the regulatory process, and then close the transaction promptly after obtaining regulatory approval. An acquiror may prefer a merger in this circumstance, as fiduciary-out provisions in a merger agreement typically terminate upon shareholder approval, while a tender offer remains subject to interloper risk so long as it remains open. In addition, if there is a possibility of a time gap between closing of the tender offer and closing of the second-step merger, the tender offer structure poses financing-related complications—albeit not insuperable ones—because financing for the tender offer will be needed at the time of its closing, before the acquiror has access to the target's balance sheet; the Federal Reserve Board's margin rules restrict borrowings secured by public company stock to 50% of its market value.

2. Dissident Shareholders

In addition to speed, another potential advantage of the tender offer structure is its relative favorability in dealing with dissident shareholder attempts to "hold up" friendly merger transactions. The tender offer structure may be advantageous in overcoming hold-up obstacles because:

(1) tender offers do not suffer from the so-called "dead-vote" problem that arises in contested merger transactions when the holders of a substantial number of shares sell after the record date and then either do not vote or change an outdated vote;

(2) ISS and other proxy advisory services only occasionally make recommendations or other commentary with respect to tender offers because there is no specific voting or proxy decision, making it more likely for shareholders to vote based on their economic interests rather than on ISS's views (that may reflect non-price factors); and

(3) recent experience indicates that dissident shareholders may be less likely to try to "game" a tender offer than a merger vote,

and therefore the risk of a "no" vote (*i.e.*, a less-than-50% tender) may be lower than for a traditional voted-upon merger.

3. Standard of Review

As discussed in Section II.C.1, transactions with a controlling shareholder are typically subject to entire fairness review. However starting in 2001, several decisions by the Delaware courts offered a method for a parent company to acquire the outstanding minority shares in a controlled subsidiary without having to satisfy the entire fairness standard. This method involves a tender offer for the minority shares, followed by a short-form merger if the parent bidder is able to obtain ownership above 90% of the target in the tender offer. In 2001, in *In re Siliconix*, the Delaware Court of Chancery ruled that a parent company has no obligation to offer a fair price in a tender or exchange offer for the minority shares, unless a minority shareholder can show actual coercion or disclosure violations, because a tender offer is a voluntary transaction.[256] The same year, in *Glassman* v. *Unocal Exploration Corp.*, the Delaware Supreme Court held that the parent company does not have to establish entire fairness in a short-form merger, and, absent fraud or illegality, the "only recourse" for a minority shareholder dissatisfied with the merger is an appraisal.[257]

In 2010, Vice Chancellor Laster rejected the *Siliconix* line of cases in *CNX Gas*.[258] In *CNX Gas*, the Court held that a tender offer/short-form merger transaction with a controlling shareholder receives business judgment review only if the offer is conditioned on the affirmative recommendation of a special committee of independent directors and included a non-waivable majority-of-the-minority shareholder approval condition. Otherwise, the Court ruled, a *Siliconix* transaction that was structurally non-coercive and free of disclosure violations would be reviewed under the entire fairness standard.[259]

b. DGCL Section 251(h)

Before the adoption of DGCL Section 251(h), a second-step merger following a tender offer always required a stockholder vote—even if the outcome was a formality because the buyer owned enough shares to singlehandedly approve the transaction—unless the buyer reached Delaware's short-form merger 90% threshold. Despite the inevitability of the vote's outcome, the extended process of preparing a proxy statement and holding a meeting would impose transaction risk, expense and complexity on the parties. The prospect of such delays had been a significant deterrent to the use of tender offers, especially by private equity buyers, who need to close on the first and second steps concurrently in order to facilitate their acquisition financing.

In order to address this shortfall, the market evolved a workaround in the form of the top-up option. While the top-up option has been used to obviate the need for a shareholder vote, this device may be unviable due to restrictions on the target's ability to issue shares. Other approaches, such as the subsequent offering period and the dual-track structure, are similarly imperfect workarounds that do not ensure the timing benefits of the tender offer followed by short-form merger.

In 2013, Delaware amended its corporate law to add Section 251(h), which permits the inclusion of a provision in a merger agreement eliminating the need for a stockholder vote to approve a second-step merger following a tender offer under certain conditions—including that following the tender offer the buyer owns sufficient stock to approve the merger pursuant to the DGCL and the target's charter (*i.e.*, 50% of the outstanding shares, unless the target's charter requires a higher threshold or the vote of a separate series or class).[260] The provision requires that the offer (i) extend to any and all outstanding voting stock of the target (except for stock owned by the target itself, the acquiror, any parent of the acquiror (if wholly owned) and any subsidiaries of the foregoing); (ii) that all non-tendering shares receive the same amount and kind of consideration as those that tender; and (iii) that the second-step merger be effected as soon as practicable following the consummation of the offer.

By eliminating in applicable transactions the need to obtain the 90% threshold, Section 251(h) has significantly diminished the prominence of the workarounds noted above. Despite their reduced importance, the top-up option, dual-track structure and subsequent offering period remain relevant because Section 251(h) may not always be available or optimal for the parties. For one thing, it would not be available for targets that are not incorporated in Delaware. Section 251(h) is likewise unavailable if the target's charter expressly requires a stockholder vote on a merger or if the target's shares are not publicly listed or held by more than 2,000 holders.

In August 2014, amendments to the DGCL expanded the scope of transactions that could be effected under Section 251(h). Most notably, the amendments eliminated a provision that had prohibited the section's use where a party to a merger agreement was an "interested stockholder" under Section 203 of the DGCL (*i.e.*, a 15% stockholder, and potentially even a buyer that had entered into a tender and support agreement with a 15% stockholder). The amendments further clarified that Section 251(h) applies to merger agreements that "*permit*" or "*require*" (rather than strictly require) the merger to be consummated pursuant to Section 251(h). As a result, contracting parties may preserve the option of a 251(h) merger at the time of signing a deal without precluding the possibility of consummating the merger pursuant to a different statutory provision if circumstances later warrant. Finally, the 2014 amendments clarified that, for purposes of determining whether sufficient shares were acquired in the first-step tender offer, shares tendered pursuant to notice of guaranteed delivery procedures cannot be counted by the acquiror towards the threshold until the shares underlying the guarantee are actually delivered.

By simplifying and accelerating combinations via the two-step tender offer and merger format, Section 251(h) has increased the use of this transaction structure. Recently, it has begun to be used for exchange offers as well as cash-only deals, including Expedia's acquisition of HomeAway, Alexion Pharmaceuticals' acquisition of Synageva BioPharma and AbbVie's acquisition of Pharmacyclics, each announced and completed in 2015. It should be noted, however, that Section 251(h) does not change the fact that, as discussed above, tender offers are not always preferable to one-step mergers (*e.g.*, when a lengthy regulatory approval process is expected).

c. Top-Up Options

One deal feature historically associated with tender offers is the top-up option. Such an option, exercisable after the close of the tender offer, permits the acquiror to purchase a number of newly issued shares directly from the target such that the acquiror may reach the short-form merger statute threshold, thereby avoiding a shareholder vote and enabling an almost immediate consummation of the transaction. However, a top-up option is limited by the amount of authorized but unissued stock of the target. In addition, parties should keep in mind that stock exchange rules require a stockholder vote for share issuances over a certain size. Before the adoption of DGCL Section 251(h), top-up options had become a standard feature of two-step tender offers. While the increased prevalence of top-up options had triggered litigation and judicial scrutiny, decisions of the Delaware Court of Chancery demonstrate that properly structured top-up options are valid under Delaware law.[261] Nevertheless, the availability of DGCL Section 251(h) has significantly reduced the use of top-up options in tender offer transactions where targets are incorporated in Delaware.

d. Dual-Track Tender Offers

A number of years ago, some private equity firms began utilizing a dual-track approach that involves launching a two-step tender offer (including a top-up option) concurrently with filing a proxy statement for a one-step merger. The logic behind this approach is that, if the tender offer fails to reach the minimum number of shares upon which it is conditioned—which in combination with the shares issued pursuant to a top-up option would allow for a short-form merger—the parties would already be well along the path to the shareholder meeting for a fallback long-form merger (it should be noted that while the SEC will begin review, it will not declare the proxy statement effective until after the expiration of the tender offer). Examples of this approach include 3G Capital/Burger King, Bain Capital/Gymboree and TPG/Immucor. As noted above, the use of dual-track tender offers has diminished as a result of the adoption of DGCL Section 251(h).

Dual-track structures continue to be potentially useful, however, even where Section 251(h) is available. Some strategic transactions (*e.g.*, Alexion/Synageva, Verizon/Terremark, Georgia Pacific/Buckeye Technologies) also have employed a dual-track approach, for example, where there is uncertainty at the outset as to whether regulatory hurdles, such as an antitrust "second request," will involve a lengthy process that could subject an acquiror in a tender offer to prolonged interloper risk. If regulatory approval is promptly received, the acquisition can close pursuant to the tender offer route (and the second-step merger can be effected pursuant to Section 251(h), if available); if not, the shareholder vote can be taken on the long-form merger route, thereby cutting off interloper risk.

3. Mergers of Equals

Combinations between large companies of similar sizes are often referred to as "mergers of equals" or "MOEs." MOEs can offer an attractive avenue for growth by allowing a company to enhance shareholder value through merger synergies at a lower cost than high-premium acquisitions (since MOEs are typically low- or no-premium-to-market transactions). They also provide an alternative to an outright sale of a company, which is often undesirable for a variety of business, economic and social reasons. Although there are no formal legal requirements for what qualifies as an MOE, MOEs are typically structured as tax-free, stock-for-stock transactions, with a fixed exchange ratio without collars or walk-aways, and with a balanced contract often containing matching representations, warranties and interim covenants from both parties. Recent examples include the combination of MeadWestvaco and Rock-Tenn, the merger of Willis Group Holdings and Towers Watson, and the recently announced merger of Johnson Controls and Tyco International plc. MOEs differ from other types of mergers in a number of important respects. Like many stock-for-stock mergers, MOEs usually do not involve a "sale of control" of either party within the meaning of the applicable case law on directors' fiduciary duties; instead, control remains with the public shareholders as a group (absent a controlling shareholder of the post-merger entity). Accordingly, *Revlon* review is generally not triggered and directors have broad discretion under the business judgment rule to pursue an MOE transaction that they deem to be in the best long-term interests of the company, its shareholders and its other important constituencies, even if they recognize that an alternative sale or merger transaction could deliver a higher premium over current market value. It is prudent, nonetheless, for a board, as part of its deliberative process, to consider what alternative business strategies might exist, including an analysis of what potential acquirors could pay in an acquisition context.

MOEs often provide little or no premium above market price for either company. Instead, an exchange ratio is set to reflect relative metrics, such as assets, earnings and capital contributions, and market capitalizations, of the two merging parties—typically, but not always, resulting in a market-to-market exchange. Assuming a proper exchange ratio is set, MOEs can provide a fair and efficient means for the shareholders of both companies to benefit from merger synergies.

Due to the absence or modesty of a premium to market, MOEs are particularly vulnerable to dissident-shareholder campaigns and competing bids. While no protection is iron-clad, steps can be taken to protect an MOE transaction. As a preliminary matter, it is important to recognize that the period of greatest vulnerability is the period before the transaction is signed and announced. Parties must be cognizant that leaks or premature disclosure of MOE negotiations can provide the perfect opening for a would-be acquiror to submit a competing proposal or pressure a party into a sale or auction. A run-up in the stock price of one of the companies—whether or not based on merger rumors—also can derail an MOE, because no company wants to announce a transaction with an exchange ratio that reflects a substantial discount to market. MOE agreements should generally include robust structural protections, such as break-up fees, support commitments, no-shops and agreements not to terminate the merger agreement in the face of a competing offer without giving the shareholders a fair opportunity to vote on the merger, and utilization of a rights plan may also be appropriate. Since an MOE generally does not involve a sale of control of the company, parties to an MOE should send a strong signal that they have no intention of engaging in a sale-of-control transaction, even if their MOE transaction is voted down by shareholders. Once the deal has been made public, it is critical to advance a strong business rationale for the MOE in order to obtain a positive stock market reaction and thus reduce both parties' vulnerability to shareholder unrest and/or a competing offer. The appearance and reality of a true combination of equals, with shareholders sharing the benefits of the merger proportionately, are essential to winning shareholder support in the absence of a substantial premium.

Achieving the reality and perception of a true combination of equals presents an MOE transaction with unique structural and governance challenges. Structurally, the companies may choose to have both companies' stock surrendered and a new company's stock issued in their place to, among other possible benefits, promote the market's understanding of the transaction as a true combination of equals, rather than a takeover of one company by the other. Similarly, parties to an MOE should carefully consider the post-merger governance and management of the combined company. Among the issues that will need to be addressed are the combined company's name, the location of the combined company's headquarters and key operations, the rationalization of the companies' separate corporate cultures and the selection of officers and directors. In most of the larger MOEs there has been substantial balance, if not exact parity, in board representation and senior executive positions. This approach allows for a selection of the best people from both organizations to manage the combined company, thereby enhancing long-term shareholder value. Frequently, the CEO of one company becomes the Chairman of the combined company, with the other CEO continuing in his role, thus providing for representation at the helm from both constituent companies.

B. Consideration and Pricing

The pricing structure used in a particular transaction (and the allocation of risk between the acquiror and the target and their respective shareholders) will depend on the characteristics of the deal and the relative bargaining strength of the parties. All-stock and part-stock mergers raise difficult pricing and market risk issues, particularly in a volatile market. In such transactions, even if the parties come to an agreement on the relative value of the two companies, the value of the consideration may be dramatically altered by market changes, such as a substantial decline in financial markets, industry-specific market trends, company-specific market performance or any combination of these. Although nominal market value is not the required legal criterion for assigning value to stock consideration in a proposed merger, a target in a transaction may have great difficulty in obtaining shareholder approval of a transaction where nominal market value is less than, or only marginally greater than, the then-current market value of the target's stock. In addition, a stock merger proposal that becomes public carries substantial market risk for the buyer, whose stock may fall due to the anticipated financial impact of the transaction. Such a market response may put pressure on the buyer to offer additional make-whole consideration to seller, worsening the impact of the transaction from an accretion/dilution perspective, or to abandon the transaction altogether.

This Section discusses the key structural and pricing decisions that must be faced in all-stock or cash-stock hybrid transactions, some of which are also relevant in the context of an all-cash transaction.

1. All-Cash Transactions

The popularity of stock as a form of consideration ebbs and flows with economic conditions. All-cash bids have the benefit of being of certain value and will gain quick attention from a target's shareholders, particularly in the case of an unsolicited offer. In addition, the acquiror's stock price is often less adversely affected by an all cash offer as compared to an all-stock offer because no shares of the buyer are being issued. Of course, some bidders may not have sufficient cash and financing sources to pursue an all-cash transaction. In such cases, the relative benefits and complexities of part-cash/part-stock and all-stock transactions must be considered.

2. All-Stock Transactions

a. Pricing Formulas and Allocation of Market Risk

The typical stock merger is subject to market risks on account of the typically lengthy interval between signing and closing and the volatility of security trading prices. A drop in the price of an acquiror's stock between execution of the acquisition agreement and the closing of the transaction can alter the relative value of the transaction to both acquiror and target shareholders: Target shareholders might receive less value for their exchanged shares or, if additional shares are issued to compensate for the drop, the transaction will be less accretive or more dilutive to the acquiror's earnings per share. Such market risk can be addressed by a pricing structure that is tailored to the risk allocation agreed to by the parties. These pricing structures may include using a valuation formula instead of a fixed exchange ratio, a collar, or, more rarely, so-called "walk-away" provisions permitting unilateral termination in the event the acquiror's share price falls below a certain level.[262]

1. Fixed Exchange Ratio

The simplest, and most common, pricing structure (especially in the context of larger transactions) in a stock-for-stock transaction is to set a fixed exchange ratio at the time a merger agreement is signed. The advantage of a fixed exchange ratio for an acquiror is that it permits the acquiror to determine at the outset how much stock it will have to issue in the transaction (and thus to determine with some certainty the impact on per-share earnings and whether a stockholder vote may be required on such issuance pursuant to rules of the applicable stock exchange). On the other hand, a fixed exchange ratio with a post-signing decline in the market value of the acquiror's stock could jeopardize shareholder approval and/or invite third-party competition (by decreasing the value that target's shareholders will receive at closing). From an acquiror's perspective, these are generally risks that can be dealt with if and when they arise, and the acquiror typically prefers the certainty of a fixed number of shares. And to the extent an acquiror and a target are in the same industry, industry-specific events could very well affect their stock prices similarly and therefore not affect the premium to be afforded by the exchange ratio (which would explain why a fixed exchange ratio is frequently used in a merger of equals).

The fixed exchange ratio is also the most common (but far from exclusive) pricing alternative in all-stock transactions with a larger aggregate dollar value. This may be due in part to the fact that large public companies typically have actively traded stocks, and the acquiror may persuasively argue that the market will soon reflect the value of the merged company. A fixed exchange ratio promotes maximum risk-sharing between the target's shareholders and the acquiror's shareholders.

Even where the market moves adversely to the acquiror's stock, companies that are parties to pending strategic mergers have been able to successfully defend their deals based on the long-term strategic prospects of the combined company. Nevertheless, in cases where there is concern that shareholders may vote down a transaction because of price fluctuation, the parties may turn to other pricing mechanisms to allocate market risk.

2. Fixed Value With Floating Exchange Ratio; Collars

In many situations, one or both parties (typically the target) will be unwilling to permit market fluctuation to impair its ability to achieve the benefits of the bargain that was struck at signing. One solution is to provide for a floating exchange ratio, which will deliver a fixed dollar value of the acquiror's stock (rather than a fixed number of shares). The exchange ratio is set based on an average market price for the acquiror's stock during some period, normally 10 to 30 trading days, prior to closing. Thus, the acquiror would agree to deliver a fixed value (*e.g.*, $30) in stock for each of the target's shares, with the number of acquiror's shares to be delivered based on the market price during the specified period. An acquiror bears the market risk of a decline in the price of its stock since, in such event, it will have to issue more shares to deliver the agreed value. Correspondingly, an acquiror may benefit from an increase in the price of its stock since it could deliver fewer shares to provide the agreed value. Because a dramatic drop in the acquiror's stock may require the acquiror to buy its target for far more shares than had been intended at the time the transaction was announced, companies should carefully consider the possibility of dramatic market events between signing and closing. A target's shareholders bear little market risk in this scenario and correspondingly will not benefit from an increase in stock prices since the per-share value is fixed.

In order to mitigate the risk posed by market fluctuations, parties may desire a longer measuring period for valuing the acquiror's stock. Longer measuring periods minimize the effects of market volatility on how many acquiror shares will be issued as merger consideration. Additionally, acquirors favor longer measuring periods because, as the transaction becomes more likely and approaches fruition, the acquiror's stock may fall to reflect any anticipated earnings dilution. By contrast, a target may argue that the market price over some period immediately prior to consummation provides a better measure of consideration received.

However, merely lengthening the valuation period is often insufficient to protect acquirors against large price declines. The number of shares that an acquiror may have to issue pursuant to a floating exchange ratio based upon the acquiror's stock price is limited only by the amount by which the stock price can decline. Consequently, acquirors must be cognizant of the fact that the price of their stock may decline precipitously based on events or circumstances having little or nothing to do with the value of the acquiror. While such declines may be only short-lived, the acquiror will still have to compensate the target for even a temporary shortfall that occurs during the measuring period for the floating exchange ratio. To protect against having to issue a very high number of shares, agreements with floating exchange ratios frequently include a "collar" that places a cap on the number of shares to be issued and, at the same time, a floor on the number of shares that may be issued. Effectively, such agreements provide upper and lower market price limits within which the number of shares to be delivered will be adjusted. If market prices go outside the range, no further adjustments to the number of shares delivered to the target's shareholders will need to be made. The size of the range determines the degree of protection afforded to the acquiror, and correspondingly, the amount of the market risk borne by the target's shareholders. An acquiror would argue that the target's shareholders should bear some of the risk of a price decline, and the target would argue that its shareholders, if they are to bear some risk of a price decline, should receive the benefits from a price increase. Collars are typically, but not always, symmetrical in the level of price protection they provide to buyers and sellers.

The determination whether to negotiate for collar pricing or another price protection device depends on various factors, including:

- the parties' views on the potential impact from an accretion/dilution perspective of issuing additional shares and any potential timing consequences thereof (*i.e.*, if an increased share issuance would require a stockholder vote and delay closing);
- the overall prospects for share prices in the relevant industry;
- the relative size of the two companies;
- the parties' subjective market expectations over time; and
- the desirability or necessity of pegging the transaction price to a cash value.

Parties must also consider the anticipated effect on the acquiror's stock price of short selling by arbitrageurs once the transaction is announced. In some mergers, pricing formulas and collars are considered inadvisable due to the potential downward pressure on an acquiror's stock as a result of arbitrage trading.

3. Fixed Exchange Ratio within Price Collar

The fixed exchange ratio within a price collar is another formulation that may appeal to a target that is willing to accept some risk of a pre-closing market price decline in an acquiror's stock, but wishes to protect against declines beyond a certain point. In this formulation, the target's shareholders are entitled to receive a fixed number of shares of acquiror stock in exchange for each of their shares, and there is no adjustment in that number so long as the acquiror's stock is valued within a specified range during the valuation period (*e.g.*, 10% above or below the price on the date the parties agree to the exchange ratio). If, however, the acquiror's stock is valued outside that range during the valuation period, the number of shares to be delivered is adjusted accordingly (often to one of the endpoints of the range). Thus, for example, if the parties agree on a one-for-one exchange ratio and value the acquiror's stock at $30 for purposes of the transaction, they might agree that price movements in the acquiror's stock between $27 and $33 would not result in any adjustments. If, however, the stock is valued at $25 during the valuation period, the number of shares to be delivered in exchange for each target share would be 1.08, *i.e.*, a number of shares equal to $27 (the low end of the collar) based on the $25 valuation. Therefore, although the target's shareholders will not receive an increased number of shares because of the drop in acquiror's stock price from $30 to $27, they will be compensated in additional acquiror shares by the drop in price from $27 to $25.

b. Walk-aways

Another, less common market-risk price protection is to include as a condition to closing the right for target to walk away from the merger if the price of the acquiror's stock falls below a certain level. For example, a fixed exchange ratio walk-away provision could permit termination of a merger agreement by the target if, at the time the transaction is to close, the acquiror's stock has decreased by 15%—a single trigger.

Some walk-away formulas provide for a double trigger, requiring not only an agreed-upon absolute percentage decline in the acquiror's stock price but also a specified absolute percentage decline in the acquiror's stock price relating to a defined peer group of selected companies during the pricing period. For example, the double-trigger walk-away may require that the acquiror's average stock price prior to closing fall (1) 15% or 20% from its price at the time of announcement and (2) 15% or 20% relative to a defined peer group of selected stocks. The double trigger essentially limits the walk-away right to market price declines specifically related to the acquiror, leaving target to bear the risk of price declines related to industry events. That is, the acquiror may argue that if its stock does no more than follow a general market trend, there should be no right on the part of the target to "walk." Walk-away rights are generally tested during a short trading period prior to closing and often include an option for an acquiror to elect to increase the exchange ratio to avoid triggering the target's walk-away right.

Walk-away rights can also be drafted for the benefit of an acquiror. An acquiror entering into a transaction with a floating exchange ratio, or with a fixed ratio within a price collar but without a cap on the number of shares it must issue, may negotiate for a termination right if its stock falls below a specified level, thus requiring it to issue more than a specified number of additional shares in order to provide the agreed consideration. In such a case, the target can be expected to negotiate for the right to waive the additional consideration on account of the acquiror's stock drop, so that the acquiror remains obligated to consummate the merger even if its walk-away right gets triggered.

Although walk-aways may appear desirable at first glance, they create additional risks that a transaction that is attractive from a business and strategic point of view will not be consummated due to temporary market fluctuations. Walk-aways can cause substantial difficulty in the planning for the post-merger combined company, since most walk-away rights relating to stock price declines are only triggered during a short period immediately prior to closing. Moreover, the necessity for shareholder approval by both parties inherent in most stock-for-stock transactions provides a *de facto* walk-away right for price declines existing at the time of the vote, assuming, of course, that such declines are sufficiently large to defeat shareholder approval. Shareholder approval, often required for mergers, generally continues to be the most effective means of ensuring that the negotiated deal, including its price, remains in the best interests of each party's shareholders closer to closing. The benefits of a walk-away, and the related components of a floating exchange ratio or a price collar, must be weighed carefully against the potentially significant costs of transaction uncertainty and the risk of non-consummation after months of planning for the combined company.

c. Finding the Appropriate Pricing Structure for All-Stock Transactions

The pricing structure used in a particular all-stock transaction (and thus the allocation of market risk between an acquiror and a target and their respective shareholders) will depend on the characteristics of the transaction and the relative bargaining strength of the parties. A pricing structure used for one transaction may, for a variety of reasons, be entirely inappropriate for another. For instance, in a situation that is a pure sale, a target might legitimately request the inclusion of protective provisions such as a floating exchange ratio and/or a walk-away, especially if the target has other significant strategic opportunities. An acquiror may argue, of course, that the target should not be entitled to absolute protection (in the form of a walk-away) from general industry (compared to acquiror-specific) risks. A double-trigger walk-away can correct for general industry-wide events. At the other end of the spectrum, in an MOE or "partnership" type of transaction, claims on the part of a target for price protection, especially walk-aways, are less convincing. The argument against price protection is that, once the deal is signed, the target's shareholders are (and should be) participants in both the opportunities and the risks of the combined company. Moreover, in both MOEs and a true acquisition, the target can always find some comfort, albeit less direct, in respect of acquiror-specific price risk in the representations and warranties on the part of the acquiror relating to the nonoccurrence of material adverse changes and other matters (the accuracy of which will be a condition to closing).

Because of the length of time required to complete some strategic acquisitions subject to high levels of regulatory scrutiny, the management of, or protection against, market risk through various price-related provisions can assume particular significance during stock-for-stock transaction negotiations. Blind adherence to precedent without an analysis of the particulars of the transaction at hand can be disastrous, as can careless experimentation. Transaction participants should carefully consider the many alternative pricing structures available in light of the parties' goals and the various risks involved. In all events, and consistent with their fiduciary duties, directors need to be fully informed as to how any price adjustments work, and understand the issues presented by such provisions.

3. Hybrid Transactions: Stock and Cash

In certain circumstances, the use of a mixture of stock and cash as consideration is appealing. Targets may find mixed consideration desirable because the cash component provides some downside protection to targets from a decline in the price of the acquiror's stock. In addition, depending on the allocation procedure employed (*e.g.*, whether each target shareholder is permitted to select his mix of consideration), both short- and long-term investors may be able to receive their preferred consideration in the form of all cash or all stock. Those who choose not to cash out may be able to retain the tax benefits of a tax-free exchange.

a. Possible Cash-Stock Combinations

There is a wide variety of potential pricing structures for a part-cash, part-stock transaction. Choosing the right pricing formula involves all of the complications raised in determining pricing formulas for an all-stock transaction (namely, the issues relating to fixed exchange ratios, floating exchange ratios, collars and walk-aways). In addition, if there is a formula for the cash component, it must be matched to the formula for the stock component. An important threshold issue is whether the parties intend for the values of the stock and cash components to remain equal as the price of the acquiror's shares fluctuates or whether there should be scenarios in which the values of the cash and stock components can diverge. This will be an important consideration in determining the proper allocation procedures for the cash and stock components.

The simplest formula in a part-cash, part-stock transaction is a fixed exchange ratio for the stock component linked with a fixed per-share cash amount for the cash component, with fixed percentages of the target's shares being converted into cash and stock, respectively. Because the value of the stock component of the transaction will vary with fluctuations in the acquiror's share price while the cash component remains fixed, it is important for the allocation procedures to be sensitive to the potential for significant oversubscriptions for stock, if the value of the acquiror's shares rises, and significant oversubscriptions for cash, if the value of the acquiror's shares declines. After all, at the time the target's shareholders make the decision to subscribe to a particular mix of consideration, they will have more visibility into what the acquiror's stock price will be at closing than the transaction parties will have had at signing. Because using a fixed exchange ratio for the stock component and fixed per share cash amount for the cash component will often lead to differing consideration being paid to shareholders making one election or the other, in some instances, the parties may agree to track the blended value of the cash and stock consideration until closing and pay all stockholders the same blended per share value while still permitting target shareholders to make a cash or stock election. This structure has the benefit of treating all shareholders equally but runs the risk of requiring the acquiror to issue more shares or pay more cash than was initially contemplated at signing. Consequently, in order to mitigate this risk and preserve the tax-free treatment of the deal, parties typically will place limits on the aggregate amount of cash to be paid or number of shares to be issued.

A more common hybrid pricing mechanism is to link a floating exchange ratio pricing formula for the stock component with a fixed cash price. This formula has the advantage of equalizing the stock and cash values (generally based upon the average trading price for the acquiror's shares over a 10- to 30-day trading period prior to the effective date of the merger). This approach helps facilitate a cash election procedure by minimizing any economic differential pushing shareholders toward either the cash or stock consideration. However, issues may still arise in situations where the acquiror's shares trade outside the collar range established for the floating exchange ratio or where there is a last-minute run-up or decline in the price of the acquiror's stock.

While there can be a variety of business reasons for adjusting the aggregate limits on the percentage of target shares to be exchanged for cash versus stock consideration, historically the most common reason has been the desire to preserve the tax-free status of the transaction. As described in Section IV.A.1, a part-cash, part-stock merger (including a two-step transaction with a first-step tender or exchange offer followed by a back-end merger) generally can qualify as a tax-free reorganization only if at least a minimum portion of the total value of the consideration consists of acquiror stock. Historically, satisfaction of this requirement was, in all cases, determined by reference to the fair market value of the acquiror stock issued in the merger (*i.e.*, on the closing date). Accordingly, a part-cash, part-stock merger, particularly with a fixed or collared exchange ratio, that met this requirement when the merger agreement was signed could fail to qualify as a tax-free reorganization if the value of the acquiror's shares declined before the closing date. As described in Section IV.A.1.a, Treasury regulations issued in 2011 permit the parties, in circumstances where the consideration is "fixed" within the meaning of the regulations, to determine whether this requirement is met by reference to the fair market value of the acquiror stock at signing rather than at closing. The regulations clarify that parties can rely on the signing date rule even if the acquisition agreement contemplates a stock/cash election as long as the aggregate mix of stock/cash consideration is fixed.

Adding an additional degree of complexity, hybrid cash-stock mergers may have formula-based walk-away rights. The walk-away formula can be quite complex, reflecting the specific concerns of the acquiror and the target.

Part-cash, part-stock transactions can also be structured to avoid triggering a vote by the acquiror's shareholders under stock exchange rules, by providing for a decrease in the stock portion of the consideration (and corresponding increase in the cash portion of the consideration) to the extent necessary to keep the number of shares issued below the relevant threshold (as was done in the Pfizer/Wyeth transaction, discussed in Section V.C).

In structuring a part-cash, part-stock pricing formula and allocating the cash and stock consideration pools, it is also important to consider how dissenting shares, employee stock options and other convertible securities will be treated. In addition, a board considering a proposal involving both cash and stock consideration should seek the advice of counsel with regard to whether the transaction may invoke enhanced scrutiny under *Revlon*.

b. Allocation and Oversubscription

A key issue in part-cash, part-stock transactions is choosing the best method of allocating the cash and stock components to satisfy divergent shareholder interests. The simplest allocation method is straight proration without target shareholder elections. In a straight proration, each of the target's shareholders receives a proportionate share of the aggregate pools of stock and cash consideration. Thus, in a transaction in which 50% of the consideration is being paid in stock and 50% of the consideration is being paid in cash, each target shareholder exchanges 50% of his shares for acquiror stock and 50% of his shares for cash. Shareholders who exchange their shares for a mixture of cash and stock generally will recognize gain, for federal income tax purposes, on the exchange to the extent of the lesser of (1) the gain on the exchange, measured as the difference between the fair market value of the stock and cash received over their tax basis in their shares, and (2) the amount of cash received. Thus, a principal drawback of straight proration is that the target's shareholders cannot choose their desired form of consideration and therefore all will likely recognize taxable gain.

Another approach is the use of a cash election merger. Cash election procedures provide the target's shareholders with the option of choosing between the cash and stock considerations. Such procedures allow the short-term investors to cash out of their positions while longer-term investors can exchange their shares in a tax-free exchange. Cash election procedures work best where the value of the cash and stock pools is equal and where there is a proportionate split between short- and long-term investors approximating the split between the available cash and stock consideration. Contractual provisions and related public disclosures concerning the election procedures must be drafted carefully to deal with the possibility that there may be significant oversubscriptions for one of the two types of consideration.

Of course, the easiest way of assuring simplicity in a cash election process is to provide for straight proration in the event of oversubscriptions for either the cash or the stock pool. This allocation method is still preferable to a straight proration without election procedures, because even if there is oversubscription, some shareholders will elect to receive the undersubscribed consideration and some shareholders will not return an election form and can be deemed to have elected to receive the undersubscribed consideration. Proration in this context, however, also has certain significant drawbacks. Few target shareholders will be fully satisfied because most will get a prorated portion of the undesired consideration and will also incur some taxation. Proration within the oversubscribed election pool will be most compelling when there is a significant difference between the value of the cash and stock consideration that is driving the oversubscriptions.

Another, albeit rarer, approach for handling oversubscriptions has been to select shareholders on a random or other equitable basis from those who have elected to receive the oversubscribed consideration until a sufficient number of shares are removed from the oversubscribed pool. The methods by which shareholders are selected for removal from the oversubscribed pool vary from a straight lottery to selection based on block size or time of election. Since proration is less problematic in the event of an oversubscription for cash, there is some precedent for using proration for cash oversubscriptions but a lottery selection process for stock oversubscriptions.

4. Valuing Stock Consideration in Acquisition Proposals

Even once the form of consideration is settled, targets are still confronted with the challenge of properly valuing the consideration offered in a proposed transaction. This valuation is a significant element in a board's decision whether to approve a particular transaction. Even with diligence, the evaluation of a stock merger, regardless of whether it involves a sale of control, can be quite complex. Directors may properly weigh a number of issues beyond the headline per share payment when evaluating a proposed transaction.

a. Short- and Long-Term Values

Although current market value provides a ready first estimate of the value of a transaction to a company's shareholders, the Delaware Supreme Court in *QVC* and in other cases has stated that such valuation alone is not sufficient, and certainly not determinative of value.[263] In the sale of control context, directors of a company have one primary objective: "to seek the transaction offering the best value reasonably available to the stockholders."[264] This objective would ordinarily not be satisfied by looking only to the latest closing prices on the relevant stock exchange.

In fact, in *Trans Union*, a seminal Delaware Supreme Court decision on director responsibilities in selling a company, the Court criticized the directors for relying upon the market prices of the company's stock in assessing value. The Court held that using stock market trading prices as a basis for measuring a premium "was a clearly faulty, indeed fallacious, premise."[265] Instead, the Court emphasized that the key issue must be the intrinsic value of the business, and that the value to be ascribed to a share interest in a business must reflect sound valuation information about the business. The same point was reiterated by the Delaware Supreme Court in its decision in *Time-Warner*, where the Court pointedly noted "that it is not a breach of faith for directors to determine that the present stock market price of shares is not representative of true value or that there may indeed be several market values for any corporation's stock."[266]

When valuing stock consideration, in addition to current stock prices, directors should also consider historical trading prices and financial indicators of future market performance. The result of such analyses may be that a target board values the stock consideration proposed by one bidder with a lower aggregate current market value more highly than that proposed by another bidder with a higher aggregate current market value. This is especially because in the context of competing bids, market prices may be a particularly confusing indicator. Once the offers are announced, the market may discount the securities of the higher bidder to reflect a likely victory and potential accompanying dilution, but it also may discount the securities of the lower bidder if that party is expected to raise its bid. These uncertainties, however, do not affect the validity of historical trading averages and other market comparisons which are not based on current stock prices. Of course, the target's shareholders may not agree with the board in such a case and may reject the offer with the lower current market value.

Under either the *Revlon* standard or the traditional business judgment rule, the valuation task necessarily calls for the exercise of business judgment by directors. A board must not only look at financial valuations, but also must make judgments concerning the potential for success of the combined company. Due diligence by both parties to a stock-based merger is indispensable to informed decision-making, as is detailed analysis of pro forma financial information and contribution analyses. Directors of a company may need to consider such factors as past performance of the security being offered as consideration, management, cost savings and synergies, past record of successful integration in other mergers, franchise value, antitrust issues, earnings dilution and certainty of consummation. While predicting future stock prices is inherently speculative, a board can and should evaluate such information in the context of the historic business performance of the other party, the business rationale underlying the merger proposal and the future prospects for the combined company. To the extent competing bids are under review, directors should be careful to apply comparable evaluation criteria in an unbiased manner to avoid any suggestion that they have a conflict of interest pushing them to favor one bid over another or that they are not acting in good faith.

Absent a limited set of circumstances as defined under *Revlon*, directors are not required to restrict themselves to an immediate or short-term time frame. Instead, directors are entitled to select the transaction that they believe provides shareholders with the best long-term prospects for growth and value enhancement with the least amount of downside risk; directors thus have substantial discretion to exercise their judgment. In its *Time-Warner* decision, the Delaware Supreme Court stated that the directors' statutory mandate "includes a conferred authority to set a corporate course of action, including time frame, designed to enhance corporate profitability."[267] In the same vein of judicial deference to director decision-making, *Time-Warner* likewise explained that even when a transaction is subject to enhanced scrutiny, a court should not be involved in "substituting its judgment as to what is a 'better' deal for that of a corporation's board of directors."[268]

b. Other Constituencies and Social Issues

In stock mergers not involving a change-of-control, Delaware directors may appropriately consider the effect of the transaction on non-shareholder constituencies. In seeking to achieve shareholder value, directors are permitted to take into account the impact of the prospective transaction on the company, its employees, its customers and the community in which it operates.[269] Some states outside Delaware, such as Illinois, Indiana, Minnesota, New Jersey, Maryland, Nevada, Ohio, Oregon and Pennsylvania, have adopted statutes known as "constituency statutes" specifically permitting boards to take into account such factors when making business decisions. Some of these statutes, such as those in Maryland and Oregon, only permit boards to consider the interests of other constituencies within the change-of-control context.[270] The manner in which more broadly drafted constituency statutes interact with a board's duties in a change-of-control context, and whether a target board can rely on such statutes to justify considering the interests of other constituencies instead of just maximum value to shareholders varies, state-by-state.[271] The economic terms of a proposed merger or acquisition transaction and the benefits that the transaction brings to shareholder interests will predominate in the directors' inquiry. Nevertheless, "social issues"—concerns for the community and the combination's impact on the continued viability of various operations—can play an important role in bringing two merger partners to the negotiating table and may be properly considered by directors in evaluating the strategic benefits of a potential merger or acquisition transaction not involving a change-of-control, at least insofar as they will promote future value.[272]

Consideration of employee and other constituent interests is also important in assuring a smooth transition period between the signing of a merger agreement and the closing of the transaction. It is important for the selling company to strive to preserve franchise value throughout the interim period, which may be more difficult in mergers that require a lengthy time period for consummation. Moreover, the impact of a proposed merger on a selling company's franchise and local community interests can have a direct impact on the acquiror's ability to obtain the requisite regulatory approvals.

5. Contingent Value Rights

a. Price Protection CVRs

Where target shareholders are particularly concerned about assessing the value of acquiror securities received as merger consideration, the parties can employ a contingent value right ("CVR") to provide some assurance of that value over some post-closing period of time. This kind of CVR, often called a "price-protection" CVR, typically provides a payout equal to the amount (if any) by which the specified target price exceeds the actual price of the reference security at maturity. Unlike floating exchange ratios, which only provide value protection to target shareholders for the period between signing and closing, price-protection CVRs are more similar to put options and are issued at closing with maturities that usually range from one to three years.

For example, a price-protection CVR for a security that has a $40 market value at the time of the closing of a transaction might provide that if, on the first anniversary of the closing, the average market price over the preceding one-month period is less than $38, the CVR holder will be entitled to cash or acquiror securities with a fair market value to compensate for the difference between the then-average trading price and $38. Price-protection CVRs may also include a floor price, which caps the potential payout under the CVR if the market value of the reference shares drops below the floor, functioning in the same manner as a collar or a cap in the case of a floating exchange ratio. For example, the previously described CVR might include a $33 floor price, such that CVR holders would never be entitled to more than $5 in price protection (the difference between the $38 target price and the $35 floor price), thereby limiting the financial or dilutive impact upon the acquiror at maturity of the CVR. Recently, Energy Transfer Equity, L.P.'s 2015 agreement to acquire the Williams Companies, Inc. for $38 billion—the largest transaction to ever include a CVR—included a price protection CVR tied to the difference, if any, between the volume-weighted average trading price of Energy Transfer Equity common units and newly-issued Energy Transfer Corp. LP common shares over a 23-month period.

In most cases, CVRs are memorialized in a separate agreement, which usually calls for a trustee or rights agent to act on behalf of the holders. At maturity, CVRs may be payable in cash or acquiror securities or, in some cases, a combination of the two at the option of the acquiror. Acquirors may also negotiate for the option of extending the maturity of the CVRs, typically in exchange for an increase in the target price. In this way, an acquiror gives itself more time to achieve the target stock price, even at the cost of establishing a higher target stock price at the time of the transaction. Targets often require the acquiror to make CVRs transferrable (in which case the CVRs generally also have to be registered under the Securities Act)[273] and, in some cases, to list them on a stock exchange.

b. Event-Driven CVRs

CVRs can also be used in other contexts, especially where the parties are unable to reach agreement as to the valuation of a specific asset, liability or contingency, including, for example, the outcome of a significant litigation, or the regulatory approval of a new drug of the target. A CVR of this type, often called an "event-driven" CVR, may be used to bridge a valuation gap between the two parties and to increase deal certainty by allowing the parties to close the deal without the contingency having been resolved. Event-driven CVRs typically provide holders with payments when certain events resolving the contingency occur, or when specific goals, usually related to the performance of the acquired business, are met. For instance, Sanofi-Aventis SA's 2011 agreement to acquire Genzyme for $20 billion provided for additional payments (up to an aggregate value of nearly $4 billion) tied to six payment triggers, including the receipt of FDA approval for a particular drug, four product sales milestones and a production milestone.

Although both price-protection and event-driven CVRs can provide significant benefits in the structuring of a transaction, parties considering their use need to be aware of potential pitfalls. CVRs are highly structured instruments with many variables, and their negotiation and implementation can introduce significant additional complexity to a deal. While CVRs may be useful tools in bridging valuation gaps and overcoming disagreements, there is also a possibility that they create their own valuation issues and increase the potential for disputes during negotiations. Moreover, because CVRs remain outstanding and often impose restrictions on the actions of the acquiror long after closing, they may become the source of litigation, particularly where great care was not taken to anticipate potential misalignments between the interests of the acquiror and the CVR holders. Finally, CVRs are subject to a host of additional securities law, accounting and tax considerations, and parties contemplating their use should seek legal, financial, accounting and tax advice.

V.

Deal Protection and Deal Certainty

Merger agreements typically include a variety of provisions intended to balance each party's desire to preserve maximum flexibility to respond to future developments and to comply with its board's fiduciary duties, while ensuring that the other party remains obligated to consummate the transaction. The key provisions in this regard are "deal protection" devices intended to regulate interloper risk; closing conditions giving a party a right to walk away from a transaction without liability if a "material adverse effect" or "material adverse change" with respect to the other party occurs; and the remedies available in connection with a party's failure to comply with the agreement or otherwise close the transaction, including as a result of a failure to obtain the requisite financing or governmental approvals. These provisions can significantly influence whether an M&A transaction will be completed, renegotiated or abandoned in the face of post-signing changes in circumstances.

A. Deal Protection Devices

"Deal protection" devices—such as break-up fees, no-shop clauses, force-the-vote provisions and shareholder voting agreements—permit bidders "to protect themselves against being used as a stalking horse and [provide] consideration for making target-specific investments of time and resources in particular acquisitions."[274] Targets often agree to such provisions in order to induce value-maximizing bids. Delaware courts have recognized that deal protection devices are permissible means of protecting a merger from third-party interference, where such provisions (viewed holistically) are reasonable under the circumstances.

Deal protection devices generally are reviewed under the enhanced scrutiny analysis set out in *Unocal* and *Revlon*.[275] The reviewing court will examine closely the context of the board's decision to agree to the deal protections. As the Delaware Court of Chancery has stated, the reasonableness inquiry contemplated by *Unocal* and *Revlon* "does not presume that all business circumstances are identical or that there is any naturally occurring rate of deal protection, the deficit or excess of which will be less than economically optimal. Instead, that inquiry examines whether the board granting the deal protections had a reasonable basis to accede to the other side's demand for them in negotiations. In that inquiry, the court must attempt, as far as possible, to view the question from the perspective of the directors themselves, taking into account the real world risks and prospects confronting them when they agreed to the deal protections."[276]

1. Break-Up Fees

A common ingredient in the package of deal protection measures is a termination (or "break-up") fee payable by the target in the event that the target terminates the merger agreement to accept a superior proposal, or in other specified circumstances generally involving the failure of the merger to occur as a result of a third-party bid. One rationale for break-up fees is to compensate a bidder whose definitive agreement to acquire the target is terminated for the risks and costs incurred in advancing the competitive bidding process and thereby incentivize potential bidders to undertake the cost of evaluating the target. Of course, termination fees, even more than other deal protection devices, impose an easily calculable cost on interlopers, and accordingly, may deter other potential acquirors from making an acquisition proposal after an agreement has been reached. An "excessive" break-up fee therefore will be viewed critically by courts.[277]

Break-up fees can be triggered by different events. A "naked no-vote" or "no-vote termination fee" is triggered if shareholders fail to approve the merger, whether or not another deal had been proposed or agreed to. As discussed further below, the size of a "naked no vote" break-up fee relative to the equity value of the target is typically lower than a break-up fee triggered in connection with an alternative offer. A break-up fee can also be triggered when a party terminates due to the other party's board changing its recommendation in favor of the deal, or if a party enters into an alternative transaction during a "tail" period following termination for failure to obtain shareholder approval where an alternative acquisition proposal was made public prior to the shareholder vote.

In determining the reasonableness of a termination fee, courts do not rely on a set threshold percentage. Indeed, the question of whether equity value or enterprise value (*i.e.*, equity value plus net debt) should be used as the denominator in calculating the percentage size of the fee will depend on the circumstances. For example, enterprise value may be more appropriate where the company's capital structure is highly leveraged,[278] although in a recent case, a Delaware judge noted that Delaware law "has evolved by relating the break-up fee to equity value," absent a "compelling reason" to deviate from that approach.[279] Courts may also question what is the appropriate numerator for calculating the percentage of the fee. In the *Comverge* case in 2014, the Court of Chancery denied a motion to dismiss a claim based on the size of the termination fee where a topping bid would trigger the conversion into equity of notes that were issued at the time the merger agreement was executed. If the cost of buying the equity into which the bridging loan was converted was included as part of the fee, the percentage value of the fee would have been as high as 13%.[280]

The Delaware Court of Chancery has stated that there is no accepted "customary" level of break-up fees (or other deal protections), but rather that such fees (like all deal protections) should be considered contextually and cumulatively:

> That analysis will, by necessity, require the Court to consider a number of factors, including without limitation: the overall size of the termination fee, as well as its percentage value; the benefit to shareholders, including a premium (if any) that directors seek to protect; the absolute size of the transaction, as well as the relative size of the partners to the merger; the degree to which a counterparty found such protections to be crucial to the deal, bearing in mind differences in bargaining power; and the preclusive or coercive power of *all* deal protections included in a transaction, taken as a whole. The inquiry, by its very nature fact intensive, cannot be reduced to a mathematical equation.[281]

The Delaware Court of Chancery has provided useful guidance in considering the quantum of break-up fees, upholding termination fees that have approached, and in some cases exceeded, 4%. For example, in *Dollar Thrifty*, the Delaware Court of Chancery upheld a 3.9% termination fee and expense reimbursement, stating approvingly that the fee at best merely deterred "fractional topping" and actually encouraged an interloper to "dig deep and to put on the table a clearly better offer rather than to emerge with pennies more."[282] In the *Topps* case, the Delaware Court of Chancery upheld a two-tiered termination fee of approximately 3% of equity value during the first 40 days, which went up to approximately 4.3% of equity value for termination after the 40-day period elapsed, albeit noting that it was "a bit high in percentage terms."[283] The Court of Chancery has also stated that a termination fee of 4.4% of equity value is "near the upper end of a 'conventionally accepted' range."[284] And in *Phelps Dodge Corp.* v. *Cyprus Amax Minerals Co.*,[285] the Delaware Court of Chancery cast doubt upon the validity of a 6.3% termination fee (calculated based on the deal value to the seller's shareholders), stating in *dicta* that the fee "certainly seems to stretch the definition of range of reasonableness and probably stretches the definition beyond its breaking point."[286]

Illustrating that context matters, in the *Lear* case, the Delaware Court of Chancery upheld a "no-vote termination fee," in which the potential acquiror had the right to receive $25 million if shareholders failed to approve the merger, whether or not another deal had been proposed or agreed to.[287] Lear's board had agreed to sell the company to

Carl Icahn in an LBO. When faced with significant shareholder opposition to the transaction, Lear obtained a slightly higher price in exchange for a "naked" no-vote termination fee equal to 0.9% of the total deal value. The shareholders rejected the deal and the company paid the termination fee. The plaintiffs then challenged the no-vote fee. Even though the deal was a cash-out LBO that implicated *Revlon*, the *Lear* court upheld the fee, noting that the shareholders had in fact rejected the deal, that it was rational for Icahn to demand such a fee as additional compensation in the event of a no vote since he was effectively bidding against himself at that stage of the deal, and that Delaware courts have previously upheld no-vote termination fees of up to 1.4% of transaction value.[288] No-vote termination fees are less customary than topping fees, and where they are included in transactions they typically are significantly lower than topping fees. In some cases, purchasers are entitled to expense reimbursement instead of a fee in the event of a no-vote.

2. "No-Shops," "No Talks" and "Don't Ask, Don't Waive" Standstills

A "no-shop" provision in a merger agreement provides that a selling company will not encourage, seek, solicit, provide information to or negotiate with third-party bidders, but generally allows the seller to respond to unsolicited offers by supplying confidential information and to consider and negotiate with respect to certain competing bids.

The Delaware Court of Chancery has held that it is "critical" that bargained-for contractual provisions be enforced, including by post-closing damages remedies in appropriate cases.[289] This principle also comes into play when a party claims that a target should be required to take actions in contravention of a buyer's rights under a no-shop. In the 2014 *C&J Energy* case, the Delaware Supreme Court reversed the grant of a mandatory preliminary injunction that required the target company to shop itself in violation of a contractually bargained no-shop provision.[290] The Court of Chancery had ruled that the board of the selling company had violated its duties under *Revlon* and enjoined the stockholder vote for 30 days while the selling company could undertake an active market check. The Supreme Court held that the judicial waiver of the no-shop clause was an error because the bidder was an "innocent third party" and, even on facts determined after trial, "a judicial decision holding a party to its contractual obligations while stripping it of bargained-for benefits should only be undertaken on the basis that the party ordered to perform was fairly required to do so, because it had, for example, aided and abetted a breach of fiduciary duty."[291]

On the other hand, Delaware courts will refuse to enforce no-shop provisions where there are "viable claims of aiding and abetting against the holder of third party contract rights."[292] In *In re Del Monte Foods Co. Shareholders Litigation*,[293] the plaintiffs sought to enjoin the enforcement of a no-shop provision by a group of private equity buyers in its proposed $5.3 billion cash acquisition of Del Monte. The merger agreement contained a number of deal protection measures, including a no-shop provision, a termination fee and matching right provisions. The no-shop provision prevented Del Monte from soliciting acquisition proposals once a 45-day go-shop period after the signing of the merger agreement had passed. In evaluating whether to enforce contract provisions, including no-shop provisions, in favor of an alleged aider and abettor of a breach of fiduciary, the Court of Chancery considered: "(1) whether the acquiror knew, or should have known, of the target board's breach of fiduciary duty; (2) whether the . . . transaction remains pending or is already consummated at the time judicial intervention is sought; (3) whether the board's violation of fiduciary duty relates to policy concerns that are especially significant; and (4) whether the acquiror's reliance interest under the challenged agreement merits protection in the event the court were to declare the agreement enforceable."[294] In *Del Monte*, the Court ultimately determined that the factors weighed against enforcement of the no-shop and enjoined the parties from enforcing the provision.

In *QVC*, the Delaware Supreme Court expressed concern that the highly restrictive no-shop clause of the Viacom/Paramount merger agreement was interpreted by the board of Paramount to prevent directors from even learning of the terms and conditions of QVC's offer, which was initially higher than Viacom's offer by roughly $1.2 billion.[295] The Court concluded that the board invoked the clause to give directors an excuse to refuse to inform themselves about the facts concerning an apparently *bona fide* third-party topping bid, and therefore the directors' process was not reasonable. And in *Phelps Dodge* in 1999, the Delaware Court of Chancery stated that "no talk" clauses that prohibit a board from familiarizing itself with potentially superior third-party bids were "troubling precisely because they prevent a board from meeting its duty to make an informed judgment with respect to even considering whether to negotiate with a third party."[296] Boards should therefore take care that a "no-shop" does not also function as a "no-talk"—*i.e.*, a clause that interferes with the board's ongoing duty to familiarize itself with potentially superior bids made by third parties.

"Go-shop" provisions, discussed above in Section III.B.2, which allow the target company to actively solicit competing offers, are a variation on the typical no-shop clause. In addition to the general no-shop restrictions, go-shops provide a period after the merger agreement signing—usually 30 to 50 days—in which the target is permitted to affirmatively solicit competing bids. The Court of Chancery has stated that the absence of a go-shop provision is not *per se* unreasonable.[297]

Targets will often require bidders to agree to a "standstill" that precludes the making of an offer. These provisions often include an anti-evasion clause that prohibits the potential bidder from requesting a waiver or taking actions that may make the bidder's interest in the target public. Even private requests for a waiver have often been prohibited by standstill agreements because under certain circumstances, they can lead to disclosure on the part of the target, or simply a leak, thus giving the impression that the target is "in play." The position that a target or bidder should take with respect to a provision prohibiting requests for waivers should be evaluated based on the particular circumstances in which the standstill is being negotiated.

In the 2012 *Genomics* case,[298] Vice Chancellor Laster of the Court of Chancery enjoined a target company subject to *Revlon* from enforcing such a clause, which he referred to as a "Don't Ask, Don't Waive" provision. The Court did not object to the bidder being prohibited from publicly requesting a waiver of the standstill (which the Court understood would eviscerate the standstill the bidders had agreed to by putting the target "into play"), but held that directors have a continuing duty to be informed of all material facts, including whether a rejected bidder is willing to offer a higher price. The Court suggested that a "Don't Ask, Don't Waive" provision is analogous to the "no-talk" provision held invalid in *Phelps Dodge* and is therefore "impermissible because it has the same disabling effect as a no-talk clause, although on a bidder-specific basis."[299]

Less than a month later, however, then-Chancellor Strine's bench ruling in *In re Ancestry.com Inc. Shareholder Litigation*[300] held that there is no *per se* rule against "Don't Ask, Don't Waive" standstill provisions, although he did express the view that they are "potent" provisions that must be used with caution. *Ancestry* recognized the valuable function that "Don't Ask, Don't Waive" standstill agreements can play in the process of selling a company as an "auction gavel" encouraging bidders to put their best offers on the table. But the Court also emphasized that "Don't Ask, Don't Waive" standstills will be subject to careful judicial review in the *Revlon* context. Then-Chancellor Strine's ruling expressed the view that the directors of the selling company should be fully informed of the use and implications of the "Don't Ask, Don't Waive" standstill provision, and shareholders whose votes are sought for the transaction should be informed if bidders that participated in the auction are contractually prohibited from offering a topping bid. Boards that are considering the use of these standstill provisions should ensure that their decision-making process is clearly documented.

In the *NetSpend* case,[301] the Court of Chancery again addressed the use of "Don't Ask, Don't Waive" standstill provisions. The seller had previously entered into "Don't Ask, Don't Waive" standstill agreements with two private equity firms, while the company was "not for sale." The Court criticized the board's decision to keep the provisions in place noting that the board had not "considered whether the standstill agreements should remain in place" and "blinded itself to any potential interest" from the private firms.[302]

The Court of Chancery has noted that "directors cannot willfully blind themselves to opportunities that are presented to them."[303] In considering the totality of the deal protection, the board should consider the effect of any "standstill provisions" included in confidentiality agreements signed with bidders, including the ability (or inability) of bidders to seek to have these restrictions waived.

3. Board Recommendations, Fiduciary Outs and "Force-the-Vote" Provisions

Public company merger agreements generally include provisions requiring the board of directors of the target (and, if the acquiror's shareholders also will be voting on the transaction, the board of directors of the acquiror) to recommend that shareholders vote in favor of the merger agreement, except in specified circumstances. Merger agreements also often include provisions that permit a party to terminate the agreement to accept a superior proposal, subject to payment of a termination fee and other conditions—commonly known as a "fiduciary out." The non-terminating party may be given the right to be notified of competing bids and a specified period of time in which to match them. The Delaware Court of Chancery has described non-solicitation clauses with fiduciary outs for superior proposals as "mild deal-protection devices."[304]

One issue that is sometimes negotiated, given the reality that a negative board recommendation often is likely to lead to a negative shareholder vote, is whether the board may change its recommendation when the directors determine that their fiduciary duties so require, or can only do so in certain circumstances, such as in the context of a "superior proposal." *Dicta* in Delaware cases raises the question whether a merger agreement provision precluding a change in recommendation except where a superior proposal has been made may be invalid, on the theory that directors' fiduciary duties require the board to be able to change its recommendation for any reason.[305] In the *Genomics* case, Vice

Chancellor Laster made clear his view that Delaware boards should retain the right to change their recommendation in compliance with their fiduciary duties, explaining that "[u]nlike in the no-shop and termination outs, fiduciary duty law in this context can't be overridden by contract" because "it implicates duties to target stockholders to communicate truthfully."[306] Similarly, in *In re NYSE Euronext Shareholders Litigation*,[307] then-Chancellor Strine in *dicta* expressed skepticism regarding provisions limiting a board's ability to change its recommendation and described them as "contractual promises to lie in the future." He also noted that although such provisions create litigation and deal risk, some companies accede to them in negotiations to gain a higher price.

Such criticism has also extended to provisions that delay the board's ability to change a positive recommendation. Vice Chancellor Laster rhetorically asked in *Compellent*: "if stockholders are entitled to a current, candid, and accurate board recommendation, can a merger agreement contractually prevent the board from updating its recommendation for 'at least four business days' and potentially longer . . . ?"[308]

In some cases, practitioners have sought a middle course, drafting provisions that bar a change in recommendation unless there has been an "intervening event." In any case, merger agreements often include termination rights for the buyer triggered upon a change in recommendation by the target board and fees payable upon such termination.

Under Section 146 of the DGCL, a Delaware corporation may, in a merger agreement, provide that the agreement be submitted to shareholders even if the board, having deemed the merger agreement advisable at the time of execution, subsequently changes its recommendation.[309] This is referred to as a "force-the-vote" provision. Where a target does not have a fiduciary out giving the target board the right to terminate the agreement, a force-the-vote provision can be useful to an acquiror by enabling it to ensure that the target's shareholders are given the opportunity to decide whether any competing offer is superior, and delaying execution of a competing transaction agreement until after that vote occurs.

4. Shareholder Commitments

In addition to other deal protections, an acquiror may also seek commitments from significant shareholders of the seller, whether members of management or otherwise, to support the transaction. Such commitments typically take the form of voting agreements entered into by stockholders concurrently with the merger or transaction agreement. The visible, up-front support of major shareholders for a transaction can be a significant deterrent to third-party bids and may be critical in consummating the transaction.

