Wachtell, Lipton, Rosen & Katz

Takeover Law and Practice

2014

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 2014.

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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 significant developments in both case law relating to corporate transactions and financial and strategic approaches to business combinations. 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 international accounting and corporate governance crises have added their own complexities. The increased activism of institutional investors, the substantial growth in hedge funds and private equity 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 a board of directors to be fully informed of its fiduciary obligations and for a company to be proactive and prepared to capitalize on business-combination opportunities, respond to unsolicited takeover offers 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 be obtained 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 aspects of the sale of a company, including the impact of a change-of-control on directors' obligations and options, as well as the methods of selling a company, 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

M&A activity historically has been cyclical, and recent years have been no exception. A strong U.S. economy combined with strong corporate profits and available cash, confidence in the boardroom, benefits of consolidation in industries such as energy, financial services and healthcare and relatively low interest rates created a macroeconomic environment conducive to mergers during the 2004–2007 period, with the volume of announced transactions worldwide peaking in 2007.

After a record-setting 2007, the collapse of the housing market and vanishing liquidity severely constrained both U.S. and global M&A activity, particularly private equity deals. Although the financial crisis saw the takeover of a number of significant financial institutions, overall strategic transactions declined, as companies hoarded cash in order to better weather the gathering economic storm, while at the same time finding their stock to be an unattractive form of deal consideration. Even in potential stock-for-stock transactions, banks became unwilling to refinance credit arrangements at acquired companies. General uncertainty surrounding the length and severity of the recession made it more difficult for parties to reach agreement on valuation.

Global M&A volume continued its downward march in 2008 and again in 2009, to the lowest level since 2004. Deal volumes began to increase in late 2009, however, as economic conditions improved, with momentum continuing to build in the next few years and modest year-over-year increases in the value of announced deals through 2012. 2013 saw a slight decline in the value of announced deals relative to the prior year, largely due to a decrease of M&A activity in the fourth quarter of 2013 relative to the fourth quarter of 2012.

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's 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. The volume of completed spin-offs reached an aggregate value of $118 billion in 2013, compared to $101.6 billion in 2012. Significant spin-off and similar break-up transactions in 2013 were seen in a broad range of industry sectors, with high-profile examples including announcements by DuPont of its intent to spin-off its performance chemicals unit, by Time Warner of its intent to spin-off Time Inc.'s magazine division and by Rayonier of its intent to spin-off its performance fibers business.

Hostile transactions accounted for approximately 6.6% of the value of announced deals involving U.S. companies in 2013, up from 4% in 2012, but down from 16.15% in 2008. Global hostile deal-making volume was $108.3 billion in 2013, up 48.7% from 2012. There were a number of notable hostile deals in the past year, including Charter's pursuit of Time Warner Cable (which subsequently signed an agreement to merge with Comcast) and the takeover battle between Men's Warehouse and Jos. A. Bank, which appears to have reached a resolution in March 2014 with Jos. A. Bank agreeing to be acquired by Men's Warehouse.

2. Private Equity Trends

As the broader economy began to improve after the financial crisis, so did the number of private equity deals. The value of private equity-backed M&A deals doubled between 2009 and 2010 and increased 20% between 2010 and 2013. The increase was fueled in part by the continuing availability of attractive financing terms. Deal volume continued to increase, with private equity-backed M&A accounting for 12.1% of global M&A activity in 2012 and 15.6% in 2013, its highest share of total M&A since the financial crisis. 2013 continued to experience favorable acquisition lending conditions and movement toward more borrower-friendly terms as evidenced by U.S. leveraged loan issuances reaching a record high. While it is too early to declare the return of the private equity "mega deals" of the last M&A boom, 2013 saw the two largest buyouts since the financial crisis, with Michael Dell and Silver Lake's $24.9 billion acquisition of Dell Inc. and the $28 billion sale of Heinz to Berkshire Hathaway and 3G Capital. Moreover, private equity firms find themselves with nearly $1.1 trillion of dry powder that needs to be deployed for new deals in the near term, as the investment periods of the 2006–2007 vintage funds approach expiration. The number of private equity-backed exits grew for the fourth consecutive year, reaching an aggregate value of $303 billion in 2013. Notable exits included Clayton, Dubilier & Rice and KKR's $7.1 billion sale of US Foodservice to Sysco Corporation and TPG/Warburg Pincus's $5.1 billion sale of Neiman

Marcus to Ares Management and the Canadian Pension Plan Investment Board.

Private equity fundraising has continued to accelerate. 2013 saw the aggregate amount of capital raised increase by 13% over 2012, with at least ten private equity funds of $5 billion or more closing in 2013, compared to eight in 2012 and three in 2011. A number of sponsors raising capital in 2013 experienced oversubscribed funds and a shorter time period to reach final closing than initially anticipated. These trends are expected to continue in 2014, with several of the largest sponsors already on the road to raise either flagship global private equity funds in the $5 to $15 billion target range (*e.g.*, TPG, Bain Capital, Permira and Clayton, Dubilier & Rice), or large regional or sector-specific funds (*e.g.*, KKR North America). Fundraising trends continue to favor large and established sponsors. This is due in part to institutional investors trying to maintain better control over their investment programs, by reducing the number of sponsors with whom they invest and by seeking bespoke arrangements with established multi-product sponsors, through which such investors commit large amounts of capital to be deployed across a number of investment strategies, often on preferential terms. Still, the majority of funds raised by first-time sponsors met or exceeded their 2013 final close targets, suggesting investors' renewed openness to newly established sponsors.

The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") brought significant changes to the private equity industry, including subjecting advisers with $150 million or more in assets under management ("AUM") to SEC registration, examinations and detailed disclosure obligations about their funds. As registered advisers have adjusted their operations to these new regulatory realities, the SEC has continued its initiative to examine newly registered advisers and conduct presence exams, and has followed through with its efforts to ramp up enforcement activity in the private equity industry. One obvious effect of Dodd-Frank and heightened SEC scrutiny has been increased compliance costs, resulting in additional pressure on registered advisers, particularly those with small to mid-sized funds.

Fundraising dynamics have changed after the entrenchment of the crisis years, resulting in a shift of bargaining power to limited partners who have successfully negotiated for lower management fees and carried interest and higher management fee offsets. This may prove to be disadvantageous to some sponsors, particularly those unable to grow AUM to compensate for lower fees. The drive for greater AUM has led sponsors to access investors through "alternative mutual funds," seek seeding arrangements in which they invest in emerging managers, and acquire other managers in an effort to both grow AUM and to diversify

fund offerings. These trends, coupled with the spin-offs and split-offs of asset managers from banks precipitated by the Volcker Rule, which significantly cut back banks' ability to sponsor private equity funds, lead to an expectation of increased sponsor-level M&A activity and consolidation in the industry.

3. Acquisition Financing

Following a robust 2012, the financing markets in 2013 continued their hot streak. Syndicated loan issuances topped $2.1 trillion, a new record in the United States. The early part of 2013, as in 2012, saw financing transactions devoted mostly to refinancings and debt maturity extensions rather than acquisitions. In fact, new money debt issuances (as a percentage of all debt issuances) were at record lows during the first half of 2013, though they increased in the second half of the year.

Debt markets have been friendly to investment grade corporate issuers, with strong demand allowing corporate borrowers to optimize their capital structures and reduce their financing costs. Large investment-grade firms were able to complete very large bond offerings and finance strategic transactions at historically low yields. For example, in April 2013, Apple issued $17 billion in bonds, setting the record at the time for the biggest ever investment-grade corporate bond deal in the U.S. (which record had previously been set by AbbVie, a spinoff of Abbott Laboratories, the year before), with interest rates ranging from 0.51% for five-year bonds to 3.883% for its 30-year bonds. Then, in September, Verizon set the record again by completing a $49 billion bond offering, with pricing ranging from 2.5% for three-year notes to 6.5% for 30-year notes, to finance its acquisition of Vodafone's interest in Verizon's wireless business. High-grade issuers have also generally been able to obtain committed bridge financing for M&A deals. Recent examples include the $61 billion bridge facility from JPMorgan Chase, Morgan Stanley, Bank of America and Barclays to finance Verizon's transaction with Vodafone, the $12.5 billion bridge facility from J.P. Morgan and Barclays to backstop the financing of ThermoFisher Scientific's acquisition of Life Technologies, the $4.75 billion bridge loan commitment from Goldman Sachs to Sysco to help Sysco fund its acquisition of U.S. Foods and the $1.3 billion bridge loan commitment from Bank of America and Merrill Lynch to Cardinal Health to finance its acquisition of AssuraMed.

2013 also saw sustained strength in the non-investment grade financing markets: Leveraged debt issuance (including both bonds and bank debt) was almost $1.5 trillion (as compared to 2012's then-record $991 billion), and issuers had success in refinancing existing debt, financing dividends to sponsor owners and financing acquisitions. In a

few deals, acquirors were able to obtain very large acquisition financing commitments. For example, in February, Michael Dell and SilverLake combined to obtain a $13.8 billion financing commitment to fund their buyout of Dell Inc. and J.P. Morgan and Wells Fargo committed to provide $14.1 billion of new debt financing for Berkshire Hathaway's and 3G Capital's acquisition of H.J. Heinz Company; in May, affiliates of Bain, Golden Gate and other private equity sponsors obtained a $6.2 billion commitment to fund their acquisition of BMC Software; and in July, Activision Blizzard obtained $4.75 billion in commitments to fund its repurchase of stock from Vivendi. Covenant-lite leveraged loans—term loans and revolvers with no or limited financial maintenance covenants—as a percentage of total institutional loan volume continued to rise in 2013, surpassing 2007 issuance levels.

While strong demand for yield among debt investors continued to afford issuers considerable bargaining power when structuring and pricing new debt issuances, banks also generally remained mindful of the market volatility of recent years. As a result, obtaining long duration commitments (more than six to nine months) continued to be challenging, and stretching into higher leverage levels to finance acquisitions often came at the expense of some key "flex" terms—that is, the ability to change specified terms of the financing in order to achieve a successful syndication. Nevertheless, the acquisition financing market seemed to strengthen across all ratings classes as the year came to a close and should provide fuel for an active year in deal-making.

4. Shareholder Activism

a. Hedge Fund Activism

Recent years have seen a resurgence of raider-like activity by activist hedge funds, often aimed at forcing the adoption of policies with the aim of increasing short-term stock prices, such as increases in dividends or share buybacks, the sale or spin-off of one or more businesses of a company or the sale of the entire company. For example, Carl Icahn is currently demanding that eBay spin off its PayPal service, Dan Loeb is urging Dow Chemical to spin off its petrochemical segment, and Nelson Peltz is urging that PepsiCo spin off its beverages business. Hedge fund activists have also pushed governance changes and occasionally have run proxy contests, usually for a short slate of directors. Activists have also worked to block proposed M&A transactions, mostly on the target side but also sometimes on the acquiror side.

In 2013 and continuing through 2014, 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. There are many recent examples of activists targeting large and successful companies, including Carl Icahn and Greenlight Capital demanding that Apple return more of its cash to shareholders. Another example is Pershing Square's acquisition of a $2 billion stake in Procter & Gamble, slightly over 1% of the company in 2012. Pershing Square expressed concerns to the company about its strategy and leadership, including recommending a CEO succession process, and in May 2013, P&G announced the replacement of its CEO.

Activist campaigns that do not involve an election contest have also increased. In 2013, activist shareholder Relational Investors teamed up with the California State Teachers' Retirement System, a Relational limited partner, to bring a Rule 14a-8 shareholder proposal at Timken calling for a split-up of the company. Following recommendations in favor of the proposal by ISS and Glass Lewis and an aggressive public relations campaign by Relational and CalSTRS, the non-binding proposal received majority support at the company's annual meeting. Timken subsequently announced it had formed a special committee and engaged an investment bank to study the proposal, and ultimately announced, and consummated, the spin-off.

Some recent high-profile contests have even pitted activists against each other. For example, Bill Ackman of Pershing Square has engaged in a very public short campaign against Herbalife, while fellow activist Carl Icahn (and, for a time, Dan Loeb) have publicly taken long positions in Herbalife. Activists have also broadened their sights beyond the U.S. including recent contests at Danone (France) and Canadian Pacific Railway (Canada).

There have been several notable victories by boards of directors and corporations over activists, as well as court decisions and potential regulatory changes, that could reduce some hedge funds' appetite for activism or alter their tactics or target selection criteria. For example, in 2012, each of AOL, Forest Laboratories and Cracker Barrel successfully defended against months-long proxy fights—even, in AOL's case, in the face of an ISS recommendation in favor of the dissident nominees. A number of companies also successfully defended against activist demands in 2013, including Canadian company Agrium in defeating a proxy contest from JANA Partners and Sony Corporation in rebuffing Third Point's demands for restructuring.

In 2013, as well as in other recent years, proxy fights initiated by dissidents have settled in about one-third of cases, have been withdrawn in about one-third of cases, and have gone to a vote in about one-third of cases (and of those that have gone on to a vote, the dissident has been able to win at least one board seat in approximately half of these cases).

Several recent election contests have featured consent solicitations launched outside of the normal annual meeting framework. Non-unanimous shareholder action by written consent is permitted by approximately 28% of companies in the S&P 500 and, as evidenced by the Wet Seal/Clinton Group, TPG-Axon/SandRidge Energy, and Corvex/Related/CommonWealth REIT election contests, consent solicitations can be a potent weapon for activist shareholders. Clinton Group's consent solicitation against the Wet Seal board to remove four of the five sitting directors (and elect four Clinton Group nominees in their stead) resulted in Wet Seal announcing in October 2012, five months after its board was duly elected at the 2012 annual meeting, the resignation of a majority of its Board, with the resigning members to be replaced by nominees proposed by the Clinton Group. TPG/Axon also succeeded in using a consent solicitation to threaten to take control of the board of SandRidge Energy, leading to a settlement in which it forced out the sitting CEO and obtained four of eleven seats on the board.

The 2013 proxy season also featured several high-profile activism situations involving opposition to announced M&A transactions. In the telecommunications sector, MetroPCS Communications' proposed transaction with Deutsche Telekom's T-Mobile USA featured a sweetened bid (and ultimate shareholder approval) following opposition by P. Schoenfeld Asset Management and several other shareholders, including Paulson & Co., and Clearwire's proposed merger with Sprint Nextel was also approved (over a competing bid by Dish Network) once the terms of the Sprint transaction were improved following opposition by Crest Financial, the largest minority shareholder in Clearwire. Dell's going-private transaction was also vigorously opposed, unsuccessfully, by Carl Icahn and Southeastern Asset Management, who sought to replace the Dell board and advanced a leveraged recapitalization as an alternative to the proposed sale.

Activism campaigns involving announced M&A transactions may also seek objectives other than an increased price from the initial bidder. Starboard Value, for example, commenced a campaign against Smithfield Foods following Smithfield's announced merger with Shuanghui International Holdings. Starboard proposed, and ultimately withdrew, a split-up of the company and piece-by-piece sale of Smithfield's various operating divisions as a means to obtain greater value than the merger with Shuanghui. After Office Depot's announced a strategic merger with

OfficeMax, Starboard also commenced an election contest in which it announced support of the transaction while seeking various business changes at the stand-alone and combined company, as well as board representation. Activist hedge funds have had to cope with recent changes to the legal environment that pose new challenges to their agendas, with a significant federal court decision taking a broad view of funds' Schedule 13D disclosure obligations,[1] a Delaware court decision reaffirming the principle that voting power and economic interests should be aligned and not decoupled,[2] and proposed legislative and regulatory reforms.[3] Many companies have also adopted changes to their governing documents, including amendments to their advance notice bylaws (and, in some cases, shareholder rights plans) that capture equity swaps and other derivatives as well as director qualification bylaws that, among other things, may require a nominee to disclose background information, including about activist shareholders supporting such nominee, and affirm that the nominee has no agreement or understanding to vote a certain way, and that the nominee will abide by confidentiality and various governance policies applicable to directors. Nonetheless, these developments have not always dissuaded activists, who remain a significant part of the corporate landscape and can be expected to seize on what they regard as catalyst opportunities.

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. Advanced 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."

b. Governance Activism

After a decline in shareholder proposals in 2011, primarily attributed to the enactment of "say-on-pay" rules under Dodd-Frank that made shareholder proposals on that topic unnecessary, the number of shareholder proposals to U.S. companies climbed by 3.8% year-over-year in 2013, slowing from the approximately 17% year-over-year increase in 2012. This may be due in part to the fact that so many companies have, in recent years, taken steps such as instituting majority voting, declassifying

their boards of directors, eliminating takeover defenses and splitting the roles of chairman and chief executive officer. Moreover, majority shareholder support is increasingly common, especially for proposals targeting anti-takeover defenses. For instance, 2013 demonstrated continued support for shareholder proposals seeking board declassification, with 77.4% of such proposals obtaining the affirmative vote of a majority of the shares outstanding.

One of the explanations for such shareholder support 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 be preordained by a blanket voting policy that is applied to all companies without reference to the particulars of a given company's situation. One notable exception to this general trend involves BlackRock, which in early 2012 sent a letter to 600 companies advising them to engage with BlackRock to address potential governance issues prior to engaging with proxy advisory firms. The letter noted that BlackRock reaches its proxy voting decisions independently of proxy advisory firms and on the basis of internal guidelines that are pragmatically applied. We believe that institutional investors are beginning to feel increasing pressure to avoid rote reliance on advisory firm recommendations and instead engage in case-by-case, pragmatic assessment of governance issues. And proxy advisory firms themselves may become subject to enhanced governmental regulation in the near future.[4]

A board of directors has no legal obligation under state or federal law to accept or act on precatory shareholder proposals that receive the vote of a majority of the outstanding shares entitled to vote. To the contrary, a board should carefully evaluate such proposals while considering all the relevant facts, and it should act only if it determines that doing so is in the best interests of the company and its shareholders. So long as a board acts on a fully informed basis, any determinations in this area should be protected by the business judgment rule and should not be subject to any heightened or extraordinary level of judicial review. Nonetheless, a board that refrains from accepting or acting upon a precatory shareholder proposal receiving majority support faces the possibility of a "withhold the vote" campaign, which can be particularly

significant if the company has adopted some form of majority voting (as outlined below).

With respect to ISS recommendations, under ISS's 2014 policy, if a board does not act on a shareholder proposal that is supported by a majority of votes cast, ISS will consider, on a case-by-case basis and based on the specific circumstances, a withhold recommendation on individual directors, committee members or the full board, as appropriate, taking into account (1) disclosed outreach efforts by the Board to shareholders in the wake of the vote; (2) the rationale provided in the proxy statement for the level of implementation of the proposal; (3) the subject matter of the proposal; (4) the level of support for and opposition to the resolution in past meetings; (5) actions taken by the Board in response to the vote and its engagement with shareholders; and (6) the continuation of the underlying issue as a voting item on the ballot (as either shareholder or management. This is a change from ISS's 2013 policy, which stated that ISS would issue a withhold recommendation on individual directors, committee members or the full board if a board does not fully implement a shareholder proposal that is supported by a majority of votes cast. It remains to be seen whether this recent change in ISS policy amounts to a change in its practice.

Rights Plans. Activist institutional shareholders, like TIAA-CREF, have sponsored precatory resolutions seeking repeal of or a shareholder vote on shareholder rights plans, also known as "poison pills." Today, many institutions routinely vote for such resolutions. Shareholders commonly support precatory shareholder proposals to submit rights plans for shareholder approval. Shareholder proposals relating to rights plans remain a fertile ground for shareholder proponents seeking governance topics that uniformly attract large institutional support, even at companies that do not have rights plans. This has been facilitated in part by changing ISS voting policies (discussed in Section VI.A) and SEC Staff no-action positions, making it difficult to stay one step ahead of shareholder gadflies, even for companies seeking to stake out the corporate governance high ground. One result of this activism has been a declining 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 2013, 7.0% 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 10.7% of the companies in the S&P 1500 having a rights plan in effect at the end of 2013 (a decline from 12.1% at the end of 2012). As discussed in Section VI.A, a number of companies have adopted rights plans with 4.9% triggers intended to protect valuable tax assets.

Staggered Boards. Similarly, shareholder proposals requesting companies to repeal staggered boards continue to be popular, and such proposals since 2005 have on average received the support of 71.27% of the votes cast at Fortune 500 companies. According to an analysis performed by the Conference Board, of the companies that moved to de-stagger their boards between the years 2003 and 2010, 60% did so in response to some form of shareholder pressure. A major advocate for destaggering boards each year is the Harvard Law School's Shareholder Rights Project. Working closely with large institutional investors, it has submitted, on behalf of its represented investors, 31 declassification proposals to S&P 500 companies in 2014. It had also submitted 76 declassification proposals to S&P 500 companies in 2013 and 89 such proposals in 2012. In 2013, approximately half of these companies agreed to include management proposals in their proxy statements to declassify their boards; the other half allowed the proposal to be voted on, and on average 79% of votes cast voted in favor of these proposals. At year-end 2013, less than 11% 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 34% of the companies in the S&P 1500 having a staggered board at the end of 2013 (a decline from 37% at the end of 2012). As distinct from rights plans, a company that gives up its staggered board cannot regain a staggered board when a takeover threat materializes; thus, a company should proceed cautiously before giving up its staggered board.

Majority Voting. Beginning mostly in 2004, in the face of 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 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 85% of S&P 500 companies currently have a majority voting policy in place. The Council of Institutional Investors has been pushing stock exchanges to impose majority voting as a listing requirement; the Toronto Stock Exchange is the first exchange to adopt such a requirement (which takes effect on June 30, 2014). Companies that adopt majority voting should ensure that once the determination is made that an election is "contested," triggering the plurality voting requirement, the plurality standard should remain in place even if there is no competing slate at the time of the

shareholders' meeting (in order to avoid a situation, as occurred in the Office Depot proxy fight, in which a dissident drops its proxy contest and contends that the vote standard therefore reverts to majority, enabling a withhold vote campaign that could result in the failure of directors to be elected).

Action by Written Consent. Governance activists have been seeking to increase the number of companies that may be subject to consent solicitations. Although 70% of S&P 500 companies prohibit shareholder action by written consent as of the end of 2013 (or require such consent to be unanimous), there has been an upswing in written consent-related Rule 14a-8 shareholder proposals. 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 2013, however, there were over 90 such proposals (roughly one-third of which passed). Institutional shareholders have also been pushing for the right of shareholders to call special meetings.

