Wachtell, Lipton, Rosen & Katz

Going Private Guide

2019

Preface

"Going private" is a term used to describe a transaction (or series of transactions) in which a stockholder or group of stockholders acquires all of the common stock of a public company, enabling the company to terminate its reporting obligations under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), with respect to its equity interests and to de-list from the applicable stock exchange.

Because such transactions may be viewed as involving conflicts of interest, particularly if management or a company affiliate is leading the buyout team, going private transactions may in certain circumstances be subject to heightened scrutiny under state corporate law, as well as closer review by the staff of the U.S. Securities and Exchange Commission under Rule 13e-3 of the Exchange Act. As a result, going private transactions require both potential bidders and the board of directors of a target company to engage in careful planning throughout all stages of a going private transaction.

This Guide provides an overview of the key considerations involved in preparing for and executing a going private transaction. Specifically, this Guide addresses the preliminary planning matters that a bidder and target company should evaluate when pursuing a going private transaction, such as timing and transaction structures. This Guide also discusses the legal standards of review applicable to transactions involving controlling shareholders and the disclosure and reporting requirements that must be met. Because the vast majority of public corporations are incorporated in Delaware, and many other jurisdictions look to Delaware corporate law for guidance, we focus on Delaware law.

Of course, each transaction brings its own specific issues and constraints, but we hope this Guide provides a helpful resource for parties considering going private transactions, both bidders and bidder groups as well as the boards of directors of public companies, company management and internal legal counsel. This Guide focuses on take-private transactions, and the reader may wish to reference our firm's Takeover Law and Practice guide for a more comprehensive discussion on issues considered in takeover transactions more generally, much of which is relevant to the issues described in this Guide. This Guide reflects developments through March 2019.

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Preliminary Planning Issues

The parties involved in a going private transaction must comply with state and federal laws that apply generally to acquisitions of public corporations. In addition, state courts and the Securities and Exchange Commission (SEC) have established additional requirements for going private transactions, and may subject such transactions—especially if they involve an affiliate as an acquiring party—to increased judicial scrutiny or regulatory review. While specific motives for heightened fiduciary obligations or increased disclosure under federal securities may vary, the general concern is that transactions in which management and/or large stockholders play a significant role "on both sides" of the deal raise particular conflict concerns and inequality of information, which Delaware law and SEC disclosure requirements attempt to balance.

These additional requirements mean that parties contemplating a going private transaction must be attentive to strategic and legal considerations and take care to avoid unintended consequences. Preliminary planning can shape the course of, and determine the success or failure of, a going private transaction. Accordingly, parties considering a potential going private transaction must keep in mind a number of potential factors, including transaction structures and their relative benefits and weaknesses, the risk of litigation and legal scrutiny (standard of review), disclosure obligations, and other considerations. These topics are briefly introduced in this section to provide an overview of the going private process and are discussed in greater detail in subsequent sections of this Guide along with other key topics.

A. Transaction Structures

Going private transactions are generally structured in one of two ways: as (i) a one-step merger or (ii) a two-step tender offer, which is a tender offer for shares of the company not already owned by the bidder followed by a second-step squeeze-out merger where all remaining shares are acquired. The decision to choose one structure over another is generally informed by timing, regulatory considerations, financing requirements and other tactical considerations. These two potential transaction structures are discussed in further detail in Section II.

B. Risk of Litigation and State Law Standards

The stockholder plaintiffs' bar commonly files lawsuits challenging going private transactions, and these suits are generally premised on claims of breach of fiduciary duties, in particular, the duty of loyalty. When a transaction creates actual or potential conflicts of interest for the target's board of directors—for example, going private transactions initiated by a controlling stockholder—a reviewing court may subject a transaction to the stringent "entire fairness" standard of review, unless certain procedural

safeguards have been properly implemented. When the "entire fairness" standard applies to a particular transaction, a target company's board of directors has the burden of demonstrating that the transaction was effected at a fair price and through a fair course of dealing. Under the framework set out in the 2014 decision *Kahn* v. *M&F Worldwide Corp.*, a conflict transaction involving a controlling stockholder will be subject to the more deferential business judgment review (as opposed to entire fairness review) if it has been approved by (1) a well-functioning and fully empowered special committee with arm's-length bargaining power and (2) a majority of unaffiliated public stockholders in a fully informed vote. The presence of either procedural safeguard, but not both, serves to shift the burden of proof to the stockholder plaintiffs in a fiduciary duty action, though the conflicted transaction would remain subject to entire fairness review.

Further detail on the state law standards that apply to going private transactions involving controlling stockholders or affiliates is provided in Section III.

C. Disclosure Obligations

Federal securities laws create additional obligations that apply to going private transactions, specifically, Rule 13e-3 of the Exchange Act, and the filing obligations of Section 13(d) of the Exchange Act. Further, the detailed disclosure obligations of Rule 13e-3 means that materials prepared internally and by outside financial advisors must be prepared with the understanding that they may be required to be disclosed to the SEC and publicly (in addition, of course, in potential litigation discovery). Exceptional care should be used with respect to documentation during all stages of the transaction, and the parties should pay particular attention to initial discussions and negotiations before decisions have been made and specific terms and intentions crystallized. Indeed, in a going private transaction involving an affiliate, the disclosures mandated by Rule 13e-3 will be carefully scoured by plaintiffs' lawyers for potential missteps or perceived conflicts of interest. The enhanced disclosure obligations imposed by Rule 13e-3 and Section 13(d) of the Exchange Act are discussed further in Section IV.

D. Other Considerations

In planning a going private transaction, parties (including bidders and the target board) should also take into account the following considerations, which are explored in greater detail in this Guide:

- The date on which a potential acquiror or acquiror group may be required to file or update a Schedule 13D and make public its intent to undertake, or consideration of, a going private transaction.

- The differences resulting from who (the bidder or the target's board of directors) initiates the going private process.

- The need for, and nature of, any arrangements with the potential acquiror. Financial buyers that seek to acquire a company often need the support of management, while senior executives seeking to take a company private often

require a financial partner. Target company boards will have a significant interest in when any such discussions take place between potential acquirors and the company's executives, and any arrangements between or among members of the acquiror group and management.

- The nature of any retention or rollover arrangements between the acquiring party and management, if desired by the acquiror, and the proper sequencing of these discussions relative to price negotiations and in light of disclosure requirements.

- The anticipated timing of regulatory reviews, including requests for information from antitrust authorities, taking into account potential delays, as well as other governmental consents (such as FCC license transfers).

- If engaging in a merger vote, the appropriate threshold for shareholder approval, as well as dates for the record date and shareholder meeting (features of all merger transactions, and not just going private transactions).

- If engaging in a tender offer, the time needed to solicit tenders and to abide by the prescribed waiting periods under tender offer rules (a feature of all tender offer transactions, and not just going private transactions).

- Potential delays and other complications resulting from litigation.

- The need to balance disclosure obligations with other strategic considerations. For example, the timing of filing (or amending) a Schedule 13D may have a direct and immediate impact on potential acquirors, the target's trading price and the negotiation process. A bidder's indication of its control intent through an amended Schedule 13D filing may put a company in play and result in competing offers, and, at a minimum, will raise substantial public comment and potential volatility in the target's market price.

- Whether the bidder has formed a group, which group may also have potential Schedule 13D filings.

For the target company's board of directors, the following additional factors will impact the timing and strategic consideration of the transaction:

- Whether the board should or must form a special committee of independent and disinterested directors to consider the transaction and, if so, which directors are eligible and should join such committee and when in the process should it be formed.

- Retention of appropriate legal and financial advisors, including whether these should or must be separate independent advisors to the special committee.

- The timing for the target board of directors and, if applicable, the target special committee to undertake a thorough review of the transaction (which may involve updating the target company's long-range plan), as well as the company's other opportunities, in compliance with their fiduciary duties under state law.

- The potential for litigation, related delays and other complications.

- Establishing communications and process protocols, including providing guidelines for senior executives on their engagement with the bidder, or, where a CEO or other senior executive is part of the bidder group, ensuring proper separation of information to create an arm's-length negotiating process.

- The need to manage internal processes, especially when senior executives are or become part of the bidding group. For example, senior executives who are seeking to take a company private may require additional time to obtain approval from the board of directors before engaging in any action that could be viewed as diverting company resources.

In light of these factors, the ultimate process and timing of a going private transaction will depend on the views of the company's board of directors and its advisors, the existence and views of a bidder's equity co-investors (if any), the existence of competitive bidders (if any) and other transaction-specific factors.

II.

Transaction Structures

Going private transactions are generally structured as (1) a one-step voted merger or (2) a two-step tender offer, which is a tender offer followed by a back-end squeeze-out merger. In a going private transaction, the legal structure may have important consequences, including the tax treatment, the speed at which the transaction will be completed, and potential litigation risks.

A. One-Step Merger

A one-step merger is a creature of state statute that provides for the assumption of all of the non-surviving entities' assets and liabilities by the surviving entity. A merger is effectively the acquisition of all assets and an assumption of all liabilities of one entity by another, except that, in a merger, the separate legal existence of one of the two merger parties ceases upon consummation of the merger by operation of law. A statutory long-form merger typically requires the target's stockholders to vote on the merger proposal at a stockholder meeting after the preparation (and potential SEC review) of a proxy statement. In addition, most states, including Delaware, subject to various exceptions, provide that the target stockholders will have appraisal rights should they vote against the proposed merger.

Most commonly, statutory mergers are structured so that the constituent entities to the merger are the target and a subsidiary of the acquiror (a so-called "triangular" merger), in lieu of the acquiror directly participating. A forward triangular merger involves the target merging with and into a subsidiary of the acquiror, with the subsidiary as the surviving entity. A reverse triangular merger involves a subsidiary of the acquiror merging with and into the target, with the target as the surviving entity. Choosing a merger structure is a deal-specific decision that is primarily driven by income tax considerations and sometimes by concerns relating to how anti-assignment and change-of-control provisions in critical target contracts may be triggered or not triggered if one form is chosen over the other.

In a going private transaction structured as a long-form one-step merger, the bidder would seek to negotiate a merger agreement with the disinterested and independent members (or a special committee) of the target's board of directors. As discussed in Section III.A, going private transactions involving a controlling stockholder or an affiliate of the company may be viewed as creating a conflict of interest for the target's board of directors and may be subject to entire fairness review. If the entire fairness standard of review is applied to a transaction, the target's board of directors must demonstrate that the transaction was at a fair price and a result of a fair process. However, as discussed further in Section III.A, a conflicted transaction involving a controlling stockholder will be subject to the more deferential business judgment review if it has been approved by (1) a well-functioning fully disinterested and empowered special committee with arm's-length bargaining power and (2) a majority of unaffiliated public stockholders in a fully informed vote, and such transaction parameters were

established early enough in the process. Accordingly, in practice, a target in a potential going private transaction often creates a special committee composed entirely of independent and disinterested directors.