In *Omnicare, Inc.* v. *NCS Healthcare, Inc.*,[310] the Delaware Supreme Court in 2003 enjoined a merger between Genesis Health Ventures and NCS Healthcare. The Court held that the approval by the NCS board of voting agreements that ensured shareholder approval of the proposed merger, together with approval of an agreement that included a "force-the-vote" provision without any ability of the board to terminate the merger agreement to accept a superior offer, precluded the directors from exercising their continuing obligation to discharge their fiduciary duties after the announcement of the merger agreement. The Court ruled that a merger agreement that leaves the board with no ability to prevent the submission of the merger to the target shareholders coupled with a majority-shareholder voting agreement is illegal *per se*—regardless of: (1) the unconflicted and fully informed view of the board that such an agreement is in the best interests of the shareholders, (2) the support by shareholders having a majority of the voting power and the largest economic interest and (3) the belief of both the board and the controlling shareholders that the inducement of a no-outs merger agreement was the best and only way to obtain the highest value for the shareholders.

The Court in *Omnicare* noted as a doctrinal matter that "deal protection devices" are subject to *Unocal* enhanced "reasonableness review" (rather than business judgment review) even in a stock-for-stock merger context. In holding that the devices agreed to by NCS's board failed the second prong of the *Unocal* analysis, the Court determined that the deal protection devices were unreasonable because they were both coercive (*i.e.*, designed to coerce the consummation of the Genesis merger) and preclusive (*i.e.,* designed to preclude the consideration of any superior transaction). More particularly, the Court held that the "latitude" that a board has in either "maintaining or using [such] deal protection devices" depends *post hoc* on the degree of the benefit or detriment to the interests of the shareholders in the value or terms of the subsequent competing transaction. In that regard, the Court declared the deal protection devices "invalid" on the alternative ground that they "prevented" the board from discharging its "continuing" fiduciary responsibilities to the minority shareholders when a superior transaction appeared.

Under the Court's ruling, no merger agreement that requires a shareholder vote can be truly "locked up," even at the behest of controlling shareholders and seemingly even at the end of a diligent shopping/auction process. The ruling has made it more difficult for majority shareholders to arrange the sale of subsidiaries or for majority-controlled companies to attract the highest and best offers from merger partners who may be reluctant to enter into a merger contract with a fiduciary out. As Chief Justice Veasey noted in his dissenting opinion, by "requiring that there must always be a fiduciary out, the universe of potential bidders who could reasonably be expected to benefit stockholders could shrink or disappear."[311] *Omnicare* remains controversial, and in 2011, the California Court of Appeal specifically declined to follow it.[312]

Even in Delaware, the effect of *Omnicare* has been limited by subsequent decisions and practice developments. In a 2004 case, the Delaware Court of Chancery clarified the type of deal protection that an acquiror can seek from a controlling shareholder after *Omnicare*. In *Orman*, the Court upheld a voting agreement that required the controlling shareholder to vote for the proposed merger and against any alternative acquisition proposal for 18 months following the termination of the merger agreement.[313] The Court identified a number of factual differences from the circumstances presented in *Omnicare*: (1) the controlling shareholders in *Orman* bound themselves to support the merger only as shareholders, but did not restrict their right as members of the board to recommend that public shareholders reject the merger, (2) the *Orman* board negotiated an effective fiduciary out that would allow them to entertain *bona fide* superior offers, while no fiduciary out existed in *Omnicare*, and (3) the deal in *Orman* was expressly subject to approval of a majority of the minority shareholders, but was not in *Omnicare*. In sum, the Court concluded, the public shareholders in *Orman* were not coerced into voting for the merger for "some reason other than the merits of that transaction," and the deal protection measures did not make the transaction a "*fait accompli*" or a "mathematical certainty" as they did in *Omnicare*. Accordingly, the voting arrangement survived the Court's review under the *Unocal* standard. It should be noted that the "fiduciary out" in *Orman* was not a right to terminate the merger agreement to accept a superior proposal, but rather consisted of the board's ability to withdraw its recommendation of the merger coupled with the shareholders' ability to vote the transaction down. Similarly, in *NetSpend*, Vice Chancellor Glasscock held that "although the voting agreements appear to lock up approximately 40% of the stock in favor of the [proposed transaction], they are saved by the fiduciary-out clause. Specifically, the voting agreements terminate upon the Board's termination of the Merger Agreement."[314] The fiduciary-out in *NetSpend* permitted the Company to accept a more favorable acquisition proposal from a third party, subject to customary "no-shop" and termination fee provisions.

After *Omnicare*, practitioners also speculated whether the *Omnicare* analysis would apply only to mergers subject to a traditional vote at a shareholder meeting, or also to mergers approved by written consent of a holder or holders of a majority of shares shortly after signing a merger agreement. Although the Delaware Supreme Court has not ruled on this issue, in 2011 in *In re OPENLANE, Inc. Shareholders Litigation*, the Delaware Court of Chancery rejected an argument that a merger was an impermissible "*fait accompli*" simply because the merger, which did not include a fiduciary out, was approved by a majority of the stockholders by written consent the day after the merger agreement was signed.[315] The Court reasoned that the merger agreement did not "force[] a transaction on the shareholders," who freely chose to submit their written consents, nor did it "deprive[] them of the right to receive alternative offers" because the board could have terminated the agreement without paying a termination fee if a majority of shareholders had not consented within 24 hours of signing.[316] *OPENLANE* adhered to *Omnicare* because shareholders could freely choose to give or withhold written consent to the transaction. Even so, a sign-and-consent structure can be analyzed under the *Revlon* standard, and boards should confirm that superior bids do not exist. Moreover, written consents may be disfavored where the acquiror intends to issue registered stock to the target's shareholders because the SEC takes the view that a consent approving a merger constitutes a private offering of the acquiring company's securities that precludes the acquiror from subsequently registering the offering on Form S-4. The staff takes the view that under such circumstances, offers and sales of the acquiror's stock have already been made and completed privately, "and once begun privately, the transaction must end privately."[317]

5. Information Rights and Matching Rights

Information rights and matching rights provide bidders with an opportunity to learn more information about competitive bids and allow them to improve their offer. Specifically, information rights require a target to supply the initial bidder with information about subsequent bids in the event that a second bidder appears. The holders of such rights have an informational advantage because they can prepare counter-offers with knowledge about counter-bids. Matching rights give bidders an explicit right to match a competing offer before the target's board can change its recommendation or terminate the agreement to accept that offer under the fiduciary out. Matching rights can take many forms, including "reset matching rights" whereby the initial bidder can match each competitive bid and "single-trigger matching rights" which allows the initial bidder to match only the first bid.

Information and matching rights have been criticized because such rights can deter subsequent bidders who do not wish to enter into a bidding contest. On the other hand, such rights can assist in initially bringing potential acquirors to the table. Because such rights reduce the uncertainty of consummating the transaction for the initial acquiror, a bidder might be more willing to make the initial investment to prepare an initial bid.

Delaware courts have routinely upheld matching rights, noting that "the presence of matching rights in the merger agreement do not act as a serious barrier to any bidder" willing to pay more than the merger consideration.[318] Delaware courts recognize that it might be reasonable for a board to grant matching rights if it is "necessary to successfully wring out a high-value bid."[319] Matching rights have become nearly universal in transactions, appearing in over 99% of transactions with an equity value of $100 million or more in 2014.[320] Similarly, information rights have been routinely upheld by the Delaware Court of Chancery.[321]

6. Other Deal Protection Devices

a. Issuance of Shares

Another mechanism available to transaction parties is the issuance of equity securities to the buyer prior to the record date for the merger vote, which increases the likelihood of shareholder approval of the merger. Although a transaction that involves the issuance of equity securities equal to or in excess of 20% of an issuer's outstanding equity securities generally requires shareholder approval under NYSE and NASDAQ rules, an exception to the shareholder approval requirement may be granted by NYSE pursuant to NYSE Rule 312.05 when "the delay in securing stockholder approval would seriously jeopardize the financial viability of the enterprise." NASDAQ has a similar exception to its shareholder approval policy. However, public disclosure of this extreme level of distress can have a number of negative consequences, including negative impact on customers and suppliers, and the possibility of triggering defaults under debt instruments and key contracts. Companies need to carefully assess these risks before invoking the "financial viability" exception to shareholder approval.

b. Loans and Convertible Loans

Some acquirors provide bridge loans or other commitments to financially distressed targets, which can have the effect of "locking-up" the transaction. For example, in *Genomics,*[322] the buyer provided $30 million in bridge financing to a financially unstable target upon the signing of a merger agreement. In the event of a topping bid, the buyer could convert the loan into shares, which, if fully drawn, represented approximately 22% of the then-outstanding stock of the target. In refusing to enjoin the transaction, Vice Chancellor Laster noted that the bridge loan "provided substantial benefit to [the target] in the form of much needed cash to get them through at least most of, and ideally all of, depending on how the future turns out, the transaction process and possibly a little bit beyond."[323] The Court of Chancery subsequently ruled in *Comverge* that a bridge loan made at the same time that a merger agreement was executed might be unreasonable because it could preclude a topping bid.[324]

c. Crown Jewels

The "crown-jewel" lock-up, in its classic form, is a device in which the target company grants the acquiror an option to purchase, or otherwise obtain the benefit of, key target assets in the event that the proposed merger does not close. This type of lock-up gives the acquiror assurance that even outside of a successful merger, it will nevertheless get key pieces of the target's business. The device may also serve to deter competing bidders, since even with a superior topping bid, the competing bidders may not get the deal they are seeking (*i.e.*, at best they may get a deal without the crown jewels). Given their generally preclusive nature to other bids, crown-jewel lock-ups fell out of favor after *Revlon*, although at times, targets have granted options for legitimate business reasons.

For example, in JP Morgan's 2008 acquisition of Bear Stearns during the financial crisis, JP Morgan received an option to purchase Bear Stearns' headquarters for $1.1 billion, which plaintiffs in the ensuing shareholder litigation claimed was a price well below the then-estimated value of the headquarters and amounted to a preclusive termination fee. The New York Supreme Court upheld the use of this option. Although a primary reason for doing so was that the record failed to substantiate plaintiffs' claims that the headquarters option price was below fair value, the court further noted that "[t]he financial catastrophe confronting Bear Stearns, and the economy generally, justified the inclusion of the various merger protection provisions intended to increase the certainty of the consummation of the transaction with JPMorgan."[325]

When carefully structured, the crown-jewel lock-up may serve as a useful deal protection device even outside of the circumstances presented by the 2008 financial crisis. For example, in 2012, in exchange for certain present and future cash payments, AuthenTec granted Apple an option to acquire a nonexclusive license to its sensor technology, separate and apart from the merger agreement between the two parties. In its proxy disclosure about this option, AuthenTec was careful to stress the reputational benefits of having public ties with Apple and the economic benefits of the expected future cash stream from Apple. A Florida court denied a stockholder plaintiff's application to enjoin the transaction.[326]

Generally, having an independent business purpose for the separate crown-jewel arrangement will help the lock-up pass judicial muster. More recently, in the merger between NYSE Euronext and IntercontinentalExchange Inc. (ICE), ICE separately agreed with NYSE to act as the exclusive provider of certain clearing services for NYSE's European derivatives business for two years, whether or not the merger took place. The parties extensively detailed the business rationale for this agreement, mostly arising out of NYSE's need for clearing services regardless of whether the ICE merger was consummated. In evaluating that agreement under the *Unocal* standard, then-Chancellor Strine noted that there was "no evidence in the record that presents a barrier to any serious acquirer" and that a topping bidder could reach an economic solution with all parties concerned for a relatively small sum.[327] In that regard, Delaware courts may take a close look at the preclusive effect of such side commercial arrangements on potential topping bidders in evaluating whether such agreements are an impermissible crown-jewel lock-up defense.

B. Material Adverse Effect Clauses

Virtually all domestic public company merger agreements allow the buyer to refuse to close if there has been a "material adverse effect" on or a "material adverse change" in the target company's business (although these provisions are less common in acquisition agreements involving European companies). This "MAE" or "MAC" clause is one of the principal mechanisms available to the parties to a transaction to allocate the risk of adverse events transpiring between signing and closing. In *IBP, Inc.* v. *Tyson Foods (In re IBP, Inc. Shareholders Litigation)*, the Delaware Court of Chancery provided important guidance on the use of these clauses.[328] The Court placed the burden of proving a material adverse effect on the buyer and clarified that an MAE must be a long-term effect rather than a short-term failure to meet earnings targets: "[An MAE] provision is best read as a backstop protecting the acquiror from the occurrence of unknown events that substantially threaten the overall earnings potential of the target in a durationally-significant manner. A short-term hiccup in earnings should not suffice; rather the Material Adverse Effect should be material when viewed from the longer-term perspective of a reasonable acquiror."[329] The *IBP* Court concluded that the acquiror had not met this standard and ordered it to complete the merger.

The *IBP* case is important not only for its explanation of the MAE concept but also because the Court ordered specific performance. The

Court found that New York law applied, requiring the party seeking specific performance to establish its entitlement to that remedy by the preponderance of the evidence (rather than, as in Delaware, by clear and convincing evidence). The Court held that IBP had met its burden, reasoning that the business combination between IBP and Tyson was a unique opportunity, that monetary damages would be difficult to calculate and "staggeringly large," and that the remedy was practicable because the merger still made strategic sense.

While then-Vice Chancellor Strine decided the *IBP* case under New York law, Delaware courts have applied his analysis to merger agreements governed by Delaware law. In *Frontier Oil Corp.* v. *Holly Corp*. in 2005, Vice Chancellor Noble reiterated that the burden of proving an MAE, based on the "expectation of the parties, as reflected in the Merger Agreement and as informed by the case law," fell on the party asserting it.[330] The *Frontier* Court, like the *IBP* Court, refused to find an MAE, concluding that the existence of a potentially catastrophic lawsuit did not constitute an MAE where there was no evidence that the target was likely to lose the suit and where defense costs, while large and material to the buyer, did not rise to the level of an MAE in the context of the target's enterprise value.[331]

In *Hexion Specialty Chems., Inc.* v. *Huntsman Corp.*,[332] the Delaware Court of Chancery in 2008 reaffirmed that the acquiring company has a "heavy burden" in establishing an MAE and reminded acquirors that it "is not a coincidence" that "Delaware courts have never found a material adverse effect to have occurred in the context of a merger agreement."[333] The Court ruled that because the merger agreement contained a provision in which the target disclaimed that it was warranting the projections that had been submitted to the acquiror, the acquiror could not claim that the target's failure to meet those projections by a wide margin should be considered in evaluating whether there had been an MAE.[334] The Court concluded that the actual and expected performance of the target company could only be compared to the performance of the target company in the corresponding periods preceding the signing of the merger agreement. When measured against those historic results, the target company's disappointing performance did not rise to the level of an MAE.

In addition to the difficulty in establishing that a "material adverse effect" has occurred, parties seeking to invoke MAE clauses have also had difficulty overcoming the long list of exceptions that a typical MAE clause contains. In *Genesco* v. *Finish Line*, the Tennessee Court of Chancery refused, in 2007, to excuse Finish Line's and UBS's performance because the cause of Genesco's downturn, general economic or industry conditions, had specifically been excluded from the definition of the MAE.[335] Since *IBP* v. *Tyson*, public company targets have tended to negotiate long lists of factors—such as economic and industry developments (often to the extent they do not have a disproportionate impact on the adversely affected party)—that are excluded from the definition of MAE.

While no Delaware court has yet found an MAE to have occurred in a fully litigated case, an MAE clause is not illusory. Because the MAE provision allows an acquiror to refuse to close if there has been a material adverse effect on the target company's business, it can also serve as a lever for renegotiating a transaction. An acquiror claiming that a target MAE occurred can put the target company in the difficult position of either litigating to enforce the original transaction terms (running the risk that the alleged MAE is established) or accepting a reduced price and other terms. Following the dramatic market downturn at the height of the LBO boom in the summer of 2007, the MAE clauses in numerous merger agreements were implicated. Some of these transactions were renegotiated (*e.g.*, the acquisition of Home Depot's supply unit by an investor group led by Bain Capital), others were terminated by mutual agreement of the parties (either with no strings attached, like the proposed merger between MGIC Investment Corp. and Radian Group Inc., or with an alternative arrangement such as the investment that KKR and Goldman Sachs made in Harman International when they terminated their agreement to take Harman private), and a few led to litigation, as described below.

C. Committed Deal Structures, Optionality and Remedies for Failure to Close

Traditionally, strategic buyers, with significant balance sheets, were expected to fully commit to the completion of a cash acquisition whereas financial sponsors, who often depended on borrowing a portion of the purchase price, negotiated for financing conditions that allowed the sponsor to exit the deal in the event that it was unable to obtain financing on the terms contemplated by the financing commitment papers executed at signing.

During the LBO boom of 2005–2007, however, sellers were able to negotiate purportedly seller-friendly provisions from financial buyers, including:

- *No Financing Condition*. The elimination of the financing condition left the buyer in breach in the event of a failure to obtain financing.

- *Reverse Termination Fee*. The reverse termination fee required the buyer to pay a fee in the event the buyer failed to close due to an inability to obtain financing (later expanded to a failure to close for any reason). The reverse termination fee often was the seller's sole remedy in the event of a failure to close.

- *Denial of Specific Performance*. The acquisition agreement would often provide that the seller could not obtain specific performance of the buyer's obligation to close, or could obtain such specific performance only in limited circumstances.

- *Limited Obligations of Financial Sponsor*. Because the buyer entity that actually signed the acquisition agreement with the target typically was a shell, the private equity fund would often sign a limited guarantee of the buyer's obligation to pay the reverse termination fee. In addition, the fund typically would sign an equity commitment letter in favor of the buyer to cover the equity portion of the purchase price. This letter usually provided that the funds would become due only if a closing occurred and sometimes, but not always, provided third-party beneficiary rights to the target company.

Although this structure was originally intended to increase deal certainty for sellers, the net effect of these features was to create a transaction structure that, depending on the specific terms of the documentation, could resemble an option to buy the target, permitting the buyer to walk away for a fixed cost (*i.e.*, the reverse termination fee).

The credit crunch and financial crisis that began in 2007 put the paradigmatic private equity structure to the test as buyers (and in some cases, lenders) decided to walk away from, or renegotiate, signed deals that had not yet closed. While many of the troubled deals were resolved consensually (including through price deductions and terminations) rather than through litigation, a number of situations were judicially resolved. For example, in *United Rentals, Inc.* v. *RAM Holdings, Inc.*,[336] the Delaware Court of Chancery in 2007 respected provisions (albeit ambiguous ones) denying specific performance and giving the buyer the right to terminate the deal upon payment of the reverse termination fee; in *Alliance Data Systems Corp.* v. *Blackstone Capital Partners V L.P.*,[337] the Court, in 2009, held that the shell companies formed by a financial sponsor to effect the merger did not have a contractual obligation to cause the sponsor, which was not a party to the merger agreement, to do anything to obtain a regulatory approval that was a condition to the shell companies' obligations to close the merger; and the same year in *James Cable, LLC* v. *Millennium Digital Media Systems, L.L.C.*,[338] the Court rejected claims, including for tortious interference, against a financial sponsor arising out of its portfolio company's alleged breach of an asset purchase agreement, where the sponsor was not a party to the agreement, did not enter into a written agreement to provide funding and did not make enforceable promises to help fund the transaction. The Court in *James Cable* reaffirmed the Delaware principle that companies affiliated through share ownership are shielded from tortious interference claims where their actions are "in furtherance of their shared legitimate business interests" unless the plaintiff offers specific allegations that the defendant was motivated by bad faith or a malicious purpose.

These market and judicial developments have influenced trends in transaction structuring in the post-crisis environment. For example, the less committed structures developed in the private equity arena were imported to some extent into several strategic transactions that occurred a number of years ago, such as the Mars/Wrigley, Pfizer/Wyeth and Hercules/Ashland deals. More recently, Berkshire Hathaway and 3G Capital's strategic acquisition of Heinz contained a reverse termination fee that allowed the buyers to walk away from the deal. Nonetheless, many strategic transactions continue to employ the traditional "full remedies" model, in which the seller is expressly granted the right to specific performance and there is no cap on damages against the buyer. On the other end of the spectrum is the "pure option" model, employed on rare occasions in financial sponsor transactions, in which the seller's right to specific performance is expressly denied and the seller's sole remedy for any and all breaches is payment of the reverse termination fee. Most private equity transactions today chart a middle course, in which a reverse termination fee is payable upon a financing failure, which also serves as the seller's sole remedy, and the seller retains a specific performance right to require the closing to occur (including the ability to compel a draw-down of the equity financing) if the debt financing is available. A further variation occasionally (but much more rarely now) seen in leveraged deals is a two-tiered reverse termination fee structure, in which a lower fee is payable for financing failures or non-willful breaches and a higher fee is payable when the financing is available or in the event of a willful breach.

Symmetry between target termination fees and reverse termination fees has become less common, with reverse termination fees often being higher. Although reverse termination fees now frequently range from 4% to 10% of transaction value, some have been higher, sometimes reaching well in excess of 10% of deal value, and in rare cases as high as the full equity commitment of the sponsor. In addition, the acquisition agreements governing many leveraged private equity transactions have obligated the buyers to use efforts to force lenders to fund committed financing, and in some cases specifically require the pursuit of litigation in furtherance of this goal. Debt commitment letters, however, usually do not allow targets to seek specific performance directly against lenders or name targets as third-party beneficiaries. Lenders have in most cases sought to include provisions directly in acquisition agreements that limit or mitigate their own liability (commonly referred to as "Xerox provisions," having been used in the Xerox/ACS transaction). These provisions vary, but generally include (1) limiting the target's remedy to the payment of the reverse termination fee, (2) requiring that any action against the lenders be governed by New York law, (3) requiring that the buyer and seller waive any right to a jury trial in any action against the lenders, and (4) making the lender a third-party beneficiary of these provisions.

A recent innovation is a grace period that allows buyers to try to force the lenders to complete a financing. In the Berkshire Hathaway and 3G Capital acquisition of Heinz, the parties agreed to a provision (sometimes referred to as a "ketchup provision") that provided that if the acquisition financing fell through, then the buyers would have four additional months to obtain financing before Heinz would be entitled to collect its reverse termination fee due to the buyer's financing failure. Such provisions help mitigate the risk related to obtaining financing. Another innovation that has appeared in some deals (such as the acquisition of Tommy Hilfiger by Phillips Van Heusen) has been the introduction of a ticking fee concept, in which the purchase price increases by a stated amount for each day that the closing is delayed beyond a specified target date.

In addition to financing risk, reverse termination fees may also be used as a mechanism to allocate regulatory risk. In the proposed AT&T/T-Mobile transaction, the merger agreement required AT&T to pay Deutsche Telekom $3 billion and transfer spectrum if the deal failed to win antitrust clearance. AT&T ultimately withdrew the deal amid regulatory opposition and paid Deutsche Telekom the termination fee. The $3.5 billion Halliburton/Baker Hughes reverse termination fee is another such example.

Another important decision related to damages for failing to consummate a transaction is the U.S. Court of Appeals for the Second Circuit's decision in *Consolidated Edison, Inc.* v. *Northeastern Utilities (Con Ed),* which held that under New York law, lost shareholder premium could be collected neither by the selling company nor by its shareholders (due to lack of standing) as damages for the buyer's alleged breach of an agreement that disclaimed third-party rights until after the "effective time" of the merger.[339] Targets have, in some cases, sought to address *Con Ed*—which potentially could leave a target without an adequate remedy for a buyer's breach where specific performance is precluded by the merger agreement or otherwise unavailable—by including language in the merger agreement to the effect that damages for the buyer's breach should be calculated based on shareholder loss, or by choosing Delaware law (under which the issue addressed in *Con Ed* has not yet been resolved) to govern the merger agreement.[340]

The *Hexion* decision discussed above in Part V.B addressed another issue that should be considered in negotiating contractual provisions relating to remedies, which is whether post-termination liability should be limited or eliminated for certain types of breaches. In *Hexion*, the Court interpreted a provision allowing uncapped damages in the case of a "knowing and intentional breach of any covenant" and liquidated damages of $325 million in the event of other enumerated breaches. The Court held that "a 'knowing and intentional' breach, as used in the merger agreement, is the taking of a deliberate act, which act constitutes in and of itself a breach of the merger agreement, even if breaching was not the conscious object of the act."[341] Whether and how a party should seek to define such limitations on liability is a question that should be considered in light of the particular circumstances.

As indicated by the variety of permutations that have been employed, negotiations of the deal certainty provisions in any particular transaction can proceed along a number of dimensions, including the amount of the reverse termination fee(s), if any, and the trigger(s) for payment; the breadth of any specific performance remedy; the types of breaches that could give rise to post-termination damages claims; the circumstances in which a cap on damages, if any, will apply; rights and remedies under ancillary documents such as equity commitment letters, limited guarantees and debt commitment letters; and expense reimbursement provisions. Transaction participants should be keenly aware of the impact and interrelation of these various components and carefully consider which package of deal certainty provisions is appropriate under the circumstances, based on factors such as whether the deal involves a strategic buyer or a financial sponsor; whether any debt financing will be required, and, if so, the extent of the leverage; the nature of any regulatory risk; the size of the transaction; and the relative bargaining power and sophistication of the parties.

VI.

Advance Takeover Preparedness and Hostile M&A

Advance takeover preparedness can improve a corporation's ability to deter coercive or inadequate bids or to secure a high premium in the event of a sale of control of the corporation. If gaps in a company's takeover defenses are found, the board must balance the desire to foreclose present vulnerabilities to unknown future threats against the risk of raising the company's profile with shareholder and governance activists. Companies should also consider contingency plans that can be adopted to deal with new threats.

Advance preparation for defending against a harmful takeover may also be critical to the success of a preferred transaction that the board has determined to be part of the company's long-term plan. As discussed in Section II, a decision to enter into a business combination transaction does not necessarily obligate a board to serve as auctioneer. In the case of a merger or acquisition not involving a change of control, the board may retain the protection of the business judgment rule in pursuing its corporate strategy.[342]

The Delaware Supreme Court's landmark *Time-Warner* decision illustrates the importance for a company that desires to maximize its ability to reject a hostile takeover bid to consider periodically its long-term business and acquisition strategies. In *Time-Warner*, both the Delaware Court of Chancery and the Delaware Supreme Court were influenced heavily by the documented history of Time's long-term business and acquisition strategies and Time's prior consideration and rejection of Paramount as a merger partner. *Time-Warner* shows that courts will respect and defer to a company's decision to reject a hostile bid and adhere to its long-term plans.

A. Rights Plans or "Poison Pills"

Rights plans, popularly known as "poison pills," are the most effective device for deterring abusive takeover tactics and inadequate bids by hostile bidders. Rights plans do not interfere with negotiated transactions, nor do they preclude unsolicited takeovers. The evidence is clear, however, that rights plans do have the desired effect of forcing a would-be acquiror to deal with a target's board. In this regard, rights plans ultimately may enable the board to extract a higher acquisition premium from an acquiror or deter inadequate offers. Economic studies have concluded that, as a general matter, takeover premiums are higher for companies with rights plans in effect than for other companies and that a rights plan or similar protection increases a target's bargaining power. *See* Section VI.A.3. In addition, numerous studies have concluded that the negative impact, if any, of adoption of a rights plan on a company's stock price is not statistically significant.

The issuance of share purchase rights has no effect on the capital structure of the issuing company. If an acquiror takes action that triggers the rights, however, dramatic changes in the capital structure of the target company and/or the acquiror can result.

Rights plans have long been the subject of active discussion and debate, and they continue to contribute significantly to the structure and outcome of most major contests for corporate control. This debate has only increased, as many companies have allowed their rights plans to expire, have affirmatively terminated their rights plans, have modified their rights plans with watered-down protections, or have agreed not to implement rights plans going forward absent shareholder approval or ratification within some period of time, generally one year. In addition, ISS has policy guidelines providing that it would recommend an "against" or "withhold" vote for directors who: (i) adopt a rights plan with a "dead-hand" or "modified dead-hand feature," (ii) adopt a rights plan with a term of more than 12 months, or renew any existing rights plan (regardless of term), without shareholder approval, although a commitment to put a newly adopted rights plan to a binding shareholder vote within 12 months "may potentially offset an adverse vote recommendation," or (iii) make a material adverse change to an existing rights plan without shareholder approval. Directors who adopt a rights plan with a term of 12 months or less will be evaluated on a case-by-case basis, taking into account, among other things, how close the plan's adoption was to the date of the next shareholders meeting and the issuer's rationale. ISS also has a general policy of recommending votes in favor of shareholder proposals calling for companies to redeem their rights plans, to submit them to shareholder votes or to adopt a principle that any future rights plan would be put to a shareholder vote, subject to certain limited exceptions for companies with existing shareholder-approved rights plans and rights plans that will be put to a shareholder ratification vote within 12 months of adoption or expiry.

According to SharkRepellent, over 3,000 companies at one point had adopted rights plans, including over 60% of the S&P 500 companies. However, recent trends in shareholder activism, as well as the ability of a board to adopt a rights plan on short notice in response to a specific threat, have led to a marked decrease in the prevalence of these plans. Today, 367 U.S.-incorporated companies, including 4% of the S&P 500, have rights plans in effect. However, rights plans continue to be adopted by small-cap companies that feel vulnerable to opportunistic hostile bids, companies responding to unsolicited approaches, including by stockholder activists, and, as noted below, companies putting in place so-called "Section 382" rights plans. In addition, many companies have an up-to-date rights plan "on the shelf," which is ready to be quickly adopted if and when warranted.

Despite the decreased prevalence of long-term rights plans, we continue to believe that rights plans—or at least a board's ability to adopt them rapidly when the need arises—remain a crucial component of an effective takeover defense and serve the best interests of shareholders. Accordingly, boards should generally endeavor to avoid situations that would lead to this ability being lost or significantly curtailed.

Rights plans may also be used to protect a corporation's tax assets. Opportunistic investors who see attractive buying opportunities may present special risks to corporations with net operating losses ("NOLs"), "built-in" losses and other valuable tax assets. Accumulations of significant positions in such a corporation's stock could result in an inadvertent "ownership change" (generally, a change in ownership by five-percent shareholders aggregating more than 50 percentage points in any three-year period) under Section 382 of the Internal Revenue Code. If a company experiences an ownership change, Section 382 will substantially limit the extent to which pre-change NOLs and "built-in" losses stemming from pre-change declines in value can be used to offset future taxable income. As with operating assets, boards of directors should evaluate the potential risks to these valuable tax assets and consider possible actions to protect them. In the last five years, 82 companies with significant tax assets have adopted rights plans designed to deter a Section 382 ownership change, according to SharkRepellent. Such rights plans typically incorporate a 4.9% threshold, deterring new shareholders from accumulating a stake of 5% or more, as well as deterring existing five-percent shareholders from increasing their stake in a way that could lead to a Section 382 ownership change. ISS recognizes the unique features of such a rights plan and will consider, on a case-by-case basis (despite the low threshold of such plans), management proposals to adopt them based on certain factors—including, among others, the threshold trigger, the value of the tax assets, other shareholder protection mechanisms and the company's governance structure and responsiveness to shareholders. ISS also states that it will oppose any management proposal relating to a Section 382 pill if it has a term that would exceed the shorter of three years or the exhaustion of the NOLs.

A rights plan has also been used as a deal protection device following the signing of a friendly merger agreement. Rights plans in such cases may help protect a deal against hostile overbids in the form of a tender offer and could deter activist shareholder efforts to accumulate large numbers of shares and vote down a proposed merger. In Apollo's 2014 acquisition of Chuck E. Cheese, Chuck E. Cheese adopted a poison pill that had a 10 percent trigger. If the board of Chuck E. Cheese waived, amended, or redeemed the rights plan, Apollo could terminate the deal and receive the termination fee.

Hedge funds and other shareholder activists have used equity swaps and other derivatives to acquire substantial economic interests in a company's shares without the voting or investment power required to have "beneficial ownership" for disclosure purposes under the federal securities laws. Rights plans can be drafted to cover equity swaps and other derivatives so as to limit the ability of hedge funds to use these devices to facilitate change-of-control efforts, although careful consideration should be given as to whether and how to draft a rights plan in this manner. One such rights plan was challenged in a Delaware court, although the case was settled with the company making clarifications to certain terms of the rights plan.

1. The Basic Design

The key feature of a rights plan is the "flip-in" provision of the rights, the effect of which, in specified circumstances, is to impose unacceptable levels of dilution on an acquiror. The risk of dilution, combined with the authority of a target's board to redeem the rights prior to a triggering event (generally an acquisition of between 10% and 20% of the target's stock), gives a potential acquiror a powerful incentive to negotiate with the target's board rather than proceeding unilaterally.

A rights plan should also provide that, once the triggering threshold is crossed, the target's board may exchange, in whole or in part, each right held by holders other than the acquiror for one share of the target's common stock. This provision avoids the expense of requiring rights holders to exercise their flip-in rights, eliminates any uncertainty as to whether individual holders will in fact exercise the rights and produce the intended dilution, and provides the board additional flexibility in responding to a triggering event. The exchange provision was used by the board of directors of Selectica when that pill was triggered by Trilogy in January 2009, and upheld by the Delaware Supreme Court in October 2010 in response to Trilogy's challenge of that pill.[343] In cases where the acquiring person holds less than 50% of a target's stock, the dilution caused by implementation of the exchange feature is substantial and can be roughly comparable to the dilution caused by the flip-in provision, assuming all eligible rights holders exercise their rights.

Some companies have adopted rights plans that do not apply to a cash offer for all of the outstanding shares of the company. Recent versions of this exception have limited its scope to cash offers containing a specified premium over the market price of the target's stock. While a so-called "chewable pill" rights plan has some limited utility and may avoid a shareholder resolution attack, it is not effective in many situations and may create an artificial "target price" for a company that does not maximize shareholder value. As discussed in the next subsection, a recent trend by some companies is to adopt rights plans with bifurcated triggers (*e.g.*, a higher trigger for Schedule 13G filers and a lower trigger for Schedule 13D filers) to allow their large, long-term institutional investors to continue to accumulate shares even during an activist situation, while placing a lower ceiling on potential "creeping control" by activists.

2. Basic Case Law Regarding Rights Plans

Rights plans, properly drafted to comply with state law and a company's charter, typically survive judicial challenge even under a *Unocal* analysis.[344] Furthermore, courts have recognized rights plans as important tools available to boards to protect the interests of a corporation.[345]

One of the most debated issues concerning rights plans focuses on whether or not a board should be required to redeem the rights plan in response to a particular bid. In this respect, courts applying Delaware law have upheld, or refused to enjoin, determinations by boards not to redeem rights in response to two-tier offers, or inadequate 100% cash offers,[346] as well as to protect an auction or permit a target to explore alternatives.[347]

In a landmark decision in February 2011 involving the broadest challenge to a poison pill in decades, the Delaware Court of Chancery reaffirmed the ability of a board of directors, acting in good faith and in accordance with their fiduciary duties, to maintain a poison pill in response to an inadequate all-cash, all-shares tender offer.[348] The decision by then-Chancellor Chandler in *Airgas* reaffirmed the vitality of the pill and upheld the primacy of the board of directors in matters of corporate control, even after the target company with a staggered board had lost a proxy fight for one-third of the board. The decision reinforces that directors may act to protect the corporation, and all of its shareholders, against the threat of inadequate tender offers, including the special danger that arises when raiders induce large purchases of shares by arbitrageurs who are focused on a short-term trading profit, and are uninterested in building long-term shareholder value. Essentially, the Court held that a well-informed, independent board may keep the pill in place so long as it has a good faith and reasonable basis for believing the bid undervalues the shareholders' interest in the company. The Court stated that it is up to directors, not raiders or short-term speculators, to decide whether a company should be sold. The board—and the Court's—decisions were vindicated four years later, when, in 2015, Airgas agreed to be sold to Air Liquide at a price of $143 per share, in cash, nearly 2.4 times Air Products' original $60 offer and more than double its final $70 offer, in each case before considering the more than $9 per share of dividends received by Airgas shareholders in the intervening years.

A second contested issue concerning rights plans is whether they may be adopted to prevent accumulations of ownership outside of the context of an outright bid for the company. On this point, the Delaware Court of Chancery has made it clear that the board may act in response to legitimate threats posed by large stockholders. For instance, the adoption of a rights plan to deter acquisitions of substantial stock positions was upheld by the Delaware Court of Chancery in the case involving Ronald Burkle's acquisition of 17% of Barnes & Noble.[349] Then-Vice Chancellor Strine held that the company's adoption of a rights plan with a 20% threshold that grandfathered Burkle's 29% stake was a "reasonable, non-preclusive action to ensure that an activist investor like [Burkle] did not amass, either singularly or in concert with another large stockholder, an effective control bloc that would allow it to make proposals under conditions in which it wielded great leverage to seek advantage for itself at the expense of other investors."[350] In the Barnes & Noble case, the Court upheld the rights plan's prohibitions on "acting in concert" for purposes of a proxy contest and noted that the key question was whether the rights plan "fundamentally restricts" a successful proxy contest. In defining the behavior that might trigger a rights plan, the Court seemed to suggest that triggers should be based on the well-recognized definition of beneficial ownership in Section 13D of the Exchange Act. However, as previously noted, this is an unsettled point of law and, in appropriate circumstances, companies are well-advised to consider adopting rights plans that encompass aggregations of voting or economic interests through synthetic derivatives that decouple the traditional bundle of rights associated with outright common stock ownership.

Additionally, in 2014, the Delaware Court of Chancery upheld a rights plan adopted by the Sotheby's board of directors in response to a rapid accumulation of its stock by Third Point and other short-term speculators. Notably, the rights plan adopted by the Sotheby's board of directors had a two-tier trigger structure (setting a 20% trigger for 13G filers and a 10% trigger for 13D filers). After Sotheby's refused Third Point's request to waive the 10% trigger threshold during a proxy contest, Third Point sued the board of directors for breach of fiduciary duty, claiming that the "primary purpose" of the board's refusal to waive the lower trigger was to prevent Third Point from prevailing in a proxy context, that the rights plan was "disproportionate" to the threat that Third Point's slate of nominees posed and that the rights plan was discriminatory because it was allegedly designed to favor the incumbent board. In *Third Point* v. *Ruprecht*, the Court of Chancery found sufficient evidence that the threat of "creeping control" posed by a hedge fund group led by Third Point created a legitimate, objectively reasonable threat and that the adoption of the rights plan was likely a proportionate response to collusive action by a group of hedge funds. In addition, the Court recognized that the board's refusal to waive the lower trigger was reasonable because Third Point still posed a threat of negative control—a "situation[] in which a [stockholder] obtains an explicit veto right … through a level of share ownership … at a level that does not amount to majority control." This decision reaffirms that a board may take action, including by adopting a rights plan, to defend the corporation against any reasonably perceived threat and the continued vitality of a rights plan in the face of evolving threats to corporate effectiveness.

Rights plans have also been upheld outside of the corporate control context. In *Selectica, Inc.* v. *Versata Enterprises, Inc.*, the Delaware Supreme Court rejected a *Unocal* challenge to the use of a "Section 382" rights plan with a 4.99% trigger designed to protect a company's NOLs, even when the challenger had exceeded the threshold and suffered the pill's dilutive effect.[351] Selectica never achieved an operating profit and had generated NOLs of approximately $160 million. These NOLs could have substantial value in the event that the company became profitable, but under Section 382 of the Internal Revenue Code they can be adversely affected if the company experiences an "ownership change" of over 50% during a three-year period (measured by reference to holders of 5% or larger blocks). During 2008, the Selectica board considered and rejected several asset purchase and takeover proposals from Trilogy, a long-time corporate rival. After Trilogy then purchased some 6% of Selectica's shares, Selectica reviewed its NOL status and learned that additional acquisitions of roughly 10% of the float by new and existing 5% holders would significantly impair the NOLs. The Selectica board responded by amending the company's rights plan to lower the trigger from 15% to 4.99% (with a grandfather clause allowing pre-existing 5% holders to purchase another 0.5%). Shortly thereafter, Trilogy purposely broke through the NOL pill's limit, with the stated rationale of "bring[ing] accountability" to the Selectica board and "expos[ing]" its "illegal behavior" in adopting the low-trigger NOL plan. The Selectica board triggered the pill's exchange feature, doubling the number of outstanding shares held by holders other than Trilogy and diluting Trilogy from 6.7% to 3.3%. This marked the first intentional triggering of a flip-in rights plan, and the first exercise of the common stock-for-rights exchange provision in a rights plan by a board of directors. Selectica then adopted a new rights plan with a 4.99% trigger to maintain the protection against additional purchases by Trilogy.

The Delaware Supreme Court in *Selectica* rejected Trilogy's challenge to the pill and the board's determination to utilize the pill's exchange feature.[352] First, the Court concluded that the board had reasonably identified the potential impairment of the NOLs as a threat to Selectica. Second, the Court held that the 4.99% rights plan was not preclusive. Explaining that a defensive measure cannot be preclusive unless it "render[s] a successful proxy contest realistically unattainable given the specific factual context," the Court credited expert testimony that challengers with under 6% ownership routinely ran successful proxy contests for micro-cap companies. The Court sharply rejected Trilogy's contention that Selectica's full battery of defenses was collectively preclusive, holding that "the combination of a classified board and a Rights Plan do[es] not constitute a preclusive defense." Finally, the Court held that the adoption, deployment and reloading of the 4.99% pill was a proportionate response to the threat posed to Selectica's tax assets by Trilogy's acquisitions.

3. "Dead Hand" Pills

When a board rejects an unsolicited bid, the tactic of choice for the bidder is often to combine a tender offer with a solicitation of proxies or consents to replace a target's board with directors committed to considering the dismantling of a rights plan to permit the tender offer to proceed. The speed with which this objective can be accomplished depends, in large part, upon the target's charter and bylaws and any other defenses that the target has in place. In Delaware, a bidder can act by written consent without a meeting of shareholders unless such action is prohibited in the certificate of incorporation, and can call a special meeting between annual meetings if permitted under a target's bylaws.

The holders of a majority of the shares can remove directors on a non-staggered board of a Delaware corporation with or without cause,[353] while directors on a staggered board can only be removed for cause unless the certificate of incorporation provides otherwise.[354]

Thus, if a target's charter does not prohibit action by written consent and the target does not have a staggered board, a bidder for a Delaware corporation generally can launch a combined tender offer/consent solicitation and take over the target's board as soon as consents from the holders of more than 50% of the outstanding shares are obtained. Even if the target's charter prohibits action by written consent and precludes shareholders from calling a special meeting, a target without a staggered board can essentially be taken over in under a year by launching a combined tender offer/proxy fight shortly before the deadline to run a proxy fight at the target's annual meeting. In contrast, a target with a staggered board may be able to resist a takeover unless a bidder successfully wages a proxy fight over two consecutive annual meetings—a point well-illustrated by Airgas' ultimately successful two-year takeover defense described in VI.A.2 above.

Some companies without staggered boards have adopted rights plans redeemable only by vote of the continuing directors on the board (*i.e.*, the incumbent directors or successors chosen by them)—a so-called "dead hand" pill. Variations of this concept come in a variety of forms, such as so-called "nonredemption" or "no hand" provisions, which typically provide that the board cannot redeem the rights plan once the continuing directors no longer constitute a majority of the board. This limitation on redemption may last for a limited period or for the remaining life of the rights plan. Another variant is the "limited duration" or "delayed redemption" dead hand pill, whereby the dead hand or no hand restriction's effectiveness is limited to a set period of time, typically starting after the continuing directors no longer constitute a majority of the board. The use of dead hand and no hand provisions was effectively foreclosed by Delaware case law over 15 years ago, although courts in Georgia and Pennsylvania have upheld their validity.[355]

B. Staggered Boards

Under Delaware law, directors on a staggered board can be removed only for cause, unless the certificate of incorporation provides otherwise.[356] Hostile bidders can be expected to be creative in attempting to circumvent a staggered board provision and to find any hole in a target's defenses.

For example, Air Products tried to reduce the effectiveness of Airgas' staggered board in connection with its 2010 hostile bid. In addition to nominating a slate of three directors to be elected to the Airgas board at the Airgas annual meeting in September 2010, Air Products proposed a bylaw amendment that would accelerate the 2011 Airgas annual meeting to January 2011. Airgas' charter—like the charter provisions of a majority of major Delaware corporations with staggered boards—provided that directors will "be elected to hold office for a term expiring at the annual meeting of stockholders held in the third year following the year of their election." The bylaw amendment was approved by Airgas shareholders, a substantial portion of which were arbitrageurs. While the Delaware Court of Chancery upheld the validity of the bylaw amendment, the Delaware Supreme Court unanimously reversed, finding that directors on staggered boards were elected to three-year terms, and that the bylaw constituted a *de facto* removal of directors in a manner inconsistent with the Airgas charter.[357]

C. Other Defensive Charter and Bylaw Provisions

Defensive charter and bylaw provisions typically do not purport to, and will not, prevent a hostile acquisition. Rather, they provide some measure of protection against certain takeover tactics and allow a board additional negotiating leverage, as well as the opportunity to respond appropriately to proxy and consent solicitations. Defensive charter provisions include: (1) provisions that eliminate shareholder action by written consent or rights to call a special meeting; (2) provisions limiting the ability of shareholders to alter the size of a board; (3) "fair price" provisions (which require that shareholders receive equivalent consideration at both ends of a two-step bid, thus deterring coercive two-tier, front-end-loaded offers); and (4) "business combination" provisions (which commonly provide for supermajority voting in a wide range of business combinations not approved by the company's continuing directors, if the transaction does not meet certain substantive requirements).

Because certain defenses (such as the elimination of the ability of shareholders to act by written consent) may only be implemented via the charter in the case of Delaware corporations and therefore require shareholder approval, and due to general institutional investor opposition to such provisions, few companies have put forth new proposals for such provisions in recent years. However, bylaws generally can be amended without shareholder approval and can be used to implement some of the structural defenses found in charters, although such defenses, if placed only in the bylaws, would be subject to further amendment by shareholders. Bylaws, as discussed in more detail below, often contain provisions in addition to those found in corporate charters, including: advance notice provisions relating to shareholder business and director nomination proposals, provisions that address the subject matters that may properly be brought before shareholder meetings and provisions establishing director eligibility standards. Bylaw provisions regarding the business to be conducted at, and the manner of presenting proposals for, annual and special meetings, as well as procedures for shareholder action by written consent (for companies that have not eliminated action by written consent in their charter), are helpful in protecting against an unexpected proxy or consent contest for control of the board of directors and can be adopted by a board without shareholder approval. Especially in light of the risks of shareholder activism, proxy fights and consent solicitations, state-of-the-art bylaw procedures can be extremely important. Such procedures help to ensure that boards have an appropriate period of time to respond in an informed and meaningful manner to shareholder concerns and to prepare and clear any related proxy statement disclosure.

ISS has adopted voting guidelines to address bylaws adopted unilaterally without a shareholder vote. ISS will generally recommend that stockholders vote against or withhold votes from directors individually, committee members or the entire board if the board "amends the company's bylaws or charter without shareholder approval in a manner that materially diminishes shareholders' rights or that could adversely impact shareholders," considering specified factors. Unless it is reversed or submitted to a binding shareholder vote, ISS will make voting recommendations on a case-by-case basis on director nominees in subsequent years, and will generally recommend voting against if the directors classified the board, adopted supermajority vote requirements to amend the bylaws or charter, or eliminated shareholders' ability to amend bylaws.

Companies should review their bylaws on a regular basis to ensure that they are up to date and consistent with recent case law and SEC developments, and to determine whether modifications may be advisable. The most significant of these bylaw provisions are discussed in detail below.

1. Nominations and Shareholder Business

These bylaw provisions require shareholders to provide advance notice of business proposed to be brought before, and of nominations of directors to be made at, shareholder meetings, and have become common. These provisions generally set a date by which a shareholder must advise the corporation of the shareholder's intent to seek to take action at a meeting (usually a minimum of 90 to 120 days in advance of the anniversary of the prior year's meeting) and fix the contents of the notice, which can include information such as beneficial stock ownership and other information required by Regulation 14A of the federal proxy rules. Failure to deliver proper notice in a timely fashion usually results in exclusion of the proposal from shareholder consideration at the meeting. Bylaw provisions may also require nominees to respond to a questionnaire providing information about the candidate's background and qualifications, address agreements the candidate may have with third parties as to voting or compensation in connection with the candidate's service as a director, and address the nominee abiding by applicable confidentiality, governance, conflicts, stock ownership, trading and other policies of the company. In light of recent activity by hedge funds and others, companies may also decide to ask for disclosure of derivative and short positions, rather than limit such disclosure to the traditional category of voting securities. The questionnaires are a useful way for boards of companies that have eligibility requirements for director nominations in their bylaws to have sufficient information to make ineligibility determinations where they are warranted.

Two 2008 Delaware Court of Chancery decisions have emphasized the need to review and update advance notice bylaw provisions. In March 2008, the Court held in *JANA Master Fund Ltd.* v. *CNET Networks, Inc.* that CNET's advance notice bylaw was applicable only to shareholder proposals made under Exchange Act Rule 14a-8 of the federal securities laws and not to the insurgent's proposed nomination of candidates for election to the CNET board.[358] On a close reading of the bylaw—taking into account its precatory nature (the shareholder "may seek" to have an issue brought), the connection of its deadline to the filing of the proxy, and its grafting of Rule 14a-8's requirements onto the bylaw—the Court found that it was clearly designed to apply only to Rule 14a-8. In April 2008, the Court ruled in *Levitt Corp.* v. *Office Depot, Inc.* that a dissident shareholder was entitled to nominate director candidates from the floor of the annual meeting, despite the company's valid advance notice of business bylaw, because the company had brought the "business" of considering director candidates before the meeting by noticing the "election of directors" as an item of business.[359] The *CNET* and *Levitt Corp.* cases indicate that the Court of Chancery views advance notice bylaws skeptically and may interpret them narrowly to require explicit reference to shareholder nominations before finding that any advance notice bylaw bars a dissident slate. Further, although the validity of advance notice bylaws has been established in many court decisions, such provisions are not immune from legal challenge. In 2012, for example, the Delaware Court of Chancery granted a motion to expedite a claim brought by Carl Icahn alleging that the directors of Amylin Pharmaceuticals had breached their fiduciary duties by enforcing the company's advance notice bylaw provision and refusing to grant Mr. Icahn a waiver to make a nomination following the company's rejection of a third-party merger proposal after the advance notice deadline.[360] In December 2014, however, the Court of Chancery alleviated some of the concerns raised by the Amylin decision. The court clarified that, in order to enjoin enforcement of an advance notice provision, a plaintiff must allege "compelling facts" indicating that enforcement of the advance notice provision was inequitable (such as the board taking an action that resulted in a "radical" change between the advance notice deadline and the annual meeting).[361] Thus, while these cases do not call into question the permissibility or appropriateness of advance notice bylaws as to director nominations, shareholder business or other matters, they show that the applicability of such bylaws to *all* shareholder nominations and proposals should be made explicit and that enforcement of such bylaws should be equitable.

2. Dissident Director Conflict/Enrichment Schemes

Some companies have adopted or considered adopting bylaws designed to deter directors from taking special compensation from third parties, typically activist hedge funds, either by completely disqualifying such a director from serving or by requiring that all such arrangements be disclosed. These compensation schemes often entitle directors to large payments if the activist's goals are met within near-term deadlines. Such compensation schemes raise a host of issues because the directors' incentives may diverge from those of shareholders. These schemes also call into question whether the directors are able to satisfy their fiduciary duties to shareholders. Bylaw provisions can be formulated to prohibit qualification as a director if a candidate is a party to any such special compensation arrangement. Companies have the authority to adopt these provisions under DGCL § 141(b), which provides that "the certificate of incorporation or bylaws may prescribe other qualifications for directors." ISS has indicated, however, in a FAQ released in February 2015, that it would consider a board-adopted bylaw that disqualifies shareholders' nominees or directors who receive third-party compensation (as opposed to requiring mere disclosure of such arrangements) as "materially adverse to shareholders" and that such a bylaw would likely draw an ISS recommendation to vote against the board if adopted without shareholder approval. Where such qualification bylaws are put to a vote of shareholders, ISS had initially indicated open-mindedness as to whether they would recommend in favor of such a bylaw, but to date ISS has recommended against proposals seeking shareholder ratification of such bylaws. Nevertheless, a few companies have obtained shareholder support for such bylaws, even in the face of an adverse ISS recommendation. And, some companies—perhaps, in the spirit of compromise—have coupled a prohibition on such "golden leash" arrangements with adoption of a proxy access bylaw. Of the approximately 160 U.S. companies that have adopted proxy access bylaws, 25 companies reserve the right to exclude shareholder nominees that are party to or that may become party to any compensatory arrangements relating to their service as a director in such bylaw. Additionally, the Council of Institutional Investors has petitioned the SEC to issue regulatory guidance or new proxy rules requiring nominating shareholders to disclose the details and impact of compensation arrangements they may have with their director candidates.

3. Meetings

Provisions regarding the regulation of meetings play an important role in controlling the timing and frequency of meetings. If, as in

Delaware, shareholders can be denied the right to call special meetings,[362] such a bylaw provision can delay potential proxy contests to the annual meeting. Where state law does not so permit, corporations should also consider adopting bylaw provisions that regulate the ability of shareholders to call special meetings.

Many bylaws specify a particular date for an annual meeting. Such provisions should be amended to provide more flexibility and discretion to the board to set an annual meeting date. A board should be authorized to postpone previously scheduled annual meetings upon public notice given prior to the scheduled annual meeting date.

The chairman of the shareholder meeting should be specifically authorized to adjourn the meeting from time to time whether or not a quorum is present. Adjournments (and postponements) may help prevent premature consideration of a coercive or inadequate bid. The chairman of the meeting should also have express and full authority to control the meeting process, including the ability to require ballots by written consent, select inspectors of elections, and determine whether proposals and/or nominations were properly brought before the meeting.

As a matter of good planning, companies should also be alert to timing issues when undertaking friendly transactions. For instance, if a transaction is signed at a time of year near an upcoming annual meeting, management may consider putting the proposal to approve the merger on the agenda of the annual meeting rather than calling a special meeting. This, however, can be a trap for the unwary, as shareholder (and thus hostile bidder) access to the annual meeting agenda is often more liberal than to special meeting agendas, and, if an annual meeting must be significantly delayed past the one-year anniversary of the prior year's meeting (*e.g.*, due to an extended SEC comment process in connection with the merger proxy), under many standard notice bylaws, a later deadline for shareholder proposals may be triggered. Once triggered, this could enable a potential interloper to run a proxy contest or otherwise interfere with the shareholder vote. In many cases, the special meeting approach will be the right choice.

4. Vote Required

To approve a proposal, except for election of directors (which requires a plurality of the quorum if a company has not adopted a bylaw providing for majority voting), the required shareholder vote should not be less than a majority of the shares present and entitled to vote at the meeting (*i.e.*, abstentions should count as "no" votes for shareholder resolutions). For Delaware corporations, Section 216 of the DGCL dictates this result unless the charter or bylaws specify otherwise.[363]

5. Action by Written Consent

If the corporation's charter does not disallow action by shareholder consent in lieu of a meeting, the bylaws should establish procedures for specifying the record date for the consent process, for the inspection of consents and for the effective time of consents. Although Sections 213 and 228 of the DGCL contemplate such procedures, Delaware courts have closely reviewed these provisions to determine whether their real purpose is to delay and whether the procedures are unreasonable.[364]

6. Board-Adopted Bylaw Amendments

Although advance takeover preparedness is optimal, it is not always possible. Delaware courts have affirmed a board's ability to adopt reasonable bylaw amendments in response to a hostile offer, but such amendments may be subject to heightened scrutiny. A bylaw amendment made after announcement or knowledge of an unsolicited offer will be reviewed under the *Unocal* standard, and possibly under *Blasius Industries, Inc.* v. *Atlas Corp*[365] as discussed in Section II.B.2. The most common forms of such after-the-fact defensive bylaws change the date of a shareholder meeting in the face of a proxy contest or change the size of the board. In a series of decisions, the Delaware courts have generally accepted that boards can delay shareholder meetings (by bylaw amendment or adjournment) where there is "new information" or a change in position by the board.[366]

7. Forum Selection Provisions

In recent years, a number of companies have adopted forum selection provisions to help reign in the cost of multiforum shareholder litigation. These forum selection provisions generally cover derivative lawsuits, actions asserting breaches of fiduciary duty, actions arising from the state of incorporation's business code, and actions asserting claims governed by the internal affairs doctrine.

In *Boilermakers Local 154 Retirement Fund* v. *Chevron Corp.*,[367] a case of first impression, the Delaware Court of Chancery upheld the validity of forum selection bylaws as a matter of Delaware law. In that case, shareholders of Chevron and FedEx challenged: (1) whether bylaws could regulate the venue for shareholder corporate and derivative litigation as a matter of Delaware law; (2) whether the unilateral adoption of forum selection bylaws by a board of directors was a breach of the board's fiduciary duties; and (3) whether such bylaws could bind shareholders. The Court ultimately concluded that forum selection bylaws were facially valid under the DGCL and that a boards' unilateral adoption of bylaws did not render them contractually invalid. The Court noted that Section

109(b) of the DGCL permits the bylaws to "contain any provision, not inconsistent with law or with the certificate of incorporation, relating to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors, officers or employees."[368] On the question of the board's fiduciary duties, the Court held that "[j]ust as the board of Household was permitted to adopt the pill to address a future tender offer that might threaten the corporation's best interests, so too do the boards of Chevron and FedEx have the statutory authority to adopt a bylaw to protect against what they claim is a threat to their corporations and stockholders, the potential for duplicative law suits in multiple jurisdictions over single events."[369] Finally, the Court held that the bylaws were valid as a matter of contract because investors knew when they bought stock of the corporation that the board could unilaterally adopt bylaws that were binding on shareholders.

In 2015, the Delaware General Assembly gave statutory backing to forum selection bylaws by adopting a new provision of the General Corporation Law, which allows a company, in its certificate of incorporation or bylaws, to provide that " any or all internal corporate claims shall be brought solely and exclusively in any or all of the courts in this State."[370] Notably, the new provision also provides that a forum selection bylaw may not divest stockholders of the right to bring suit in Delaware, thus overturning the result of *City of Providence* v. *First Citizens BancShares, Inc.*, where the Court of Chancery had ruled that a company could validly adopt a bylaw providing that all litigation must be brought in its non-Delaware headquarters state.[371] Jurisdictions outside Delaware are increasingly enforcing forum selection bylaws that provide that shareholder litigation must be conducted in Delaware.[372] The Court of Chancery, however, has consistently stated that it is reluctant to grant an anti-suit injunction against proceedings in a sister jurisdiction to uphold these bylaws, and instead still requires litigation filed outside of the contractually selected forum to be challenged in that jurisdiction.[373]

Although a growing number of companies are adopting forum selection bylaws, companies should also consider the risk of adverse recommendations from proxy advisory firms. ISS has stated that unilateral adoption by the board of an exclusive forum bylaw will be evaluated under ISS' policy on unilateral bylaw and charter amendments. As discussed in Part VI.C, this policy focuses on whether such a bylaw "materially diminishes shareholder rights" or "could adversely impact shareholders." Glass Lewis' policy is to recommend voting against the chairman of the nominating and governance committee when a company adopts an exclusive forum provision without shareholder approval outside of a spin-off, merger or IPO.