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 2014 and the years ahead, well-established relationships with significant investors can be outcome determinative when it comes to the mandatory say on pay vote.

c. 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, including with respect to investments that have a long-term horizon. 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. The value of shareholder engagement has been endorsed in the past year by entities as diverse as the SEC, BlackRock and ISS, as well as by a host of corporate executives, 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 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-termist pressures in the market. In appropriate cases, director-level shareholder engagement may also serve to enhance credibility, preempt shareholder resolutions/contests and defuse contentious situations.

5. Shareholder Litigation

Virtually every major M&A transaction in the U.S. now attracts shareholder litigation. The M&A plaintiffs' bar has become increasingly aggressive over the past several years, with lawsuits filed against 97.5% of deals with a transaction value greater than $100 million in 2013 compared to just 39% in 2005.[5] This regularity is underscored by the speed with which most lawsuits are filed (over 65% of lawsuits regarding deals announced in 2010 and 2011 were filed within 14 days of deal announcement) and settled (over 65% of such lawsuits were settled within 60 days of filing).[6] In 2013, deals with a transaction value greater than $100 million were subject to seven different lawsuits on average.[7]

Historically, companies have often settled these shareholder lawsuits by revising the deal-related proxy disclosures and paying plaintiffs' attorneys' fees. While many shareholder lawsuits challenging M&A transactions continue to be settled for additional disclosures, with 84.8% of settlements in 2013 being settled for disclosure only (in transactions exceeding $100 million in value),[8] the Delaware Court of Chancery has placed increased scrutiny on such settlements, focusing on whether plaintiffs have undertaken sufficient investigation prior to compromising shareholders' claims. For example, in February 2014, then-Chancellor Strine denied an unopposed motion to approve a settlement of a deal-related litigation that provided only additional disclosures to the selling company's stockholders, holding that the additional disclosures added nothing of value to the total mix of information.[9]

In 2013, multi-jurisdictional litigation was found in over 40% of all transactions.[10] A notable recent trend is the increasing adoption by Delaware corporations of charter or bylaw provisions requiring shareholders to bring suit in Delaware. In June 2013, the Court of Chancery unambiguously concluded that exclusive forum bylaws were statutorily valid, as well as contractually valid, even though stockholders did not vote to adopt the bylaws.[11] Plaintiffs initially stated their intent to appeal the ruling, but they dropped their proposed appeal in October 2013,

leaving the Chancellor's decision as the authoritative word on the validity of forum selection bylaws (although there is currently a motion pending in a related federal court action to certify the legality of the bylaw to the Delaware Supreme Court). Over 550 companies have now adopted exclusive forum bylaws. These bylaw provisions are not self-executing—if a plaintiff sues a company in a jurisdiction other than that which is stated in such company's bylaws as the exclusive forum for adjudicating such a dispute, the company will need to litigate to enforce its forum selection provision. In March 2014, an Illinois state court upheld the validity of a board-adopted Delaware forum selection bylaw and dismissed the shareholder lawsuit on that ground.

6. Regulatory Trends in M&A Activity

The U.S. antitrust agencies remain active in enforcement. In 2012, the U.S. Department of Justice ("DOJ") successfully litigated a challenge to H&R Block's proposed acquisition of TaxAct's parent company, and in 2014 the DOJ prevailed in its challenge to Bazaarvoice's consummated acquisition of PowerReviews. These cases represent the DOJ's first successfully litigated challenges to merger transactions since its failed attempt to block the Oracle/PeopleSoft deal in 2004. In addition, there have been several recently proposed transactions abandoned prior to full-blown litigation in the face of threatened action by the DOJ, most notably AT&T's proposed acquisition of T-Mobile, NASDAQ's unsolicited bid for NYSE Euronext, and 3M's attempt to acquire Avery Dennison's office and consumer products business. The DOJ also filed lawsuits in 2013 to block both Anheuser-Busch InBev's proposed purchase of the rest of Grupo Modelo and US Airways' merger with American Airlines; both transactions were ultimately settled following significant divestitures by the acquiring companies.

The DOJ also imposed consent remedies modifying other transactions in 2013, including in Cinemark's acquisition of Rave Cinemas and Gannett's acquisition of Belo.

In addition to its recent victory in the proposed transaction between Bazaarvoice and PowerReviews, the DOJ recently challenged another consummated acquisition by Heraeus Electro-Nite, requiring a clean sweep divestiture of the acquired assets, an action that brings the number of consummated deals challenged by the antitrust agencies during the Obama administration to more than 20. These actions highlight the increased scrutiny of non-reportable transactions and underscore the antitrust risks buyers assume in entering into these deals. While parties to HSR-exempt mergers sometimes operate under the misimpression that antitrust concerns are moot, ignoring the issue effectively transfers all antitrust risk to the buyer at closing. Before entering into such

transactions, buyers should consider the substantive antitrust issues raised by the acquisition, just as they would in a reportable deal, including the feasibility of remedies short of clean sweep divestitures, the practicality of unscrambling assets post-integration, and the impact on their business in the event of a future mandated divestiture.

The U.S. Federal Trade Commission ("FTC") was similarly active in 2013, highlighted by its lawsuit to enjoin Ardagh Group's proposed merger with Saint-Gobain Containers; the matter remains pending in federal court as the parties attempt to negotiate divestiture remedies sufficient to resolve the FTC's allegations. The FTC also settled many cases with consent decrees, including Western Digital/Hitachi Global Storage, Nielsen/Arbitron, Pinnacle Entertainment/Ameristar, Service Corporation International/Stewart Enterprises, and Thermo Fisher Scientific/Life Technologies.

State Attorney Generals 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. competition authorities also continue to vigorously enforce breaches of compliance with the pre-merger notification and waiting periods under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (the "HSR Act"), including both failures to file and so-called "gun-jumping" violations. For example, in 2012, the FTC extracted an $850,000 fine from Biglari Holdings for failing to comply with HSR requirements before acquiring a significant stake in Cracker Barrel. The FTC concluded that Biglari's actions, including requesting a meeting with Cracker Barrel executives to demand board representation just one day after its final open market purchase, were inconsistent with the HSR Act's so-called "passive investment" exemption. The FTC has also shown its willingness to pursue much less significant HSR violations. In 2013, the FTC brought a complaint against Barry Diller for inadvertently failing to file for the acquisition of shares of Coca-Cola, where he serves on the board of directors, which was settled with a relatively low fine.

In addition to failure-to-file situations, the agencies aggressively police and investigate behavior that "jumps the gun" on pre-merger integration. Another case, by the DOJ against Smithfield Foods in 2010, charged that Smithfield exercised operational control over the target's hog procurement business before the expiration of the statutory pre-merger waiting period, thereby prematurely assuming beneficial ownership in violation of the HSR Act. Smithfield agreed to pay a $900,000 fine to

settle the case. In contrast to its 2006 settlement in connection with Qualcomm's acquisition of Flarion Technologies, the DOJ did not allege that the interim covenants contained in the Smithfield/Premium Standard merger agreement themselves violated the antitrust laws. The settlement with Smithfield serves as a stark reminder that parties must take care not to engage in conduct that the antitrust agencies may perceive as a premature transfer of beneficial ownership. Even short of such formal actions, investigations into "gun jumping" violations present a costly and delaying distraction during a substantive merger investigation. With appropriate covenants and suitable controls, however, integration planning and pre-merger contacts will not run afoul of the antitrust laws.

The U.S. is not alone in its careful review of M&A transactions as further discussed in chapter VII. 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. 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.

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 2012 and 2013. ICE's acquisition of NYSE Euronext—following regulatory rejection of two previously proposed transactions—included a $750 million reverse termination fee, and Arbitron's merger with Nielsen included a reverse termination fee equal to 10% of the deal value. Both transactions closed in 2013.

II.

Directors' Duties — Basic Principles

The basic duties of corporate directors are well established. Directors must act with care and loyalty in all situations and in all contexts. Although these duties are well known, the level of scrutiny with which courts will review directors' compliance with their duties can and does vary with situation and context. The default rule is the traditional business judgment rule, which holds that directors' business decision-making will generally 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, invite a heightened level of scrutiny. In those cases, the so-called "*Unocal* standard" or the "*Revlon* test" may be applied. Finally, in transactions involving a conflict of interest, an "entire fairness" standard will typically 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). Sometimes, there is a reference to other duties, such as a duty of "good faith" or a duty of "candor." According to recent Delaware court decisions, candor and good faith, however, are not distinct duties but specific applications of the duties of care and loyalty,[12] respectively.

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).[13] Delaware statutory law permits directors in exercising their duty of care to rely on certain materials and information:

> 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.[14]

At its core, the duty of care may be characterized as the directors' obligation to act on an informed basis after due consideration of the relevant materials and appropriate deliberation, including the input of legal and financial experts. 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 and other experts.[15] And, although Section 141(e) of the DGCL recognizes that directors may use outside experts to advise the board on significant legal and financial matters affecting their analysis, that provision does not permit a board to delegate its duty of care to other decision-makers.[16]

Directors who act without adequate information or without active involvement in a decision to enter into a business combination transaction will have difficulty defending that transaction in court, regardless of the level of scrutiny applied by that court. Although many of the cases discussed below involve changes-of-control, directors seeking to avoid liability for their actions or to preserve a transaction in the face of competing bids, even outside of a change of control context, are well advised to assume an active role in the decision-making process and to remain fully informed throughout that process.[17] Failure to do so may enable a plaintiff to rebut the presumption inherent in the traditional business judgment rule, discussed below, and win a duty of care claim. Similarly, failure to assume an active role and remain fully informed may prevent directors from sustaining their burden of proof in cases where there is enhanced scrutiny.

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. For example, the Delaware Supreme Court in *Paramount Communications, Inc.* v. *Time, Inc.* ("*Time-Warner*")[18] placed great weight on the extensive participation of Time's board in the decision whether to seek a merger partner, its identification of important factors to be considered in evaluating any potential merger and its initial decision to seek a merger with Warner Communications, as well as the board's active involvement after Paramount first appeared with a competing bid.[19] Although the Court ultimately deferred to the board's decisions, it did so only after extended analysis of the board's level of engagement throughout the process, which included evidence of the board's prior consideration of Paramount as a potential merger candidate. In contrast, the Court in the *Trans Union* case, which found the board of directors liable for breaches

of the duty of care, was specifically disturbed that the directors of the selling company approved the merger agreement without a robust review of it, only after two hours of deliberations, and failed to obtain the advice of investment bankers.[20] Accordingly, the importance of informed, independent board decision-making cannot be overstated.

In the wake of the *Trans Union* case and the subsequent increase in the cost of director and officer liability insurance, Delaware adopted Section 102(b)(7) of the General Corporation Law. That section permits corporations to include in their certificates of incorporation provisions that exculpate directors from monetary liability for breaches of the duty of care. Section 102(b)(7) provisions cannot, however, exculpate breaches of the duty of loyalty, and they do not prevent a court from ordering equitable relief against violations of any duty.[21]

2. Duty of Loyalty

Every director has a duty to act in what he believes to be in the best interests of the corporation and its shareholders. 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 shareholders' interests.[22] The classic manner of showing that a director has not met his 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 the 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 will review the corporate action under the "entire fairness" level of scrutiny, described more fully below.[23]

The duty of loyalty also encompasses the concept of good faith. At one time, Delaware law seemed to view the duty of good faith as an independent fiduciary obligation.[24] But, 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."[25] Instead, the traditional duty of loyalty "encompasses cases where the fiduciary fails to act in good faith."[26] A director violates his 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."[27]

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). Take, for example, the Delaware Supreme Court's opinion in *Lyondell Chemical Co.* v. *Ryan*, which rejected shareholder claims that directors had breached their duty of loyalty and were liable for failing to act in good faith in selling the company. There, under the procedural posture of summary judgment review, the 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 (at a substantial premium to market) containing a no-shop provision and a 3.2% break-up fee.[28] But even this conduct, the Court held, did not rise to the level of "bad faith," because the Lyondell board had not "utterly failed" to try to meet its obligations. 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."[29] *Lyondell* is a powerful statement that courts appreciate the complex decisions directors must make in selling the company, and will not equate post hoc process attacks with a duty of good faith violation.[30]

B. The Standards of Review

The fiduciary duties of care and loyalty are standards of conduct describing a director's obligations to the corporation.[31] Whether a court determines that a director breached his fiduciary duties can depend heavily on the standard of review the court applies to the director's 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."[32] 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.'"[33] In the case of a Delaware corporation, the statutory basis for the business judgment rule is Section 141(a) of the DGCL, which provides that "[t]he business and affairs of every corporation . . . shall be managed by or under the direction of a board of

directors. . . ."[34] In cases where the traditional business judgment rule applies, directors' decisions are protected, unless a plaintiff is able to carry its burden of proof in showing that a board has in fact acted disloyally, in bad faith or with gross negligence.[35] 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."[36] Indeed, the Court of Chancery has described business judgment review as a "bare rationality test."[37] 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.[38]

2. Enhanced or Intermediate Scrutiny

There are certain situations and contexts in which Delaware courts will not defer to board conduct under the traditional business judgment rule. These include a board's (a) adoption of a defensive mechanism in response to an alleged threat to corporate control or policy,[39] and (b) approval of a transaction involving a sale of control.[40]

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."[41] The decision-making process, including the information relied on, must satisfy the court's enhanced standard. In addition, under the enhanced scrutiny test, unlike under the traditional business judgment rule, the court will need to be satisfied that the directors' decisions were *reasonable* rather than merely rational. Discussed below are various iterations of the intermediate scrutiny test, which largely center around questions of reasonableness.[42]

a. *Unocal*

Unocal Standard. Instead of benefiting from the presumption attending the traditional business judgment rule, directors who adopt defensive measures against a potential threat to control[43] carry the burden of proving that their process and conduct satisfy the enhanced standard established in 1985 by *Unocal Corp*. v. *Mesa Petroleum Co*. and its progeny.[44] 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. (In re Unitrin, Inc. Shareholders Litigation)* the Delaware Supreme Court defined as being action that is not "coercive or preclusive" and otherwise falls within "the range of reasonableness."[45]

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 is justified in deploying 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 offered price was inadequate, although it considered the threat from American General's publicly announced all-cash offer "a mild one."[46] The application of the second prong was clarified in *Unitrin*, where the Delaware Supreme Court ruled that a court should engage in a two-step process: first, the court should determine whether the defensive steps were "coercive or preclusive"; second, if the defensive steps were not "coercive or preclusive," then the court should determine whether the defensive conduct falls within a "range of reasonableness." If there is no coercion or preclusion and the conduct is within a "range of reasonableness," the defensive action will be upheld.[47] *Unitrin* reaffirms a board's discretion to act within a range of reasonably proportional responses to unsolicited offers.[48]

A self-interested board or one that acts without reasoned, informed deliberation may be exposed to reversal of its defensive measures in response to a perceived takeover threat. 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.[49] Then-Vice Chancellor Strine found that a majority of the directors were self-interested and characterized the level of attention that the target's board paid to the relevant issues as "grossly insufficient."[50] Applying *Unocal*, the Court found that the only threat the board met its burden to show—price inadequacy—was a "mild" one.[51] 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 shareholders 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."[52]

The 2011 landmark decision in *Air Products & Chemicals, Inc.* v. *Airgas, Inc.*,[53] 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. The Delaware Court of Chancery upheld under *Unocal* the Airgas directors' decision to block a hostile tender offer, ruling that the "power to defeat an inadequate hostile tender offer ultimately lies with the board of directors."[54] 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 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."[55] 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."[56]

Notably, even in the absence of a known hostile threat, deal protection devices such as termination fees, force-the-vote provisions, expense reimbursements and no-shop provisions are generally 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."[57] Generally, Delaware courts will consider the preclusive nature of "all deal protections included in a transaction, taken as a whole," in determining whether the *Unocal* standard has been met.[58]

b. ***Revlon***

Transactions involving a "sale of control" or "change of control" of a corporation (*i.e.*, a cash merger, or a merger in which 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.[59] In *Revlon, Inc.* v. *MacAndrews & Forbes Holdings, Inc.*, the Delaware Supreme Court explained that fiduciary duties in a sale of control context require directors to take efforts to achieve the highest value reasonably available for shareholders.[60] To be clear, "*Revlon* neither create[d] a new type of fiduciary duty in the sale-of-control context nor alter[ed] the nature of the fiduciary duties that generally apply."[61] Rather, *Revlon* sets out the board's objective in a sale of control context: maximizing the sale price of the enterprise.[62]

The Delaware Supreme Court has written that 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."[63] 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.

All that said, the Delaware Supreme Court has also been very clear that "there is no single blueprint that a board must follow to fulfill its duties" in the *Revlon* context,[64] and "[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."[65]

1. When does *Revlon* apply?

The Delaware Supreme Court has explained that 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."[66] The prototypical example of this is where the board of a non-controlled company decides 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 put "in play,"[67] *Revlon* review will not apply. Accordingly, enhanced scrutiny is not triggered by a board's mere refusal to engage in negotiations where an offeror invites discussion of a friendly deal.[68]

Nor will enhanced scrutiny 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 1989 seminal 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.[69] 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.[70] 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. These principles were confirmed in the Delaware Supreme Court's 1994 decision in *Arnold* v. *Society for Savings Bancorp, Inc.*, where the Court rejected a shareholder challenge to an all-stock bank merger in a case that the Court considered to be controlled by its decision in *QVC*.[71] The Court noted that there is no change-of-control when control remains "in a large, fluid, changeable and changing market."[72] The Delaware Supreme Court rejected the argument that a change-of-control occurs solely because a company's shareholders are relegated to a minority position in the post-merger combined company.

Nor is there a "change of control" in the cash (or stock) sale of a company with a controlling shareholder to a third party.[73] 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.[74]

The law is less clear, however, in transactions involving the sale of non-controlled companies for consideration that is a blend of cash and stock. 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.[75] However, in one recent case, 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."[76] The Court twice noted, however, that the issue remains unresolved by the Delaware Supreme Court, and that the "conclusion that *Revlon* applies [where

merger consideration consists of an equal or almost equal split of cash and stock] is not free from doubt."[77]

2. What is maximum value?

Revlon does not require boards to blindly accept the highest nominal offer for a company. For example, factors may lead a board to conclude that a particular offer, although "higher" in terms of price, is substantially less likely to be consummated; the risk of non-consummation is directly related to value. 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."[78] The Delaware Supreme Court has stated that a board may assess a variety of additional practical considerations, including an offer's "fairness and feasibility; the proposed or actual financing for the offer, and the consequences of that financing; questions of illegality; . . . the risk of nonconsummation; . . . the bidder's identity, prior background and other business venture experiences; and the bidder's business plans for the corporation and their effects on stockholder interests."[79] 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.[80] Such concerns, however, must be fairly and evenly applied when evaluating competing bids.

A key recent example of Delaware courts deferring to board strategic decisions when conducting a sale of control is *In re Dollar Thrifty Shareholder Litigation*,[81] wherein 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."[82] In this case, the Court rejected the claim that a board is required to conduct a pre-signing auction and upheld the decision of the Dollar Thrifty board to negotiate only with Hertz, especially in light of the board's concern that Hertz might have withdrawn from the process if it faced pre-signing competition. The Court then 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."[83]

3. What sort of sale process is necessary?

Even under *Revlon*, a board has substantial latitude to decide what tactics will result in the best price. 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."[84] 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, and upon meeting the enhanced duty mandated by *Unocal*, the actions of an independent board of directors in designing and conducting a corporate auction are protected by the business judgment rule."[85] 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.'"[86] The decision as to which process will produce the best value reasonably available to shareholders is, therefore, within the business judgment rubric, provided that a board or special committee evaluating the proposed transaction is not affected by self-interest and is well informed as to the process. A board approving any sale of control must 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 the best value reasonably available to shareholders.

In *In re Toys "R" Us, Inc. Shareholder Litigation*, the Court strongly endorsed the principle that well-advised boards have wide latitude in structuring sale processes.[87] While the Court's opinion does include some criticism of the board's sale process, the Court's noteworthy holdings included, among others: (1) the dismissal of the plaintiffs' challenges that a 3.75% break-up fee and a matching right 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, thus potentially reducing the number of competing bidders in later rounds;

(3) the dismissal of allegations of a conflict of interest on the part of the CEO arising out of his stock and option holdings; and (4) the dismissal of claims that the board's financial advisor's advice was tainted under 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, which deals with many questions that arise in the course of competitive bidding situations involving cash offers, reaffirmed the business judgment rule's long-held tradition that courts will not second-guess well-informed, good-faith decisions that need to be made to bring a sale process to successful conclusion.

In *Topps*, 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 buying group led by Michael Eisner.[88] The Court also approved the array of deal protection terms in the Eisner agreement (match rights, 4.3% break-up fee and others). The Court found that the Topps board was justified in signing the Eisner 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 corrective proxy disclosure and 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. *Topps* reiterates that Delaware law authorizes directors to employ their business judgment in designing and conducting sale processes and post-signing dealings with overbidders, and that such judgments are rarely set aside. But the case also signals that Delaware courts are prepared to scrutinize directorial decision-making in both pre- and post-signing sale periods.

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."[89] 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."[90] *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."[91] 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 such conflict was fully disclosed to the board, and the board believed that the CEO was best-positioned to advance the company's interest.[92]

The key thread tying the cases together is that compliance with *Revlon* requires the Board to make an informed decision about maximum value and about the most effective process to achieve it. 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 canvas 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."[93]

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.[94] 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. Then-Vice Chancellor Strine took the unusual step of finding a likely fiduciary violation because of this tactical decision, in part because he believed 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.[95] 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 micro-cap structure of the target

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 temporarily enjoined the private equity buyout of the Del Monte Foods Company because of an apparent violation of the duty of care by the company's board of directors.[96] 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."[97] 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, thus effectively forcing Del Monte to hire a second banker to perform a fairness analysis of the proposed transaction. In deciding to issue a preliminary injunction, the Court of Chancery ruled that "[a]lthough the blame for what took place appears at this preliminary stage to lie with Barclays, the buck stops with the Board."[98] Because the board failed to ask tough questions and adequately oversee its advisors and the process, and because its reliance on its advisors was unprotected on account of the advisors' deception, the board failed to act reasonably and thus failed to satisfy *Revlon* review.[99] And the Court of Chancery held in *In re Rural Metro Corp. Stockholders Litigation* that a facially disinterested and independent board of directors breached its fiduciary duties in making certain decisions in connection with a third-party sale where its financial advisor also clandestinely sought to provide buy-side financing.[100] Because the Rural board settled before trial, the Court did not decide whether its breaches were nonexculpated, but the Court's decision condemned the board for failing to appropriately monitor the advisor's conflicts of interest and for running an insufficient process that included only two formal meetings and no review of valuation analysis until hours before approving the transaction.