The one-step merger also requires a stockholder vote and, for the reasons discussed in Section III.B, the target's board of directors may also seek to have the merger approved by a majority of unaffiliated stockholders. In connection with a stockholder vote, the target company must file a proxy statement on Schedule 14A with the SEC. The proxy statement would provide information about the target's stockholders meeting convened to approve the merger agreement and transactions contemplated therein, including detailed information concerning the acquiror and the proposals that will be brought at the special meeting. In addition, the proxy statement, which includes a proxy card, is used to solicit proxies from each target stockholder for voting on the proposals presented at the special meeting. If the going private transaction involves an affiliate of the company, the SEC also requires the company to prepare and distribute to all minority stockholders an information statement in compliance with Rule 13e-3 of the Exchange Act at least 20 calendar days before the target's board may submit the transaction to a stockholder vote. The SEC reviews all Rule 13e-3 transactions carefully, so additional time should be factored into the transaction timeline to address SEC comments. As discussed in Section IV.A, Rule 13e-3 transactions also require extensive disclosure that is intended to give minority stockholders a comprehensive and detailed history of the proposed transaction and of preliminary contacts and negotiations (including those with third parties in certain cases) preceding and leading up to it. The breadth and depth of the Rule 13e-3 disclosure requirements, and the potential implications thereof, are significant and must be kept in mind by all participants during the process.

B. Two-Step Tender Offer (Tender Offer Followed by Back-End Squeeze-Out Merger)

A going private transaction can also be effected by way of a "two-step" tender offer, in which the acquiror makes a direct offer to the target's public shareholders to acquire their shares, commonly conditioned on the acquiror acquiring at least a majority of the target's common stock upon the close of the tender offer. In cases where, upon consummation of the offer, the acquiror holds at least the statutorily prescribed percentage (typically 90% for a short-form merger, or a majority in the case of a transaction effected pursuant to Section 251(h) of the DGCL, as discussed below) of each class of target stock entitled to vote on the merger, the acquiror can complete the acquisition through a merger without a shareholder vote promptly following consummation of the tender offer, thereby avoiding the need to incur the expense and delay of soliciting proxies and holding a stockholders' meeting to approve the second-step merger.

In order to overcome shortfalls in reaching a short-form merger threshold of 90%, the market has historically relied upon workarounds that were commonplace features of merger agreements contemplating such tender offers before DGCL 251(h) became available. Namely, the merger agreement may provide: for a "subsequent offering

period" (provided for in Exchange Act rules) during which the acquiror may purchase additional tendered shares following the close of the initial tender period; for a "top-up option," which permits the acquiror to purchase newly issued shares directly from the target in order to reach the requisite threshold; or for a "dual track" process, which begins the process for a one-step merger in conjunction with that of a two-step tender offer followed by a merger.

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

By eliminating, in applicable transactions, the need to obtain the 90% threshold, Section 251(h) has significantly diminished the prominence of the workarounds noted above. The provision adds speed and certainty to the applicable acquisition by allowing the squeeze-out merger to be completed substantially simultaneous with the completion of the tender offer without having to wait for a stockholder vote, the result of which—because the acquiror already holds sufficient shares to approve the merger at a stockholders' meeting—is a foregone conclusion. Despite their reduced importance, the subsequent offering period, top-up option and dual-track structure remain relevant because Section 251(h) may not always be available or optimal for the parties. For one thing, it would not be available for targets that are not incorporated in Delaware (or another state that has adopted a provision similar to Section 251(h)). Section 251(h) is likewise unavailable if the target's charter expressly requires a stockholder vote on a merger or if the target's shares are not publicly listed or held by more than 2,000 holders.

Amendments to the DGCL in 2014 and 2016 expanded the scope of transactions that could be effected under Section 251(h). Notably, the 2014 amendments clarified that, for purposes of determining whether sufficient shares were acquired in the first-step tender offer, shares tendered pursuant to notice of guaranteed delivery procedures cannot be counted by the acquiror toward the threshold until the shares underlying the guarantee are actually delivered. Amendments exempting "rollover stock" from the requirement that all non-tendering shares receive the same amount and kind of consideration as those that tender, may increase the appeal of two-step structures to private equity acquirors—which sometimes seek to have target management roll over some or all of their existing equity in connection with an acquisition to properly incentivize the management team to continue increasing the value of the target's equity post-acquisition. The 2016 amendments also permit rollover stock to be counted toward satisfaction of the requirement that the acquiror own sufficient shares following completion of the tender

offer to approve the second-step merger in situations where rollover stock is exchanged following completion of the tender offer.

A going private transaction involving a controlling stockholder or "affiliate" that is structured as a tender offer typically would involve the following documents:

- Schedule TO (tender offer statement), which is filed by the bidder, generally incorporates information by reference to the Offer to Purchase (described below) and requires the bidder to complete certain disclosure items set forth in Regulation M-A, the SEC's integrated set of disclosure requirements for tender offers.

- Offer to Purchase, an exhibit to Schedule TO, sets out the terms of the transaction and is the primary disclosure document for the target company's stockholders. The Offer to Purchase includes, among other things, information as to the identity and background of the parties, the material terms of the transaction (including conditions to completing the tender offer), a background describing the process and events leading up to the transaction, the bidder's plans or proposals concerning the target, and the source and amount of the bidder's funds.

- Schedule 14D-9, which is a responsive filing made by the target, discloses the target board of director's position on the tender offer. The target's board must indicate whether it recommends, opposes, is unable to take a position on the tender offer or is neutral. The Schedule 14D-9 must be filed within 10 business days from the commencement of the tender offer, and any changes to the board's position must be filed in an amendment to the Schedule 14D-9. Before filing the Schedule 14D-9, the target's board may issue a "stop-look-and-listen communication" requesting that its stockholders not decide on the tender offer until the board makes its recommendation on Schedule 14D-9. In a negotiated transaction, the Schedule 14D-9 is typically mailed together with the Offer to Purchase to the target's stockholders.

- Schedule 13E-3 jointly filed by the bidder(s) and the target company, incorporates by reference relevant information in the Schedule TO, the Offer to Purchase and the Schedule 14D-9. The Schedule 13E-3 includes, among other things, information on the purposes of the transaction, the fairness of the transaction, and reports, opinions, appraisals and negotiations provided and entered into in connection with the transaction.

- Letter of transmittal and accompanying materials detail the process for stockholders to tender their shares.

For reference, the relative strategic advantages and disadvantages of a one-step merger and a two-step tender offer / back-end merger are listed in the table below:

One-Step Merger	Two-Step Tender Offer / Merger
Advantages	
• Useful if a longer period of time between signing and closing is needed to obtain regulatory or other third-party approvals because interloper risk is eliminated at the time of the stockholder vote • Financing simpler, particularly in the case of highly leveraged transactions • Best price rule is not implicated (*e.g.*, if management equity rollovers are contemplated, one-step merger may be preferred)	• Can commence stockholder solicitation activity prior to any SEC review • No stockholder vote provides for faster execution and greater deal certainty • Useful in transactions where regulatory approvals will not cause closing delay
Disadvantages	
• Often subject to SEC review and approval, particularly where there is stock consideration • Longer timeframe to convene and hold a shareholder meeting (also creates additional expenses)	• Potential for hold-ups if the tender offer is conditioned on 90% tender in the first step (and a top-up option is not available) to permit the acquiror to implement a short-form merger in the second step (though the hold-up issue would be mitigated if the two-step merger would be effected pursuant to 251(h)) • From the acquiror's perspective, target's "fiduciary out" remains open until the end of the offer (*i.e.*, closing, which may be longer than in a typical merger situation in the event of regulatory delays) • Tender offers are subject to the "best price rule," so the bidders may have less flexibility in determining the form and amount of consideration (as compared to a one-step merger)

One-Step Merger	Two-Step Tender Offer / Merger
	• Federal margin rules may impose certain impediments on the acquiror's ability to pledge all of the company's assets to its lenders at the initial closing or provide its lenders full covenant coverage, among other complicating factors

C. Considerations in Selecting a Merger vs. a Tender Offer Structure

1. Speed

Depending on the circumstances, a tender offer structure can lead to a transaction being completed faster than a long-form merger. This is because the stockholder vote contemplated by a merger requires the filing, and potential review by the SEC, of a proxy statement, followed by a stockholder solicitation period. In contrast, a tender offer statement for an all-cash tender offer can usually be mailed to stockholders within a week of the parties reaching agreement, and any SEC review is typically conducted during the tender offer period (which is required to be a minimum of 20 business days under the federal securities laws),[1] even if the transaction involves an "affiliate" for purposes of Rule 13e-3 of the Exchange Act and the bidder must provide the information required by Rule 13e-3. Additionally, amendments to the tender offer rules 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 initial filing of a registration statement, rather than upon effectiveness of the registration statement following SEC review. If an acquiror commences an exchange offer on the basis of an initial registration statement, the SEC typically will endeavor to work with an offeror to clear the registration statement in time for the exchange offer to be completed within 20 business days of commencement, although this outcome is not assured. As a result, absent any requisite third-party approvals or regulatory concerns, a tender offer can result in time savings.

However, a two-step structure involving a tender offer is not always preferable to or faster than a one-step merger; the decision of which structure to employ must be made in light of the particular circumstances of the transaction. For example, on the one hand, 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 "squeeze-out" merger, additional time would be needed to complete the back-end merger structure. On the other hand, a one-step merger would permit the parties to obtain shareholder approval during the pendency of the regulatory process, and then close the

[1] 17 C.F.R. § 240.14e-1(a).

transaction promptly after obtaining regulatory approval. An acquiror may prefer a one-step 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 and the risk that market changes make the offer less attractive to target shareholders so long as the tender offer remains open. In addition, if there is a possibility of a time gap between the closing of the tender offer and the closing of the second-step merger, the tender offer structure poses financing-related complications—albeit ones that have been manageable in most instances—because financing for the tender offer will be needed at the time of its closing, before the acquiror has access to the target's balance sheet; the Federal Reserve Board's margin rules restrict borrowings secured by public company stock to 50% of its market value. Finally, the length of time between signing and closing a one-step merger may depend on the type of consideration. The SEC recently has declined to review and provide comments on all-cash merger proxy statements with increasing frequency. In 2018, the SEC provided comments on less than 10% of proxy statements for all-cash transactions, a decline from approximately 23% in 2016. The increased likelihood that the SEC will not review an all-cash merger proxy statement may change the calculus of whether to structure an all-cash deal as a one-step merger or a two-step tender offer, by decreasing the delay between signing and closing of all-cash mergers.

2. Dissident Shareholders

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

- 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.

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

- Recent experience indicates that dissident shareholders may be less likely to try to "game" a tender offer than a merger vote, and therefore the risk of a "no" vote (*i.e.*, a less-than-50% tender) may be lower than for a traditional voted-upon merger.

3. The "Best Price Rule"

Tender offers, unlike merger transactions, are subject to Rule 14d-10, which is commonly known as the "best price rule." The best price rule generally requires that

"[t]he consideration paid to any security holder for securities tendered in the tender offer is the highest consideration paid to any other security holder for securities tendered in the tender offer," and that all shareholders involved must have an equal right to elect the type of consideration from among those offered.[2]

The best price rule specifically permits the negotiation, execution or amendment of employment compensation, severance or other employee benefit arrangements, or payments made or to be made or benefits granted or to be granted according to any such arrangement, with respect to any shareholder of the target company, as long as the amounts payable under any such arrangements are:

- paid or granted as compensation for past services performed, future services to be performed, or future services to be refrained from performing, by the securityholder (and matters incidental thereto);

- not calculated based on the number of securities tendered or to be tendered in the tender offer by the securityholder; and

- approved solely by independent directors via the compensation committee (or similar committee of independent directors) of the target company (regardless of whether or not the target company is a party to the arrangement) or, if the acquiring entity is a party to the arrangement, then by such same or similar committee of the acquiring entity.[3]

It is important to note that this "best price safe harbor rule" covers payment for options, restricted stock and other equity-based compensation made in connection with a tender offer, as long as the enumerated requirements are met. In addition, the SEC has made expressly clear that these employment compensation, severance and other employee benefit arrangements may be conditioned upon the completion of the tender offer, as long as they are not conditioned on the recipient of the compensation, severance or benefit under the approved arrangement tendering stock in the offer.