8. Fee-Shifting Bylaws and Mandatory Arbitration Provisions

Although it is common in some jurisdictions outside the United States for the losing party to pay the prevailing party's attorney's fees and costs, under the majority rule in the U.S. each party must pay its own attorney's fees and costs, regardless of the outcome of the litigation. The Delaware Supreme Court in *ATP Tour, Inc.* v. *Deutscher Tennis Bund*, on a question of law certified to it from the District Court for the District of Delaware, held that a board-adopted fee-shifting bylaw that imposed the costs of litigation on a non-prevailing plaintiff in a private non-stock corporation is facially valid under Delaware law.[374] In so ruling, the Delaware Supreme Court recognized that a "bylaw that allocates risk among parties in intra-corporate litigation" relates to the conduct of the affairs of the corporation.[375] The Delaware Supreme Court cautioned that a fee-shifting bylaw enacted for an improper purpose would be invalid, even if the board had authority to adopt it in the first instance.

In response to the *ATP* case, the Delaware legislature adopted an amendment to the Delaware General Corporation Law providing that "[t]he certificate of incorporation may not contain any provision that would impose liability on a stockholder for the attorneys' fees or expenses of the corporation or any other party in connection with an internal corporate claim."[376] Although the statutory amendment bars fee-shifting provisions in stock corporations, it specifically does not apply to non-stock corporations, and thus leaves the holding of *ATP* intact.

Some bylaws and certificates of incorporation also include mandatory arbitration provisions requiring the resolution of any disputes, claims or controversies brought by shareholders in either a personal, class or derivative capacity to be resolved through binding and final arbitration. In *Corvex Management LP* v. *CommonWealth REIT*,[377] a Maryland Court upheld the validity of such a provision. The Court rejected the plaintiffs' arguments that the bylaw was unenforceable because the shareholders had neither "assented" to the provision nor received consideration for its adoption. Instead the Court noted that the plaintiffs were sophisticated parties who had both constructive and actual knowledge of the clause, and therefore had assented to being bound by the provision. Companies considering adopting such provisions should take into account the fact that Maryland has not extended its ruling to unsophisticated shareholders and that other states, including Delaware, have not yet upheld the validity of mandatory arbitration provisions.

D. Change-of-Control Employment Arrangements

In order to attract and retain executives, most major companies have adopted executive compensation programs containing change-of-control protections for senior management. Change-of-control employment agreements or severance plans are not defensive devices intended to deter sales or mergers; rather they are intended to ensure that management teams are not deterred from engaging in corporate transactions that are in the best interests of shareholders on account of the potential adverse effects those transactions may have on management's post-transaction employment. A well-designed change-of-control employment agreement should neither incentivize nor disincentivize management from engaging in a transaction on the basis of personal circumstances.

Although there continues to be a great deal of scrutiny of executive compensation arrangements, appropriately structured change-of-control employment agreements are both legal and proper. Courts that have addressed the legality of change-of-control agreements and other benefit protections have almost universally found such arrangements to be enforceable and consistent with directors' fiduciary duties so long as such directors do not have a conflict of interest.[378] A board's decision to adopt change-of-control provisions is usually analyzed under the business judgment rule.[379] The scrutiny applied to such arrangements may be heightened if they are adopted during a pending or threatened takeover contest, thereby making careful planning in advance of a merger all the more important. Public companies that do not already maintain reasonable change-of-control protections for senior management should consider implementing them, and companies that already maintain such arrangements should monitor and periodically review them.

Over the years, a generally consistent form of change-of-control employment agreement or plan has emerged. Typically, the protections of the agreement or plan become effective only upon a change-of-control or in the event of a termination of employment in anticipation of a change-of-control. A protected period of two years following a change-of-control is fairly typical. If the executive's employment is terminated during the protected period by the employer without cause or by the executive following a specified adverse change in the terms of employment, the executive is entitled to severance benefits.

The severance benefits must be sufficient to ensure neutrality and retention, but not so high as to be excessive or to encourage the executive to seek a change-of-control when it is not in the best interests of the company and its shareholders. For the most senior executives at public companies, a multiple of an executive's annual compensation (*e.g.*, two or three times) is the standard severance formula in most industries. "Compensation" for this purpose generally includes base salary and annual bonus (based on a fixed formula, usually related to the highest or average annual bonus over some period, or target bonus) and in some cases accruals under qualified and supplemental defined benefit pension plans. In addition, severance benefits typically include welfare benefit continuation during the severance period. In the change-of-control context, severance is customarily paid in a lump sum within a specified period of time following a qualifying termination, as opposed to installment payments, which prolong a potentially strained relationship between the executive and the former employer.

Many change-of-control agreements incorporate provisions to address the impact of the federal excise tax on excess parachute payments. The "golden parachute" tax rules subject "excess parachute payments" to a dual penalty: the imposition of a 20% excise tax upon the recipient and non-deductibility by the paying corporation. Excess parachute payments result if the aggregate payments received by certain executives of the company that are treated as "contingent" on a change-of-control equal or exceed three times the individual's "base amount" (the average annual taxable compensation of the individual for the five or lesser number of years during which the employee was employed by the corporation preceding the year in which the change-of-control occurs). If the parachute payments to such an individual equal or exceed three times the "base amount," the "excess parachute payments" generally equal the excess of the parachute payments over the employee's base amount. Historically, many public companies have provided a "gross-up" for the golden parachute excise tax to their most senior executives. Recently, however, there has been increasing shareholder pressure against gross-ups, and they have become less common, particularly in new or modified agreements.

Companies should periodically analyze the impact the golden parachute excise tax would have in the event of a hypothetical change of control. The excise tax rules, for a variety of reasons, can produce arbitrary and counter-intuitive outcomes that punish long-serving employees in favor of new hires, punish promoted employees in favor of those who have not been promoted, punish employees who do not exercise options in favor of those who do, disadvantage employees who elect to defer compensation relative to those who do not and penalize companies and executives whose equity compensation programs include performance goals. Indeed, companies have historically implemented gross-ups because they are concerned that the vagaries of the excise tax would otherwise significantly reduce the benefits intended to be provided under the agreement and that such a reduction might undermine the shareholder-driven goals of the agreement. As gross-ups become less prevalent, the importance of understanding the impact of the excise tax has increased, and companies and executives are more frequently considering excise tax impact and mitigation techniques in the context of compensation design.

In addition to individual change-of-control agreements, some companies have adopted so-called “tin parachutes” for less senior executives in order to formalize company policies regarding severance in the change-of-control context. Because of the number of employees involved, careful attention should be paid to the potential cost of such arrangements and their effect on potential transactions

Companies should also review the potential impact of a change-of-control on their stock-based compensation plans. Because a principal purpose of providing employees with equity incentives is to align their interests with those of the shareholders, plans should contain provisions for the acceleration of equity compensation awards upon a change-of-control (“single-trigger”) or upon a severance-qualifying termination event following a change-of-control (“double-trigger”). There has been a trend in recent years towards double-trigger vesting, although a significant minority of public companies still provide for single-trigger vesting.

Companies can expect increasing shareholder scrutiny of change-of-control employment arrangements, particularly in light of the nonbinding shareholder advisory votes on executive compensation in annual proxy statements and on golden parachute arrangements in transaction proxy statements that were mandated by Dodd-Frank in 2010. Heightened disclosure requirements regarding golden parachutes are triggered where shareholders are asked to approve an acquisition, merger, consolidation or proposed sale or other disposition of all or substantially all of the assets of a company. Furthermore, ISS and other shareholder advisory groups continue to criticize certain change-of-control practices such as excise tax gross-ups, single-trigger equity award vesting and post-retirement perks. Notwithstanding this increased scrutiny, companies should assess these and other executive compensation arrangements in light of company-specific needs, rather than broad policy mandates.

E. “Poison Puts”

Debt instruments may include provisions, sometimes known as “poison puts,” that allow debtholders to sell or “put” their bonds back to the issuing corporation at a predetermined price, typically at par or slightly above par value, if a defined “change of control” event occurs. Poison puts began to appear in bond indentures during the LBO boom of the 1980s in response to acquirors’ practice of levering up targets with new debt, which in turn led to ratings downgrades and a decline in the prices of the targets' existing bonds. The inclusion of these protections, which generally cover mergers, asset sales and other change of control transactions, as well as changes in a majority of the board that is not approved by the existing directors (the latter being sometimes referred to as a "proxy put"), is generally bargained for by debtholders and therefore is assumed to lead to better terms (such as lower pricing) for the borrower.

In recent years, Delaware courts have addressed so-called proxy puts and, in so doing, have provided cautionary guidance on the effectiveness of poison puts in general. In 2009, in *San Antonio Fire & Police Pension Fund* v. *Amylin Pharmaceuticals, Inc.*, the Delaware Court of Chancery held that the board has the power, and so long as it is complying with the contractual implied duty of good faith and fair dealing to the debtholders also the right, to "approve" a dissident slate of director nominees for purposes of a proxy put in the company's bond indenture, even while the board is conducting a public campaign against them.[380] Interpreting the terms of the indenture to preclude the board from "approving" the slate would have "an eviscerating effect on the stockholder franchise" and would "raise grave concerns" about the board's fiduciary duties in agreeing to such a provision.[381] The Court also clarified that the board is "under absolutely *no* obligation to consider the interests of the noteholders" in determining whether to approve the dissident slate.[382]

In its March 2013 decision in *Kallick* v. *SandRidge Energy Inc.*, the Court of Chancery cast further doubt on the effectiveness of proxy puts. *SandRidge* applied *Unocal*'s intermediate standard of review both to a board's decision to agree to poison put provisions in the first place and its subsequent conduct with respect to such clauses.[383] Citing *Amylin*, then-Chancellor Strine held that a board must approve a dissident slate for purposes of a proxy put unless "the board determines that passing control to the slate would constitute a breach of the duty of loyalty, in particular, because the proposed slate poses a danger that the company would not honor its legal duty to repay its creditors." According to then-Chancellor Strine, a board may only decline to approve dissident nominees where the board can "identify that there is a specific and substantial risk to the corporation or its creditors posed by the rival slate" (such as by showing the nominees "lack the integrity, character, and basic competence to serve in office") or where the dissident slate has announced plans that might affect the company's ability to "repay its creditors." Thus, even though the board there believed itself to be better qualified and prepared to run the company than the dissident nominees, the Court enjoined the incumbent directors from opposing a control contest unless and until they approved their rivals for purposes of the put.

In 2014, the Court of Chancery, in *Pontiac General Employees Retirement* v. *Ballantine*, expressed further skepticism that proxy puts could be employed in a manner consistent with a board's fiduciary duties. In *Ballantine*, a company entered into restated credit and term loan agreement with a poison put. Two years later, an 11% stockholder, North Tide Capital, sent a critical letter to the board and threatened to wage a proxy fight, which was ultimately settled when the company agreed to nominate three North Tide candidates to the board.[384] The board was then sued by stockholders who argued that the directors breached their fiduciary duties by approving a credit agreement with a poison put. Because the proxy fight with North Tide Capital had settled, the defendants argued that there was no present risk that the poison puts would trigger and that therefore the case was not ripe. Vice Chancellor Laster disagreed. He concluded that poison puts have a "deterrent effect," that "[a] truly effective deterrent is never triggered" and that "[i]f the deterrent is actually used, it has failed its purpose."[385] Pointing to *Toll Brothers*, the Court noted that the put could have a chilling effect now and that there is no "requirement that an actual[] proxy contest be underway."[386] The Court refused to dismiss the defendant directors from the case, and also ruled that the complaint had stated a claim against the lender on an aiding and abetting theory. In 2015, the Court went so far as to suggest that a proxy put might be so difficult to use that it was akin to a "toothless bulldog."[387] When the case was later settled, the credit agreement was amended to eliminate the proxy put (without any payment to the lenders for agreeing to the amendment) and the company agreed to pay up to $1.2 million in attorneys' fees.

Boards considering adoption of poison puts, and possibly other change of control agreements, should be aware that the adoption itself, as well as a board's decisions with respect to such instruments, may be challenged and reviewed by a skeptical court. Courts recognize, of course, that lenders may legitimately demand these positions and that companies may benefit from their use. But because courts may view poison puts as possibly having an entrenching effect in some circumstances, the board should weigh the potential effect of entrenchment against the needs of the lender and document carefully the process it followed. At least one board has heeded the warning—Morgans Hotels pre-approved the dissident nominees as continuing directors, so as not to trigger the change of control covenant in its notes.

F. Responding to an Unsolicited Offer—Preliminary Considerations

Takeover preparedness remains critical in today's M&A environment. Failure to prepare for a takeover attempt exposes potential targets to pressure tactics and reduces the target's ability to control its own destiny. Further, while takeover defense is more art than science, there are some generally applicable principles to which companies should generally adhere.

1. Disclosure of Takeover Approaches and Preliminary Negotiations

When a takeover approach is made, keeping the situation private is generally preferable as it is much easier to defeat an unsolicited bid if it never becomes public. Once a takeover approach becomes public, a target company's options narrow dramatically because arbitrageurs and hedge funds often take positions in its stock, changing its shareholder base. These short-term investors' objectives will necessarily conflict with the company's pursuit of a standing, long-term plan and will most often pressure the board to accept a bid, with less regard to its adequacy than the board.

Because there are a limited number of ways to acquire control of a target without the support of its board—*i.e.*, through a tender offer, a stock purchase, or a combined tender offer and proxy contest—and each available hostile acquisition method is less preferable than a negotiated transaction, most initial takeover approaches are made privately and indicate a desire to agree to a friendly transaction. Acquirors generally begin their approach with either: (i) a "casual pass" where a member of the acquiror's management will contact a senior executive or director of the target and indicate the desire to discuss a transaction; or (ii) through a private bear-hug letter. Bear-hug letters come in various forms and levels of specificity but generally are viewed as a formal proposal to the target's management or board to engage in a transaction. While these private approaches give target boards time to consider the merits of a potential friendly transaction, they often put targets in the unenviable position of having to decide whether public disclosure is desirable or required. Determining if disclosure is required in response to a takeover approach or preliminary merger negotiations is a factually driven inquiry. The two guiding factors in this inquiry are: (i) whether information about the acquisition proposal is material and (ii) whether the target has a duty to disclose the approach.

The materiality of speculative events such as preliminary merger negotiations is determined based on the particular facts of each case by applying the Supreme Court's test in *Basic* v. *Levinson*[388]: whether, balancing the probability that the transaction will be completed and the magnitude of the transaction's effect on the issuer's securities, there is a substantial likelihood that the disclosure would be viewed by the reasonable investor as having significantly altered the total mix of information. To assess probability, companies must look at the "indicia of interest in the transaction at the highest corporate levels" considering, among other things, board resolutions, instructions to investment bankers, and actual negotiations between the parties. The magnitude of the transaction on the issuer's securities is determined by reference to the size of the two corporate entities and the potential premium over market value. However, "[n]o particular event or factor short of closing the transaction need be either necessary or sufficient by itself to render merger discussions material."[389]

Even if preliminary merger negotiations are material, no disclosure is required absent an affirmative disclosure duty.[390] A corporation is not required to disclose a fact merely because reasonable investors would very much like to know it.[391] However, an acquiror's acquisition of a toehold position in the target's stock or rumors regarding a potential transaction may occasionally lead to inquiries directed at the target. Consequently, disclosure duties most commonly arise in two situations: (i) when subsequent factual developments occur that make the issuer's previous statements misleading or (ii) when leaks and market rumors are attributable to the issuer.

As a general matter, a company is not required to disclose approaches and negotiations in response to such inquiries.[392] However, if a target elects to speak publicly about mergers or acquisitions, it must speak truthfully and completely.[393] Therefore, in most situations, the best response is a "no comment" posture. However, a "no comment" response may not be appropriate if the issuer had previously made a statement that has been rendered materially false or misleading as a result of subsequent events or if market rumors are attributable to issuer leaks.[394]

Similarly, a company cannot reply "no comment" in response to inquiries about unusual market activity or rumors if the leak is attributable to the company.[395] However, if the leak is not attributable to the company, there is no duty to correct the market or verify the rumor.[396] Market rumors and leaks are attributed to a company if it has "sufficiently entangled itself" with the disclosure of information giving rise to the rumor.[397] In *State Teachers Retirement Board* v. *Fluor*,[398] Fluor, a construction company, was awarded a $1 billion contract to build a coal gasification plant in South Africa and, prior to it publicly disclosing award of the contract, its share price surged and daily trading volume increased threefold. Fluor received several inquiries from market analysts and reporters regarding rumors of the contract award but Fluor declined to comment due to contractual restrictions.[399] The Second Circuit held that the company's decision to not confirm the rumors could not give rise to liability because there was no indication that the leak was attributable to the company or its employees.[400] However, while courts have not required disclosure to combat rumors and leaks that are not attributable to the company, stock exchange rules, subject to certain exceptions, impose prompt disclosure duties to combat unusual market activity.[401]

2. Other Considerations

In addition to keeping the situation private, all communications from and to an acquiror should be directed through the CEO unless otherwise decided by the board. Acquirors often will attempt to contact individual board members directly in order to undermine the target's ability to present a unified negotiating front or to learn information. Additionally, maintaining board unity is essential to producing the best outcome, whether the goal is independence or negotiating the best possible sale price. In this regard, the CEO should keep the board informed of developments, consult the board and solicit its advice. Honest and open debate should be encouraged, but kept within the boardroom.

During a takeover defense, every decision is tactical and must align with the target's defensive strategy. No conversation with a hostile bidder should be assumed to be off the record and any signs of encouragement, self-criticism or dissension within the board can be used against the company. Consequently, the board should carefully craft a formal response. Except in the case of a publicly disclosed tender offer, there is no period in which a company must respond to an offer. And, there is no duty to negotiate, even in the face of a premium bid, because no company is for sale from a legal perspective until the board determines that the company is for sale.

G. Defending Against an Unsolicited Offer

1. "Just Say No"

Unless the target has otherwise subjected itself to *Revlon* duties (*e.g.*, by having previously agreed to enter into an acquisition involving a change-of-control, as in *QVC*), it seems clear that the target may, if it meets the relevant standard, "just say no" to an acquisition proposal.

Targets of unsolicited offers have been successful in rejecting such proposals in order to follow their own strategic plans. In response to a hostile bid by Moore, Wallace Computer Services relied on its rights plan and long-term strategy, rather than seeking a white knight, initiating a share repurchase program or electing another "active" response to Moore's offer. When Moore challenged the rights plan in Delaware federal district court, Wallace was able to satisfy the refusal to redeem the pill under the *Unocal* standard. Although 73% of Wallace's shareholders tendered into Moore's offer, the Court found that the Wallace board had sustained its burden of demonstrating a "good faith belief, made after reasonable investigation, that the Moore offer posed a legally cognizable threat" to Wallace. The evidence showed that the favorable results from a recently adopted capital expenditure plan were "beginning to be translated into financial results, which even surpass management and financial analyst projections."[402] As the *Moore* decision illustrates, where the target of a hostile bid wishes to consider rejecting the bid and remaining independent, it is critical that the board follow the correct process and have the advice of an experienced investment banker and legal counsel.

Additionally, the ability of a board to reject an unsolicited offer by relying on its rights plan was reaffirmed in *Airgas*, as discussed in Sections II.B.2.a and VI.A.2. The Airgas board rejected a series of increasing tender offers from Air Products because it found the price to be inadequate, and the Delaware Court of Chancery upheld the primacy of the board's determination, even though Airgas had recently lost a proxy fight to Air Products for one-third of the company's staggered board.[403]

However, while a rights plan is the most useful tool for staving off a hostile bid, it is not necessary to successfully "just say no" in every situation. What is necessary in every case—and what a rights plan is designed to protect—is a thoughtful long-term plan that was developed by a board and management who long-term shareholders trust to deliver value. This proposition was on full display in Perrigo's recent successful defense of Mylan's $35.6 billion takeover bid—the largest hostile takeover battle in history to ever go to the tender offer deadline.

In April 2015, Mylan made an exchange offer to acquire Perrigo (which had inverted from Michigan to Ireland). Perrigo's board rejected the bid because it undervalued the company. As an Irish company, Perrigo was prevented from adopting typical, U.S. style defenses, such as a rights plan, by a prohibition under the Irish Takeover Rules on the taking of "frustrating actions" in response to a bid. Consequently, Perrigo's best defense was to convince its shareholders that the value of a stand-alone Perrigo exceeded the value of a combined Mylan/Perrigo plus the offer's cash consideration and that the risk of owning Mylan shares—from a valuation and governance perspective—was significant. The saga took numerous twists and turns over the following seven months, including Teva Pharmaceuticals announcing its own bid for Mylan shortly after Mylan announced its offer for Perrigo, which Teva later withdrew in favor of an alternative deal after facing fierce resistance from Mylan; proceedings before courts and regulators on three continents; and extensive public relations campaigning and shareholder outreach.

During this time, Perrigo consistently emphasized its proven track record of delivering above market returns to shareholders, its consistently high trading multiple and its shareholder-focused corporate governance. These were contrasted with Mylan's relatively weaker historical performance and significant governance concerns, demonstrated by its use of extreme defenses—such as a self-perpetuating board structure and the issuance of a call option on 50% of Mylan's voting power to a Dutch trust—to fend off Teva's premium bid. Ultimately, more than 60% of Perrigo's shareholders rejected Mylan's bid, which resulted in the failure to satisfy the minimum tender condition and defeated the takeover attempt.

Along the way, much was discussed about whether merger arbitrageurs seeking short-term gains, who had acquired almost 25% of Perrigo's shares, would be able to deliver Perrigo into Mylan's hands. Much was also made of the fact that Perrigo did not agree to sell to a "white knight" or to do large acquisitions of its own, raising questions about whether a premium offer, even a questionable one, had put Perrigo on a "shot clock" to do the least bad deal that it could find. It did not. Perrigo's long-term shareholders accepted the judgment of the Perrigo board that Mylan's offer was too low to serve as a basis for discussions, rejecting the often-asserted notion that a board is obliged to negotiate with any bidder who offers a premium. The Perrigo situation shows that a target company can win a takeover battle and defeat short-term pressures by pursuing a shareholder-focused stand-alone strategy of value creation, especially where it fights for and wins the backing of its long-term shareholders.

2. White Knights and White Squires

A white knight transaction, namely a merger or acquisition transaction with a friendly acquiror, can be a successful strategy where the white knight transaction provides greater economic value to target company shareholders than the initial hostile offer. In some contexts, however, white knight transactions are more difficult to accomplish because of required regulatory approvals and related procedures. For example, in a banking or telecommunications acquisition, a white knight will require the same regulatory approvals as are required by the hostile acquiror and, to the extent that the white knight commences the approval process after the hostile acquiror does, the white knight will suffer a timing disadvantage. If a target has defended itself against the hostile acquiror by arguing that the deal is subject to antitrust risk, such arguments may be used against a proposed combination between the target and a white knight as well. Certain target companies may also be constrained by a scarcity of available acquirors, depending upon applicable regulatory restrictions and antitrust considerations.

A recent situation involving Allergan reinforces the viability of a white knight strategy. In 2014, Pershing Square teamed up with Valeant and sought to carefully engineer a tender offer to avoid the securities laws designed to prevent secret accumulation of stock (although serious questions have been raised about the legality of their tactics).[404] The pair formed a purchasing vehicle (funded primarily by Pershing Square) to purchase a large block in Allergan using stock options instead of shares of common stock. They also took advantage of the 10-day reporting window to acquire more stock until they nearly held 10% of the outstanding shares and then announced a proposed merger between Valeant and Allergan. Soon thereafter, Allergan's board adopted a rights plan and rejected Valeant's undervalued bid and cost-cutting strategy. Several months later Valeant launched an exchange offer for Allergan's shares that Allergan's board rejected as being a "grossly inadequate" offer. After several more months of public exchanges between Allergan and Pershing Square, Allergan announced that it would be acquired by Actavis at a much higher premium.

A white squire defense, which involves placing a block of voting stock in friendly hands, may be more quickly implemented. This defense has been successfully employed in a handful of instances, and the Delaware Court of Chancery has upheld the validity of this defense.[405] Such sales to "friendly" parties should be carefully structured to avoid an unintended subsequent takeover bid by the former "friend." Voting and standstill agreements may be appropriate in this context.

3. Restructuring Defenses

Restructurings have been driven in part by the threat of hostile takeovers. The failure of a company's stock price to fully reflect the value of its various businesses has provided opportunities for acquirors to profit by acquiring a company, breaking it up, and selling the separate pieces for substantially more than was paid for the entire company. A primary goal of any restructuring is to cause the value of a company's various businesses to be better understood and, ultimately, to be better reflected in its stock price.

Like many forms of takeover defenses, a restructuring is best initiated well before a company is actually faced with a bid. In most cases, a restructuring will only be possible if there has been careful advance preparation by the company and its investment bankers and counsel. For example, arranging for a friendly buyer of a particular asset and restructuring a business to accommodate the loss of the asset are time-consuming, costly and complicated endeavors and are difficult to effect in the midst of a takeover battle.

Nonetheless, restructuring defenses have been attempted or implemented in a number of prominent transactions. For example, during the course of BHP Billiton's effort to take over global mining giant Rio Tinto, Rio Tinto announced in late 2007 its decision to divest its aluminum products business (Alcan Engineered Products) and instead focus on its upstream mining businesses. BHP ultimately dropped its bid for Rio Tinto in November 2008, although it publicly attributed this decision to turmoil in the financial markets, uncertainty about the global economic outlook and regulatory concerns.

In addition to asset sales, a stock repurchase plan, such as that pursued by Unitrin in response to American General's unsolicited bid, may be an effective response to a takeover threat. Buybacks at or slightly above the current market price allow shareholders to lock in current market values and reduce a company's available cash, which may be critical to any leveraged acquisition bid. Companies may also initiate such buybacks when they choose not to pursue other publicly announced acquisitions in order to prevent a deterioration in the stock price and/or to reduce vulnerability to unsolicited offers. A principal benefit of stock buybacks is that they may be quickly implemented. Buybacks can be implemented through either a self-tender offer or an open market buyback program.

4. Making an Acquisition and the "Pac-Man" Defense

Companies can fend off a suitor by making an acquisition using either stock consideration or issuing new debt. Acquiring a new company through stock consideration has the effect of diluting the suitor's ownership interest if it has purchased a toehold in the target. An acquisition can also make the cost of a transaction significantly greater. In 2008, Anheuser-Busch considered acquiring Grupo Modelo so as to make the brewer too large for InBev to purchase the company. More recently, Jos. A. Bank agreed to buy retailer Eddie Bauer to make an acquisition by Men's Warehouse more difficult.

The "Pac-Man" defense involves a target company countering an unwanted tender offer by making its own tender offer for stock of the would-be acquiror.[406] The Pac-Man defense recognizes that a transaction is appropriate while challenging which party should control the combined entity. This tactic first arose in the 1980s when Martin Marietta reversed a hostile takeover bid by Bendix and launched its own hostile bid for Bendix. Men's Warehouse also employed the Pac-Man defense in late

2013 to reverse an offer by Jos. A. Bank in a move that resulted in Men's Warehouse stitching up a deal to buy Jos. A. Bank in 2014.

5. Corporate Spin-Offs, Split-Offs and Split-Ups

Companies have used spin-offs, split-offs and similar transactions to enhance shareholder value and, in some cases, to frustrate hostile acquisition attempts. One means of focusing stock market attention on a company's underlying assets is to place desirable assets in a corporation and exchange shares of the new company for shares of the parent company (known as a "split-off"), which usually is done after issuing some shares of the new company in an initial public offering. Another method, known as "spin-off," is to distribute all of the shares of the new company to the parent company's shareholders as a dividend. The Court of Chancery has recently ruled that in a spin-off, barring exceptional circumstances, a company will be able to make a clean break between the two entities, and release liabilities between the entities.[407] Another means of boosting the share price of a company is to "split up" (*i.e.*, to sell off businesses that no longer fit the company's strategic plans or split the company into logically separate units). In all of these cases, a company tries to focus the market's attention on its individual businesses which, viewed separately, may enjoy a higher market valuation than when viewed together.

In addition to potentially increasing target company valuations, spin-offs and similar structures may produce tax consequences that discourage takeover attempts for a limited period of time. Commercial Intertech used this defense to thwart an unsolicited offer by United Dominion. The spin-off of the profitable Cuno filtration business to CIC shareholders in effect created a "tax poison pill." Had United Dominion acquired either CIC or Cuno following the spin-off, the acquisition could have generated a prohibitive tax liability. A similar technique was employed by ITT in response to the hostile bid by Hilton.

6. Litigation Defenses

As shown by the litigation between Vulcan and Martin Marietta, a successful litigation strategy can delay, if not entirely eliminate, a hostile threat. As a remedy for Martin Marietta's breach of two binding confidentiality agreements, the Delaware Court of Chancery ordered that Martin Marietta be enjoined from prosecuting a proxy contest, making an exchange offer, or otherwise seeking to acquire Vulcan assets for a period of four months. In light of Vulcan's staggered board, the ruling had the practical effect of delaying Martin Marietta's ability to win a proxy fight (and thereby seating directors more likely to favor a combination of the two companies) by an entire year. While Delaware courts do not regularly enjoin transactions, they are able and willing to do so when there is a clear record and a compelling legal theory to support such a decision.

The potential merit of a litigation defense was again shown in 2015 when a California court in *Depomed Inc.* v. *Horizon Pharma, PLC*[408] preliminarily enjoined a hostile bidder on the ground that it misused information in violation of a confidentiality agreement, effectively ending the hostile takeover attempt, as discussed previously in III.A.1. Both of these cases illustrate that a company faced with a takeover threat should closely analyze its prior contractual dealings with the hostile acquiror and other entities and not shy away from using courts to enforce its rights.

VII.

Cross-Border Transactions

A. Overview

International capital flows, multinational enterprises and cross-border M&A activity have become ever-larger and more multifaceted parts of the global economy. Cross-border transactions reached $1.57 trillion in 2015, the second highest volume ever and an increase of approximately 27% over 2014.[409] Cross-border transactions accounted for 32.9% of 2015 global deal volume and included the three largest deals announced in 2015.[410] The activity featured a diverse variety of target countries and sources of acquisition capital, and was again strong across sectors, as healthcare, industrials, financials, energy and power, media and entertainment and consumer staples all experienced cross-border M&A volume greater than $100 billion each.[411]

Cross-border M&A involving U.S. companies was approximately $644 billion in 2015, 73% of which was in-bound to the United States.[412] Emerging markets continue to drive a significant share of cross-border activity, as the volume of deals involving an emerging economy acquiror and a developed economy target grew 40% in 2015 (compared to 26.7% growth in 2014 and a decrease of 27.5% in 2013) and the volume of deals involving a developed economy acquiror and an emerging economy target grew 3%, slightly less than 2014 growth of 4.7%.[413]

With the substantial increase in cross-border deal volume, regulatory issues also have risen in significance. In recent years, a number of significant cross-border deals, including several mega-deals, were not consummated or the consummation was delayed for regulatory reasons. For instance, the FTC brought an action to enjoin STERIS Corporation acquiring Synergy Health plc. Although the transaction parties ultimately won at trial, the parties had announced the deal on October 13, 2014, the FTC brought the case on June, 4, 2015, and the deal did not close until November 2, 2015. In addition, in December 2015, the Canadian Competition Commission brought an action before the Tribunal to block the Office Depot/Staples transaction. Non-consummated deals include the NYSE Euronext-Deutsche Börse business combination, AT&T's $39 billion acquisition of T-Mobile USA from Deutsche Telekom, and AB Electrolux's acquisition of General Electric Company's appliance business. United Parcel Service's $6.9 billion bid for TNT Express was withdrawn due to concerns from European antitrust regulators, and telecom providers TeliaSonera AB and Telenor Group abandoned their proposed combination to create Denmark's largest mobile phone operator, citing as the cause the failure to reach an agreement with the European Commission on acceptable conditions.

Continuing a trend that began in 2014, hostile cross-border activity was abundant during 2015. Forty-five unsolicited or hostile cross-border bids, worth approximately $237 billion, were launched during the year.[414] Major recent proposed unsolicited or hostile cross-border deals include, among others, Anheuser-Busch InBev's unsolicited but eventually agreed $117 billion bid for SABMiller; Shire's hostile but ultimately friendly $32 billion bid for Baxalta; the three-way battle among Perrigo, Mylan and Teva (ultimately resulting in Teva acquiring Allergan's generics business for $40 billion and Perrigo and Mylan each remaining independent); Pfizer's abortive $118 billion bid for AstraZeneca; Valeant Pharmaceuticals' unsuccessful attempt to buy Allergan for more than $50 billion; AbbVie's unsolicited (and agreed but ultimately terminated) $55 billion offer for Shire; BHP Billiton's ultimately withdrawn $39 billion offer for Canada's Potash Corp.; and Sanofi-Aventis' unsolicited (and ultimately friendly and successful) offer for Genzyme.

Another trend that contributed to cross-border M&A activity in recent years is "inversion" transactions. In 2015, inversion transactions accounted for approximately 14% of cross-border activity, compared to approximately 66% in 2014.[415] In a typical inversion transaction, a publicly traded U.S. parent combines with a foreign company in a transaction in which the foreign merger party (or a newly formed foreign holding company) becomes the parent of the combined group (*i.e.*, the former U.S. parent becomes a wholly owned subsidiary of a foreign parent) and the shareholders of the foreign merger party own more than 20% of the resulting foreign parent.

B. Special Considerations in Cross-Border Deals

With advance planning and careful attention to the greater complexity and spectrum of issues that characterize cross-border M&A, such transactions can be accomplished in most circumstances without falling into the pitfalls and misunderstandings that have sometimes characterized cross-cultural business dealings. A number of important issues should be considered in advance of any cross-border acquisition or strategic investment, whether the target is within the U.S. or elsewhere.

1. Political and Regulatory Considerations

Even though non-U.S. investment in the U.S. remains generally well-received and rarely becomes a political issue, prospective non-U.S. acquirors of U.S. businesses or assets should undertake a comprehensive analysis of political and regulatory implications well in advance of making an acquisition proposal, particularly if the target company operates in a sensitive industry or if the acquiror is controlled, sponsored or financed by a foreign governmental entity or organized in a jurisdiction where a high level of government involvement is generally understood to exist. Any weaknesses in the ability to clear regulatory hurdles could be used defensively by reluctant targets or offensively by competing bidders to frustrate or delay the completion of an acquisition.

In the U.S., many parties and stakeholders have potential leverage (economic, political, regulatory, public relations, *etc.*), and consequently it is important to develop a plan to address anticipated concerns that may be voiced by these stakeholders in response to the transaction. Moreover, it is essential that a comprehensive communications plan be in place prior to the announcement of a transaction so that all of the relevant constituencies can be targeted and addressed with the appropriate messages. It is often useful to involve local public relations firms in the planning process at an early stage. Planning for premature leaks is also critical. Similarly, potential regulatory hurdles require sophisticated advance planning. In addition to securities and antitrust regulations, acquisitions may be subject to review by the Committee on Foreign Investment in the United States ("CFIUS," discussed below), and acquisitions in regulated industries (*e.g.*, energy, public utilities, gaming, insurance, telecommunications and media, financial institutions, transportation and defense contracting) may be subject to additional layers of regulatory approvals. Regulation in these areas is often complex, and political opponents, reluctant targets and competitors may seize on any perceived weaknesses in an acquiror's ability to clear regulatory obstacles. Most obstacles to a cross-border deal are best addressed in partnership with local players (including, in particular, the target company's management where appropriate) whose interests are aligned with those of the acquiror, as local support reduces the appearance of a foreign threat.

It is in most cases critical that the likely concerns of federal, state and local government agencies, employees, customers, suppliers, communities and other interested parties be thoroughly considered and, if possible, addressed prior to any acquisition or investment proposal becoming public. Flexibility in transaction structures, especially in strategic or politically sensitive situations, may be helpful in particular circumstances, such as no-governance or low-governance investments, minority positions or joint ventures, possibly with the right to increase to greater ownership or governance over time; when entering a non-domestic market, making an acquisition in partnership with a local company or management or in collaboration with a local source of financing or co-investor (such as a private equity firm); or utilizing a controlled or partly controlled local acquisition vehicle, possibly with a board of directors having a substantial number of local citizens and a prominent local figure as a non-executive chairman. Use of preferred securities (rather than ordinary common stock) or structured debt securities should also be considered. While an acquisition of outright control of a target by a foreign entity in a sensitive industry may attract significant political attention and regulatory scrutiny, minority and non-controlling investments may be permitted (for example, CNOOC abandoned its attempt to acquire Unocal amid significant political controversy, but CNOOC's $2.2 billion investment in oil and gas assets owned by Chesapeake Energy in 2010 was permitted by regulators).

In addition, local regulators and constituencies may seek to intervene in global transactions. Ostensibly modest social issues, such as the name of the continuing enterprise and its corporate seat, or the choice of the nominal acquiror in a merger, may affect the perspective of government and labor officials. Depending on the industry involved and the geographical distribution of the workforce, labor unions and "works councils" may be active and play a significant role in the current political environment, and as a result, demand concessions. In several recent transactions, the perspective of local constituencies influenced the transaction structure. For example, in its 2014 acquisition of Tim Hortons, Burger King agreed to list the new company on the Toronto Stock Exchange, reflecting the status of Tim Hortons as an iconic Canadian brand and local regulators' desire to maintain a Canadian listing. Similarly, in its attempted hostile acquisition of Perrigo, Mylan committed to list itself on the Tel Aviv Stock Exchange, regardless of the outcome of its offer, in part to portray a commitment to a long-term presence in Israel and appease Israeli securities regulators and Perrigo's Israeli shareholders. AB InBev also listed on the Johannesburg Stock Exchange in connection with its pending acquisition of SABMiller.

In the U.S., CFIUS is one of the key authorities to consider when seeking to clear U.S. acquisitions by non-U.S. acquirors. CFIUS is a multi-agency committee that reviews transactions for potential national security implications where non-U.S. acquirors could obtain "control" of a U.S. business or assets or transactions involving investments by non-U.S. governments or investments in U.S. critical infrastructure, technology or energy assets. In recent years, some high profile deals have failed due to CFIUS hurdles—including the January 2016 abandonment of GO Scale Capital's acquisition of an 80.1% interest in Philip's Lumileds Holding BV, and CFIUS's 2013 order that India-based Polaris Financial Technology divest its 85% ownership stake in U.S. company IdenTrust Inc., a provider of digital identification authentication services to banks and U.S. government agencies. However, many other transactions that have faced significant CFIUS review—such as the 2013 acquisition by

Wanxiang Group, China's biggest auto-parts maker, of most of the assets of U.S. battery-manufacturer A123 Systems Inc., and the 2013 acquisition by BGI-Shenzen, a Chinese operator of genome sequencing centers, of Complete Genomics, Inc., a publicly traded U.S. life sciences company—have been able to achieve approval. It is often prudent to make a voluntary filing with CFIUS if control of a U.S. business is to be acquired by a non-U.S. acquiror and the likelihood of an investigation is reasonably high or if competing bidders are likely to take advantage of the uncertainty of a potential investigation. National security implications are not limited to defense sectors; critical infrastructure and industrial base assets and technology transfers can provide a basis for CFIUS interest. Any filing typically should be preceded by discussions with U.S. Treasury officials and other relevant agencies. In some cases, it may even be prudent to make the initial contact prior to the public announcement of the transaction. Given the higher volume of filings that have occurred in the last few years, such discussions can be instrumental in minimizing the review period. Nonetheless, in today's environment, in any transaction that may be of interest to CFIUS, the pre-filing consultation and review period is taking 75 days on average.

As a CFIUS review is only applicable when the foreign person is acquiring "control" over a "U.S." business (which can include the assets, intellectual property, or operations located in the U.S. of a non-U.S. business), such review may be avoided by structuring a transaction so that the investor is not acquiring "control." CFIUS regulations issued by the U.S. Department of the Treasury provide an exemption for non-U.S. investments of 10% or less in the voting securities of a U.S. business if made "solely for the purpose of passive investment," although this exclusion does not apply if the non-U.S. person intends to exercise control over the U.S. business or takes other actions inconsistent with passive intent. If the foreign acquiror's intent later changes, CFIUS may review the investment retroactively. Control status is fact-specific and subject to a number of guidelines, including with respect to implications of possession of a board seat or the exercise of pro rata voting rights, and whether the investor wields a degree of influence sufficient to determine, direct or decide "important" matters. Certain minority shareholder protections and negative rights may be held by non-U.S. investors without rendering such investors in control of an entity.

For acquisitions of control by U.S. or other acquirors of non-U.S. domiciled companies, similar provisions exist under the laws of other jurisdictions, including most notably in Canada, Australia and China as well as some European nations. Some countries that have traditionally been hospitable to off-shore investors have focused more attention recently on acquisitions by state-owned or state-connected enterprises.

For example, Canada's government initially blocked the $5.2 billion bid by Malaysia's Petronas for Progress Energy Resources on the grounds that it would not create a net benefit for Canada before approving a revised bid, and CNOOC's $15.1 billion acquisition of Canadian oil company Nexen was also subject to significant review by Canadian regulators. On the same day that the Canadian government approved the acquisitions of Progress Energy and Nexen, it announced changes to Canadian policy in reviewing investments in Canada by state-owned enterprises, which changes would increase the scrutiny applied to acquisitions by foreign-owned or influenced enterprises of control over Canadian enterprises, particularly in the oil-sands business, where such acquisitions would be approved only in exceptional circumstances. In 2013, the Australian Treasurer blocked the $3.1 billion takeover bid of GrainCorp by the American-listed Archer Daniels Midland, after the Australian Foreign Investment Review Board could not reach a consensus on whether to allow the deal to proceed.

Besides the CFIUS filing, foreign investors have to keep in mind that the U.S. Department of Commerce, Bureau of Economic Analysis (BEA), has reinstated in March 2015 the mandatory filing of "BE-13" survey forms as to foreign direct investment in the U.S., including in respect of the acquisition of all or an interest in U.S. public or private companies, and of U.S. real estate, among other things. In particular, a report is required by the U.S. entity if (i) a foreign direct investment in the United States relationship is created or (ii) an existing U.S. affiliate of a foreign parent establishes a new U.S. legal entity, expands its U.S. operations, or acquires a U.S. business enterprise. Foreign direct investment is defined as the ownership or control, directly or indirectly, by one foreign person of 10% or more of the voting securities of an incorporated U.S. business enterprise, or an equivalent interest of an unincorporated U.S. business enterprise, including a branch. The form is to be submitted within 45 days of closing. The failure to report can be subject to a civil penalty of between $2,500 and $32,500. Willful failure to report can result in additional fines and potentially criminal penalties.

2. Integration Planning and Due Diligence

Integration planning and due diligence also warrant special attention in the cross-border context. Wholesale application of the acquiror's domestic due diligence standards to the target's jurisdiction can cause delay, wasted time and resources, or result in missing issues. Making due diligence requests that appear to the target as particularly unusual or unreasonable (a not uncommon occurrence in cross-border deals, where custom on the type and scope of diligence may vary) can easily cause a bidder to lose credibility. At the same time, missing a significant local issue for lack of local knowledge can be highly problematic and costly. The $10.3 billion acquisition of Autonomy by Hewlett-Packard and subsequent $8.8 billion write-down, and the $653 million acquisition of Zhengzhou Siwei Mechanical and Electrical Engineering by Caterpillar and subsequent $580 million write-down, each underscore the importance of effective due diligence in the cross-border acquisition context.

Due diligence methods must take account of the target jurisdiction's legal regime and local norms, including what steps a publicly traded company can take with respect to disclosing material non-public confirmation to potential bidders and implications for disclosure obligations. Many due diligence requests are best funneled through legal or financial intermediaries as opposed to being made directly to the target company. Due diligence with respect to risks related to the Foreign Corrupt Practices Act ("FCPA")—and understanding the U.S. Department of Justice's guidance for minimizing the risk of inheriting FCPA liability—is critical for U.S. buyers acquiring a company with non-U.S. business activities; even acquisitions of foreign companies that do business in the U.S. may be scrutinized with respect to FCPA compliance. Diligence relating to compliance with the sanction regulations overseen by the Treasury Department's Office of Foreign Asset Control can also be important for U.S. entities acquiring non-U.S. businesses.

Careful attention must also be paid to foreign operations of domestic companies, including joint ventures with foreign parties. The importance of this issue was dramatically illustrated in the failed attempt by Apollo Tyre, an Indian company, to acquire Cooper Tire and Rubber, which is a U.S.-based company with a significant joint venture in China. During the pendency of the deal, the Chinese minority partner locked Cooper out of the Chinese factory and made demands about a higher price and the potential clash between Indian and Chinese culture at the plant, contributing in part to the termination of the merger agreement with Apollo.

Cross-border deals sometimes fail due to poor post-acquisition integration where multiple cultures, languages, historic business methods and distance may create friction. If possible, the executives and consultants who will be responsible for integration should be involved in the early stages of the deal so that they can help formulate and "own" the plans that they will be expected to execute. Too often, a separation between the deal team and the integration/execution teams invites slippage in execution of a plan that in hindsight is labeled by the new team as unrealistic or overly ambitious. However, integration planning needs to be carefully phased-in, as implementation cannot occur prior to the time most regulatory approvals are obtained and merging parties must exercise care not to engage in conduct that antitrust agencies perceive as a premature transfer of beneficial ownership or conspiracy in restraint of trade. Investigations into potential "gun-jumping" present costly and delaying distractions during substantive merger review.

3. Competition Review and Action

Cross-border M&A activity is subject to careful review by competition authorities, and parties should prepare for multi-jurisdictional review and notifications. Nearly 100 jurisdictions have pre-merger notification regimes, and the list continues to grow; multinational transactions (including minority investments) may require over a dozen notifications. For example, the Dell/EMC transaction required approval from approximately 20 jurisdictions, while the Siemens/Dresser-Rand transaction required filings in almost a dozen countries. In recent years, the FTC, DOJ and the European Commission have not been hesitant to challenge and block cross-border mergers and other cross-border transactions, even, in rare cases, post-consummation. Notably, United Parcel Service's $6.9 billion bid for TNT Express was withdrawn in 2013 due to concerns of European antitrust regulators, and in early 2012 the European Commission blocked the proposed merger of NYSE Euronext and Deutsche Börse.

Competition authorities (particularly those in the U.S., Europe and Canada) often, though not always, coordinate their investigations of significant transactions. To the extent that a non-U.S. acquiror directly or indirectly competes or holds an interest in a company that competes in the same industry as the target company, antitrust concerns may arise either at the federal agency- or state attorneys general-level in the U.S., as well as in the home country. Although less typical, concerns can also arise if the foreign acquirer of a U.S. target participates in a market either upstream or downstream of the target. Competition analyses will need to consider variations in market conditions and competition law across relevant jurisdictions. How conglomerate relationships are treated (and views as to required relief) is one area of meaningful variation among competition authorities.

China also now has a robust pre-merger notification system and has been active in its review and enforcement activities. In June 2014, the Anti-Monopoly Bureau of the Ministry of Commerce in China ("MOFCOM") issued a decision prohibiting the formation of the P3 Network, a long-term container shipping alliance among A.P. Møller-Maersk, Mediterranean Shipping Company and CMA CGM, which are Danish, Swiss and French companies, respectively. In the seven years since the adoption of a pre-merger notification law in China, MOFCOM had previously imposed restrictive conditions in 27 cases and rejected only one transaction (Coca-Cola's proposed acquisition of China Huiyuan Juice Group, a leading Chinese juice maker back in 2009). Transactions upon which MOFCOM imposed restrictions included Google's $12.5 billion acquisition of Motorola Mobility (conditioned on Google's commitment to keep the Android operating system free for five years), and United Technologies' acquisition of Goodrich (conditioned on a divestiture). China's antitrust laws require that MOFCOM review any acquisition where aggregate global sales of all parties exceed $1.5 billion and sales in China for each of at least two parties exceed $62 million. This low threshold for Chinese sales puts many U.S. or European deals squarely within MOFCOM's jurisdiction. China's laws also give MOFCOM broad latitude in selecting remedies and the timing of review. The review clock in China only starts ticking after MOFCOM accepts the filing, which can take weeks or months at MOFCOM's discretion. The review process itself can take a long time (longer than most jurisdictions). For example, FedEx's ongoing acquisition of TNT Express, which was announced in April of 2015, received clearance from U.S., EU and Brazilian regulatory authorities by early February in 2016, yet, as of mid-March 2016, the deal is still under ongoing review in China.

Additionally, India's merger control regime, which came into force in 2011 with the creation of the Competition Commission of India ("CCI"), and is now in full swing. Since then, the CCI has received 250 notices of a combination of enterprises and approved 234 of them without modification, two involved modifications and the remainder were still being reviewed as of the reporting year-end (May 2015). According to the CCI's last annual report, it has not prohibited any transaction. An extensive amount of information about the parties and the transaction is required to be included in the notification, and India is one of very few jurisdictions that require notification to be filed within 30 days of either the boards of directors' approval of the combination or the execution of any binding documents related to the combination. The CCI has 30 to 210 days from the date of filing to issue a decision but the clock stops whenever the CCI issues a request for supplemental information. Parties should expect at least one or two supplemental requests for information to stop the clock. Consequently, the review period will generally be at least two to three months and depending upon the complexity of the matter can be longer.

4. Deal Techniques and Cross-Border Practice

Understanding the custom and practice of M&A in the jurisdiction of the target is essential. Successful execution is more art than science, and will benefit from early involvement by experienced local advisors.

For example, understanding when to respect—and when to challenge—a target's sale "process" may be critical. Knowing how and at what price level to enter the discussions will often determine the success or failure of a proposal. In some situations it is prudent to start with an offer on the low side, while in other situations offering a full price at the outset may be essential to achieving a negotiated deal and discouraging competitors, including those who might raise political or regulatory issues. In strategically or politically sensitive transactions, hostile maneuvers may be imprudent; in other cases, unsolicited pressure may be the only way to force a transaction. Similarly, understanding in advance the roles of arbitrageurs, hedge funds, institutional investors, private equity funds, proxy voting advisors and other important market players in the target's market—and their likely views of the anticipated acquisition attempt as well as when they appear and disappear from the scene—can be pivotal to the outcome of the contemplated transaction.

Where the target is a U.S. public company, the customs and formalities surrounding board of director participation in the M&A process, including the participation of legal and financial advisors, the provision of customary fairness opinions, and the inquiry and analysis surrounding the activities of the board and the financial advisors, can be unfamiliar and potentially confusing to non-U.S. transaction participants and can lead to misunderstandings that threaten to upset delicate transaction negotiations. Non-U.S. participants need to be well-advised as to the role of U.S. public company boards and the legal, regulatory and litigation framework and risks that can constrain or prescribe board action. In particular, the litigation framework—which, as discussed in Part I.B.5, has recently been shifting—should be kept in mind as shareholder litigation often accompanies M&A transactions involving U.S. public companies. The acquiror, its directors, shareholders and offshore reporters and regulators should be conditioned in advance (to the extent possible) to expect litigation and not to necessarily view it as a sign of trouble. The litigation risk and the other factors mentioned above can impact both tactics and timing of M&A processes and the nature of communications with the target company. Additionally, local takeover regulations often differ from those in the acquiror's home jurisdiction. For example, the mandatory offer concept common in Europe, India and other countries—in which an acquisition of a certain percentage of securities requires the bidder to make an offer for either the balance of the outstanding shares or for an additional percentage—is very different from U.S. practice. Permissible deal protection structures, pricing requirements and defensive measures available to targets also differ. Sensitivity also must be given to the contours of the target board's fiduciary duties and decision-making obligations in home jurisdictions, particularly with respect to consideration of stakeholder interests other than those of shareholders and nonfinancial criteria.

This multifaceted overlay of foreign takeover laws and the legal and tactical considerations they present can be particularly complex when a bid for a non-U.S. company may be unwelcome. Careful planning and coordination with foreign counsel are critical in hostile and unsolicited transactions, on both the bidder and target sides. For example, Italy's "passivity" rule that limits defensive measures a target can take without shareholder approval is suspended unless the hostile bidder is itself subject to equivalent rules. A French company's organizational documents can provide for a similar rule, and as of April, 2016, France's Florange Law will make it the default that a French company's long-term shareholders are granted double voting rights, which would reduce the influence of toehold acquisitions or merger arbitrageurs. Dutch law and practice allow for the target's use of an independent "foundation" or *stichting* to at least temporarily defend against hostile offers. The foundation, which is controlled by independent directors appointed by the target and has a broad defensive mandate, is issued high-vote preferred shares at a nominal cost, which allow it to control the voting outcome of any matter put to target shareholders. The recent three-way battle among Mylan, Perrigo and Teva illustrates how the applicable takeover regime can have significant impact. Perrigo (which had inverted from Michigan to Ireland) was subject to the "frustrating action" rule and other Irish Takeover Rules, which made it more difficult to defend against Mylan's hostile bid—though Perrigo ultimately succeeded in convincing shareholders not to accept the bid. By contrast, Mylan (which had inverted from Pennsylvania to the Netherlands) used a potent combination of takeover defenses facilitated by Dutch law and its own governance documents, including the use of a foundation, to take a resist-at-all-costs approach to Teva's bid.

In many ways, the acquisition financing markets in 2015 experienced a continuation of trends that began in 2014, with increasing volatility constraining the availability and increasing the cost of committed acquisition financing for leveraged issuers and for transactions with long closing periods. Given this environment, in the context of cross-border transactions, potential acquirors should consider whether this volatility has created inefficiencies and opportunities in different geographic credit markets such that financing is cheaper or otherwise available on more favorable terms in one local market as opposed to another; how committed acquisition financing is required to be under local regulation (*e.g.*, the "funds certain" requirement in certain European jurisdictions) and whether a transaction with a financing contingency or other non-certain funds structure might be feasible; whether to explore alternative, non-traditional financing sources and structures, including seller paper; whether there are transaction structures that can minimize refinancing requirements; and how comfortable the target will feel with the terms and conditions of the financing. Under U.S. law, unlike the laws of some other jurisdictions, non-U.S. acquirors are not prohibited from borrowing from U.S. lenders, and they generally may use the assets of U.S. targets as collateral (although there are some important limitations on using stock of U.S. targets as collateral).

As the U.S. continues to be a popular destination for restructuring of multinational corporations, including those with few assets or operations in the country, firms evaluating a potential acquisition of a distressed U.S. target should consider the full array of tools that may be available. This might include acquisition of the target's fulcrum debt securities that are expected to become the equity through an out-of-court restructuring or plan of reorganization, acting as a plan investor or sponsor in connection with a plan, backstopping a plan-related rights offering, or participating as a bidder in a court-supervised "Section 363" auction process, among others. Transaction certainty is of critical importance to success in a "Section 363" sale process or confirmation of a Chapter 11 plan, and non-U.S. participants accordingly need to plan carefully for transaction structures that will result in a relatively level playing field with U.S. participants. Acquirors also need to consider the differing interests and sometimes conflicting agendas of the various constituencies, including bank lenders, bondholders, distressed-focused hedge funds and holders of structured debt securities and credit default protection.

Disclosure obligations may also vary across jurisdictions. How and when an acquiror's interest in the target is publicly disclosed should be carefully controlled to the extent possible, keeping in mind the various ownership thresholds or other triggers for mandatory disclosure under the law of the jurisdiction of the company being acquired. Treatment of derivative securities and other pecuniary interests in a target other than equity holdings also vary by jurisdiction and have received heightened regulatory focus in recent periods.

5. U.S. Cross-Border Securities Regulation

U.S. securities regulations apply to acquisitions and other business combination activities involving non-U.S. companies with U.S. security holders unless bidders can avoid a jurisdictional nexus with the U.S. and exclude U.S. security holders. Where a transaction cannot escape U.S. securities regulations in this manner, exemptive relief may be available. Under the current two-tiered exemptive regime, relief from certain U.S. regulatory obligations is available for tender offers that qualify for one of two exemptions—the "Tier I" exemption where U.S. security holders comprise less than 10% of a security subject to a tender offer, and the "Tier II" exemption, where the U.S. shareholder base does not exceed 40%. Tier I transactions are exempt from almost all of the disclosure, filing and procedural requirements of the U.S. federal tender offer rules, and securities issued in Tier I exchange offers, business combination transactions and rights offerings need not be registered under the Securities Act. Tier II provides narrow relief from specified U.S. tender offer rules that often conflict with non-U.S. law and market practice (such as with respect to prompt payment, withdrawal rights, subsequent offering periods, extension of offers, notice of extension and certain equal treatment requirements) but does not exempt the transaction from most of the procedural, disclosure, filing and registration obligations applicable to U.S. transactions or from the registration obligations of the Securities Act. Non-U.S. transactions where U.S. ownership in the target company exceeds 40% are subject to U.S. regulation as if the transaction were entirely domestic.

Several of the revisions to the U.S. cross-border securities regulatory regime enacted in 2008 have provided U.S. and non-U.S. bidders with somewhat enhanced flexibility and certainty in structuring deals for non-U.S. targets, even if the amendments did not fundamentally alter the nature or scope of the existing regulations, nor, in some respects, go far enough in enacting reforms.[416] The 2008 revisions also codified relief in several areas of frequent conflict and inconsistency between U.S. and non-U.S. regulations and market practice.

Significantly, neither Tier I nor Tier II exemptive relief limits the potential exposure of non-U.S. issuers—in nearly all cases already subject to regulation in their home jurisdiction—to liability under the antifraud, anti-manipulation and civil liability provisions of the U.S. federal securities laws in connection with transactions with U.S. entanglements. Both this risk and a desire to avoid the demands of U.S. regulation have persuaded many international issuers and bidders to avoid U.S. markets and exclude U.S. investors from significant corporate transactions. Notably, the exclusionary techniques that have developed for avoiding applicability of U.S. securities regulation are often simply not available to non-U.S. purchasers who buy shares through, for example, open market purchases. It may be impossible when transacting on non-U.S. exchanges to exclude U.S. sellers, and hence this inability to exclude U.S. sellers may render problematic any attempts to structure around U.S. laws. As was seen in the Endesa/E.ON/Acciona matter, such uncertainty—and the potential for ensuing litigation—can be exploited to gain tactical advantage in a takeover battle.

Also notable is the U.S. Supreme Court's landmark decision in *Morrison* v. *National Australia Bank Ltd.*, in which the Court sharply limited the extraterritorial reach of U.S. securities laws, particularly Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5.[417] The decision overturned 40 years of lower-court precedent. The decision and its progeny have eradicated billions of dollars in potential liability for foreign securities issuers and curtailed, if not eliminated, a burgeoning species of securities litigation that had been known as "foreign-squared" and "foreign-cubed" class actions.

C. Deal Consideration and Transaction Structures

While cash remains the predominant (although not exclusive) form of consideration in cross-border deals, non-cash structures are not uncommon, offering target shareholders the opportunity to participate in the resulting global enterprise. Where target shareholders will obtain a continuing interest in the acquiring corporation, expect heightened focus on the corporate governance and other ownership and structural arrangements of the acquiror in addition to business prospects. Pricing structures must be sensitive to exchange rate and currency risk as well as volatility in international markets. Alternatives to all-cash structures include non-cash currencies such as depositary receipts, "global shares" and straight common equity, as well as preferred securities and structured debt.

Transaction structure may affect the ability to achieve synergies, influence actual or perceived deal certainty and influence market perception. Structures should facilitate, rather than hinder, efforts to combine the operations of the two companies so as to achieve greater synergy, promote unified management and realize economies of scale. The importance of simplicity in a deal structure should not be underestimated—simple deal structures are more easily understood by market players and can facilitate the ultimate success of a transaction.

One of the core challenges of cross-border deals using acquiror stock is the potential "flowback" of liquidity in the acquiror's stock to the acquiror's home market. This exodus of shares, prompted by factors ranging from shareholder taxation (*e.g.*, withholding taxes or loss of imputation credits), index inclusion of the issuer or target equity, available liquidity in the newly issued shares and shareholder discomfort with non-local securities, to legal or contractual requirements that certain institutional investors not hold shares issued by a non-local entity or listed on a non-local exchange, can put pressure on the acquiror's stock price. It may also threaten exemptions from registration requirements that apply to offerings outside the home country of the acquiror.