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.*[101] 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 where 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, Vice Chancellor Glasscock 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).[102] The NetSpend decision serves as a reminder that boards engaging in single-bidder sales strategies and deploying potent contractual features such as "don't-ask-don't-waive" standstills must do so as part of a robust and carefully designed strategy.

c. Third-Party Overbids

Entry into a merger agreement may give rise to an unsolicited competing cash bid by a third party. Since such a third-party bid would 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."[103] 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."[104] 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.

In these circumstances, any actions taken defensively against the potential change-of-control overbid will be evaluated under the *Unocal* standard. The Delaware Supreme Court in *Time-Warner* gives directors great latitude in determining when a threat to a preconceived merger exists by stating that the first prong of *Unocal* does not contemplate a "mechanistic" comparison of the relative economic merits of a target board's long-term plan and the takeover bid. *Time-Warner* characterizes

the *Unocal* analysis as "open-ended" and states that the threats to corporate policy and effectiveness presented by the Paramount offer (and identified in good faith by an informed Time board) included: (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) the question 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."[105] Most importantly, the decision makes clear that it is not for a court to determine whether a threat exists, but, rather, that a board is free to make the determination—so long as it acts in good faith and after reasonable investigation.[106]

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 invoke 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.[107] 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 abandons the corporation's existence (say by pursuing 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, and it requires the Director Defendants to demonstrate their utmost good faith and the most scrupulous inherent fairness of the" transaction or decision under review.[108] A court will review a board's decision or action under the entire fairness standard when the presumptive protections of the business judgment rule have been rebutted. This may occur when a plaintiff pleads facts showing:

- that a majority of the board has an interest in the decision or transaction that differs from the shareholders in general;[109]

- that a majority of the board lacks independence from an interested party;[110]

- that the transaction at issue is one where the directors or a controlling shareholder "stand on both sides" of a transaction;[111] or

- that a majority of the board has breached the duty of care by acting with "gross negligence."[112]

Although there is no bright-line test to determine what level of director self-interest will result in entire fairness review of the whole board's action, conflicts of interest triggering this enhanced level of review may arise in situations where the directors appear on both sides of a transaction or derive a personal financial benefit that does not devolve generally upon all the shareholders.[113] Potential conflicts can take many shapes, including when a director receives certain payments,[114] has certain family relationships with,[115] has certain prior business relationships with, a party to the transaction,[116]and other instances where a director will benefit or suffer a detriment in a manner that is not aligned with the interests of the corporation to which he owes fiduciary duties.

The Delaware Court of Chancery has stated that it applies the following test to determine when entire fairness review is appropriate 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.[117]

The entire fairness standard may also be applied in a "squeeze-out" merger in which a controlling shareholder 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 shareholders arguably are not treated equally in connection with the transaction.[118] In these controlling shareholder 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.[119] This year, the Delaware Supreme Court explained in *Kahn* v. *M&F Worldwide Corp.* that "business judgment is the standard of review that should govern mergers between a controlling stockholder and its corporate subsidiary, where the merger is conditioned *ab initio* upon *both* the approval of an independent, adequately-empowered Special Committee that fulfills its duty of care; and the uncoerced, informed vote of a majority of the minority stockholders."[120]

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.[121] As the Delaware Court of Chancery has 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.[122]

A "fair price" also 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.[123]

Because entire fairness review focuses holistically on both process and price, the Delaware courts have in practice, at least at the trial court level, been unlikely to award equitable relief or damages where the price is fair, even if there may have been process flaws.[124] And the Supreme Court has stressed that, "although entire fairness review comprises the dual components of fair dealing and fair price, in a non-fraudulent transaction price may be the preponderant consideration outweighing other features of the merger."[125] Nevertheless, the Delaware courts have stressed their belief that "[a] fair process usually results in a fair price," and, in defending suits governed by the entire fairness standard, it is advantageous to be able to build a record reflecting a robust and meaningful process.[126]

With respect to such process, the Delaware Supreme Court has long encouraged boards to utilize a "Special Committee" when a conflict transaction is proposed. 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 genuinely independent directors); (2) have an appropriately broad mandate from the full board (*i.e.*, not be limited to simply reviewing an about-to-be-agreed-to transaction); and (3) have legal and financial advisors.[127] As noted above, the use of a well-functioning special committee can shift the burden of proof to the plaintiff.[128] Approval of a cash-out merger with a controlling shareholder by a majority of the minority shareholders also could shift the burden.[129] 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.[130] 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.[131] And, in light of *M&F Worldwide*, a controller's *ex ante* agreement to "voluntarily relinquish[] its control" by conditioning a transaction "*ab initio* 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 imposition of business judgment review rather than entire fairness review."[132]

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.[133]

III.

Key Aspects of 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 and agreements that take place 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, 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 the first discussions and that each step in the process may have consequences for the entire deal.

1. Confidentiality Agreements

Often, the first legally binding undertaking in a merger negotiation is the execution of a "Confidentiality Agreement." This seemingly innocuous document often includes important substantive agreements concerning the use of information exchanged between the parties, and may give rise to claims that the agreement acts as an express or implied "standstill" barring unsolicited bids. Such agreements should be carefully reviewed by counsel before execution.

In addition to requiring that information be kept confidential, these 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.*,[134] Delaware courts had not considered whether a violation of nondisclosure 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, among other things, 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. Since this case, parties have focused more on making clear the extent, if any, to which the confidentiality agreement should be interpreted to prevent a hostile bid.

Other typical provisions in confidentiality agreements have also had far-reaching consequences for the parties to a potential transaction. For example, confidentiality agreements often contain broad disclaimer and non-reliance language that the party providing the confidential information has not made any representation or warranty to the party receiving the information as to its accuracy, and that the providing party will not have any liability to the receiving party arising from the use of the information. In *RAA Management, LLC* v. *Savage Sports Holdings, Inc.*, a 2012 Delaware Supreme Court case, such non-reliance language was held to bar a claim by RAA Management to recover its transaction expenses after a potential deal had been abandoned by the parties.[135] RAA Management alleged that Savage Sports, the target, committed fraud by misrepresenting and concealing from RAA certain material information, and that but for such concealment, RAA Management would not have continued to incur expenses pursuing a potential transaction. The Court held that, although Savage Sports did knowingly make material misstatements and omissions, RAA Management had agreed under its confidentiality agreement that Savage would have no liability and could not be sued for "any allegedly inaccurate or incomplete information provided by Savage to RAA during the due diligence process."[136] The Court explained that RAA Management, a sophisticated party, could have negotiated for Savage Sports to represent that its due diligence disclosures were accurate and complete, but it did not do so and had to abide by the deal it did strike. Delaware courts, therefore, will enforce broad disclaimer and non-reliance language agreed to by two parties who would prefer that the transaction risk allocation be made in a definitive transaction agreement instead of in a preliminary agreement such as a confidentiality agreement.

Delaware courts also recently have focused on what they have called "don't-ask-don't-waive" provisions, which typically prohibit a potential auction bidder from publicly or privately asking the public target company to waive some of the standstill restrictions in a signed confidentiality agreement. Section V.A.2 discusses developments in Delaware case law on this issue from late 2012 and their implications for the future of public auctions.

2. Letters of Intent

Another common preliminary agreement is the letter of intent, sometimes referred to as a "memorandum of understanding," which is mostly (but not entirely) an agreement to agree.[137] Letters of intent can identify any deal-breakers early on in negotiations, saving the parties from unfruitful expenditure of time and money. Letters of intent also can serve several purposes at the outset of negotiations, including demonstrating both parties' commitment to the possible transaction, allocating responsibility for certain documents and establishing a timeframe for executing definitive agreements, and serving to provide preliminary documentation to third parties requesting it (such as lenders). While most provisions included in letters of intent are intended to be non-binding, some provisions are expressly intended to be binding, for example, the grant of an exclusivity period or an expense-reimbursement provision.

The enforceability of a letter of intent typically turns on two questions in Delaware law: "(1) whether the parties intended to be bound by the document; and (2) whether the document contains all the essential terms of an agreement."[138] 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 may result in the letter of intent being 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.[139] In reaching its decision, the Court stated that parties that wish to enter into non-binding 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 addition, since letters of intent can be *partially* binding, if parties do not want *any* provisions to be deemed binding, it is important that they state unambiguously in the letter of intent that *all* of the provisions are intended by the parties to be non-binding. Failure to do so leaves a party susceptible to a claim that, while the letter of intent was generally nonbinding, a binding agreement was reached as to a particular provision.

To avoid having a letter of intent become enforceable by a court, it is also important that the parties do not act as if the letter of intent is a binding agreement. 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."[140] The LATS was later attached by the parties to a

merger agreement term sheet which provided, in part, that if merger negotiations broke down, the parties would nevertheless negotiate a licensing agreement in accordance with the terms of the LATS. When merger negotiations ultimately fell apart, SIGA claimed that the LATS was non-binding 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 incorporating the LATS into the merger agreement reflected an intent 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 an enforceable commitment to negotiate in good faith.[141] 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.[142] The *SIGA* case underscores the importance of avoiding statements or actions that may indicate that a letter of intent was understood by the parties to be binding. Parties 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.

The term of a letter of intent can also be a significant variable that courts consider when ascertaining whether parties have reached a binding agreement. In *Turner Broadcasting Systems, Inc.* v. *McDavid*,[143] a jury awarded damages against TBS for breach of an alleged oral contract, even though no definitive merger agreement was ever signed and the letter of intent was explicit that neither party would be bound unless such a definitive agreement was reached (a "definitive agreement requirement"). The issue in *TBS* was that the letter of intent expired before contractual negotiations terminated. Thus, the Georgia Court of Appeals concluded that TBS was not entitled to the benefit of the letter of intent's liability disclaimer for any of the post-expiration negotiations (which included an oral statement by the TBS CEO that the parties "have a deal"). Accordingly, a carefully drafted letter of intent should indicate that the definitive agreement requirement will survive the expiration of the letter of intent and, additionally, that the parties agree that no oral agreement reached after the expiration of the letter of intent will be binding. These provisions should be identified clearly as intending to be binding. Moreover, parties that seek protections in a letter of intent should consider extending the expiration date of all of the binding provisions for so long as negotiations are under way.

B. Techniques for a Public Sale

A merger transaction may impose special obligations on a board. But every transaction is different, and the courts have recognized that a

board has significant latitude in designing and executing a merger process. The law is clear that there is "no single blueprint" that directors must follow in selling a company.[144] This is true even if *Revlon* applies: directors are not guarantors of price, 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"[145] and thus *Revlon* "does not . . . require every board to follow a judicially prescribed checklist of sales activities."[146] 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 in an arm's-length negotiated transaction, as opposed to placing the company on the "auction block," if it in good faith determines that such a process is in the best interest of the company's shareholders. 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."[147] The various possible approaches to satisfying *Revlon* duties should be considered not as boxes that need to be mechanically checked but as points on a continuum. Any method chosen, however, that does not involve a realistic market check (even if passive and post-signing) may fail to withstand judicial scrutiny.[148]

1. Formal Auction

In a "formal" auction (sometimes referred to as a "closed 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," 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 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 knowing whether there are other bidders, and can be expected to put forward its best bid. In addition, the seller in a formal auction can negotiate with bidders to try to elicit higher bids. It is difficult to conduct a formal auction without rumors of a sale leaking into the marketplace. As

a result, many public companies conduct a formal auction only after they have announced an intention to seek a sale of the company. Other companies engage in a "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 some of the valuation and pricing mechanisms discussed below in Section IV). The 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 accedes to an otherwise attractive bidder's refusal to participate in an auction. 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 identify interested acquirors and 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 publicity has indicated 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.[149] 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 "no-shop" covenants, 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, bidders must be aware of the opportunity to bid, have sufficient information and time to make a bid, and not be 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—the "go-shop" provision—or passive, where new bidders must take the first step of declaring their interests: so-called "window shop."

Go-shop provisions are a frequent feature of financial sponsor and management buyouts, utilized as a means of 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 60 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."[150] 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. Other recent buyouts that have made use of a go-shop provision include those of Dole Food Company, BMC Software and Duff & Phelps Corporation. Delaware courts have generally found go-shops to be a reasonable, but not mandatory, approach to satisfying *Revlon* duties.[151]

To date go-shops have not become commonplace amongst strategic deals (although they have perhaps become somewhat more common in recent years). One recent and notable exception is the tailored variation on a go-shop, or the "qualified pre-existing bidder" provision, that US pork processor Smithfield and Chinese meat processor Shuanghui employed in their 2013 combination. Pursuant to this arrangement, the agreement carves out two pre-existing bidders from the no-shop provision and provides for a reduced break-up fee ($75 million, versus $175 million in other scenarios) for thirty 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 (*see*, *e.g.*, the Pfizer-Wyeth deal).

Finally, a board may sell itself through a single-bidder negotiation coupled with a post-signing, passive market check. While this method is more vulnerable to judicial review than those previously described, it is permissible so long as the board is informed and the transaction provides sufficient opportunity for competing bids to emerge. In the 1989 case *Barkan* v. *Amsted Industries*, the Delaware Supreme Court held that, while *Revlon* ordinarily requires a market check because without it the board "has no reliable grounds upon which to judge [an offer's] adequacy," a board may forgo a market check if it has "sufficient knowledge of relevant markets to form the basis for its belief that it acted in the best interests of

the shareholders."[152] The *Barkan* Court found this requirement satisfied because the Amsted board had reason to believe that its suitor uniquely valued the company and because no competing bidders came forward, despite the market's knowledge that the company was "in play" for nearly a year.[153] Similarly, in 2011, Vice Chancellor Parsons ruled in *In re Smurfit-Stone* that a market check was unnecessary because the selling company had been "in play" both during and after its bankruptcy, yet no competing offers were made.[154]

Two 2013 decisions of the Delaware Court of Chancery provide valuable guidance for sellers considering forgoing an active market check. In *In re Plains*, Vice Chancellor Noble held that the board of Plains Exploration satisfied its *Revlon* duties in connection with the company's merger with Freeport despite not engaging in an active market check.[155] 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.'"[156] 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 *In re Plains*, in *Koehler* v. *NetSpend* Vice Chancellor Glasscock found that the NetSpend board's failure to perform a market check was likely a violation of its *Revlon* duties, given the other facts surrounding the merger.[157] 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 interest. 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.[158] 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.[159] Vice Chancellor Glasscock explained that, while a board may "forgo a market check and focus on a single bidder, that decision must inform its actions . . . going forward, which *in toto* must produce a process reasonably designed to maximize price."[160] *Plains* and *NetSpend* reinforce the lesson 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. 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%) of each class of target stock entitled to vote on the merger, the acquiror can complete the acquisition by a short-form merger,[161] thereby avoiding the need to solicit proxies or hold a shareholders' meeting. In order to overcome shortfalls in reaching the short-form merger threshold, the market has relied upon workarounds that have become commonplace features of merger agreements contemplating 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. To hedge against the risk of delays, including from not acquiring sufficient shares for a short-form merger even with the aforementioned features, 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 tender offer.

The use of tender offers has been facilitated by changes in federal and state law. In 1986 the SEC adopted a rule requiring that the consideration paid to any security holder pursuant to a tender offer be the highest consideration paid to any other security holder during the offer, generally referred to as the "best-price" rule.[162] In 2006, the SEC amended the best-price rule to resolve a split in the federal courts by clarifying that the rule applies only to consideration paid for securities tendered in the tender offer, and does not cover payments or benefits pursuant to an employment compensation, severance or other employee benefit arrangement if the amounts payable under the arrangement are compensation for past or future services and are not based on the number of securities tendered by the security holder. The rule now includes a safe harbor under which the requirements of the compensation exemption are deemed to be satisfied if the arrangements are approved by an independent compensation committee of the target (whether or not the target is a party to the arrangement) or, if the bidder is a party to the arrangement, of the bidder. The best price amendment removed much of the litigation uncertainty that had previously surrounded tender offers, leading to a marked increase in the use of this deal structure.

An amendment to Section 251 of the DGCL effective August 1, 2013 is expected to have a similarly significant impact on the use of tender offers. As described below, the new 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) will diminish the need for a top-up option and a dual-track approach. The provision also adds speed and certainty to some tender offers by circumventing a shareholder vote, the result of which—because the acquiror already holds sufficient shares to approve the merger—is a foregone conclusion. Given the many advantages of the tender offer and short-form merger described below, we expect the use of tender offers to continue to increase as legal impediments are removed.

1. Advantages of the Tender Offer Structure

a. Speed

A tender offer combined with a second-step merger can provide parties with a more appealing deal structure than a one-step merger under certain circumstances. The tender offer's most notable advantage is speed. The speed with which parties can consummate a deal is of critical importance because a protracted time period between the signing, shareholder approval and consummation of the deal exposes both the acquiror and the seller to greater market risk and material adverse effect risk. Additionally, a prolonged period between signing and shareholder approval can translate into increased risk to the acquiror of a third-party, topping bid. A one-step merger generally takes several months to consummate, with the length of delay usually driven by SEC requirements for a proxy statement (and registration statement, where stock is to be issued in the transaction) and the need for a shareholder meeting to vote on the merger. By comparison, because they do not require a proxy statement, registration statement or shareholder vote, all-cash tender offers can generally be consummated subject only to a minimum offering period of 20 business days from commencement (assuming no extensions based on certain changes to the offer, SEC comments, regulatory review, closing conditions or otherwise).

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. Despite this change, exchange offers may continue to extend longer than all-cash tender offers because they cannot

be consummated until the registration statement becomes effective, and this process in many cases extends beyond the 20-business-day minimum applicable to an all-cash tender offer. One consequence of the increased speed with which exchange offers can be consummated is the facilitation of hostile takeover bids. This shortened exchange offer timeframe emphasizes the need for a company to be prepared to respond to unsolicited takeover attempts.

A two-step structure involving a tender offer is not always preferable to or faster than a one-step merger, however, and 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, 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, when the acquiror will not yet have access to the target's balance sheet, and the Federal Reserve Board's margin rules restrict borrowings secured by public company stock to 50% of its market value.

b. 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 by engineering "no" votes. As recently exemplified by the activities of Carl Icahn and Southeastern Asset Management with respect to the Dell buyout, such efforts pose an increasing threat to negotiated M&A 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, allowing shareholders to vote based on

economic interests rather than on ISS' views, which may reflect process or other 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.

c. Standard of Review

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 the *In re Siliconix Inc. Shareholders Litigation* case, the Delaware Court of Chancery confirmed 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.[163] 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.[164]

The next year, in *In re Pure Resources, Inc. Shareholders Litigation*, the Delaware Court of Chancery concluded that a tender/short-form merger transaction with a controlling shareholder does not require application of the entire fairness standard as long as (1) the tender offer is subject to a non-waivable majority-of-the-minority condition (excluding from the minority the target's management and those stockholders affiliated with the controlling shareholder), (2) the controlling shareholder promises to consummate a prompt short-form merger at the same price if it obtains at least 90% of the shares and (3) the controlling shareholder has made no retributive threats (such as cancellation of future dividends). Additionally, to avoid entire fairness review, the controlling shareholder must give independent directors "free rein and adequate time to react" to the offer by "(at the very least) hiring their own advisors, providing the minority with a recommendation as to the advisability of the offer, and disclosing adequate information for the minority to make an informed judgment."[165] The first three criteria are meant to protect minority shareholders against the potential "coercion and unfairness" posed by controlling shareholders, while the fourth is meant to protect against the "informational and timing advantages" that controlling shareholders possess.[166] This so-called "*Siliconix*" tender offer/short-form merger approach may avoid the timing and pricing risks that would be inherent in the alternative route of a squeeze-out merger negotiation, with a special

committee representing the minority shareholders (discussed below), assuming the parent is confident that its proposed tender offer price will cause enough shareholders to tender that the parent reaches the 90% short-form ownership threshold.

The ability for a controlling shareholder to avoid entire fairness analysis through a tender/short-form merger created a tension in Delaware law. The Delaware Supreme Court's 1994 ruling in *Kahn* v. *Lynch Communication Systems, Inc.* was widely interpreted to require entire fairness in a controlling stockholder merger regardless of any procedural protections.[167] Consequently, a tender/short-form merger would be reviewed with a different level of scrutiny than a one-step merger with a controlling stockholder, despite producing the same end result. In his 2005 *In re Cox Communications, Inc. Shareholders Litigation* ruling,[168] then-Vice Chancellor Strine suggested, albeit in *dicta*, that Delaware courts may be willing to reconcile the different standards of review for controlling shareholder mergers and tender offers (a so-called "unified standard") by extending the business judgment rule's protection to negotiated going-private deals with controlling shareholders where the controlling shareholders propose a transaction that is subject to (1) special committee negotiation and approval and (2) approval by a majority of disinterested shareholders, while also tightening the conditions for avoiding entire fairness review through the *Siliconix* approach by "subjecting the controlling stockholder to the entire fairness standard if a special committee recommended that the minority not tender."[169]

In 2010, Vice Chancellor Laster rejected the *Siliconix* line of cases in *In re CNX Gas Corp. Shareholders Litigation*.[170] Applying the "unified standard" suggested in *Cox Communications*, he held that a tender offer/short-form merger transaction with a controlling shareholder would receive deferential business judgment review only if the offer were conditioned on the affirmative recommendation of a special committee of independent directors and included a non-waivable majority-of-the-minority shareholder approval condition,[171] and that a pure *Siliconix* transaction meeting the *Pure Resources* guidelines would be reviewed under entire fairness. In *Krieger* v. *Wesco Financial Corp.* in 2011, a case involving a squeeze-out merger by a controlling shareholder — *i.e.*, the type of transaction involved in *Kahn* v. *Lynch* (as opposed to the type of tender offer/short-form merger transaction involved in *CNX Gas*) — Vice Chancellor Laster indicated that the transaction would be reviewed under the "unified standard" he had outlined in *CNX Gas*.[172]

In re MFW Shareholders Litigation, the Court of Chancery recently applied the "unified standard" in ruling that a merger with a controlling shareholder may receive business judgment review if certain procedural protections are in place.[173] In its opinion affirming, however,

the Delaware Supreme Court did not address the so-called "unified standard" and did not address either the standard of review applicable to tender offers or the viability of *Siliconix*.[174]

2. Top-Up Options

One deal feature that has introduced increased certainty for, and therefore attractiveness of, tender offers is the use of a top-up option. Such an option, exercisable after the close of the tender offer, permits the acquiror to purchase sufficient newly issued shares directly from the target such that the acquiror may reach the short-form merger statute threshold (90% in Delaware), thereby avoiding a shareholder vote and enabling an almost immediate consummation of the transaction. Targets occasionally negotiate requirements for the minimum percentage of shares that are required to be tendered for the option to be triggered, and parties need to keep in mind the amount of authorized but unissued stock of the target and the stock exchange rules requiring stockholder votes for certain share issuances. In recent years, before the adoption of DGCL Section 251(h), discussed in more detail below, top-up options had become a standard feature of two-step tender offers (a top-up option was included in approximately 98% of all tender offers in 2012[175]). While the increased prevalence of top-up options had triggered litigation and judicial scrutiny, recent decisions of the Delaware Court of Chancery demonstrate that properly structured top-up options are valid under Delaware law.[176]

The *ev3* opinion, although rendered in the context of an attorney fee dispute, is the clearest such statement. The decision effectively codifies best practices in structuring a top-up option, making the following points:

- where (as is usual) the purchase price of the top-up option will be paid for in a combination of cash and a promissory note, the aggregate par value of the top-up option shares is best paid for in cash, with the material terms of the promissory note specified in the merger agreement;

- although Vice Chancellor Laster gave little weight to an "appraisal dilution" argument advanced by the plaintiffs, it would seem prudent to provide in the merger agreement that shares issued under the top-up option and related consideration paid should be excluded for purposes of determining fair value in any appraisal action;

- shares to be issued under the top-up option should not exceed the target's "available headroom" under its charter for shares available for issuance;

- the record of target board deliberations should reflect the directors' consideration of the top-up option [and board resolutions should provide for its creation and issuance] (which would generally be included in the board's consideration and approval of the merger agreement setting forth the top-up option and its key terms);[177] and

- the option holder should first possess a sufficient number of shares to exercise voting control (usually one share more than 50%).[178]

3. Dual-Track Tender Offers

In recent years, some private equity firms have utilized 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. Examples include 3G Capital/Burger King, Bain Capital/Gymboree and TPG/Immucor. Some strategic transactions (*e.g.*, Verizon/Terremark) 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.