A going private transaction may be challenged as violating the best price rule when it involves a rollover of securities by the target's directors and/or senior management. Such individuals almost uniformly own stock of the target company, and may seek (or be asked) to participate in the newly private company. In a management buyout, senior management would seek to exchange their shares in the target company for shares in the acquisition vehicle. Similarly, private equity firms often permit or require management to roll over all or a portion of their equity into equity of the

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[2] 17 C.F.R. 240.14d-10(a)(2).

[3] 17 C.F.R. 240.14d-10(d)(1) and (2)(i). Also note that if the target company or acquiring entity is a foreign private issuer, any or all of the members of the board of directors or any committee thereof authorized to approve employment compensation, severance or other employee benefit arrangements under the laws or regulations of the home country may approve the arrangement in satisfaction of this safe harbor rule.

acquisition vehicle, rather than selling shares in the deal. Because in either such transaction, management intends to roll over outstanding securities in the target company that it already holds (which may include securities that were not acquired through the vesting of equity-based compensation awards in the target company), the securities in the newly private company that management receives could be viewed as additional consideration paid to management if management's securities are tendered in the tender offer, and not amounts payable in connection with an employment compensation, severance or employee benefit arrangement that would be excepted from the best price rule under the best price safe harbor rule described above.

To resolve this potential violation of the best price rule, because Rule 14d-10 applies only to "securities tendered in a tender offer," acquirors in certain going private transactions have taken the position that a management rollover of equity would not fall afoul of Rule 14d-10 so long as management commits not to tender in the offer itself and is only bought out in a back-end merger. As a result, tender offer transactions involving management rollovers typically provide for the execution of non-tender and support agreements prior to or concurrently with the execution of the merger agreement with the target company, pursuant to which the supporting management shareholder agrees not to tender its shares into the tender offer. Acquirors also have contended that, if approved by an independent committee as a compensatory arrangement, management rollovers could be covered by the best price safe harbor rule described above.

However, this approach to management rollovers in tender offer transactions is not without some risk. In the acquisition of Epicor by Apax in 2011, prior to entering into the merger agreement, Apax Partners entered into non-tender and support agreements with three shareholders of Epicor holding approximately 21% of Epicor's outstanding shares—two directors of Epicor and the son of one of the directors. Under the non-tender and support agreements, these three shareholders agreed not to tender their shares in the tender offer and agreed to vote in favor of the transactions. In exchange, the shareholders would receive, promptly following the closing of the offer, cash in an amount per share equal to the offer price (without interest). The merger agreement, on the other hand, provided that, immediately following the closing of the offer, the shareholders would be paid cash and/or securities of parent in exchange for their Epicor shares.

To help insulate the agreement against purported violations of the best price rule, the Epicor non-tender and support agreements expressly stated that the non-tender and support agreements were executed before the merger agreement and that the supporting shareholders would not tender any of their shares into the tender offer. Nevertheless, prior to the closing of the tender offer, four shareholder lawsuits were brought against the company, which were settled for $18 million in cash in May 2014. The lawsuits suggest that non-tender and support agreements may create litigation risk and potentially result in disruptions to the transaction. Consequently, in the absence of a clear SEC rule that management rollovers are exempt from the best price rule, acquirors have generally declined to structure acquisitions as two-step deals where management rollovers are present.

D. Partial Buyouts with a Public or Private Stub

Going private transactions may be criticized by shareholders, hedge funds and proxy advisory firms because they preclude the target's shareholders from continuing to participate in the future growth of the target. While examples are few and far between, it is possible to complete a buyout transaction while leaving a public stub outstanding. In this structure, a target's shareholders are given the opportunity to retain a minority equity stake in the newly formed acquiring parent company acquisition vehicle, after the going private transaction is consummated. The terms and amount of the "stub equity" option offered to target shareholders can be varied to suit the particular needs of the parties.

In the 2007 proposed acquisition of Harman International Industries by KKR and Goldman Sachs Partners, which was ultimately not completed for unrelated reasons, Harman's shareholders were to be given the right (but not the obligation) to elect to exchange up to approximately 12.5% of Harman shares for stock of the newly formed acquiring parent company. The stock portion of the transaction was to be entirely optional, and Harman shareholders were to have the right to elect to receive only cash, a combination of cash and stock or only stock (with stock consideration to be prorated if oversubscribed). The new shares were to be registered with the SEC, but not listed for trading on a public exchange. Similarly, in Apollo Management LP's 2007 acquisition of Countrywide PLC, shareholders were given the opportunity to receive all or part of their consideration in the form of the unlisted securities of the acquisition vehicle, with the stub equity accounting for a 45% interest in the newly formed parent company. Apollo decided to offer stub equity to Countrywide shareholders in response to several takeover proposals from competing bidders.

As the Harman and Countryside examples illustrate, there are several situations in which a public stub may be strategic. By offering target shareholders who have long-term investment horizons an equity stake in the target company, the acquiror may be able to outmaneuver competing bidders. A public stub also provides acquirors with greater flexibility in structuring a deal. Assuming that shareholders elect to subscribe for the equity rollover portion, the structure also has the advantage of decreasing the amount of cash that the acquiror will have to fund. Depending on how the deal is structured, shareholders may also be able to exchange their shares in the target for shares in the newly formed public company on a tax-free basis.

Maintaining a public stub, however, may have downsides for the acquiror. Shares in the acquisition vehicle offered to the target shareholders in exchange for shares in the target will typically be subject to ongoing SEC reporting requirements. The company will also be subject to ongoing SEC and exchange rules regarding corporate governance. Additionally, unlike in a private company, the directors of the company in which the target shareholders now own equity will also be subject to ongoing fiduciary duties with respect to the company's treatment of its minority shareholders,[4] and the company's

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

controlling shareholders will similarly have fiduciary duties to the minority.[5] For instance, in the 2008 acquisition of Clear Channel by Thomas H. Lee Partners LLP and Bain Capital Partners LLC, the acquirors left an 11% public stub in Clear Channel's publicly traded subsidiary, Clear Channel Outdoor. To aid Clear Channel with its large debt burden, Clear Channel entered into a cash sweeping arrangement with Clear Channel Outdoor, which effectively allowed Clear Channel to borrow money from its subsidiary at an interest rate of 9.25% (compared with the roughly 18% yield demanded by the market for Clear Channel bonds due in 2016). A group of shareholders who owned a public stub in the subsidiary filed a claim alleging that the arrangement gave unduly favorable treatment to the parent holding company Clear Channel. The parties eventually settled the dispute, as a result of which Clear Channel made a $200 million payment to shareholders and agreed to make additional monthly and annual reporting on the company's liquidity position.[6] In addition, Clear Channel Outdoor was entitled to create a committee to oversee the ongoing arrangement, and the committee was entitled to demand payment or raise interest rates if the loan exceeded certain specified thresholds.

While the buyout with public stub will not be ideal or practical in most situations, it is a creative alternative that a bidder may want to consider in today's highly competitive environment.

As an alternative to a public stub, the company may wish to consider retaining a private stub and deregistering its outstanding securities. The SEC will allow the company to suspend its SEC reporting obligations if (i) its registered securities are held by fewer than 300 record holders, (ii) the company can certify to the SEC that it had filed all required reports for the most recent three fiscal years, and (iii) the company has not had a registration statement for that class of securities become effective under the Securities Act during the current fiscal year. A buyout with a private stub will free the company of its SEC reporting obligations but, because private stub equity will be less liquid than the company's previously listed equity, certain institutional holders—such as mutual funds—may be restricted from holding certain amounts or any private stub equity. Other shareholders may also prefer to be cashed out, especially if they anticipate that their holdings will be diluted by future capital contributions.

E. Tax Considerations

Tax efficiency—for the company, the target shareholders and the investors—is a goal in any going private transaction. For the shareholders, this entails tax-efficient receipt of cash and, for shareholders who continue to hold a stake in the company, a tax-free rollover of their shares.

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5 *See Kahn* v. *M&F Worldwide Corp.*, 99A.3d 635 (Del. 2014).

6 Vipal Monga, Clear Channel Settlement Leaves Buyout Firms with New Reporting Burden, WALL STREET JOURNAL (Apr. 3, 2013), http://blogs.wsj.com/cfo/2013/04/03/buyout-firms-under-new-disclosure-burden-in-clear-channel-settlement.

A going private transaction generally does not result in current tax for the company itself. But, steps can be taken to enhance tax efficiency going forward for the company. For instance, if it is desired to avoid closing the target's taxable year, a holding company would generally not be used to acquire the public company target.

For investors, it may be desirable to style a portion of their equity investment as straight preferred stock or participating preferred stock (generally, a preferred share and a common share stapled together) in order to enhance the likelihood that initial dollars received on a liquidity event are a tax-free return of capital.

For shareholders, tax efficiency entails tax-efficient receipt of cash and, for shareholders who continue to hold a stake in the company, a tax-free rollover of their shares. Shareholders fall into three categories: shareholders who are cashed out entirely, shareholders who roll over all their shares and shareholders who receive part-cash and part-stock in the transaction. For shareholders who are cashed out entirely, the transaction is generally straightforward, giving rise to capital gain or loss and full recovery of the shareholder's tax basis. If the shareholder held the shares for more than one year, the sale will generally be eligible for long term capital gains rates of 20%.

By the same token, for shareholders who roll over all their shares, *i.e.*, who receive no cash at all, the transaction will generally be tax-free. Indeed, even if a newly formed corporation is created to acquire the historic corporation, it is generally possible to have a historic shareholder receive shares of the newly formed corporation in exchange for the shareholder's historic stake on a tax-free basis.

The analysis is more complicated for shareholders who roll over a portion of their shares and receive cash for the balance. Whether the receipt of the cash is viewed as a capital gain transaction or a dividend to such a shareholder can depend on the structure and on how much the shareholder's percentage interest in the company has gone down by reason of the transaction.

Multi-jurisdictional tax considerations can also come into play in a going private transaction. For example, insofar as the transaction is treated as a dividend, withholding tax may apply to foreign holders. As mentioned above, though, where a holder is cashing out entirely, the transaction should not be treated as a dividend.

Cash held in foreign subsidiaries of a domestic target can potentially be used to fund a portion of the deal consideration. Under legislation enacted in December 2017, the United States generally does not tax a domestic corporation upon the receipt of a dividend from its foreign subsidiary, but tax and other frictions affecting the ability to access such cash could nonetheless come into play and be critical in determining whether or how much of a premium could be paid in a transaction.

Taking a foreign company private can be challenging in jurisdictions where it is impossible to squeeze out minority holders. Most foreign jurisdictions have rules to squeeze out a public minority at some threshold of ownership by the acquiror, but in many jurisdictions, the threshold is much higher than under Delaware law. For example,

in order to squeeze out a public minority of a French company, the acquiror must own 95% of the target. By the same token, a French acquiror cannot file consolidated tax returns with a French subsidiary, unless it owns at least 95% of the French subsidiary. Thus, the inability to squeeze out minority owners can create impediments to tax efficiency going forward.