U.S. and foreign tax issues will, of course, also influence deal structure. In structuring a cross-border deal, the parties will attempt to maximize tax efficiency from a transactional and ongoing perspective, both at the entity and at the shareholder level. Transactions involving a U.S. target corporation generally will be tax-free to its U.S. shareholders only if, in addition to satisfying the generally applicable rules regarding reorganizations or Section 351 exchanges, they satisfy additional requirements under Section 367(a) of the Internal Revenue Code and related Treasury Regulations (which require, among other things, that the value of the foreign merger party be at least equal to the value of the domestic merger party). In addition, cross-border transactions in which shareholders of the U.S. merger party receive equity in the combined foreign group need to be analyzed under Section 7874 of the Internal Revenue Code, which relates to "inversions."

1. All-Cash

All-cash transactions are easy for all constituencies to understand and do not present flowback concerns. The cash used in the transaction frequently must be financed through equity or debt issuances that will require careful coordination with the M&A transaction. Where cash constitutes all or part of the acquisition currency, appropriate currency hedging should be considered, given the time necessary to complete a cross-border transaction. In addition, parties should be cognizant of financial assistance rules in certain non-U.S. jurisdictions that may limit the ability to use debt financing for an acquisition.

2. Equity Consideration

U.S. securities and corporate governance rules can be problematic for non-U.S. acquirors who will be issuing securities that will become publicly traded in the U.S. as a result of an acquisition. SEC rules, the Sarbanes-Oxley and Dodd-Frank Acts and stock exchange requirements should be evaluated to ensure compatibility with home country rules and to be certain that the non-U.S. acquiror will be able to comply. Rules relating to director independence, internal control reports, and loans to officers and directors, among others, can frequently raise issues for non-U.S. companies listing in the U.S. Similar considerations must be addressed for U.S. acquirors seeking to acquire non-U.S. targets. Structures involving the issuance of non-voting stock or other special securities of a non-U.S. acquiror may serve to mitigate some of the issues raised by U.S. corporate governance concerns. Governance practices can be particularly relevant when equity consideration is used in a hostile acquisition. For example, in Mylan's hostile cash and stock offer for Perrigo, Mylan's shareholder-unfriendly governance regime, which was permissible in the Netherlands, was a sticking point for many Perrigo investors, and was a significant driver in Mylan's inability to generate sufficient support for its offer among Perrigo shareholders.

3. Stock and Depositary Receipts

All-stock transactions provide a straightforward structure for a cross-border transaction but may be susceptible to flowback. A depositary receipt approach carries many of the same advantages as an all-stock transaction but may mitigate flowback, as local institutional investors may be willing to hold the depositary receipts instead of the underlying non-local shares, easing the rate at which shares are sold back into the acquiror's home country market. However, in the typical depositary receipt program, the depositary receipt holders are free to surrender their receipts to the depositary in exchange for the underlying shares. Once the underlying shares are received, the non-U.S. shareholder is free to trade them back into the acquiror's home market.

4. "Dual Pillar" Structures

A more complex structure for a cross-border combination is known as the dual listed company ("DLC") structure. In a DLC structure, each of the publicly traded parent corporations retains its separate corporate existence and stock exchange listing. Management integration typically is achieved through overlapping boards of directors. Broadly speaking, DLC structures can be divided into two categories: "downstream" DLCs and "synthetic" DLCs. In a downstream DLC, the merged businesses are combined under one or more holding companies that are jointly owned by the two publicly traded parent companies. In a synthetic DLC, the merged businesses typically are not jointly owned, and economic integration is achieved solely through contractual "equalization" arrangements.

Examples of downstream DLC structures include ABB Asea Brown Boveri and Reed-Elsevier. Royal Dutch/Shell, which had utilized such a structure for several decades, restructured into a single holding company a number of years ago. Examples of synthetic DLCs include RTZ-CRA and BHP-Billiton.

Because DLC structures raise novel and complex tax, accounting, governance and other issues as applied to the U.S., to date, these structures have not been successfully employed in cross-border combinations involving a U.S. parent corporation.

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[1] *2015 Annual PE Exits & Company Inventory Report*, PITCHBOOK 4 (Feb. 17, 2016), http://pitchbook.com/news/reports/2015-annual-pe-exits-company-inventory-report.

[2] *Id.* at 7.

[3] *Id.* at 9. Percentage change was calculated from data provided.

[4] *Annual Fundraising Report 2015*, PRIVATE EQUITY INTERNATIONAL (January 2016)

[5] *2015 Annual PE & VC Fundraising & Capital Overhang Report*, PITCHBOOK 4 (Feb. 23, 2016), http://pitchbook.com/news/reports/2015-annual-global-pe-vc-league-tables-report

[6] *Id*. at 9.

[7] *See, e.g.*, Dawn Lim, *Calpers Asks for Disclosure on Fees Charged to Portfolio Companies*, WALL ST. J. (August 18, 2015), http://blogs.wsj.com/privateequity/2015/08/18/calpers-asks-for-disclosure-on-fees-charged-to-portfolio-companies.

[8] *See* Matthew D. Cain & Steven Davidoff Solomon, *A Great Game: The Dynamics of State Competition and Litigation*, 100 IOWA L. REV. 465, 476 (2015); Matthew D. Cain & Steven Davidoff Solomon, *Takeover Litigation in 2014* (2015), *avail able at* http://ssrn.com/abstract=2567902 .

[9] *See* Cain & Davidoff, *Takeover Litigation in 2014*, *supra* note 8, at 2.

[10] *Id.* at 477-78.

[11] *E.g.*, *In re Trulia, Inc. S'holder Litig.*, 129 A.3d 884 (Del. Ch. 2016); *City Trading Fund* v. *Nye*, 46 Misc. 3d 1206(A) (N.Y. Sup. Ct. 2015).

[12] *Boilermakers Local 154 Ret. Fund* v. *Chevron Corp.*, 73 A.3d 934 (Del. Ch. 2013).

[13] DEL. CODE ANN. tit. 8, § 115.

[14] *See* Cain & Davidoff, *Takeover Litigation in 2014*, *supra* note 8, at 3; Alison Frankel, *Forum Selection Clauses Are Killing Multiforum M&A litigation*, REUTERS, Jun.

24, 2014, *available at* http://blogs.reuters.com/alison-frankel/2014/06/24/forum-selection-clauses-are-killing-multiforum-ma-litigation/.

[15] DEL. CODE ANN. tit. 8, § 102(f).

[16] *E.g.*, *Merion Capital LP* v. *BMC Software, Inc.*, C.A. No. 8900-VCG, 2015 WL 6164771 (Del. Ch. Oct. 21, 2015); *Huff Fund Inv. P'ship* v. *CKx*, No. 6844-VCG,2013 WL 5878807 (Del. Ch. Nov. 1, 2013), *aff'd*, 2015 WL 631586 (Del. Feb. 12, 2015).

[17] *E.g.*, *LongPath Capital, LLC* v. *Ramtron Int'l Corp.*, 2015 WL 4540443 (Del. Ch. June 30, 2015).

[18] *In re Ancestry.com, Inc.*, 2015 WL 66825 (Del. Ch. Jan. 5, 2015); *Merion Capital LP*, C.A. No. 8900-VCG, 2015 WL 6164771. .

[19] Transactions abandoned in 2015 due to antitrust opposition include General Electric's bid for Electrolux which was abandoned after five months of litigationin July of 2015; Comcast's proposed acquisition of Time Warner Cable that was abandoned in April 2015 over 15 months after proposal of the acquisition; the proposed merger between Applied Materials and Tokyo Electron, also abandoned in April 2015; and the proposed merger between Chicken of the Sea and Bumble Bee Foods.

[20] *Smith* v. *Van Gorkom (Trans Union)*, 488 A.2d 858, 874 (Del. 1985) (holding that in the context of a proposed merger, directors must inform themselves of all "information . . . reasonably available to [them] and relevant to their decision" to recommend the merger); *see also Aronson* v. *Lewis*, 473 A.2d 805, 812 (Del. 1984) ("[U]nder the business judgment rule director liability is predicated upon concepts of gross negligence.").

[21] DEL. CODE ANN. tit. 8, § 141(e) (West 2015).

[22] *See supra* note 18; *see also* Accounting and Auditing Enforcement SEC Release No. 34-1763, Litigation Release No. 18104 (Apr. 24, 2003) (describing enforcement action against, *inter alia*, a member of the company's audit committee for violation of antifraud provisions of the securities laws by "ignoring clear warning signs that financial improprieties were ongoing at the company," among other reasons). In a 2004 decision that departs from prior law and the scope of which remains uncertain, the Delaware Court of Chancery suggested that a director's specialized knowledge may be one factor taken into account in determining whether he satisfied the duty of care. *In re Emerging Commc'ns, Inc. S'holders Litig.*, C.A. No. 16415, 2004 WL 1305745 (Del. Ch. June 4, 2004). *But see In re Citigroup Inc. S'holder Derivative Litig.*, 964 A.2d 106, 128 n.63 (Del. Ch. 2009) (explaining that "[d]irectors with special expertise are not held to a

higher standard of care in the oversight context simply because of their status as an expert.").

[23] *See Paramount Commc'ns, Inc.* v. *Time Inc. (Time-Warner)*, 571 A.2d 1140, 1153-54 (Del. 1990).

[24] *RBC Capital Mkts., LLC* v. *Jervis*, 129 A.3d 816, 865 n.191 (Del. 2015).

[25] Under Del. Code Ann. tit. 8, section 102(b)(7), a Delaware corporation may in its certificate of incorporation either limit or eliminate entirely the personal liability of a director to the corporation or its shareholders for monetary damages for breach of fiduciary duty, but such provisions may not eliminate or limit the liability of a director for, among other things, (1) breach of the director's duty of loyalty to the corporation and its shareholders or (2) acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law. Many Delaware corporations have either eliminated or limited director liability to the extent permitted by law. The Delaware Supreme Court has ruled that the typical Delaware corporation charter provision exculpating directors from monetary damages in certain cases applies to claims relating to disclosure issues in general and protects directors from monetary liability for good faith omissions. *See Arnold* v. *Soc'y for Sav. Bancorp, Inc.*, 650 A.2d 1270 (Del. 1994). Similar provisions have been adopted in most states. The limitation on personal liability does not affect the availability of injunctive relief.

[26] An ancillary of the duty of loyalty is the corporate opportunity doctrine. Generally, a director may not appropriate an opportunity belonging to the corporation for himself. *See Guth* v. *Loft, Inc.*, 5 A.2d 503, 510 (Del. 1939); *see also Broz* v. *Cellular Info. Sys., Inc.*, 673 A.2d 148, 155-57 (Del. 1996) (stating that a director "may not take a business opportunity for his own if: (1) the corporation is financially able to exploit the opportunity; (2) the opportunity is within the corporation's line of business; (3) the corporation has an interest or expectancy in the opportunity; and (4) by taking the opportunity for his own, the [director] will thereby be placed in a position inimicable to his duties to the corporation" but that a director "may take a corporate opportunity if: (1) the opportunity is presented to the director…in his individual and not his corporate capacity; (2) the opportunity is not essential to the corporation; (3) the corporation holds no interest or expectancy in the opportunity; and (4) the director or officer has not wrongfully employed the resources of the corporation in pursuing or exploiting the opportunity").

[27] *See, e.g.*, *Ivanhoe Partners* v. *Newmont Mining Corp.*, 535 A.2d 1334, 1341 (Del. 1987); *In re PNB Holding Co. S'holders Litig.*, C.A. No. 28-N, 2006 WL 2403999 (Del. Ch. Aug. 18, 2006) (reviewing under the entire fairness standard a transaction in which most public shareholders were cashed out but some shareholders, including the directors, continued as shareholders of the recapitalized company); *Blasius Indus., Inc.* v. *Atlas*

Corp., 564 A.2d 651 (Del. Ch. 1988) (holding that actions by the board after a consent solicitation had begun which were designed to thwart the dissident shareholder's goal of obtaining majority representation on the board, violated the board's fiduciary duty); *AC Acquisitions Corp.* v. *Anderson, Clayton & Co.*, 519 A.2d 103, 111 (Del. Ch. 1986) ("[W]here a self-interested corporate fiduciary has set the terms of a transaction and caused its effectuation, it will be required to establish the entire fairness of the transaction to a reviewing court's satisfaction.").

[28] *Stone ex rel. AmSouth Bancorporation* v. *Ritter*, 911 A.2d 362, 370 (Del. 2006).

[29] *Id.*

[30] *In re Walt Disney Co. Derivative Litig*., 906 A.2d 27, 67 (Del. 2006).

[31] *In re Cornerstone Therapeutics Inc. S'holder Litig.*, 115 A.3d 1173 (Del. 2015).

[32] *Lyondell Chem. Co.* v. *Ryan*, 970 A.2d 235, 235 (Del. 2009).

[33] *See Chen* v. *Howard-Anderson*, 87 A.3d 648, 680-85 (Del. Ch. 2014) (interpreting *Lyondell* to address only one theory of bad faith and noting that *Lyondell* did not foreclose possibility of bad-faith claims premised on improper motives of fiduciaries).

[34] *Lyondell*, 970 A.2d at 243.

[35] *Id.* at 244; *see also In re Answers Corp. S'holders Litig.*, C.A. No. 6170-VCN, 2014 WL 448427 (Del. Ch. Feb. 3, 2014); *Wayne Cnty. Emps.' Ret. Sys.* v. *Corti*, C.A. No. 3534-CC, 2009 WL 2219260, at *14 (Del. Ch. July 24, 2009); *In re NYMEX S'holder Litig.*, C.A. Nos. 3621-VCN, 3835-VCN, 2009 WL 3206051, at *7 (Del. Ch. Sept. 30, 2009); *In re Lear Corp. S'holder Litig.*, 967 A.2d 640, 654–55 (Del. Ch. 2008) ("Courts should…be extremely chary about labeling what they perceive as deficiencies in the deliberations of an independent board majority over a discrete transaction as not merely negligence or even gross negligence, but as involving bad faith. In the transactional context, a very extreme set of facts would seem to be required to sustain a disloyalty claim premised on the notion that disinterested directors were intentionally disregarding their duties.").

[36] J. Travis Laster, Revlon *Is a Standard of Review: Why It's True and What It Means*, 19 FORDHAM J. CORP. & FIN. L. 5, 26-27 (2013) (discussing the distinction between standards of conduct and standards of review).

[37] *Panter* v. *Marshall Field & Co.*, 646 F.2d 271, 293-95 (7th Cir. 1981); *Treadway Cos.* v. *Care Corp*., 638 F.2d 357, 382-83 (2d Cir. 1980); *Johnson* v. *Trueblood*, 629

F.2d 287, 292-93 (3d Cir. 1980); *Ivanhoe Partners* v. *Newmont Mining Corp.*, 535 A.2d 1334, 1341 (Del. 1987); *Cede & Co*. v. *Technicolor, Inc. (Technicolor I)*, 634 A.2d 345, 360-61 (Del. 1993); *Pogostin* v. *Rice*, 480 A.2d 619, 624 (Del. 1984); *Aronson* v. *Lewis*, 473 A.2d 805, 811-12 (Del. 1984).

38 *In re Goldman Sachs Grp., Inc. S'holder Litig.*, C.A. No. 5215-VCG, 2011 WL 4826104, at *23 (Del. Ch. Oct. 12, 2011) (quoting *In re Citigroup Inc. S'holder Derivative Litig*., 964 A.2d 106, 139 (Del. Ch. 2009)).

39 DEL. CODE ANN. tit. 8, § 141(a) (West 2011).

40 *See, e.g., Aronson*, 473 A.2d at 812-13 & n.6.

41 *Unitrin, Inc.* v. *Am. Gen. Corp.*, 651 A.2d 1361, 1373 (Del. 1995).

42 *In re Cox Commc'ns, Inc. S'holders Litig.*, 879 A.2d 604, 615 (Del. Ch. 2005).

43 *E.g.*, *Orman* v. *Cullman*, 794 A.2d 5, 20 (Del. Ch. 2002).

44 *Unocal Corp*. v. *Mesa Petrol. Co*., 493 A.2d 946 (Del. 1985).

45 *Revlon, Inc.* v. *MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986).

46 *Reis* v. *Hazelett Strip-Casting Corp*., 28 A.3d 442, 457 (Del. Ch. 2011).

47 *RBC Capital Mkts., LLC* v. *Jervis*, 129 A.3d 816, 857 (Del. 2015).

48 *Corwin* v. *KKR Fin. Holdings, LLC*, 125 A.3d 304, 312 (Del. 2015).

49 *See e.g.*, *Id.* at 308-14; *But cf. Id.* at 311 n.20 (declining to rule on the continued vitality of *In re Santa Fe Pac. Corp. S'holder Litig.*, 669 A.2d 59 (Del. 1995), in which the court did not apply the business judgment rule to the Santa Fe board's decision to adopt defensive measures to ward off a hostile approach from Union Pacific, on the ground that "the stockholders of Santa Fe merely voted in favor of the merger [with Burlington] and not the defensive measures").

50 *See, e.g., Paramount Commc'ns Inc.* v. *QVC Network Inc. (QVC)*, 637 A.2d 34, 45 (Del. 1994); *Barkan* v. *Amsted Indus., Inc.*, 567 A.2d 1279 (Del. 1989). Two subsequent Delaware Supreme Court decisions confirm that board actions subject to review under *Unocal* in the context of an active takeover defense will in other circumstances need to satisfy only the standard business judgment analysis. In *Williams* v. *Geier*, 671 A.2d 1368 (Del. 1996), the Delaware Supreme Court reiterated that adoption of a defensive measure approved by shareholder vote would not be subjected to *Unocal* scrutiny since it would not constitute unilateral board action. In *Kahn ex rel.*

DeKalb Genetics Corp. v. *Roberts*, 679 A.2d 460 (Del. 1996), the Delaware Supreme Court refused to apply *Unocal*'s enhanced scrutiny to a share repurchase program, because that program was not initiated in response to any perceived threat.

[51] *Unitrin, Inc.* v. *Am. Gen. Corp.*, 651 A.2d 1361, 1361 (Del. 1995).

[52] The Unitrin board also claimed that American General's offer created a risk of an antitrust violation. The Court preliminarily rejected the theory of an "antitrust threat" as relevant to the first part of the *Unocal* analysis, stating that either the Federal Trade Commission would block the transaction (in which case no defensive device is necessary) or it would not (in which case there is no antitrust threat). *Am. Gen. Corp.* v. *Unitrin, Inc.*, C.A. Nos. 13656, 13699, 1994 WL 698483, at *12 (Del. Ch. Oct. 14, 1994), *rev'd and remanded*, 651 A.2d 1361 (Del. 1995).

[53] The Delaware Court of Chancery's decision in *Santa Fe*, which concluded that the adoption of a "discriminatory" rights plan to defend against a third-party unsolicited, all-cash all-shares offer was a reasonable measure under *Unocal*, again recognizes the board's discretion in preserving a strategic plan. *In re Santa Fe Pac. Corp. S'holder Litig.*, C.A. No. 13587, 1995 WL 334258, at *9-10 (Del. Ch. May 31, 1995), *rev'd on other grounds*, 669 A.2d 59, 71-72 (Del. 1995).

[54] *See Chesapeake Corp.* v. *Shore*, 771 A.2d 293 (Del. Ch. 2000).

[55] *Id*. at 331.

[56] *Id.* at 344.

[57] *Air Prods. & Chems., Inc*. v. *Airgas, Inc.*, 16 A.3d 48 (Del. Ch. 2011).

[58] *Id.* at 129.

[59] *Id.*

[60] *Ace Ltd.* v. *Capital Re Corp.*, 747 A.2d 95, 108 (Del. Ch. 1999); *see also Phelps Dodge Corp.* v. *Cyprus Amax Minerals Co.*, C.A. No. 17398, 1999 WL 1054255, at *2 (Del. Ch. Sept. 27, 1999); *La. Mun. Police Emps.' Ret. Sys.* v. *Crawford*, 918 A.2d 1172, 1181 n.10 (Del. Ch. 2007) ("Nor may plaintiffs rely upon some naturally-occurring rate or combination of deal protection measures, the existence of which will invoke the judicial blue pencil. Rather, plaintiffs must specifically demonstrate how a given set of deal protections operate in an unreasonable, preclusive, or coercive manner, under the standards of this Court's *Unocal* jurisprudence, to inequitably harm shareholders.").

[61] *Crawford*, 918 A.2d at 1181 n.10.

[62] *Blasius Indus. Inc.* v. *Atlas Corp.,* 564 A.2d 651 (Del. Ch. 1988).

[63] *MM Cos.,* v. *Liquid Audio, Inc.*, 813 A.2d 1118, 1130 (Del. 2003).

[64] *Id.*

[65] *Id.* at 1120.

[66] *Id.* at 1132.

[67] *Mercier* v. *Inter-Tel (Delaware), Inc.*, 929 A.2d 786, 808-09 (Del. Ch. 2007).

[68] *Id.* at 819.

[69] On a motion for preliminary injunction, Vice Chancellor Parsons "conclude[d] that Plaintiffs are likely to succeed on their argument that the approximately 50% cash and 50% stock consideration here triggers *Revlon*." *In re Smurfit-Stone Container Corp. S'holder Litig.,* C.A. No. 6164-VCP, 2011 WL 2028076, at *16 (Del. Ch. May 24, 2011).

[70] *Revlon, Inc.* v. *MacAndrews & Forbes Holdings, Inc.*, 506 A.2d, 173 182 (Del. 1986).

[71] *Paramount Commc'ns Inc.* v. *QVC Network Inc. (QVC)*, 637 A.2d 34, 46 (Del. 1994) (citation omitted).

[72] *Barkan* v. *Amsted Indus., Inc*., 567 A. 2d 1279, 1286 (Del. 1989).

[73] *QVC*, 637 A.2d at 45.

[74] *C&J Energy Servs., Inc.* v. *City of Miami Gen. Emps.' & Sanitation Emps.' Ret. Trust*, 107 A.3d 1049, 1053 (Del. 2014).

[75] *Lyondell Chem. Co.* v. *Ryan*, 970 A.2d 235, 242 (Del. 2009).

[76] *Id.*

[77] *See Gantler* v. *Stephens,* 965 A.2d 695 (Del. 2009) (*Unocal* review not required where the plaintiff challenged the board's decision to reject the offers of three suitors and pursue a recapitalization instead); *TW Servs., Inc.* v. *SWT Acquisition Corp.*, C.A. Nos. 10427, 10298, 1989 WL 20290 (Del. Ch. Mar. 2, 1989) (*Revlon* not triggered by an unsolicited offer to negotiate a friendly deal).

[78] *Paramount Commc'ns, Inc.* v. *Time Inc. (Time-Warner),* 571 A.2d 1140 (Del. 1989).

[79] *Paramount Commc'ns Inc.* v. *QVC Network Inc. (QVC)*, 637 A.2d 34 (Del. 1994).

[80] Transactions in which a controller cashes or squeezes out the minority are often subject to entire fairness review, discussed *infra* Section II.C.

[81] *In re Synthes, Inc. S'holder Litig.*, 50 A.3d 1022, 1047–48 (Del. Ch. 2012); *In re NCS Healthcare, Inc., S'holders Litig.*, 825 A.2d 240, 254–55 (Del. Ch. 2002) ("The situation presented on this motion does not involve a change of control. On the contrary, this case can be seen as the obverse of a typical *Revlon* case. Before the transaction . . . is completed, [the seller] remains controlled by the [controlling stockholder]. The record shows that, as a result of the proposed [] merger, [the seller's] stockholders will become stockholders in a company that has no controlling stockholder or group. Instead, they will be stockholders in a company subject to an open and fluid market for control."), *rev'd on other grounds sub nom. Omnicare, Inc.* v. *NCS Healthcare, Inc.*, 822 A.2d 397 (Del. 2002).

[82] *In re Santa Fe Pac. Corp. S'holder Litig.*, 669 A.2d 59 (Del. 1995).

[83] *In re Smurfit-Stone Container Corp. S'holder Litig.*, C.A. No. 6164-VCP, 2011 WL 2028076, at *15 (Del. Ch. May 24, 2011).

[84] *Lyondell Chem. Co.* v. *Ryan*, 970 A.2d 235, 241 (Del. 2009).

[85] *In re Rural Metro Corp. S'holders Litig.*, 88 A.3d 54, 89-96 (Del. Ch. 2014), *aff'd sub nom. RBC Capital Mkts., LLC* v. *Jervis*, 129 A.3d 816 (Del. 2015).

[86] *Paramount Commc'ns Inc.* v. *QVC Network Inc. (QVC)*, 637 A.2d 34, 44 (Del. 1994).

[87] *Golden Cycle, LLC* v. *Allan*, C.A. No. 16301, 1998 WL 892631, at *16 (Del. Ch. Dec. 10, 1998); *accord In re MONY Grp. Inc. S'holder Litig.*, 852 A.2d 9, 15 (Del. Ch. 2004).

[88] *In re Dollar Thrifty S'holder Litig.*, 14 A.3d 573 (Del. Ch. 2010).

[89] *Id.* at 595-96.

[90] *Id.* at 578.

[91] *In re Family Dollar Stores, Inc. Stockholder Litig.*, C.A. No. 9985-CB, 2014 WL 7246436 (Del. Ch. Dec. 19, 2014).

[92] *Id.* at 16.

[93] *C&J Energy Servs., Inc.* v. *City of Miami Gen. Emps.' & Sanitation Emps.' Ret. Trust*, 107 A.3d 1049, 1053 (Del. 2014).

[94] *Mills Acquisition Co.* v. *Macmillan, Inc.*, 559 A.2d 1261, 1286 (Del. 1989); *Barkan* v. *Amsted Indus., Inc.*, C.A. No. 9212, slip op. at 13 (Del. Ch. Sept. 21, 1990).

[95] *Macmillan*, 559 A.2d at 1287.

[96] *Id.* (citations omitted).

[97] *In re Toys "R" Us, Inc. S'holder Litig.*, 877 A.2d 975 (Del. Ch. 2005).

[98] *In re Topps Co. S'holders Litig.*, 926 A.2d 58 (Del. Ch. 2007).

[99] *In re Smurfit-Stone Container Corp. S'holder Litig.*, C.A. No. 6164-VCP, 2011 WL 2028076, at *17, *18, *22 (Del. Ch. May 24, 2011).

[100] *In re Plains Exploration & Prod. Co. Stockholder Litig.*, C.A. No. 8090-VCN, 2013 WL 1909124, at *5 (Del. Ch. May 9, 2013).

[101] *Id.*

[102] *Id.*

[103] *Barkan* v. *Amsted Indus., Inc.*, 567 A. 2d 1279, 1287 (Del. 1989) (citations omitted). Similarly, with respect to auctions, Delaware law "does not require that whenever a corporation is to be sold for cash an auction be held, it does require . . . at the least that directors take reasonable steps designed to assure that they have probed for alternatives and have a reasonable basis to conclude that the choice that they make is the best available alternative." *Braunschweiger* v. *Am. Home Shield Corp.*, C.A. No. 10755, 1989 WL 128571, at *1008-09 (Del. Ch. Oct. 26, 1989) (citation omitted).

[104] *In re Netsmart Techs., Inc. S'holders Litig.*, 924 A.2d 171 (Del. Ch. 2007); *see also* Transcript of Oral Argument at 14, 20, *Forgo* v. *Health Grades, Inc.*, C.A. No. 5716-VCS (Del. Ch. Sept. 3, 2010) (criticizing the target's board for failing to "sift through possible . . . buyers and make a judgment about whether there might be someone who would be interested" and create "any record that it really segmented the market or considered whether there was a likely buyer").

[105] *Netsmart*, 924 A.2d at 198-99.

[106] *Koehler* v. *NetSpend Holdings Inc.*, C.A. No. 8373-VCG, 2013 WL 2181518 (Del. Ch. May 21, 2013).

[107] *Id.* at *23.

[108] *RBC Capital Mkts., LLC* v. *Jervis*, 129 A.3d 816 (Del. 2015).

[109] *Id.* at 830-31.

[110] *In re Rural Metro Corp. S'holders Litig.*, 88 A.3d 54, 94 (Del. Ch. 2014), *aff'd sub nom. RBC Capital Mkts.*, 129 A.3d 816.

[111] *In re Rural/Metro Corp. S'holders Litig.*, 102 A.3d 205, 224 (Del. Ch. 2014), *aff'd sub nom. RBC Capital Mkts.*, 129 A.3d 816.

[112] *RBC Capital Mkts.*, 129 A.3d at 860.

[113] *In re Del Monte Foods Co. S'holders Litig.*, 25 A.3d 813 (Del. Ch. 2011).

[114] *Id.* at 822.

[115] *Id.* at 836.

[116] *See Paramount Commc'ns, Inc.* v. *Time Inc. (Time-Warner)*, 571 A.2d 1140, 1154 (Del. 1990); *accord In re Santa Fe Pac. Corp. S'holder Litig.*, C.A. No. 13587, 1995 WL 334258, at *8 (Del. Ch. May 31, 1995) (holding that although a "bidding contest" did occur, *Revlon* duties not triggered where board did not initiate bidding and sought strategic stock-for-stock merger), *aff'd in part, rev'd in part*, 669 A.2d 59 (Del. 1995).

[117] *Time-Warner*, 571 A.2d at 1150 (emphasis in original); *see also id.* at 1154 ("The fiduciary duty to manage a corporate enterprise includes the selection of a time frame for achievement of corporate goals."); *accord Arnold*, 650 A.2d at 1289-90.

[118] *Time-Warner*, 571 A.2d at 1153.

[119] *Compare Gilbert* v. *El Paso Co.*, 575 A.2d 1131, 1143-44 (Del. 1990) (holding that because all of the board's actions were in response to an unsolicited tender offer seeking control of company, *Unocal* standard applied throughout), *with Santa Fe*, 1995 WL 334258, at *9 n.7 (holding that the board's decision to enter into original stock-for-stock merger was subject to business judgment review, but altered transaction in response to unsolicited third-party offer must be subjected to enhanced scrutiny under *Unocal*), *aff'd in part, rev'd in part*, 669 A.2d 59 (Del. 1995); *Time-Warner*, 571 A.2d at 1151 n.14 (holding that original plan of merger entered into as part of corporate strategy subject to business judgment rule, while later actions in response to hostile tender offer are subject to enhanced *Unocal* standard).

[120] *Encite LLC* v. *Soni*, C.A. No. 2476-VCG, 2011 WL 5920896, at *20 (Del. Ch. Nov. 28, 2011) (internal quotation marks omitted).

[121] *In re Tyson Foods, Inc.*, 919 A.2d 563, 596 (Del. Ch. 2007).

[122] *N.J. Carpenters Pension Fund* v. *infoGROUP, Inc.*, C.A. No. 5334-VCN, 2011 WL 4825888, at *11 (Del. Ch. Oct. 6, 2011).

[123] *Americas Mining Corp*. v. *Theriault*, 51 A.3d 1213, 1240 (Del. 2012).

[124] *See, e.g.*, *Ivanhoe Partners* v. *Newmont Mining Corp.*, 535 A.2d 1334 (Del. 1987).

[125] *See, e.g.*, *O'Reilly* v. *Transworld Healthcare, Inc.*, 745 A.2d 902, 913 (Del. Ch. 1999).

[126] *See, e.g.*, *Harbor Fin. Partners* v. *Huizenga*, 751 A.2d 879 (Del. Ch. 1999).

[127] *See, e.g.*, *Kahn* v. *Tremont Corp.*, 694 A.2d 422 (Del. 1997).

[128] *Cinerama, Inc.* v. *Technicolor, Inc. (Technicolor II)*, 663 A.2d 1134, 1153 (Del. Ch. 1994) (emphasis in original), *aff'd*, *Cinerama, Inc.* v. *Technicolor, Inc. (Technicolor III)*, 663 A.2d 1156 (Del. 1995). Separate from the question whether the interest of a director in a transaction may trigger entire fairness review, is the question of the applicability of the statutory "safe harbor" protecting a transaction from being void solely by reason of such interest or because of the participation of the interested director in board action. DGCL Section 144(a) provides that a director's self-interest or participation in board action will not void a transaction or contract if (1) the director discloses, or the board is otherwise aware of, the material facts of the director's interest and a majority of disinterested directors approves the action; (2) a majority of shareholders similarly aware of the director's interest approves the action; or (3) the transaction or contract is fair to the corporation as of the time it was authorized, approved or ratified by the board or the shareholders. Del. Code Ann. tit. 8, § 144(a) (West 2011).

[129] *See In re John Q. Hammons Hotels Inc. S'holder Litig.*, C.A. No. 758-CC, 2011 WL 227634, at *12 (Del. Ch. Jan. 14, 2011) (holding, in cases involving third-party mergers where the controller and unaffiliated stockholders may be competing for consideration, "business judgment would be the applicable standard of review if the transaction were (1) recommended by a disinterested and independent special committee, and (2) approved by stockholders in a non-waivable vote of the majority of all the minority stockholders."); *Americas Mining Corp*. v. *Theriault*, 51 A.3d 1213, 1240 (Del. 2012) (holding, in mergers where the controller stands on both sides, "the defendants may shift the burden of persuasion by one of two means: first, they may show that the

transaction was approved by a well-functioning committee of independent directors; or second, they may show that the transaction was approved by an informed vote of a majority of the minority shareholders.")

[130] *Kahn* v. *M&F Worldwide Corp.*, 88 A.3d 635, 645 (Del. 2014).

[131] *Id.* at 646.

[132] Tr. of Oral Arg. and Court's Ruling, *Swomley* v. *Schlecht*, C.A. No. 9355-VCL (Del. Ch. Aug. 27, 2014).

[133] *Id.* at 73.

[134] *Swomley* v. *Schlecht*, 128A.3d 992 (TABLE), (Del. 2015).

[135] *Weinberger* v. *UOP, Inc.*, 457 A.2d 701, 711 (Del. 1983); *accord Kahn* v. *Lynch Commc'n Sys., Inc.*, 638 A.2d 1110, 1115 (Del. 1994) (quoting *Weinberger*, 457 A.2d at 711).

[136] I*n re John Q. Hammons Hotels Inc. S'holder Litig.*, C.A. No. 758-CC, 2009 WL 3165613, at *13 (Del. Ch. Oct. 2, 2009) (internal quotations and citations omitted).

[137] *Cinerama, Inc.* v. *Technicolor, Inc. (Technicolor II)*, 663 A.2d 1134, 1143 (Del. Ch. 1994).

[138] *See Kahn* v. *Tremont Corp.*, 694 A.2d 422 (Del. 1997); *Kahn* v. *Lynch Commc'n Sys.*, 638 A.2d 1110 (Del. 1994); *Rosenblatt* v. *Getty Oil Co.*, 493 A.2d 929 (Del. 1985).

[139] *Lynch*, 638 A.2d 1110.

[140] *Ams. Mining Corp*. v. *Theriault*, 51 A.3d 1213, 1243 (Del. 2012).

[141] *Id.* at 1244.

[142] *Kahn* v. *M&F Worldwide Corp.*, 88 A.3d 635, 639, 642 (Del. 2014).

[143] *See, e.g.*, *Gesoff* v. *IIC Indus. Inc.*, 902 A.2d 1130 (Del. Ch. 2006) (criticizing a special committee that did not bargain effectively, had limited authority, and was advised by legal and financial advisors selected by the controlling shareholder); *In re Tele-Commc'ns, Inc. S'holders Litig. (TCI)*, C.A. No. 16470, 2005 WL 3642727 (Del. Ch. Jan. 10, 2006); *In re Emerging Commc'ns, Inc. S'holders Litig.*, C.A. No. 16415, 2004 WL 1305745 (Del. Ch. June 4, 2004) (criticizing a special committee that never met to consider the transaction together).

[144] *Corwin* v. *KKR Fin. Holdings LLC*, 125 A.3d 304, 307 (Del. 2015).

[145] *In re Sea-Land Corp. S'holders Litig.*, C.A. No. 8453, 1988 WL 49126, at *3 (Del. Ch. May 13, 1988).

[146] *In re W. Nat'l Corp. S'holders Litig.*, C.A. No. 15927, 2000 WL 710192 (Del. Ch. May 22, 2000).

[147] *Williamson* v. *Cox Commc'ns, Inc.*, C.A. No. 1663-N, 2006 WL 1586375 (Del. Ch. June 5, 2006).

[148] *In re KKR Fin. Holdings LLC S'holder Litig.*, 101 A.3d 980, 993 (Del. 2014), *aff'd, Corwin*, 125 A.3d 304.

[149] *Del. Cty. Emps.' Ret. Sys.* v. *Sanchez*, 124 A.3d 1017, 1019 (Del. 2015).

[150] *See Orman* v. *Cullman*, C.A. No. 18039, 2004 WL 2348395, at *5 (Del. Ch. Oct. 20, 2004).

[151] *Cf. Kahn* v. *Tremont Corp.*, 694 A.2d 422 (Del. 1997) (reversing trial court's decision to place burden of proving unfairness on plaintiffs in part on the Delaware Supreme Court's finding that three members of the special committee had previous affiliations with the buyer and received financial compensation or influential positions from the buyer).

[152] *In re Emerging Commc'ns, Inc. S'holders Litig.*, C.A. No. 16415, 2004 WL 1305745 (Del. Ch. June 4, 2004).

[153] *Harbor Fin. Partners* v. *Huizenga*, 751 A.2d 879 (Del. Ch. 1999); *see also Mizel* v. *Connelly*, C.A. No. 16638, 1999 WL 550369, at *4 (Del. Ch. Aug. 2, 1999) (stating that close familial ties should "go a long (if not the whole) way toward creating a reasonable doubt" as to independence).

[154] *Sanchez*, 124 A.3d at 1019.

[155] *See also In re J.P. Morgan Chase & Co. S'holder Litig.*, 906 A.2d 808 (Del. Ch. 2005) (dismissing plaintiffs' claims that the acquiror "overpaid" for the target because claims were derivative and therefore could not survive if a majority of the acquiror's board was independent, and concluding that the overwhelming majority of directors were in fact independent, despite directors' various business relationships with the acquiror and (in some cases) leadership positions held by directors of charitable institutions which were alleged to be major recipients of the acquiror's corporate giving), *aff'd*, 906 A.2d 766 (Del. 2006).

[156] *Yucaipa Am. Alliance Fund II, L.P.* v. *Riggio*, 1 A.3d 310 (Del. Ch. 2010), *aff'd*, 15 A.3d 218 (Del. 2011).

[157] *See Citron* v. *Fairchild Camera & Instrument Corp.*, 569 A.2d 53 (Del. 1989).

[158] *In re KKR Fin. Holdings LLC S'holder Litig.*, 101 A.3d 980, 997 (Del. Ch. 2014).

[159] *Kahn* v. *M&F Worldwide Corp.*, 88 A.3d 635, 639, 649 (Del. 2014).

[160] *Id.* at 648 n.26.

[161] *Beam ex. rel Martha Stewart Living Omnimedia, Inc.* v. *Stewart*, 845 A.2d 1040, 1049-50 (Del. 2004).

[162] *Id.* at 1049-52.

[163] *In re Plains Exploration & Prod. Co. Stockholder Litig.*, C.A. No. 8090-VCN, 2013 WL 1909124, at *5 (Del. Ch. May 9, 2013) (quoting *Gesoff* v. *IIC Indus., Inc.*, 902 A.2d 1130, 1145 (Del. Ch. 2006)).

[164] *See Kahn* v. *Lynch Commc'n Sys., Inc.*, 638 A.2d 1110, 1115 (Del. 1994).

[165] *See, e.g.*, *Cede & Co.* v. *Technicolor, Inc. (Technicolor I)*, 634 A.2d 345 (Del. 1993).

[166] *In re Digex, Inc. S'holders Litig.*, 789 A.2d 1176 (Del. Ch. 2000).

[167] *McMullin* v. *Beran*, 765 A.2d 910 (Del. 2000).

[168] In *In re CompuCom Sys., Inc. Shareholders Litigation*, C.A. No. 499-N, 2005 WL 2481325 (Del. Ch. Sept. 29, 2005), the Delaware Court of Chancery affirmed that the mere presence of a controlling shareholder in the context of a sale to an unaffiliated third party, conducted by an independent special committee after an 18-month search for a buyer, did not give rise to a claim by plaintiffs upon which relief could be granted.

[169] *Rabkin* v. *Olin Corp.*, C.A. No. 7547, 1990 WL 47648, at *6 (Del. Ch. Apr. 17, 1990), *aff'd*, 586 A.2d 1202 (Del. 1990); *accord Kahn* v. *Dairy Mart Convenience Stores, Inc.*, C.A. No. 12489, 1996 WL 159628, at *6 (Del. Ch. Mar. 29, 1996).

[170] *Cf. Kahn* v. *Lynch Commc'n Sys., Inc.*, 638 A.2d 1110, 1118-21 (Del. 1994) (reversing trial court's finding that the special committee acted at arm's length in negotiation with controlling shareholder). To avoid the burden of proving entire fairness, interested directors must inform a special committee of (1) material transaction terms; (2) material facts relating to the use or value of the assets in question, including "hidden

value"; and (3) material facts relating to the value of the assets to third parties, such as forthcoming changes in technology or legal regulation. On the other hand, interested directors need not disclose the reservation price they have assigned to assets nor their plans regarding the use of sale proceeds. Such information, though material, is protected by a "negotiation privilege." *Kahn* v. *Tremont Corp.*, C.A. No. 12339, 1996 WL 145452, at *15-16 (Del. Ch. Mar. 21, 1996), *rev'd and remanded*, 694 A.2d 422 (Del. 1997); *see also Hollinger Int'l, Inc.* v. *Black*, 844 A.2d 1022 (Del. Ch. 2004) (placing equitable limitations on statutory and common law powers normally enjoyed by controlling shareholder), *aff'd*, 872 A.2d 559 (Del. 2005).

171 *Lynch*, 638 A.2d 1110.

172 *See Gesoff* v. *IIC Indus. Inc.*, 902 A.2d 1146, 1150 (Del. Ch. 2006).

173 *In re S. Peru Copper Corp. S'holder Derivative Litig.*, 30 A.3d 60 (Del. Ch. 2011), *revised and superseded*, 52 A.3d 761 (Del. Ch. 2011).

174 *Id.* at 97-98.

175 *See Ams. Mining Corp*. v. *Theriault*, 51 A.3d 1213 (Del. 2012).

176 *See La. Mun. Police Emps'. Ret. Sys.* v. *Fertitta*, C.A. No. 4339-VCL, 2009 WL 2263406, at *8 n.34 (Del. Ch. July 28, 2009).

177 *Kahn* v. *Lynch Commc'n Sys., Inc.*, 638 A.2d 1110, 1117 (Del. 1994).

178 *See, e.g., In re Rural Metro Corp. S'holders Litig.*, 88 A.3d 54, 90 (Del. Ch. 2014).

179 *See, e.g., In re El Paso Pipeline Partners, L.P. Derivative Litig.*, C.A. No. 7141-VCL, 2015 WL 1815846 (Del. Ch. Apr. 20, 2015).

180 *Mills Acquisition Co.* v. *Macmillan, Inc.*, 559 A.2d 1261, 1279-80 (Del. 1989).

181 *In re Tele-Commc'ns, Inc. S'holders Litig. (TCI)*, C.A. No. 16470, 2005 WL 3642727, at *10 (Del. Ch. Jan. 10, 2006).

182 *Gesoff* v. *IIC Indus. Inc.*, 902 A.2d 1150 (Del. Ch. 2006).

183 *In re Emerging Commc'ns, Inc. S'holders Litig.*, C.A. No. 16415, 2004 WL 1305745, at *32 (Del. Ch. June 4, 2004).

184 *See, e.g., RBC Capital Mkts., LLC* v. *Jervis*, 129 A.3d 816, 864 (Del. 2015).

[185] *TCI*, 2005 WL 3642727.

[186] *In re Trados Inc. S'holder Litig.*, 73 A.3d 17 (Del. Ch. 2013). However, the mere fact that directors own shares of common stock but not preferred stock, in and of itself, does not necessarily deprive them of the protections of the business judgment rule with respect to a decision of how to allocate merger consideration amongst common and preferred shareholders. *See LC Capital Master Fund, Ltd.* v. *James*, 990 A.2d 435 (Del. Ch. 2010).

[187] *In re John Q. Hammons Hotels Inc. S'holder Litig.*, C.A. No. 758-CC, 2009 WL 3165613, at *12, *18 (Del. Ch. 2009); *see also In re John Q. Hammons Hotels Inc. S'holder Litig.*, 2011 WL 227634 (Del. Ch. Jan. 14, 2011).

[188] *John Q. Hammons*, 2009 WL 3165613, at *12, *18.

[189] *Id.* at *12.

[190] *Id.*

[191] In reaching its decision, the Court noted that the members of the special committee were "highly qualified" and had "extensive experience," "understood their authority and duty to reject any offer that was not fair to the unaffiliated stockholders" and were "thorough, deliberate, and negotiated at arm's length with [multiple bidders] over a nine month period to achieve the best deal available for the minority stockholders." *John Q. Hammons*, 2011 WL 227634, at *2.

[192] *In re Delphi Fin. Grp. S'holder Litig.*, C.A. No. 7144–VCG, 2012 WL 729232 (Del. Ch. Mar. 6, 2012).

[193] *Id.* at *6.

[194] *Id.* at *7.

[195] *Id*.

[196] *Id.* at *19, *21.

[197] *Id.* at *16.

[198] *Martin Marietta Materials, Inc.* v. *Vulcan Materials Co.*, 56 A.3d 1072 (Del. Ch. 2012), *aff'd*, 68 A.3d 1208 (Del. 2012).

[199] *Depomed Inc.* v. *Horizon Pharma, PLC*, Nos. 1-15-CV-283834, 1-15-CV-283835 (Cal. Sup. Ct. Nov. 19, 2015).

[200] *Id*. at 2-3.

[201] Bid procedure letters sent on behalf of a selling company to potential bidders in an auction context can serve a similar function, and should similarly include language making absolutely clear that the target company has no legal, fiduciary or other duty to any bidder with respect to the manner in which it conducts the auction. Bid procedure letters should also include an express disclaimer to the effect that the bidder is not relying on any express or implied representation concerning the manner in which the auction will be conducted.

[202] *PharmAthene, Inc.* v. *SIGA Techs., Inc.*, C.A. No. 2627-VCP, 2010 WL 4813553, at *7 (Del. Ch. Nov. 23, 2010) (citing *Hindes* v. *Wilmington Poetry Soc'y*, 138 A.2d 501, 502-04 (Del. Ch. 1958)).

[203] Transcript of Oral Argument, *Global Asset Capital, LLC* v. *Rubicon US Reit, Inc.*, C.A. No. 5071-VCL (Del. Ch. Nov. 16, 2009).

[204] *SIGA Techs., Inc.* v. *PharmAthene, Inc.*, 67 A.3d 330, 336 (Del. 2013).

[205] *Id.* at 346.

[206] *Id.* at 334.

[207] *Siga Techs., Inc.* v. *PharmAthene, Inc.*, No. 2627-VCP, 2015 WL 9591986, at *4 (Del. 2015).

[208] *Ev3, Inc.* v. *Lesh*, 114 A.3d 527 (Del. 2014).

[209] *Id*. at 529.

[210] *Id*. at 530.

[211] *C&J Energy Servs., Inc.* v. *City of Miami Gen. Emps.' & Sanitation Emps.' Ret. Trust*, 107 A.3d 1049, 1067 (Del. 2014) (quoting *Barkan* v. *Amsted Indus., Inc.*, 567 A.2d 1279, 1286 (Del. 1989)); *Paramount Commc'ns Inc.* v. *QVC Network Inc. (QVC)*, 637 A.2d 34, 44 (Del. 1994).

[212] *Lyondell Chem. Co.* v. *Ryan*, 970 A.2d 235, 242 (Del. 2009).

[213] *In re Netsmart Techs., Inc. S'holders Litig.*, 924 A.2d 171, 192 (Del. Ch. 2007).

[214] *In re Fort Howard Corp. S'holders Litig*., C.A. No. 9991, 1988 WL 83147, 14 DEL. J. CORP. L. 699, 722 (Del. Ch. Aug. 8, 1988).

[215] *See, e.g.*, *In re MONY Grp. Inc. S'holder Litig.*, 852 A.2d 9 (Del. Ch. 2004) (denying shareholder plaintiffs' request for injunctive relief based upon allegations that the MONY board of directors, having decided to put the company up for sale, failed to fulfill their fiduciary duties by foregoing an auction in favor of entering into a merger agreement with a single bidder and allowing for a post-signing market check).

[216] *In re Topps Co. S'holders Litig.*, 926 A.2d 58, 86 (Del. Ch. 2007).

[217] *Id.* at 86-87; *see also In re Lear Corp. S'holder Litig.*, 926 A.2d 94, 119-20 (Del. Ch. 2007).

[218] *In re Del Monte Foods Co. S'holders Litig.*, 25 A.3d 813 (Del. Ch. 2011).

[219] *In re Fort Howard Corp. S'holders Litig.*, CIV. A. No. 9991, 1988 WL 83147, (Del. Ch. Aug. 8, 1988); *see C&J Energy Servs., Inc.* v. *City of Miami Gen. Emps.' Ret. Trust*, 107 A.3d 1049, 1070 (Del. 2014) ("In prior cases like *In re Fort Howard Corporation Shareholders Litigation*, this sort of passive market check was deemed sufficient to satisfy *Revlon*.").

[220] *Fort Howard*, 1988 WL 83147, at *12.

[221] *In re Smurfit-Stone Container Corp. S'holder Litig.*, C.A. No. 6164-VCP, 2011 WL 2028076, at *19 n.133 (Del. Ch. May 24, 2011).

[222] *Id.* at *5 (citing *In re Pennaco Energy, Inc.*, 787 A.2d 691, 707 (Del. Ch. 2001)).

[223] *Koehler* v. *NetSpend Holdings Inc.*, C.A. No. 8373-VCG, 2013 WL 2181518 (Del. Ch. May 21, 2013).

[224] *Id.* at *19.

[225] *Id.* at *20.

[226] *Cinerama, Inc.* v. *Technicolor, Inc. (Technicolor II)*, 663 A.2d 1134, 1142 (Del. Ch. 1994).

[227] *See generally*, Leo E. Strine, Jr., *Documenting the Deal: How Quality Control and Candor Can Improve Boardroom Decision-Making and Reduce the Litigation Target Zone*, 70 BUS. LAW. (forthcoming May 2015).

[228] *See, e.g., Smith* v. *Van Gorkom (Trans Union)*, 488 A.2d 858, 876-77 (Del. 1985).

[229] *See Steinhardt, et al.* v. *Occam Networks, Inc., et al.*, C.A. No. 5878-VCL, at 15 (Del. Ch. Jan. 24, 2011) (ordering disclosure concerning, among other things, "what

appear to be longitudinal changes from previous Jefferies' books that resulted in the final book making the deal look better than it would have been had the same metrics been used that were used in prior books.").

[230] *See* Self-Regulatory Organizations, SEC Release No. 34-56645, 91 SEC Docket 2216 (Oct. 11, 2007).

[231] *See* FINRA Manual, FINRA Rule 5150.

[232] *In re Tele-Commc'ns, Inc. S'holders Litig. (TCI),* C.A. No. 16470, 2005 WL 3642727, at *10 (Del. Ch. Jan. 10, 2006).

[233] *In re Toys "R" Us, Inc. S'holder Litig.,* 877 A.2d 975, 1005 (Del. Ch. 2005).

[234] *See In re Atheros Commc'ns, Inc. S'holders Litig.,* C.A. No. 6124-VCN, 2011 WL 864928 (Del. Ch. Mar. 4, 2011) (concluding that a fee arrangement in which the ratio of contingent to non-contingent compensation was 50:1 must be disclosed).

[235] *La. Mun. Police Emps.' Ret. Sys.* v. *Crawford*, 918 A.2d 1172 (Del. Ch. 2007).

[236] *Atheros,* 2011 WL 864928, at *8.

[237] *In re Del Monte Foods Co. S'holders Litig.*, 25 A.3d 813 (Del. Ch. 2011).

[238] *Id.* at 835 (internal quotations and citations omitted).

[239] *Id.* at 834.

[240] *In re Rural Metro Corporation Stockholders Litig.,* 88 A.3d 54 (Del. Ch. 2014).

[241] *Id.* at 100.

[242] *Id.*

[243] *RBC Capital Mkts., LLC* v. *Jervis*, 129 A.3d 816 (Del. 2015).

[244] *Id*. at 865.

[245] *Id*. at 855 n.129.

[246] *See*, *e.g.*, *In re Zale Corp. S'holders Litig.*, No. 9388-VCP, 2015 WL 6551418 (Del. Ch. Oct. 29, 2015).

[247] *See, e.g., In re El Paso Corp. S'holder Litig.,* 41 A.3d 432 (Del. Ch. 2012).

[248] *In re Tele-Commc'ns, Inc. S'holders Litig.*, C.A. No. 16470, 2005 WL 3642727 (Del. Ch. Jan. 10, 2006)*; see also Levco Alternative Fund Ltd.* v. *Reader's Digest Ass'n, Inc.*, 2002 WL 1859064 (Del. Aug. 13, 2002).

[249] *See In re Netsmart Techs., Inc. S'holders Litig.*, 924 A.2d 171, 177 (Del. Ch. 2007); *see also Maric Capital Master Fund, Ltd.* v. *PLATO Learning, Inc.*, 11 A.3d 1175, 1178 (Del. Ch. 2010) ("[I]n my view, management's best estimate of the future cash flow of a corporation that is proposed to be sold in a cash merger is clearly material information.").

[250] *In re 3Com S'holders Litig.*, C.A. No. 5067-CC, 2009 WL 5173804, at *3 (Del. Ch. Dec. 18, 2009) (holding that plaintiffs have failed to show how disclosure of full projections, instead of the summary provided by the financial advisors, would have altered the "total mix of available information"); *see also In re CheckFree Corp. S'holders Litig.*, C.A. No. 3193-CC, 2007 WL 3262188 (Del. Ch. Nov. 1, 2007).

[251] *See David P. Simonetti Rollover IRA* v. *Margolis*, C.A. No. 3694-VCN, 2008 WL 5048692, at *10 (Del. Ch. June 27, 2008) (explaining that "Delaware law requires that directors disclose the substance of the investment banker's work, which usually depends in part upon management's best estimates," and holding that a proxy statement that discloses projections that "reflected management's best estimates at the time" instead of "lower-probability projections" meets the requirement to disclose projections that "would have been considered material by the reasonable stockholder").

[252] *In re Micromet, Inc. S'holders Litig.*, C.A. No. 7197-VCP, 2012 WL 681785, at *13 (Del. Ch. Feb. 29, 2012) (quoting *Globis Partners, L.P.* v. *Plumtree Software, Inc.*, C.A. No. 1577-VCP, 2007 WL 4292024 (Del. Ch. Nov. 30, 2007)) (holding that there is no legal requirement to disclose projections that present "overly optimistic 'what-ifs'").

[253] Transcript of Oral Argument on Plaintiffs' Motion For Preliminary Injunction and Rulings of the Court, *In re BEA Sys., Inc. S'holder Litig.*, C.A. No. 3298-VCL (Del. Ch. Mar. 26, 2008).

[254] *Id.* at 94.

[255] *See*, *e.g.*, DEL. CODE ANN. tit. 8, § 251(h) and § 253 (West 2010).

[256] *In re Siliconix Inc. S'holders Litig*., C.A. No. 18700, 2001 WL 716787 (Del. Ch. June 19, 2001).

[257] *Glassman* v. *Unocal Exploration Corp*., 777 A.2d 242, 243 (Del. 2001).

[258] *In re CNX Gas Corp. S'holders Litig*., 4 A.3d 397 (Del. Ch. 2010).

[259] *Id.* at 412-14.

[260] *See* DEL. CODE ANN. tit. 8, § 251(h) (West 2013).

[261] *See, e.g., Olson* v. *ev3, Inc.*, C.A. No. 5583-VCL, 2011 WL 704409 (Del. Ch. Feb. 21, 2011); *In re Cogent, Inc. S'holder Litig.*, 7 A.3d 487 (Del. Ch. 2010).

[262] Companies considering cross-border transactions may also need to consider the impact of different currencies on the pricing structure. Currency risk raises similar issues to those found in market risk and can amplify the market volatility factor inherent in all-stock transactions. *See* Section VII.D.

[263] *See, e.g., Smith* v. *Van Gorkom (Trans Union)*, 488 A.2d 858, 875 (Del. 1985).

[264] *Paramount Commc'ns Inc*. v. *QVC Network Inc. (QVC)*, 637 A.2d 34, 43 (Del. 1994).

[265] *Trans Union*, 488 A.2d at 876 (pointing to evidence that members of Trans Union's Board "knew that the market had consistently undervalued the worth of Trans Union's stock, despite steady increases in the Company's operating income in the seven years preceding the merger").

[266] *Paramount Commc'ns, Inc*. v. *Time Inc. (Time-Warner)*, 571 A.2d 1140, 1150 n.12 (Del. 1990).

[267] *Id*. at 1150.

[268] *Id*. at 1153.

[269] *E.g., id.*

[270] MD. CODE CORPS. & ASS'NS §2-104(9) (2013) (permitting corporations to adopt a charter provision that allows the board of directors "in considering a potential acquisition of control of the corporation, to consider the effect of the potential acquisition of control on" among, other constituencies, employees, suppliers, customers, creditors, and communities in which the corporation's offices are located); OR. REV. STAT. §60.357 (1989) (permitting directors to consider the social, legal and economic effects on constituencies other than shareholders "[w]hen evaluating any offer of another party to make a tender or exchange offer for any equity security of the corporation, or any proposal to merge or consolidate the corporation . . . or to purchase or otherwise acquire all or substantially all the properties and assets of the corporation").

[271] *See, e.g., Norfolk S. Corp., et al*. v. *Conrail Inc., et al.*, C.A. No. 96-CV-7167 (E.D. Pa. Nov. 19, 1996) (concluding that Pennsylvania's constituency statute "provides

that in considering the best interests of the corporation or the effects of any action, the directors are not required to consider the interests of any group, obviously including shareholders, as a dominant or controlling factor… "); *Georgia-Pacific Corp. v. Great N. Nekoosa Corp.,* 727 F.Supp. 31, 33 (D. Me.1989) (justifying use of a poison pill in response to a cash tender offer partly on the basis of Maine's other constituency statute).

[272] *See Unocal Corp*. v. *Mesa Petrol. Co*., 493 A.2d 946 (Del. 1985); *Mills Acquisition Co*. v. *Macmillan, Inc.*, C.A. No. 10168, 1988 WL 108332 (Del. Ch. Oct. 18, 1988), *rev'd on other grounds*, 559 A.2d 1261. In the *Macmillan* case, the Delaware Supreme Court noted that it was legitimate for a board to consider the "effect on the various constituencies" of a corporation, the companies' long-term strategic plans and "any special factors bearing on stockholder and public interests" in reviewing merger offers. *Macmillan*, 559 A.2d at 1285 n.35.

[273] *See* Minnesota Mining and Manufacturing Co., SEC No-Action Letter, 1988 WL 234978 (Oct. 13, 1988) (indicating that the following factors will be considered by the SEC to conclude that a CVR is not a security: (1) the CVR to be granted to the selling shareholders are an integral part of the consideration to be received in the proposed merger; (2) the holders of the CVR will have no rights common to stockholders such as voting and dividend rights, nor will they bear a stated rate of interest; (3) the CVRs will not be assignable or transferable except by operation of law; and (4) the CVRs will not be represented by any form of certificate or instrument).

[274] *NACCO Indus., Inc.* v. *Applica Inc.*, 997 A.2d 1, 19 (Del. Ch. 2009).

[275] *Revlon, Inc.* v. *MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986); *Unocal*, 493 A.2d 946; *see also* Section II.B.2.

[276] *In re Toys "R" Us, Inc. S'holder Litig.*, 877 A.2d 975, 1016 (Del. Ch. 2005).