4. DGCL Section 251(h)

Delaware recently amended its corporate law to add Section 251(h), effective August 1, 2013, 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).[179] The provision requires that the offer extend to any and all outstanding voting stock of the target, that all non-tendering shares receive the same amount and kind of consideration as those that tender, and that the second-step merger be effected as soon as practicable following the consummation of the offer.

Without the application of Section 251(h), a second-step merger following a tender offer requires a stockholder vote—even if the outcome

is a formality because the buyer owns enough shares to singlehandedly approve the transaction—unless an acquiror reaches 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 impose transaction risk, expense and complexity on the parties. The prospect of such delays has been a significant deterrent to many tender offers, especially those involving 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 has evolved a workaround in the form of the previously discussed 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. By eliminating in applicable transactions the need to obtain the 90% threshold, Section 251(h) should diminish the prominence of these workarounds.

Despite their reduced importance, the top-up option, dual-track structure and subsequent offering period remain relevant because Section 251(h) will not always be available or optimal for the parties. Most significantly, a stockholder vote may not be avoided through Section 251(h) if, at the time the target board approves the merger agreement, another party to the agreement is an "interested stockholder" (as defined in DGCL Section 203(c)) of the target. An "interested stockholder" is defined in Section 203(c) generally as a person (other than the company and certain subsidiaries) that (1) owns 15% or more of the company's outstanding voting stock or (2) is an affiliate or associate of the company and was the owner of 15% or more of the outstanding voting stock in the past three years. Importantly, while Section 251(h) borrows its definition of "interested stockholder" from Section 203, it is not subject to Section 203's exceptions that allow a company to opt out of the provision or to waive it in particular circumstances. Thus, parties wishing to avail themselves of Section 251(h) must take care that the acquiror does not trigger the interested-stockholder threshold prior to the target board's approval of the merger agreement. Section 251(h) is likewise unavailable if the target's charter expressly requires a stockholder vote on a merger or if the target is not publicly listed or held by more than 2,000 holders. In certain circumstances, even acquirors eligible for Section 251(h) may choose to forgo the provision and instead attempt to reach the 90% threshold through voting agreements with large shareholders combined with a top-up.

We expect that, by simplifying and accelerating combinations via the two-step tender offer and merger format, Section 251(h) will increase the use of this transaction structure. Already, it has been used in several deals, including Amgen's acquisition of Onyx Pharmaceuticals, Paulson & Co.'s buyout of Steinway Musical Instruments and Mallinckrodt plc's acquisition of Cadence Pharmaceuticals. The benefits of Section 251(h) may, however, be somewhat tempered by the incentive for opposing stockholders not to tender, given that the provision removes the comparative cost of not tendering by essentially eliminating the delay in receiving the merger consideration. It should also be noted 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).

D. Mergers of Equals

Combinations between large companies of comparable size 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. 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. 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 Duke Energy and Progress Energy and the initially announced merger of Glencore International and Xstrata.

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* duties are 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 affordability 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 features, 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 cash 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 positive stock market 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.

E. Controlling Shareholders, Conflicts and Special Committees

Transactions involving companies with controlling shareholders and other conflict transactions present special considerations and are often subject to heightened judicial scrutiny. In such cases, directors may need to employ special procedural protections, including possibly forming a special committee of disinterested directors, in order to fulfill their fiduciary duties. To understand when procedural protections may be necessary, it is useful to begin with the Delaware courts' definition of a controlling shareholder and an understanding of what constitutes a director conflict.

1. Controlling Shareholders

Any shareholder controlling a majority of a company's stock is a controlling shareholder. A minority shareholder will also be considered a controlling shareholder if it exercises "such formidable voting and managerial power that [it] as a practical matter, [is] no differently situated than if [it] had majority voting control."[180] For a minority shareholder to be considered a controlling shareholder, a plaintiff must allege well-pled facts showing "actual domination and control" over the board by the minority shareholder.[181] While this definition does not provide a bright-line rule, some guidance to its outer limit is offered by *In re Cysive*,[182] which then-Chancellor Strine recently described as perhaps the Delaware Chancery's "most aggressive finding that a minority blockholder was a controlling stockholder."[183] In that case, the Court found that a 35% stockholder that was also the company's founder, CEO and chairman and had two relatives serving as executives of the company was a controlling shareholder. In contrast, last year in *In re Morton's*, then-Chancellor Strine found that a plaintiff had failed to adequately allege control by a shareholder who had a 27.7% stake in the company and two employees on its board (one of whom approached an investment bank about the possibility of a merger), where the other eight directors were independent of the shareholder.[184]

2. Conflicts and Director Independence

In considering whether directors are interested and thus not independent, it is important to determine whether the interests of any directors are in conflict with those of the shareholders generally. In determining director independence, a board should have its directors disclose their compensatory, financial, professional and business relationships, as well as any significant personal, social or family ties that may impair their ability to discharge their duties. 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.[185]

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 shareholder.[186] Even if a director does not have a direct interest in the matter being reviewed, other factors have sometimes been considered by Delaware courts to cast doubt on a special committee member's independence. 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 shareholder.[187] Familial relationships may also be disqualifying. In *Harbor Finance Partners* v. *Huizenga*, the Delaware 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.[188]

Not all relationships between special committee members and management or controlling shareholders 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.[189] 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 ten years prior.[190] Nor is the fact that a shareholder had elected a director a sufficient reason to deem that director lacking independence.[191] This year, 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.[192] 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.[193]

The purpose for which the special committee is created may 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?"[194] 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 *Beam* v. *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.[195] In distinguishing its holding from that of *In re Oracle Corporation Derivative Litigation*[196]—where the Delaware Court of Chancery found that the members of a special litigation committee formed to investigate alleged insider trading by other directors lacked the requisite level of independence because of their personal and professional ties to Stanford University—the Delaware Supreme Court looked to the purpose for which the special committee was formed and stated that "[u]nlike the demand-excusal context, where the board is presumed to be independent, the [special litigation committee] has the burden of establishing its own independence by a yardstick that must be 'like Caesar's wife'—'above reproach.'"[197]

3. The Special Committee's Procedures and Role

The function of a special committee is to protect shareholder interests in cases where the interests of certain directors (such as directors participating in a management buyout or representing a controlling shareholder) differ significantly from those of the public shareholders 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.

If directors who have a personal interest conflicting with those of the public shareholders 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, the merger will be reviewed under the "entire fairness" standard, which generally places the burden of proof in any shareholder litigation on the board.[198]

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 that may arise. Failure to disclose such conflicts may result in substantial difficulties in defending the board's actions in court.[199]

Even where a majority of directors are independent, delegation of negotiation or review functions to a special committee may be appropriate 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 shareholder 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 shareholder 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 shareholder over the opposition of the independent directors.[200] The same year, in *McMullin* v. *Beran*,[201] 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 shareholder controlled the process and allegedly had interests divergent from those of the public shareholders.[202]

In order for the 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 shareholder, "the special committee must have real bargaining power that it can exercise with the majority shareholder on an arm's length basis."[203] The

special committee should receive independent financial and legal advice, negotiate diligently and without the influence of the controlling shareholder, and possess all relevant material information.[204] In *Kahn* v. *Lynch Communication Systems, Inc.*, the Delaware Supreme Court in 1994 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 shareholder fail to establish that the committee had the power to negotiate independently.[205]

The special committee should have a clear conception of its role, which should include a power to say no to the potential transaction.[206] In the 2011 *Southern Peru* case,[207] the Delaware Court of Chancery criticized the role of the special committee in reviewing a merger proposal from a controlling shareholder. 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 shareholder] to dictate the terms and structure of the [m]erger."[208] 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.[209] A special committee that does not recognize, even in the context of a takeover bid by a controlling shareholder, that it may refuse to accept the offer might bear the burden of proving the entire fairness of the transaction in court.[210] 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 shareholder's threat to acquire the company in a hostile takeover at a much lower price if the committee did not endorse the controlling shareholder's offer.

Special committees and their advisors should be proactive in seeking all relevant information (including, where relevant, valuation information and information held by management or the transaction proponent) and in negotiating diligently on behalf of shareholders.[211] The records of the deliberations of a special committee and the full board should reflect careful and informed consideration of the issues. Counsel can help frame the agenda and review in advance the nature of the oral and written reports that the financial advisors and others will render.

4. Selecting Special Committee Advisors

The best practice is for a special committee, rather than management or a controlling shareholder, to choose its 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.[212] In *TCI*,[213] 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," while in 2006 in *Gesoff* v. *IIC Industries Inc.*,[214] Vice Chancellor Lamb strongly criticized a special committee's use of advisors who were handpicked by the majority shareholder seeking a merger.

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 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 shareholder, leaving the special committee with independent advisors who did not know the company well and who lacked the information available to the majority shareholder's advisors.[215] Whether the special committee should retain advisors with a previous corporate relationship is a context-specific decision. In the *Gesoff* case, Vice Chancellor Lamb explained that, even had the special committee's advisor been "fully independent," he was still troubled that the special committee did not adequately investigate the qualifications of the advisor, which resulted in the advisor being of "little use" to the special committee.[216] Thus, special committees must walk the fine line of choosing advisors who are free of undue influence from the interested party but who are competent and well-informed about the value and prospects of the company.

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 hiring more than one advisor for a particular role, negotiating carefully worded confidentiality provisions, and structuring the advisor's fee to prevent any misaligned incentives. 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

A director of a company that has more than one class or series of shares may have conflicts with shareholders that own a different class or series of shares than that owned by the director or that director's affiliates, giving rise to entire fairness review. 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 shareholder — received an approximate 10% premium over the consideration received by the low-vote holders.[217] 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 shareholder'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 shareholders' large liquidation preference and allowed them to exit their investment while leaving the common shareholders with nothing, and a majority of the board was designated by preferred shareholders and had other alleged relationships with those preferred shareholders.[218]

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 shareholder and the minority shareholders received 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.[219] 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 shareholders were cashed out but the controlling shareholder received a continuing interest in the surviving company.[220] 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."[221] 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."[222] In a post-trial opinion, the Court of Chancery found that the transaction was entirely fair.[223]

In the 2012 *In re Delphi Financial Group Shareholder Litigation*[224] decision, the special committee approved a merger that paid the founder, CEO and controlling shareholder 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."[225] Although the special committee attempted to persuade the founder to accept the same price as the low-vote shareholders, the founder "remained obstinate, refusing to back down on his demand for some level of disparate consideration."[226] The record showed that the special committee members believed that the founder would "jettison" the deal and deprive the low-vote shareholders of the opportunity to realize a "circa-100%" premium on their shares.[227] 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 that damages against the founder were an available remedy, shareholders should "decide for themselves" whether to accept the merger consideration.[228] The Court did, however, conclude that while a controlling shareholder is permitted to negotiate a control premium, in this case, plaintiffs were likely to demonstrate at trial that the founder violated his fiduciary and control duties, largely because he had already "sold his right to a control premium" to the low-vote shareholders via the charter (even though stockholders approved an amendment of this provision in connection with the deal).[229]

6. Standard of Review in Squeeze-Out Mergers

In 1994, the Delaware Supreme Court held in *Kahn* v. *Lynch Communication Systems, Inc.* that entire fairness review applied to a merger in which a controlling stockholder acquires the remainder of a company's shares (also known as a squeeze-out merger), but that the burden of establishing entire fairness could be shifted from the defendant to the plaintiff if the squeeze-out merger was approved by either an independent committee of disinterested directors or the non-waivable, informed vote of a majority of the minority stockholders.[230] Since that time, it had been widely assumed by practitioners and courts that entire

fairness would remain the applicable standard of review for squeeze-out mergers regardless of the procedural protections employed, with plaintiffs at best shifting the burden of proof. This year, however, the Delaware Supreme Court held in *Kahn* v. *M&F Worldwide Corp.* that business judgment review is available in controlling stockholder transactions if certain procedural protections are used and certain other conditions are met.[231]

M&F Worldwide arose from a stockholder challenge to a go-private merger in which MacAndrews & Forbes acquired the 57% of M&F Worldwide it did not already own. From the beginning, MacAndrews stated that it would not proceed with the transaction unless it was approved by both a special committee and by a majority of stockholders unaffiliated with MacAndrews. A special committee was formed, picked its own legal and financial advisors, met eight times in three months and negotiated a price increase from $24 to $25—a 47% premium on M&F Worldwide's pre-offer stock price. The transaction was then approved by 65% of the unaffiliated stockholders. In the ensuing challenge, then-Chancellor Strine held that the controller's decision to condition the transaction *ex ante* on the approval of both an effective independent special committee and the majority of the unaffiliated stockholders resulted in business judgment review rather than entire fairness review and thus granted summary judgment in favor of the defendants.

On appeal, the Supreme Court acknowledged that the effect of using both procedural devices was an issue of first impression, and it affirmed the Court of Chancery's decision. The Court held that a controller may obtain business judgment review of a going-private merger, and avoid more onerous "entire fairness" scrutiny, if "(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." The Court explained that in these circumstances, the merger "acquires the shareholder-protective characteristics of third-party, arm's-length mergers, which are reviewed under the business judgment standard." The Court also stressed 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."

In so ruling, however, the Court warned that "[i]f a plaintiff can plead a reasonably conceivable set of facts showing that any or all of [the]

enumerated conditions did not exist, that complaint would state a claim for relief that would entitle the plaintiff to proceed and conduct discovery," and the Court also emphasized that one requirement for avoiding a trial is a determination that "a fair price was achieved by an empowered, independent committee that acted with care." Thus, while *M&F Worldwide* provides welcome confirmation that business judgment review is attainable, its practical value will be diminished if it is interpreted to require that the controlling stockholder first establish the fairness of the transaction price.

IV.

Tax and Financial Considerations

A. 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, 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.

1. 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 which 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" 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 preferred stock (referred to as "nonqualified 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, unless the acquiror nonqualified preferred stock is received in exchange for target nonqualified preferred stock. 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). Final 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. Proposed Treasury regulations would extend the signing date rule to certain variable consideration transactions with collars.

2. 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 the merger 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.

3. 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 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.

4. 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. Shareholders of the acquiror and the target would receive tax-free treatment 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 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 the transaction as long as the 80% ownership test is satisfied. Cash and nonqualified preferred stock received will be taxable up to the amount of gain realized in the transaction.

5. 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, the tax law 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.

6. Spin-Offs Combined With M&A Transactions

A 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 transfer a business to a third-party in a transaction involving solely stock consideration in a manner that is tax-free to the parent 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 public company and then the parent merges with the acquiror. 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 public company and then the new company merges with the acquiror.

In order to qualify as tax-free, 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 the divesting parent own a majority of the stock of the combined entity). Recent examples of Reverse Morris Trust transactions include MeadWestvaco's 2012 spin-off of its consumer and office products business and merger of such business with ACCO Brands, 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 concurrently with 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 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 spin-off company's stock if, as part of the plan (or series of related transactions) that includes the spin-off, one or more persons acquires 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 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 spinoff company or a "similar acquisition" within two years prior to the spin-off, an 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. Because post-spin transactions can cause the spin-off to become taxable to the parent corporation (and, in the case of a taxable transaction, its shareholders), it is customary for tax matters agreements entered into in connection with the spin-off to impose restrictions with respect to such transactions and to allocate any corporate tax liability resulting from the spin-off to the corporation the acquisition of whose stock after the spin-off triggered the tax.

B. Consideration and Pricing

The pricing structure used in a particular transaction (and the allocation of risk between the acquiror and the seller 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 seller 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 seller's stock. In addition, a stock merger proposal that becomes public carries substantial market risk for the buyer, whose stock may fall due to anticipated dilution or the financial impact of the transaction. Such a market response may put pressure on the buyer to offer additional make-whole consideration to seller, exacerbating the dilutive effect of the transaction, 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 seller'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 of the lack of dilution of the seller's equity when the consideration is cash. 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 Formulae 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 result in the seller's shareholders receiving less value for their exchanged shares or can increase the transaction's potentially dilutive effect on the acquiror's shares. Such market risk can be addressed by a pricing structure that is tailored to the risk allocation that the parties agree to. These pricing structures may include using a valuation formula instead of a fixed exchange ratio, a collar or so-called "walk-away" provisions permitting unilateral termination in the event the acquiror's share price falls below a certain level.[232]

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 seller'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 seller 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 seller'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 on account of price fluctuation, the parties may turn to other pricing mechanisms that more closely align with their market risk allocation intentions.

2. Fixed Value With Floating Exchange Ratio; Collars

In many situations, one or both parties (typically the seller) will be unwilling to permit market fluctuation to impair their ability to achieve the benefits of the bargain that was struck between the parties 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 seller'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 seller'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.

The longer the measuring period, the smaller effect any market volatility will have on how the acquiror's stock is valued, and relatedly, how many shares of such stock will ultimately be delivered to seller. Typically, acquirors favor longer measuring periods because, as the transaction becomes more likely and approaches fruition, the acquiror's

stock may fall due to anticipated dilution. By contrast, sellers may argue that the market price over some period immediately prior to consummation provides a better measure of consideration received.

A floating exchange ratio based upon the acquiror's stock price during a pre-closing period, while protecting the seller's shareholders against price declines, exposes the acquiror to the possibility of massive dilution, limited only by the amount by which the stock price can decline. In this regard, 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 seller for even a temporary shortfall that occurs during the measuring period for the floating exchange ratio. To protect against such extreme dilution, agreements with floating exchange ratios frequently include a "collar" that places a cap on the maximum number of shares to be issued and, at the same time, a floor on the minimum 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 seller 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 seller's shareholders. An acquiror would argue that the seller's shareholders should bear some of the risk of a price decline, and the seller 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 potentially dilutive effect of an issuance and any potential timing consequences thereof, the overall prospects for the stock market 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. An acquiror must also consider the anticipated effect on its stock price of shorting 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 seller 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 seller'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 seller 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 seller's shareholders will not receive an increased number of shares on account 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 market-risk price protection is to include as a condition to closing the right for seller 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 seller if, at the time the transaction is to close, the acquiror's stock has decreased by 15% — a single trigger.

Some walk-away formulae 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 seller 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 seller to "walk." Walk-away rights are generally tested during a short trading period prior to closing

and often include a "top-up" option for an acquiror to elect to increase the exchange ratio to avoid triggering the seller'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 seller 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 appears desirable 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 seller 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 seller might legitimately request the inclusion of protective provisions such as a floating exchange ratio and/or a walk-away, especially if the seller has other significant strategic opportunities. An acquiror may argue, of course, that the seller should not be entitled to absolute protection (in

the form of a walk-away) from general market (compared to acquiror-specific) risks. A double-trigger walk-away can correct for general market or industry-wide events. At the other end of the spectrum, in an MOE or "partnership" type of transaction, claims on the part of a seller for price protection, especially walk-aways, are less firmly based. The argument against price protection is that, once the deal is signed, the seller's shareholders are (and should be) participants in both the opportunities and the risks of the combined company. Moreover, in both this type of transaction and a true acquisition, the seller can always find some comfort, albeit less direct, in respect of acquiror-specific price risk in the representations on the part of the acquiror relating to the nonoccurrence of material adverse changes and other warranties (the accuracy of which will be a condition to closing).

Because of the length of time required to complete some strategic acquisitions such as bank or telecommunications mergers, and the fact that they are generally stock-for-stock transactions, the management of, or protection against, market risk through various price-related provisions can assume particular significance during 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, Boards 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. Sellers may find mixed consideration desirable because the cash component provides some downside protection to sellers from a decline in the price of the acquiror's stock. In addition, depending on the allocation procedure employed (*e.g.*, whether each seller's 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 are a wide variety of potential pricing structures that can be utilized in 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), plus

the added complication of matching the formula for the stock component to the formula for the cash 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 seller'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 shares declines. After all, at the time the seller'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.

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- or 20-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, 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 amount 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 final 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. The final 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 seller.

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/*Revlon* duties.

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 seller shareholder elections. In a straight proration, each of the seller'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 seller 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 seller'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 seller'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 seller 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 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. Flexibility also can be preserved for giving preference to elections by officers and directors or other significant shareholders. Holders of director and employee stock options are also typically provided with an opportunity to roll over their stock options into options exercisable for acquiror shares at the exchange ratio. 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, sellers 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.[233] 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."[234] 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."[235] 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."[236]

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 one bidder's security with a lower current market value more highly than another security with a higher 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 the 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 seller'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. Extensive 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 the same 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 obliged 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."[237] 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."[238]

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.[239] Some states outside Delaware, such as Indiana, Minnesota, New Jersey, Nevada, Ohio, and Pennsylvania, have adopted statutes known as "constituency statutes" specifically permitting boards to take into account such factors. In states with constituency statutes, there is generally an open issue on how such statutes interact with *Revlon* 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.[240] 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.[241]

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. Mergers may require a lengthy time period for consummation; for example, many strategic mergers in industries such as banking and telecommunications have raised regulatory and antitrust issues that must be resolved prior to consummation. Given the risk of non-consummation in these types of transactions, it is important for the selling company to strive to preserve franchise value throughout the interim period. 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.