It may be desirable to consider going private by having a newly formed foreign company acquire the domestic target. Having a foreign company as the new "topco" may provide tax efficiencies going forward. The December 2017 legislation mentioned above reduced the United States federal corporate income tax rate for domestic corporations to 21 percent and made other changes that together make it more difficult to analyze whether a foreign parent is more tax-efficient than a domestic parent. Moreover, the IRS has released a series of limitations on putting in place a foreign parent, but a transaction in which the newly formed foreign acquiror cashes out all the historic shareholders of the domestic target may be able to succeed.

Finally, if the company operates in multiple jurisdictions, there may be scope for "pushing down" acquisition debt to jurisdictions where the company can make efficient use of the interest deductions, whether through third-party borrowings in the local jurisdictions or intercompany debt.

III.

State Law Standards Regarding Going Private Transactions

This section provides an overview of the entire fairness standard and the principal case law on burden shifting in going private transactions. It then discusses key considerations when establishing and negotiating with a special committee of the target's board of directors and in determining whether to condition a transaction on approval of a majority of the outstanding unaffiliated shares, and provides an overview of shareholder remedies under Delaware law.

A. Entire Fairness

The "entire fairness" standard is "Delaware's most onerous standard [of review]."[7] It imposes the burden of proof upon directors to show the fairness of both the price and process of the transaction they approved. A court will review a board's actions under the entire fairness standard in the following situations:

- when a majority of the board has an interest in the decision or transaction that differs from the stockholders in general;
- when a majority of the board lacks independence from or is dominated by an interested party;
- when the transaction at issue is one where the directors or a controlling stockholder "stand[] on both sides" of a transaction; or
- when a controlling stockholder receives additional consideration to the detriment of the other stockholders.[8]

There is no bright-line test to determine whether an individual director is conflicted, or a majority of directors are conflicted, for purposes of determining whether the entire fairness standard will be applied. A conflict must generally be "material" if it is to be considered disabling,[9] although in some cases, self-dealing by a director standing on both sides of the transaction may suffice to disable that director, regardless of

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

[8] *See In re Martha Stewart Living Omnimedia, Inc. Stockholder Litig.*, Cons. C.A. No. 11202-VCS, 2017 WL 3568089, at *11 (Del. Ch. Aug. 18, 2017) (noting that a controller not standing on both sides of the transaction "can nonetheless 'compete' with the minority by leveraging its controller status to cause the acquiror to divert consideration to the controller that would otherwise be paid into the deal").

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

materiality.[10] Potential conflicts can take many shapes, including when a director receives certain payments,[11] has certain family relationships with,[12] or has certain significant prior business relationships with, a party to the transaction,[13] and other instances where a director will benefit or suffer a detriment in a manner that is not aligned with the interests of the public stockholders. A key consideration is whether the director can be said to stand on both sides of the transaction in question, or whether he or she has obtained some benefit not ratably shared with the public stockholders.

For example, in *In re Trados Inc. Shareholder Litigation*, the Delaware Court of Chancery applied entire fairness review to a board's decision to approve a merger that provided consideration to members of management and the company's preferred stockholders, where a majority of the directors were affiliated with either management or the preferred stockholders.[14] On the other hand, directors' mere ownership of different classes of stock, or of common stock rather than preferred stock, will not necessarily trigger entire fairness review, absent a showing that the directors' holdings of different classes of stock were sufficiently material to make it improbable that the directors could fulfill their obligation to act in the collective best interest of holders of common stock.[15]

Entire fairness review can be triggered even though a majority of directors are disinterested if the conflicted directors control or dominate the board, or if one or more of the conflicted directors failed to disclose his or her interest:

> [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.[16]

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[10] *See Harbor Fin. Partners* v. *Huizenga*, 751 A.2d 879, 887 & n.20 (Del. Ch. 1999); *see also Cede & Co.* v. *Technicolor, Inc.*, 634 A.2d 345, 362 (Del. 1993), *decision modified on reargument*, 636 A.2d 956 (Del. 1994).

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

[12] *See, e.g.*, *Harbor Fin. Partners*, 751 A.2d 879.

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

[14] *In re Trados Inc. S'holder Litig.*, 73 A.3d 17 (Del. Ch. 2013).

[15] *See Solomon* v. *Armstrong*, 747 A.2d 1098, 1118 (Del. Ch. 1999), *aff'd*, 746 A.2d 277 (Del. 2000); *In re Gen. Motors Class H S'holders Litig.*, 734 A.2d 611, 617 (Del. Ch. 1999); *see also LC Capital Master Fund, Ltd.* v. *James*, 990 A.2d 435, 451 (Del. Ch. 2010).

[16] *Cinerama, Inc.* v. *Technicolor, Inc. (Technicolor II)*, 663 A.2d 1134, 1153 (Del. Ch. 1994) (internal citations omitted), *aff'd*, *Cinerama, Inc.* v. *Technicolor, Inc. (Technicolor III)*, 663 A.2d 1156 (Del. 1995).

In addition, entire fairness review frequently applies to transactions involving conflicted controlling stockholders, including "squeeze-out" mergers and other transactions in which the controller stands on both sides.

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.[17] As the Delaware Court of Chancery stated in *In re John Q. Hammons Hotels Inc. Shareholder Litigation*:

> The concept of entire fairness has two components: fair dealing and fair price. These prongs are not independent, and the Court does not focus on each of them individually. Rather, the Court determines entire fairness based on all aspects of the entire transaction. Fair dealing involves questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained. Fair price involves questions of the economic and financial considerations of the proposed merger, including all relevant factors: assets, market value, earnings, future prospects, and any other elements that affect the intrinsic or inherent value of a company's stock.[18]

A "fair price" has been described as follows:

> A fair price does not mean the highest price financeable or the highest price that fiduciary could afford to pay. At least in the non-self-dealing context, it means a price that is one that a reasonable seller, under all of the circumstances, would regard as within a range of fair value; one that such a seller could reasonably accept.[19]

B. Stockholder Approval and Shifting the Standard of Review

Under certain circumstances and by following certain procedural requirements, the standard of review generally applicable to specific going private transactions may be lowered to business judgment review. Specifically, recent case law has held that the fully informed and uncoerced approval of a third-party (*i.e.*, non-controller) change-of-control transaction by disinterested stockholders can lower the standard of review from enhanced scrutiny to business judgment. And the fully informed approval of *both* a well-functioning and independent special committee of directors *and* the majority of the

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

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

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

minority stockholders can lower the standard of review from entire fairness to business judgment in controller transactions.

1. Standard Shifting in Controlling Stockholder Transactions

Since the 2014 Delaware Supreme Court's decision in *Kahn* v. *M&F Worldwide Corp.*, a controlling stockholder has been able to obtain business judgment review treatment if it and the board follow specific requirements. As described below, although *M&F Worldwide* addressed a squeeze-out merger, the Court of Chancery has held that the standard applies to other conflict transactions and third-party sales involving a controlling stockholder as well.[20] To qualify for business judgment review, the following conditions must be satisfied: "(i) the controller conditions the procession of the transaction on the approval of both a Special Committee and a majority of the minority stockholders; (ii) the Special Committee is independent; (iii) the Special Committee is empowered to freely select its own advisors and to say no definitively; (iv) the Special Committee meets its duty of care in negotiating a fair price; (v) the vote of the minority is informed; and (vi) there is no coercion of the minority."[21] Moreover, the conditions of approval by a Special Committee and by a majority of the minority stockholders must apply to the proposed transaction from the outset.[22] The Court in *M&F Worldwide* also noted that the proper use of *either* special committee *or* majority-of-the-minority approval alone "would continue to receive burden-shifting within the entire fairness standard of review framework."[23]

The Delaware Supreme Court recently clarified application of the *M&F Worldwide* requirements in *Flood* v. *Synutra Int'l, Inc.* The Court affirmed the Court of Chancery's dismissal of the complaint, rejecting a "bright-line" requirement that the controller commit to the protective conditions in the very first written expression of interest, and agreeing with the trial court that *M&F Worldwide*'s requirement that the controller's proposal be conditioned on approval by a Special Committee and by a majority of the minority stockholders is satisfied if these conditions are included "before any substantive economic negotiations begin."[24] The Supreme Court also clarified that a plaintiff must plead that the Special Committee failed to meet its duty of care by sufficiently alleging "that the Special Committee acted with gross negligence, not by questioning the sufficiency of the price."[25]

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[20] *See In re Martha Stewart Living Omnimedia, Inc. Stockholder Litig.*, Cons. C.A. No. 11202-VCS, 2017 WL 3568089, at *16-18 (Del. Ch. Aug. 18, 2017); *IRA Trust FBO Bobbie Ahmed* v. *Crane*, C.A. No. 12742-CB, 2017 WL 6335912, at *11 (Del. Ch. Dec. 11, 2017); *see also In re Ezcorp Inc. Consulting Agreement Derivative Litig.*, C.A. No. 9962-VCL, 2016 WL 301245, at *11 (Del. Ch. Jan. 25, 2016).

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

[22] *Id.* at 644.

[23] *Id.* at 646.

[24] 195 A.3d 754, 762 (Del. 2018).

[25] *Id.* at 768.

The Court of Chancery applied the *M&F Worldwide* standard on a motion to dismiss in multiple cases. In *Olenik* v. *Lodzinski*, the Court of Chancery rejected the plaintiffs' argument that the Special Committee was ineffective because the target's CEO had preliminary discussions with the acquiror before *M&F Worldwide*'s procedural safeguards were utilized and thereafter played a major role in the merger negotiations.[26] The Court found that the CEO's role was "not surprising" given his "proven track record and expertise" in the industry and that the Special Committee was "actively engaged in the process."[27] In *In re Books-A-Million Stockholders Litigation*, the Court discussed the effect of pleading bad faith in an *M&F Worldwide* context, opining that successfully pleading bad faith would suffice to rebut the business judgment rule under the framework.[28] The Court rejected the plaintiffs' argument that the Special Committee's decision to take a lower-priced offer from the controlling stockholder rather than a comparable, higher-priced offer from a third party, was indicative of bad faith by the committee, reasoning that the controller's offer was of a different nature because it already possessed control, while a third party would be expected to pay a premium for control.[29] Furthermore, the controlling stockholder was not obliged to become a seller, nor was the Special Committee required to deploy corporate powers to attempt to force the controller to sell.[30] Finding no reasonably conceivable inference of bad faith or that the *M&F Worldwide* conditions were not met, the Court applied the business judgment rule and dismissed the case.

A controlling stockholder is one who (a) controls a majority of a company's voting power, or (b) exercises "a combination of potent voting power and management control such that the stockholder could be deemed to have effective control of the board without actually owning a majority of stock."[31] To plead that a stockholder is controlling despite controlling less than a majority of the company's voting power, a plaintiff must allege facts showing "actual domination and control" over the board by the minority stockholder, either generally or with respect to the challenged transaction.[32] Where control over a transaction is alleged, it must be established "that the defendant exercised 'actual control with regard to the particular transaction that is being challenged.'"[33] Delaware decisions have also emphasized that a minority stockholder is only properly held to be a controlling stockholder where its voting power is nevertheless significant

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[26] 2018 WL 3493092, at *18 (Del. Ch. July 20, 2018).

[27] *Id.* at *20, *23.

[28] *Id.* at *11.

[29] *Id.* at *15-16.

[30] *Id.* at *15.