[277] *Id.* at 1021.

[278] *See, e.g.*, *In re Cogent, Inc. S'holder Litig.*, 7 A.3d 487, 503-04 (Del. Ch. 2010) (citing *In re Lear Corp. S'holder Litig.*, 926 A.2d 94, 120 (Del. Ch. 2007)) (observing that the decision whether to view a termination fee's preclusive effect in terms of equity value or enterprise value will depend on the factual circumstances existing in a given case).

[279] *In re Answers Corp. S'holders Litig.*, C.A. No 6170-VCN, 2011 WL 1366780, at *4 n.52 (Del. Ch. Apr. 11, 2011).

[280] *In re Comverge, Inc. S'holders Litig.*, Consol. C.A. No. 7368-VCP, 2014 WL 6686570, at *15-17 (Del. Ch. Nov. 25, 2014).

[281] *La. Mun. Police Emps.' Ret. Sys.* v. *Crawford*, 918 A.2d 1172, 1181 n.10 (Del. Ch. 2007).

[282] *In re Dollar Thrifty S'holder Litig.*, 14 A.3d 573, 575 (Del. Ch. 2010).

[283] *In re The Topps Co. S'holders Litig.*, 926 A.2d 58, 86 (Del. Ch. 2007).

[284] *Answers*, 2011 WL 1366780 at *4 n.52; *see also id.* at *9 (noting that, in the context of a relatively small transaction, a "somewhat higher than midpoint on the 'range' is not atypical").

[285] *Phelps Dodge Corp.* v. *Cyprus Amax Minerals Co.*, C.A. No. 17398, 1999 WL 1054255 (Del. Ch. Sept. 27, 1999).

[286] *Id.* at *5.

[287] *In re Lear Corp. S'holder Litig.*, 926 A.2d 94 (Del. Ch. 2007).

[288] *See H.F. Ahmanson & Co.* v. *Great W. Fin. Corp.*, C.A. No. 15650, 1997 WL 305824 (Del. Ch. June 3, 1997).

[289] *NACCO Indus., Inc.* v. *Applica Inc.*, 997 A.2d 1, 19 (Del. Ch. 2009).

[290] *C&J Energy Servs., Inc.* v. *City of Miami Gen. Emps.' Ret. Trust*, 107 A.3d 1049 (Del. 2014).

[291] *Id.* at 1054, 1072.

[292] *Id.* at 1072 n.110 (quoting *OTK Assocs. LLC* v. *Friedman*, 85 A.3d 696, 720 n.2 (Del. Ch. 2014)).

[293] *In re Del Monte Foods Co. S'holders Litig.*, 25 A.3d 813 (Del. Ch. 2011).

[294] *Id.* at 841 (quoting *ACE Ltd.* v. *Capital Re Corp.*, 747 A.2d 95, 105-106 (Del. Ch. 1999)).

[295] *Paramount Commc'ns Inc.* v. *QVC Network Inc. (QVC)*, 637 A.2d 34, 47-48 (Del. 1994).

[296] *Phelps Dodge Corp.* v. *Cyprus Amax Minerals Co.*, C.A. No. 17398, 1999 WL 1054255, at *1 (Del. Ch. Sept. 27, 1999).

[297] *Koehler* v. *NetSpend Holdings Inc.*, C.A. No. 8373-VCG, 2013 WL 2181518, at *18 (Del. Ch. May 21, 2013) ("It is not per se unreasonable for a board to forgo a go-

shop where it makes an informed decision that such forbearance is part of a process designed to maximize price."). Go-shop provisions were found in 11% of deals between public targets and strategic acquirors in 2013, up from 6% in 2012 and 4% in 2011. AM. BAR ASS'N, 2014 STRATEGIC BUYER/PUBLIC TARGET M&A DEAL POINTS STUDY 48 (2015).

[298] Transcript of Telephonic Oral Argument and Ruling of the Court, *In re Complete Genomics, Inc. S'holder Litig. (Genomics II)*, C.A. No. 7888-VCL (Del. Ch. Nov. 27, 2012).

[299] *Id.* at 18.

[300] Transcript of Ruling of the Court, *In re Ancestry.com Inc. S'holder Litig.*, C.A. No. 7988-CS (Del. Ch. Dec. 17, 2012).

[301] *Koehler*, 2013 WL 2181518 .

[302] *Id.* at *19.

[303] *Cirrus Holding Co. Ltd.* v. *Cirrus Indus.*, 794 A.2d 1191, 1207 (Del. Ch. 2001).

[304] *Koehler*, 2013 WL 2181518, at *14.

[305] *See Frontier Oil Corp.* v. *Holly Corp.*, C.A. No. 20502, 2005 WL 1039027, at *27 (Del. Ch. Apr. 29, 2005) ("The Merger Agreement, of course, was not an ordinary contract. Before the Merger could occur, the shareholders of Holly had to approve it. The directors of Holly were under continuing fiduciary duties to the shareholders to evaluate the proposed transaction. The Merger Agreement accommodated those duties by allowing, under certain circumstances, the board of directors to withdraw or change its recommendation to the shareholders that they vote for the Merger.").

[306] Transcript of Telephonic Ruling of the Court at 18, *In re Complete Genomics, Inc. S'holder Litig. (Genomics I)*, C.A. No. 7888-VCL (Del. Ch. Nov. 9, 2012).

[307] Transcript of Oral Argument at 133, *In re NYSE Euronext S'holders Litig.*, C.A. 8136-CS (Del. Ch. May 10, 2013).

[308] *In re Compellent Techs., Inc. S'holder Litig.*, C.A. 6084-VCL, 2011 WL 6382523, at *13 (Del. Ch. Dec. 9, 2011).

[309] *See* DEL. CODE ANN. tit. 8, § 146 (West 2011).

[310] *Omnicare* v. *NCS Healthcare, Inc.*, 818 A.2d 914 (Del. 2003).

[311] *Id.* at 946.

[312] *See Monty* v. *Leis*, 123 Cal. Rptr. 3d 641, 646 (Ct. App. 2011) (quoting *In re Toys "R" Us, Inc. S'holder Litig.*, 877 A.2d 975, 1016 n.68 (Del. Ch. 2005), for the proposition that *Omnicare* "'represents . . . an aberrational departure from [the] long accepted principle' that what matters is whether the board acted reasonably in light of all the circumstances").

[313] *See Orman* v. *Cullman*, C.A. No. 18039, 2004 WL 2348395 (Del. Ch. Oct. 20, 2004); *see also Majority Shareholders' Voting Agreement Not Impermissible Lock-Up, Del. Court Says*, 7 M&A L. REP. 863 (Nov. 8, 2004).

[314] *Koehler* v. *NetSpend Holdings Inc.*, C.A. No. 8373-VCG, 2013 WL 2181518, at *17 (Del. Ch. May 21, 2013).

[315] In re OPENLANE, Inc. S'holders Litig., C.A. No. 6849-VCN, 2011 WL 4599662 (Del. Ch. Sept. 30, 2011); *see also Optima Int'l of Miami, Inc.* v. *WCI Steel, Inc.*, C.A. No. 3833-VCL, 2008 WL 3822429 (Del. Ch. June 17, 2008) (distinguishing *Omnicare* and rejecting an argument that a shareholder written consent, which was received within a day of the target board's approval of the merger agreement, was impermissible under the *Omnicare* analysis).

[316] *OPENLANE*, 2011 WL 4599662, at *10.

[317] *See* SEC Compliance and Disclosure Interpretation, Securities Act Section 239.13 (Nov. 26, 2008), *available at* https://www.sec.gov/divisions/corpfin/guidance/sasinterp.htm.

[318] *In re Toys "R" Us, Inc. S'holder Litig.*, 877 A.2d 975, 980 (Del. Ch. 2005).

[319] *Id.* at 1018.

[320] PRACTICAL LAW COMPANY, DEAL PROTECTIONS AND REMEDIES: A COMPARATIVE ANALYSIS OF 2014 PUBLIC MERGER AGREEMENTS, 16 (2014).

[321] *In re BioClinica, Inc. S'holder Litig.*, C.A. No. 8272-VCG, 2013 WL 5631233, at *8 (Del. Ch. Oct. 16, 2013).

[322] Transcript of Telephonic Ruling of the Court, *In re Complete Genomics, Inc. S'holder Litig. (Genomics I)*, C.A. No. 7888-VCL (Del. Ch. Nov. 9, 2012); Transcript of Telephonic Oral Argument and Ruling of the Court, *In re Complete Genomics, Inc. S'holder Litig. (Genomics II)*, C.A. No. 7888-VCL (Del. Ch. Nov. 27, 2012).

[323] Transcript of Telephonic Ruling of the Court at 16, *Genomics I*, C.A. No. 7888-VCL.

[324] *In re Comverge, Inc. S'holders Litig.*, Consol. C.A. No. 7368-VCP, 2014 WL 6686570, at *15-17 (Del. Ch. Nov. 25, 2014).

[325] *In re Bear Stearns Litig.*, 870 N.Y.S.2d 709, 734-35 (N.Y. Sup. Ct. 2008).

[326] *Brown* v. *Authentec, Inc.*, Case No. 05-2012-CA-57589 (Fla. Cir. Ct. Sept. 18, 2012), *aff'd*, 109 So. 3d 219 (Fla. Dist. Ct. App. 2013) (table).

[327] Transcript of Oral Argument on Plaintiffs' Motion for a Preliminary Injunction and Rulings of the Court at 106, *In re NYSE Euronext S'holders Litig.,* C.A. 8136-CS (Del. Ch. May 10, 2013).

[328] *IBP, Inc.* v. *Tyson Foods, Inc.*, 789 A.2d 14 (Del. Ch. 2001).

[329] *Id*. at 68 (footnote omitted). In *Ameristar Casinos, Inc.* v. *Resorts Int'l Holdings, LLC*, the Court accepted the premise, although did not decide, that an MAE had occurred where there was a 248% increase in the property tax assessment on the target asset, which translated to a tax liability of $18 million per year for an asset generating $30 million per year in net income. *Ameristar Casinos, Inc.* v. *Resorts Int'l Holdings, LLC*, C.A. No. 3685-VCS, 2010 WL 1875631 (Del. Ch. May 11, 2010).

[330] *Frontier Oil Corp.* v. *Holly Corp.*, C.A. No. 20502, 2005 WL 1039027, at *35 (Del. Ch. Apr. 29, 2005).

[331] The Court specifically noted that "[i]n the context of [a merger agreement], the concept of 'Material Adverse Effect' and 'material' are analytically distinct, even though their application may be influenced by the same factors." *Id.* at *38.

[332] *Hexion Specialty Chems., Inc.* v. *Huntsman Corp.*, 965 A.2d 715 (Del. Ch. 2008).

[333] *Id.* at 738.

[334] *Id.* at 740.

[335] *Genesco, Inc.* v. *The Finish* Line, Inc., No. 07-2137-II(III), 2007 WL 4698244 (Tenn. Ch. Dec. 27, 2007).

[336] *United Rentals, Inc.* v. *RAM Holdings, Inc.*, 937 A.2d 810 (Del. Ch. 2007).

[337] *Alliance Data Sys. Corp.* v. *Blackstone Capital Partners V L.P.*, 963 A.2d 746 (Del. Ch.), *aff'd*, 976 A.2d 170 (Del. 2009) (table).

[338] *James Cable, LLC* v. *Millennium Dig. Media Sys., L.L.C.*, C.A. No. 3637-VCL, 2009 WL 1638634 (Del. Ch. June 11, 2009).

[339] *Consol. Edison, Inc.* v. *Ne. Utils.*, 426 F.3d 524 (2d Cir. 2005).

[340] For a discussion of sample contract language, see Ryan Thomas & Russell Stair, *Revisiting Consolidated Edison—A Second Look at the Case That Has Many Questioning Traditional Assumptions Regarding the Availability of Shareholder Damages in Public Company Mergers*, 64 BUS. LAW. 329, 349-57 (2009). *Cf. Amirsaleh* v. *Bd. of Trade*, C.A. No. 2822-CC, 2008 WL 4182998 (Del. Ch. Sept. 11, 2008) (holding that stockholder who received late election form had standing to sue for his preferred form of consideration after the merger was consummated).

[341] *Hexion Specialty Chems., Inc.* v. *Huntsman Corp.*, 965 A.2d 715, 748 (Del. Ch. 2008).

[342] *See Paramount Commc'ns, Inc.* v. *Time Inc. (Time-Warner)*, 571 A.2d 1140 (Del. 1990).

[343] *Versata Enters., Inc.* v. *Selectica, Inc.*, 5 A.3d 586 (Del. 2010).

[344] *See, e.g., Moran* v. *Household Int'l, Inc.*, 500 A.2d 1346, 1346 (Del. 1985); *Leonard Loventhal Account* v. *Hilton Hotels Corp.*, C.A. No. 17803, 2000 WL 1528909 (Del. Ch. Oct. 10, 2000), *aff'd*, 780 A.2d 245 (Del. 2001).

[345] *See Hollinger Int'l, Inc.* v. *Black*, 844 A.2d 1022, 1085-88 (Del. Ch. 2004) (upholding the adoption of a rights plan in the context of a company's ongoing process of exploring strategic alternatives, where the court found that the controlling shareholder seeking to sell its control bloc had breached fiduciary duties and contractual obligations to the company, such that the normal power of a majority shareholder to sell its stock without sharing the opportunity with minority holders could not be used to further these breaches).

[346] *See Desert Partners, L.P.* v. *USG Corp.*, 686 F. Supp. 1289 (N.D. Ill. 1988); *BNS Inc.* v. *Koppers Co.*, 683 F. Supp. 458, 474-75 (D. Del. 1988); *Moore Corp.* v. *Wallace Computer Servs. Inc.*, 907 F. Supp. 1545 (D. Del. 1995); *Air Prods. & Chems., Inc.* v. *Airgas, Inc.*, 16 A.3d 48 (Del. Ch. 2011).

[347] *CRTF Corp.* v. *Federated Dep't Stores, Inc.*, 683 F. Supp. 422, 438-42 (S.D.N.Y. 1988) (refusing to enjoin discriminatory application of rights plan during auction); *MAI Basic Four, Inc.* v. *Prime Computer, Inc.*, C.A. No. 10428, 1988 WL 140221 (Del. Ch. Dec. 20, 1988); *In re Holly Farms Corp. S'holders Litig.*, C.A. No. 10350, 1988 WL 143010 (Del. Ch. Dec. 30, 1988).

[348] *Airgas*, 16 A.3d 48.

[349] *Yucaipa Am. Alliance Fund II, L.P.* v. *Riggio*, 1 A.3d 310 (Del. Ch. 2010); *see also In re Bioclinica, Inc. S'holder Litig.*, C.A. 8272-VCG, 2013 WL 673736 (Del. Ch. Feb. 25, 2013).

[350] *Yucaipa*, 1 A.3d at 350.

[351] *Versata Enters., Inc.* v. *Selectica, Inc.*, 5 A.3d 586, 586 (Del. 2010).

[352] *Id.*

[353] In a recent transcript ruling, the Court of Chancery invalidated charter and bylaw provisions providing that directors of a company without a staggered board and cumulative voting could only be removed for cause. The stockholder plaintiffs argued—and the court agreed—that under §141(k) of the DGCL, stockholders have the right to remove directors without cause unless the company has a staggered board or cumulative voting. *In re Vaalco Energy S'holder Litig.*, Cons. C.A. No. 11775-VCL (Dec. 21, 2015).

[354] DEL. CODE ANN. tit. 8, § 141(k) (West 2011).

[355] In the case of *Quickturn Design Sys., Inc.* v. *Shapiro*, the Delaware Supreme Court ruled that dead hand and no hand provisions—even of limited duration—are invalid. *See Quickturn Design Sys., Inc.* v. *Shapiro*, 721 A.2d 1281 (Del. 1998). The Court held that the dead hand feature of the rights plan, which barred a newly elected board from redeeming the pill for six months, ran afoul of Section 141(a) of the DGCL, which empowers the board with the statutory authority to manage the corporation. The Court also criticized dead hand provisions because they would prevent a newly elected board "from completely discharging its fundamental management duties to the corporation and its stockholders for six months" by restricting the board's power to negotiate a sale of the corporation. *Id.* at 1291 (emphasis omitted). The reasoning behind the *Quickturn* holding, together with that of the 1998 decision in *Carmody* v. *Toll Bros.* (which dealt with a pure dead hand pill rather than a no hand pill), leaves little room for dead hand provisions of any type in Delaware. *Carmody* v. *Toll Bros. Inc.*, 723 A.2d 1180 (Del. Ch. 1998). In contrast to Delaware, courts in both Georgia and Pennsylvania have upheld the validity of dead hand and no hand provisions. *See Invacare Corp.* v. *Healthdyne Techs. Inc.*, 968 F. Supp. 1578 (N.D. Ga. 1997); *AMP Inc.* v. *Allied Signal Inc.*, C.A. Nos. 98-4405, 98-4058, 98-4109, 1998 WL 778348 (E.D. Pa. Oct. 8, 1998), *partial summary judgment granted*, 1998 WL 967579 (E.D. Pa. Nov. 18, 1998), *rev'd and remanded*, 168 F.3d 649 (3d Cir. 1999).

[356] *See* DEL. CODE ANN. tit. 8, § 141(k)(1) (West 2011).

[357] *Airgas, Inc.* v. *Air Prods. & Chems., Inc.*, 8 A.3d 1182, 1185 (Del. 2010).

[358] *JANA Master Fund, Ltd.* v. *CNET Networks, Inc.*, 954 A.2d 335 (Del. Ch. 2008).

[359] *Levitt Corp.* v. *Office Depot, Inc.*, C.A. No. 3622-VCN, 2008 WL 1724244 (Del. Ch. Apr. 14, 2008).

[360] *Icahn Partners LP* v. *Amylin Pharm., Inc.*, No. 7404-VCN, 2012 WL 1526814 (Del. Ch. Apr. 20, 2012).

[361] *AB Value Partners, LP* v. *Kreisler Mfg. Corp.*, No. 70434-VCP, 2014 WL 7150465, at *5 (Del. Ch. Dec. 16, 2014).

[362] *See* DEL. CODE ANN. tit. 8, § 211(d) (West 2011).

[363] *See Licht* v. *Storage Tech. Corp.*, C.A. No. 524-N, 2005 WL 1252355 (Del. Ch. May 13, 2005) (holding that, as a default matter, when the shareholders of a corporation vote on matters other than the election of directors (and barring the application of a more specific voting standard under another Delaware statute), abstentions are properly counted as negative votes).

[364] *See, e.g.*, *Allen* v. *Prime Computer, Inc.*, 540 A.2d 417 (Del. 1988); *Edelman* v. *Authorized Distribution Network, Inc.*, C.A. No. 11104, 1989 WL 133625 (Del. Ch. Nov. 3, 1989); *Nomad Acquisition Corp.* v. *Damon Corp.*, C.A. Nos. 10173, 10189, 1988 WL 383667 (Del. Ch. Sept. 20, 1988).

[365] *Blasius Indus. Inc.* v. *Atlas Corp.*, 564 A.2d 651 (Del. Ch. 1988).

[366] *See, e.g.*, *Kidsco Inc.* v. *Dinsmore*, 674 A.2d 483 (Del. Ch.), *aff'd*, 670 A.2d 1338 (Del. 1995); *Stahl* v. *Apple Bancorp, Inc.*, C.A. No. 11510, 1990 WL 114222 (Del. Ch. Aug. 9, 1990).

[367] *Boilermakers Local 154 Ret. Fund* v. *Chevron Corp.*, 73 A.3d 934 (Del. Ch. 2013).

[368] *Id.* at 950.

[369] *Id.* at 953 (referring to *Moran* v. *Household Int'l*, 500 A.2d 1346 (Del. 1985)).

[370] DEL. CODE ANN. tit. 8, § 211.

[371] *City of Providence* v. *First Citizens BancShares, Inc.*, 99 A.3d 229 (Del. Ch. 2014).

[372] *E.g.*, *In re CytRX Corp. S'holder Derivative Litig.*, No. CV-14-6414, 2015 WL 9871275 (C.D. Cal. Oct. 30, 2015); *Brewerton* v. *Oplink Commc'ns, Inc.*, No. RG14-750111 (Cal. Super. Ct. Dec. 14, 2014); *Groen* v. *Safeway, Inc.*, No. RG14-716651, 2014 WL 3405752 (Cal. Super. Ct. May 14, 2014); *Miller* v. *Beam, Inc.*, No. 2014 CH 00932, 2014 WL 2727089 (Ill. Ch. Ct. Mar. 5, 2014); *Genoud* v. *Edgen Grp., Inc.*, No. 625,244, 2014 WL 2782221 (La. Dist. Ct. Jan. 17, 2014); *Collins* v. *Santoro*, No. 154140/2014, 2014 WL 5872604 (N.Y. Sup. Ct. Nov. 10, 2014); *HEMG Inc.* v. *Aspen Univ.*, C.A. No. 650457/13, 2013 WL 5958388 (N.Y. Sup. Ct. Nov. 14, 2013); *North* v. *McNamara*, 47 F. Supp. 3d 635 (S.D. Ohio 2014); *Roberts* v. *TriQuint Semiconductor, Inc.*, 358 Or. 413, 415 (2015); *see also City of Providence* v. *First Citizens BancShares*, 99 A.3d 229 (Del. Ch. 2014) (enforcing a North Carolina forum-selection bylaw).

[373] Order, *Centene Corp.* v. *Elstein*, C.A. No. 11589-VCL (Del. Ch. Oct. 8, 2015); Tr. of Rulings of the Ct., *Edgen Grp. Inc.* v. *Genoud*, C.A. No. 9055-VCL (Del. Ch. Nov. 5, 2013).

[374] *ATP Tour, Inc.* v. *Deutscher Tennis Bund*, 91 A.3d 554 (Del. 2014).

[375] *Id.* at 558.

[376] DEL. CODE ANN. tit. 8, § 102(f).

[377] *Corvex Mgmt. LP* v. *Common Wealth REIT*, Case No. 24-C-13-001111, 2013 WL 1915769 (Md. Cir. Ct. May 8, 2013).

[378] *See, e.g.*, *Moore Corp.* v. *Wallace Computer Servs. Inc.*, 907 F. Supp. 1545 (D. Del. 1995) ; *Buckhorn, Inc.* v. *Ropak Corp.*, 656 F. Supp. 209 (S.D. Ohio 1987), *aff'd*, 815 F.2d 76 (6th Cir. 1987).

[379] *See, e.g.*, *In re Walt Disney Co. Derivative Litig.*, 731 A.2d 342 (Del. Ch. 1998), *aff'd in part, rev'd in part sub nom. Brehm* v. *Eisner*, 746 A.2d 244 (Del. 2000); *Grimes* v. *Donald*, 673 A.2d 1207 (Del. 1996) ; *Worth* v. *Huntington Bancshares, Inc.*, 540 N.E.2d 249 (Ohio 1989).

[380] *San Antonio Fire & Police Pension Fund* v. *Amylin Pharm., Inc.*, 983 A.2d 304 (Del. Ch. 2009), *aff'd*, 981 A.2d 1173 (Del. 2009).

[381] *Id.* at 315.

[382] *Id.* at 316 n.37.

[383] *Kallick* v. *SandRidge Energy, Inc.*, 68 A.3d 242 (Del. Ch. 2013).

[384] Transcript of Oral Argument on Defendants' Motions to Dismiss and Rulings of the Court, *Pontiac Gen. Emps. Ret. Sys.* v. *Ballantine*, No. 9789-VCL (Del. Ch. Oct. 14, 2014) at 70.

[385] *Id*. at 73.

[386] *Id*. at 74; *see Carmody* v. *Toll Bros., Inc.*, 723 A.2d 1180 (Del. Ch. 1998).

[387] Tr. of Bench Ruling at 8, *Fire & Police Pension Fund, San Antonio* v. *Stanzione*, C.A. No. 10078-VCG (Del. Ch. Feb. 25, 2015).

[388] *Basic* v. *Levinson*, 485 U.S. 224, 239 (1988); *see also*, *TSC Industries, Inc.* v. *Northway, Inc.*, 426 U.S. 438, 439 (setting forth the basic test for materiality under the securities laws).

[389] *Basic*, 485 U.S. at 239-41.

[390] Targets only must disclose a potential transaction if (i) such disclosure is affirmatively required by SEC rules, (ii) the target or a corporate insider desires to trade on the basis of material non-public information (the "disclose or abstain rule"), or (iii) disclosure is required to make prior statements not misleading. *Vladmir* v. *Bioenvision Inc.*, 606 F. Supp.2d at 484; *SEC* v. *Texas Gulf Sulphur*, 401 F.2d 833, 848 (2d Cir. 1968); *see also* Exchange Act Rule 14e-3 (prohibiting trading in the context of tender offers on the basis of material non-public information). Disclosure is only required by SEC rules in limited situations and Item 1.01 of Form 8-K does not require disclosure of mergers until a formal agreement is signed. Further, the SEC staff takes the position that although Item 303 of Regulation S-K could be read to require companies to address pending talks as "likely to have material effects on future financial condition or results of operations," where disclosure is not otherwise required, a company's management's discussion and analysis need not contain a discussion of the impact of negotiations where inclusion of such information would jeopardize the completion of the transaction. Management's Discussion and Analysis of Financial Condition and Results of Operations; Certain Investment Company Disclosures, SEC Release No. 33-6835 (May 18, 1989); 17 C.F.R. §229.303.

[391] "The duty of a corporation and its officers to disclose is limited. To that end, a corporation is not required to disclose a fact merely because a reasonable investor would very much like to know that fact. Rather an omission is actionable under the securities laws only when the corporation is subject to a duty to disclose the omitted facts." *Vladmir,* 606 F. Supp.2d at 484 (S.D. N.Y. 2009) (quoting *In re Time Warner Sec. Litig.*, 9 F.3d 259, 267 (2d Cir. 1993); *see also*, *Basic*, 485 U.S. at 239 n. 17 (1988).

[392] However, the NYSE takes the position that "[n]egotiations leading to mergers and acquisitions . . . are the type of developments where the risk of untimely and inadvertent disclosure of corporate plans are most likely to occur. . . . If unusual market activity should arise, the company should be prepared to make an immediate public announcement of the matter. . . . A sound corporate disclosure policy is essential to the maintenance of a fair and orderly securities market. It should minimize the occasions where the [NYSE] finds it necessary to temporarily halt trading in a security due to information leaks or rumors in connection with significant corporate transactions." *NYSE Listed Company Manual,* Rule 202.01. Similarly, Nasdaq imposes a duty on listed companies to promptly disclose, except in unusual circumstances, any material information which would reasonably be expected to affect the value of their securities or influence investors' decisions. *Nasdaq Stock Market Rules,* Rule 5250(b)(1). Nasdaq defines unusual circumstances as, among other things, "where it is possible to maintain confidentiality of those events and immediate public disclosure would prejudice the ability of the Company to pursue its legitimate corporate objectives." *Nasdaq Stock Market Rules,* Rule IM 5250-1.

[393] *See, e.g.,* In *re MCI Worldcom, Inc. Sec. Litig.*, 93 F. Supp.2d 276, 280 (E.D.N.Y. 2000) (concluding that a disclosure duty arose only after the company affirmatively denied merger negotiations); *In re Columbia Sec. Litig.*, 747 F.Supp. 237, 243 (S.D.N.Y. 1990) (concluding that the plaintiff sufficiently pled that affirmative denial of merger negotiations during ongoing merger negotiations was materially misleading).

[394] *In the Matter of Carnation Company*, SEC Release No. 34-22214 (July 8, 1985).

[395] *Eisenstadt* v. *Centel Corp.*, 113 F.3d 738, 744 (7th Cir. 1997) ("Obviously a corporation has no duty to correct rumors planted by third parties."); *Carnation Company*, SEC Release No. 34-22214. Additionally, there may be a duty to make corrective disclosure where there is evidence that market rumors stem from trading by insiders in the company's shares. *In re Sharon Steel*, SEC Release No. 34-18271 (Nov. 19, 1981).

[396] *State Teachers Ret. Bd.* v. *Fluor*, 654 F.2d 843, 850 (2d Cir. 1981); *see also*, *Eisenstadt* , 113 F.3d at 744; *In re Time Warner Inc. Sec. Litig.*, 9 F.3d 259, 265 (2d Cir. 1993); *Holstein* v. *Armstrong*, 751 F. Supp. 746, 747 (N.D. Ill. 1990).

[397] The test of whether a leak or rumor is attributable to an issuer mirrors the test for whether a company is liable for analyst statements and forecasts—that is, whether the company has "sufficiently entangled" itself with the disclosure of information giving rise to the rumor. "Sufficient entanglement" can occur either explicitly by leaking information or implicitly if the company reviews information and represents that it is accurate or comports with the company's views. *Elkind* v. *Liggett & Myers, Inc.*, 653 F.2d 156, 162-63 (2d Cir. 1980).

[398] *Fluor*, 652 F.2d 843.

[399] *Id.* at 846-49.

[400] *Id.* at 851.

[401] For example, Nasdaq notes that "Whenever unusual market activity takes place in a Nasdaq Company's securities, the Company normally should determine whether there is material information or news which should be disclosed. If rumors or unusual market activity indicate that information on impending developments has become known to the investing public, or if information from a source other than the Company becomes known to the investing public, a clear public announcement may be required as to the state of negotiations or development of Company plans. Such an announcement may be required, even though the Company may not have previously been advised of such information or the matter has not yet been presented to the Company's Board of Directors for consideration. In certain circumstances, it may also be appropriate to publicly deny false or inaccurate rumors, which are likely to have, or have had, an effect on the trading in its securities or would likely have an influence on investment decisions." *Nasdaq Stock Market Rule*, Rule IM 5250-1. See also *supra* note 392.

[402] *Moore Corp.* v. *Wallace Computer Servs. Inc.*, 907 F. Supp. 1545, 1558, 1560 (D. Del. 1995).

[403] *Air Prods. & Chems., Inc.* v. *Airgas, Inc.*, 16 A.3d 48 (Del. Ch. 2011).

[404] *See Allergan, Inc.* v. *Valeant Pharm. Int'l Inc.*, No. SACV 14–1214 DOC(ANx), 2014 WL 5604539 (C.D. Cal. Nov. 4, 2014).

[405] The technique of a white squire defense combined with a self-tender offer at market or a slight premium to market was used defensively by Diamond Shamrock and Phillips-Van Heusen in 1987. In neither of those instances, however, did the would-be acquiror challenge the defense. In 1989, the Delaware Court of Chancery upheld the issuance of convertible preferred stock by Polaroid Corporation to Corporate Partners in the face of an all-cash, all-shares tender offer, marks the most significant legal test of the white squire defense. *See Shamrock Holdings, Inc.* v. *Polaroid Corp.*, 559 A.2d 278 (Del. Ch. 1989). The Polaroid decision confirmed the prevailing line of cases upholding the issuance of stock to a white squire as a defensive measure when the result was not to consolidate voting control in management or employee hands.

[406] *Moran* v. *Household Int'l, Inc.*, 500 A.2d 1346, 1350 n.6 (Del. 1985).

[407] *In re AbbVie S'holder Derivative Litig.*, Cons. C.A. No. 9983-VCG, 2015 WL 4464505 (Del. Ch. July 21, 2015).

[408] *Depomed Inc.* v. *Horizon Pharma, PLC,* Nos. 1-15-CV-283834, 1-15-CV-283835 (Cal. Sup. Ct. Nov. 19, 2015).

[409] THOMSON REUTERS, MERGERS & ACQUISITIONS REVIEW, FULL YEAR 2015, *available at* http://dmi.thomsonreuters.com/Content/Files/4Q2015_Global_MandA_Legal_Advisory_Review.pdf.

[410] *Id.*

[411] INT'L INST. FOR THE STUDY OF CROSS-BORDER INVESTMENT AND M&A, XBMA ANNUAL REVIEW 2015 (Raaj Narayan & Francis Stapleton, eds., 2016) (2016), *available at* http://xbma.org/StatisticalReviews.aspx.

[412] THOMSON REUTERS DATABASE, SPECIAL MERGER SECTORS CUSTOM SEARCH, accessed on January 25, 2016.

[413] XBMA ANNUAL REVIEW 2015.

[414] THOMSON REUTERS DATABASE, SPECIAL MERGER SECTORS CUSTOM SEARCH, accessed on January 25, 2016.

[415] Julia Chariell and Tiffany Young, *US Federal Budget Dashboard: State of the Union 2016*, BLOOMBERG INTELLIGENCE (January 12, 2016); Richard Summerfield, *Cross-Border M&A* Boom, FINANCIER WORLDWIDE, Dec. 2014, *available at* http://www.financierworldwide.com/cross-border-ma-boom/#.VOzPpEfF_zg.

[416] *See* Wachtell, Lipton, Rosen & Katz, Comment Letter to SEC (July 24, 2008), *available at* http://www.sec.gov/comments/s7-10-08/s71008-28.pdf (commenting that the SEC's proposed revisions, which ultimately were adopted substantially as proposed with a few notable exceptions, should be revised to enact comprehensive reform, such as using U.S. trading volume—and not beneficial ownership—as the relevant criterion for determining the level of exemption; providing Tier I-style exemeptive relief to Section 13(d) regulation under the Williams Act; and eliminating the use of "unconventional tender offer" analysis in foreign transactions).

[417] *Morrison* v. *Nat'l Australia Bank Ltd.*, 561 U.S. 247 (2010).

NOTES

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Practical Law: Contingent Value Rights (CVRs)

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The authors would like to thank their colleague Thomas F. Coyle and their former colleague Octavian Timaru for their contributions to this article, and their colleague Eric Robinson for his thoughtful review and comments.

Contingent Value Rights (CVRs)

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The authors would like to thank their colleague Thomas F. Coyle and their former colleague Octavian Timaru for their contributions to this article, and their colleague Eric Robinson for his thoughtful review and comments.

This Practice Note explains contingent value rights (CVRs), including their most common structures, key features of a CVR, and the advantages and disadvantages of using a CVR. This Note also identifies the principal securities, accounting, and tax considerations associated with CVRs.

The contingent value right (CVR), an instrument committing an acquiror to pay additional consideration to a target company's stockholders on the occurrence of specified payment triggers, has long been a creative structuring technique for public M&A dealmakers. Sometimes referred to by other names, such as contingent payment rights, CVRs were first used in several high-profile transactions in the late 1980s to guarantee the value of acquiror shares used as merger consideration. More recently, CVRs have been primarily used to bridge valuation gaps relating to uncertain future events that would impact the target company's value.

Despite their resurgence in recent years, CVRs are not often used in public M&A transactions in part due to their complexity and risks. However, experience suggests that CVRs can be usefully deployed to solve some of the valuation and closing challenges that parties encounter and help get deals done.

THE FRAMEWORK OF A CVR

There are two main types of CVRs:

- **Price-Protection CVRs.** These guarantee the target's stockholders the value of acquiror shares issued as consideration in the transaction (see Price-Protection CVRs).
- **Event-Driven CVRs.** These give additional value to the target's stockholders depending on specified contingencies (see Event-Driven CVRs).

Because CVRs are created by contract and have been used to address a wide range of problems, they have evolved into customized instruments. While a comprehensive review of all the nuances that can be included in a CVR is beyond the scope of this Note, it is worthwhile to focus on some of the key features that are most often seen in these two varieties of CVRs.

PRICE-PROTECTION CVRs

Price-protection CVRs are used in transactions in which the consideration includes publicly traded securities, generally the acquiror's stock. This type of CVR is meant to assure the target's stockholders of the value of the consideration over some post-closing period. These CVRs typically provide for a payout equal to the amount (if any) by which the specified target price exceeds the actual price of the reference security at maturity. This value protection technique, which effectively sets a floor on the value of the reference securities issued to target stockholders, represents additional value for target stockholders.

The price-protection CVR rose to prominence when it was used to win the epic takeover contest between Viacom and QVC for control of Paramount Communications in 1993 and 1994. After several rounds of bidding in which both Viacom and QVC proposed transactions including cash and stock consideration, Viacom tipped the scales in its favor by adding a CVR to the consideration. That CVR offered Paramount stockholders an additional payment to the extent that the market value of Viacom stock was less than specified target prices on the first, second, or third anniversary of the closing (as chosen by Viacom). At the first anniversary, Viacom paid out about $1.44 for each CVR (as compared to a maximum potential cash payout at that maturity date of $12 for each CVR), for a total payment of about $82 million.

Viacom also used a CVR in its purchase of Blockbuster in 1994 (referred to in that transaction as a variable common right). It offered Blockbuster stockholders the right to receive an additional fraction of a share of Viacom Class B common stock. The exact additional amount was dependent on the market price of Viacom Class B common stock during the year following the closing.

While price-protection CVRs have also been used in recent years, their use has been less frequent than the event-driven variety (see Event-Driven CVRs). The price-protection CVR made a limited comeback during the record-setting 2015 M&A season in two well-publicized deals: Canadian Pacific Railway's unsolicited bid for Norfolk Southern and Energy Transfer Equity's later terminated agreement to acquire The Williams Companies.

Canadian Pacific's bid for Norfolk Southern featured a price-protection CVR that would have entitled the holder to receive a cash payment from Canadian Pacific equal to the amount (if any) by which the combined company's share price during the relevant measurement period was less than $175 per share, up to a maximum value of $25 per CVR. Energy Transfer Equity's terminated agreement to acquire The Williams Companies included a price protection CVR (which would have required an additional payment of shares or cash) tied to the difference, if any, between the volume-weighted average trading price of the acquiror's existing common units and its affiliate's newly issued common shares to be issued in the merger, over approximately a two-year period.

Target Prices, Caps, and Maturity Dates

Typically, a price-protection CVR has a maturity of one to three years. At maturity the holder receives a payment of either cash or securities if the market price of the acquiror's stock is below a target price. Parties usually set the target price above the pre-announcement trading price of the securities tied to the CVR. This effectively guarantees price appreciation. But the target price could also be set at or below the pre-announcement price, offering protection against declines.

Price-protection CVRs typically also include a floor price, which caps the potential payout under the CVR if the market value of the reference shares drops below the floor, functioning as a "collar." For example, in the Viacom/Paramount CVR, the first-year floor price was $36, meaning that the maximum payout to CVR holders would be $12 ($48 target price minus $36) because any share price below $36 effectively would be treated as if it were $36 for this purpose. Floor prices vary depending on the deal, but often range between a 25% and 50% discount to the target price.

Sometimes an acquiror may negotiate for the right to extend the CVR's maturity date as protection against short-term fluctuations in share prices. Typically any extension carries with it an increase in the target price and the floor price (often in the range of 5% to 10% a year). For example, in the Viacom/Paramount CVR, Viacom had the right to extend the maturity date two separate times, in each case by one year. The target price was $48 on the first maturity date, rose to $51 on the second maturity date, and rose again to $55 on the third. Similarly, the floor price increased from $36 on the first maturity date, to $37 on the second, and to $38 on the third. While Viacom did not exercise this extension right, acquirors tend to like the flexibility of the option, which can send a bullish signal to the market.

Cash Versus Stock

A threshold issue in any CVR negotiation, regardless of the nature of the payment trigger, is whether the CVR will be payable in cash and/or securities. Although most CVRs are cash settled, it is possible to settle a CVR with stock. If a CVR is to be settled at least partially in shares, the parties must determine how those shares will be valued at settlement. The shares are usually valued according to either:

- A formula based on trading prices over a period of time (which may, in the case of a price-protection CVR, be the same formula used to determine the current market value for purposes of determining whether payment is due).
- A predetermined price (less frequently).

For example, in Clinical Data's 2008 agreement to acquire Avalon Pharmaceuticals, Avalon's stockholders received CVRs payable on satisfaction of certain milestones. The CVR was to be settled in stock that was valued at a predetermined fixed price (the volume-weighted average trading price of Clinical Data common stock for the 15 trading days ending on the date of the merger agreement).

Occasionally the parties negotiate limits on the acquiror's obligation or right to issue shares to settle a CVR payment, which may:

- Protect the acquiror and its stockholders against significant dilution in case of a large drop in the acquiror's stock price. One method of accomplishing this is to put a minimum on the value used to determine the number of shares issuable on settlement (similar in effect to the "floor" concept, see Target Prices, Caps, and Maturity Dates). Another way to achieve the same result is to limit the overall stock payout by capping the amount of shares payable under the CVR, as was the case in the Viacom/Blockbuster CVR.
- Address other concerns, such as:
  - **Securities registration.** In ViroLogic's 2004 acquisition of ACLARA Biosciences, ViroLogic could make a portion of the CVR payment with its stock, but only if issuance of the stock was exempt from registration under Section 3(a)(9) of the Securities Act of 1933 (Securities Act) or was made under an effective Securities Act registration statement. Otherwise, the entire payment due would have to be made in cash.
  - **Avoiding need for stockholder approval.** In the 2006 Iconix/Mossimo transaction, the parties agreed to cap the aggregate number of shares issuable at the closing and at the maturity of the CVR to 19.99% of the acquiror's issued and outstanding shares (at the closing date or the end of the CVR measurement period), possibly to avoid stockholder approval requirements under stock exchange rules. The balance of any payment due under the CVR would be made in cash.

To provide additional flexibility, the acquiror may be given the right to settle the CVR in either cash or stock, at its election. Some examples of this election feature can be found in the following transactions: Viacom/Paramount (1994), Markel/Terra Nova (2000), ViroLogic/ACLARA BioSciences (2004), Aldabra/Boise Paper (2008), and Energy Transfer Equity/The Williams Company (2015) (agreement terminated). In the Viacom/Paramount CVR, Viacom not only could elect between cash and stock, but it could also use a range of Viacom securities to settle the CVR.

Redemption and Early Termination

Some CVRs permit the acquiror to redeem the CVRs, usually at a price equal to the target price less the current market price of acquiror shares on the redemption date, discounted back from the maturity date. Although an acquiror may prefer having the option to redeem the CVRs, exercising that right may, depending on the stated discount rate, send a bearish signal on expected future price appreciation.

Price-protection CVRs sometimes have early termination provisions, which provide for the CVRs to expire automatically in the event that the current market value of the acquiror's stock exceeds the target price (or some higher price) during the measurement period. Examples of these types of early termination provisions can be found in the following mergers: Viacom/Blockbuster (1994), ViroLogic/ACLARA BioSciences (2004), and Iconix/Mossimo (2006). To protect the holders of CVRs against a short-term price appreciation that would prematurely terminate the CVR, the early termination provision is often structured to require sustained price appreciation (for example, a period of 30 consecutive trading days).

Other Covenants and Events of Default

Certain covenants are designed to give CVR holders additional protections (both in price-protection and event-driven CVRs), such as:

- **Reservation of stock.** This type of covenant can be included in a CVR that may be settled with the acquiror's stock and requires the acquiror to reserve sufficient shares to satisfy the CVR obligations.
- **Stock exchange listing.** Where the CVR is to be listed, the CVR agreement typically requires the acquiror to use some level of efforts to cause the CVRs to be approved for listing on the relevant securities exchange.
- **Deal-specific matters.** Certain CVRs also include covenants tailored for the particular transaction. For example, the Dow Chemical/Marion (1989) and Rhone Poulenc/Rorer Group (1990) transactions (involving CVRs tied to the value of target securities) both:
  - prohibited the acquiror from causing the target to make any extraordinary distribution (defined as any dividend or distribution exceeding the ordinary quarterly dividends); and
  - included restrictions on the incurrence of liens by the acquiror.

CVR agreements may also include limited event of default provisions tied to, for example:

- Failure to make payment on the CVR when due.
- Certain breaches of the CVR agreement.
- Certain bankruptcy and insolvency events.

The occurrence of an event of default generally gives rise to certain remedies, including, in some cases, the accrual of interest until payment is made and/or the right to accelerate future CVR payments.

Other Common Provisions

Other features commonly associated with price-protection CVRs include:

- **Prohibition on share repurchases.** The acquiror and its affiliates typically are restricted from purchasing the acquiror's own stock (and occasionally, engaging in hedging activity) during the valuation period. This type of prohibition limits the potential upward pressure on acquiror stock that could lessen the value of the CVR. Although restrictions on share repurchases typically do not cover the announcement of a repurchase, there have been lawsuits against acquirors claiming that an announcement of an intention to make a tender offer for the reference securities (or allegedly false statements) were made to artificially inflate the stock price.
- **Protections against extraordinary transactions.** The acquiror may be required to make an early settlement of the CVR obligation if it enters into certain extraordinary transactions, such as a sale of substantially all of its assets or certain types of mergers. In this case the acquiror would likely pay to CVR holders the difference, if any, between:
  - the target price (discounted back for this purpose from the scheduled maturity date to the date of the transaction); and
  - the value of the consideration received in the transaction (or the floor price, if greater).

CVR agreements may also prohibit the acquiror from engaging in certain types of mergers or in a sale of substantially all of its assets unless the successor entity assumes the CVR obligations.

- **Anti-dilution adjustments.** CVRs frequently include provisions that adjust the target price and floor price upon the occurrence of certain events relating to the acquiror's shares (such as a stock dividend or stock split and, in some cases, certain mergers). However, CVR agreements do not typically provide for an adjustment in the event of a below-market share issuance. In the case of a CVR to be settled in stock, a stock-for-stock merger might also result in an adjustment of the securities issuable at maturity of the CVR. In that case any adjustment must be harmonized with any provision requiring the acquiror to make an early settlement of the CVR obligation upon certain mergers.

EVENT-DRIVEN CVRs

In recent years, CVRs have more frequently been used by acquirors and targets as a means of bridging a valuation gap related to a contingency. For example, these types of CVRs have included payouts dependent on:

- Milestone achievement (such as Food and Drug Administration (FDA) drug approval or entry into licensing agreements).
- Financial performance metrics (such as drug sales or company performance).
- Proceeds from litigations, sales of assets, or tax refunds.

For examples of transactions with these and other types of events triggering payment under a CVR, see Table, Deals With Event-Driven CVRs.

An event-driven CVR that is tied to financial performance metrics, such as EBITDA or revenues, is effectively the public M&A version of an earn-out (for a discussion of earn-outs in private M&A transactions, see Practice Note, Earn-Outs (0-500-1650)). For example, when Fresenius agreed to acquire APP Pharmaceuticals in 2008 for $23 per share in cash, it included a CVR that could deliver up to an additional $6 per share in cash. The CVR was dependent on whether APP's aggregate EBITDA for 2008, 2009, and 2010 (taking into account certain adjustments in connection with asset sales) exceeded a specified threshold. Many CVRs with earn-out features are focused on the financial performance of one or more particular products or segments of the target (for instance revenues from a particular drug), rather than company-wide measures (as in the Fresenius/APP transaction).

Event-driven CVRs have been particularly common in healthcare and biotech M&A deals, accounting for a majority of all CVRs. The prevalence of event-driven CVRs in the healthcare and biotech industries is explained by:

- The disproportionate impact that even a single successful or failed drug could have on the valuation of the target.
- Industry familiarity with the use of milestones in commercial arrangements, such as licensing and research and development agreements.

Sanofi-Aventis's 2011 agreement to acquire Genzyme for $20 billion and Celgene's 2010 agreement to acquire Abraxis BioScience for $2.9 billion are examples of CVRs with payments dependent on achieving regulatory milestones and product sales.

In the Sanofi/Genzyme transaction, each CVR provided for additional payments (up to an aggregate of nearly $4 billion) based on FDA approval, a production milestone, and four different product sales milestones. In the Celgene/Abraxis transaction, each CVR provided for additional payments to the Abraxis stockholders (up to an aggregate of $650 million) if certain FDA approvals were achieved before specific dates. The CVR also provided for a further payment if aggregate annual net sales of a chemical compound and certain Abraxis pipeline products exceeded $1 billion during specified periods.

Event-driven CVRs can be structured to address both contingent assets and contingent liabilities. For instance:

- A CVR that passes along a portion of a litigation recovery is an example of a CVR tied to a contingent asset.
- A CVR that pays out the portion of escrowed funds remaining after satisfaction of a litigation liability is an example of a CVR tied to a contingent liability. A CVR structured in this manner would require the parties to determine the amount to set aside for the potential liability, however, which may have a negative impact on settlement negotiations. Another method of addressing a potential litigation liability is to issue CVRs to the acquiror's stockholders that would ultimately be settled with a number of shares that increases with the size of the ultimate judgment or settlement in the litigation, diluting the interest of former target stockholders.

Payment Triggers

A key economic and legal term of an event-driven CVR is the definition of the payout trigger. For example, if the relevant trigger is FDA approval, the parties must be careful how to define the drug (or component thereof) and specify whether or not approval can be given subject to conditions (such as requiring certain labeling), and if so, what type. In the 2009 Endo Pharmaceuticals/Indevus Pharmaceuticals deal, the amount payable under the CVRs depended, in part, on whether the relevant drug was approved with certain labeling requirements. The payment trigger may also require that the regulatory approval be granted for at least a specified time period.

Some CVRs employ multiple triggers. For example, where FDA approval is a trigger, it is also common to see a trigger related to drug sales. In Ligand's 2009 agreement to acquire MetaBasis Therapeutics, separate CVR instruments were used to reflect the separate triggers (in that case, four CVR agreements were used). The separate payment triggers may or may not be dependent on one another, and may or may not provide alternative means of satisfying a particular payment trigger. For example, the Sanofi/Genzyme CVR employed four separate product sales milestones that looked at drug sales both during specified periods and on a rolling basis (with some overlap permitted between two of the four triggers).

Another variable in the event-driven CVR is the duration, which depends on the nature of the trigger and how soon after closing the contingency is expected to be resolved. CVRs tied to financial performance metrics or drug approval often use multi-year periods, with one to five years being common. The period over which drug sales revenue is measured often starts only once regulatory approval has been obtained, rather than on the date the CVR is issued.

Determining the Amount of the Payout

Another key economic term of an event-driven CVR is the formula for determining the amount of the payout. Where the trigger depends solely on meeting a milestone (such as regulatory approval), the payout is often a binary event. However, it can also be related to other variables such as timing of approval or attached conditions. In cases where variables tied to financial performance are incorporated into the trigger, the CVR might provide for a range of payments depending on the results.

This is illustrated in the Celgene/Abraxis CVR where one of the triggers provided for the following payments related to drug sales:

- 2.5% of annual net sales between $1 billion and $2 billion.
- An additional 5% of annual net sales between $2 billion and $3 billion.
- An additional 10% of annual net sales in excess of $3 billion.

Financial metric CVRs might also include special rules for calculating the relevant measurement metric, for example rules for calculating drug sales on a net basis after specified deductions.

Support Obligations

Because an acquiror frequently can influence the payout on an event-driven CVR (such as through its investment and marketing efforts), targets negotiating CVRs often request provisions designed to align incentives.

For example, where CVR holders are entitled to a large share of proceeds from a particular litigation, the target may desire provisions that give the acquiror incentives to maximize any recovery. Some ways to accomplish this are to:

- Provide the acquiror an economic stake in the outcome by assigning a portion of the litigation proceeds to the acquiror.
- Impose a duty to prosecute the litigation in good faith, with a view to maximizing the value of the proceeds.
- Allow a representative of the CVR holders to have partial or complete control over the conduct of the litigation and/or any settlement agreement. The representative generally has the right to engage and consult with counsel, tax experts, valuation firms, and other experts and third parties. These arrangements typically require that the acquiror be responsible for some amount of litigation expenses, with any expenses in excess of the agreed amount to be deducted from the litigation proceeds.

In CVR instruments where the payout depends on FDA approval or other product development milestones, target companies often require the acquiror to undertake a specified level of efforts to achieve the milestones. The consequences of not having this type of covenant were illustrated in the 2003 OSI Pharmaceuticals/Cell Pathways CVR. In that CVR, payment was triggered by the filing of an FDA application for either of two drugs by a specified date. Two years before the deadline, OSI stopped developing both products, eliminating the possibility of payouts under the CVR.

A typical covenant calls for the acquiror to use commercially reasonable efforts to continue development of a particular product. For example, in the CVR issued in the 2008 ViroPharma/Lev Pharmaceuticals transaction, ViroPharma was required to use "commercially reasonable effort consistent with pharmaceutical industry practices relating to products in a similar stage of marketing, development and approval and with similar economic potential, and considering the regulatory, legal, business, commercial and other facts and circumstances." Other examples of CVRs employing a commercially reasonable efforts or similar standard are Indevus/Valera (2006) and Ligand/Seragen (1998).

Another efforts standard sometimes used is diligent efforts (sometimes with specific language defining this standard). The Sanofi/Genzyme CVR used both a specifically defined "diligent efforts" standard for some purposes as well as a "commercially reasonable efforts" standard for others. In other situations, acquirors retain the sole discretion to make decisions concerning milestones that serve as triggers for the CVR (as in the Ligand Pharmaceuticals/Pharmacopeia CVR). Sole discretion and similar clauses may help an acquiror avoid committing itself to actions that, in the future, may not be in its best interest. However, granting broad discretion to the acquiror may leave CVR holders without protection in situations where the interests of the parties are no longer aligned.

Reporting Obligations and Audit Rights

Event-driven CVR agreements may require the acquiror to provide periodic reports to CVR holders of information relevant to the value of the CVR, such as the performance of the relevant operating segment, product line or loan portfolio on which the value of the CVR depends. For example, in the Fresenius/APP CVR, Fresenius was required to provide an adjusted EBITDA calculation in detail (along with a reconciliation to the most comparable GAAP measure) in its annual and quarterly reports filed with the SEC.

In addition, in some cases the CVR agreement expressly grants audit rights to CVR holders. These clauses often limit the frequency of audits and require reasonable advance notice. When negotiating audit rights, the parties must decide who pays for audits.

In the Celgene/Abraxis CVR, for example, the parties agreed that holders of a majority of CVRs could request one audit a year, but the requesting CVR holders would bear the cost of any audit (through a reduction in future CVR payments), unless the acquiror underpaid by more than 10%. In contrast, the Fresenius/APP CVR contained no limits on the number of audits and allocated the costs of the audits to the acquiror.

Other Protections

Transactions with affiliates. A target company may insist that a CVR tied to its financial performance include provisions restricting certain transactions with the acquiror's affiliates. For example, the Eaton/Fusion Systems CVR agreement (based on net sales) included a covenant prohibiting the acquiror from engaging in material transactions with affiliates that would reduce net sales during the measurement period, unless the transaction was on arms'-length terms. Another way to achieve a similar goal is to build a rule into the calculation of the relevant performance metric that ignores the effect of affiliate transactions that are not on arms'-length terms.

Disposal of assets. Another feature sometimes found in event-driven CVRs is a required payout in the event the acquiror disposes of the assets or businesses to which the CVR is tied. Also, some CVR agreements broadly prohibit the acquiror from entering into any agreement that restricts the company's ability to timely make any CVR payment.

THE PROS AND CONS OF CVRs

While the advantages and disadvantages of a CVR structure are best understood in the context of a particular transaction and largely depend on the type of CVR employed, there are several common themes that should be kept in mind.

POTENTIAL ADVANTAGES OF USING CVRs

Bridging Valuation Gaps

A key use of CVRs has been as a tool for bridging valuation gaps, especially in relation to a significant contingency. In some cases the parties can reach agreement on the appropriate value of a large part of the target business, but have fundamental disagreements about the likely future impact of a material contingency on the target's value. CVRs can offer the parties a way to save the transaction from falling apart over valuation.

Increasing Deal Certainty

A CVR can also provide an acquiror with protection similar to that offered by a closing condition without threatening the overall transaction. For example, if an acquiror has concerns about the likelihood of a development-stage drug receiving approval by the FDA or about the risk of an adverse judgment in a significant litigation, it may want to delay the signing or closing until the contingency has been resolved. This type of uncertainty may be unacceptable to the target. In this situation, a CVR can allow the parties to close a deal without resolving the contingency, and can also cut down on the acquiror's need for additional due diligence related to contingencies that are covered by the CVR.

For example, it was reported that ViroPharma's initial proposal to acquire Lev Pharmaceuticals was conditioned on Lev receiving FDA approval and orphan drug exclusivity for one of its drugs. By employing a CVR with payment triggers tied in part to satisfaction of these milestones, ViroPharma was able to drop that condition.

Providing Financing Benefits

Some acquirors may realize financing-related benefits from the use of a CVR. By reducing the total consideration required at closing, the CVR can act as a form of deferred financing. This can be an advantage depending on the acquiror's needs for and ability to obtain financing on acceptable terms through other means. A related point is that the delay in payment in a price-protection CVR gives the acquiror's management team time to realize value from synergies, which may, in the case of a price-protection CVR, reduce the likelihood that the CVR payment will be triggered.

Improving Market Perceptions

A CVR can also be beneficial in terms of market perceptions. For example, a price-protection CVR can signal management's confidence in the combined company's future performance. An acquiror's agreement to use a CVR whose value increases inversely with its stock price is generally perceived to be a bullish signal.

POTENTIAL DRAWBACKS OF USING CVRs

Execution Risks

A significant disadvantage to CVRs, and the likely reason for their relatively limited use, is their complexity. Because CVRs are highly-structured instruments with many variables, a large number of legal and other issues can arise when negotiating and implementing these devices.

CVR agreements are generally lengthy and involve many issues that require detailed negotiation and careful drafting, requiring time and resources that can otherwise be devoted to other aspects of the deal. In addition, including CVRs as a component of the deal could impose requirements under the federal securities laws that potentially lengthen the timeline to closing (see Securities Law and Other Legal Considerations).

Potential for Dispute

The complexity of CVRs can increase the risk of potential litigation in a transaction. One possible type of dispute involves a claim that the acquiror did not use adequate efforts to cause satisfaction of the CVR trigger conditions. A typical CVR likely would not entitle its holder to fiduciary protections under the law of most states. Indeed, most CVR agreements include express language limiting a CVR holder's rights to those set out in the agreement. Examples of this type of limiting language can be found in the CVR agreements from the following transactions: Celgene/Abraxis (2010), Ligand/MetaBasis Therapeutics (2009), Fresenius/APP (2008), Cytogen/Cytorad (1994), and ViroLogic/ACLARA BioSciences (2004).

However, as noted above, parties often impose efforts standards such as "commercially reasonable efforts" or "diligent efforts" that may be vague enough to form the basis of a claim. In addition, as a contractual instrument, a CVR may be deemed to include an implied covenant of good faith and fair dealing. In this regard the CVR holder can possibly claim that the acquiror breached an implied obligation to use efforts to enable the CVR holders to satisfy the event trigger. However, this type of claim may be difficult to sustain, particularly where contractual language grants the acquiror discretion in running the acquired business post-closing.

Tongue v. Sanofi, involved an event-driven CVR (worth up to an additional $3.8 billion) issued in connection with Sanofi's 2011 $20 billion acquisition of Genzyme (816 F.3d 199 (2d Cir. 2016)). At the time of the deal, Genzyme was engaged in clinical trials seeking FDA approval for Lemtrada, a promising multiple sclerosis drug. The CVR payments were tied to Lemtrada timely achieving certain regulatory approvals, namely FDA approval, which Sanofi was required to use "diligent efforts," "ignor[ing] the cost of potential milestone payments" to obtain under the terms of the agreement. However, at the time of the deal, Sanofi was also developing a competing multiple sclerosis drug, which received FDA approval in roughly half the time it took Lemtrada to get to market. The two class action lawsuits brought on behalf of subsequent purchasers of CVRs and certain former Genzyme shareholders alleged intentional misrepresentations in the CVR offering documents related to the status of the Lemtrada's FDA approval process. While the cases were ultimately dismissed on appeal to the Second Circuit, the Sanofi opinion was particularly noteworthy because it charged the plaintiffs who received CVR's pursuant to the merger with the knowledge and status of a sophisticated investor: "[w]hile a layperson, unaccustomed to the subtleties and intricacies of the pharmaceutical industry and registration statements, may have misinterpreted Defendants' statements as evincing assurance of success, Plaintiffs here can claim no such ignorance" (*Tongue v. Sanofi*, 816 F.3d 199, 211–12 (2d Cir. 2016)).