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)[242] 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. 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 — the largest transaction to ever include a CVR — 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. As another more recent example, Capital Bank Financial Corp.'s 2012 acquisition of Southern Community Financial Corporation utilized a CVR as part of the merger consideration, whose value was determined by the performance of Southern Community's legacy loan and foreclosed asset portfolio at the end of a five-year period—with the payments under the CVR ranging from zero to $1.30 per share in addition to the primary merger consideration of $2.875 per share.

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.

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 investment bankers in reaching an informed view. In merger transactions, an investment banker's 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* ("*Trans Union*") 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, less frequently, 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.[243] 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. Courts reviewing the actions of boards have commented favorably on the use by boards of investment bankers in evaluating merger and related proposals (although generally receipt of a fairness opinion by independent investment bankers is not required as a matter of law).[244]

Particularly, in change-of-control situations, where directors are obligated to choose 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.

The issue of whether a fairness opinion should be "brought down" from the time of signing a merger agreement to the time of mailing the related proxy statement is a point to be considered by each party's board. 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, earning and assets, not the absolute dollar value of the stock being received by one party's shareholders. Parties to a stock-for-stock merger may 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 may enhance 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. In cases where parties have negotiated an agreement without a bring-down, the SEC Staff has required detailed disclosure with respect to whether there have been any changes that would have affected the opinion had it been rendered as of a date closer to the mailing.

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.[245]

1. Conflicts and Fairness Opinions

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.[246] FINRA requires, among other things, disclosure as to 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 the compensation that the member firm will receive that is contingent upon the successful completion of the transaction, as well as any other "significant" payment or consideration that is contingent upon the completion of the transaction.

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, a contingent fee arrangement will cause Delaware courts to find triable issues of bias. In *El Paso*, the Delaware Court of Chancery questioned the valuation advice given by an investment bank that would receive a fee of $35 million if the target's board agreed to a merger and zero if it continued to pursue a spin-off it had already begun or chose an alternative transaction.[247] 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."[248] These cases contrast with *Toys "R" Us*, which acknowledged that contingent fee arrangements "ha[ve] been recognized as proper by [Delaware] courts."[249]

Disclosure of contingent fees may also be required.[250] For example, in *Crawford*,[251] 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.

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's advice to a target's board was so conflicted as to give rise to a likelihood of a breach of fiduciary duty by the board. In *In re Del Monte Foods Co. Shareholders Litigation*,[252] 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 they 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."[253] 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."[254] The case ultimately settled for $89 million, with the investment bank bearing roughly half of the cost.

Recently, in *In Re Rural Metro Corporation Stockholders Litigation*,[255] the Delaware Court of Chancery found that RBC Capital Markets ("RBC") aided and abetted fiduciary duty violations of the board of directors of Rural/Metro Corporation in its sale of the company to Warburg Pincus. Vice Chancellor Laster 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 Warburg Pincus to participate in buy-side financing, even as the board sent RBC to negotiate against Warburg Pincus 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 from buy-side financing work."[256] 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 Warburg Pincus' offer was fair to and in the best interests of Rural's shareholders.[257]

2. Fairness Opinions and Differential Consideration

In cases where there are different classes of stock, Delaware courts suggest that companies should consider whether bankers' fairness opinions should address the issue of whether the consideration received by each group of shareholders is fair relative to the other classes.[258] In the 2005 *TCI* merger, 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. The Delaware Chancery Court interpreted the fairness opinion to mean that each group of shareholders received consideration that was fair in relation to the intrinsic value of their 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.

The *TCI* opinion does not indicate that two separate financial advisors (or special committees) would always be necessary, and the Court addressed other deficiencies in the board's decision-making process, including the fact that directors held a disproportionately higher amount of high-vote shares and problems with the special committee. In addition, major investment banks, in contrast to certain boutique banks, historically have resisted giving "relative fairness" opinions, a trend that generally has continued with few exceptions even after *TCI*. Whether or not a relative fairness opinion is obtained, it will be important that the special committee inform itself of other similar transactions involving different classes of stock and the relative premiums (both on a per share basis and on an aggregate basis) in those deals that involve differential consideration. As described in Section III.E.6, if a controlling or significant shareholder will receive such differential consideration and a majority of the board is disinterested, the use of a special committee and a non-waivable majority-of-the-minority shareholder approval condition may insulate the transaction further by avoiding entire fairness review.

D. Use and Disclosure of Financial Projections

Financial projections are often prepared by the management of the target company 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 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 may also lead to delay in completing a transaction.

As it did in the *Netsmart* decision, the Delaware Court of Chancery typically requires disclosure of management projections underlying the analyses of a fairness opinion, where such projections are considered to be material to shareholders' decisions regarding voting and whether to seek appraisal[259] (a point echoed in 2010 in *Maric Capital Master Fund, Ltd.* v. *PLATO Learning, Inc.*).[260] Courts have also indicated that partial or selective disclosure of certain projections can be problematic.

Not all projections will be deemed sufficiently material 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.[261] 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.[262] 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."[263]

In *In re BEA Systems, Inc. Shareholders Litigation*, the plaintiffs argued that certain financial data considered by BEA's financial advisor — including the company's future financial performance under different scenarios, synergy analyses drawn from public sources regarding other transactions, and preliminary discounted cash flow analyses — had been presented to the board and thus had to be disclosed.[264] In the opinion, 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. The Court concluded that, therefore, there had been no showing that such information was material, and disclosure of such unreliable information "could well mislead shareholders rather than inform them."[265] 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. Delaware law and the views of the SEC Staff on how much disclosure to require (both of target projections and, in the case of stock-for-stock transactions, 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.

The SEC and Delaware law are not always in sync as to what projections need to be disclosed to shareholders, and often the SEC may require more to be disclosed than would be the case under Delaware law. 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.

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 comply with the 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."[266] Sellers are generally willing to agree to provisions of this variety as a means of inducing 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 in transactions not involving a sale of control have mostly been reviewed under the *Unocal/Unitrin* enhanced scrutiny analysis.[267] The *Unocal* test as applied to deal protection devices requires that the board show that (a) it had reasonable grounds to believe that a third-party bid would be a danger to corporate policy and (b) that the deal protection measure was reasonable in response to the perceived threat. In contrast, review of deal protection devices in certain sale or change-of-control transactions, as described below, involves the more exacting *Revlon* test — where the board's duty is to secure the best value reasonably available for shareholders.

Regardless of the particular doctrinal rubric that may be applicable, the key point is that context matters. 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."[268]

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, as well as other specified circumstances generally involving the failure of the merger to occur as a result of a third-party bid. Of course, termination fees, even more than other deal protection devices, impose an easily calculable cost on overbids, and accordingly, may deter the making of overbids in the first instance. An "excessive" break-up fee therefore will be viewed critically by the courts. In some cases, break-up fees are offered by sellers to compensate an unsuccessful bidder for the risk and costs incurred in advancing the competitive bidding process and incentivize potential bidders to undertake the cost of evaluating the target.

Break-up fees can be triggered by different events. A "naked no-vote" or "no-vote termination fee" is triggered if shareholders failed 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 having been made. A break-up fee can also be triggered by termination by a party due to the other party's board changing its recommendation in favor of a deal or by the failure to consummate a transaction by a drop dead date, or a breach of the representations, warranties and covenants, typically in circumstances where an alternative acquisition proposal has been made public prior to the time of termination.

In determining the reasonableness of a termination fee, courts do not rely on a set threshold percentage. Indeed, the question of whether the fee should be measured against equity value or enterprise value (*i.e.*, equity value plus net debt) will depend on the circumstances — for example, enterprise value may be more appropriate where the company's

capital structure is highly leveraged,[269] 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.[270]

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.[271]

The Delaware Court of Chancery has offered guidance that a termination fee of 4.4% of equity value is "near the upper end of a 'conventionally accepted' range."[272] The same court upheld in *Dollar Thrifty* 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."[273] In *In re Plains Exploration & Production Company S'holders Litig.*, the Court held a 3% fee was "not unreasonable,"[274] in *Koehler* v. *NetSpend Holdings Inc.*, the Court upheld a 3.9% termination fee,[275] in *In re Cogent*, a termination fee that was 3% of equity value was held reasonable,[276] in *In re Toys "R" Us, Inc. S'holders Litig.*, a 3.75% termination fee was approved by the Delaware Court of Chancery,[277] and in *In re 3Com*, a termination fee and expense reimbursement greater than 4% of equity value was held reasonable.[278] In *In re The Topps Co. S'holders Litig.*, the Delaware Court of Chancery upheld, albeit noting that it was "a bit high in percentage terms," 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 (both tiers being inclusive of the maximum amount of the expense reimbursement).[279] However, in *Phelps Dodge Corp.* v. *Cyprus Amax Minerals Co.*,[280] a 1999 decision regarding a merger not involving a

change-of-control, the Delaware Court of Chancery issued a reminder that there are limits on termination fees even when *Revlon* duties do not apply. The Court 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."[281]

Reaffirming that context matters, the Delaware Court of Chancery upheld a "no-vote termination fee," in which the potential acquiror had the right to receive a $25 million termination fee if shareholders failed to approve the merger, whether or not another deal had been proposed or agreed to. In *In re Lear Corp. Shareholder Litigation*, Lear's board had agreed to sell the company to Carl Icahn in an LBO.[282] 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. The *Lear* court found that the deal was not coercive or disruptive, noting both that the shareholders in fact rejected it and that Delaware courts have previously upheld no-vote termination fees of up to 1.4% of transaction value.[283] No-vote termination fees are less customary than topping fees, and where they are included in transactions they are significantly lower than topping fees. In fact, purchasers often include an expense reimbursement provision instead of a fee in such circumstances.

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. In 2009, in *NACCO Industries, Inc.* v. *Applica Inc.*, the Delaware Court of Chancery stated that it is "critical to [Delaware] law" that bargained-for contractual provisions be enforced, including by post-closing damages remedies in appropriate cases.[284] Once a merger agreement is signed, directors and corporate representatives inside and outside the company should be instructed to adhere to its terms.

On the other hand, Delaware courts will refuse to enforce no-shop provisions where the party seeking to enforce the contract rights aided and abetted the board's breach of fiduciary duty. In *In re Del Monte Foods*

Co. Shareholders Litigation,[285] 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 Foods Co. The merger agreement contained a number of deal protection measures, including a no-shop provision, a termination fee and matching right provisions. In evaluating whether to enforce contract provisions, including no-shop provisions, by 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."[286] 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 noting, among other things, that the private equity buyers had knowingly participated in the breach of duty and that breaches of fiduciary duties relate to policy concerns that are especially significant.

Overly restrictive no-shop clauses may also be rejected by Delaware courts as breaches by the board of its fiduciary duties. 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.[287] 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.

Similarly, in 1999, in *Phelps Dodge*, 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."[288] The Court acknowledged that under *Time-Warner*, where the business judgment standard rather than *Revlon* applies, parties to a stock-for-stock merger have no duty to negotiate with third parties, but noted that "even the decision not to negotiate, in my opinion, must be an informed one."[289] 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 and are sometimes used in deals where there has not been any extensive pre-signing market canvass, 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 60 days — in which the target is permitted to affirmatively solicit competing bids. Although go-shop provisions have become more prevalent in deals, the Court of Chancery has noted that the absence of a go-shop provision is not *per se* unreasonable.[290]

Targets in an auction will often require that bidders agree to a "standstill" that precludes the bidder from making a topping bid. A properly drafted standstill will also 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 generally been prohibited by standstill agreements because under certain circumstances, they can lead to disclosure on the part of the target, or simply leak to the public, thus giving the impression that the target is "in play."

In *In re Complete Genomics, Inc. Shareholder Litigation*,[291] Vice Chancellor Travis Laster of the Delaware Court of Chancery enjoined a target company subject to *Revlon* director duties from enforcing such a clause, which he referred to as a "Don't Ask, Don't Waive" provision. In his November 2012 bench ruling, 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."[292]

Less than a month later, however, then-Chancellor Strine's bench ruling in *In re Ancestry.com Inc. Shareholder Litigation*[293] 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.com* 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.

More recently, in *Koehler* v. *NetSpend Holdings Inc.*,[294] 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.[295] The court of Chancery has noted that "directors cannot willfully blind themselves to opportunities that are presented to them."[296] 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. One issue that is sometimes negotiated 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." In light of Delaware case *dicta*, some Delaware practitioners believe that a merger agreement provision precluding a change in recommendation except where a superior proposal has been made may be invalid, on the theory that a "duty of candor" (or a duty of disclosure) requires directors to be able to change the recommendation for any reason.[297] In Vice Chancellor Laster's recent bench ruling in *In re Complete Genomics, Inc. Shareholder Litigation*, he 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."[298] Similarly, in *In re NYSE Euronext Shareholders Litigation*,[299] then-Chancellor Strine *in dicta* expressed skepticism for recommendation

provisions 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: "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 . . . ?"[300]

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 an attempt to preserve some measure of protection against an unwarranted change in recommendation while minimizing an attack on duty of candor grounds. 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.

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 match competing bids, and may contractually specify a period of time that must pass before the fiduciary out may be exercised. The Delaware Court of Chancery has described non-solicitation clauses with fiduciary outs for superior proposals as "mild deal-protection devices."[301]

Under Section 146 of the DGCL, a Delaware corporation may, in a merger agreement, provide that the agreement may be submitted to shareholders even if the board, having deemed the merger agreement advisable at the time of execution, subsequently changes its recommendation.[302] 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 permitting it to ensure that the target's shareholders are given the decision to determine whether any competing offer is superior, and delaying execution of a competing transaction agreement until after that vote is taken. Parties negotiating a force-the-vote provision should consider whether a termination fee will be payable upon a change in a board's recommendation.[303]

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.*,[304] the Delaware Supreme Court in 2003 enjoined a merger between Genesis Health Ventures, Inc. and NCS Healthcare, Inc., holding 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 so-called "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 negotiate a sale of the company. The Court held 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 may make 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."[305] *Omnicare* remains controversial, and in 2011, the California Court of Appeal specifically declined to follow it.[306]

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.[307] 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 *Koehler* v. *NetSpend Holdings Inc.*,[308] 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."[309] The fiduciary-out in *Net Spend* permitted the Company to accept a more favorable acquisition proposal

from a third party, notwithstanding 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.[310] 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.[311] *OPENLANE* adhered to *Omnicare* because shareholders could freely choose to give or withhold written consent following the transaction. Even so, a sign-and-consent structure can be analyzed under the *Revlon* standard, and boards should confirm that superior bids or offers 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."[312]

5. Information Rights, Advance Notice Provisions, and Matching Rights

Information rights and matching rights provide bidders with an opportunity to learn more information about competitive bids and allow bidders to better their offer. Specifically, information rights provide that a target will supply the initial bidder with information about subsequent bids in the event that a second bid or bidder appears. The holders of such rights have an informational advantage because they can prepare counter-offers with knowledge about counter-bids. Advance notice provisions, like information rights, also give the holder of such information an advantage. Such rights are often found in one of three sections of a merger agreement, requiring notice by the seller to the acquiror when: (1) changing the board recommendation, (2) terminating the agreement under

the fiduciary out, or (3) providing information to a potentially interested third party under the no-shop provision. Finally, matching rights give bidders an explicit right to match a competing offer. 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 mach only one 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 bringing potential acquirors to the table initially. 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.[313] Indeed, 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."[314] Similarly, information rights have been routinely upheld by the Delaware Court of Chancery.[315] As a result of these decisions, matching rights have become common-place in transactions, appearing in approximately 96% of transactions in 2012.[316]

6. Other Deal Protection Devices

a. Stock Options

Other deal protection devices also are available to transaction participants. For example, a party may be granted an option (typically 19.9% of the pre-issuance shares, below the NYSE and NASDAQ requirements for issuances requiring a shareholder vote) to purchase newly issued shares from the other party. Such stock options were popular in some deals in the 1980s and 1990s, and became less prevalent after the elimination of pooling-of-interests accounting in 2001, although they continue to appear occasionally in M&A transactions involving financial institutions.

b. 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.

c. 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 *In re Complete Genomics, Inc. Shareholder Litigation*,[317] 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." Similarly, in the merger between Sprint Nextel Corp. and Softbank Corp. that closed in 2013, Sprint issued a convertible bond to Softbank for $3.1 billion in cash that was convertible into approximately 17% of the Sprint common stock.

d. Crown Jewels

The "crown-jewel" lock-up, in its classical form, is a device in which the target company agrees to grant the acquiror an option to purchase, or otherwise obtain the benefit of, certain of the target's key 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* and its progeny became the law in Delaware, although at times, targets have granted options for legitimate business reasons.

For example, during 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."[318]

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. 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.[319] 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 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. 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 in 2001 provided important guidance on the use of these clauses.[320] 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."[321] 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.[322] 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,[323] did not rise to the level of an MAE in the context of the target's enterprise value.

In *Hexion Specialty Chems., Inc.* v. *Huntsman Corp.*,[324] 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."[325] 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.[326] 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, plaintiffs 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. 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 necessarily 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.

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

Historically, 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 purported 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 crises 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.*,[327] 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.*,[328] 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.*,[329] 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-crises 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, most 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, occasionally employed 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. Many 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 a draw-down of the equity financing if the debt financing is available. Yet a further variation seen in some 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, in some cases reaching well in excess of 10% of deal value, sometimes as high as the full equity commitment of the sponsor. In addition, many private equity transactions have obligated the buyers to use efforts to force lenders and sponsors to deliver committed funding, and in some cases specifically require the pursuit of litigation in furtherance of this goal. Debt commitment letters, however, usually do not allow sellers to seek specific performance directly against lenders or name sellers as third-party beneficiaries. Lenders have in some 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 the commitment letter be governed by New York law, (3) requiring that the buyer and seller waive any right to a jury trial, 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 $2.5 billion Google/Motorola Mobility 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 not be collected by the selling company as damages for the buyer's alleged breach of an agreement that disclaimed third-party rights until after the "effective time" of the merger.[330] 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 with respect to calculating remedies for the buyer's breach with respect to 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.[331]

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 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 size of the transaction; and the relative bargaining power and sophistication of the parties.

VI.

Advance Takeover Preparedness and Responding to Unsolicited Offers

Advance takeover measures 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 ability to foreclose present vulnerabilities against unknown and future threats against the risk of raising the company's profile with shareholder and governance activists. The company should also consider contingency plans that can be adopted to deal with new threats.

Advance preparation for defending against a 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 merely 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.[332]

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 long-term plans and will not force a company to accept a hostile takeover bid if its board determines to reject the bid and pursue the long-term plans.

A. Rights Plans

Rights plans, popularly known as "poison pills," are the most effective device at 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 and ultimately may enable the board to extract from such acquiror a higher acquisition premium or deter offers that the board determines to be inadequate. Economic studies have concluded that, as a general matter, takeover premiums are higher for

companies where rights plans are in effect than where they are not 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 to trigger 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 of late, as a number of 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 adopt a rights plan with a "dead-hand" or "modified dead-hand feature," 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 make a material adverse change to an existing rights plan without shareholder approval. ISS also stated that it would review companies with classified boards every year, and annually elected boards at least once every three years, and recommend an against or withhold vote from all nominees if the company still maintains a non-shareholder-approved rights plan. 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, submit them to shareholder votes or adopt a principle that any future rights plan would be put to a shareholder vote, with 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, a little over 500 U.S.-incorporated companies, including 7% 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 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 to 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. Because the Section 382 limitation is determined by reference to the value of the stock of such corporation at the time of the ownership change, depressed stock prices can exacerbate the impact of an inadvertent "ownership change." 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, over 100 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.

As discussed above in Section I.B.5, hedge funds and other shareholder activists have used equity swaps and other derivatives to acquire substantial economic interests in a company's shares but without the voting and investment power that may be required to have "beneficial ownership" of such shares 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.[333] In a 2010 bench ruling, Chancellor Chandler suggested that properly designed rights plans that cover synthetic and derivative interests could survive legal challenge.[334] Rights plans can also be drafted to cover "wolf-pack" tactics whereby activists and hedge funds coordinate attacks pursuant to informal arrangements. One recent case, however, suggests that Delaware courts will closely scrutinize such plans.[335]

1. The Basic Design

The key feature of a rights plan are the "flip-in" and "flip-over" provisions 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, producing 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.[336] 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.

In order to satisfy activist shareholders, some companies have resorted to a rights plan that does 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.

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, including under a *Unocal* analysis.[337] The flip-in feature of rights plans was held, in some early cases, to violate state corporate law in a few states other than Delaware. These rulings, however, have now been overruled, either judicially or by legislation that explicitly authorizes the flip-in. Furthermore, courts have recognized rights plans as important tools available to boards to protect the interests of a corporation.[338]

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,[339] as well as to protect an auction or permit a target to explore alternatives.[340]

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.[341] The decision by 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: "a board cannot be forced into *Revlon* mode any time a hostile bidder makes a tender offer that is at a premium to market value."[342] Even in response to a tender offer that had been outstanding for over a year, the Court concluded: "in order to have any effectiveness, pills do not — and cannot — have a set expiration date."[343]

In addition to its broad reaffirmation of Delaware case law giving directors the ability to eschew offers they believe to be against the shareholders' best interests through refusal to redeem a rights plan, *Airgas* contains a number of important lessons for directors and practitioners: (1) the level of the Court's scrutiny — two four-day trials and an opinion of 153 pages with 514 footnotes — demonstrates that while the law remains strongly committed to respecting board decisions, every detail of a board's response to an unsolicited bid will be examined in detail; and (2) it is noteworthy that the target board in *Airgas* did not take a "just say never" position, but indicated that there were prices at which it was ready to consider a sale, and named this level to the court and the bidder (although the Court also favorably contrasted the Airgas board's "just say no" determination to maintain the status quo with takeover defenses in the form of extraordinary transactions that are functional alternatives to an acquisition offer).

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.[344] 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%). The board also created an "Independent Director Evaluation Committee" to periodically review the new NOL plan and its trigger level. 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. After Trilogy repeatedly refused to enter into a standstill agreement to allow the board more time to review the matter, the Selectica board allowed the trigger of 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.[345] 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.

The adoption of a rights plan to deter acquisitions of substantial stock positions, even in a situation where the founding stockholder had a larger stock position, was upheld by the Delaware Court of Chancery in the case involving Ronald Burkle's acquisition of 17% of Barnes & Noble.[346] Then-Vice Chancellor Strine held that the company's adoption of a rights plan with a 20% threshold that grandfathered the founder'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."[347] In the Barnes & Noble case, the then-Vice Chancellor 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.