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

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

[33] *Basho Techs. Holdco B, LLC* v. *Georgetown Basho Inv'rs, LLC*, C.A. No. 11802 VCL, 2018 WL 3326693, at *26 (Del. Ch. July 6, 2018) (quoting *Superior Vision Servs., Inc.* v. *ReliaStar Life Ins. Co.*, C.A. No. 1668-N, 2006 WL 2521426, at *4 (Del. Ch. Aug. 25, 2006)).

enough to make the stockholder "the dominant force in any contested . . . election," even "without having to attract much, if any, support from public stockholders."[34]

"Control" is a fact-intensive concept under Delaware law. Although voting power is a critical component in the control analysis for non-majority stockholders, a stockholder's possession of significant voting power alone is not necessarily sufficient to establish control. For instance, in *In re Western National Corp. Shareholders Litigation*, the Court of Chancery held that a 46% stockholder was not a controller because the plaintiffs could not show that the large stockholder took steps to dominate or interfere with the board of directors' oversight of the company.[35] By contrast, in *In re Tesla Motors, Inc. Stockholder Litigation*, the Court of Chancery held that it was reasonably conceivable that a company's CEO holding only 22% voting power was a controlling stockholder.[36] The reasoning underpinning the control ruling appeared to be divorced from the CEO's voting power, focusing instead on an amalgamation of factors, including the CEO's "extraordinary influence within the Company," which the Court found could conceivably allow the CEO to dominate the board's decision-making or influence a shareholder vote due to his ability to "rally other stockholders" to support him.[37] The Court also appeared to be persuaded that the lack of independence of other directors impacted the control analysis, reasoning that a director is "less likely to offer principled resistance when the matter under consideration will benefit him or a controller to whom he is beholden."[38] Other recent decisions have, however, maintained a principled separation between consideration of board independence and minority control, noting that "it does not necessarily follow that an interested party also *controls* directors, simply because they lack independence."[39]

The Court may also look to contractual rights or restrictions that enhance or limit a stockholder's voting power. For example, in *Williamson* v. *Cox Communications, Inc.* the Court denied a motion to dismiss where the complaint alleged that a group of stockholders with a combined 17.1% stake was a control group in light of the group's board-level appointment rights and certain charter provisions, which together effectively granted the stockholder group veto power over all decisions of the board of directors.[40] In contrast, in *Sciabacucchi* v. *Liberty Broadband Corp.*, the Court of Chancery found it was not reasonably conceivable that a 26% stockholder could be a controller because,

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34 *In re Cysive, Inc. S'holders Litig.*, 836 A.2d 531, 551-52 (Del. Ch. 2003).

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

36 *In re Tesla Motors, Inc. Stockholder Litig.*, C.A. No. 12711-VCS, 2018 WL 1560293 (Del. Ch. Mar. 28, 2018).

37 *Id.* at *15-16, *19.

38 *Id.* at *17.

39 *Sciabacucchi* v. *Liberty Broadband Corp.*, C.A. No. 11418-VCG, 2017 WL 2352152, at *17 (Del. Ch. May 31, 2017).

40 *Williamson* v. *Cox Commc'ns, Inc.*, C.A. No. 1663-N, 2006 WL 1586375, at *2-5 & n.4 (Del. Ch. June 5, 2006).

among other reasons, a stockholders agreement prevented that stockholder from accumulating a stake greater than 35%, designating more than four of the company's 10 directors, or soliciting proxies or consents.[41]

Managerial influence or control of a company's day-to-day operations at the executive level in the absence of significant voting power should not be sufficient to establish control. In *In re KKR Financial Holdings LLC Shareholder Litigation*, the Court of Chancery, later affirmed by the Supreme Court, rejected the argument that an entity hired by a corporation to manage its "day-to-day operations" was the corporation's controlling stockholder because the plaintiffs had not pleaded facts showing that the entity, which held only 1% of the corporation's stock, was capable of controlling the *board's* decision-making regarding the transaction in question.[42] Other decisions, however, have focused on corporations' public disclosures that particular minority stockholders exert outsized managerial influence as a basis for holding such minority stockholders to be controlling stockholders.[43] In *Zhongpin*, for example, the Court found it was reasonably conceivable that a 17% stockholder could be a controller, citing statements in the company's public filings that their CEO could "exercise significant influence over our company" through his stockholdings.[44]

In addition, the Court may consider that two or more minority stockholders acting together could constitute a control group where they otherwise would not individually. In *In re Hansen Medical, Inc. Stockholders Litigation*, the Court of Chancery declined to grant a motion to dismiss on the basis that plaintiff stockholders had sufficiently pleaded a "reasonably conceivable" claim that two constituent groups holding 34% and 31% of the company's stock respectively, together constituted a control group, on the basis of their 21-year history of investment cooperation and coordination.[45]

The standard for control sets a high bar that stockholders with significant voting and managerial influence may nonetheless not meet.[46] But certain recent case law has tended to focus less on voting power and more on other factors, and transaction planners should accordingly consider carefully whether a minority stockholder with a relatively

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41 *Sciabacucchi*, 2017 WL 2352152, at *17.

42 *In re KKR Fin. Holdings LLC S'holder Litig.*, 101 A.3d 980, 983 (Del. Ch. 2014), *aff'd sub nom. Corwin* v. *KKR Fin. Holdings LLC*, 125 A.3d 304 (Del. 2015).

43 *In re Tesla Motors, Inc. Stockholder Litig.*, 2018 WL 1560293, at *18-19; *In re Zhongpin Inc. Stockholders Litig.*, 2014 WL 6735457, at *7-8 (Del. Ch. Nov. 26, 2014), *rev'd on other grounds sub nom. In re Cornerstone Therapeutics Inc., Stockholder Litig.*, 115 A.3d 1173 (Del. 2015).

44 *Zhongpin*, 2014 WL 6735457, at *7-8.

45 *In re Hansen Med., Inc. Stockholders Litig.*, C.A. No. 12316-VCMR, 2018 WL 3025525, at *8 (Del. Ch. June 18, 2018).

46 *Larkin* v. *Shah*, C.A. No. 10918-VCS, 2016 WL 4485447, at *13 (Del. Ch. Aug. 25, 2016); *In re PNB Holding Co. S'holders Litig.*, C.A. No. 28-N, 2006 WL 2403999, at *9 (Del. Ch. Aug. 18, 2006).

small voting stake could be at risk of facing Court-imposed controlling stockholder obligations.[47]

Finally, as recently explained in *In re Martha Stewart Living Omnimedia, Inc. Stockholder Litigation*, standard-shifting under *M&F Worldwide* can occur not only in squeeze-out transactions or other transactions in which the controller stands on both sides of the transaction, but also in third-party sales in which the controller allegedly receives disparate consideration.[48] The same requirements, including that the standards be applied from the outset, apply in such circumstances.[49] In *IRA Trust FBO Bobbie Ahmed* v. *Crane*, the Court also held that the *M&F Worldwide* standard could be used to shift the standard of review in conflict transactions not involving a sale of the company, finding "no principled basis on which to conclude that the dual protections in the [*M&F Worldwide*] framework should apply to squeeze-out mergers but not to other forms of controller transactions."[50]

2. Standard Shifting in Non-Control Transactions

Stockholders' ability to approve or ratify a transaction and thereby shield it from judicial scrutiny stems from a longstanding doctrine.[51] As explained below, recent decisions have clarified that a fully informed, uncoerced vote of a disinterested stockholder majority will result in the irrebutable application of the business judgment presumption, provided that a conflicted controlling stockholder is not present. The rule can apply to transactions that may otherwise have been subject to enhanced scrutiny or entire fairness, unless entire fairness applies *ab initio* due to the presence of a conflicted controlling stockholder. In such cases, a more rigorous procedure explained Section III.B.1 can be used to shift the standard of review.

The renewed interest in this rule began with *Corwin* v. *KKR Financial Holdings LLC*, where the Delaware Supreme Court held that "the business judgment rule is invoked as the appropriate standard of review for a post-closing damages action when a merger that is not subject to the entire fairness standard of review has been approved by a fully informed, uncoerced majority of the disinterested stockholders."[52] In doing so, the Court rejected plaintiffs' argument that enhanced scrutiny under *Revlon* should apply, noting that Delaware's longstanding policy has been to avoid second-guessing the

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47 *In re Tesla Motors*, 2018 WL 1560293, at *18-19; *In re Zhongpin*, 2014 WL 6735457, at *7-8.

48 *In re Martha Stewart Living Omnimedia, Inc. Stockholder Litig.*, Cons. C.A. No. 11202-VCS, 2017 WL 3568089, at *16-18 (Del. Ch. Aug. 18, 2017).

49 *Id.*

50 *IRA Trust FBO Bobbie Ahmed* v. *Crane*, C.A. No. 12742-CB, 2017 WL 6335912, at *11 (Del. Ch. Dec. 11, 2017).

51 *See, e.g.*, *In re Lukens Inc. S'holders Litig.*, 757 A.2d 720, 737 (Del. Ch. 1999), *aff'd sub nom. Walker* v. *Lukens, Inc.*, 757 A.2d 1278 (Del. 2000); *Schiff* v. *RKO Pictures Corp.*, 104 A.2d 267, 270-72 (Del. Ch. 1954).

52 *Corwin*, 125 A.3d at 305-06.

decisions of informed, disinterested, and uncoerced stockholders.[53] The Supreme Court further clarified that the cleansing effect of stockholder approval applied regardless of whether the stockholder vote was held on a voluntary basis or was statutorily required to complete the transaction.[54]

In addition to stockholder votes, the act of tendering shares as the first step of a two-step merger under 8 *Del. C.* § 251(h) can also cleanse a transaction under *Corwin*. In *In re Volcano Corporation Stockholder Litigation*, the Court of Chancery determined that the fully informed acceptance of a tender offer by an uncoerced, disinterested stockholder majority as the first step of a two-step merger would result in the same cleansing effect as a stockholder vote.[55] The Court rejected the argument that a first-step tender offer under a two-step merger is inherently more coercive than a one-step merger, noting that the procedural protections under 8 *Del. C.* § 251(h) alleviate such concerns.[56]

Subsequent decisions have further explained the cleansing effect of stockholder approval. In *Singh* v. *Attenborough*, the Supreme Court noted that the application of the business judgment rule following stockholder approval under *Corwin* precludes any attempt to rebut the rule based on allegations of breach of the duty of care.[57] The Court stressed that applying the business judgment in this context should typically result in dismissal, because the transaction would be shielded from attack on all grounds other than waste, and the "vestigial waste exception has long had little real-world relevance, because it has been understood that stockholders would be unlikely to approve a transaction that is wasteful."[58] Importantly, the Court also extinguished aiding and abetting claims against the financial advisor as part of the cleansing effect of *Corwin*.[59]

Later rulings have clarified *Corwin*'s exception for transactions that are "subject to the entire fairness standard of review." In *Larkin* v. *Shah*, the Court of Chancery held that, if fully informed, uncoerced, disinterested stockholders approve a transaction under *Corwin*, the business judgment rule irrebutably applies in the absence of a conflicted

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53 *Id.* at 312-14.

54 *Id.* at 309-11 & n.19 (distinguishing *Gantler* v. *Stephens*, 965 A.2d 695, 713-14 (Del. 2009)).