Rossdeutscher v. Viacom, a case involving the CVRs issued by Viacom in its acquisitions of Paramount and Blockbuster, illustrates a type of claim that can arise in the context of price-protection CVRs (768 A.2d 8 (Del. 2001)). In this case the plaintiffs claimed that Viacom released false economic data to artificially and temporarily inflate the value of Viacom's common stock during the measurement period of both CVRs to reduce the payment owed to the CVR holders. On appeal, the Delaware Supreme Court (applying New York law) held that the plaintiff's complaint stated claims for breach of the implied covenant of good faith and fair dealing inherent in the CVRs. A similar claim based on Rule 10b-5 under the Securities Exchange Act of 1934 (Exchange Act) was made by a holder of CVRs issued in the Dow Chemical/Marion transaction.

Negative Effect on the Acquiror and its Stock

In the case of event-driven CVRs, a potential disadvantage is that the acquiror may face significant multi-year operational restraints as a result of commitments to CVR holders. CVR agreements may have significant support obligations related to milestones or other triggers. Contractual restrictions may constrain the acquiror's management team and board of directors in making operational choices that would otherwise be preferable in the absence of these commitments.

CVRs can also have negative effects on the acquiror's stock. One drawback is the overhang associated with the potential payout under a price-protection CVR. Unlike in the event-driven variety, where large payouts are generally associated with positive outcomes, a payout under a price-protection CVR highlights poor stock price performance. Another potential drawback is the possibility that arbitrageurs, who tend to buy these CVRs and hedge their exposure with the acquiror's stock, may at times generate unwanted trading activity in the acquiror's shares.

In the case of CVRs where the payout is settled in stock, acquirors must reserve adequate shares and register (if not registered at the time of the initial transaction) and list them. Likewise, if the payout is in cash, acquirors must arrange for financing in advance, which has an associated cost. Target companies unwilling to assume the financing risk can try to require acquirors to deposit cash in escrow to satisfy any CVR obligations.

In addition, acquirors may be required to record the CVR as a liability on their balance sheets, which may be subject to subsequent mark-to-market adjustments that could result in income statement charges (see Accounting Considerations).

Valuation and Transferability Issues

While CVRs may be useful tools for bridging valuation gaps, there is also a possibility that they create their own valuation issues. Usually the greatest disagreement during negotiations concerns the selection of performance metrics or price-protection targets and the value of the CVRs.

Discussions regarding the intrinsic value of CVRs can be tricky because parties considering a CVR structure often negotiate price on parallel tracks (one track including the CVRs in the consideration and the other track not including the CVRs). In these situations an acquiror (in the case of a price-protection CVR) or target (in the case of an event-driven CVR) may be bullish about its prospects when discussing a deal not including CVRs. However, they may be less willing to stand behind these valuation claims when the parties are constructing and valuing a CVR.

Because target stockholders may not be natural holders of CVRs, they may undervalue CVRs as merger consideration. To enhance their value, parties can choose to make CVRs transferable (in which case, they are often also listed on a stock exchange), although nontransferable CVRs have been employed even in large public company deals. If transferable, arbitrageurs or event-driven hedge funds often end up acquiring a significant percentage of those CVRs. For example, it was reported that arbitrageurs held as much as 75% of each of the Viacom/Paramount and Viacom/Blockbuster CVRs.

These arbitrageurs and hedge funds often purchase CVRs at a discount to their intrinsic value and capture a significant part of the gains associated with them. For example, the Celgene/Abraxis CVRs traded at just 35% of their probability-adjusted net present value 30 days after the closing, while the Fresenius/APP CVRs traded at 55% of their probability-adjusted net present values in the same timeframe. As a result, even where a CVR is transferable, it is possible that the acquiror's cost of issuing the CVR is greater than the value that the target stockholders place on it.

A transferable CVR is likely to require registration under the federal securities laws, which may create timing disadvantages, although the protections of the securities laws also might be viewed as increasing the value of the CVRs (see Securities Law and Other Legal Considerations).

In some cases the possible consequences of registration may be viewed as so burdensome that the parties condition the very existence of the CVR on its exemption from registration. For example, in the 2000 Saga Systems/Software AG transaction, the CVR agreement provided that if the SEC requested registration of the CVR, the parties would use reasonable efforts to satisfy the SEC that the CVR was not a "security," and that the CVRs would terminate without any payment if registration was required.

Credit Risk

A CVR exposes its holders to the credit risk of the acquiror because it typically is an unsecured obligation that may not be repaid in full in the event of bankruptcy. CVR agreements often contain provisions expressly subordinating the CVRs to senior obligations of the acquiror. Also, CVR holders receiving securities of the acquiror as part of the consideration may even find that their bankruptcy claims arising under the CVRs can be subordinated to all other unsecured obligations (not only senior obligations) of the acquiror under Section 510(b) of the Bankruptcy Code.

Courts have subordinated price-protection CVR claims where the CVRs were deemed to be "obligation[s] undertaken by [the debtor] in connection with the issuance of [its] stock" (see *In re Kaiser Group Intl.*, 260 B.R. 684, 687 (Bankr. D. Del. 2001)). On the other hand, though the precedential value is unclear because of other factors in the case, there was no subordination where the CVRs were deemed "claims to recover payment due under agreements of sale of businesses" and merely "deferred compensation" providing the "bargained for sales price" (see *In re Nationsrent, Inc.*, 381 B.R. 83, 92 (D. Del. 2008)). CVR holders who remain investors in the acquiring company are more likely to be at risk of subordination than holders who "divest [themselves] of all indicia of share ownership" (see *In re Kaiser Group Intl.*, 260 B.R. at 688).

Disclosure Obligations

The use of a CVR that requires registration under the Exchange Act may impose additional ongoing disclosure and reporting obligations on an acquiror (see Exchange Act Registration and Reporting). For some acquirors, such as private or foreign companies, this may represent a large administrative and financial burden.

For an overview of public company periodic reporting and disclosure obligations, see Practice Note, Periodic Reporting and Disclosure Obligations: Overview (7-381-0961).

SECURITIES LAW AND OTHER LEGAL CONSIDERATIONS

DOES A CVR REQUIRE REGISTRATION UNDER THE SECURITIES ACT?

The issuance of a CVR, even if payable in cash, may require registration under the Securities Act if it is considered a "security." In a series of no-action letters, the SEC has developed a multi-factor test that is applied to determine whether a CVR is a security as defined in Section 2(a)(1) of the Securities Act. The SEC has indicated that the following five factors (with some variation in wording) must be present to conclude that a CVR is not a security:

- The rights are an integral part of the consideration in the merger.
- The holders of the rights have no rights common to stockholders (such as voting and dividend rights).
- The rights are non-interest bearing.
- The rights are not assignable or transferable except by operation of law.
- The rights are not represented by any form of certificate or instrument.

(See *Minnesota Mining and Manufacturing Co.*, SEC No-Action Letter, 1988 WL 234978 (Oct. 13, 1988).)

Although these five factors are generally considered key in analyzing whether the SEC will deem a CVR a security, no-action letters have also, on occasion, noted additional factors as supporting the conclusion that the CVR is not a security, including:

- The right is not dependent on the operating results of any party involved.

- Almost all of the holders of the rights will continue with the surviving corporation as employees.
- The value of the payments resulting from the rights is a small fraction of the overall consideration.

(See *Genentech Clinic Partners III*, SEC No-Action Letter, 1989 WL 246044 (Apr. 28, 1989) and *Northwestern Mutual Life Insurance Co.*, SEC No-Action Letter, 1983 WL 30832 (Mar. 3, 1983).)

In particular, while the link between CVR payments and the operating results of the acquiror has been listed as a factor in many no-action letters, it has not been consistently applied. Even where that factor has been discussed, acquirors have often successfully argued that the CVR being issued does not depend on the overall operating results of the company, but rather on the results of a particular product or subsidiary (usually the target company) (for example, see *Safeway Inc.*, Letter in Response to SEC Comments re. Preliminary Proxy on Schedule 14A (April 17, 2014), *Essex Communications Corp.*, SEC No-Action Letter, 1988 WL 234498 (June 28, 1988), *GID/TL, Inc*., SEC No-Action Letter, 1989 WL 245921 (Mar. 21, 1989), and *Genentech Clinic Partners III*, SEC No-Action Letter, 1989 WL 246044 (April 28, 1989)).

In practice, transferability of the CVR is likely the most significant determinant of whether or not SEC registration is necessary. If the target company is willing to accept nontransferable CVRs, the parties typically can structure the CVR in a manner that does not require registration.

If a CVR is deemed a security, its issuance can generally be registered on the same form as other types of acquiror securities, if any, issued in the transaction (on a Form S-4, in the case of a typical merger transaction). In the case of stock-settled CVRs, the underlying shares are usually also registered on the same form. Even if a CVR is a security, it may be possible to structure the CVR in a manner that does not require registration of its issuance under the Securities Act. For example, in the 1997 Eaton/Fusion Systems transaction, the target distributed transferable CVRs to its stockholders through a dividend. For an examination of the disclosure requirements of a registration statement on Form S-4, see Practice Note, Registration Statement: Form S-4 and Business Combinations (5-384-6225).

EXCHANGE ACT REGISTRATION AND REPORTING

CVRs may also give rise to registration and reporting obligations under the Exchange Act. Section 12(b) of the Exchange Act requires registration of any security listed on a national securities exchange. Even where CVRs are not listed, it may be necessary to register them under Section 12(g) of the Exchange Act, which generally requires registration of a class of "equity security" that is held by 2,000 or more persons (or 500 or more persons who are not accredited investors) if the issuer has assets exceeding $10 million. For this analysis, the acquiror must determine whether the CVRs fall under the definition of equity security in Section 3(a)(11) of the Exchange Act, which includes specific instruments such as warrants but is also broadly defined to include "any stock or similar security" (Rule 3a11-1, Exchange Act). In practice, most CVR issuers who register under the Securities Act also register under the Exchange Act.

Where Exchange Act registration is required, it is usually effected on a Form 8-A. Once CVRs have been registered under the Securities Act, registration under the Exchange Act typically would not impose a significant burden, because it is likely that the acquiror can simply incorporate the information in the Securities Act registration statement into the Exchange Act registration statement. For information on the requirements of registration on Form 8-A, see Practice Note, Registration Statement: Form 8-A (9-382-2519).

Section 13 of the Exchange Act requires an issuer of a security registered under Section 12(b) or 12(g) to file periodic reports (such as annual reports on Form 10-K, quarterly reports on Form 10-Q, and current reports on Form 8-K). There appears to be no direct SEC authority discussing the disclosure requirements concerning a CVR registered under the Exchange Act. However, parties should be aware of the possibility of additional disclosure as a result of Exchange Act registration. For example, if a CVR is tied to the settlement of a litigation, there may be questions regarding whether the Exchange Act would require ongoing disclosure of developments concerning that litigation, even if the litigation would not otherwise be material to the acquiror and developments would not ordinarily be disclosed in the acquiror's Exchange Act filings.

The questions concerning the disclosure and reporting requirements for CVRs (particularly of the earn-out variety) can be viewed as similar to those raised in the context of tracking stock. Generally tracking stock is an additional class of stock that a company creates to track the performance of a particular business or division. Like tracking stock, an earn-out CVR registered under the Exchange Act is a security whose value depends on a particular business or division of a company.

The SEC has stated that an issuer of tracking stock must include financial statements about the tracking stock in its Exchange Act reports. The burden of Exchange Act registration of CVRs may be even greater on private companies or foreign issuers, which may not otherwise have Exchange Act reporting obligations at all (or have only limited obligations). For an overview of public company periodic reporting and disclosure obligations, see Practice Note, Periodic Reporting and Disclosure Obligations: Overview (7-381-0961).

LISTING CVRs ON A SECURITIES EXCHANGE

CVRs may be traded on a securities exchange, provided that the requisite listing standards are met. To be listed on the New York Stock Exchange (NYSE), an issue of CVRs must meet the following conditions:

- At least one million CVRs must be outstanding.
- There must be at least 400 CVR holders.
- The CVR must have a minimum life of one year.
- The CVRs must have a market value of at least $4 million.

(Section 703.18, NYSE Listed Company Manual.)

CVRs may be delisted from the NYSE when either:

- The market value of the CVRs is less than $1 million.
- The related equity security to which the cash payment at maturity is tied is delisted.

As a result, in the case of a price-protection CVR, delisting of the CVR may occur where the reference security is trading at a sufficiently high level.

For a CVR to qualify for listing on NASDAQ, the acquiror must have:

- More than $100 million in assets.
- Stockholders' equity of at least $10 million.
- Annual income from continuing operations before taxes of at least $1 million in the most recently completed fiscal year or in two of the three most recently completed fiscal years. In the case of a company that is unable to satisfy this income criteria, NASDAQ generally requires the company to have the following:
  - assets in excess of $200 million and stockholders' equity of at least $10 million; or
  - assets in excess of $100 million and stockholders' equity of at least $20 million.

(Rule 5730(a)(1)(A), NASDAQ Listing Rules.)

In addition, the CVR issue must have:

- At least 400 CVR holders.
- A minimum public distribution of at least 1 million units.
- A minimum market value/principal amount of at least $4 million.

(Rule 5730(a)(1)(B)-(C), NASDAQ Listing Rules.)

For more information on the listing requirements for the NYSE and NASDAQ, see Practice Note, Selecting a US Securities Exchange (3-381-1953).

TRUST INDENTURE ACT MATTERS

The terms of a CVR are typically embodied in a separate CVR agreement, with the form attached as an exhibit to the merger agreement. The CVR agreement is usually executed at the closing. In rare cases involving nontransferable CVRs, the CVR terms have been set out in the merger agreement rather than in a stand-alone document. Before drafting the terms of the CVR, the parties must determine whether a CVR has to be qualified under the Trust Indenture Act of 1939 (TIA). When it applies, the TIA requires, among other things, that CVRs be issued under an indenture and that a trustee be appointed to protect the rights of the CVR holders (see The Role of the Trustee or Representative).

Under TIA Section 304(a)(1), a security will be exempted if it is not any of the following:

- A note, bond, debenture, or evidence of indebtedness, whether or not secured.
- A certificate of interest or participation in any note, bond, debenture, or evidence of indebtedness.
- A temporary certificate for, or guarantee of, any note, bond, debenture, evidence of indebtedness, or certificate.

As a result, qualifying under the TIA is required only in connection with debt securities. Where CVRs combine elements of debt and equity, determining whether TIA qualification is required can be a difficult judgment call.

Qualifying under the TIA protects CVR holders by mandating that certain provisions be automatically included in the CVR agreement or indenture. For example, TIA Section 316(b) requires that any CVR holder's right to receive payment generally not be impaired without the holder's consent.

The TIA also automatically includes in each qualified agreement certain default provisions that can be modified by contract. This includes the Section 316(a) provision authorizing the holders of a majority of the CVRs to instruct the trustee to assert claims or exercise powers under the CVR agreement.

THE ROLE OF THE TRUSTEE OR REPRESENTATIVE

Because the number of CVR holders can be large, CVR agreements generally appoint a trustee, rights agent, or other representative to oversee the rights of the holders and perform certain actions on their behalf. The powers and responsibilities of the trustee or representative depend partly on whether the agreement must be qualified under the TIA (see Trust Indenture Act Matters).

The trustee or representative generally is either named in the form of CVR agreement or chosen mutually by the parties after signing the merger agreement. Where the CVR agreement is qualified under the TIA, the trustee must meet certain independence and capital requirements set out in the TIA. If a trustee subsequently becomes conflicted, he may be required to resign. In some cases CVR holders can petition a court for removal and replacement of the trustee. TIA-qualified CVR agreements also typically allow holders of a specified percentage of CVRs (usually a majority) to remove a trustee and appoint a successor.

A typical trustee or representative is responsible for certain administrative functions, including:

- Maintaining a register of the CVRs and their current holders.
- Facilitating any transfers (if permitted).
- Handling payments to the holders.

When acting under a TIA-qualified agreement (see Trust Indenture Act Matters), the CVR trustee usually has broad powers to act on behalf of the holders. However, holders of a specified percentage of CVRs (generally a majority) have the right to instruct the trustee to take certain actions on behalf of the CVR holders, such as requesting an audit or claiming a breach. In a CVR agreement that is not TIA-qualified, the threshold for directing the action of the representative is sometimes set lower (as low as 20% in some cases).

In some cases the CVR agreement requires the acquiror to deliver a certificate to the trustee or representative stating its calculation of the payment amount (or that no payment is due). It may also permit holders of a certain percentage of CVRs to direct the trustee or representative to object to the acquiror's determination within a specified period.

In addition, many CVR agreements also limit the ability of individual holders to institute any action against the acquiror under the agreement, except where the trustee or representative has failed to follow the instructions of the holders of the required percentage of CVRs. However, as a result of TIA Section 316(b), individual holders cannot be limited from bringing a claim under a TIA-qualified agreement if the action concerns the right of the holder to receive payment. TIA-qualified agreements also tend to lack dispute resolution or arbitration clauses that limit individual holders' options in the event of a dispute (though the TIA technically only forecloses these limitations where the right to sue for payment is involved). On the other hand, non-TIA-qualified agreements often include arbitration or dispute resolution clauses, particularly where there is a complex mechanism for determining the outcome of the contingency or the payment due.

Both TIA-qualified and non-TIA-qualified agreements often have a multi-tiered approach to amendments. Some amendments can be made by the acquiror and trustee or representative without the consent of any holders. These are generally administrative amendments that do not have a significant impact on the rights of the CVR holders or amendments to add acquiror covenants giving CVR holders additional protections. Other amendments typically require the consent of the holders of a designated percentage of the CVRs (often 50%).

However, under TIA Section 316(b), TIA-qualified agreements require the unanimous consent of the holders for amendments that affect the amount or payment date(s) of the CVRs. By contrast, some non-TIA-qualified agreements can be amended with the consent of holders of the designated percentage, regardless of whether or not the amendment may have an adverse impact on individual holders.

For more information on the TIA and the rights of securityholders, see Practice Note, Indenture and Indenture Trustee: Governing Laws: Directions to Trustee (9-386-4929).

SPECIAL ISSUES IN TENDER OFFERS

While most CVRs have been issued in transactions structured as one-step mergers, CVRs can also be used as consideration in a tender offer (for example, see What's Market, Valeant Pharmaceuticals International/Synergetics Tender Offer Summary, What's Market, Actavis/Durata Therapeutics Tender Offer Summary, and What's Market, Sanofi-Aventis/Genzyme Tender Offer Summary). This may raise additional issues under the Williams Act and various SEC tender offer rules (see Practice Note, Tender Offers: Overview: Regulation of Tender Offers (1-382-7403)). The SEC has issued comments on tender offer filings raising the question of whether or not the use of CVRs violates Exchange Act Rule 14e-1(c), which requires that the offeror "pay the consideration offered ... promptly after the termination ... of a tender offer."

For example, in Endo Pharmaceuticals' tender offer for all shares of Indevus Pharmaceuticals, the SEC questioned whether unregistered future cash payments contingent on regulatory and commercial milestones would comply with Rule 14e-1(c) when the additional payments may not be made for five years (if at all). Endo Pharmaceuticals succeeded in arguing that it did not violate the prompt payment requirement because the CVRs should be viewed as contractual rights to receive additional cash payments in the future if certain events occur. As a result, the tendering Indevus stockholders did promptly receive their consideration (the contractual rights issued on closing of the tender offer), even if no cash was paid at that time. Most recently, this line of argument was again advanced successfully by Valeant Pharmaceuticals in response to SEC comments on its offer to purchase Synergetics USA in October of 2015 (see *Valeant Pharmaceuticals International*, Letter in Response to SEC comments re: Synergetics USA, Inc. Schedule TO-T and TO-T/A (September 28, 2015)).

Although a tender offer structure generally may provide timing benefits relative to a one-step transaction, parties should be aware that tender offers involving CVRs deemed to be "securities" can create timing delays. As a general matter, the offering of securities in an exchange offer must be registered under the Securities Act. This requires SEC clearance of the registration statement and may have a longer timeline to complete than a cash tender offer.

Unless there is another means of issuing the CVR without registration (for example, by distributing the CVR as a dividend as discussed above), parties should determine whether the desire for speed of execution outweighs the benefits of using a CVR.

For an overview of tender offers, including the types of tender offers, how a tender offer is initiated and the steps required to complete a tender offer, see Practice Note, Tender Offers: Overview (1-382-7403).

ACCOUNTING CONSIDERATIONS

Generally, the accounting treatment for CVRs under US GAAP is governed by the Accounting Standards Codification 805 "Business Combinations" (ASC 805) (formerly SFAS 141R). ASC 805 mandates fair value accounting for contingent consideration in business combinations. Before the adoption of this accounting standard, contingent payments were usually recognized only when the contingency was resolved.

After the adoption of ASC 805, the issuance of cash-settled CVRs requires the acquiror to set up a liability account on its balance sheet equal to the fair value of the CVRs at the time of closing. The fair value of the CVRs is typically determined at issuance by one of two ways:

- Discounting the probability-weighted future payments at an appropriate risk-adjusted rate.
- Using derivative valuation methods such as the Black-Scholes option pricing model.

Because the fair value of the CVR is deemed part of the consideration paid in the transaction, under the purchase accounting method for business combinations mandated by ASC 805, the fair value of the CVR will also be reflected on the asset side of the balance sheet (generally by an equal increase in the goodwill account).

Each quarter, the established CVR liability must be marked to market, with the resulting increases and decreases flowing through the income statement. At settlement, any cash ultimately paid reduces the previously established CVR liability without further impact on the income statement (to the extent that the marked-to-market liability accurately predicted the cash ultimately paid at settlement).

Where CVRs are to be paid in stock, the same accounting rules generally apply. As with cash-settled CVRs, the acquiror must establish an appropriately valued liability that must be marked to market. The only significant difference in treatment arises at settlement, at which time the equity account is increased.

TAX TREATMENT

The US federal income tax consequences resulting from the target stockholder's receipt of a CVR and the receipt of payments under a CVR depend on a variety of factors, including:

- Whether the target's securities are publicly traded.
- Whether the CVR has a reasonably ascertainable fair market value.
- The type of consideration payable under the CVR.

Generally, a target stockholder who receives a CVR with a reasonably ascertainable fair market value in a taxable acquisition of a publicly traded corporation must include the fair market value of that CVR in determining the amount of gain or loss recognized. By contrast, if a CVR does not have a reasonably ascertainable fair market value, the target stockholder may be able to defer the recognition of income until payments are received under the CVR.

Use of a CVR in a transaction that otherwise qualifies as a tax-free reorganization may not result in immediate taxation to the exchanging stockholders or jeopardize the tax-free nature of the transaction if the CVR provides for certain features, including that:

- It can only give rise to the receipt of additional stock.
- The maximum number of shares which may be issued is stated.
- Not more than 50% of the total number of shares issued in the transaction are issued under the CVR.
- All the stock will be issued within five years.
- The CVR is not transferable.

(Rev. Proc. 84-42.)

Therefore, merger partners may be able to structure either a tax-free or a taxable transaction without having CVRs jeopardize the desired overall tax treatment.

EVENT-DRIVEN CVRs

Event	Deals
FDA Approval	Shire/Dyax (2015), Actavis/Durata Therapeutics (2014), Forest Laboratories/Furiex Pharmaceuticals (2014), Astra Zeneca/Omthera (2013), Wright Medical Group/BioMimetic Therapeutics (2012), Spectrum Pharmaceuticals/Allos Therapeutics (2012), Sanofi-Aventis/Genzyme (2011), Celgene/Abraxis (2010), Endo Pharmaceuticals/Indevus Pharmaceuticals (2009), ViroPharma/Lev Pharmaceuticals (2008), Boston Scientific/Rubicon (2005) and Ligand Pharmaceuticals/Seragen (1998).
Product Sales Revenues	Valeant Pharmaceuticals/Synergetics (2015), Actavis/Durata Therapeutics (2014), Teva Pharmaceuticals/NuPathe (2014), H. Lundbeck/Chelsea Therapeutics (2014), Astra Zeneca/Omthera (2013), Endo Health Solutions/NuPathe (2013), Cubist Pharmaceuticals/Optimer Pharmaceuticals (2013), Cubist Pharmaceuticals/Trius Therapeutics (2013), Sanofi-Aventis/Genzyme (2011), Forest Laboratories/Clinical Data (2011), Celgene/Abraxis (2010), Endo Pharmaceuticals/Indevus Pharmaceuticals (2009), ViroPharma/Lev Pharmaceuticals (2008), Boston Scientific/Rubicon (2005) and Baxter International/Somatogen (1998).
Operating Performance/Commercial Milestones	Alexza Pharmaceuticals/Grupo Ferrer Internacional (2016), Daiichi Sankyo/Ambit Biosciences (2014), Fresenius/APP Pharmaceuticals (2008), Onstream Media/Narrowstep (2008) and Toro/Exmark Manufacturing (1997).
Sale or License of Assets	Nexstar Broadcasting Group/Media General (2016), RestorGenex/ Diffusion Pharmaceuticals (2015), Albertson's/Safeway (2014), AT&T/Leap Wireless (2013), MB Financial/Taylor Capital (2013), NYSE Euronext/American Stock Exchange (2008), Petters Group/Polaroid (2005), Software AG/Saga Systems (2000) and Harvey's Casino Resorts/Pinnacle Entertainment (2000).
Litigation Collections	Community Health Systems/Health Management Associates (2013), Vision Technologies Kinetics/Miltope Group (2003) and Symphony Technologies and Tennenbaum & Co./Information Resources (2003).
Accounts Receivable Collections	Psychiatric Solutions/PMR Corp. (2002).
Tax Refunds	Cambium Learning Group/Voyager Learning Company (2009).

CVR PRECEDENTS

BUSINESS LAW CENTER

Sign on to the Business Law Center on WestlawNext to access recent examples of merger agreements with contingent value rights. This list of precedents has been generated for you by Practical Law editors and can be further filtered or modified.

Not currently a subscriber of the Business Law Center? Request a free trial to the Business Law Center on Westlaw to access this list of search results as well as conduct your own business law research.

The Business Law Center, available on Westlaw, is a comprehensive database of SEC and global filings, offering memoranda and other agreements.

WHAT'S MARKET DATABASE

What's Market includes a continuously updated database of public filings and agreements, including merger agreements, allowing you to analyze and compare terms or features across multiple deals or filings, and access relevant precedents through direct links to the underlying agreements and disclosure documents. Our What's Market team reviews and summarizes the key terms of publicly filed acquisition agreements of US reporting companies (excluding REITs and debt-only issuers) with a signing value of at least $100 million. In addition to being able to categorize deals by type, such as public merger agreements, you can also categorize deals by:

- Industry.
- Consideration.
- Tender offer.
- Buyer type.
- Debt financing.
- Go-shop provisions.
- Break-up fee percentage.
- Reverse break-up fee percentage.
- Date.
- Value.

To use What's Market to find the latest public merger agreements utilizing contingent value rights follow these steps:

- Go to the What's Market database.
- Click on "Public Merger Agreements" under "Corporate and M&A."
- Add "and 'contingent value rights'" to the search parameters and click on the search button.
- Then either:
  - Click on the precedent summary you want to see (the contingent value rights information will appear under the "Consideration" section); or
  - Select multiple precedents by clicking on the applicable boxes, then click the "Compare" button, and select the "Consideration" category to see your selected precedents' consideration summaries side-by-side in a convenient layout that allows you to export these deal comparisons in either Word or Excel format.

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Deal Lawyers; Vol. 11, No. 1: The Disclosure of Material Relationships by Financial Advisors—Board Disclosure Memos v. Engagement Letter Provisions (January–February 2017)

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The author gratefully acknowledges the comments of David M. Schwartzbaum, a partner of Covington & Burling LLP. Any errors are the sole responsibility of the author.

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The Disclosure of Material Relationships by Financial Advisors

Board Disclosure Memos v. Engagement Letter Provisions

By Kevin Miller[1]

> *"But what is critical is that banks have a sensible and defensible disclosure policy that tracks and helps surface potential material conflicts. … It is also vital that there not be a partial approach to conflict disclosure, which leaves open the possibility for 'oh by the way' moments that were foreseeable. Disclosure is comforting to clients and the courts, as it suggests a forthright attempt to grapple with self-interest in [a] principled, ethical way." Leo E. Strine, Jr., Chief Justice of the Supreme Court of Delaware"*[2]

Board Disclosure Memos

Given the focus of the Delaware courts on the duties of boards to investigate and consider the potential conflicts of their financial advisors,[3] many financial advisors are now providing the boards of their sellside clients or prospective clients with memos containing information regarding their material relationships with the most-likely buyers.

These "Board Disclosure Memoranda" are typically provided at a relatively early stage in the sales process, when the most-likely buyers are believed to have been identified and are intended to assist the board in evaluating the depth and breadth of the financial advisor's relationships with those most-likely buyers so that the board can make an informed decision with respect to whether the financial advisor will be able to provide the board with the objective financial and strategic advice that the board needs.

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[1] Kevin Miller is a partner in the New York office of Alston & Bird LLP. The views expressed in this article are solely those of the author and do not necessarily reflect the views of Alston & Bird LLP or its clients. The author gratefully acknowledges the comments of David M. Schwartzbaum, a partner of Covington & Burling LLP. Any errors are the sole responsibility of the author.

[2] Strine, Leo E., Documenting the Deal: How Quality Control and Candor Can Improve Boardroom Decision-Making and Reduce the Litigation Target Zone. Business Lawyer, Vol. 70 No. 3 (Summer 2015).

[3] *See e.g., RBC Capital Mkts. v. Jervis,* No. 140, 2015, (Del. Nov. 30, 2015); *In re Zale Corp. S'holder Litig.,* No. 9388-VCP (Del. Ch. Oct. 1, 2015), *amended on reargument* by (Del. Ch. Oct. 29, 2015), *rev'd sub. nom. Singh v. Attenborough,* 137 A.3d 151 (Del. May 6, 2016); *In re Dole Food Co. S'holder Lit.,* CA No. 8703-VCL (Del. Ch. Aug. 27, 2015); *In re PLX Technology S'holders Lit.,* CA No. 9880-VCL (Del. Ch. April 15, 2015) (Transcript of Oral Argument) and Sept. 3, 2015 (Telephonic Ruling); *In re El Paso Corp. S'holder Litig.,* CA No. 6949-CS (Del. Ch. Feb. 29, 2012); and *In re Del Monte Foods Co. S'holders Litig.,* No. 6027-VCL (Del. Ch. Feb. 14, 2011). However, it is worth noting that at a legal seminar in May, 2012, then Chancellor Strine is reported to have said, "Banks with the least number of potential conflicts (*i.e.*, boutique banks) are not necessarily the best advisors for a target company."

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The forms of Board Disclosure Memoranda that financial advisors have developed typically focus on the range of aggregate fees received during the past two years for providing investment banking advice and services (*e.g.*, M&A advisory, capital markets and financing) to the most-likely buyers and any material financial interests the financial advisor has in those most-likely buyers. Board Disclosure Memoranda also typically disclose whether any of the senior investment banking professionals assigned or expected to be assigned by the financial advisor to perform the sellside advisory engagement have material relationships with or financial interests in the most-likely buyers. To the extent facts and circumstances warrant, the forms of Board Disclosure Memoranda being used by financial advisors can be modified to provide additional information requested by the board.

Engagement Letter Provisions

As an alternative to the Board Disclosure Memorandum approach, an article in *The Business Lawyer* recommended that companies engaging financial advisors obtain detailed representations, warranties, covenants and remedy provisions in financial advisor engagement letters with respect to the disclosure of the financial advisor's material relationships with potential buyers.[4]

Requirements for Effective Disclosure

Consistent with the theme of Chief Justice Strine's article, the primary goal of counsel and financial advisors should be to assist boards in making informed business decisions.

Effective disclosure for purposes of informed board decision making requires three things:

> *Content*—the disclosure of adequate information regarding the financial advisor's material relationships with prospective buyers;
>
> *Timing*—the disclosure of information at the beginning or at a relatively early state in the sales process; and
>
> *Access*—board access and attention to the disclosed information.

Though not the primary objective, collateral benefits of effective disclosure that assists boards in making informed business decisions include the increased likelihood that a board's decisions will survive legal challenge and the reduced likelihood that a company's board or its financial advisor will be found liable for any damages resulting from those business decisions.

Board Disclosure Memorandum v. Engagement Letter Provisions

- Content—The delivery of a Board Disclosure Memorandum to a client's or prospective client's board at a relatively early stage in the sale process that discloses the range of aggregate fees received during the past two years (*e.g.*, less than $X million; between $X and $Y million; between $Y million and $Z million; more than $Z million) for providing investment banking advice and services to the most-likely buyers, as well as any material financial interests the financial advisor has in those most-likely buyers, will generally provide the board with adequate information to assess the benefits and risks associated with relying on the financial advisor's advice when making key decisions.[5]

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[4] Klinger-Wilensky, Eric S. and Emeritz, Nathan P., Financial Advisor Engagement Letters: Post-Rural/Metro Thoughts and Observations. Business Lawyer, Vol. 71 No.1 (Winter 2015/2016). The authors of *The Business Lawyer* artic)le acknowledged many of the issues and concerns discussed below, but nevertheless advocated for detailed representations, warranties, covenants and remedy provisions in financial advisor engagement letters to address the disclosure of material financial advisor relationships with prospective bidders.

[5] *See In re OM Group S'holders Litig.,* CA No. 11216-VCS (Del. Ch. Oct. 12, 2016) ("The Proxy also disclosed that 'more than €140 million in fees [had been paid to [OM Group's financial advisor]] from [the Buyer]' since January 1, 2013. In this regard, stockholders were advised that the OM Board knew upon [OM Group's financial advisor]'s engagement that it 'had an ongoing relationship with [the Buyer] and its affiliated funds and had received significant fees from [the Buyer] and its affiliates for a variety of investment and commercial banking services over the prior three years.' With these disclosures in hand, OM stockholders knew … that the OM Board was aware that [OM Group's financial advisor] had received 'significant fees' from Apollo at the time the OM Board agreed to the engagement. *It is not reasonably conceivable that stockholders would have found the timing of the OM Board's discovery that 'significant fees' means '€140 million' to be important in deciding whether to vote to approve the merger.*" (emphasis added)).

In contrast, the principal purpose of contractual provisions in engagement letters, like other professional services contracts and contracts generally, is to define the much broader rights, responsibilities, obligations and remedies of the parties for purposes of allocating risk and liability. Attempting to address the need for adequate disclosure regarding a financial advisor's material relationships with potential buyers by means of contractual provisions in an engagement letter as advocated by *The Business Lawyer* article often results in demands for overly detailed disclosure that takes too long to negotiate and prepare (and, to the extent verifiable, adequately verify) and that may require the consent of third parties unwilling to provide consent in a timely manner, if at all. Furthermore, because of issues regarding the effectiveness of contractual remedies, it is not clear that contractual provisions regarding the disclosure of material relationships in an engagement letter do a very good job of allocating risk and liability.

– Timing—Proponents of Board Disclosure Memoranda believe that once a limited number of the most-likely buyers has been identified—whether before or at the outset of a sale process, following the receipt of first-round indications of interest or following management presentations—information regarding the financial advisor's material relationships with the most-likely buyers can and should be promptly provided to a client's or prospective client's board and periodically updated as facts and circumstances warrant—*e.g.*, to reflect additional likely buyers or material changes in the previously disclosed information regarding the financial advisor's material relationships with the most-likely buyers. By providing a Board Disclosure Memorandum to a client's or prospective client's board at a relatively early stage in the sale process, financial advisors provide the board with an opportunity to review and discuss the financial advisor's material relationships with the most-likely buyers directly with the financial advisor when it has the greatest utility, without having to wait for the terms of the engagement letter to be finalized. Delaying the selection of a financial advisor and/or action upon its advice until the detailed disclosure provisions in an engagement letter have been finalized and the resulting disclosures regarding the financial advisor's material relationships with potential buyers have been reviewed by the board risks delay that could adversely affect the likelihood of a successful transaction.

– Access—Providing a Board Disclosure Memorandum to the board at a relatively early stage in a sales process also significantly increases the likelihood that the board will be better positioned to make informed judgments regarding the selection of a financial advisor and/or the weight to be given to the financial advisor's advice, the need for additional information regarding those relationships and the possible need for a second advisor. Given that contractual provisions in an engagement letter relating to the disclosure of a financial advisor's material relationships with potential buyers would form only a part of the broader contractual relationship established by a financial advisor's engagement letter and that engagement letters are often negotiated contemporaneously with the performance of an engagement, the board may not have adequate time to address the resulting disclosures regarding a financial advisor's material relationships with potential buyers if the contractually required disclosures are received toward the end of the sales process.

– Other Considerations—In addition, if a primary goal of detailed contractual provisions in an engagement letter relating to the disclosure of the financial advisor's material relationships with potential buyers is to allocate risk and liability, it is far from clear that such provisions will provide an effective remedy. Given that, despite alleged conflicts, virtually all negotiated mergers still close, any contractual claims for breach of provisions in an engagement letter brought by a target company will inure to the benefit of the buyer as the new owner of the target. Even if the target becomes aware of such claims prior to the execution of the merger agreement, attempts by the target to negotiate for additional consideration from the buyer reflecting the value of such claims will not likely succeed since buyers will be unlikely to attribute much value to claims against the target's financial advisor that allegedly resulted in the buyer obtaining a favorable purchase price.

* * *

In practice, it appears that, as a result of the issues and concerns discussed above regarding the use of contractual provisions in financial advisor engagement letters to address the need for the disclosure of a financial advisor's material relationships with the potential buyers and issues and concerns with respect to the available remedies for any breach of those engagement letter provisions, the Board Disclosure Memorandum has become the predominant market approach for addressing the need for disclosure of a financial advisor's material relationships with the most-likely buyers to a client's or prospective client's board.

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Investment Banker Issues & Considerations (PowerPoint slides)

Kevin Miller

Alston & Bird LLP

Investment Banker Issues & Considerations

Doing Deals 2017:
The Art of M&A Transactional Practice

Wednesday, March 8, 2017

Kevin Miller
Alston & Bird LLP
New York, NY

Investment Banker Issues & Considerations

- *Identifying and Addressing Material Investment Banker Relationships*
- *Financial Analyses Underlying Fairness Opinions – What's on the Football Field?*
- *Aiding and Abetting Claims – Implications of Trulia and Attenborough (aka Zale)*

Investment Banker Issues & Considerations

Identifying and Addressing Material Investment Banker Relationships

Disclosure of Material Financial Advisor Relationships

The Focus on Disclosure

- Disclosure of material relationships and actual and potential conflicts of interest has received increased attention given the number of breach of fiduciary duty claims and aiding and abetting breach of fiduciary duty claims based in whole or in part on alleged inadequate disclosure of material relationships and conflicts to the board.
- Boards need to consider the implications of material relationships between prospective financial advisors and potential counterparties and other interested parties (which may include management):

> “But what is critical is that banks have a sensible and defensible disclosure policy that tracks and helps surface potential material conflicts …. It is also vital that there not be a partial approach to conflict disclosure, which leaves open the possibility for “oh by the way” moments that were foreseeable. Disclosure is comforting to clients and the courts, as it suggests a forthright attempt to grapple with self-interest in principled, ethical way. . . . If conflicts were surfaced, contained, and addressed, and a strong hand was given to the impartial members of the board, the plaintiffs’ ability to suggest that those conflicts infected the why [certain decisions were made] is impaired. It will therefore be more difficult for the plaintiffs to get the deal enjoined or to press a damages case.” Strine, Leo E., “Documenting the Deal: How Quality Control and Candor Can Improve Boardroom Decision-Making and Reduce the Litigation Target Zone,” Business Lawyer, Vol. 70 No. 3 (Summer 2015).

Disclosure of Material Financial Advisor Relationships (cont'd)

But Chief Justice Strine has also noted that:

"Banks with the least number of potential conflicts (i.e., boutique banks) are not necessarily the best advisors for a target company..." http://www.paulhastings.com/publicationdetail.aspx?publicationId=2191.

"[T]here is a difference between the typical conflicts that involve a bank or lawyer working semi-regularly on engagements for key players, such as private equity firms, and more unusual, more material conflicts." Strine, Leo E., "Documenting the Deal: How Quality Control and Candor Can Improve Boardroom Decision-Making and Reduce the Litigation Target Zone," Business Lawyer, Vol. 70 No. 3 (Summer 2015).

And others have observed that:

"The Delaware courts are undoubtedly cognizant and respectful of the fact that the most effective advisory services are often rendered by bankers with relationships that run broadly and deeply in the relevant industry. In general, the courts are not seeking to dictate the choice of adviser, but rather are promoting transparency and supervision." http://blogs.law.harvard.edu/corpgov/2012/05/31/delaware-decisions-data-points-not-doctrine/.

Disclosure of Material Financial Advisor Relationships (cont'd)

Examples of What May Need to be Disclosed

- Material investment banking relationships – aggregate fees or revenues received for providing material investment banking advice and services (M&A advisory, capital markets, financing) to most likely buyers during past two years
- Material financial interests – i.e., material amounts of equity, debt and other securities and financial instruments held by the financial advisor and senior deal team members in the most likely buyers
- Loans to or participations in credit facilities of most likely buyers
- Interest in seeking other roles in transaction, such as financing potential buyers
- Recent targeted pitches to potential buyers concerning a potential transaction involving the client (*e.g., Zale*)
- Material relationships between senior members of the investment banking team (including as a recent employee at other investment banks) and most likely buyers

Disclosure of Material Financial Advisor Relationships (cont'd)

Mechanics of Disclosure

- When and how to disclose relationships/actual and potential conflicts of interest:
  - Outset of engagement (e.g., single bidder process)
  - Once limited number of likely buyers identified
    - At outset if most likely buyers believed to be known
    - Prior to second round of bids (e.g., if broad auction)
- How to disclose to the board:
  - Verbally
    - Evidentiary concerns if recollections differ
  - Writing
    - Creates contemporaneous written record
- Where to disclose:
  - Memo to Board of Directors/Board book
  - Engagement letters

Disclosure of Material Financial Advisor Relationships (cont’d)

Board Disclosure Memoranda

- “Board Disclosure Memoranda” are typically provided at a relatively early stage in the sales process, so that the board can make an informed decision with respect to whether the financial advisor will be able to provide the board with the objective financial and strategic advice that the board needs.
- The forms of Board Disclosure Memoranda typically focus on the range of aggregate fees received during the past two years for providing investment banking advice and services (e.g., M&A advisory, capital markets and financing) to the most-likely buyers and any material financial interests the financial advisor has in those most-likely buyers.
- Board Disclosure Memoranda also typically disclose whether any of the senior investment banking professionals assigned by the financial advisor to perform the sellside advisory engagement have material relationships with or financial interests in the most-likely buyers.
- To the extent facts and circumstances warrant, the forms of Board Disclosure Memoranda being used by financial advisors can be modified to provide additional information requested by the board or as otherwise may be appropriate.

Disclosure of Material Financial Advisor Relationships (cont'd)

Engagement Letter Provisions

- As an alternative to the Board Disclosure Memorandum approach, an article in *The Business Lawyer* recommended that companies engaging financial advisors obtain detailed representations, warranties, covenants and remedy provisions in financial advisor engagement letters with respect to the disclosure of the financial advisor's material relationships with potential buyers. Klinger-Wilensky, Eric S. and Emeritz, Nathan P., "Financial Advisor Engagement Letters: Post-*Rural/Metro* Thoughts and Observations. Business Lawyer," Vol. 71 No.1 (Winter 2015/2016).

Disclosure of Material Financial Advisor Relationships (cont'd)

Requirements for Effective Disclosure

Consistent with the theme of Chief Justice Strine's article, the primary goal of counsel and financial advisors should be to assist boards in making informed business decisions.

- Effective disclosure for purposes of informed board decision making requires three things:
  - *Content* – the disclosure of adequate information regarding the financial advisor's material relationships with prospective buyers;
  - *Timing* – the disclosure of information at the beginning or at a relatively early state in the sales process; and
  - *Access* – board access and attention to the disclosed information.
- Though not the primary objective, additional benefits of effective disclosure that assists boards in making informed business decisions include the increased likelihood that a board's decisions will survive legal challenge and the reduced likelihood that a company's board or its financial advisor will be found liable for any damages resulting from the board's business decisions.

Disclosure of Material Financial Advisor Relationships (cont'd)

Board Disclosure Memorandum v. Engagement Letter Provisions - Content

- *Content* – The delivery of a Board Disclosure Memorandum to a client's or prospective client's board at a relatively early stage in the sale process that discloses the range of aggregate fees received during the past two years (e.g., less than $X million; between $X and $Y million; between $Y million and $Z million; more than $Z million) for providing investment banking advice and services to the most-likely buyers, as well as any material financial interests the financial advisor has in those most-likely buyers, will generally provide the board with adequate information to assess the benefits and risks associated with relying on the financial advisor's advice when making key decisions.
- Attempting to address the need for adequate disclosure regarding a financial advisor's material relationships with potential buyers by means of contractual provisions in an engagement letter often results in demands for detailed disclosure that takes a long time to negotiate and prepare (and, to the extent verifiable, adequately verify) and that may require the consent of third parties (e.g., the financial advisor's other clients) who may not be willing to provide consent in a timely manner, if at all.

Disclosure of Material Financial Advisor Relationships (cont'd)

Board Disclosure Memorandum v. Engagement Letter Provisions - Timing

- *Timing* – Proponents of Board Disclosure Memoranda believe that once a limited number of the most-likely buyers has been identified, information regarding the financial advisor's material relationships with the most-likely buyers can and should be promptly provided to a client's or prospective client's board and periodically updated as facts and circumstances warrant – e.g., to reflect additional likely buyers or material changes in the previously disclosed information regarding the financial advisor's material relationships with the most-likely buyers.
- Delaying the selection of a financial advisor and/or board action upon its financial advisor's advice until the detailed disclosure provisions in an engagement letter have been finalized and the resulting disclosures regarding the financial advisor's material relationships with potential buyers have been reviewed by the board, risks delay that could adversely affect the timing (and potentially even the likelihood) of a successful transaction.

Disclosure of Material Financial Advisor Relationships (cont'd)

Board Disclosure Memorandum v. Engagement Letter Provisions - Access

- *Access* – Providing a Board Disclosure Memorandum to the board at a relatively early stage in a sales process also significantly increases the likelihood that the board will be better positioned to make informed judgments regarding the selection of a financial advisor and/or the weight to be given to the financial advisor's advice, the need for additional information regarding those relationships and the possible need for a second advisor.
- Given that contractual provisions in an engagement letter relating to the disclosure of a financial advisor's material relationships with potential buyers would form only a part of the broader contractual relationship established by a financial advisor's engagement letter and that engagement letters are often negotiated concurrently with the performance of an engagement, the board may not have adequate time to address the resulting disclosures regarding a financial advisor's material relationships with potential buyers if the contractually required disclosures are not received until late in the sales process.

Disclosure of Material Financial Advisor Relationships (cont'd)

Board Disclosure Memorandum v. Engagement Letter Provisions - Other

- *Other Considerations* – In addition, if a primary goal of detailed contractual provisions in an engagement letter relating to the disclosure of the financial advisor's material relationships with potential buyers is to allocate risk and liability, it is far from clear that such provisions will provide an effective remedy to the company retaining the financial advisor or that company's stockholders.
  - Given that, despite alleged conflicts, virtually all negotiated mergers still close, any contractual claims for breach of provisions in an engagement letter brought by a target company will inure to the benefit of the buyer as the new owner of the target.
  - Even if the target becomes aware of such claims prior to the execution of the merger agreement, attempts by the target to negotiate for additional consideration from the buyer reflecting the value of such claims will not likely succeed since buyers will be unlikely to attribute much value to claims against the target's financial advisor that allegedly resulted in the buyer obtaining a favorable purchase price.

Disclosure of Material Financial Advisor Relationships (cont'd)

Board Disclosure Memorandum v. Engagement Letter Provisions

- In practice, it appears that, as a result of the issues and concerns discussed above, the Board Disclosure Memorandum has become the predominant market approach for addressing the need for disclosure of a financial advisor's material relationships with the most-likely buyers to a client's or prospective client's board.

Investment Banker Issues & Considerations

Financial Analyses Underlying Fairness Opinions – What's on the Football Field?

Financial Analyses Underlying Fairness Opinions – *What's on the football field*

- **Purpose of the Football Field**
  - Summarizes the financial analysis performed in connection with preparation of a fairness opinion but may include other considerations
  - Format typically tracks the transaction structure
    - dollar values in cash or fixed value transactions
    - exchange ratios in stock-for-stock/fixed exchange ratio mergers
  - As a summary, should be reviewed and considered in the context of the more detailed underlying analysis
    - "All analyses are not created equal"- each reflects a different focus and perspectives and needs to be considered in the context of the specific facts and circumstances presented
    - Different analyses have unique advantages and limitations, and as such, differ in informational value under the facts and circumstances presented

Financial Analyses Underlying Fairness Opinions – *What's on the football field (cont'd)*

- **Most Common Financial Analyses**
  - Selected Companies Analysis
  - Selected Transactions Analysis
  - Discounted Cash Flow Analysis
  - Contribution Analysis (Stock Consideration)
- **Other Potential Analyses and Considerations (whether or not on the football field)**
  - Historical Stock Trading Analysis (i.e., 52 week high/low)
  - Wall Street Research Price Targets
  - Premiums Paid Analysis
  - Leveraged Buyout (LBO) Analysis
  - Merger Consequences – accretion/dilution
  - Illustrative Future Stock Trading Analysis

Financial Analyses Underlying Fairness Opinions – *Selected Considerations*

- Choice of Analytical Methodologies, Assumptions and Inputs
  - Exercise of professional judgment taking into account relevant facts and circumstances
  - Precedent, convention and consistency plays an important role in establishing the analytic parameters of the valuation
  - Certain common analyses may be excluded if significant limitations impair their value/utility

Financial Analyses Underlying Fairness Opinions – *Selected Considerations (cont'd)*

- Choice of Methodologies, Assumptions and Inputs (cont'd)
  - Discounted cash flow analysis
    - Projections are the critical input to the analysis and should reflect management's current best estimates with respect to the future financial performance of the Company
    - Financial advisors rely upon the Company for the preparation of projections and approval to use/rely upon the projections for purposes of their dcf and other analyses
      - Multiple forecasts endorsed by management can create issues
    - Treatment of synergies, NOLs
    - Other dcf considerations:
      - cost of capital discount rates
        - Equity risk premia, betas and other inputs
      - approaches to terminal valuation
        - multiples vs. perpetuity growth rates
        - terminal value multiples based on selected companies analysis vs. selected transactions analysis

Financial Analyses Underlying Fairness Opinions – *Selected Considerations (cont'd)*

- Choice of Methodologies, Assumptions and Inputs (cont'd)
  - Selected companies analysis
    - How comparable are the companies relative to each other and to the subject company – business profile, operating and financial metrics
    - Addressing material changes in the subject company's business- historical and/or projected
    - Relevant metrics for assessing value – industry/company specific
    - Selection of reference ranges: mathematical/fixed criteria vs. exercise of professional judgment (median vs. selected multiple ranges that may not be centered on median)

Financial Analyses Underlying Fairness Opinions – *Selected Considerations (cont'd)*

- Choice of Methodologies, Assumptions and Inputs (cont'd)
  - Selected transactions analysis (additional considerations to those for selected companies)
    - Timeframe of completed transactions included in the analysis
    - Changes in market conditions over time for the transactions considered
    - Different forms of consideration (cash, cash/stock, all-stock)
    - Different transaction structure terms – 338 (h)(10), acquired NOLs
    - Unique considerations of particular acquirer which impact price paid – quantum of synergies, strategic imperative

Financial Analyses Underlying Fairness Opinions – *Selected Considerations (cont'd)*

- Selected Discussion Topics
  - Must financial analyses underlying fairness opinions follow case law regarding statutory appraisals?
  - What if management projections generate DCF valuation ranges significantly in excess of the proposed purchase price?
  - What if not all of the analyses support a fairness conclusion?
  - How do inadequacy opinions rendered in response to unsolicited offers differ from fairness opinions?

Investment Banker Issues & Considerations

Aiding and Abetting Claims – Implications of Trulia and Attenborough (aka Zale)

Trulia

***In re Trulia, Inc. S'holder Litig.*, CA 10020-CB (Del. Ch. Jan. 22, 2016)**

- In *Trulia*, the Delaware Court of Chancery rejected a disclosure-only settlement as inadequate.
  - The Court found that the supplemental disclosures obtained by the plaintiffs were inadequate to support a broad release of class claims – the supplemental disclosures were not "plainly" material
    - In order to support a broad release of class claims, the supplemental disclosures must be "plainly" material – i.e., "significantly alters the total mix of information made available"

Trulia

In re Trulia (cont'd)

- "A fair summary, however, is a summary. By definition, it need not contain all information underlying the financial advisor's opinion or contained in its report to the board. 56 Indeed, this Court has held that the summary does not need to provide sufficient data to allow the stockholders to perform their own independent valuation.57 The essence of a fair summary is not a cornucopia of financial data, but rather an accurate description of the advisor's methodology and key assumptions.58 In my view, disclosures that provide extraneous details do not contribute to a fair summary and do not add value for stockholders.59"

See "Additional Materials" – on pages 61 to 63 for footnotes 56 through 59

Trulia

In re Trulia (cont'd)

- "[P]ractitioners should expect that disclosure settlements are likely to be met with continued disfavor in the future unless the supplemental disclosures address a *plainly material misrepresentation or omission*, and the subject matter of the proposed re-lease is narrowly circumscribed to encompass nothing more than disclosure claims and fiduciary duty claims concerning the sale process, if the record shows that such claims have been investigated sufficiently. In using the term "plainly material," I mean that it should not be a close call that the supplemental information is material as that term is defined under Delaware law. Where the supplemental information is not plainly material, it may be appropriate for the Court to appoint an *amicus curiae* to assist the Court in its evaluation of the alleged benefits of the supplemental disclosures, given the challenges posed by the non-adversarial nature of the typical disclosure settlement hearing."

Trulia

In re Trulia (cont'd)

Materiality of Individual Transaction Multiples

- "The Proxy disclosed that J.P. Morgan used publicly available information to analyze certain selected precedent transactions involving companies engaged in businesses that J.P. Morgan considered analogous to Trulia's businesses. The Proxy listed the date, the target, and the acquirer for each of 32 transactions that were considered. It also disclosed the low and high forward EBITDA multiples for the group of transactions. . . . Plaintiffs' grievance is that the Proxy did not provide the relevant multiples for each of the 32 individual transactions. The individual multiples were added in the Supplemental Disclosures for those transactions for which the information was publicly available. The addition of this information made evident that multiples were not publicly available for 15 of the 32 transactions. . . . **The addition of the individual multiples and the revelation that some were not publicly available could not reasonably have been expected to significantly alter the total mix of information (emphasis added).**"

Trulia

In re Trulia (cont'd)

Materiality of Individual Company Multiples

- "The Proxy disclosed the names of sixteen publicly traded companies that J.P. Morgan used to construct ranges of forward EBITDA and revenue multiples for Trulia and Zillow. The Proxy provided these multiples for Trulia and Zillow based on their last unaffected trading day before the announcement of the merger. . . . The Supplemental Disclosures added the revenue and EBITDA multiples for each of the sixteen companies. Citing In re Celera Corporation Shareholder Litigation, plaintiffs argue, in essence, that individual company multiples are material per se. **That is not a fair reading of the case. . . . . Although the decision reluctantly concluded that a multiples disclosure was compensable, it found it "questionable whether [the multiples] altered the 'total mix' of available information" because that information "already was publicly available." The individual company multiples in the Supplemental Disclosures here also were already publicly available. (emphasis added)"**

Trulia

In re Trulia (cont'd)

Materiality of Implied Terminal EBITDA Multiples

- "J.P. Morgan performed a relative discounted cash flow analysis to determine the per-share equity values of Trulia and Zillow, using expected cash flows from 2014 through 2028 based on management's projections for each company and the perpetuity growth method to calculate the companies' respective terminal values. The Proxy explained this methodology and provided the assumptions J.P. Morgan used in its analysis. Specifically, the Proxy disclosed management's projections of unlevered free cash flows, the ranges of discount rates (11.0% to 15.0%) and perpetuity growth rates (2.5% to 3.5%) that were used, the terminal period projected cash flows, and other details. **In my view, these disclosures already provided a more-than-fair summary of the relative discounted cash flow analysis that J.P. Morgan performed** The Supplemental Disclosures added to this summary the EBITDA exit multiple ranges for Trulia and Zillow that were implied by the range of terminal values calculated based on J.P. Morgan's chosen inputs. Plaintiffs argue that, although J.P. Morgan used the perpetuity growth method and only derived the implied EBITDA exit multiples to check the strength of its methodology, the implied multiples were important to stockholders. **. . . . . the supplemental disclosure immaterial. (emphasis added)"**

Trulia

In re Walgreen, No 15-3799 (7th Cir 8-10-16) – *Subsequent Federal Judicial Commentary on Trulia*

- "The type of class action illustrated by this case—the class action that yields fees for class counsel and nothing for the class—is no better than a racket. It must end. No class action settlement that yields zero benefits for the class should be approved, and a class action that seeks only worthless benefits for the class should be dismissed out of hand. . . . And so *Trulia* adopted a clearer standard for the approval of such settlements, *id*. at 898–99 (footnotes omitted, emphasis added), which we endorse, and apply in this case . . ."

Singh v. Attenborough

***Singh v. Attenborough*, Case No.: 645, 2015 (Del May 6, 2016)**

- In *Attenborough*, the Supreme Court affirmed the Court of Chancery's decision upon reargument following the Delaware Supreme Court's decision in *Corwin v. KKR Fin. Holdings LLC,* 125 A.3d 304 (Del. 2015) finding that a fully informed, uncoerced vote of the disinterested stockholders invoked the business judgment standard of review, effectively extinguishing those claims. "When the business judgment rule standard of review is invoked because of a vote, dismissal is typically the result."
- In effect, fully informed and uncoerced, stockholders only get one bite at the apple – if they approve a transaction, they cannot then turn around and sue their directors or executive officers for gross negligence or pursue aiding and abetting breach of fiduciary claims against buyers, advisors or other third parties predicated on such alleged gross negligence.

Singh v. Attenborough (cont'd)

Subsequent Court of Chancery Opinions Interpreting Corwin

***In Re Volcano,* CA 10485-VCMR (Del. Ch. June 30, 2016)**

- Corwin also applies to two step mergers pursuant to 251(h)
- The failure of the breach of fiduciary duty claims against Volcano's directors as a result of the irrebuttable presumption of the business judgment rule resulted in the dismissed the aiding and abetting claims against Volcano's financial advisor. *See also* Attenborough ("Having correctly decided, however, that the stockholder vote was fully informed and voluntary, the Court of Chancery properly dismissed the plaintiffs' claims against all parties.") and Corwin ("An aiding and abetting claim[, however,] 'may be summarily dismissed based upon the failure of the breach of fiduciary duty claims against the director defendants.")

Singh v. Attenborough (cont'd)

Subsequent Court of Chancery Opinions Interpreting Corwin

City of Miami General Employees' and Sanitation Employees' Retirement Trust v Comstock, CA No. 9980-CB (Del. Ch. Aug. 24, 2016)

- "I conclude that plaintiff's claims for postclosing damages against C&J's directors and officers are subject to the business judgment presumption under the Delaware Supreme Court's decision in Corwin v. KKR Financial Holdings LLC because of the legal effect of the stockholder vote, and that judicial review of plaintiff's fiduciary duty claims (and related aiding and abetting claims) thus ends there. This conclusion follows from two subsidiary determinations: that plaintiff has failed to plead facts sufficient to demonstrate that the C&J stockholder vote was not fully informed, and that plaintiff has not alleged facts showing that the challenged transaction, which was approved by a majority of disinterested and independent directors, should be subject to entire fairness review."
- No discussion of whether business judgment rule presumption is irrebuttable.
- "A claim for aiding and abetting a breach of fiduciary duty cannot survive if the underlying fiduciary duty claims do not."