3. Rights Plans and Economic Evidence

A study jointly released in February 2004 by ISS and Georgia State University found that companies with rights plans and other takeover defenses outperformed companies without such defenses. Strong takeover defenses were found to be correlated with: (1) higher shareholder returns over three-, five- and ten-year periods, (2) stronger profitability measures (return on equity, return on assets, return on investment and net profit margin), (3) higher dividend payouts and dividend yields and (4) higher interest coverage and operating cash flow to liability ratios. Moreover, a 2009 study released by Citigroup Global Markets showed that since 2001, initial takeover premiums offered in hostile transactions average 28.5% when the target company has a rights plan, as compared with 22.8% for a target lacking a rights plan or staggered board. The Citigroup study also showed that since 2001, the average revision in offer price for companies with rights plans equaled 9.8%, whereas on average there was no net upward revision in offer prices for companies lacking a rights plan or staggered board. Accordingly, companies with a rights plan received an average final premium of 38.3%, almost twice the average final premium of 21.5% for companies without a rights plan or staggered board. A study in 2013 by Boris Janezic, found that firms with poison pills in place before a takeover attempt enjoyed a 19.66% premium over firms that did not. Further, the study found that the adoption of a poison pill in response to an unsolicited bid resulted in a 4.05% increase in the premium paid.

4. "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, bylaws and any other defenses that a 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, while directors on a staggered board can only be removed for cause unless the certificate of incorporation provides otherwise.

Thus, if a target's charter does not prohibit action by written consent and does not provide for 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.

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.[348]

5. "Shareholder Rights" Bylaws

Activist shareholders have sometimes attempted to limit the utility of rights plans by proposing bylaws that either require a board to dismantle the plan under certain circumstances or to adopt one only with subsequent shareholder ratification. While shareholders have a statutory right under Section 109 of the DGCL to adopt bylaws, the Delaware Supreme Court has strongly endorsed the fundamental freedom of

directors to act in accordance with their fiduciary duties under circumstances as they exist, and certain circumstances can require a board to keep a rights plan in place.

Prior to 2008, the SEC generally permitted companies to exclude proposals which sought to regulate the board's ability to adopt or continue a rights plan.[349] Specifically, Rule 14a-8(i)(1) provides that a shareholder proposal can be excluded "[i]f the proposal is not a proper subject for action by shareholders under the laws of the jurisdiction of the company's organization."[350] During the 2008 proxy season, CA, Inc. received a Rule 14a-8 proposal from AFSCME, proposing a bylaw amendment that would require the board of directors to reimburse shareholders for the reasonable expenses of a successful short-slate proxy solicitation. CA, Inc. sought the SEC's permission to omit the proposal from the proxy statement under Exchange Act Rule 14a-8 on several grounds, including that the matter was not a proper subject for shareholder action under state law. In response, the SEC certified the question to the Delaware Supreme Court.

In *CA, Inc.* v. *AFSCME Employees Pension Plan*, the Delaware Supreme Court held that the shareholder proposal was invalid as a matter of Delaware law[351] because the proposal violated the fundamental principle that directors cannot be forced into a course of action that would preclude them from discharging fully their fiduciary duties. Importantly, the Court's opinion made clear that the statutory provision authorizing shareholder-adopted bylaws is itself subordinate to the statutory command that it is the board of directors that manages the business and affairs of every Delaware corporation. The court ruled that the scope of the statutory provision authorizing shareholders to adopt bylaws is "limited by the board's management prerogatives" under the statute because the board's authority to manage the corporation is "a cardinal precept" of Delaware law. Under this reasoning, a binding bylaw proposal to prohibit a board of directors from adopting or implementing a poison pill should similarly be invalid.[352]

The treatment of such bylaws in courts outside of Delaware has been inconclusive. The Oklahoma State Supreme Court, for example, held that shareholders of Oklahoma corporations may propose bylaws that restrict the board of directors' implementation of rights plans, absent a provision in the charter to the contrary.[353] In Georgia, a court held that a proposed bylaw amendment compelling the target board to remove a dead hand provision would undercut the statutory powers and authority of the board and would be "inimical to the corporate structure contemplated by the Georgia Business Corporation Code."[354] A federal court reached a similar result applying Pennsylvania law.[355]

For the most part, governance experts believe that the bylaw amendments proposed in the Oklahoma, Georgia, and Pennsylvania cases would be held invalid under Delaware law as an unauthorized infringement on the statutory power of a board to manage the "business and affairs" of a Delaware corporation. Delaware cases have long made clear that the responsibility of responding to a takeover lies with the board and may not be delegated to shareholders. The statutory grounding of the *Quickturn* decision supports this reading of Delaware law.

B. 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) staggered board provisions, (2) provisions that eliminate shareholder action by written consent, (3) provisions limiting the ability of shareholders to alter the size of a board, (4) "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 (5) "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 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 addressing 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 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.

Companies should review their bylaws on a regular basis to ensure that they are state of the art and consistent with recent case law and SEC developments, and 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 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, to represent that he has no agreements with any third party as to voting or compensation in connection with his service as a director, and to agree to abide by applicable confidentiality, governance, conflicts, stock ownership and trading 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 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.[356] 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.[357] 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. 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.

2. Dissident Director Conflict/Enrichment Schemes

These bylaw provisions are intended to disqualify directors who receive compensation from third parties, typically activist hedge funds. 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 deriving from the fact that the directors' incentives may diverge from those of shareholders. For example, a director may have a personal interest in pursuing a short-term sale at the cost of realizing value over the long-term. These schemes also call into question whether the directors are able to satisfy their fiduciary duties to shareholders. Such provisions are often formulated to prohibit qualification as a director if a director candidate is a party to any such 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 indicated in a new FAQ in January 2014 that if a board adopts "restrictive director qualification bylaws" designed to prohibit "golden leashes" without submitting them to a shareholder vote, ISS "may" recommend a withhold vote against the director nominees.

3. Meetings

Provisions regarding the regulation of meetings play an important role in controlling the timing and frequency of meetings. If, as in Delaware, the state corporation law permits elimination of the calling by

shareholders of special meetings,[358] 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), 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, choosing 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.[359]

5. Action by Shareholder 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.[360]

6. Staggered Boards

Under Delaware law, directors on a staggered board can be removed only for cause, unless the certificate of incorporation provides otherwise.[361] 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.[362]

7. Forum Selection Provisions

In recent years, a number of companies have adopted forum selection provisions to help reign in the cost of multiforum litigation challenging merger transactions. 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 Ret. Fund* v. *Chevron Corp.*,[363] 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 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. 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."[364] 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 *Edgen Group Inc.* v. *Jason Genoud*,[365] however, the Court of Chancery refused to enjoin litigation in Louisiana against a corporation that had a forum selection clause in its certificate of incorporation selecting Delaware as the forum of choice. The Court stated that the proper procedure for enforcing a forum selection clause is to seek relief in the non-contractually selected forum (that is, in the non-Delaware forum).

In that regard, the future of forum selection bylaws remains unclear; while Delaware has upheld their validity as a matter of Delaware law, their enforcement requires the cooperation of other states.[366] Companies should also consider the risk of adverse votes from proxy advisory firms. Glass Lewis and ISS have both indicated that they will generally oppose forum selection provisions, but will make determinations on whether to vote for forum selection provisions on a case-by-case basis.

8. Mandatory Arbitration Provisions

Some bylaws and certificates of incorporation also include mandatory arbitration provisions requiring the resolution of any disputes, claims, or controversies brought by shareholder in either a personal, class, or derivative capacity to be resolved through binding and final arbitration. In *Corvex Management LP* v. *CommonWealth REIT*,[367] 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, nor have other states, including Delaware, upheld the validity of mandatory arbitration provisions.

9. 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 a higher level of scrutiny. A bylaw amendment made after announcement or knowledge of an unsolicited offer will be reviewed under the *Unocal* standard, or, sometimes, under the standard enunciated in *Blasius Indus., Inc.* v. *Atlas Corp*.[368] 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 (*e.g.*, from "just say no" to "reviewing alternatives").[369]

In *Blasius*, the board of the target increased the size of the board so that the 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 on the principle that when tinkering with the ground rules of an election contest, a board was striking at the very basis for the legitimacy of corporate governance — the effective exercise of the corporate franchise by shareholders. A board is required under *Blasius* to show that it has a "compelling justification" for any conduct that makes it impossible for an insurgent to win. As to bylaws and other conduct that influence the outcome of a proxy contest but do not determine it definitively, there will need to be a case-by-case determination as to whether *Blasius* or a less exacting standard of review applies.[370] In *MM Companies Inc.* v. *Liquid Audio, Inc.*,[371] the Delaware Supreme Court applied *Blasius* scrutiny to a board's appointment of two new directors immediately prior to a contested election, for the purpose of frustrating stockholder attempts to gain control of 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 on appeal reflected that the decision to expand the board was "taken for the primary purpose of

impeding the shareholders' right to vote effectively in an impending election."[372] The Court explained that *Blasius* applies 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 an "election contest need not involve a challenge for outright control of the board of directors" for *Blasius* to apply.[373] It is enough that the directors' primary purpose was to "interfere with and impede the effective exercise of the stockholder franchise."[374] Under *Blasius* review, the director defendants did not demonstrate a "compelling justification" for the defensive action to increase the board, and so the Court invalidated the bylaw amendment enabling the director appointments.

In litigation arising out of the unsolicited bid by SoftKey International to acquire The Learning Company ("TLC"), the Delaware courts upheld the TLC board's decision to amend a bylaw in order to delay a special TLC shareholder meeting demanded by SoftKey. SoftKey demanded the meeting under TLC's existing bylaw, which authorized holders of 10% or more of the shares to call a special meeting on 35 days' notice; SoftKey sought to replace the TLC directors in order to redeem TLC's rights plan and implement SoftKey's takeover. In response, the TLC board amended the bylaw to require a minimum of 60 days' notice. That delay enabled TLC to schedule the vote on its previously announced stock merger with Broderbund Software approximately 30 days in advance of the SoftKey removal meeting. The board's action was defended on the basis that the delay gave the board a reasonable period of time to seek better alternatives to SoftKey's offer in the event that the shareholders were to reject the Broderbund merger. Without the bylaw amendment, the SoftKey-initiated removal meeting would have occurred two days after the then-scheduled meeting on the Broderbund merger. The Delaware Court of Chancery upheld the bylaw amendment.[375] The Court tested the amendment under the *Unocal* reasonable proportionality test and found SoftKey's tactics to constitute a threat to legitimate shareholder interests inasmuch as SoftKey's goal was to "circumvent[] the current board's negotiating power."[376] The Delaware Supreme Court affirmed the decision on the basis of the opinion of the lower court.

B. 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 their employment at the company.

Although there generally continues to be a great deal of governmental and public scrutiny of executive compensation arrangements, appropriately structured change-of-control employment agreements are both legal and proper. Ideally, change-of-control protections will be implemented or amended in advance of an actual or threatened transaction. 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.[377] A board's decision to adopt change-of-control provisions is usually analyzed under the business judgment rule.[378] 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. In light of the foregoing, public companies should consider adoption of reasonable change-of-control protections for senior management.

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, although some companies provide a three-year period of protection. 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 interest 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.

Many public companies provide a "gross-up" for the golden parachute excise tax to their most senior executives. Recently, however, there has been increasing shareholder pressure to stop providing such gross-ups, and they have become somewhat less common, particularly in new or modified agreements. Most fundamentally, companies implement gross-ups because they are concerned that 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. Furthermore, 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.

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"). While there has been a trend in recent years towards double-trigger vesting, it remains the case that close to half of public companies 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 golden parachute arrangements in transaction proxy statements that have become a staple of the proxy season since the enactment of 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.

C. "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*, 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.[379] 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.[380] 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.[381]

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.[382] 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.

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 weight 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 in *SandRidge*; Morgans Hotels pre-approved the dissident nominees as continuing directors, so as not to trigger the change of control covenant in its notes.

D. Passive Responses to Unsolicited Offers — "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."[383] 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.

The ability of a board to reject an unsolicited offer was reaffirmed in *Airgas*, 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.[384]

E. Active Responses to Unsolicited Offers

Recent takeover practice has involved relatively few instances of a board authorizing classic defensive tactics that reshape the company's structure. Nonetheless, such alternatives can be appropriate and lawful.

1. 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 white squire defense, which involves placing a block of voting stock in friendly hands, may be more quickly realized. This defense has been successfully employed in a handful of instances, and the Delaware Court of Chancery has upheld the validity of this defense.[385] 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.

2. 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. The CBS buyback announced in 1994, shortly after CBS stated that it would not pursue its previously disclosed merger with QVC (which had received an unsolicited offer from Comcast), is one example of the speed with which a buyback may be implemented following termination of merger discussions.

3. 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. 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.[386] 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. For the first time in over 13 years, Men's Warehouse employed the Pac-Man defense to reverse an offer by Jos. A. Bank.

4. 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 selling off some of the shares of the new company in an initial public offering; another is to distribute all of the shares of the new company to the parent company's shareholders as a dividend (known as a "spin-off"). Another means of boosting the share price of a company is to "split-up" (*i.e.*, deconglomerate — 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. 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 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.

5. Regulatory Action

In addition to antitrust risk, which may itself provide an important ground for disputing the feasibility of a hostile offer, many companies are subject to other regulatory authorities that must approve a change-of-control. In industries such as telecommunications, public utilities and banking, federal (and sometimes state or foreign) regulators may be receptive to arguments made on behalf of a target (or by a target itself) maintaining that a merger is not consistent with the policies and practices of the relevant agency (*e.g.*, Oracle/PeopleSoft). A company subject to such regulation may take full advantage of any rights it may have to file protests and comments with such agencies. However, in view of the ongoing oversight of such agencies and the importance of maintaining strong relationships with regulators, companies should avoid filing dilatory or frivolous comments. Still, concerns regarding antitrust, financing, management resources and relevant public policy interests may properly be brought to the attention of regulators. A target can also slow or prevent a hostile foreign-bidder from acquiring a domestic corporation by notifying CFIUS (discussed further in Section VII.B.1) of the proposed transaction, particularly if the transaction is in a strategically important or sensitive industry, such as the defense, aerospace, communications, or advanced technology industries.

As with other defensive responses, a seller must be careful in responding to a hostile bid with regulatory objections, since regulatory issues, once raised, may be used against a seller interested in a white knight transaction or even a transaction with the original hostile bidder, if later agreed to.

6. Litigation Defenses

As shown by the recent litigation between Vulcan Materials Company ("Vulcan") and Martin Marietta Materials Inc. ("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. A company faced with a takeover threat should closely analyze its prior contractual dealings with the hostile acquiror 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 activity has featured a diverse variety of industries, target countries and sources of acquisition capital. Such transactions have increased since a recent trough in 2009, reaching $925 billion in value in 2012 and $725 billion in 2013, although deal volume remains well below the pre-crisis multi-trillion dollar high water mark of 2007. Cross-border M&A by volume declined approximately 20% in 2013 as compared to 2012, due perhaps in part to cooling economies in certain emerging markets, and cross-border deals comprised 30% of global M&A volume in 2013. In the U.S., only 13% of announced U.S. deals in 2013 involved non-U.S. acquirors or investors, reflecting a decline from 19% of announced U.S. deals in 2012, perhaps due to European acquirors sitting on the sidelines and Asian acquirors focusing largely on regional consolidation and emerging market opportunities. Emerging markets continue to drive a significant share of cross-border activity, most notably in the energy, power, materials and financial sectors, but also in the acquisitions of household names and of sophisticated industrial enterprises in developed economies — as emerging market companies increasingly look abroad for new markets and resources. Nonetheless, consistent with the overall reduction in cross-border M&A volume in 2013, the volume of deals involving an emerging economy acquiror and a developed economy target fell 27.5% in 2013 (after increasing four consecutive years). The volume of deals involving a developed economy acquiror and an emerging economy target declined for the third consecutive year. A number of significant cross-border deals have already been announced in 2014, including the announcement of Lenovo's acquisition of IBM's low-end server business and Lenovo's acquisition of Motorola Mobility from Google.

In the last decade, mega-deals have surged in prominence in the international arena. But along with the proliferation of cross-border mega-deals (such as Verizon's $130 billion acquisition from Vodafone of the 45% interest in Verizon Wireless that it did not already own; Glencore's $46 billion acquisition of Xstrata, SoftBank's $20 billion acquisition of Sprint Nextel Corp and many others) the importance of regulatory issues has also risen in significance. In a trend that was fortunately not as pronounced in 2012 and 2013, a number of significant cross-border deals announced over the past few years, including several mega-deals, were not

consummated. These include the NYSE Euronext-Deutsche Börse AG business combination and AT&T's $39 billion acquisition of T-Mobile USA from Deutsche Telekom AG, both of which were terminated amid regulatory opposition. United Parcel Service's $6.9 billion bid for TNT Express was withdrawn due to concerns from European antitrust regulators

In recent years, friendly mergers have continued to predominate over hostile takeover activity in the cross-border context, although there have` been notable hostile activity and contested situations in cross-border M&A. Major strategic buyers have been responsible for a significant portion of such activity and have had to navigate "overbid" situations. Major hostile cross-border deals include, among others, BHP Billiton's ultimately withdrawn $39 billion offer for Canada's Potash Corporation; Sanofi-Aventis SA's unsolicited (and ultimately friendly and successful) offer for Genzyme; Kraft's hostile (and subsequently friendly and successful) bid for Cadbury; the four-way battle among CF Industries, Calgary-based Agrium, Oslo-based Yara International and Terra Industries (resulting in CF acquiring Terra); Sinosteel's successful hostile acquisition of Midwest Corp.; InBev N.V.'s successful acquisition of Anheuser-Busch; the acquisition by Roche of the shares of Genentech that it did not already own; BHP Billiton Ltd.'s hostile $147 billion bid for Rio Tinto Group (ultimately abandoned); the battle over ABN Amro; and U.K.-based SABMiller's over $10 billion hostile (and ultimately friendly) takeover of Foster's Group of Australia.

Another trend that may have contributed to cross-border M&A activity in recent years are "inversion" transactions in which a publicly traded U.S. parent combines with a smaller 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). U.S. multinationals have long been attracted to the tax benefits available to foreign-parented multinationals, including the ability to access earnings of offshore subsidiaries without incurring incremental U.S. tax and the ability to reduce the U.S. tax base through deductible intragroup payments of interest and royalties.

Under Section 7874 of the Internal Revenue Code, if the historic owners of the U.S. parent hold 80 percent or more of the stock of the foreign acquiring corporation by reason of holding stock in the U.S. parent, the foreign acquiring corporation will be treated as a domestic corporation for U.S. federal income tax purposes (*i.e.*, the inversion will have failed) unless the combined group conducts "substantial business activities" in the country in which the foreign parent is organized. Treasury regulations issued in June of 2012 adopt a bright-line test

pursuant to which substantial business activities are deemed to exist in such country only if at least 25% of the group's employees (by headcount and compensation) and gross assets are located in such country, and at least 25% of group's income is derived from such country. The restrictive nature of the "substantial business activities test" likely would preclude the ability of most U.S. multinationals to engage in a stand-alone inversion transaction (*i.e.*, a transaction following which the former shareholders of the U.S. parent own all or substantially all of the stock of the new foreign parent), and may have created greater emphasis on business combination transactions in which the shareholders of the foreign merger party receive more than 20% of the stock of the combined entity as a means of effecting an inversion.

Notable recent inversion transactions include Eaton Corporation, headquartered in Cleveland, Ohio, combining with Cooper Industries, based in Ireland. Eaton disclosed that it expected to save $160 million in taxes a year as a result of the transaction. In July 2013, Perrigo Company, a Michigan-based pharmaceutical company, announced its business combination with Elan Corporation plc, an Irish drug company. Perrigo disclosed estimated savings (including tax-related savings) of $150 million a year. Actavis plc, a New Jersey-based pharmaceutical company, combined with Warner Chilcott, an Irish pharmaceutical company, and disclosed an estimated $150 million in tax-related savings over two years.

Looking forward, cross-border deals are likely to be driven by strategic investors seeking to streamline their business through spin-offs, carve-outs and divestitures of non-core assets, and/or to make opportunistic acquisitions to increase their market share and scale and to further solidify their market position. Other possible drivers include potential acquirors' strong cash positions from defensive stockpiling (including an accumulation of U.S. Dollars in emerging economies), the search for external growth to replace oft-missing internal growth, the need for heightened access to emerging markets and a desire to capture capital and tax advantages of redomiciling from the United States to a foreign jurisdiction. Consolidation plays will inevitably attract the attention of competition authorities who may be reluctant to approve "synergistic" mergers that may result in significant job loss, even if job preservation is not a part of their mandates.

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. In election years, politics may play a bigger role than usual in transactions involving offshore acquirors or investors, and such deals will accordingly require greater advance planning and sensitivity. 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 at an early stage in the planning process. 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 CFIUS review (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, 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 more active and play a greater role in the current political environment.

In the U.S., the Committee on Foreign Investment in the United States ("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. CFIUS by no means imposes an insurmountable hurdle, notwithstanding some highly publicized examples to the contrary, such as CFIUS's September 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; the unwinding of Sany Group-controlled Ralls Corporation's acquisition of four Oregon wind farm projects; Dubai Ports World's scuttled attempt to buy the U.S. port assets of the Peninsular and Oriental Steam Navigation Company; certain acquisitions involving Huawei, a private Chinese technology company (such as its joint, and ultimately abandoned, bid with Bain Capital for 3Com Corporation and the required unwinding of its acquisition of the assets of 3Leaf Systems, a

U.S. technology company); and the attempt by Northwest Non-Ferrous International Investment Company, a China-based company, to acquire control of U.S.-based mining firm Firstgold.

The preceding examples notwithstanding, foreign acquirors from China, the United Arab Emirates (the country of origin for Dubai Ports World) and other locales have successfully cleared the CFIUS process. For example, Wanxiang Group, China's biggest auto-parts maker, obtained CFIUS approval for its acquisition of most of the assets of U.S. battery-manufacturer A123 Systems Inc. in January 2013, and BGI-Shenzen, a Chinese operator of genome sequencing centers, obtained CFIUS approval for its acquisition of Complete Genomics, Inc., a publicly traded U.S. life sciences company, in December 2012. CNOOC's acquisition of Canadian oil company Nexen was also slowed by the need to secure U.S. national security review even though only a small percentage of Nexen's production and reserves are in the United States, and Canadian regulators had approved the transaction. CNOOC did, however, obtain approval following its agreement to certain conditions. Similarly, Japanese owned Softbank Corp. obtained CFIUS approval to acquire a 70% interest in Sprint following Softbank's agreement to a number of conditions. The highly public $4.7 billion acquisition of Smithfield Foods by Chinese meat producer Shuanghui also underwent a lengthy CFIUS review, but ultimately cleared without conditions. The vast majority of cross-border transactions that are reviewed are cleared within the initial review period of 30 days, and only a small (albeit growing) percentage of transactions require further stages of review and possibly some form of remedial action to be taken.