55 *In re Volcano Corp. Stockholder Litig.*, 143 A.3d 727, 747 (Del. Ch. 2016) ("I conclude that the acceptance of a first-step tender offer by fully informed, disinterested, uncoerced stockholders representing a majority of a corporation's outstanding shares in a two-step merger under Section 251(h) has the same cleansing effect under *Corwin* as a vote in favor of a merger by a fully informed, disinterested, uncoerced stockholder majority."), *aff'd sub nom. Lax* v. *Goldman Sachs & Co.*, C.A. No. 10485-VCM, 156 A.3d 697 (Del. Feb. 9, 2017); *see also Larkin* v. *Shah*, C.A. No. 10918-VCS, 2016 WL 4485447, at *7 (Del. Ch. Aug. 25, 2016) (applying *Corwin* to tender offer under 8 *Del. C.* § 251(h)).

56 *In re Volcano*, 143 A.3d at 742-43 (citing mitigating factors of statutory requirement to purchase all outstanding stock, to effect second step as soon as practicable following completion of tender offer, to offer the same kind and amount of consideration, and the availability of appraisal rights).

57 *Singh* v. *Attenborough*, 137 A.3d 151, 151-52 (Del. 2016).

58 *Id.* at 152.

59 *Id.* at 152-53.

controlling stockholder.[60] Consequently, even if the business judgment presumption could have been rebutted because a board was alleged to lack a disinterested and independent majority, stockholder approval will cleanse the transaction and shield it from judicial scrutiny, provided that there is no conflicted controller.[61]

Corwin will not apply if the stockholders' vote was not fully informed. The plaintiff bears the initial burden of adequately pleading a material omission or misstatement.[62] If the plaintiff is successful, the defendant will bear the burden of proving that the vote was fully informed.[63] In order for the stockholders' vote to be viewed as fully informed, stockholders must be apprised of all material facts regarding the transaction.[64] Although the preference of the Court of Chancery is to consider disclosure claims before closing, so as to provide equitable relief that could lead to a fully informed vote,[65] it remains to be seen whether the failure to bring such disclosure claims before closing can prevent a plaintiff from later using them to circumvent *Corwin* by pleading that stockholder approval was not fully informed.[66]

Because a fully informed vote can be the determining factor in whether a transaction is afforded business judgment deference under *Corwin* or is subjected to the enhanced scrutiny or entire fairness review, complete and accurate disclosure of material information before any stockholder vote is of particular importance in this context, and Delaware courts have refused to grant business judgment deference under *Corwin* when it considers stockholder disclosures to be potentially inadequate. In *Morrison* v. *Berry*, the Delaware Supreme Court reversed a *Corwin*-based dismissal, finding that the company's disclosures misleadingly represented the founder's agreement with the buyer to roll over his equity interest in a transaction and that the founder had stated that he would sell his shares absent a transaction.[67] Importantly, the Court held that "'partial and elliptical disclosures' cannot facilitate the protection of the business judgment rule under the

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60 *Larkin*, 2016 WL 4485447, at *13; *see also In re Solera Holdings, Inc. Stockholder Litig.*, C.A. No. 11524-CB, 2017 WL 57839, at *6 n.28 (Del. Ch. Jan. 5, 2017); *Chester Cty. Ret. Sys.* v. *Collins*, C.A. No. 12072-VCL, 2016 WL 7117924, at *2 (Del. Ch. Dec. 6, 2016) (ORDER).

61 *In re Merge Healthcare Inc. Stockholders Litig.*, Consol. C.A. No. 11388-VCG, 2017 WL 395981, at *7 (Del. Ch. Jan. 30, 2017) (noting that an unconflicted controller would not exempt a transaction from cleansing under *Corwin*); *Larkin*, 2016 WL 4485447, at *13.

62 *In re Solera*, 2017 WL 57839, at *7-8.

63 *Id.* at *7.

64 *See Corwin*, 125 A.3d at 312 ("[I]f troubling facts regarding director behavior were not disclosed that would have been material to a voting stockholder, then the business judgment rule is not invoked."). The materiality standard required under *Corwin* is the same standard applied elsewhere under Delaware law, which tracks the federal securities laws. *See In re Solera*, 2017 WL 57839, at *9.

65 *See Nguyen* v. *Barrett*, C.A. No. 11511-VCG, 2016 WL 5404095, at *7 (Del. Ch. Sept. 28, 2016).

66 *See In re Merge Healthcare*, 2017 WL 395981, at *10 (noting the Court's preference to remedy disclosure deficiencies before closing but declining to consider whether failure to do so prevents using disclosures to circumvent *Corwin*).

67 191 A.3d 268, 284-88 (Del. 2018).

Corwin doctrine," particularly in transactions involving the sale of the company.[68] In *Appel* v. *Berkman*, the Delaware Supreme Court reversed another *Corwin*-based dismissal where a target company in a front-end tender offer transaction failed to disclose that its founder and former CEO abstained from voting on the transaction (in his capacity as chairman of the board) and held off on deciding whether or not to tender his shares due to his disagreement with the board's assessment of the fairness or timing of the transaction.[69] In *Xura*, the Court of Chancery found that *Corwin* deference was not appropriate where the plaintiffs adequately pled several inadequate disclosures, including failing to disclose that the company's CEO had regularly communicated with the acquiror and negotiated price terms without the board's knowledge.[70] In *Tangoe*, the Court of Chancery likewise refused dismissal under *Corwin* where the company's disclosures did not include audited financial statements, finding that while Delaware law "by no means deems audited financials material per se," such information was material under the circumstances as stockholders had only previously been provided "sporadic and heavily qualified" financial information.[71]

The vote also must not be coerced for business judgment deference under *Corwin* to be granted. Coercion and control are related inquiries, because "coercion is assumed, and entire fairness invoked, when the controller engages in a conflicted transaction, which occurs when a controller sits on both sides of the transaction, or is on only one side but 'competes with the common stockholders for consideration.'"[72]

However, recent cases have suggested that coercion can also occur outside the control context. In *Sciabacucchi* v. *Liberty Broadband Corp.*, although the Court held that no controlling stockholder was present, it found it reasonably conceivable that the transactions being challenged had been approved through a structurally coercive stockholder vote sufficient to prevent the use of a *Corwin* defense.[73] The Court explained that a structurally coercive vote is "a vote structured so that considerations extraneous to the transaction likely influenced the stockholder-voters, so that [the Court] cannot determine that the vote represents a stockholder decision that the challenged transaction is in the corporate interest."[74] The Court found that certain value-enhancing

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68 *Id.* at 272.

69 *Appel* v. *Berkman*, 180 A.3d 1055, 1064-65 (Del. 2018).

70 *In re Xura, Inc. Stockholder Litig.*, Consol. C.A. No. 12698-VCS, 2018 WL 6498677, at *12 (Del. Ch. Dec. 10, 2018).

71 *In re Tangoe, Inc. Stockholders Litig.*, C.A. No. 2017-0650-JRS, 2018 WL 6074435, at *10 (Del. Ch. Nov. 20, 2018).

72 *In re Merge Healthcare*, 2017 WL 395981, at *6; *Larkin*, 2016 WL 4485447, at *9, *12 ("Coercion is deemed inherently present in controlling stockholder transactions of both the one-sided and two-sided variety, but not in transactions where the concerns justifying some form of heightened scrutiny derive solely from board-level conflicts or lapses of due care.").

73 *Sciabacucchi* v. *Liberty Broadband Corp.*, C.A. No. 11418-VCG, 2017 WL 2352152, at *17-18 (Del. Ch. May 31, 2017).

74 *Id.* at *20.

transactions had been conditioned on the approval of the challenged transactions, and that the challenged transactions therefore had not been evaluated solely on their own merit.[75] In *In re Saba Software, Inc. Stockholder Litigation*, the Court of Chancery similarly refused to grant business judgment deference under *Corwin* after finding it reasonably conceivable that the stockholder vote was structurally coerced because stockholders were presented with a "Hobson's choice" between approving the merger in question or holding shares that had recently been de-listed as a result of the company's inexplicable and repeated failure to restate its financials.[76]

The *Corwin* doctrine reflects the powerful but simple principle that the informed judgment of stockholders who control the corporate vote is entitled to deference, and the Delaware courts have stressed that the doctrine was intended to "avoid judicial second-guessing" about the economic merits of a transaction but "was never intended to serve as a massive eraser, exonerating corporate fiduciaries for any and all of their actions or inactions preceding their decision to undertake a transaction for which stockholder approval is obtained."[77] The Court of Chancery has also recently clarified that *Corwin* is not intended to restrict stockholders' rights to obtain books and records under 8 *Del. C.* § 220, noting that the fact that defendants may seek to dismiss a challenge to a transaction under *Corwin* does not inhibit stockholders from seeking books and records regarding the challenged transaction, which the stockholders may use to attempt to overcome a *Corwin* defense.[78]

Finally, although it appears that the *Corwin* doctrine can apply to transactions that would otherwise have been subject to enhanced scrutiny under *Revlon* or to transactions that would otherwise be subject to entire fairness review, the Court of Chancery has not yet opined on whether *Corwin* can shield transactions challenged as preclusive and coercive under *Unocal*. In *In re Paramount Gold & Silver Corp. Stockholders Litigation*, the Court of Chancery noted potential tension in that regard between the Supreme Court's earlier decision in *In re Santa Fe Pacific Corporation Shareholder Litigation* and the more recent *Corwin* doctrine, but declined to address the question, finding instead that the agreement in question was not a deal protection device and thus did not implicate *Unocal* analysis in the first instance.[79]

3. Further Considerations – Management Participation in Transactions

In any take private transaction, the elephant in the room may well be the target company's own Chief Executive Officer and senior management team. Corporate

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75 *Id.* at *21-22.

76 *In re Saba Software, Inc. Stockholder Litig.*, Consol. C.A. No. 10697-VCS, 2017 WL 1201108, at *15-16 (Del. Ch. Apr. 11, 2017).

77 *In re Massey Energy Co. Derivative & Class Action Litig.*, 160 A.3d 484, 507 (Del. Ch. 2017).

78 *Lavin* v. *W. Corp.*, C.A. No. 2017-0547-JRS, 2017 WL 6728702, at *10 (Del. Ch. Dec. 29, 2017).

79 *In re Paramount Gold & Silver Corp. Stockholders Litig.*, C.A. No. 10499-CB, 2017 WL 1372659, at *6-9, *14 (Del. Ch. Apr. 13, 2017).

managers owe a duty of loyalty to their employer, but given the wealth of public knowledge regarding private equity deals over the past decades, any management team could reasonably assume that a potentially lucrative equity compensation package could be waiting on the other side of the transaction. For this reason alone, public companies would be well-advised to have a policy in place where management is required to bring any offers to acquire the target company where significant management participation is expected first to its board of directors[80] and it may thereafter be advisable to require at least one disinterested and independent director to participate in any conversation between the potential acquiror and management.[81] In the same vein, management would be well-advised to disclose all intentions regarding the transaction that may involve management personally benefiting.[82] And finally, where management may have significant conflicts (*e.g.*, in a buyout led by management), it is considered best practice in the current environment for a target company to establish, at the beginning of any potential sale process, a special committee that retains its own independent advisors to oversee the sale process (and management's participation therein), in order to help avoid the risk of a higher level of judicial scrutiny being applied to the transaction, of the types discussed above in this Section III.