Singh v. Attenborough (cont'd)

Subsequent Court of Chancery Opinions Interpreting Corwin

***Larkin v. S*hah (*aka Auspex*), CA No. 10918-VCS (Del. Ch. Aug. 25, 2016)**

- C Bouchard's opinion in C&J appeared to suggest that Corwin does not apply to transactions subject to the entire fairness standard of review ("the Supreme Court held in Corwin that if a transaction that is not subject to entire fairness is approved by a fully informed, uncoerced vote of stockholders, Revlon review does not apply and the appropriate standard for a post-closing damages action is the business judgment rule.. . . .plaintiff has not alleged facts showing that the challenged transaction, which was approved by a majority of disinterested and independent directors, should be subject to entire fairness review")
- In Auspex, VC Slights independently examined the issue in a decision rendered one day later and concluded that "[i]n the absence of a controlling stockholder that extracted personal benefits, the effect of disinterested stockholder approval of the merger is review under the **irrebuttable business judgment rule**, even if the transaction might otherwise have been subject to the entire fairness standard due to conflicts faced by individual directors." (emphasis added)

Singh v. Attenborough (cont'd)

Subsequent Court of Chancery Opinions Interpreting Corwin

***Chester County Retirement System v Collins (aka Blount)*, CA No. 12072-VCL (Del. Ch. Dec. 6, 2016)**

- "[W]hen a transaction has been approved by a majority of the disinterested stockholders in a fully informed and uncoerced vote, the business judgment rule applies and 'insulates the transaction from all attacks other than on the grounds of waste[.]'"
- Cites ***Larkin v. S*hah -** "In the absence of a controlling stockholder that extracted personal benefits, the effect of disinterested stockholder approval of the merger is review under the **irrebuttable business judgment rule**, even if the transaction might otherwise have been subject to the entire fairness standard due to conflicts faced by individual directors." (emphasis added)
- Having failed to adequately plead a claim for breach of fiduciary duty, the Court of Chancery held that the plaintiff likewise failed to adequately plead aiding and abetting breach of fiduciary duty claims against Blount's financial advisor and against the buyers and also granted dismissal of those claims.

Singh v. Attenborough (cont'd)

Dicta Regarding Financial Advisor Liability

- "Delaware has provided advisors with a high degree of insulation from liability by employing a defendant-friendly standard that requires plaintiffs to prove scienter and awards advisors an effective immunity from due-care liability. As held in *RBC Capital Markets, LLC v. Jervis* [*aka Rural/Metro*], however, an advisor whose bad-faith actions cause its board clients to breach their situational fiduciary duties (e.g., the duties Revlon imposes in a change-of-control transaction) is liable for aiding and abetting. The advisor is not absolved from liability simply because its clients' actions were taken in good-faith reliance on misleading and incomplete advice tainted by the advisor's own knowing disloyalty. To grant immunity to an advisor because its own clients were duped by it would be unprincipled and would allow corporate advisors a level of unaccountability afforded to no other professionals in our society. In fact, most professionals face liability under a standard involving mere negligence, not the second highest state of scienter—knowledge—in the model penal code."

Investment Banker Issues & Considerations

Additional Materials

Investment Banker Issues & Considerations

Additional Materials – Financial Analyses Underlying Fairness Opinions – What's on the Football Field?

Fairness Opinions

- What Are They?
  - An opinion with respect to whether the consideration (sometimes expressed as an exchange ratio in a stock for stock deal) paid/issued or received in a transaction is fair from a financial point of view to the party or persons paying/issuing or receiving the consideration, as applicable.
- Why Does a Board Want One?
  - To help the board demonstrate that it gathered all reasonably available information in fulfilling its fiduciary duty of care in approving the transaction.
- When Are They Required?
  - They are not required under Delaware law or the Federal Securities Laws. Most companies will obtain them in connection with transactions requiring shareholder approval and many companies will obtain them in connection with transactions of a certain size or significance even if no stockholder approval is required (i.e., if sufficiently material to the company).
- When Do Boards Need Them Delivered?
  - Generally at the meeting at which the board approves the transaction.

Fairness Opinion Considerations

- Fairness opinions are not a substitute for the exercise of business judgment by a board and senior management – the scope of a fairness opinion is limited to an evaluation of the fairness of the consideration to be paid or received from a financial point of view.
- The benefits of a fairness opinion are limited if rendered after the transaction is authorized by the board.
- The key for boards is to gather all reasonably available information and to act in good faith on an informed basis. A detailed financial presentation and discussion with the board is often more valuable than a two- or three-page fairness opinion.

Fairness Opinions – *What They Say*

- What Do Fairness Opinions Say:
  - In connection with a divestiture, a Fairness Opinion addresses the fairness, from a financial point of view, to the seller of the consideration to be received by the seller.
  - In connection with an acquisition, a Fairness Opinion addresses the fairness, from a financial point of view, to the buyer of the consideration to be paid by the buyer.
  - Only in connection with transactions where the stockholders of a company receive consideration (i.e., a sale of the entire company) will a Fairness Opinion address the fairness, from a financial point of view, to the holders of common stock of the company of the consideration to be received by such stockholders in the sale. Certain stockholders may be carved out.
  - Fairness Opinions only address the fairness “from a financial point of view” of the consideration being paid or received by a party actually paying or receiving consideration.
  - Fairness Opinions speak of a specific date, and opinion providers generally disclaim any duty or obligation to update or reaffirm their opinions.

Fairness Opinions –
What They Don't Say

- What Fairness Opinions Don't Say:
  - They do not address the relative merits of a particular transaction as compared to alternative business strategies.
  - They do not address the company's underlying business decision to pursue a transaction.
  - They do not constitute a recommendation to stockholders on how to vote or act with respect to a transaction.

Fairness Opinions –
What They Don't Say (cont.)

- What Fairness Opinions Don't Say (cont.):
  - They do not typically address the allocation of the aggregate consideration to be received among holders of different classes of capital stock. *But see In re Tele-Communications, Inc. S'holders Litig.*, No. CIV.A. 16470, 2005 WL 3642727 (Del. Ch. Dec. 21, 2005).
  - They do not typically address the fairness of consideration to be received by holders of preferred stock whose rights are typically contractual or quasi-contractual.
  - They do not typically address any other terms of the transaction or agreements entered into in connection with the transaction or otherwise, like: lockups, termination fees, severance agreements, no shop provisions, financing arrangements, etc.
  - They do not address the price at which a buyer's stock will trade after giving effect to the transaction or the price at which buyer or seller stock can be purchased or sold at any other time.

Selected Projections Issues

- Do financial advisors prepare projections?
- When and on what basis should projections be prepared by management?
  - What is the role of the board and company counsel in supervising the preparation and approval of projections?
- Dealing with unrealistic projections or projections that change or are updated during a sale process.
  - What should a buyer be told and when?
- What if a board/special committee or a financial advisor has reservations regarding a counterparty's projections?
  - Which are more relevant:
    - counterparty management's projections for counterparty; or
    - client management's projections for counterparty?
- Avoiding disputes regarding the projections on which financial advisors were authorized to rely.
- What to do if a counterparty won't provide internal projections?
  - Criteria for determining whether to press for buyer projections?
  - Under what circumstances can you consider relying on publicly available analyst estimates in lieu of internal management projections?
- How should multiple projections cases be considered by the board/special committee and financial advisors?
  - What if management cannot or will not identify a single set of projections representing its best estimates as to the future financial performance of the company?

Investment Banker Issues & Considerations

Additional Materials – Aiding and Abetting Claims

Aiding and Abetting a Breach of Fiduciary Duty

Four Elements of a Claim Under Delaware Law

Under Delaware law, the four elements of a claim for aiding and abetting a breach of fiduciary duty include:

(i) the existence of a fiduciary relationship;

(ii) breach of fiduciary duty;

(iii) knowing participation in that breach by defendants; and

(iv) damages proximately caused by that breach. *Morgan v. Cash*, No. 5053-VCS, 2010 WL 2803746, at *4 (Del. Ch. July 16, 2010).

Rural/Metro Background

- On June 30, 2011, Rural/Metro Corporation merged with an affiliate of Warburg Pincus LLC and each share of Rural common stock was converted into the right to receive $17.25 in cash.
- Plaintiffs alleged that the members of the Rural board of directors breached their fiduciary duty of care in approving the merger and by failing to disclose material information in the Company‘s definitive proxy statement
- Plaintiffs further contended that defendant RBC Capital Markets, LLC, a financial advisor to Rural, aided and abetted the directors‘ breach of fiduciary duty.
- Before trial, the directors settled ($6.6 million) as did Moelis & Company LLC, Rural’s other financial advisor ($5 million).
- On March 7, 2014, the Court of Chancery issued a post-trial opinion in which it held that RBC was liable for aiding and abetting breaches of fiduciary duty by the Rural Board. *In re Rural/Metro,* CA No. 6350-VCL (Del. Ch. Mar. 7, 2014).
- On October 10, 2014 the Court of Chancery issued a post-trial opinion in which it held that RBC was responsible for $75.8 million in damages accruing interest at a rate of 5.75%, 5% above the Federal Reserve Discount Rate of 0.75%, from June 30, 2011, the closing date of the merger through the date of payment. *In re Rural/Metro,* CA No. 6350-VCL (Del. Ch. Oct. 10, 2014).
- On November 30, 2015, the Delaware Supreme Court affirmed the principal legal holdings of the Court of Chancery’s decision. *RBC Capital Mkts. v. Jervis*, No. 140, 2015, (Del. Nov. 30, 2015).

Standard Applied in *Rural/Metro* for Determining Whether a Breach of Fiduciary Duty Has Occurred – *Reasonableness*

- In assessing whether RBC was liable for aiding and abetting a breach of fiduciary duty by the Rural Metro Board, the Chancery Court applied the Revlon reasonableness standard of review to the Board's conduct.
- According to the Chancery Court, the combination of RBC's behind the scenes maneuvering, the absence of any disclosure to the Board regarding RBC's activities, and the belated and skewed valuation deck caused the Board decision to approve Warburg's offer to fall short under the enhanced scrutiny test.
- The Supreme Court affirmed this approach.

The *Rural/Metro* Board's *Revlon* Breaches

According to the Chancery Court:

- RBC designed a process that favored its own interest in gaining financing work from the bidders for EMS. RBC divided the possible bidders into Track 1 buyers involved in the EMS process and Track 2 buyers who were not. RBC reached out to the Track 1 buyers in December to let them know that Rural was in play and planned to contact the Track 2 buyers during the first week of January. RBC prioritized the EMS participants so they would include RBC in their financing trees. RBC also planned to push its staple financing package for Rural. [One of RBC's lead bankers] stressed to his leveraged finance colleagues that RBC had the inside track on financing because of Rural's confidentiality agreements.
- When it approved the merger, the Board was unaware of RBC's last minute efforts to solicit a buy-side financing role from Warburg, had not received any valuation information until three hours before the meeting to approve the deal, and did not know about RBC's manipulation of its valuation metrics. Under the circumstances, the Board's decision to approve Warburg's bid lacked a reasonable informational basis and fell outside the range of reasonableness. No one ever told the Board that its bankers had helped Warburg by giving Carney [internal Rural board] information. No one ever told the Board that senior leveraged financing bankers at RBC spent March 26, 2011, making a final push to get a role in Warburg's financing, including by offering to fund a $65 million revolver for a different Warburg portfolio company.

Knowing Participation and the Scienter Requirement – *The Supreme Court Found that the Board's Revlon Breaches Were the Result of RBC's Fraud on the Board and an Informational Vacuum Created By RBC*

The Supreme Court held that:

"The trial court, in a lengthy analysis of aiding and abetting law and tort law, held that if a '[i]f the third party knows that the board is breaching its duty of care and participates in the breach by misleading the board or creating the informational vacuum, then the third party can be liable for aiding and abetting.' We affirm this narrow holding.

"It is the aider and abettor that must act with *scienter*. The aider and abettor must act 'knowingly, intentionally, or with reckless indifference …[;]' that is, with an 'illicit state of mind.' To establish *scienter*, the plaintiff must demonstrate that the aider and abettor had 'actual or constructive knowledge that their conduct was legally improper.' Accordingly, the question of whether a defendant acted with *scienter* is a factual determination. The trial court found that, '[o]n the facts of this case, RBC acted with the necessary degree of *scienter* and can be held liable for aiding and abetting.' The evidence supports this finding.…

"Here … the claim for aiding and abetting was premised on RBC's 'fraud on the Board,' and that RBC aided and abetted the Board's breach of duty where, for RBC's own motives, it 'intentionally duped' the directors into breaching their duty of care." *RBC Capital Mkts. v. Jervis*, No. 140, 2015, (Del. Nov. 30, 2015)

Rural/Metro – Principal Legal Holdings

Principal Legal Holdings of Supreme Court Decision

- "We agree with the trial court that the individual defendants breached their fiduciary duties by engaging in conduct that fell outside the range of reasonableness, and that this was a sufficient predicate for its finding of aiding and abetting liability against RBC."
- "To establish *scienter*, the plaintiff must demonstrate that the aider and abettor had 'actual or constructive knowledge that their conduct was legally improper.' Accordingly, the question of whether a defendant acted with *scienter* is a factual determination."
- DUCATL contemplates giving non-settling defendants "settlement credit" in certain circumstances for the "pro rata share" of any damages attributable to the conduct of "joint tortfeasors" but the Court found that directors that qualified for exculpation under the Company's 102(b)(7) charter provision were not "joint tortfeasors" under DUCATL and should be excluded from any settlement credit calculations. As a consequence, RBC could only get credit for the portion of the damages allocated to the Rural/Metro director defendants who failed to qualify for exculpation under 102(b)(7).

But Financial Advisors Are Not Gatekeepers

"[O]ur holding is a narrow one that should not be read expansively to suggest that any failure on the part of a financial advisor to prevent directors from breaching their duty of care gives rise to a claim for aiding and abetting a breach of the duty of care.[191]" *RBC Capital Mkts. v. Jervis*, No. 140, 2015 (Del. Nov. 30, 2015)

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[191] In affirming the principal legal holdings of the trial court, we do not adopt the Court of Chancery's description of the role of a financial advisor in M & A transactions. In particular, the trial court observed that '[d]irectors are not expected to have the expertise to determine a corporation's value for themselves, or to have the time or ability to design and carryout a sale process. Financial advisors provide these expert services. In doing so, they function as gatekeepers.' *Rural I*, 88 A.3d at 88 (citations omitted). Although this language was *dictum*, it merits mention here. <u>The trial court's description does not adequately take into account the fact that the role of a financial advisor is primarily contractual in nature, is typically negotiated between sophisticated parties, and can vary based upon a myriad of factors. Rational and sophisticated parties dealing at arm's-length shape their own contractual arrangements and it is for the board, in managing the business and affairs of the corporation, to determine what services, and on what terms, it will hire a financial advisor to perform in assisting the board in carrying out its oversight function. The engagement letter typically defines the parameters of the financial advisor's relationship and responsibilities with its client.</u> (emphasis added)

Rural/Metro Discussion Topics

- What are the implications of applying the *Revlon* reasonableness standard for purposes of evaluating whether the board breached its fiduciary duty?
  - "When disinterested directors themselves face liability, the law, for policy reasons, requires that they be deemed to have acted with gross negligence in order to sustain a monetary judgment against them. That does not mean, however, that if they were subject to *Revlon* duties, and their conduct was unreasonable, that there was not a breach of fiduciary duty.[139] The Board violated its situational duty by failing to take reasonable steps to attain the best value reasonably available to the stockholders. We agree with the trial court that the individual defendants breached their fiduciary duties by engaging in conduct that fell outside the range of reasonableness, and that this was a sufficient predicate for its finding of aiding and abetting liability against RBC."
    - *But see Corwin v. KKR Fin. Holdings LLC*, 2015 WL 5772262, at *6 (Del. Oct. 2, 2015) ("*Unocal* and *Revlon* are primarily designed to give stockholders and the Court of Chancery the tool of injunctive relief to address important M & A decisions in real time, before closing. They were not tools designed with post-closing money damages claims in mind, the standards they articulate do not match the gross negligence standard for director due care liability under *Van Gorkom* . . . .").
  - What if Rural/Metro had been acquired in a stock-for-stock merger – i.e., no change in control – would a financial advisor that allegedly engaged in many of the same bad acts as RBC be liable for aiding and abetting a breach of fiduciary duty if the necessary predicate finding that directors breached their fiduciary duty required a finding that they were grossly negligent?
  - Is requiring a director acting with the ordinary care expected of a reasonably prudent fiduciary to detect RBC's 'fraud on the Board,' tantamount to blaming the victim for being knowingly and intentionally duped by a third party's fraudulent acts?

Rural/Metro Discussion Topics (cont'd)

- What is the effect of the Delaware Supreme Court's definition of scienter for purposes of evaluating whether a defendant knowingly participated in a board's breach of fiduciary duty?
  - Is egregious behavior such as “a fraud on the board” required or does “constructive knowledge that their conduct was legally improper” suggest a much lower, potentially vague and ambiguous standard?

Rural/Metro Discussion Topics (cont'd)

- Under DUCATL, does stockholder adoption of a 102(b)(7) authorized exculpatory charter provision effectively "exonerate" – i.e., in addition to providing a shield against director liability, does DUCATL allow stockholders to use the 102(b)(7) as a sword to shift liability to third party aiders and abetters – i.e., under Rural/Metro the directors exculpated from liability for their breaches of their fiduciary duty of care were not deemed joint tortfeasors and any damages attributable to those breaches were excluded from any settlement credit calculations.
- While plaintiffs may be able to plead in the alternative, can defendants mount an effective defense to aiding and abetting claims in the alternative?
  - The Prisoner's Dilemma – A united front amongst the fiduciary and advisor defendants facing similar claims as those in Rural/Metro may not serve the interests of individual defendants who, in order to maximize the potential for contribution (or settlement credit) from joint tortfeasors, may need to seriously consider breaking ranks and presenting evidence that other defendants that participated in the transaction acted wrongfully even if their preferred primary defense would otherwise be that no underlying breach of fiduciary duty occurred.

Rural/Metro Discussion Topics (cont'd)

- What role should an additional/second financial advisor play – second opinion; additional source of strategic and financial advice; assistance in process oversight; assistance in conducting post-signing market check; etc?
  - Following his opinion in Toys-R-Us, then Vice Chancellor Strine was reported to have clarified certain of his views at the 2006 Tulane Corporate Law Institute. Among other things, VC Strine was reported by *Corporate Control Alert* to have expressed the view that to get [a second] opinion, a target must either pay a lot of money to a first-tier firm or get an opinion from a less-distinguished one, which, the judge said "doesn't give me a lot of comfort. What's going to impress us about whether you got a good deal is the quality of the market check." The second opinion is "banker protection," he said, and does little to benefit target shareholders.
  - According the Supreme Court in *RBC Capital Mkts. v. Jervis,* "[T]he presence of Moelis failed to cleanse the defects in the process and the defective financial advice the Board received from RBC. The Board treated its advice as secondary to that of RBC and, like RBC, Moelis's compensation was mostly contingent upon consummation of a transaction."

Rural/Metro Discussion Topics (cont'd)

- What should financial advisors be doing differently in light of the *Rural/Metro* decision and other developments?
  - Minimum of two meetings so that the board as an opportunity to digest financial analyses and ask additional questions prior to approving transaction.
  - Disclosure of "longitudinal changes" to financial analyses reviewed with the board/special committee.
    - Chief Justice Strine advocates blacklining v. prior Board book
    - Many banks identify key changes (assumptions, inputs, etc.) in separate "longitudinal change" pages included in their board/special committee discussion materials:
      - Changes to management projections
      - Changes to selected companies and transactions used for comparative purposes
      - Changes to discount rate calculation, including methodology and inputs
      - Changes to selected multiple range
    - Other financial advisors identify those changes orally or in footnotes.

Aiding and Abetting a Breach of Fiduciary Duty Claims and Allegations

Other Examples

- **Inadequate Disclosure Regarding Material Relationships and/or Ulterior Motives**
  - *City of Daytona Beach Police and Fire Pension Fund v. **Examworks**,* CA No. 12481-VCL (Del. Ch. Sept. 26, 2016) (First Amended Complaint)
  - *In re **Good Technology**,* CA No. 11580-VCL (Del. Ch. Sept. 1, 2016) (Second Amended Complaint)
  - *Haverhill Retirement System v. Kerley (aka **Providence Service**),* CA No. 11149-VCL (Del. Ch. Feb. 9, 2016) (Settlement Hearing and Petition for Attorney's Fees Transcript)
  - *In re **Zale** Corp. S'holder Lit.*, CA No. 9388-VCP (Del. Ch. Oct. 1, 2015) (Ruling on Motions to Dismiss)
  - *In re **Dole Food** Co. S'holder Lit.*, CA No. 8703-VCL (Del. Ch. Aug. 27, 2015)
  - *Laborers' Local #231 Pension Fund v. Merrill Lynch (aka **Websense**),* CA No. 12350-VCL (Del. Ch. May 20, 2016) (Complaint)
  - *In re **PLX** Technology S'holders Lit.*, CA No. 9880-VCL (Del. Ch. April 15, 2015 (Transcript of Oral Argument) and Sept. 3, 2015 (Telephonic Ruling)
  - *In re **Rural Metro***, CA No. 6350-VCL (Del. Ch. Aug, 29, 2012) (Second Amended Complaint) (VC Laster)

Aiding and Abetting a Breach of Fiduciary Duty Claims and Allegations

Other Examples (cont'd)

- **Inadequate or Inappropriate Financial Analyses**
  - *Chen v Howard-Anderson (aka* ***Occam****)*, CA No. 5878-VCL (Del. Ch. March 23, 2015) (Hearing to Amend Complaint Transcript)
  - *In re* ***Tibco*** *Software*, CA No. 10319 - CB (Del. Ch. Nov. 25, 2014)
  - *Koehler v.* ***NetSpend*** *Holdings*, CA No. 8373-VCG (Del. Ch. May 21, 2013)
  - *In re* ***Rural Metro***, CA No. 6350-VCL (Del. Ch. Aug, 29, 2012) (Second Amended Complaint)
  - *In re* ***McCormick & Schmick's*** *,* CA No. 7058-VCL (Del. Ch. Nov. 2, 2012) (Settlement Hearing Transcript)
  - *In re* ***Celera*** *S'holder Litig.,* CA No. 6304-VCP (Del. Ch. March 23, 2012)
  - *In re* ***BJ's Wholesale*** *Club*, CA 6623-VCN (Del. Ch. Jan. 31, 2013)
  - *See also In re* ***El Paso*** *Corp. S'holders Litig.,* 41 A.3d 432 (Del. Ch. 2012) (C Strine)

Aiding and Abetting a Breach of Fiduciary Duty Claims and Allegations

Other Examples (cont'd)

- **Buyer Financing Conflicts - Winning Bidder Financing**
  - *In re **Del Monte** Foods Co. S'holders Litig.*, No. 6027-VCL 2011 WL 532014 (Del. Ch. Feb. 14, 2011) (VC Laster).
  - *In re **Morton's Restaurants**,* CA No. 7122-CS (Del. Ch. July 23, 2013) (C Strine).
  - *See also In re **Toys 'R' Us**,* 877 A.2d 975 (Del. Ch. 2005) (VC Strine).
- **Buyer Financing Conflicts - Stapled Financing**
  - *Cleveland Bakers & Teamsters Pension Fund v. Benson* (aka ***Emergency Medical Services***), CA No. 6230 (Del. Ch. Feb. 28, 2011) (Complaint) (C Strine).
  - See also *In re **Rural Metro*** (VC Laster) (Second Amended Complaint).
- **Investment Interest Conflicts – Ownership Interests in Counterparty**
  - *In re **El Paso** Corp. S'holders Litig.,* 41 A.3d 432 (Del. Ch. 2012) (C Strine).
- **Investment Interest Conflicts – Derivatives Transactions (e.g., call spread hedges)**
  - *City of Monroe Employees Retirement System v Capps* (aka ***Amerigroup***)*,* CA No. 7788-CS (Del. Ch. Aug. 12, 2012) (Complaint).
  - ***Illumina**,* Wall Street Journal – Deal Politik Column by Ron Barusch (Feb. 8, 2012).

Trulia

In re Trulia – the footnotes

- 56 See, e.g., In re Micromet, Inc. S'holders Litig., 2012 WL 681785, at *11 (Del. Ch. Feb. 29, 2012) (rejecting claim that the board failed to disclose underlying assumptions and bases for probabilities of success of clinical trial drugs) ("Stockholders are entitled to a fair summary of the substantive work performed by the investment bankers, but Delaware courts have repeatedly held that a board need not disclose specific details of the analysis underlying a financial advisor's opinion.") (internal quotation marks omitted); In re Cogent, Inc. S'holder Litig., 7 A.3d 487, 511 (Del. Ch. 2010) (holding stockholders are entitled to fair summary, but not to minutiae, and rejecting requests for additional disclosures); Ryan v. Lyondell Chem. Co., 2008 WL 2923427, at *20 & n.120 (Del. Ch. July 29, 2008) (finding that fair summary did not require disclosure of all projections, as long as it disclosed description of valuation exercises, key assumptions, and range of values generated; but noting that the failure to disclose that the financial advisor used a significantly higher WACC in its calculation than management's WACC estimate, even when it was using management's other financial projections, could constitute a disclosure violation), rev'd on other grounds, 970 A.2d 235 (Del. 2009). See also David P. Simonetti Rollover IRA v. Margolis, 2008 WL 5048692, at *9-10 (Del. Ch. June 27, 2008) (distinguishing Pure Resources as a case in which a proxy statement was deficient because it did not disclose "any substantive portions of the bankers' work") (internal quotation marks omitted); In re MONY Grp. Inc. S'holder Litig., 852 A.2d 9, 28 (Del. Ch. 2004) ("The plain meaning of 'summary' belies the Stockholders' interpretation.").

Trulia

In re Trulia – the footnotes (cont'd)

- 57 See Globis P'rs, L.P. v. Plumtree Software, Inc., 2007 WL 4292024, at *12-13 (Del. Ch. Nov. 30, 2007) (rejecting disclosure claims for various details that may have been helpful in determining accuracy of analysis) ("Delaware law does not require disclosure of all the data underlying a fairness opinion such that a shareholder can make an independent determination of value."); In re Gen. Motors (Hughes) S'holder Litig., 2005 WL 1089021, at *16 (Del. Ch. May 4, 2005) (rejecting claim for information that would amount to "the raw data behind the advisors' updated summaries") ("A disclosure that does not include all financial data needed to make an independent determination of fair value is not, however, per se misleading or omitting a material fact. The fact that the financial advisors may have considered certain non-disclosed information does not alter this analysis."), aff'd, 897 A.2d 162 (Del. 2006). One important qualification bears mention. Although management projections and internal forecasts are not per se necessary for a fair summary, this Court has placed special importance on this information because it may contain unique insights into the value of the company that cannot be obtained elsewhere. See In re Netsmart Techs., 924 A.2d at 203 (noting that management projections can be important because management can have "meaningful insight into their firms' futures that the market [does] not").

Trulia

In re Trulia – the footnotes (cont'd)

- 58 See In re 3Com S'holders Litig., 2009 WL 5173804, at *2-3 (Del. Ch. Dec. 18, 2009) (rejecting claim for omission of financial projections because "an adequate and fair summary of the work performed by [the advisor] [was] included in the proxy"); In re CheckFree Corp. S'holders Litig., 2007 WL 3262188, at *3 (Del. Ch. Nov. 1, 2007) (distinguishing Netsmart and rejecting disclosure claim based on omission of management financial projections, because proxy statement fairly summarized financial advisor's methods and conclusions); In re Pure Res., 808 A.2d at 449 (noting in fair summary discussion that stockholders would find it material to know the advisor's basic valuation exercises, key assumptions of those exercises, and range of values produced).
- 59 See In re PAETEC Hldg. Corp. S'holders Litig., 2013 WL 1110811, at *8 (Del. Ch. Mar. 19, 2013) (citing In re Pure Res., 808 A.2d at 449) (declining to award settlement fees for disclosures that "provide a level of detail beyond what the law of Delaware requires"). 2006).

Trulia

In re Trulia – Subsequent Delaware Judicial Commentary on Trulia

The Chancery Daily reported that on June 17, 2016 Vice Chancellor Laster spoke at the Delaware State Bar Association's Bench and Bar Conference and commented on certain aspects of *In re Trulia*.

The Vice Chancellor first discussed his interpretation of the "plainly material" standard under Trulia, suggesting examples of tests of whether disclosures satisfy that standard (emphasis added):

> In terms of practicality . . . 4 out of 5 deal lawyers ought to think this is material. . . . It shouldn't be . . . where only 5% of the people surveyed thought it was material.
>
> Another example of plainly material -- if, when this comes up, you think 'do I need to call my malpractice carrier?'
>
> If it was something that, when you find out that something wasn't disclosed, you have a pit in your stomach -- that's plainly material.
>
> If you feel like . . . because we missed this in a disclosure document, we're going to write-off a little bit of our fees on our bill. That's plainly material. . . .

Trulia

***In re Trulia* – Subsequent Delaware Judicial Commentary on Trulia (cont'd)**

> **What is not plainly material . . . the list of 26 'tell me more' disclosure violations. 'Tell me more about this paragraph in the background of the merger statement.' 'Tell me more about this aspect of the banker's analysis.' . . . Those aren't plainly material.**
>
> Show me something that's wrong, yeah, that's going to be plainly material. Wrong and material -- that's plainly material. That's one of those ones where you're like 'oh my god -- how did we miss this? This is awful. I'm worried. This is a problem for me.' That is plainly material.
>
> **But when it's something that the complaint can list as to any deal, that's not plainly material."**

The Vice Chancellor responded to the observation by another panelist that disclosures on a company's financial projections and disclosures on a discounted cash flow analysis were found to satisfy the "plainly material" standard shortly after the issuance of Trulia, suggesting that he would probably not find such disclosures plainly material.

Trulia

In re Trulia – Subsequent Delaware Judicial Commentary on Trulia (cont'd)

Those are disclosures that probably wouldn't pass under the description I gave you.

The give us more information about the discounted cash flow inputs was one of the standard things that we used to see all the time. 'You just didn't tell us the components of the weighted average cost of capital.' 'You just didn't tell us what the cost of equity was and what you used as your equity risk premium.' . .

If you brought to me that type of information, I would say maybe it might be material, maybe I could have gotten there back in the day when we weren't really calling materiality on this stuff, when we were trying to help settle these cases. But under a plainly material standard, no."

The Vice Chancellor expressed his belief that Corwin did not preclude pre-close injunctive relief for all disclosure claims, but that the materiality of "tell-me-more" disclosure claims should be adjudicated, rather than addressed in a pre-close context.

I think disclosure injunctions remain available for real disclosure types.

Trulia

***In re Trulia* – *Subsequent Delaware Judicial Commentary on Trulia* (cont'd)**

So if what you're bringing is the tell-me-more stuff . . . Part of the reason for Trulia was to say to people that we don't want suits on every deal involving these types of tell-me-more theories anymore.

So if people are worried about those types things, don't be worried. We're saying that they aren't the type of plainly material claim that's going to cause you problems.

If it is something like, do you need to put these types of projections in the proxy statement or not, let's actually get a ruling on it and find out.

Is [William M. Skeen, et al. v. Jo-Ann Stores, Inc., et al., No. 448, 1999, opinion (Del. May 3, 2000),] still the right answer? It's certainly controlling authority from the Chancery Court's perspective. Let's actually find out. Let's get some certainty and some answers that way, rather than having the churning of pre-closing applications on the same issues that drove the M&A litigation epidemic and explosion."

Trulia

In re Trulia – Pre Trulia Delaware Commentary on the Materiality of Disclosures

Materiality of "Tell Me Why and Tell me More?" Disclosure Claims

- ***Scully v. Nighthawk Radiology Holdings Inc*., C.A. No. 5890-VCL (Del. Ch. Oct. 21, 2010)** "Romanette (ii) on down to Romanette (vii) were all of the I-want-to-follow-up-tell-me-a-little-more variety. And I felt that the summary of the Morgan Stanley book was -- was fair and complete on all those issues. These types of underlying valuation judgment calls are the types of things that bankers are paid to do and that stockholders can do for themselves if they want to do this type of underlying analysis". *See also* ***In re Sauer-Danfoss S'holders Litig.*, No. 5162-VCL (Del. Ch. Apr. 29, 2011)** "Asking "why" does not state a meritorious disclosure claim.". . . When a plaintiff's "only beef is that [an investment banker] made mistakes in subjective judgment, even though those judgments were disclosed to the . . . stockholders," then the plaintiff has not identified a material omission or misstatement.. . . A "quibble with the substance of a banker's opinion does not constitute a disclosure claim" and ***In re SeraCare Life Sciences, CA No. 7250-VCG (Del. Ch. March 20, 2012)*** "This Court, like most courts, draws a line at materiality. . . . A list of disclosure requirements of the "more details please" kind tend not to constitute colorable claims worthy of significant expense through an expedited proceeding***."***

Trulia

In re Trulia – Pre Trulia Delaware Commentary on the Materiality of Disclosures

Materiality of Failure to Disclose Metrics Utilized to Calculate Discount Rate

- ***In re Vertro, Inc. S'holders' Litig*., CA No. 7010-VCP (Del. Ch. Hearing Transcript 12-21-11)**. "In addition, plaintiffs claim that the description of the discounted cash flow analysis in the preliminary proxy statement fails to describe the metrics utilized by AGC in determining Vertro's weighted average cost of capital for purposes of arriving at the utilized discount rate. It is well-settled that a disclosure that does not include all financial data needed to make an independent determination of fair value is not per se misleading or an -- one that omits a material fact. Instead, stockholders are entitled to a fair summary of the substantive work performed by the investment bankers upon whose advice the merger [sic] of their board as to how to vote on the merger or tender rely. Therefore, defendants committed no disclosure violation by failing to include the manner in which AGC derived the discount rate it used in its analysis. Delaware courts have repeatedly held that a board need not disclose specific details of the analysis underlying a financial advisor's opinion. . . . Under Delaware law, an omitted fact is material if a reasonable stockholder would consider it important in a decision pertaining to his or her stock. If including the omitted fact would significantly alter the total mix of information available to stockholders, that fact is material. But omitted facts are not material simply because they might be helpful. So long as the proxy statement, viewed in its entirety, sufficiently discloses and explains the matter to be voted on, the omission or inclusion of a particular fact is generally left to management's business judgment."

Trulia

In re Trulia – Pre Trulia Delaware Commentary on the Materiality of Disclosures

Materiality of Financial Advisor Calculated Free Cash Flows

- ***In re SeraCare Life Sciences* (VC Glasscock March 20, 2012)** “In the recent Nighthawk case, Vice Chancellor Laster plainly found that, unlike a situation where the board provides free cash flow projections to its financial advisor, where the advisor derived the projections on its own, those projections do not have to be disclosed. To me, this is consistent with the principle that the board need not disclose every piece of information used by its financial advisor, such that an investor could conduct its own fair value analysis using that same data.”
- ***Nguyen v. Barrett*, CA No. 11511-VCG (Del. Ch. Oct. 8, 2015) (Motion to Expedite)** “Our case law provides that, where the bankers derive unlevered, after-tax free cash flows rather than relying on management projections, the inputs on which they rely are not per se subject to disclosure. As this Court has previously noted, ‘a disclosure that does not include all financial data needed to make an independent determination of fair value is not per se misleading or omitting a material fact.’” **Nguyen v Barrett, CA No. 11511-VCG (Del. Ch. Sept. 28, 2016) (Motion to Dismiss)** “After careful review of the Proxy and applicable precedent, I determined that “a fair reading of the Proxy disclosed accurately that management did not prepare forecasts of unlevered, after-tax free cash flows,”12 and, “[w]ith respect to the argument that all inputs provided by management on which the financial advisor relied in its [discounted cash flow] valuation must, as a matter of law, be disclosed to stockholders, I found such a per se rule inconsistent with our case law.”

Trulia

In re Trulia – Pre Trulia Delaware Commentary on the Materiality of Disclosures

Materiality of Financial Advisor Criteria For Choosing Selected Companies

- ***In re Ness Technologies S'holders Litig.,* CA No. 6569-VCN (Del. Ch. Aug. 3, 2011)** "[T]he Plaintiffs seek additional details regarding the financial advisors' analyses such as the reasons why different companies were selected for each advisor's comparable company analysis or information regarding how the advisors arrived at the multiples they used for those comparable companies. Again, the Preliminary Proxy provides shareholders with fair summaries of the financial advisors' work, and the Plaintiffs have not shown that additional detail would be material to shareholders." See also ***In re Sauer-Danfoss S'holders Litig.*, No. 5162-VCL (Del. Ch. Apr. 29, 2011)** "Asking "why" does not state a meritorious disclosure claim.". . . The original Schedule 14D-9 disclosed the calculation of the comparable companies' multiples and the banker's selection of a multiple for Sauer-Danfoss based on those multiples "in a manner that allowed a reasonably sophisticated investor to see the key judgments that [the banker] made and to make her own independent determination of whether those judgments struck her as proper. . . and ***In re Delphi Financial Group S'holder Litig***., CA 7144-VCG (Del. Ch. March 6, 2012) denying motion for preliminary injunction on claims that, among other thing: the Preliminary Proxy (i) failed to identify the companies or provide information sufficient to evaluate the relevance of these companies to Lazard's analysis and (ii) failed to provide information sufficient to evaluate the relevance of these companies to Lazard's analyses."

NOTES

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6

The ABCs of Purchase and Sale Agreements

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The author would like to thank Raymond O. Gietz, a partner at Weil, Gotshal & Manges LLP for permitting the use of portions of his article “The Nuts and Bolts of M&A Agreements”. The views expressed in this section reflect those of the author and are not necessarily the views of Milbank, Tweed, Hadley & McCloy LLP.

In the complex world of M&A, there is no single, one-size-fits-all purchase agreement. Because the structure and form of M&A transactions vary significantly, the agreements used to document those transactions also differ in important ways. The provisions vary based on a number of factors, including negotiating leverage, the type of transaction being consummated (stock purchase, asset sale or merger), timing considerations, how the purchase price is calculated and paid and the nature of the parties to the agreement (private or publicly-owned). Despite this variation, certain fundamental contractual provisions are found in nearly all M&A agreements. This paper will discuss the basic provisions of a purchase and sale agreement, including the rationale underlying each provision's inclusion in the agreement and common permutations of each provision. In addition, where appropriate, this paper will identify current market trends and recent caselaw as they relate to specific provisions found purchase and sale agreements.

The fundamental aspects of an acquisition agreement include, among others, the following: (i) representations and warranties; (ii) covenants; (iii) closing conditions; and (iv) indemnification. Typically, these provisions are highly negotiated, and, in part, serve to allocate risk between a buyer and a seller in a number of areas. Among the many situations that these risk allocation provisions address are:

- the risk of unknown or unquantifiable contingent liabilities of the business being purchased;
- the risk that the reality of the business and its operations and assets deviate from what the buyer was told about the business (through the representations and warranties provided by the seller in the purchase agreement);
- the risk that the state of business at signing has materially deteriorated prior to closing;
- the risk that a required consent or approval for the deal may not be obtained or will be conditioned in such a way as to impair the value of the business to be sold; and
- the risk that a third party will fail to perform (such as providing acquisition financing).

REPRESENTATIONS AND WARRANTIES

In connection with entering into an acquisition agreement, each party agrees to represent and warrant the accuracy of specific factual statements. As a technical matter, representations and warranties are different legal concepts. *Black's Law Dictionary* defines a representation as "a presentation of fact – either by words or by conduct – made to induce someone to act, especially to enter into a contract."[1] Alternatively, a warranty is defined as "an express or implied promise that something in furtherance of the contract is guaranteed by one of the contracting parties; especially a seller's promise that the thing being sold is as represented or promised."[2] The primary technical difference between a representation and warranty reveals itself when a representation or warranty is found to be inaccurate post-closing. If a representation is breached, the non-breaching party will seek to redress the breach by filing a misrepresentation tort claim. The tort claim will assert that the breaching party failed to honor its duty to act honestly when contracting. Nevertheless, liability for a "misrepresentation" generally will be imposed only if the breaching party made a material misrepresentation on a fraudulent or (sometimes) negligent basis and the non-breaching party relied on the misrepresentation to its detriment. Liability for a breach of warranty, on the other hand, is strict. If the promised warranty is inaccurate, the non-breaching party is entitled to recover its damages (absent some other limitation in the agreement) regardless of the breaching party's state of mind or whether the non-breaching party relied on the warranty. Ultimately, however, this distinction is not particularly relevant, because in modern practice the statements in a purchase agreement are styled as both representations and warranties.

A. Functions of Representations and Warranties

In all deals, whether public or private, representations and warranties: (i) provide the buyer with disclosure (through the seller's disclosure schedules, which set forth information required by and exceptions to the seller's representations and warranties) against which the buyer can verify the results of its due diligence review; and (ii) serve as a closing condition in that the accuracy of the seller's representations and warranties at closing will be a condition to the

1. BLACK'S LAW DICTIONARY 1415 (9th ed. 2009).
2. *Id*. at 1725.

buyer's obligation to proceed with the transaction, and *vice versa*. In addition, in a private transaction, representations and warranties form the basis for indemnification claims if one party can prove that a representation or warranty of the other party was untrue. Typically, such an indemnification claim would be brought by the buyer in connection with a breach of the seller's representations and warranties.

From a due diligence perspective, representations and warranties are helpful because any exceptions to the seller's representations and warranties are set forth on the seller's disclosure schedules, which are typically attached as an exhibit to the acquisition agreement. The process of putting together disclosure schedules is a lengthy one, which requires input from numerous constituencies within a business, as they often cover multiple aspects of the business being sold. Complicating this process may be the confidential nature of the discussions where the input of individuals not yet "brought over the wall" is needed. The seller will often prepare the disclosure schedules with the help of its counsel, based on initial drafts of the acquisition agreement, and update them as the negotiations progress and the representations and warranties are finalized. Prior to signing the acquisition agreement, the buyer will review and comment on the disclosure schedules and compare them to its due diligence findings. The buyer should verify that the disclosure schedules do not include language that negates a representation (thereby shifting the risk of breach back to the buyer) or is so unclear as to trigger a disagreement about whether an exception was actually disclosed. To the extent something is disclosed that was not identified in the buyer's due diligence, the buyer will typically require more information regarding the item being disclosed to understand any potential risk before signing the acquisition agreement.

In addition to confirming the results of a buyer's due diligence review, inaccuracies in a party's representations and warranties at the time of signing or closing may provide the other party with a right to walk away from the deal and sue the other party for its damages (at a minimum, legal fees and other expenses). When a transaction involves a gap between signing and closing, a buyer will typically require that the seller's representations and warranties, which were made at the time of signing, be "brought down" at closing. As part of the closing conditions, a seller is often required to deliver an officer's certificate reaffirming that the representations and warranties that were made at signing by the seller continue to be true (either in all respects, in all material respects or to a "Material Adverse Effect" standard) at the time of closing (MAE and materiality standards are discussed in further detail below). Buyers and sellers will often debate whether there should be certain representations and warranties that are not required to be brought down to closing and whether there should be some type of materiality qualifier on those representations and warranties that are brought down. The outcome of the latter point usually is determined based on which party has the most negotiating leverage, as well as the type of deal. For example, public deals always have an MAE bring-down standard. However, it is customary that buyers will require that certain fundamental representations (e.g., authority to enter into the acquisition agreement, corporate status, capitalization and title to the assets or shares being sold) be true in all respects (or inaccurate only in *de minimis* ways), without any materiality or MAE qualification.

As noted above, with respect to private transactions only, representations and warranties also serve as a basis for indemnification because each party typically will indemnify the other party for any damages (subject to negotiated thresholds and other limitations) that result from any inaccuracies in its representations or warranties. Conversely, in public transactions, given the large number of public stockholders and the practical difficulty of collecting indemnification claims from such stockholders, representations and warranties do not survive closing and the buyer has no post-closing right of indemnification or other recourse based upon any inaccuracies in the representations and warranties. The relationship between representations and warranties, on the one hand, and indemnification provisions, on the other hand, is discussed in further detail below.

B. Types of Representations and Warranties

In most acquisition agreements, representations and warranties made by a seller can be classified into two broad categories: (i) representations and warranties regarding the ability of the seller or target company to effect the transaction; and (ii) representations and warranties regarding the condition and status of the target company or business being sold. The scope of the representations and warranties made by a seller may be limited by knowledge, materiality or time, as discussed in further detail below.

A buyer's representations and warranties will likely be determined by the nature of the consideration offered as payment. For example, in an all-cash transaction, a buyer will give minimal representations and warranties, such as those relating to its authority to enter into and perform the acquisition agreement and its ability to pay the purchase price. When the purchase price will be paid in the form of stock of the buyer or a mix of cash and stock, the buyer typically will give many of the same representations and warranties that are provided by the seller so as to give assurance to the selling stockholder(s) regarding the state of the buyer's business (with the degree of symmetry between the buyer's and seller's representations and warranties often being a function of the size of the buyer relative to the size of the target business and whether the buyer's stock is publicly traded). Likewise, in a transaction where a buyer is offering stock as consideration, a seller will perform due diligence on the buyer just as a buyer would perform due diligence on the target, although the scope of the two investigations typically will differ.

In order to properly draft representations and warranties, it is important for the lawyers involved to understand the business, assets or entity being sold, as the representations and warranties should be tailored to the specific transaction.[3] Typically, the most highly negotiated representations and warranties are those made by the seller about the target company and its business. Examples of some typical representations and warranties made by a seller regarding itself and the target company or the assets being sold are set forth in the chart below.[4] The descriptions provided may refer to "materiality" or "knowledge" qualifiers in certain instances. Such qualifiers are designed to limit the scope of a particular representation or warranty. Their use is discussed in further detail in the next section of this paper.

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3. If the business operates within a highly-regulated industry, a buyer may consider asking for industry-specific regulatory representations from the seller. For example, if the target business is an investment management firm, the buyer may ask for certain SEC or Investment Advisors Act-related representations. Likewise, if the target is an energy or utilities company, the buyer may ask for FERC-related representations.
4. In addition to those discussed here, a buyer typically will request customary representations regarding specialty areas such as taxes, employee benefits, labor matters, real property, intellectual property, regulatory matters and environmental matters.

Typical Representations and Warranties made by the Seller regarding itself and the Company (or Assets) being sold.	
Organization and Good Standing	This representation is intended to provide comfort that the seller and target: (i) are in good standing under the laws of the jurisdiction where they are organized; (ii) have all requisite authority to conduct their business; and (iii) are qualified to do business in any other jurisdiction where so required.
Authorization of the Agreement	This representation provides comfort to the buyer that: (i) the seller and target are authorized to execute and deliver the acquisition agreement and any ancillary agreements; (ii) the seller and target are authorized to perform their obligations under the transaction agreements and consummate the transactions contemplated thereby; and (iii) the transaction agreements constitute valid, legal and binding obligations, enforceable against the seller and target in accordance with their terms.
Conflicts; Consents of Third Parties	This representation is intended to address whether the transaction would conflict with the organizational documents, contracts or laws applicable to the seller or the target, require the consent of any person, entity or governmental authority or result in the imposition of any lien on the assets of the seller or the target. A seller will often try to seek to limit this representation to material violations of law and contract. A buyer will often seek to not only have all violations of law and contract covered but also seek disclosure of conflicts, losses of benefits, the increase or acceleration of obligations, etc. A seller will often object to a buyer's request that the seller provide conflicts/consent representations as to the seller itself. From a buyer's perspective, this is necessary to avoid tortious interference claims. In addition, a seller will often request a materiality qualifier for this representation, but from a buyer's perspective a materiality qualifier should not be given with respect to conflicts with the target's governing documents in order to avoid an *ultra vires* act.
Ownership and Transfer of Shares (or Assets)	This representation is intended to provide the buyer with comfort that the seller has title to the shares or assets it is selling free and clear of any claims or

	encumbrances and that it has the power and authority to transfer such shares or assets to the buyer.
Litigation	This representation is intended to provide the buyer with notice and information regarding any litigation (whether pending or threatened) against the seller or the target. The seller will often request a knowledge qualifier with respect to threatened litigation. In addition, the seller will often seek to make this representation as of the signing date so that if any claims or litigation arise after signing, the seller is not required to "bring down" this representation, with the effect that claims and litigation that arise in the executory period are not subject to indemnification.
Capitalization and Subsidiaries	In the case of a stock purchase or merger, this representation gives the buyer information as to the capitalization of the target and whether there are any outstanding options, warrants or other equity-based rights in the target. In addition, it informs the buyer of the organizational structure of the target and whether the target has any subsidiaries and the ownership level in such subsidiaries.
Corporate Records	This representation assures the buyer that it has received copies of, or access to, true and complete copies of the target's organizational documents and books and records (e.g., board resolutions and minutes, stock transfer ledgers, etc.).
Financial Statements / SEC Filings	This representation is intended to give comfort to the buyer that it has received financial statements of the target business that are complete and correct in all material respects, have been prepared in accordance with GAAP and fairly present in all material respects the financial position of the target. In public transactions, a buyer will also ask for certain SEC filing and Sarbanes-Oxley related representations. For example, the buyer will want to confirm that the target has made all necessary SEC filings, that these filings are accurate and that the target has established and maintains adequate disclosure controls and procedures.
No Undisclosed Liabilities	This representation provides comfort to the buyer that the target has no liabilities other than those: (i) set forth on its most recent balance sheet; (ii) that

	have been incurred since the date of such balance sheet in the ordinary course; or (iii) that are immaterial. The parties will likely debate whether the representation covers all liabilities, contingent or otherwise, or is limited to liabilities of a type required to be disclosed on a GAAP balance sheet.
Absence of Certain Developments	This representation serves two general functions: First, it assures the buyer that there has been no material adverse change since a stated date (typically, the date of the most recent balance sheet or most recently audited balance sheet); Second, it assists the buyer in establishing a snap-shot of the target as of that date and permits the buyer to calibrate changes in the target since that date (e.g., the seller will affirmatively state that as of signing there has been no damage or loss since the specified date, that the target has not made any dividends or other distributions since the specified date and that the target has not incurred indebtedness (other than in the ordinary course) since the specified date).
Material Contracts	This representation requires a seller to disclose contracts that meet certain criteria, which are then defined as the "material contracts." For example, a buyer typically will require that the seller disclose, among others, all of the target's contracts: (i) with affiliates; (ii) with certain key customers; (iii) that contain some type of non-compete or restrictive covenant; (iv) pursuant to which the target makes or receives annual payments in excess of an agreed dollar amount; (v) relating to any joint venture or partnership in which the target is a party; or (vi) relating to indebtedness of the target. The buyer will also typically ask for a representation that each material contract is a valid, legal and binding obligation in full force and effect and that the target (and to seller's knowledge, each other party to the contract) is not in default with its terms. The seller will also confirm that it has made available to the buyer true and complete copies of all such material contracts.
Compliance with Laws	This representation provides comfort to the buyer that the target is in compliance with all applicable laws (typically subject to a materiality qualifier) and that to the knowledge of seller, the target is not

	under any investigation with respect to the violation of any applicable laws. The buyer will also seek to have the seller disclose any previous violations of law. An area of negotiation is how many years are covered by this representation (e.g., the target has complied with all laws since its formation or for a shorter period of time (typically one to five years) or merely that it is in compliance with applicable laws as of signing).
Related Party Transactions	This representation is intended to provide information to the buyer so that the buyer can assess the potential impact of the transaction on commercial relationships with affiliates or other "related" parties of the target, since those relationships are often not on arm's-length terms and ordinarily will be terminated at closing.
Full Disclosure	Often referred to as a "10b-5" representation, this representation provides the buyer with assurance that the seller has disclosed all material matters about the target to the buyer and that there are no material misstatements or omissions in its representations and warranties. The effect of this representation is to shift the burden of due diligence from the buyer to the seller. Typically, a seller will strongly resist this representation.

C. Qualifiers and Limitations

As referenced above, buyers and sellers will often negotiate limitations on the scope of the seller's representations and warranties. A seller will argue that it can only make certain representations and warranties to the extent it has knowledge of applicable facts or circumstances (e.g., threatened litigation) and therefore these representations and warranties should be qualified by "knowledge." Sellers often contend that a knowledge qualifier is needed to reduce the sizable burden associated with preparing disclosure schedules and to make certain that the disclosures sought are, in fact, material. Typically, when a knowledge qualifier is used, a seller will want to limit its meaning to the knowledge of a scheduled list of specified officers and employees of the seller and the target business. Buyers will resist knowledge qualifications on representations and warranties when possible because allowing this limitation shifts the risk of the unknown from the seller to the buyer. If there are knowledge qualifiers included in an agreement, a buyer will attempt to define "knowledge" so that it includes a certain level of diligence on the seller's part. A standard "knowledge" definition proposed by a buyer would consist of the actual knowledge of the target's senior executives after those individuals have made reasonable inquiries and investigations (i.e., "due inquiry") of the personnel responsible for the relevant functions or areas of the business.

Similarly, a seller will often take the position that it cannot make representations and warranties regarding all aspects of the target's business, but that it can make representations and warranties regarding the material aspects of the business. Said another way, a seller will argue that it is unrealistic for the buyer to expect that the target's business is in "pristine" condition. From a seller's perspective, materiality qualifiers are a businessman's way of acknowledging that the business is expected to have non-material and unknown imperfections. The debate typically will include a discussion of the nature of the materiality qualifier – small "m" material or Material Adverse Effect. The difference can be illustrated as follows: "The Company is in compliance in all material respects with all applicable Laws" vs. "The Company is in compliance with all applicable Laws, except for such non-compliance as would not have a Material Adverse Effect." The small "m" designation comes about because the word "material" – though often used throughout an acquisition agreement – is rarely defined. "Material Adverse Effect" is always defined (although the definition uses the undefined word "material").[5] The Material Adverse

5. The following is a typical formulation: "Material Adverse Effect" means any change, effect, event, development, state of facts, occurrence or circumstance which, individually or in the aggregate with all other changes, effects, events, developments, state of facts, occurrences or circumstances, is or would reasonably be expected to be materially adverse to the business, assets, financial condition or results of operations of the Company, taken as a whole; provided, however, that changes, effects, events, developments, state of facts, occurrences or circumstances to the extent relating to or resulting from the following shall be excluded from the determination of Material Adverse Effect: (i) any change, effect or circumstance in any of the industries or markets in which the Company operates; (ii) any change in any Law or GAAP (or changes in interpretations of any Law or GAAP) applicable to the Company; (iii) changes in general economic, regulatory or political conditions or the financial, credit or securities markets in general (including changes in interest or exchange rates) in any country or region in which the Company conducts business; (iv) any acts of God, natural disasters, terrorism, armed hostilities, sabotage, war or any escalation or worsening of acts of war; (v) the negotiation, execution, announcement, consummation or existence of this Agreement, or the Transactions (including the impact of any of the foregoing on

Effect definition has been the subject of a number of high profile Delaware cases that came on the heels of the 2007/2008 financial crisis. The takeaways from these cases – which typically arise in the context of a buyer seeking to walk away from a transaction – are that the term is forward-looking in nature and is meant to convey a very substantial change for the worse. Using the undefined "material" exception, notwithstanding its vagueness and ambiguity, could be argued to be more appropriate in the context of representations and warranties in that its focus is at the point in time at which the particular representation or warranty is made (or deemed to be made).[6]

In most acquisition agreements, a seller will also include a provision (typically appearing in the buyer's representation and warranties) pursuant to which the buyer acknowledges that the seller has no liability or responsibility for, and that the buyer may not claim any reliance upon, any representation, warranty, projection, forecast, statement, or information, made, communicated or furnished (whether orally or in writing) to the buyer, except for those matters specifically included in the acquisition agreement. This disclaimer would include any

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relationships with customers, suppliers, employees or regulators and any suit, action or proceeding arising therefrom or in connection therewith (it being understood and agreed that the facts and circumstances that may have given rise to such suit, action or proceeding that are not otherwise excluded from the determination of a Material Adverse Effect by reason of the exclusions to this definition may be taken into account in determining whether there has been a Material Adverse Effect); provided that, any contractual consequence (in accordance with the terms of the applicable Contract) of the execution of this Agreement or the consummation of the Transactions shall not be excluded under this proviso); (vi) any action taken as expressly permitted or required by this Agreement; and (vii) any changes in the market price or trading volume of the Shares, any failure by the Company to meet internal, analysts' or other earnings estimates or financial projections or changes in credit ratings; provided that this clause (vii) shall not preclude any change, effect, event, development, state of facts, occurrence or circumstance that may have contributed to or caused such failure to the extent not otherwise excluded from the determination of a Material Adverse Effect by reason of the exclusions to this definition from being taken into account in determining whether a Material Adverse Effect has occurred (except, with respect to clauses (i) - (iv), to the extent the Company is materially disproportionately adversely affected by such changes or events relative to other participants in the industry in which the Company participates, in which case only the materially disproportionate extent of the effect may be taken into account in determining whether a Material Adverse Effect has occurred).

6. *Black's Law Dictionary* defines material as "of such a nature that knowledge of the item would affect a person's decision-making process." A typical negotiator's definition is an item which is "significant."

information furnished to a buyer in a management presentation and/or a confidential information memorandum (which will typically include financial projections) or the data room. The seller's motivation is that it wants to avoid liability for extra-contractual representations and confine any possible liability that it may have to that which it specifically negotiated within the "four corners" of the acquisition agreement. In addition, in certain jurisdictions, the seller will be concerned about exposure to possible 10b-5 securities law violations for untrue statements or omissions of material fact if a sale of stock is involved. This "disclaimer-of-reliance" clause is part of a panoply of provisions that are included in an agreement at the behest of the seller in an attempt to limit its potential liability to the acquisition agreement and to give effect to any contractual limitations that have been negotiated (e.g., indemnification baskets, deductibles and caps, as discussed in more detail below).

COVENANTS

Most acquisition agreements also contain a series of covenants obligating the parties to act in a specified manner. Legally speaking, a covenant is a formal agreement or promise, usually in a contract or deed, to do or not to do a particular act.[7] Covenants, as opposed to representations and warranties, are forward-looking and relate to the conduct of a party either between signing of the acquisition agreement and closing of the transaction (a.k.a. the "executory period") or after closing. Covenants principally fall into three categories: (i) covenants that relate to the conduct of the target's business between signing and closing; (ii) covenants that detail the degree of efforts and specified actions necessary to close the transaction; and (iii) post-closing covenants. Along with express covenants that are included in an acquisition agreement, there may also be implied covenants that can be inferred from the entire agreement and the conduct of the parties generally (e.g., implied covenant of good faith and fair dealing).[8]

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7. BLACK'S LAW DICTIONARY 419 (9th ed. 2009).
8. For a discussion of issues raised by implied covenants in the context of an M&A agreement, please see Milbank's Global Corporate Client Alert, dated January 13, 2010, entitled "*Delaware Court of Chancery Finds a Genuine Issue of Material Fact in Connection with a Claimed Breach of the Implied Covenant of Good Faith and Fair Dealing in a Merger Agreement.*" The Client Alert is available at: http://www.milbank.com/images/content/7/8/788/011310Amirsaleh_v_Bd_Of_Trade_of_City_of_NY_Inc.pdf.