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. Any filing typically should be preceded by discussions with U.S. Treasury officials and other relevant agencies. Although filings with CFIUS are voluntary, CFIUS also has the ability to investigate transactions on its own initiative, including after the transaction has closed. CFIUS conducted such a post-consummation investigation in Chinese-owned Ralls Corporation's purchase of windfarms near a sensitive Navy flight area in 2012, and ultimately the President ordered that the transaction be retroactively unwound. Proactively suggesting mitigation for any issues early in the review process in order to help shape any remedial measures can be critical in avoiding delay or potential disapproval. In transactions that may involve a CFIUS filing, a carefully crafted communications plan should be put in place prior to any public announcement or disclosure of the pending transactions.

As a CFIUS review is only applicable when the foreign person is acquiring "control" over a 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.

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. acquirors 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 recent failed attempt by Apollo Tyre, an Indian company, to acquire the Cooper Tire and Rubber Company, which is a U.S.-based company but 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. 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.

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. 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. 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, including the 2009 prohibition of Coca-Cola's proposed acquisition of China Huiyuan Juice Group, a leading Chinese juice maker, conditioning its approval of Google's $12.5 billion acquisition of Motorola Mobility on Google's commitment to keep the Android Operating System free for five years, and conditioning its approval of United Technologies' acquisition of Goodrich on a divestiture. China's antitrust laws require that MOFCOM review any acquisition if the combined company would have approximately $63 million in Chinese sales and $1.5 billion in global sales. 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. And the review process itself can take very long, with the review process for the four deals subject to remedies in 2013 ranging from 8 months to 13

months. Also, in March 2011, the Indian Ministry of Corporate Affairs released its competition merger review provisions. While India has yet to assert itself in major cross-border transactions, as an important emerging jurisdiction it is likely to become more active in the pre-merger review. On the other hand, India's increased scrutiny of anticompetitive behavior suggests that India may play a larger role going forward.

Parties involved in multinational acquisitions should prepare for a global competition review, taking into account the divergences in market conditions, substantive antitrust analysis, and process that may exist among the various jurisdictions that review a particular transaction. Company documents, transactional data and the views of customers are important inputs during the review process. In addition, transactions in certain politically sensitive industries, such as oil & gas and pharmaceuticals, have faced heightened scrutiny for a number of years. Antitrust enforcement can be a major stumbling block to consummation of a transaction, and strategies for allocating and addressing regulatory risk (including timing) should be assessed pre-announcement, particularly given the potentially dire consequences to the parties that a prolonged investigation may have.

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 of use. 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. These factors 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.

While volatility in the global credit markets can result in opening and closing of "windows" in which particular sorts of financing are available, overall the volume of financing and the rates at which financing is recently available have been unprecedented and have facilitated acquisitions, particularly by larger, well-established companies and sovereign-affiliated borrowers. In the context of a cross-border transaction, important questions to consider include where financing with the most favorable terms and conditions is available; how committed the financing is or is required to be under local regulation (*e.g.*, the "funds certain" requirement in certain European jurisdictions); which lenders have the best understanding of the acquiror's and target's business; 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). Likewise, the relative ease of structured financing in the U.S. market should benefit an offshore acquiror, with both asset-based and other sophisticated securitized lending strategies relatively easy to implement and available in the market.

Disclosure obligations may also vary across jurisdictions. How and when an acquiror's interest in the target is publicly disclosed should be carefully controlled, keeping in mind the various ownership thresholds that trigger 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. Under the current two-tiered exemptive regime, relief from U.S. regulatory obligations is available when the transaction qualifies 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. 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.

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. takeover regulation are often simply not available to non-U.S. purchasers who buy shares through open market purchases or other routine means not involving fully negotiated, contracted deals. 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.

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.[387] 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.

Also notable is the U.S. Supreme Court's landmark decision in *Morrison* v. *National Australia Bank Ltd.*, 130 S. Ct. 2869 (2010), in which the Supreme Court sharply limited the extraterritorial reach of the U.S. securities laws, particularly Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5. 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-cubed" and "foreign-squared" class actions.

C. Harmonization of Accounting Standards

Recent years featured significant movement towards the creation of global accounting standards. Following the SEC's revision of its treatment of foreign private issuers to permit them to prepare financial statements under International Financial Reporting Standards ("IFRS") without reconciliation to U.S. GAAP, the SEC published a proposed "Roadmap" for the use by U.S. issuers of IFRS, as issued by the International Accounting Standards Board ("IASB"). The Roadmap provided for limited early usage of IFRS by selected issuers and called for the SEC to determine in 2011 whether mandating the adoption of IFRS by U.S. issuers in 2014 would be in the public interest. In February 2010, the SEC issued a formal statement on global accounting standards (the "2010 Statement"), confirming the SEC's view that a single set of high-quality globally accepted accounting standards — based on a convergence of IFRS and GAAP — would be desirable, extending the earliest mandatory adoption date to 2015 instead of 2014 and indicating that the SEC continued to expect to determine in 2011 whether and how to incorporate IFRS into the U.S. financial reporting system. In December 2011, the Staff of the SEC indicated that a final comprehensive report concerning

IFRS was in progress and would likely be published in 2012, and that the Staff continued work on developing a recommended approach to IFRS harmonization for the Commission to consider. Recent statements by the SEC have emphasized that any harmonization framework should, among other things, provide for clear U.S. authority over the standards that apply to U.S. capital markets and a strong U.S. voice in the process of establishing global accounting standards. They have also indicated that retaining U.S. GAAP as the basis for U.S. financial reporting remains under consideration. On July 13, 2012, the SEC's Office of Chief Accountant published its final report on the Work Plan, which indicated that additional analysis would be necessary before any decision is made by the SEC about incorporating IFRS into the U.S. financial reporting system. As of early 2014, no additional analysis has been disseminated by the SEC.

The harmonization of accounting standards may facilitate cross-border M&A. Companies engaged in cross-border transactions often face difficult due diligence and integration questions with respect to accounting standards, and cross-border M&A activity often spurs *de facto* limited, but expensive and time-consuming, convergence among GAAP and IFRS (including as to jurisdictional variants). IFRS as issued by the IASB is not the only form of IFRS, and "home country" interpretations must be attended to with respect to reconciling valuations and ensuring a true — and sustainable — "meeting of the minds" with respect to pre- and post-closing purchase price adjustments.

D. Deal Consideration and Transaction Structures

While cash remains the predominant 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.

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). When shareholder-level taxation proved to be an insufficient impediment to stand-alone "inversion" transactions, Congress enacted Section 7874 of the Code as part of the American Jobs Creation Act of 2004. As described above, Section 7874 can recast a foreign corporation as a domestic corporation if former shareholders of the domestic corporation own at least 80 percent of the stock (by vote or value) of the foreign corporation by reason of holding stock in the domestic corporation and the combined group does not have "substantial business activities" in the foreign country in which the foreign parent is created or organized.

1. All-Cash

All-cash transactions are easy for all constituencies to understand and present no 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.

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.

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., they have not yet been successfully employed in cross-border mergers involving U.S. parent corporations.

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Takeover Law and Practice Endnotes

1 *See CSX Corp.* v. *Children's Inv. Fund Mgmt. (UK) LLP*, 562 F. Supp. 2d 511 (S.D.N.Y.), *aff'd*, 292 F. App'x 133 (2d Cir. 2008).

2 *See Crown Emak Partners, LLC* v. *Kurz*, 992 A.2d 377 (Del. 2010).

3 On March 7, 2011, Wachtell, Lipton, Rosen & Katz filed a rule-making petition with the SEC advocating for changes to the current Schedule 13D rules. That petition proposed that the 10-day window between crossing the 5% beneficial ownership threshold and filing a Schedule 13D be narrowed to one business day consistent with the "prompt" disclosure standard that applies with respect to material amendments to existing Schedule 13D filings, and that the SEC impose a "cooling off period" from crossing the beneficial ownership filing threshold until two business days after the initial Schedule 13D filing is made, during which acquirors would be prohibited from acquiring additional beneficial ownership. The petition also proposed that the SEC modify its current definition of "beneficial ownership" to encompass the ownership of any derivative instrument that includes the opportunity, directly or indirectly, to profit or share in any profit derived from any increase in the value of the subject security, in order to harmonize the definition with the disclosure regimes applicable to other developed financial markets. (The petition is available at http://www.sec.gov/rules/petitions/2011/petn4-624.pdf.) Several memos in support were submitted to the SEC in response to the petition, including by the International Corporate Governance Network (*available at* http://www.sec.gov/comments/4-624/4624-1.pdf), as were several opposition memos by academics including Professors Lucian A. Bebchuk and Robert J. Jackson, Jr. (*available at* http://www.sec.gov/comments/4-624/4624-3.pdf) and Professors Alon Brav and Wei Jiang (*available at* http://www.sec.gov/comments/4-624/4624-2.pdf). In February 2013, the NYSE, the Society of Corporate Secretaries and Governance Professionals and the NIRI filed a joint rule-making petition with the SEC seeking prompt updating of the reporting rules under Section 13(f) of the 1934 Act, as well as supporting a more comprehensive study of the beneficial ownership reporting rules under Section 13. Specifically, the petitioning parties argued that the length of the current 45-day period to file a 13F to report certain investment transactions "is unnecessarily long, and to that extent the current delay period runs contrary to the interests of investors and public companies." (The petition is available at http://www.sec.gov/rules/petitions/2013/petn4-659.pdf). Over a dozen comments were submitted in response to this petition, roughly evenly split between parties (typically companies) in support of the petition and parties (typically investment funds) in opposition.

4 In February 2012, the California State Teachers' Retirement System ("CalSTRS") released a report commenting on corporate pay practices and the say-on-pay vote during the 2011 proxy season. The report makes clear that CalSTRS assumes responsibility for deciding how to respond to the say-on-pay vote of the companies in which it invests. This is another example of a major investor taking direct responsibility for voting proxies, rather than simply outsourcing that decision to non-investor proxy advisory firms. The CalSTRS report identifies the review of pay practices as an "important fiduciary duty" of institutional investors.

5 *See* Matthew D. Cain & Steven M. Davidoff, *A Great Game: The Dynamics of State Competition and Litigation* 4 (2012), *available at* http://ssrn.com/abstract=198475

8; Matthew D. Cain & Steven M. Davidoff, *Takeover Litigation in 2013* (2014), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2377001.

[6] *See* CORNERSTONE RESEARCH, RECENT DEVELOPMENTS IN SHAREHOLDER LITIGATION INVOLVING MERGERS AND ACQUISITIONS 4, 9 (2012).

[7] *See* Cain & Davidoff, *Takeover Litigation in 2013*, *supra* note 5 at 1.

[8] *See* Cain & Davidoff, *Takeover Litigation in 2013*, *supra* note 5 at 4.

[9] *See* Settlement Hearing and The Court's Ruling, *In re Medicis Pharma. Corp. S'holders Litig.*, C.A. No. 7857-CS (Del. Ch. Feb. 26, 2014).

[10] *See* Cain & Davidoff, *Takeover Litigation in 2013*, *supra* note 5 at 3.

[11] *Boilermakers Local 154 Ret. Fund* v. *Chevron Corp.*, 73 A.3d 934 (Del. Ch. 2013). Chancellor Strine did note that plaintiffs can still argue that the application of such provisions could be unreasonable in particular cases.

[12] *See, e.g.*, *In re Transkaryotic Therapies, Inc.*, 954 A.2d 346, 357 & n. 20 (Del. Ch. 2008) (collecting authorities). *See, e.g.*, *Stone ex rel. AmSouth Bancorporation* v. *Ritter*, 911 A.2d 362 (Del. 2006). In *Stone*, the Court noted that "A failure to act in good faith may be shown, for instance, 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 duties." *Id.* at 369 (internal quotations omitted). However, "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." *Id.* at 370. That is, failing to act in good faith does not result, "ipso facto, in the direct imposition of fiduciary liability. The failure to act in good faith may result in liability because the requirement to act in good faith is a subsidiary element, *i.e.*, a condition, of the fundamental duty of loyalty." *Id.* at 369-370 (internal quotations and citations omitted)

[13] *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.").

[14] DEL. CODE ANN. tit. 8, § 141(e) (West 2011).

[15] *See supra* note 14; *see also* Accounting and Auditing Enforcement Release No. 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, 127 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.").

16 *See In re Bally's Grand Derivative Litig.*, C.A. No. 14644, 1997 WL 305803, at *4 (Del. Ch. June 4, 1997) (holding that "decisions by directors to delegate responsibilities to others are normally regarded as exercises of business judgment," but "[t]he board must retain the ultimate freedom to direct the strategy and affairs of the Company, for the delegation decision to be upheld") (internal quotations and citations omitted).

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

18 *Id*.

19 *Id.* at 1143-46.

20 *Smith* v. *Van Gorkom*, 488 A.2d 858, 869 (Del. 1985).

21 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.

22 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").

[23] *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").

[24] *See, e.g.*, *Cede & Co*. v. *Technicolor, Inc. (Technicolor I)*, 634 A.2d 345, 361 (Del. 1993) (describing a "triad" of fiduciary duties: care, loyalty, and good faith).

[25] 911 A.2d 362, 370 (Del. 2006).

[26] *Id.*

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

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

[29] *Id.* at 243.

[30] *Id.* at 244; *see also In re Answers Corp. S'holders Litig.*, C.A. No. 6170-VCN (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.").

[31] 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).

[32] *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*, 535 A.2d at 1341; *Technicolor I*, 634 A.2d at 360-61; *Pogostin* v. *Rice*, 480 A.2d 619, 624 (Del. 1984); *Aronson*, 473 A.2d at 811-12.

[33] *In re Goldman Sachs Group, 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)).

[34] DEL. CODE ANN. tit. 8, § 141(a) (West 2011).

[35] *See, e.g.*, *Aronson*, 473 A.2d at 812-813 & n.6.

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

[37] *In re Cox Commc'ns, Inc. S'holder Litig.*, 879 A.2d 604, 615 (Del. Ch. 2005).

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

[39] *Unocal Corp*. v. *Mesa Petroleum Co*., 493 A.2d 946 (Del. 1985).

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

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

[42] *Id*.

[43] *Kahn ex rel. DeKalk Genetics Corp.* v. *Roberts*, 679 A.2d 460, 465 (Del. 1996).

[44] *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. DeKalk 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.

[45] *Unitrin,* 651 A.2d at 1361.

[46] 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. No. 13656, 1994 WL 698483, at *12 (Del. Ch. Oct. 13, 1994), *rev'd and remanded*, 651 A.2d 1361 (Del. 1995).

[47] *Unitrin,* 651 A.2d at 1387-88, 1387 n.38 (citations omitted).

[48] 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. *Santa Fe*, 1995 WL 334258, at *9-1, *rev'd on other grounds*, 669 A.2d at 71-72 (Del. 1995).

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

[50] *Id*. at 344.

[51] *Id*. at 331.

[52] *Id.* at 344.

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

[54] *Id.* at 55.

[55] *Id.* at 129.

[56] *Id.*

[57] *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 Del. Ch. LEXIS 202, at *5 (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.").

[58] *La. Mun. Police Emps.' Ret. Sys.*, 918 A.2d at 1181 n.10.

[59] 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).

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

[61] *Malpiede* v. *Townson*, 780 A.2d 1075, 1083–84 (Del. 2001).

[62] *Id.* at 1083.

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

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

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

[66] *Lyondell Chem.*, 970 A.2d at 242.

[67] *Id.*

[68] *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).

[69] *Time-Warner*, 571 A.2d at 1140.

[70] *QVC*, 637 A.2d at 34.

[71] *Arnold v. Society for Savings Bancorp, Inc.*, 650 A.2d 1270 (Del. 1994); *accord Wells Fargo & Co.* v. *First Interstate Bancorp*, C.A. No. 14696, 1996 WL 32169 (Del. Ch. Jan. 18, 1996), *dismissed sub nom.*, *In re First Interstate Bancorp Consol. S'holder Litig.*, 729 A.2d 851 (Del. Ch. 1998), *aff'd*, *Bradley* v. *First Interstate Bancorp*, 748 A.2d 913 (Del. 2000).

[72] *Arnold*, 650 A.2d at 1290 (citations omitted).

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

[74] *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).

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

[76] *Smurfit-Stone*, 2011 WL 2028076, at *15.

[77] *Id.*

[78] *QVC*, 637 A.2d at 44.

[79] *Mills Acquisition Co.* v. *Macmillan, Inc.*, 559 A.2d 1261, 1282 n.29 (Del. 1989).

[80] *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).

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

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

[83] *Id.* at 578.

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

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

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

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

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

[89] *Smurfit-Stone*, 2011 WL 2028076, at *17, 18, 22.

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

[91] *Id.*

[92] *Id.*

[93] *Barkan*, 567 A.2d at 1287. (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).

[94] *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").

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

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

[97] *Id.* at 822.

[98] *Id.* at 835.

[99] *Id.* at 836.

[100] *In re Rural Metro Corp. Stockholders Litig.*, C.A. No. 6350-VCL (Del. Ch. Mar. 7, 2014).

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

[102] *Id.* at *23.

[103] *Time-Warner*, 571 A.2d at 1154; *accord Santa Fe*, 1995 WL 334258, at *8 (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*, *both on other grounds*, 669 A.2d 59 (Del. 1995).

[104] *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.

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

[106] *See Chesapeake Corp.*, 771 A.2d at 332 (stating that since the target board did not appear to concentrate on a particular alleged threat until after the defensive measure at issue was adopted and a new set of legal and financial advisors had arrived, the target board had "not come close to demonstrating that it identified this threat *at any time* 'after a reasonable investigation' and 'in good faith'") (emphasis in original) (quoting *Unitrin*, 651 A.2d at 1375).

[107] *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 In re Santa Fe Pac. Corp. S'holder Litig.*, C.A. No. 13587, 1995 WL 334258, at *9 n.7 (Del. Ch. May 31, 1995) (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*, *both on other grounds*, 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).

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

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

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

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

[112] *See In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 52 (Del. 2006) ("Our law presumes that 'in making a business decision the directors of a corporation acted on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the company.' Those presumptions can be rebutted if the plaintiff shows that the directors breached their fiduciary duty of care or of loyalty or acted in bad faith. If that is shown, the burden then shifts to the director defendants to demonstrate that the challenged act or transaction was entirely fair to the corporation and its shareholders."). Note, however, that if the "failure to withstand an entire fairness analysis is *exclusively attributable* to a violation of the duty of care," liability would be exculpable if the corporation has a charter provision authorized by 8 *Del. C.* § 102(b)(7). (emphasis added) *In re Emerging Commc'ns, Inc. S'holders Litig*. C.A. No. 16415, 2004 WL 1305745, at *40 (Del. Ch. June 4, 2004).

[113] *See, e.g.*, *Ivanhoe Partners*, 535 A.2d at 1334.

[114] *See, e.g.*, *Selectica, Inc.* v. *Versata Enterprises, Inc.*, C.A. No. 4241-VCN, 2010 Del. Ch. LEXIS 39, at *48-*50 (Del. Ch. Feb. 26, 2010).

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

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

[117] *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).

[118] For example, in *In re Tele-Communications, Inc. Shareholders Litigation* ("*TCI*"), AT&T acquired Tele-Communications, Inc. in an arm's-length all-stock merger in which the holders of TCI's high-vote shares—including TCI's controlling shareholder—received an approximate 10% premium over the consideration received by the low-vote holders. *In re Tele-Commc'ns, Inc. S'holders Litig. (TCI)*, C.A. No. 16470, 2005 WL 3642727 (Del. Ch. Jan. 10, 2006). 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. In *In re John Q. Hammons Hotels Inc. Shareholder Litigation*, discussed in Section III.B.3, the Delaware Court of Chancery held that entire fairness applied to a merger where the controlling shareholder and the minority shareholders received 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. *In re John Q. Hammons Hotels Inc. S'holder Litig.*, C.A. No. 758-CC, 2009 WL 3165613, *12 (Del. Ch. Oct. 2, 2009); *see also In re John Q. Hammons Hotels Inc. S'holder Litig.*, C.A. No. 758-CC, 2011 WL 227634 (Del. Ch. Jan. 14, 2011). And in *In re Trados Inc. Shareholder Litigation*, the Delaware Court of Chancery held that a common shareholder'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 shareholders' large liquidation preference and allowed them to exit their investment while leaving the common shareholders with nothing, and a majority of the board was designated by preferred shareholders and had other alleged relationships with those preferred shareholders. *In re Trados Inc. S'holder Litig.*, C.A. No. 1512-CC, 2009 WL 2225958 (Del. Ch. July 24, 2009). 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).

[119] *See John Q. Hammons Hotels*, 2009 WL 3165613, at *12 (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."); *Theriault*, 51 A.3d at 1240 (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.")

[120] *Kahn* v. *MFW Worldwide Corp.*, No. 334, 2013, slip op. at 15 (Del. Mar. 14, 2014) (emphasis added).

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

[122] *John Q. Hammons Hotels*, 2009 WL 3165613, at *13 (internal quotations and citations omitted).

[123] *Technicolor II*, 663 A.2d at 1143.

[124] *In re Trados Inc. S'holder Litig.*, 73 A.3d 17, 76 (Del. Ch. 2013) ("Although the defendant directors did not adopt any protective provisions, failed to consider the common stockholders, and sought to exit without recognizing the conflicts of interest presented by the Merger, they nevertheless proved that the transaction was fair" because the common stock had no value at the time of the merger). *But see Oliver* v. *Boston University*, C.A. No. 16570-NC, 2006 WL 1064169 (Del. Ch. Apr. 14, 2006) (awarding nominal damages where process was not entirely fair but there was no economic damage).

[125] *MFW Worldwide*, slip op. at 17.

[126] *Theriault*, 51 A.3d at 1243–44.

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

[128] Approval of a cash-out merger with a controlling shareholder by a majority of the minority shareholders also could shift the burden. *Lynch Commc'n Sys.*, 638 A.2d 1110.

[129] *Id.*

[130] *Theriault*, 51 A.3d at 1243.