C. Effective Special Committees

With respect to process, the Delaware Supreme Court has long encouraged boards to utilize a "special committee" of independent directors when a conflict transaction is proposed. As discussed at greater length below, the purpose of a special committee is to attempt to reproduce the dynamics of arm's-length bargaining. To be effective, a special committee generally should: (1) be properly constituted (*i.e.*, consist of independent and disinterested directors); (2) have an appropriately broad mandate from the full board (*e.g.*, not be limited to simply reviewing an about-to-be-agreed-to transaction); and (3) have its own legal and financial advisors.[83] The use of a well-functioning special committee can shift the burden of proof regarding entire fairness from the defendant to the plaintiff, thus requiring plaintiff to prove that a transaction was not entirely fair, rather than requiring defendant to prove that it was entirely fair. 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.[84] 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

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[80] *See In re J. Crew Group, Inc. S'holders Litig.*, Consol. C.A. No. 6043-CS, 2011 WL 6298959 (Del. Ch. Dec. 16, 2011).

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

[82] *See In re Lear Corp. S'holder Litig*., 926 A.2d 94 (Del. Ch. 2007).

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

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

committees remain important in conflict transactions.[85] And, in light of *M&F Worldwide*, a controller's agreement in advance to "voluntarily relinquish[] its control" by conditioning a transaction "upon the approval of both an independent, adequately empowered Special Committee that fulfills its duty of care, and the uncoerced, informed vote of a majority of the minority stockholders" will result in the application of business judgment review rather than entire fairness review.[86] Factors considered in determining whether a special committee functioned adequately are further described below. It bears noting that approval of a take-private merger with a controlling shareholder by a majority of the minority shareholders also shifts the burden of proof, provided that the disclosures to the shareholders are deemed sufficient.

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.[87]

1. Disinterestedness and Independence of Committee Members

Special committees are only effective to impact the standard of review and/or the burden of proof if their members are disinterested and independent. In determining director independence and disinterestedness, a board should have its directors disclose their compensatory, financial and business relationships, as well as any significant social or personal ties that could be expected to impair their ability to discharge their duties. The Delaware Supreme Court has stressed that all of these factors must be considered "in their totality and not in isolation from each other."[88] Paying close attention to which directors are selected to serve on a special committee is important, and care should be taken to vet the independence of those selected.[89] The use of a special committee will not shift the burden of proving unfairness to the plaintiffs if the directors on the committee are viewed as "beholden" to a controlling stockholder.[90] Even if a director does not have a direct personal interest in the matter being reviewed, the director will not

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85 *Id.* at 1244.

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

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

88 *Del. Cty. Emps.' Ret. Fund* v. *Sanchez*, 124 A.3d 1017, 1019 (Del. 2015).

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

90 *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).

be considered qualified if he or she lacks independence from the controlling stockholder or some other person or entity that is interested in the transaction.

Certain compensatory relationships can lead to independence concerns. For example, in the 2004 case *In re Emerging Communications, Inc. Shareholders Litigation*, the Court of Chancery questioned the independence of a member of a special committee because he was a paid consultant of an affiliate of the controlling stockholder.[91] Familial relationships may also be disqualifying. In *Harbor Finance Partners* v. *Huizenga*, the Court of Chancery held that a director who was the brother-in-law of the CEO and involved in various businesses with the CEO could not impartially consider a demand that was adverse to the CEO's interests.[92] And the confluence of business and social relationships may together compromise a director's independence. For instance, in *Delaware County Employees' Retirement Fund* v. *Sanchez*, the Supreme Court ruled that allegations that a director had "a close friendship of over half a century with the interested party" and that "the director's primary employment . . . was as an executive of a company over which the interested party had substantial influence" adequately raised a doubt that the director was not independent.[93] In *Sandys* v. *Pincus*, the Supreme Court held that a director lacked independence from an interested party because the director and her husband co-owned a private plane with the interested party.[94] In so holding, the Court noted that co-owning an airplane was uncommon and inferred that the families of the director and the interested party were extremely close to each other and thus were intimate friends.[95] In *Cumming* v. *Edens*, the Court of Chancery found that one director lacked independence from an interested party because of her employment in a leadership position at a charity where the interested party's wife served on the board of directors and to which the interested party had made significant financial contributions.[96] The Court in *Cumming* also found that another director lacked independence from the same interested party because that director had been invited by the interested party to join an ownership group of a professional basketball team.[97] Additionally, in the recent *In re Oracle Corporation Derivative Litigation*, the Court of Chancery found that a director lacked independence from founder and 28% stockholder Lawrence Ellison based on the director's "multiple layers of business connections with Oracle," including being "affiliated with two venture capital firms that operate in areas dominated by Oracle."[98]

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91 *Emerging Commc'ns*, 2004 WL 1305745.

92 *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).

93 *Sanchez*, 124 A.3d at 1019.

94 *Sandys* v. *Pincus*, 152 A.3d 124, 135 (Del. 2016).

95 *Id.* at 126.

96 2018 WL 992877, at *14-16 (Del. Ch. Feb. 20, 2018).

97 *Id*. at *16.

98 *In re Oracle Corp. Derivative Litig.*, C.A. No. 2017-0337-SG, 2018 WL 1381331, at *17 (Del. Ch. Mar. 19, 2018).

The Court found that those connections, combined with the "rather lucrative" director fees that would be jeopardized if the director sued Ellison, were sufficient to discredit the director's independence.[99] Although some of these cases involved the demand futility framework rather than the assessment of a special committee's independence, they reflect a trend in the Delaware courts that may suggest closer scrutiny of business, social, or financial relationships between board members.

Not all relationships between special committee members and management or controlling stockholders will give rise to independence concerns, however, 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.[100] In *Yucaipa American Alliance Fund II, L.P.* v. *Riggio*, the Court of Chancery found a director independent despite her having previously served as an executive under the company's founder and former CEO 10 years prior.[101] Nor is the fact that a stockholder had elected a director a sufficient reason to deem that director lacking independence.[102] The Court of Chancery has also refused to accept a "transitive theory" of conflict, rejecting the argument that a director lacks independence from an alleged controller because the director is allegedly beholden to someone else who, in turn, is allegedly beholden to the controller.[103] 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.[104] Notably, the Supreme Court approved then-Chancellor Strine's finding that the directors' satisfaction of the independence standards of the New York Stock Exchange (the "NYSE") was informative, although not dispositive, of their independence under Delaware law.[105] A failure to meet stock exchange independence standards can be informative of a director's independence under Delaware law as well. In *Sandys*, the

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99 *Id.*

100 *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 that were alleged to be major recipients of the acquiror's corporate giving), *aff'd*, 906 A.2d 766 (Del. 2006).

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

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

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

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

105 *Id.* at 648 n.26.

Supreme Court reasoned that the board would not have taken lightly the decision to classify directors as lacking independence under Nasdaq standards, and that the Nasdaq standards raised similar issues to those relevant under Delaware law, while reiterating that Delaware and stock exchange standards were still not equivalent.[106] The Court concluded that the directors in question lacked independence.[107]

2. The Committee's Role and Process

The purpose for which the special committee is created may also be relevant in determining whether its directors are independent. As the Delaware Supreme Court said in *Beam ex rel. Martha Stewart Living Omnimedia, Inc.* v. *Stewart*, "[i]ndependence is a fact-specific determination made in the context of a particular case. The court must make that determination by answering the inquiries: independent from whom and independent for what purpose?"[108] For example, special litigation committees are analyzed differently from transactional special committees because, as a defendant in a lawsuit, the board itself is interested in the outcome of the litigation and whether it should be pursued. In *Stewart*, the Delaware Supreme Court explained that a personal friendship or outside business relationship, standing alone, is insufficient to raise a reasonable doubt about a director's independence in the context of pre-suit demand on the board.[109]

The function of a special committee is to protect stockholder interests by delegating a decision to a group of independent, disinterested directors in cases where the interests of certain directors (such as directors participating in a management buyout or representing a controlling stockholder) differ significantly from those of the public stockholders. The influence (and number) of interested directors on a board may be relevant in determining the desirability of forming a special committee. For example, a board consisting of a majority of independent directors may not be significantly affected by management directors promoting a leveraged buyout. It may be sufficient for interested directors to recuse themselves from any deliberations and votes in connection with a proposed transaction. As the Court of Chancery has explained, "[t]he formation of a special committee can serve as 'powerful evidence of fair dealing,' but it is not necessary every time a board makes a decision."[110]

If directors who have a personal interest that conflicts with those of the public stockholders constitute a minority of the board, the disinterested majority can act for the board, with the interested members abstaining from the vote on the proposal. But if a majority of the board is not disinterested, under Delaware law, absent appropriate

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106 *Sandys* v. *Pincus*, 152 A.3d 124, 133 (Del. 2016).

107 *Id.* at 134.

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

109 *Id.* at 1049-52.

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

procedural protections, the merger will be reviewed under the "entire fairness" standard, with the burden of proof in any stockholder litigation placed on the board.[111]

The need for a special committee may shift as a transaction evolves. Acquirors that begin as third-party bidders may become affiliated with management directors, or management may organize and propose a management buyout in response to an unsolicited bid from a third party. Throughout a sale process, the board and its advisors must be aware of any conflicts or potential conflicts that arise. Failure to disclose such conflicts may result in substantial difficulties in defending the board's actions in court.[112]

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

Delaware courts closely review the conduct of parties in controlling stockholder transactions and have in several cases been skeptical of processes that did not involve the active participation of a special committee. In 2000, the Delaware Court of Chancery held in *In re Digex, Inc. Shareholders Litigation* that the conflicted directors on a board controlled by a majority stockholder had likely breached their fiduciary duties by agreeing to waive the protections of the Delaware business combination statute in favor of the acquiror of that majority stockholder over the opposition of the independent directors.[113] The same year, in *McMullin* v. *Beran*,[114] the Delaware Supreme Court reversed a dismissal of a challenge to the directors' conduct where, in connection with the approval of a merger agreement between a controlled subsidiary and a third party, an already established special committee was not empowered to participate in the sale process and the majority stockholder controlled the process and allegedly had interests divergent from those of the public stockholders.

As explained in Section III.B.1 above, the presence of a well-functioning special committee can shift the burden of proof to the plaintiff in an entire fairness case. To achieve this burden shift, the special committee must follow proper procedures. For example, in the context of a transaction with a majority stockholder, "the special committee must have real bargaining power that it can exercise with the majority shareholder on an arm's-length basis."[115] The special committee should receive

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

112 *See, e.g.*, *Cede & Co.* v. *Technicolor, Inc. (Technicolor I)*, 634 A.2d 345 (Del. 1993), decision modified on reargument, 636 A.2d 956 (Del. 1994).

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

114 *McMullin* v. *Beran*, 765 A.2d 910 (Del. 2000).