A. Covenants Relating to the Conduct of the Business Prior to Closing

In transactions where there is a period of time between signing and closing, pre-closing covenants relating to how the target's business will be operated in the interim period are very important. Typically, where there is a "gap" between signing and closing, a buyer will require the seller to agree to a set of "conduct of business" covenants. The pre-closing operational covenants take the form of an affirmative covenant to operate the target business in the ordinary course of business. The affirmative covenants may also include, among others, an undertaking to maintain good relations with the business' employees, customers and suppliers and to maintain the assets and properties of the target in their current condition (subject to ordinary course wear and tear). There is also a customary set of negative covenants that are often referred to as "hand-cuffs" because they limit the actions a seller may take with respect to the business being sold during the executory period. The purposes of these covenants are to ensure that the target business is operated in the ordinary course (i.e., that the status quo is maintained) and that no extraordinary actions are taken, without the consent of the buyer, that could have a negative effect on the target. Pre-closing negative covenants include, for example, undertakings that the target business will not: (i) make any capital expenditures over a certain dollar threshold or deviate from an agreed-upon budget; (ii) declare any dividends or distributions; (iii) effect any changes in capitalization; (iv) incur any indebtedness above certain agreed levels; (v) amend its organizational documents; (vi) increase or change employee salaries or benefits except as may be required by law or existing contract; (vii) acquire or dispose of material assets or enter into any merger or consolidation with another entity; (viii) enter into, modify or terminate any material contract; (ix) change accounting practices, except as required by applicable accounting standards or law; (x) settle any existing litigation; or (xi) liquidate or dissolve any of its businesses or operations. An issue often arises as to whether the buyer must act "reasonably" in considering any requests a seller might make for relief from these handcuffs or whether these "rules of the road," which are the subject of negotiated exceptions and thresholds, may strictly be enforced by the buyer in its sole discretion. In this context, implied duties of "reasonableness" may come into play, which may be extended by specifically negotiated contractually-required standards of "reasonable" behavior.

It is important to note that some transactions are structured to "sign and close" simultaneously, such that there is no executory period. A number of factors must be considered when deciding whether to sign and close simultaneously or not. In almost every deal, there are third-party or governmental consents that are required to close and the seller will not want to approach these parties until it has a signed, legally-binding sale agreement. In addition, if the buyer needs to obtain financing for the deal, it will want to have a binding purchase agreement before spending the time and money necessary to finalize the terms of the financing. Although very uncommon today, certain deals are negotiated to include a "due diligence out" to allow the buyer to complete its due diligence review between signing and closing, and to potentially terminate the deal if it is not satisfied with the result of its review. Finally, public deals sometimes include a go-shop provision to enable the target to seek superior offers prior to closing. Under each of these circumstances, a period between signing and closing is required.

B. Covenants To Close the Transaction

The parties to an acquisition agreement will typically agree to take specified actions in order to close the transaction after the execution of the acquisition agreement. As with covenants that operate during the executory period, covenants to close the transaction will not be included in an acquisition agreement when the transaction is structured to sign and close simultaneously.

Covenants that address the efforts or actions that must be taken by the parties to close the transaction include: (i) making filings and taking specified actions in connection with obtaining necessary governmental approvals; (ii) seeking third-party consents; (iii) obtaining any necessary financing; and (iv) seeking stockholder or other necessary organic approvals for the transaction. These pre-closing covenants can be extremely important in allocating the risk relating to the certainty of closing. For example, in a transaction where there are possible antitrust concerns, it is common for a seller to argue for a "hell or high water" clause, which would require a buyer to take all steps necessary to obtain regulatory approvals to consummate the deal (e.g., divesting any business or product lines insisted upon by the government regulators as a condition to obtaining antitrust approval for the transaction). Buyers typically will reject this open-ended standard (particularly in cases where the seller is attempting to impose an absolute standard) and argue for some type of materiality test (e.g., the buyer will need to make the requested divestitures unless their impact would be material to the target business (or, friendlier to the seller, to the business of the buyer and target on a combined basis)). The seller often will seek to substitute a higher "Material Adverse Effect" standard for the "small m" materiality standard. Alternatively, since these approaches rely on ill-defined concepts of materiality, which generally are thought to favor the seller in this context, a buyer may seek to substitute a quantitative standard (e.g., the buyer must agree to divest assets/properties that historically contributed EBITDA of up to $X based upon the prior year's results in order to obtain antitrust approval).[9] In recent years, the market has moved towards the concept of a "reverse break-up fee" as liquidated damages if the buyer cannot obtain the necessary regulatory approval or is unwilling to accept the terms imposed by the regulator (e.g., the $4 billion reverse break-up fee paid by AT&T in connection with the termination of its deal to acquire T-Mobile in 2011).[10] Houlihan Lokey recently published a study of transaction termination fees.[11]

Similarly, in transactions involving buyers that do not have the funds on hand necessary to complete the transaction, financing covenants will be the subject of intense focus in defining the buyer's obligations or responsibilities in dealing with its lenders and sources of capital. Also, in public company transactions, "deal protection" provisions will describe the steps that a target company may or may not take in soliciting or responding to alternative transaction proposals. These covenants, together with related closing conditions, termination provisions, break-up fees and reverse break-up fees, serve to allocate the risk that events that develop post-signing could imperil the closing.

9. In this context, an ancillary concern for both parties might include the extent to which the antitrust regulators are given a "roadmap" in the acquisition agreement regarding what steps might be acceptable to the parties to eliminate antitrust concerns.

10. Recent examples of agreements requiring a reverse break-up fee in this context include: (1) Electrolux's agreement to acquire GE's appliances business (announced September 8, 2014), (2) Halliburton Co.'s agreement to acquire Baker Hughes Inc. (signed November 17, 2014), (3) acquisition of Hi-Tech Pharmacal Co. by Akorn, Inc. (signed August 26, 2013) and (4) acquisition of Maidenform Brands, Inc. by Hanesbrands Inc. (signed July 23, 2013).

11. Houlihan Lokey, *2015 Transaction Termination Fee Study*, https://www.hl.com/uploadedFiles/12_Insights_and_Ideas/Articles/2015_HL_Termination_Fee_Study.pdf.

C. Post-Closing Covenants

The parties to an acquisition agreement will also typically agree to take (or refrain from taking) certain actions after the closing. Through post-closing covenants, buyers and sellers provide each other further assurances that they will work together after the closing to ensure the intent of the agreement is realized. Buyers frequently seek non-compete and non-solicitation covenants from the seller. Sellers may seek post-closing covenants from buyers to shield various constituencies like employees from changes in ownership (e.g., a seller may seek a promise from the buyer that it will maintain a certain number of employees at a compensation level, that is the same, in all material respects as the pre-closing compensation). If a buyer agrees to such covenants, in order to protect itself from future litigation it will typically maintain that no third-party rights are established by the covenants. Negotiations in this area will largely focus on the scope and length of the covenants. Additional post-closing covenants may address the parties' obligations relating to confidentiality, access to information, preservation of records and publication of the transaction.

It should be noted that post-closing covenants from a seller do not appear in acquisition agreements involving public company transactions since the selling stockholders are not a party to the acquisition agreement and, in any event, would be unwilling to take on such obligations. Any such undertakings would be in a separate agreement between the buyer and a large selling stockholder.

CLOSING CONDITIONS

A party's obligation to close a transaction is typically subject to the satisfaction of certain conditions. Like covenants that operate between signing and closing, closing conditions are only found in acquisition agreements where there is a period of time between signing and closing.

Closing conditions can be broken down into three general categories: (i) mutual conditions to both parties' obligation to close; (ii) conditions to a buyer's obligation to close; and (iii) conditions to a seller's obligation to close. Active conditions focus on whether the closing can occur (e.g., receipt of governmental approvals and no injunctions) while status conditions are intended to provide each party with the comfort that it will receive at closing the deal it bargained for at signing (e.g., that the representations and warranties are true and correct and all covenants have been performed). Neither party to the acquisition agreement will be required to close until the mutual conditions and all of its specific closing conditions have been satisfied or otherwise waived by such party. Care needs to be given to the specific wording of closing conditions because parties will generally be entitled to strictly enforce the conditions without resort to any reasonableness or implied materiality standard. Parties will sometimes use the ability to enforce closing conditions as a negotiation tool following signing to renegotiate contract provisions prior to closing.

Typical mutual conditions include: (i) receipt of regulatory approvals or clearances, such as pursuant to the HSR Act; (ii) stockholder approval (in the case of a public company target, or where the buyer is issuing a large number of shares of its stock); and (iii) no injunction or law having been enacted that would prohibit the transaction.

Conditions to a buyer's obligation to perform typically include: (i) a bring down of the seller's representations and warranties, as discussed above; (ii) compliance by the seller (either in all respects or more typically in all material respects) with its pre-closing covenants; (iii) the absence of a Material Adverse Effect on the target; (iv) the absence of any litigation, investigation, action or proceeding by or before any governmental authority that would or is reasonably likely to impact the transaction or the target in a material way; (v) the receipt of all documents and certificates required to be delivered by the seller under the acquisition agreement; and (vi) the receipt of any material third-party consents.[12]

In recent years, the Delaware Court of Chancery has been asked to interpret the applicability of an MAE closing condition.[13] In 2007, Hexion Specialty Chemicals, Inc. and Huntsman Corp. agreed to the terms of a merger pursuant to which Hexion would acquire Huntsman. After examining Huntsman's first quarter 2008 results, however, Hexion filed suit to avoid closing the deal based on its view that Huntsman had suffered an MAE. The Court, ruling in favor of Huntsman, demonstrated that a party seeking to avoid its contractual obligations by claiming the occurrence of an MAE will be faced with a "heavy burden." Noting that "Delaware courts have never found a material adverse effect to have occurred in the context of a merger agreement," the Court reaffirmed that the party

12. Parties may underestimate the effort that is necessary to secure third-party consents. A counterparty to a contract with the seller may have no motivation to grant a consent and may be concerned about how its business will be affected by the transaction. Accordingly, it is common for the seller to specifically limit the amount of effort it is required to take to obtain the consents (commercially reasonable efforts vs. "best" efforts) and to limit or eliminate the duty to pay consent fees or other amounts.

13. *Hexion Specialty Chemicals, Inc. v. Huntsman Corp.*, C.A. No. 3841-VCL (Del. Ch. Sept. 29, 2008).

asserting an MAE carries the burden to prove the occurrence of an MAE, and that an MAE requires a consequential change to the target's long-term earnings power. Furthermore, the Court discussed the appropriate "benchmark to use in examining changes in results of business operations post-signing of the merger agreement" to determine whether an MAE has occurred. Rejecting an earnings per share benchmark – a metric that is sensitive to the capital structure of a company, "reflecting the effects of leverage" – as problematic in the case of a cash acquisition in which the capital structure of the target company is being replaced, the Court focused instead on the results of operation of the business, or EBITDA.[14]

The typical conditions to a seller's obligation to perform are usually more focused in scope, and often include: (i) a bring down of the buyer's representations and warranties; (ii) compliance by the buyer with its pre-closing covenants (including payment of the purchase price); (iii) the absence of litigation and other proceedings challenging the transaction; and (iv) the receipt of all documents and certificates required to be delivered by the buyer under the agreement.

It is worth noting that, in a public transaction (particularly in the case of a leveraged buyout where the buyer will be using a significant amount of debt to finance the transaction), a buyer or seller may condition its obligation to close on the receipt of a solvency opinion (taking into account the financing for the acquisition) from a nationally recognized financial advisory firm.

INDEMNIFICATION

Among the most contentious provisions of an acquisition agreement are the indemnification provisions. Indemnification provisions detail the monetary payments that a party may be entitled to receive in the event such party suffers damages arising out of certain categories of indemnified events. Because the buyer is the party most likely to suffer losses after a deal closes, greater attention is often paid to the buyer's indemnification rights, although a seller is potentially at risk if the buyer has breached its representations or covenants. Typically, a buyer will seek indemnification for: (i) the breach or inaccuracy of representations and warranties made by the seller; (ii) the breach of covenants made by the

14. For additional discussion of the *Hexion* case please see Milbank's Global Corporate Client Alert, dated October 13, 2008, entitled, "*Hexion v. Huntsman: Delaware Court Offers Interpretive Guidance on Key Terms of Disputed Merger Agreement.*" The Client Alert is available at: http://www.milbank.com/images/content/8/5/854/Hexion_v_Huntsman.pdf.

seller; and (iii) other special matters that may arise in the course of the buyer's due diligence or any specified liabilities that are to be retained by the seller (e.g., pending litigation, litigation arising out of pre-closing sales of products, pre-closing tax liabilities or environmental liabilities in existence as of the closing). Although theoretically possible, public acquisitions do not provide the buyer with post-closing indemnification rights.

A. Survival

When negotiating the indemnification section of an acquisition agreement, the seller will attempt to limit its indemnification obligations in various ways, such as limiting the time period within which the buyer can bring an action to enforce an indemnity (a.k.a. the "survival period"). Often, a seller will require that its representations and warranties survive the agreement for a period of time less than the statute of limitations. In that case, the buyer may only bring an action based on a breach of the seller's representations and warranties within the shortened period. Typically, the survival period for breaches of "general" representations and warranties is limited to a period between twelve and twenty-four months after closing. Fundamental representations and warranties, such as the legal existence, good standing and capitalization of the target and seller's unencumbered title to the shares of stock or assets being acquired, are generally not subject to any survival period, and instead survive indefinitely. The parties may also agree that special areas of concern, such as taxes, environmental matters or other matters identified by a buyer in due diligence, should have a longer survival period. Typically, a seller will attempt to require pre-closing covenants to expire at closing and post-closing covenants to survive closing according to their terms. A buyer, however, may argue that pre-closing covenants should survive closing for a specified period of time, often the same length of time that the seller's representations and warranties survive in order to allow the buyer a reasonable period of time to discover pre-closing breaches of the pre-closing covenants.

In a 2011 case,[15] the Delaware Court of Chancery was asked to interpret the meaning of the following survival provision, which was set forth in a securities purchase agreement between GRT, Inc., as the investor, and Marathon GTF Technology, Ltd.:

15. *GRT, Inc. v. Marathon GTF Technology, LTD.*, C.A. No. 5571-CS (Del. Ch. July 11, 2011).

> "…All other representations and warranties in Sections 3 and 4 will survive for twelve (12) months after the Closing Date, and will thereafter terminate, together with any associated right of indemnification pursuant to Section 7.2 or 7.3 or the remedies provided pursuant to Section 7.4."

The purchase agreement also provided that the indemnification rights contained in the agreement were GRT's sole and exclusive remedy for any breach of the applicable representations and warranties.

In its complaint, GRT alleged that Marathon breached certain representations that were subject to the one year survival period, but no claim was brought within the one year period following closing. GRT argued that the survival provision should be interpreted to allow GRT to bring a breach claim within the normal three year statute of limitations, but only for breaches which occurred in the one year period following closing. In support of its argument, GRT urged the Court to adopt a stricter interpretation of survival provisions which purport to shorten the statute of limitations, as other jurisdictions have done, including New York and California. For policy reasons, those jurisdictions have held that, although parties can contract to shorten the statute of limitations, they must use language that clearly and unequivocally evidences their intent to do so in the purchase agreement. The Court rejected GRT's argument. According to the Court, under Delaware law, parties to a contract may limit the period of time in which claims for breach may be brought by including a survival provision similar to the one set forth in the parties' purchase agreement. No additional clear and explicit language is necessary. In its decision, the Court added that, although not required under Delaware law, the purchase agreement in this case did in fact evidence a clear intent by the parties to shorten the statute of limitations. Rather than simply stating that the representations and warranties survived for one year, the parties also agreed that GRT's sole remedy (the indemnification provisions contained in the purchase agreement) expired one year from closing. Together, this demonstrated unambiguously that the parties intended to shorten the statute of limitations to one year.

As a takeaway, practitioners should be aware that, although a standard survival provision akin to the one included in the GRT purchase agreement will effectively shorten the statute of limitations in Delaware, such provisions may be interpreted differently in other jurisdictions. As a result, careful attention to drafting is necessary when dealing with survival provisions.

B. Caps and Baskets

A seller's liability for breach of general representations and warranties is usually limited or capped at a certain figure. While it may once have been typical to cap liability at the purchase price paid to the seller, in recent years it has become the norm to set the cap well below the purchase price (e.g., 7-10%). In contrast, it is "market" that breaches of fundamental representations and warranties, covenants and special indemnities (e.g., retained or assumed liabilities) are capped at the purchase price. In a recent study, investment bank Houlihan Lokey analyzed middle market transactions ($10 million to $1 billion in value) from 2005 to 2014 in which Houlihan Lokey served as financial advisor to either the buyer or seller. The study was based on both public and private deals.[16] According to the Houlihan Lokey study, 77% of the transactions had representations and warranties that survived the closing and the average survival period was 18 months. Of those transactions, 88% employed a cap on liability, with the median cap being 9.8% of the purchase price.[17]

Claims for breaches of general representations and warranties are also typically subject to a "basket." If an agreement contains a basket, the seller will not be liable for any damages until they exceed a threshold amount. If the indemnifiable losses never exceed the threshold, they are borne entirely by the buyer. Sellers often advocate for baskets because they do not want to be troubled by the time and likely expense associated with adjudicating small indemnity claims. Sellers will argue that such minor costs are part of the risk the buyer assumes when purchasing a business. A basket can be a "tipping basket" or a true "deductible." If an agreement contains a tipping basket, then once indemnifiable losses exceed the threshold amount, the entire amount of such losses are recoverable from the seller beginning at dollar one. Alternatively, if an agreement contains a deductible, the indemnifiable losses that are below the threshold amount are borne by the buyer. Only damages that exceed the threshold amount will be borne by the seller. Fundamental representations and covenants are typically not subject to a basket. In addition to a tipping basket or deductible, parties often agree to a *de minimis* deductible or "throw away" amount. This is generally a small amount that could be between,

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16. Houlihan Lokey, *Purchase Agreement Study - For Transactions Completed in 2014 and Prior Years*, http://www.hl.com/email/pdf/2015/HL_Purchase_Agreement_Study_2014.pdf.
17. *Id* at 11.

for example, $1,000 and $50,000, depending on the enterprise value of the target. The buyer's losses for each and every breach below this amount are not recoverable from the seller and do not count towards the tipping basket or deductible. According to the Houlihan Lokey study, of the transactions in which representations and warranties survived, 88% included a basket. Deductible baskets accounted for 78% of the baskets and tipping baskets accounted for the remaining 22%.[18]

C. Escrows and Other Indemnification Terms

In order to secure the seller's indemnification obligations, the parties may agree that a portion of the purchase price will be held in escrow with a third-party escrow agent until the expiration of the general survival period or, if later, the resolution of any indemnification claim pending at the time the escrow period expires. If an escrow is included in an acquisition agreement, the parties will have to determine the amount that will be placed into escrow and the period that the escrow will remain in effect. Buyers and sellers will also have to negotiate whether indemnification claims will be limited to the escrow. Buyers will attempt to obtain a sizable escrow if the indemnities are to be limited to the escrow and there is no recourse to recover the portion of the purchase price paid to the seller at closing. Sellers will generally resist the inclusion of an escrow because it delays the seller's ability to receive the proceeds of the deal and provides an attractive and readily available source of cash that may encourage the buyer to bring indemnity claims of questionable merit. According to the Houlihan Lokey study, of the transactions in which representations and warranties survived, 82% contained some form of an escrow. The median escrow was 5% of the purchase price and had a term of 18 months.[19]

Other indemnification terms that will be the subject of negotiations include each party's duty to mitigate losses; exclusion from indemnified losses for "consequential" or punitive damages (including "lost profits" or "diminution in value"); whether to disregard materiality qualifiers contained in representations and warranties (a so-called "materiality scrape" or a "readout" of materiality) on the theory that the basket amount serves as the materiality threshold for indemnification purposes and having both materiality qualifiers and a basket would amount to double materiality protection for the seller;

18. *Id* at 11.
19. *Id* at 14.

subrogation of the indemnifying party to the indemnified party's rights against third parties; and a reduction in indemnification payments to account for insurance proceeds or any tax benefit actually received or potentially recoverable by the indemnified party as a result of the indemnified loss. Indemnification provisions also typically grant the indemnifying party certain rights to defend against third-party claims.

In addition, the seller and buyer will negotiate whether to include an "anti-sandbagging" provision, which provides that the seller will not be liable for damages arising out of any breach that the buyer was aware of prior to closing. The theory behind such a provision is that the buyer should not be entitled to close the deal over a breach that it was aware of and then subsequently sue for damages based on that breach. Buyers will resist the inclusion of an "anti-sandbagging" provision, and may even try to include a provision which states that the buyer's ability to recover damages for a breach by the seller will not be affected by whether the buyer was aware of the breach before the closing of the transaction.

To attempt to preserve the benefit of various limitations on liability drafted into the contract, the seller should include a provision to the effect that the indemnification provisions of the acquisition agreement are the indemnified party's exclusive post-closing remedy for losses under the acquisition agreement. [20] This is part of a broader effort by the seller to avoid any liability for extra-contractual claims based upon tort theories (e.g., fraud) or securities law claims (e.g., 10b-5). A buyer may seek to preserve its ability to bring extra-contractual claims by excepting "fraud" from these limitations. While this general exception as a contractual matter raises a number of uncertainties for a seller, the degree to which a seller can insulate itself against fraud claims (irrespective of the precise wording of the exclusive remedy language) will vary from jurisdiction to jurisdiction.

CONCLUSION

Throughout the course of most M&A transactions, the seller's primary objective is to maximize the amount of consideration it will receive for its business and the likelihood of closing, while minimizing the ways the buyer can "claw back" the purchase price. The buyer, on the other hand,

20. The remedies for pre-closing breaches will often include the right to seek specific performance.

will be most concerned with ensuring that it properly obtains the ownership rights to the specific property it is purchasing, that it has obtained adequate and accurate information about the target so that it can accurately value the target and that the business will be delivered to it at closing in the condition in which it was represented to be at signing. A lawyer's role is to do more than merely draft the definitive agreement and related documents. He or she must fully appreciate the client's goals with respect to the transaction and provide as many options as possible to the client in order to achieve those goals. Although no two deals are identical, having a firm understanding of the basics of an M&A agreement will help a lawyer fulfill his or her role.

NOTES

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It's a Hostile World: Responding to Unsolicited Take-Over Proposals

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PRESENTATION OUTLINE

I. OVERVIEW OF UNSOLICITED ACQUISITIONS

A. UNSOLICITED ACQUISITIONS

1. Defensive Review / Profile
2. Legal and business due diligence
3. Indemnification provisions
4. Change of control agreements and provisions
5. State law "anti-takeover" statutes
6. Stockholder profile (e.g., capitalization, impact on debt arrangements, management, employee plans, large stockholders).

B. THE TARGET'S PERSPECTIVE

1. Important to contact advisors to assist in preparing a response to an unsolicited bid.
   a. Advisor team should include legal counsel, financial advisor and possibly other advisors including consultants, public relations advisors and proxy solicitors.
2. Target should ascertain level of interest in transaction in order to formulate a strategy and response.
   a. Target should examine the Bidder to ascertain its motivations for acquisition (i.e. strategic vs. financial) and weigh the value of the offer against the long-term prospects of the business and other value-enhancing strategies.
   b. Target should decide whether to "just say no" or to negotiate with the Bidder.
3. In conjunction with its legal and financial advisors, the Target should consider other value-enhancing strategies.
   a. Alternatives may include, among others, (i) adopting defensive provisions (e.g., shareholder rights plan), (ii) sale of its assets, (iii) sale of the company through an auction or to a White Knight acquirer, (iv) engaging in a restructuring, recapitalization, or spin-off/split off or (v) launching its own takeover proposal for the Bidder or another target.

b. Advance preparation (including anticipation of what bidders/activists may do) can be crucial for success.

4. Important for the Target to keep decision-makers at the highest level fully informed and involved.

   a. Target's Board of Directors should drive the Target's strategic decisions and responses to the unsolicited offer.

5. Target's Board of Directors, senior management and investor relations/public relations department should review its internal disclosure guidelines and develop a comprehensive response plan in case of inquiries.

C. THE BIDDER'S APPROACH

1. In communicating with the Target, the Bidder must consider a number of variables:

   a. Bidder must decide whether to approach the Target via a high level executive or using an investment banker.

   b. Bidder should determine whether to approach via a phone call or whether to request a face to face meeting with the Target.

   c. Bidder should work with its advisors (legal, financial and others) to script a conversation which maximizes the interest of the Target in the transaction by setting a clear message and goals for the transaction.

   d. Bidder must keep its decision-makers and advisors fully informed by providing debriefings after each interaction with the Target.

   e. Bidder must take all necessary steps to ensure confidentiality of its interactions/conversations with the Target.

   f. Bidder usually controls whether and when to go public because target generally prefers all contacts remain private (unless forced to disclose).

2. The Bidder should consider the various ways the parties may terminate the deal and the tools available to protect against uncertainty of closing.

   a. <u>Fiduciary Out</u>: Provision that permits the Target's board of directors to terminate a proposed merger if required to do so by its fiduciary duties (usually limited to where a better deal arises with another party).

b. Financing Out: Provision that permits the Bidder to terminate a proposed merger if it cannot secure the necessary funds to complete the transaction.

c. Break-Up Fee: Fee paid by the Target to the Bidder if the Target terminates the transaction (usually in response to a limited negotiated set of circumstances).

d. Reverse Break Up Fee: Fee paid by the Bidder to the Target if the transaction is terminated (usually in response to a limited negotiated set of circumstances).

e. Specific Performance: Provision that allows a party to compel the other party to complete the transaction.

f. Material Adverse Change / Material Adverse Effect Clauses: Provisions that allow a party to refuse to complete a transaction if there is a major change during the pre-closing period that affects the value of, or ability of the other party to complete, the transaction. MAC/MAE clauses are highly negotiated and generally include a number of exceptions which have become standard in the market place (e.g., changes caused by general economic conditions). Delaware Chancery Court decisions, however, demonstrate the difficulty of successfully triggering these clauses (*Hexion v. Huntsman* and *IBP v. Tyson*).

g. In one of the largest LBO transaction since the financial crisis began, IMS Health was able to extract certain provisions that were designed to increase the certainty of transaction consummation in the wake of a period when several announced LBO transactions failed to close. These provisions included a general specific performance provision; an explicit specific performance provision against the equity contribution (subject, among other things, to the debt being available); a relatively high reverse break-up fee (6.9% of the deal value); a provision that permitted the seller to go down the specific performance path but preserved the seller's right ultimately to claim the reverse break-up fee (including a provision that restricted the buyers' unilateral ability to terminate and pay the reverse break-up fee); and a provision that obligated the sponsors to fund the shell companies up to $6 million so that they would be in a financial position to fulfill their obligations under the merger agreement.

D. THE CORPORATE RAIDER

1. A <u>Corporate Raider</u> has a variety of tools at its disposal to acquire/influence a Target:

a. <u>Approach Senior Management or the Board of Directors of the Target</u>

(i) Acts as a "friendly" approach in which the Raider proposes a transaction to the Target's CEO or a Director.

(ii) Raider can use this approach to "take the temperature" of the Target in order to check its receptiveness to a transaction.

(iii) Target Board and management must be prepared and know how to respond to "casual passes".

b. <u>Make Open Market Purchases ("Accumulation")</u>

(i) Can creep into a controlling position without paying a control premium.

(ii) Can provide a base from which to launch an unsolicited hostile offer or proxy contest.

(iii) Must be mindful of public disclosure/disclosure to Target obligations and regulatory approval thresholds (HSR / 13D) and industry-specific ownership thresholds.

(iv) In addition, public disclosure of intentions may put the Target "in play" and cause it to be less receptive to a transaction with the Raider or lead to a process that will result in the Target pursuing a transaction with a White Knight.

(v) Use of derivatives (e.g., cash and equity-settled total return swaps, options, etc.). Interaction with HSR and 13D filing obligations and potential new SEC rule-making.

c. Deliver a Letter of Interest to the Target

(i) "Bear Hug" Letter – A written offer that provides a specific price; generally Raider will disclose the letter in order to put the Target "in play".

(ii) "Teddy Bear Hug" Letter – A written proposal stating interest but that usually does not include a specific price; generally Raider will not disclose the letter as it is used to gauge the Target's receptiveness to a transaction.

(iii) In most circumstances, a Target does not have an obligation to disclose either letter.

(iv) A Target should, however, work with its advisors to formulate a strategy and response to such letters especially if the Raider makes the Bear Hug Letter public.

d. Make an Unsolicited Tender or Exchange Offer

(i) Offer made directly to stockholders to purchase the shares of the Target – usually for a premium.

(ii) Often follows a "Bear Hug" Letter.

(iii) Governed by Sections 14(d), (e) and (f) of the Securities Exchange Act of 1934 (the "Exchange Act"), Schedule TO and Regulations 14D and 14E of the Exchange Act. If an exchange offer, also governed by the Securities Act of 1933.

(iv) Absent regulatory issues (including HSR or other antitrust issues), an all cash tender offer can close in 20 business days unless the Target's Board takes defensive measures (i.e., implements a Rights Plan).

(v) Raider prohibited from acquiring securities outside of the tender offer once the tender offer is announced.

(vi) Exchange offers potentially more time consuming as Raider must file and SEC must review Form S-4, although early commencement rules permit bidder to simultaneously launch and file exchange offer, and SEC staff generally reviews exchange offers on an expedited basis.

(vii) May be combined with litigation to, among other things, invalidate defenses.

(viii) Note of Caution: In light of recent Delaware case, Bidders should carefully avoid using confidential information previously gathered from a Target if the information was subject to a confidentiality or non-disclosure agreement.[1]

e. Launch a Proxy Contest

(i) Generally aimed at seeking to replace the Target's existing directors with a dissident slate chosen by the Raider.

(ii) Governed by Section 14 of the Exchange Act and the rules thereunder.

(iii) Raider will likely engage a proxy solicitor and public relations firm to assist with the solicitations of proxies through stockholder mailings, advertisements, telephone solicitations and meetings with institutional stockholders.

(iv) Proxy contest can be done alone ("poor man's tender offer") or in conjunction with a tender offer.

(v) If combined with a tender offer, the goal is to change the Target's existing directors, remove the Target's defenses and allow the tender offer to proceed.

(vi) May be combined with litigation to, among other things, invalidate defenses.

(vii) Proxy contest continues to be the most effective tool for putting pressure on the Target's board to remove the Target's defenses. Recent examples include:

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1. In *Martin Marietta Materials v. Vulcan Materials*, the Delaware Chancery Court granted an injunction restraining Martin Marietta from proceeding with its exchange offer for Vulcan Materials. The two parties had previously entered into a confidentiality agreement in connection with exploring a transaction.

A. Inbev SA's use of a proxy to threaten replacing the board of Anheuser-Busch through a shareholder action by written consent.

B. King Pharmaceuticals threat of a proxy fight which successfully pressured Alpharma's board to back King's offer.

C. NRG Energy Inc.'s threat of a proxy fight with Excelon Energy, Inc. to increase the number of directorships and name the majority of directors in order to pressure Excelon to accept an outstanding exchange offer.

D. Roche's use of a proxy fight with Illumina to increase the number of directorships and name the majority of directors in an effort to pressure Illumina into accepting Roche's exchange offer.

E. Air Products' use of a proxy fight to elect Air Products nominees to the board of Airgas in an effort (ultimately unsuccessful) to pressure Airgas into supporting Air Products' proposed acquisition.

F. Valeant's use of a proxy fight to elect Valeant nominees to the board of Cephalon in an effort to pressure Cephalon into supporting Valeant's proposed acquisition (ultimately unsuccessful – White Knight).

f. <u>Force Other Alternative</u>

(i) Raider may negotiate an issuer repurchase of its holdings.

(ii) In addition, the Raider may force the Target to consider certain measures which will provide it with a profit on its acquired shares, including, a restructuring, spin-off, recapitalization/extraordinary dividend or a sale to a White Knight acquirer.

2. <u>Activist Hedge Funds</u> – The New Corporate Raiders

a. Present estimates indicate that hedge funds worldwide manage in excess of $2 trillion, at or near an all-time high.

b. Increased growth in hedge fund numbers and increased competition for superior returns has led to some hedge funds becoming activist investors.

c. Hedge funds typically target companies who have:

(i) Lower market capitalizations relative to their peers

(ii) Substantial cash balances

(iii) Low financial leverage

(iv) Stock price or earnings underperformance

(v) Depressed valuation multiples

(vi) Low market value relative to apparent “asset value”

d. Hedge funds often fight their takeover battles in the arena of public/investor relations rather than with legal and financial maneuvering.

e. Hedge funds often use pressure (i.e., 13D filings or other public disclosures of intent) and proxy contests to compel strategic changes such as:

(i) Higher dividends

(ii) Stock buybacks

(iii) Asset dispositions

(iv) Removal of executives/board members

(v) Sale of company

f. Hedge funds are also exerting their influence in opposition to proposed transactions in order to extract “bumps” and sweetened bids including by taking advantage of appraisal rights in M&A transactions in order to increase their returns.

g. Hedge funds employ a range of tactics (moderate, aggressive and hostile) to accomplish their value maximizing goals. See APPENDIX A.

3. Publicly Traded Investment Vehicles

a. Recently, activist investors have turned their attention to publicly traded investment vehicles such as real estate investment trusts (REITs) and business development corporations (BDCs).

b. Such investors perceive opportunity where underperformance of such vehicles has led the market to value them at a price that is lower than the net asset value of their assets (NAV), as a change in the manager or trustee alone can produce an immediate and substantial return. In many cases, the target company's managers or trustees are criticized for improper conflicts of interest.

c. In addition, other publicly traded vehicles may make unsolicited offers to acquire underperforming vehicles at prices that represent a premium to the market price of the target's shares yet would be accretive to their own shares given the NAV multiple at which they trade.

d. Many REITs and BDCs are incorporated in Maryland, whose corporate laws are more company-favorable than the laws of Delaware. For example, the Maryland corporation law expressly disavows the Revlon doctrine.

e. In 2014, Corvex Management LP and Related Companies ousted the management and board of trustees of CommonWealth REIT and installed Sam Zell as its new chairman following a 15 month battle involving accusations of conflicts of interest.

f. In 2015, the managers of TICC Capital Corp., an underperforming BDC, sought to sell their management company to Benefit Street Partners. The announcement of the sale, which would require approval by TICC's shareholders, spawned a competing bid by NexPoint Advisors to be appointed as TICC's manager, as well as a bid by TPG Specialty Finance to acquire TICC. Notwithstanding Benefit Street's commitment to reduce management fees for the benefit of shareholders, on December 22, 2015, TICC's shareholders rejected the sale of its manager to Benefit Street.

g. In 2015, RiverNorth, an activist investor, disclosed that it had acquired 6% of Fifth Street Finance, an underperforming BDC. RiverNorth demanded that Fifth Street's manager reduce its management and incentive fees and increase the size of its stock repurchase program. RiverNorth also nominated a slate of nominees for election as directors of Fifth Street, and announced its intention to seek the termination of its existing management contract.

E. UNSOLICITED TENDER OFFER

1. Conditions

2. Cash vs. Stock

3. Fast-track exchange offer in stock deal

4. Timing issues

II. ASSESSMENT OF TAKEOVER DEFENSES – SEE APPENDIX B

A. DISTINCTION BETWEEN A CHARTER AND A BYLAW PROVISION

1. Stockholders cannot unilaterally amend Charter; the Board must first approve.

2. However precatory shareholder resolutions to amend the Charter (e.g., to eliminate a classified board) have more teeth in light of majority voting and the ISS policy of recommending that shareholders withhold votes from directors who ignore shareholder resolutions. Under ISS's standards, they will recommend against/withheld from directors' who do not implement proposals that receive a majority of votes cast.

B. LIMITS ON STOCKHOLDERS' ACTIONS

1. Provisions that restrict stockholders from (i) taking action by written consent and (ii) calling a special meeting.

   a. These provisions restrict the "window of Board vulnerability" only to a proxy context conducted in connection with the annual meeting.

   b. Provision denying stockholders the ability to act by written consent (or requiring unanimous written consent) must be in Charter.

   c. Critical defensive provisions that give the Board control of the voting mechanism.

   d. Usually accompanied by Bylaw provisions giving the Board maximum flexibility in setting stockholder meeting dates.

2. To the extent stockholders can act by written consent, bylaws can contain provision for establishing record date/notice (the 10/10 standard).

C. CLASSIFIED OR "STAGGERED" BOARD

1. A Classified Board is one in which directors are divided into separate classes.

   a. Usually three classes, with the directors in each class serving three-year terms and only one class elected annually.

   b. Staggering directors' terms makes it more difficult for dissidents to use a proxy contest to seize control of a target company immediately.

   c. Even if dissidents control a majority of the company's stock, they can elect only one-third of the directors in any one year.

   d. As of December 2016, approximately 10% of S&P 500 companies had staggered boards, down from approximately 53% at the end of 2005 and over 60% in 2002.

D. BOARD VACANCIES & SIZE; REMOVAL OF DIRECTORS

1. Provisions allowing Board the sole authority to fix the size of the Board and fill vacancies; gives Board control over its own size and constitution.

2. Having the Board determine its own size (within limits) prevents dissidents from "packing" the Board by increasing its size and filling the newly created vacancies.

   a. Provisions fixing size of Board should be in Charter; if in Bylaws, it is vulnerable to amendment by stockholders.

3. Removal of directors *only for cause* prevents dissident stockholders from causing the removal of a director for any reason other than fraud, criminal acts, etc. (In Delaware, directors can be removed without cause, unless there is a staggered board, as the Vaalco decision emphasized.)

4. These provisions serve as a necessary complement to the Classified Board provision.

5. In Delaware, a Classified Board provision automatically provides for the removal only for cause even if Charter is silent.

E. LIMITED ABILITY TO AMEND CHARTER OR BYLAWS

1. These provisions provide limitations on the rights of stockholders to amend the corporation's governing documents.

    a. Typical restrictions include requiring a supermajority vote to amend the Charter and/or Bylaws and, where such powers are not granted under state law, empowering directors to amend the Bylaw without stockholders' consent.

    b. In Delaware, stockholder vote is required to amend the Charter and stockholders cannot be denied absolutely the right to amend Bylaws. Proxy contests seeking to amend the Bylaws can be restricted more effectively by using supermajority stockholder vote requirements for such action.

    c. After years of shareholder activism and ISS disapproval, supermajority requirements are increasingly rare.

F. FAIR PRICE PROVISIONS

1. Fair price provisions require a bidder to pay all stockholders a "fair price," usually defined as the highest price the bidder paid for any of the shares it acquires of a target company during a specified period of time before the commencement of a tender offer.

2. Most fair price provisions do not apply if a merger is approved by the target's Board or if the bidder obtains a specified supermajority level of approval for the merger from the target's stockholders.

3. Generally designed to deal with coercive two-tier offers. The advent of the stockholders rights plan has greatly reduced the need for these provisions and they are fairly unusual.

G. BLANK CHECK PREFERRED STOCK

1. "Blank check preferred stock" describes preferred stock authorization provisions that give the Board of Directors broad discretion to establish voting, dividend, conversion and other rights for preferred stock.

    a. Such broad authorization provides a Board with flexibility to meet changing financial conditions, but it also grants the Board authority to issue the preferred stock necessary to implement certain defenses, including a poison pill stockholder rights plan.

b. Blank check preferred also can be placed with an employee stock ownership plan or a friendly or strategic investor. These parties may control enough voting power to block a takeover attempt. Such actions will generally be subject to judicial scrutiny, especially if they threaten the shareholder franchise (if under the Blasius standard.)

H. ADVANCE NOTICE

1. All public companies should have a Charter or Bylaw provision that requires stockholders to provide advance notice of business that they intend to present at a stockholders' meeting. Such requirements may apply to Board nominations, resolutions to be offered from the floor, or both.

   a. In most cases, the advance notice requirements takes the form of a "window" that specifies the earliest and latest dates for such submissions (typically 90-150 days in advance of the annual meeting).

2. If stockholders fail to comply with the notice requirements, the company has the right to disregard any efforts to discuss or vote on the business at the meeting.

3. Advance notice provisions prevent "last minute" matters from being proposed at meetings of stockholders, generally dissuading disruptive practices.

4. These provisions are usually used with other provisions that give the Board power to determine meeting procedures.

5. In recent years, practitioners and their clients have been giving greater consideration has been given to expanding advance notice bylaws. Such expansions include:

   a. Disclosure of derivative positions that allow an investor to vote the security or to create the economic equivalent of ownership without acquiring ownership of the security itself.[2]

2. In the U.S. N.Y. District Court case of *CSX v. TCI Management*, the court held that the holders of derivative instruments were beneficial owners for Exchange

b. Continuous disclosure for beneficial owners of greater than 5% of voting equity securities so that investors must disclose any change of position after the initial advance notice is made.

6. Delaware case law (*JANA v. CNET* and *Levitt v. Office Depot*) suggests that the court will construe the language of a company's bylaws narrowly and resolve ambiguity in favor of stockholder rights.

7. As more companies adopt proxy access bylaws (which allow shareholders to nominate candidates for director in the company's proxy materials), companies will have to decide whether to require the usual advance notice for those nominations or a longer period (such as the advance notice requirement for SEC Rule 14a-8).

I. SHAREHOLDER RIGHTS PLANS – SEE <u>APPENDIX C</u>.

1. A Shareholder Rights Plan (also known as a "Poison Pill") can help a board maximize stockholder value.

2. A Shareholders Rights Plan is not intended to and will not prevent a hostile takeover of a company, nor does it eliminate obligation of the directors to exercise fiduciary duty.

3. Additional Advantages:

   a. Provides time to evaluate alternatives in order to maximize value for all stockholders.

   b. Board can implement this common takeover defense relatively quickly without a stockholder vote, knowing that it has been endorsed by the courts.

   c. Board retains power to redeem rights.

Act disclosure purposes because they had entered into the derivative agreements with the intention of avoiding disclosure requirements. Although a partial remand on appeal has left the law in a state of flux, practitioners have extrapolated this securities law finding to the corporate governance arena through the expansion of advance notice bylaw provisions.

4. Key Considerations:

   a. Shark Repellant reports that under 6% of S&P 1,500 companies had poison pills as of December 2016, down from 30% at the end of 2008.

   b. For the S&P 500 the number is 3.5%, compared to 62% in 2002.

   c. Some companies have been adopting "stockholder friendly" features to rights plans, including requiring oversight by independent directors, sunset provisions and "chewable" pills.

   d. Many companies are putting prepared "ready to go" rights plans "on the shelf" that can quickly be adopted if a take-over threat arises.

5. Recent Reaffirmation of Rights Plans. In Air Products vs. Airgas, the Delaware Court of Chancery upheld the use of a shareholder rights plan utilized to block a structurally non-coercive, all-cash, all shares, fully financed tender offer. The Court upheld the right of the target board which had unanimously rejected the bidder's offer as inadequate to refuse to redeem the pill even though a year had passed since the initial offer, and the bidder had won the last annual meeting and captured a third of the staggered board (although it is important to note that the nominees of offeror also rejected the offer as inadequate).

   While court found that board cannot "just say no" forever, the court confirmed that a board acting in good faith, after reasonable investigation and reliance on outside advisors, and which articulates and convinces the court that a hostile tender offer poses a legitimate threat to the corporate enterprise, may address that perceived threat by blocking the tender offer and forcing the bidder to elect a board majority that supports its bid.

6. Activist (Differential Trigger) Rights Plans:

   In 2014 in the Sotheby's case (*Third Point LLC v. Ruprecht*), the Delaware Court of Chancery upheld the use by the Sotheby's board of a two-tiered rights plan that triggered at a 10% level for 13D filers and at 20% for "passive investors" who file on Schedule 13G. The plan exempted whole-company tender offers that treat all stockholders equally. The Sotheby's decision reaffirms that Delaware directors may take appropriate action to defend against any reasonably perceived danger to corporate effectiveness, including an activist threat.

7. Net Operating Loss Poison Pills:

   a. Recently, rights plans with a lower trigger threshold of 4.99% (as opposed to the 15-20% threshold of traditional rights plans) have been deployed to protect a corporation's net operating loss carry forwards (NOLs). The ability to carry forward NOLs is forfeited if a company undergoes a "change of ownership" of more than 50 percentage points by one or more 5% shareholders within a three-year period.

   b. The lower trigger of 4.99% effectively requires board approval in order for a shareholder to increase ownership above the 5% threshold. This allows the board to prevent a shareholder from causing a "change of ownership" that would forfeit the company's NOL carry forwards.

   c. Under Delaware law, board actions with respect to NOL poison pills should be reasonable in relation to protecting a corporation's NOL asset. Delaware courts may view skeptically any attempt to adopt or use NOL poison pills for defensive purposes.

   d. <u>Example</u>: In 2008, Selectica's board reduced the trigger threshold of its shareholder rights plan to 4.99% to protect its NOLs from Versata's share accumulations. Versata subsequently triggered the pill and its share holdings were diluted. The Delaware Court of Chancery upheld the validity of Selectica's NOL pill as well as the "exchange and reload" feature of the pill.

J. STATE TAKEOVER LAWS

1. <u>Generally</u>: The inherent threat of plant closings, lost jobs, headquarters relocations and other such community-damaging results provides motivation for state legislatures to take an active interest in takeovers. State legislatures are limited, however, in the degree to which they can regulate takeovers because such state anti-takeover legislation must not be so excessive as to be unconstitutional.

2. Control Share Acquisition Statutes bar creeping acquisitions over the 20% threshold.

   a. Once an “acquiring person” purchases over 20%, 33% or 50% of target’s shares, the “control shares” (the shares to be purchased by the acquiring person that are over the applicable threshold percentage) may not exercise voting rights unless other stockholders approve at a special meeting.

3. Business Combination Statutes prevent front-end loaded, two-step coercive takeovers.

   a. Target may not engage in any business combination with an “interested stockholder” (a 15% or greater percent stockholder) for three years following such 15% (or greater percentage) acquisition unless:

      (i) 85% or more of outstanding shares are acquired;

      (ii) the acquisition or business combination was approved by the target’s Board before the date of the acquisition; or

      (iii) the business combination is approved by the target’s Board and the holders of at least 66 2/3% of target’s outstanding shares, excluding shares owned by the interested stockholder.

4. Fair Price Statutes accomplish the same objective as fair price provisions found in a company’s organizational documents.

   a. Some states have fair price provisions as the default rule by statute.

K. CONSTITUENCY PROVISIONS

1. Constituency Provisions under some states’ laws permit a target’s board to use broad discretion in the face of a hostile bid or, when faced with a choice of competing bids, to accept a takeover proposal that retains employees and a strong local presence but that may be slightly less advantageous to stockholders than a competing nominally higher proposal that involves plant closings or the disposition of critical assets.

2. Delaware does not have a constituency provision.

3. Directors of target may, in discharging the director's duties relating to any proposed corporate action, including any response to a takeover proposal, consider the interests of the corporation's employees, customers, suppliers and creditors, the economy of the state and nation, community and societal considerations, and the long-term as well as short-term interests of the corporation including the possibility that these interests may be best served by the continued independence of the target. (New York, Indiana, Pennsylvania have such provisions.)

4. While such provisions do provide directors with an additional layer of legal protections, boards almost always justify their actions by reference to the best long-term interests of the shareholders (as opposed to just other constituencies) in responding to takeover bids.

J. NDAs and Standstills

1. Standstill agreements, which restrict one party from taking actions to acquire or assert control over another, are often included in confidentiality agreements between commercial partners and parties to joint ventures and are frequently required of potential acquirers before confidential information is provided by a target.

2. Although they are not generally applicable to takeover defenses, because they are individually negotiated agreements, standstill agreements can be an important part of a company's strategy of independence.

3. Confidentiality and use restrictions can have some protective value even in the absence of a standstill agreement (see, for example, Vulcan vs. Martin Marietta Materials).

III. DUTIES OF DIRECTORS IN ADOPTING AND MAINTAINING TAKEOVER DEFENSES

A. THE BUSINESS JUDGMENT RULE

1. Under Delaware law, a director's duties in managing the business and affairs of a corporation involve three key elements:

   a. Duty of loyalty.

   b. Duty of care.

c. Duty to act in a manner the director reasonably believes to be in the best interests of the corporation and its stockholders.

2. The duty of loyalty requires that the director not have any special and material interest in the transaction inconsistent with that of stockholders generally.

   a. The fact that a director may be a director of the combined entity does not itself create self-interest under Delaware law.

3. The duty of care requires a director to act in an informed and considered manner and to take the care that a prudent business person would take when considering a business decision.

   a. A director will be considered well-informed if he/she carefully considers the various financial, legal and other aspects of the proposed transaction.

   b. A director is entitled, and expected, to rely upon information provided by management and outside advisors, but his/her duty of care is not satisfied merely by the receipt and review of information, recommendations and opinions of others.

4. As long as a board of directors properly discharges its fiduciary duties of loyalty and care and acts in the best interest of the corporation and its stockholders, the "business judgment rule" should apply to the decisions of a company's board of directors.

   a. Under the business judgment rule, directors' decisions are presumed to have been made on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company and its stockholders.

   b. A rationale for this doctrine of judicial deference is that business decisions ought to be made in the boardroom not the courtroom.

   c. When the traditional business judgment rule applies, directors' decisions (even if they turn out to be incorrect) are protected unless a plaintiff is able to carry its burden of proof in showing that a company's board has not met its duty of care or loyalty or acted in the best interests of the corporation and its stockholders.

B. DUTIES IN RESPONDING TO AN UNSOLICITED OFFER

1. There is <u>no</u> legal duty to negotiate or propose alternate terms in response to an offer.

    a. The duty is to respond to the offer <u>as presented</u>.

2. There is a duty to carefully investigate the offer and to respond to it in good faith on a reasonable basis.

    a. When a board is confronted with an unsolicited offer, it has the obligation to determine whether the offer is in the best interests of the company and its stockholders.

3. Unless a company is in "<u>Revlon</u> mode," its board is <u>not</u> under any duty to sell the company or negotiate with the offeror, even if the offer represents a substantial premium to current market prices.

C. UNOCAL "ENHANCED SCRUTINY" STANDARD

1. Enhanced Scrutiny for Defensive Measures

    a. A decision by target's board not to accept an unsolicited offer generally would be reviewed under the business judgment rule.

    b. When a board adopts a defensive mechanism in response to an alleged threat to corporate control or policy, however, Delaware courts review the board's action under an "enhanced scrutiny" standard rather than the traditional business judgment rule. The directors have the burden of proof to show that the "enhanced scrutiny" standard has been satisfied. (*Unocal* v. *Mesa Petroleum*, 493 A.2d 946 (Del. 1985).

2. <u>Unocal</u>'s enhanced scrutiny standard requires, in the context of a defensive device or transaction that the board show:

    a. that it had "reasonable grounds for believing that a danger to corporate policy and effectiveness existed" and

    b. that the defensive measure chosen was "reasonable in relation to the threat posed".

3. First Unocal Prong: "reasonable grounds for believing that a danger to corporate policy and effectiveness".

   a. To satisfy the first Unocal prong, a board has a duty to investigate an offer carefully and to respond to the offer in good faith and on a reasonable basis.

   b. When assessing whether an unsolicited offer poses a danger to corporate policy, a board's analysis should consider:

      (i) the adequacy and terms of the offer;

      (ii) the offer's fairness and feasibility;

      (iii) the proposed or actual financing for the offer, and the consequences of that financing;

      (iv) questions of illegality;

      (v) the risk of nonconsummation; and

      (vi) the bidder's identity, prior background and other business venture experience.

4. Second Unocal Prong: defensive measures are "reasonable in relation to the threat posed".

   a. To satisfy second Unocal prong, board must show (based on *Unitrin v. American General*):

      (i) defensive measure was not draconian (i.e., not "coercive" or "preclusive"); and

      (ii) defensive measure, if not draconian, was within a "range of reasonableness".

5. Miscellaneous Unocal Considerations

   a. Poison pills have survived Unocal's/Unitrin's enhanced scrutiny.

   b. An unfair price is a legally cognizable danger to corporate policy and effectiveness under Unocal.

   c. The proof presented by the board in support of its burden is "materially enhanced" where a majority of the board consists of "outside independent directors".

6. The target board's actions must be "defensive" to be subject to enhanced scrutiny.

    a. A previously announced merger is not "defensive" in response to an unsolicited bid unless and until the form of the previously announced transaction changes in response to the unsolicited bid.

D. THE "JUST SAY NO" DEFENSE

1. Under Delaware law, if the target's board maintains a "good faith belief, made after reasonable investigation," that the unsolicited offer poses a legally cognizable threat, the target's board may "just say no" by refusing to redeem a poison pill.

2. In *Moore Corp.* v. *Wallace*, the Wallace Board was able to show that the favorable results from a recently adopted capital expenditure plan were "beginning to be translated into financial results which even surpass management and financial analyst projections." Wallace successfully argued that the risk that its stockholders might tender into the Moore offer without fully appreciating the potential impact of the capex plan on Wallace's intrinsic value constituted a "legally cognizable threat."

E. REVLON DUTIES

1. The Unocal standard applies to a board's adoption of defensive measures in response to an unsolicited acquisition proposal.

2. However, the standard changes if the target is already trying to sell itself (e.g., by merging with a third party) or the board deems that a break-up of the company is inevitable.

3. The directors' role changes from "defenders of corporate policies" to "auctioneers charged with getting the best reasonably attainable value".

4. When do "Revlon duties" apply?

    a. Target initiates an active bidding process or seeks an alternative transaction involving a break-up of the company.

    b. Change of control situation:

        (i) All cash mergers;

(ii) Not stock-for-stock mergers (in the absence of a controlling stockholder);

(iii) Certain mixed cash/stock mergers.

5. Revlon duties not triggered by stock-for-stock merger so long as no controlling stockholder controls the combined entity because the combined entity is considered to remain in the hands of the market (i.e., there is no "change in control").

6. If Revlon duties apply, directors are required to examine competing acquisition proposals and choose a course of action "reasonably calculated to secure the best value available" to the target's stockholders.

   a. Auctions, market checks and "fiduciary outs"

   b. Lock-up devices – break-up fees, no-talks and crown jewel options

7. Deal Protection Devices

   a. Deal protection devices (as distinguished from defensive measures) in a friendly stock-for-stock merger context will also trigger enhanced scrutiny under Unocal.

APPENDIX A

Range of Tactics Employed (Often in Combination)

Moderate	Aggressive	Hostile
Accumulate Stake	Stockholder proposals	Present detailed proposal (breakup or sale of company, change in strategic direction and/or cash distribution)
Use trading, derivative and hedging strategies to increase position and leverage	Withhold vote campaign	Demand seat on board
Encourage other hedge funds to enter stock	Agitate for removal of takeover defenses	Public relations battle to replace board and/or management
Observe and comment	Form committee/alliance with other stockholders	Solicit buyers for all or part of business
Agitate privately	Interview customers, stockholders and line management	Enlist ISS and Glass Lewis to publicly support dissident action
Aggressive questioning on conference calls	Leak ideas to research analyst community	Litigation against company
	File Schedule 13D	Tender offer
	Hire former employees and/or experts in sector	Proxy fight/consent solicitation

APPENDIX B

Assessment of Takeover Defenses: Charter and Bylaws*

Provision	What Provision Does	Where to Find Provision
Prohibition on Stockholders' Ability to Act by Written Consent**	Denies hostile raider the ability to remove and replace directors fairly quickly and without a meeting of stockholders.	Must be in Charter.
Prohibition on Ability of Stockholders to Call Special Meeting**	Confines all business to the annual meeting, limiting a Board's "window of vulnerability" to a proxy contest to one meeting per year.	Can be in either Charter or Bylaws.
Classified Board***	Makes it more difficult to get control of Board by limiting the number of directors elected in any given year (generally elect 1/3 of Board each year).	Should be in Charter. (In Delaware must be in Charter or an initial or shareholder-approved bylaw).
Removal of Directors Only for Cause***	Prevents dissident stockholders from causing the removal of a director for any reason other than fraud, criminal acts, etc.	Should be in Charter; is automatically part of a Classified Board provision in Delaware.
Number of Directors Fixed Only by Board	Prevents dissident stockholders from "packing" the Board by increasing its size.	Should be in Charter, but often in Bylaws, where it is vulnerable to amendment.
Remaining Directors have Sole Right to Fill Vacancies	Prevents dissident stockholders from "packing" the Board by filling vacant seats.	Should be in Charter, but often in Bylaws, where it is vulnerable to amendment.
Board has Explicit Authority to Amend Bylaws	Allows Board flexibility in adopting or amending Bylaw provisions.	Charter and/or Bylaws.
Supermajority Vote to Amend Certain Bylaw Provisions	Limits rights of stockholders to change a corporation's governing documents so as to facilitate a takeover.	Should be in Charter.
Stockholder Proposal Advance Notice Provisions	Requires stockholders to provide notice to a corporation prior to making a proposal at a annual or special meeting; Limits the use of "last minute" proposals and gives the Board advance notice of any dissent to its agenda. Usually requires not less than 90 days' and not more than 120 days' advance notice.	Bylaws.
Flexibility in Setting Annual Meeting	When coupled with other restrictions on special meetings and action by consent, grants Board flexibility to determine best time to schedule annual meeting (subject to certain Delaware law requirements).	Usually in Bylaws.
Blank Check Preferred Stock	Grants the Board authority to issue the preferred stock necessary to implement certain defenses, including a poison pill stockholder rights plan.	Must be in Charter.
Advance Notice	Prevents last minute matters from being proposed at meetings of stockholders and gives the Board time to prepare defensive measures. These provisions should be reviewed in light of recent DE case law.	Bylsws.

* Chart describes Delaware law. The law of the state of incorporation of the target company governs these provisions, and laws will vary from state to state.
** Connotes "High Vulnerability" if lacking.
*** Connotes "Lower Vulnerability," especially if combined with a Shareholder Rights Plan.

APPENDIX C

Typical Shareholder Rights Plan

ADOPTION OF RIGHTS PLAN

The Company's Board of Directors declares a dividend distribution of one Right for each outstanding share of the Company's common stock. These Rights are initially redeemable, trade with the common stock and are not exercisable. These Rights are initially redeemable, trade with the common stock and are not exercisable.

EFFECT OF INITIAL ADOPTION

No tax, accounting or financial effect of initial adoption.

SEPARATION OF RIGHTS

If a person or group makes a tender offer for 10% or more of the common stock the Rights will detach from the common stock, unless the Board delays the separation.

If the Rights separate, they will trade independently and become exercisable, entitling stockholders to purchase one one-hundredth of a share of the Company's Participating Preferred Stock (a common stock equivalent) at an exercise price which is initially not in-the-money.

FLIP-IN TRIGGER

Upon an announcement that any person (an "Acquiring Person") has become the beneficial owner of 10% or more of Company's common stock the Rights will automatically separate and each Right, except those held by the Acquiring Person and any transferee thereof (which are voided), "flips in" and becomes a right to buy, for an amount in cash equal to the exercise price, common stock of the Company having a market value equal to twice the exercise price.

FLIP-OVER TRIGGERS

If (i) the Company is acquired in a merger or other business combination with the Acquiring Person or the Acquiring Person is treated differently or (ii) fifty percent or more of the Company's assets or earning power is sold or transferred at a time when the Acquiring Person controls the Board of Directors, each Right "flips over" and becomes a right to buy, for an amount in cash equal to the exercise price, common stock of the entity involved in the "flip-over" transaction having a market value equal to twice the exercise price.

REDEMPTION

The Rights are initially redeemable by the Company's Board for a nominal sum (*i.e.*, $0.01 per Right). Immediately upon public announcement that a person has acquired beneficial ownership of 10% or more of the common stock, the Rights can no longer be redeemed.

EXCHANGE FEATURE

If the Acquiring Person acquires beneficial ownership of between 10% and 50% of the common stock, the Company, at its option, can exchange one share of common stock for each Right not held by the Acquiring Person and any transferee thereof.

AMENDMENT TO RIGHTS PLAN

Prior to the time that the Company announces the existence of an Acquiring Person the plan may generally be amended without holders' consent.

INADVERTENCE PROVISION

Flip-in will not occur if any person acquires 10% or more of common stock without control intent and promptly divests shares to reduce position below 10%.

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