[131] *Id.* at 1244.

[132] *MFW Worldwide*, slip op. at 4, 12.

[133] *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); *TCI*, 2005 WL 3642727; *Emerging Commc'ns*, 2004 WL 1305745 (criticizing a special committee that never met to consider the transaction together).

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

[135] *RAA Mgmt., LLC* v. *Savage Sports Holdings, Inc.*, 45 A.3d 107, 116-19 (Del. 2012) (applying New York law but stating that Delaware law is the same).

[136] *Id.* at 115.

[137] Term sheets are often used in lieu of letters of intent, which can spell out the most critical terms of a proposed transaction but, unlike letters of intent, are typically unsigned. Term sheets raise similar issues as letters of intent. Bid procedure letters also fall into the category of preliminary agreements to agree, 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.

[138] *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)).

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

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

[141] *Id.* at 346.

[142] *Id.* at 334.

[143] *Turner Broad. Sys., Inc.* v. *McDavid*, 693 S.E.2d 873 (Ga. Ct. App. 2010).

[144] *Barkan* v. *Amsted Indus., Inc.*, 567 A.2d 1279, 1286 (Del. 1989); *Paramount Commc'ns Inc.* v. *QVC Network Inc. (In re Paramount Commc'ns Inc. S'holders' Litig.)*, 637 A.2d 34, 44 (Del. 1994).

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

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

[147] *In re Fort Howard Corp. S'holders Litig.*, C.A. No. 9991, 1988 WL 83147, at *722 (Del. Ch. Aug. 8, 1988).

[148] *Barkan*, 567 A.2d 1279; *see also Kahn* v. *Caporella*, C.A. No. 13248, 1994 WL 89016 (Del. Ch. Mar. 10, 1994) (suggesting that the *Revlon/QVC* standard may not be met by market check where directors are not kept informed of inquiries; preliminary injunction as to "entire fairness" attack denied).

[149] *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).

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

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

[152] *Barkan* v. *Amsted Indus., Inc.*, 567 A2d. 1279, 1287-88 (Del. 1989).

[153] *Id.* at 1287.

[154] *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).

[155] *In re Plains Exploration & Prod. Co. Stockholder Litig.*, 2013 WL 1909124 (Del. Ch. May 9, 2013).

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

[157] *Koehler* v. *NetSpend Holdings Inc.*, 2013 WL 2181518 (Del. Ch. May 21, 2013).

[158] *Id.* at 19.

[159] *Id.* at 20.

[160] *Id.* at 16.

[161] *See, e.g.,* DEL. CODE ANN. tit. 8, § 253 (West 2010).

[162] 17 C.F.R. § 240.14d-10(a) (2006).

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

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

[165] *In re Pure Res., Inc., S'holders Litig.*, 808 A.2d 421, 445 (Del. Ch. 2002).

[166] *Id*.

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

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

[169] *Id.* at 607.

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

[171] *Id.* at 400.

[172] *See, e.g.*, Transcript of Oral Argument, *Krieger* v. *Wesco Fin. Corp.*, C.A. No. 6176-VCL (Del. Ch. May 10, 2011).

[173] *In re MFW S'holders Litig.*, 67 A.3d 496 (Del. Ch. 2013), *aff'd sub nom. Kahn* v. *M&F Worldwide Corp.*, No. 334, 2013, slip op. (Del. Mar. 14, 2014).

[174] *See M&F Worldwide*, slip op. 18-39.

[175] FactSet Mergers

[176] *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).

[177] *Olson* v. *ev3, Inc.*, 2011 WL 704409 (Del. Ch. Feb. 21, 2011)

[178] *See In re Celera Corp. S'holder Litig.*, C.A. No. 6304-VCP, 2012 WL 1020471, at *6, n.16 (Del. Ch. Mar. 23, 2012) *aff'd in part and rev'd in part*, 59 A.3d 418 (Del. 2012) ("Top-up options may be lawful so long as the option holder first possesses voting control, usually one share more than 50%." *See generally Olson* v. *ev3, Inc.*, 2011 WL 704409, at *1-3 (Del. Ch. Feb. 21, 2011)).

[179] *See* DEL. CODE ANN. tit. 8, § 251(h) (West 2013).

[180] *In re PNB Holding Co. S'holders Litig.*, No. Civ. A. 28-N, 2006 WL 2403999, at *9 (Del. Ch. Aug. 18, 2006).

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

[182] *In re Cysive, Inc. S'holders Litig.*, 836 A.2d 531 (Del. Ch. 2003).

[183] *In re Morton's Rest. Grp., Inc. S'holders Litig.*, 74 A.3d 656, 665 (Del. Ch. 2013).

[184] *In re Morton's Rest. Grp., Inc. S'holders Litig.*, 74 A.3d 656 (Del. Ch. 2013).

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

[186] *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).

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

[188] *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).

[189] *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).

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

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

[192] *M&F Worldwide*, slip op. at 26-27.

[193] *Id.* at 26 n.26.

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

[195] *Beam*, 845 A.2d at 1049-52.

[196] *In re Oracle Corp. Derivative Litig.*, 824 A.2d 917 (Del. Ch. 2003).

[197] *Beam*, 845 A.2d at 1055 (quoting *Lewis* v. *Fuqua*, 502 A.2d 962, 967 (Del. Ch. 1985)).

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

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

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

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

[202] In the case of *In re CompuCom Systems, 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.

[203] *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).

[204] *Cf. Lynch Commc'n Sys.*, 638 A.2d at 1118-21 (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).

[205] *Lynch Commc'n Sys.*, 638 A.2d 1110.

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

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

[208] *Id.* at 97-98.

[209] *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).

[210] *Lynch Commc'n Sys.*, 638 A.2d at 1117.

[211] *See, e.g.*, *In re Rural Metro Corp. Stockholders Litig.*, C.A. No. 6350-VCL, 2014 WL 971718, at *25 (Del. Ch. Mar. 7, 2014).

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

[213] *In re Tele-Commc'ns, Inc. S'holders Litig. (TCI)*, C.A. No. 16470, 2005 WL 3642727, at *10 (Del. Ch. Dec. 21, 2005).

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

[215] *Emerging Commc'ns*, 2004 WL 1305745, at *32.

[216] *Gesoff* , 902 A.2d at 1151.

[217] *TCI*, 2005 WL 3642727.

[218] *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).

[219] *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).

[220] *In re John Q. Hammons Hotels*, 2009 WL 3165613, at *12, *18.

[221] *Id.* at *12.

[222] *Id.*

[223] 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 Hotels*, 2011 WL 227634, at *2.

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

[225] *Id.* at *6.

[226] *Id.* at *7.

[227] *Id*.

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

[229] *Id.* at *16.

[230] *Lynch Commc'n Sys.*, 638 A.2d at 1117.

[231] *In re MFW S'holders Litig.*, 67 A.3d 496, 509 (Del. Ch. 2013).

[232] 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.

[233] *See, e.g.*, *Trans Union*, 488 A.2d at 875.

[234] *QVC*, 637 A.2d at 43.

[235] *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.").

[236] *Time-Warner*, 571 A.2d at 1150 n.12.

[237] *Time-Warner*, 571 A.2d at 1150.

[238] *Id.* at 1153.

[239] *E.g.*, *id.*

[240] *But see Norfolk Southern Corporation, 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 . . .."); *see id.* ("[T]he Pennsylvania statutes . . . were enacted . . . in order to exclude . . . decisions that seem to mandate or suggest that the primary or perhaps only consideration in a situation where there is an attempted takeover or a rival competition for a takeover merger between corporations is what is the best financial deal for the stockholders . . .").

[241] *See Unocal*, 493 A.2d 946; *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.

[242] *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).

[243] *Technicolor II*, 663 A.2d at 1142.

[244] *See, e.g.*, *Trans Union*, 488 A.2d at 876-77.

[245] *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.").

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

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

[248] *TCI*, 2005 WL 3642727, at *10.

[249] *Toys "R" Us*, 877 A.2d at 1005.

[250] *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).

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

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

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

[254] *Id.* at 834.

[255] *In Re Rural Metro Corporation Stockholders Litig., C*.A. No. 6350-VCL, (Del. Ch. Mar. 7, 2014).

[256] *Id.*

[257] *Id.*

[258] *TCI*, 2005 WL 3642727.

[259] *See Netsmart*, 924 A.2d at 177.

[260] *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.").

261 *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 advisers, would have altered the "total mix of available information"); *see also In re CheckFree Corp. S'holders Litig.*, C.A. No. 3198-CC, 2007 WL 3262188 (Del. Ch. Nov. 1, 2007).

262 *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").

263 *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'").

264 Transcript of Oral Argument, *In re BEA Sys., Inc. S'holder Litig.*, C.A. No. 3298-VCL (Del. Ch. Mar. 26, 2008).

265 *Id.*

266 *NACCO Indus., Inc.* v. *Applica Inc.*, 997 A.2d 1, 19 (Del. Ch. 2009).

267 *Revlon*, 506 A.2d 173; *Unocal*, 493 A.2d 946. *See also* Section II.A.2. *But see In re IXC Commc'ns, Inc. S'holders Litig.*, C.A. Nos. 17324, 17334, 1999 WL 1009174, at *10 (Del. Ch. Oct. 27, 1999) (holding that the business judgment standard of review applies to certain deal protection provisions that are not instituted as a response to a perceived threat from a potential acquiror or as a result of a violation of the duty of loyalty or duty of care).

268 *Toys "R" Us*, 877 A.2d at 1016.

269 *See, e.g.*, *In re Cogent, Inc. S'holder Litig.*, 7 A.3d 487, 503-04 (Del. Ch. 2010) (citing *Lear*, 926 A.2d at 120) (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).

270 *In re Answers Corp. S'holders Litig.*, C.A. No 6170-VCN, 2011 Del. Ch. LEXIS 57, at *19 n.52 (Del. Ch. Apr. 11, 2011).

271 *Crawford*, 918 A.2d at 1181 n.10.

272 *Answers Corp.*, 2011 Del. Ch. LEXIS at *19 n.52.

[273] *Dollar Thrifty*, 14 A.3d at 575.

[274] *In re Plains Exploration & Production Co. S'holders Litig.*, C.A. 8090-VCN, 2013 WL 1909124, at *6 (Del. Ch. May 9, 2013).

[275] *Koehler* v. *NetSpend Holdings Inc.*, C.A. No. 8373-VCG, 2013 WL 2181518, at *18 (Del. Ch. May 21, 2013).

[276] *In re Cogent*, 7 A.3d at 502-03.

[277] *Toys "R" Us*, 877 A.2d at 1021.

[278] *In re 3Com S'holders Litig.*, 2009 WL 5173804 at *7.

[279] *Topps*, 926 A.2d at 86.

[280] *Phelps Dodge Corp.* v. *Cyprus Amax Minerals Co.*, C.A. No. 17398, 1999 WL 1054255 (Del. Ch. Sept. 27, 1999).

[281] *Id.* at *5.

[282] *Lear*, 967 A.2d at 640.

[283] *See H.F. Ahmanson & Co.* v. *Great W. Fin. Corp.*, C.A. No. 15650, 1997 WL 305824 (Del. Ch. June 3, 1997).

[284] *NACCO*, 997 A.2d at 19.

[285] *In re Del Monte Foods Co. Shareholders Litigation,* 25 A.3d 813 (Del. Ch. 2011).

[286] *Id.* at 841 (quoting *ACE Ltd.* v. *Capital Re Corp.*, 747 A.2d 95, 105-106 (Del. Ch. 1999)).

[287] *QVC*, 637 A.2d at 47–48.

[288] *Phelps Dodge*, 1999 WL 1054255 at *1.

[289] *Id.*

[290] *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.").

[291] *In re Complete Genomics, Inc. S'holder Litig.*, C.A. No. 7888-VCL (Del. Ch. Nov. 27, 2012).

[292] *Id.*

[293] *In re Ancestry.com Inc. S'holder Litig.*, C.A. No. 7988-CS (Del. Ch. Dec. 17, 2012).

[294] *Koehler*, 2013 WL 2181518.

[295] *Id.* at * 19.

[296] *Cirrus Holding Co. Ltd. v. Cirrus Indus.*, 794 A.2d 1191, 1207 (Del. Ch. 2001)

[297] *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.").

[298] *In re Complete Genomics, Inc. S'holder Litig.*, C.A. No. 7888-VCL (Del. Ch. Nov. 9, 2012).

[299] Oral Argument on Plaintiffs' Motion for a Preliminary Injunction and Rulings of the Court at 133, *In re NYSE Euronext S'holders Litig.*, C.A. 8136-CS (Del. Ch. May 10, 2013).

[300] *In re Compellent Techs., Inc. S'holder Litig.*, C.A. 6084-VCL, 2011 WL 6382523, at *13 (Del. Ch. Dec. 9, 2011).

[301] *Koehler* v. *NetSpend Holdings Inc.*, C.A. No. 8373-VCG, 2013 WL 2181518, at *14 (Del. Ch. May 21, 2013).

[302] *See* DEL. CODE ANN. tit. 8, § 146 (West 2011).

[303] *See* Christina M. Sautter, *Rethinking Contractual Limits on Fiduciary Duties*, 38 Fla. St. U. L. Rev. 55, 91 (2010).

[304] *Omnicare, Inc.* v. *NCS Healthcare, Inc.*, 818 A.2d 914 (Del. 2003).

[305] *Id.* at 946.

[306] *See Monty* v. *Leis*, 123 Cal. Rptr. 3d 641 (Cal. Ct. App. 2011) (quoting *Toys "R" Us*, 877 A.2d at 1016, fn. 68 that *Omnicare* "represents . . . an aberrational departure from [the] long accepted principle.").

[307] *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 Law Rep. 43 (Nov. 8, 2004).

[308] C.A. No. 8373-VCG, 2013 WL 2181518 (Del. Ch. May 21, 2013).

[309] *Id.* at *18.

[310] *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).

[311] *OPENLANE*, 2011 WL 4599662, at *10.

[312] *See* SEC CD&I 239.13, Securities Act Sections (Nov. 16, 2009).

[313] *Toys "R" Us*, 877 A.2d at 980.

[314] *Id.* at 1018.

[315] *In re BioClinica, Inc. S'holder Litig.*, 2013 WL 5631233, at *8 (Del. Ch. Oct. 16, 2013).

[316] Steven M. Davidoff & Christina M. Sautter, *Lock-Up Creep*, 38 J. Corp. L. 681, 686 (2013) ("The period during which matching rights can be exercised varies from transaction to transaction, being anywhere from one to ten days, or longer.").

[317] Telephonic Ruling of the Court, *In re Complete Genomics, Inc. S'holder Litig.*, C.A. No. 7888-VCL (Del. Ch. Nov. 9, 2012) ("*Genomics I*"); Telephonic Oral Argument and the Court's Ruling, *In re Complete Genomics, Inc. S'holder Litig.*, C.A. No. 7888-VCL (Del. Ch. Nov. 27, 2012) ("*Genomics II*")

[318] *In re Bear Stearns Litig.*, 870 N.Y.S.2d at 734-35.

[319] 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).

[320] *IBP, Inc.* v. *Tyson Foods, Inc.*, *(In re IBP, Inc. S'holders Litig.),* 789 A.2d 14 (Del. Ch. 2001).

[321] *Id*. at 68 (footnote omitted). In *Ameristar Casinos, Inc.* v. *Resorts International 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).

[322] *Frontier Oil Corp.*, 2005 WL 1039027, at *35.

[323] 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.

[324] *Hexion Specialty Chems., Inc.* v. *Huntsman Corp.*, 965 A.2d 715 (Del. Ch. 2008).

[325] *Id.* at 738.

[326] *Id.* at 740.

[327] *United Rentals, Inc.* v. *RAM Holdings, Inc.*, 937 A.2d 810 (Del. Ch. 2007).

[328] *Alliance Data Sys. Corp.* v. *Blackstone Capital Partners V L.P.*, 963 A.2d 746 (Del. Ch. 2009), *aff'd*, 976 A.2d 170 (Del. 2009) (TABLE).

[329] *James Cable, LLC* v. *Millennium Digital Media Sys., L.L.C.*, C.A. No. 3637-VCL, 2009 WL 1638634 (Del. Ch. June 11, 2009).

[330] *Consol. Edison, Inc.* v. *Ne. Utils.*, 426 F.3d 524 (2d Cir. 2005).

[331] For a discussion of sample contract language, see Ryan Thomas and 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).

[332] *See Time-Warner*, 571 A.2d at 1140.

[333] *La. Mun. Police Emps.' Ret. Sys.* v. *Laub*, C.A. No. 4161-CC (Del. Ch. filed Nov. 14, 2008).

[334] Transcript of Plaintif's (sic) Motion for Injunctive Relief, *In re Atmel Corp. Shareholders' Litigation*, C.A. No. 4161-CC (Del. Ch. May 19, 2009) .

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

[336] *Versata Enters., Inc.* v. *Selectica, Inc.*, 5 A.3d 586 (Del. 2010).

[337] *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).

[338] *See Hollinger Int'l*, 844 A.2d at 1085-88 (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).

[339] *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.*, 907 F. Supp. 1545 (D. Del. 1995); *Airgas*, 16 A.3d 48.

[340] *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).

[341] *Airgas*, 16 A.3d at 48.

[342] *Id.* at 129.

[343] *Id.*

[344] *Versata*, 5 A.3d at 586.

[345] *Id.*

[346] *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).

[347] *Id.* at 350.

[348] 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.*, 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.*, 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).

[349] *See* Novell, Inc., SEC No-Action Letter, 2000 WL 223715 (Feb. 14, 2000); Atlas Air World Holdings, Inc., SEC No-Action Letter, 2002 WL 1058533 (April 5, 2002); General Dynamics Corp., SEC No-Action Letter, 2001 WL 246749 (Mar. 5, 2001). *But see* Mattel, Inc., SEC No-Action Letter, 2003 WL 1529968 (March 10, 2003).

[350] 17 C.F.R. § 240.14a-8(i)(1).

[351] *CA, Inc.* v. *AFSCME Employees Pension Plan*, 953 A.2d 227 (Del. 2008).

[352] *But see Bebchuk* v. *CA, Inc.*, 902 A.2d 737 (Del. Ch. 2006) (stating in *dicta* that a mandatory shareholder bylaw proposal to CA, Inc. requiring unanimous board approval

of any rights plan was not "obviously invalid" and that the case raised "a highly contentious and important matter").

[353] *See Int'l Bhd. of Teamsters Gen. Fund* v. *Fleming Cos.*, 975 P.2d 907 (Okla. 1999).

[354] *Invacare*, 968 F. Supp. at 1582.

[355] *See AMP Inc.*, 1998 WL 778348, at *14-16.

[356] *JANA Master Fund, Ltd.* v. *CNET Networks, Inc.*, 954 A.2d 335 (Del. Ch. 2008).

[357] *Levitt Corp.* v. *Office Depot, Inc.*, C.A. No. 3622-VCN, 2008 WL 1724244 (Del. Ch. Apr. 14, 2008).

[358] *See* DEL. CODE ANN. tit. 8, § 211(d) (West 2011).

[359] *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).

[360] *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. No. 10189, 1988 WL 383667 (Del. Ch. Sept. 20, 1988).

[361] *See* DEL. CODE ANN. tit. 8, § 141(k)(1) (West 2011).

[362] *Airgas, Inc.* v. *Air Prods. & Chems., Inc.*, 8 A.3d 1182 (Del. 2010).

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

[364] *Id.* at 953 (referring to *Moran* v. *Household International*, 500 A.2d 1346 (Del. 1985)).

[365] Telephonic Hearing on Plaintiff's Motions for Expedited Proceedings and for Temporary Restraining Order and Rulings of the Court, *Edgen Group Inc. v. Jason Genoud*, C.A. No. 9055-VCL (Del. Ch. Nov. 5, 2013).

[366] In *Galaviz* v. *Berg*, the U.S. District Court for the Northern District of California struck down a forum-selection bylaw unilaterally adopted by the board of Oracle on the basis that there was "no element of mutual consent to the forum choice" because "the bylaw was adopted by the very individuals who are named as defendants, and after the alleged wrongdoing took place." 763 F.Supp.2d. 1170, 1171 (N.D. Cal. 2011). In that regard, it is important for boards to adopt such provisions before they become embroiled in litigation.

[367] *Corvex Management LP* v. *Common Wealth REIT* Case No. 24-C-13-001111,

2013 WL 1915769 (Md. Cir. Ct. May 8, 2013).

[368] *Blasius Indus.*, 564 A.2d at 651.

[369] *See, e.g.*, *Kidsco Inc.* v. *Dinsmore*, 674 A.2d 483 (Del. Ch. 1995), *aff'd on opinion below*, 670 A.2d 1338 (Del. 1995) (Order); *Stahl* v. *Apple Bancorp, Inc.*, C.A. No. 11510, 1990 WL 114222 (Del. Ch. Aug. 9, 1990).

[370] As a matter of technical doctrinal nomenclature, *Blasius* is simply a factual subset of *Unocal* analysis, but practitioners often refer to it by name and view it as a special form of *Unocal* review.

[371] *MM Companies, Inc.* v. *Liquid Audio, Inc.*, 813 A.2d 1118 (Del. 2003).

[372] *Id.* at 1120

[373] *Id.* at 1132

[374] *Id.*; *see also id.* ("When the primary purpose of a board of directors' defensive measure is to interfere with or impede the effective exercise of the shareholder franchise in a contested election for directors, the board must first demonstrate a compelling justification for such action as a condition precedent to any judicial consideration of reasonableness and proportionately.").

[375] *Kidsco*, 674 A.2d at 483.

[376] *Id.* at 496.

[377] *See, e.g.*, *Moore*, 907 F. Supp. at 1545; *Buckhorn, Inc.* v. *Ropak Corp.*, 656 F. Supp. 209 (S.D. Ohio), *aff'd*, 815 F.2d 76 (6th Cir. 1987).

[378] *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).

[379] *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).

[380] *Id.* at 315.

[381] *Id.* at 316 n.37.

[382] *Kallick* v. *SandRidge Energy, Inc.*, C.A. No. 8182-CS (Del. Ch. Mar. 8, 2013).

[383] *Moore*, 907 F. Supp. at 1558, 1560.

[384] *Airgas*, 16 A.3d at 48.

[385] 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.

[386] *Moran v. Household Int'l, Inc.*, 500 A.2d 1346, 1350 n.6 (Del. 1985).

[387] *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 exemptive relief to Section 13(d) regulation under the Williams Act; and eliminating the use of "unconventional tender offer" analysis in foreign transactions).