115 *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).

independent financial and legal advice, negotiate diligently and without the influence of the controlling stockholder, and should possess all relevant material information, including material facts relating to the value of the assets to the stockholder itself, including alternative uses.[116] The controlling stockholder need not, however, disclose information relating to its reservation price, how it would finance a purchase or invest the proceeds from a sale, or other information that "would undermine the potential for arm's-length negotiations to take place."[117] In *Kahn* v. *Lynch Communication Systems, Inc.*, the Delaware Supreme Court suggested that even where a special committee obtains independent legal and financial advice and negotiates diligently, the requisite degree of independence may still be lacking if the committee and controlling stockholder fail to establish that the committee has the power to negotiate independently.[118]

The special committee should have a clear conception of its role, which should include a power to say no to the potential transaction.[119] In the 2011 *Southern Peru* case,[120] the Delaware Court of Chancery criticized the role of the special committee in reviewing a merger proposal from a controlling stockholder. The Court stated that the special committee's "approach to negotiations was stilted and influenced by its uncertainty about whether it was actually empowered to negotiate" and that the special committee "from inception . . . fell victim to a controlled mindset and allowed [its controlling stockholder] to dictate the terms and structure of the [m]erger."[121] The Delaware Supreme Court affirmed the Court of Chancery's rulings and adopted its reasoning.[122] 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.[123] A special committee that does not recognize, even in the context of a takeover bid by a controlling stockholder, that it may refuse to accept the offer might bear the burden of proving the entire fairness of the transaction in court.[124] The ability to say no must include the ability to do so without fear of retaliation. In *Lynch*, the Supreme Court was persuaded that the

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116 *In re Dole Food Co. Stockholder Litig.*, C.A. Nos. 8703-VCL, 9079-VCL, 2015 WL 5052214, at *29-30 (Del. Ch. Aug. 27, 2015) (quoting *Kahn* v. *Tremont Corp.*, C.A. No. 12339, 1996 WL 145452, at *16 (Del. Ch. Mar. 21, 1996), *rev'd*, 694 A.2d 422 (Del. 1997)).

117 *ACP Master, Ltd.* v. *Sprint Corp.*, C.A. Nos. 8508-VCL, 9042 VCL, 2017 WL 3421142, at *23 (Del. Ch. July 21, 2017, *corrected* Aug. 8, 2017); *see also In re Dole Food Co.*, 2015 WL 5052214, at *29.

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

119 *See Gesoff* v. *IIC Indus. Inc.*, 902 A.2d 1130, 1150 (Del. Ch. 2006).

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

121 *Id.* at 97-98.

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

123 *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).

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

special committee's negotiations were influenced by the controlling stockholder's threat to acquire the company in a hostile takeover at a much lower price if the special committee did not endorse the controlling stockholder's offer.

Even where a process is imperfect, a fully empowered and well-functioning special committee can significantly influence an entire fairness analysis. In the 2017 case *ACP Master, Ltd.* v. *Sprint Corp.*,[125] the Court of Chancery found that the acquisition of Clearwire by its controlling stockholder, Sprint, satisfied entire fairness notwithstanding "blemishes, even flaws" early in the deal process, including retributive threats and vote-buying by Sprint.[126] The Court noted that minority stockholders' opposition to Sprint's initial offer and the special committee's engagement with a competing buyer "freshened the atmosphere and created a competitive dynamic," which ultimately resulted in a higher price for Clearwire.[127]

Special committees and their advisors should be proactive in seeking all relevant information (potentially including valuation information and information held by management or the transaction proponent) and in negotiating diligently on behalf of stockholders.[128] The records of the deliberations of a special committee and the full board should reflect careful and informed consideration of the issues.[129]

3. Selection of the Committee's Advisors

The best practice is for the special committee itself, rather than management or a controlling stockholder, to choose its own financial and legal advisors. In *Macmillan*, the Delaware Supreme Court was critical of the conduct of an auction to sell the company in which a financial advisor selected by the company's CEO, rather than by the special committee, played a dominant role.[130] In *In re Tele-Communications, Inc. Shareholders Litigation*,[131] Chancellor Chandler found that the special committee's decision to use TCI's legal and financial advisors rather than retaining independent advisors "raise[d] questions regarding the quality and independence of the counsel and advice received." And in 2006 in *Gesoff* v. *IIC Industries Inc.*,[132] Vice Chancellor Lamb strongly criticized

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125 *ACP Master, Ltd.* v. *Sprint Corp.*, C.A. Nos. 8508-VCL, 9042-VCL, 2017 WL 3421142 (Del. Ch. July 21, 2017, *corrected* Aug. 8, 2017).

126 *Id.* at *29.

127 *Id.*

128 *See, e.g.*, *In re Rural Metro Corp. Stockholders Litig.*, 88 A.3d 54, 90 (Del. Ch. 2014).

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

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

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

132 *Gesoff* v. *IIC Indus. Inc.*, 902 A.2d 1130 (Del. Ch. 2006).

a special committee's use of advisors who were handpicked by the majority stockholder seeking a merger.

Whether the special committee should retain advisors with a previous relationship with the corporation is a context-specific decision. While having a special committee advised by firms that have close ties to the company may raise independence concerns, it is not in all cases better for the special committee to choose advisors who are unfamiliar with the company or to avoid hiring advisors who have done prior work for the company. In one case, Justice Jacobs (sitting as a Vice Chancellor) criticized a process in which the company's historical advisors were "co-opted" by the majority stockholder, leaving the special committee with independent advisors who did not know the company well and who lacked the information available to the majority stockholder's advisors.[133]

As a practical matter, some companies may have had at least some prior dealings with close to all of the financial or legal advisors who would have the relevant experience and expertise to advise a special committee on a transaction that is particularly complicated or of a certain size. If the special committee chooses to engage an advisor with such prior dealings, it should carefully document any potential conflict, the reasons the special committee considered it important to engage the advisor, and the measures the special committee took to mitigate any such conflict. Such measures may include negotiating carefully worded confidentiality provisions and structuring the advisor's fee to prevent any misaligned incentives. The committee may also choose to hire a second advisor for a particular role, although it should take care to ensure that the second advisor's presence will successfully mitigate the conflict that has been identified—for example, by ensuring that the new advisor is not merely a "secondary actor," and by not compensating it on a contingent basis.[134] Interviewing several advisors, and ensuring a record of such through board and committee minutes, 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.

D. Majority-of-the-Minority Stockholder Vote

As discussed in Section III.B above, a fully informed, uncoerced majority-of-the-minority vote (or a majority-of-the-minority tender) can have burden shifting or burden reducing effects in conflict transactions. But subjecting a transaction to such a voting requirement—which requires approval of a transaction by a majority of the outstanding unaffiliated shares, instead of a majority of those voting on the transaction—can pose a significant obstacle to closing certainty. As a primary matter, this standard makes the failure to cast a vote the equivalent of a vote against the deal. If a company has a significant number of retail stockholders, whose turnout at stockholder meetings is typically much less than the turnout of institutional investors and hedge funds, conditioning approval of a transaction on a majority-of-the-minority standard imposes

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

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

significant pressure on the company to solicit the retail vote. For example, in the proxy contest between Dell Inc. and Carl Icahn over Michael Dell's proposal to take the company private, which conditioned the completion of the merger on majority-of-the-minority approval, the company had to adjourn the meeting for six days to give the board an opportunity to solicit additional votes. The day after the meeting was adjourned, *The New York Times* reported that 23% of the shares had not been voted. Second, the majority-of-the-minority standard, in some circumstances, may enable other large stockholders of the company—including, for instance, arbitrageurs who purchase into the company after a buyout is announced—to have an effective blocking position in an otherwise attractive transaction.

As a result, certain conflicted transactions have adopted a modified "majority-of-the-voting-minority" standard, which premises the closing of a transaction on the approval of a majority of the unaffiliated stockholders who vote on the transaction. The rationale of the majority-of-the-voting-minority standard is that it still prevents insiders from using their voting power to tip the balance on their own proposal, but would mitigate the concerns regarding shareholder turnout and reduce the tactical advantage of large shareholder opponents. Transactions that are only conditioned on the majority-of-the-voting-minority, however, may not receive the same deference as those conditioned on a majority-of-the-minority standard when challenged.

In all events, the vote must be fully informed. An informed vote requires not only that the transaction will be sufficiently attractive to secure the approval of the majority of the disinterested stockholders, but also that such stockholders are provided with all material information when deciding whether to approve a transaction. As a matter of both Delaware and federal law, information is "material" "if there is a substantial likelihood that a reasonable stockholder would consider it important in deciding how to vote."[135] As a result, care must be taken in considering what information and materials should be included in the proxy statement (for example, financial projections and underlying assumptions) to ensure that stockholders receive appropriate and sufficient information and, if possible, to limit future plaintiffs' claims of inadequate disclosure.

Under Rule 13e-3 of the Exchange Act, which is discussed in Section IV.A, an issuer or affiliate is required to state whether a transaction is structured so that approval of at least a majority of unaffiliated security holders is required. The Rule 13e-3 requirement reflects, in part, state court holdings that such a vote is a major factor in determining the fairness of a transaction, and to an extent, may provide safeguards against shareholder fairness challenges.

E. Shareholder Appraisal Rights

If a stockholder does not tender or vote for the transaction and follows the procedures specified under the relevant appraisal statute, he or she may have the right to have a Delaware judge determine and award the inherent fair value of his or her shares.

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135 *Loudon* v. *Archer-Daniels-Midland Co*., 700 A.2d 135, 142-43 (Del. 1997).

This after-the-fact appraisal creates uncertainty as to the ultimate amount that will have to be paid to acquire the minority interests.

Section 262 of the Delaware General Corporation Law entitles a stockholder dissenting from a merger to "fair value" for its shares, "exclusive of any element of value arising from the accomplishment or expectation of the merger."[136] The court conducting an appraisal must value the company "as a going concern based upon the 'operative reality' of the company as of the time of the merger."[137] The court must "perform an independent evaluation of 'fair value' at the time of a transaction," and the law "vests the Chancellor and Vice Chancellors with significant discretion to consider 'all relevant factors.'"[138] Although the Delaware courts do not give a presumption in favor of the fairness of a deal price, the law is clear that "the price of a merger that results from a robust market check, against the back drop of a rich information base and a welcoming environment for potential buyers, is probative of the company's fair value."[139] Stockholders are permitted to pursue appraisal rights in addition to claims alleging a lack of fairness and breaches of fiduciary duty.[140]

136 8 *Del. C.* § 262(h).

137 *M.G. Bancorporation, Inc.* v. *Le Beau*, 737 A.2d 513, 525 (Del. 1999).

138 *Golden Telecom, Inc.* v. *Global GT LP*, 11 A.3d 214, 217-18 (Del. 2010).

139 *DFC Global Corp.* v. *Muirfield Value Partners, L.P.*, 172 A.3d 346, 366 (Del. 2017).

140 *Cede & Co.* v. *Technicolor, Inc.*, 542 A.2d 1182, 1188 (Del. 1988).

IV.

Federal Law Disclosure Requirements

In 1979, in response to negative public response to a wave of going private transactions in the 1970s, the SEC implemented Rule 13e-3 of the Exchange Act.[141] Rule 13e-3 imposes broad disclosure requirements upon issuers seeking to go private and requires that such disclosures be made to stockholders no later than 20 calendar days before any action can be taken with respect to completing a going private transaction. The purpose of Rule 13e-3 is to give unaffiliated stockholders access to information regarding a going private transaction.[142] The disclosures called for by Rule 13e-3 can be extremely onerous and often shape the process of a going private transaction, as parties understand that materials and steps must be prepared with the knowledge that they will eventually be disclosed publicly.

In addition, subject to certain exceptions, a potential bidder may be subject to the disclosure obligations of Section 13(d) of the Exchange Act. If required to file a Schedule 13D, a potential bidder will be required to disclose its intent in owning an issuer's securities and any changes thereto. As a result, consideration should be given as to whether a potential bidder is required to disclose its control intent under Section 13(d) before it is prepared to do so.

A. Rule 13e-3 of the Exchange Act

1. Persons and Securities Covered by Rule 13e-3

a. Covered Securities

Rule 13e-3 applies to all classes of securities that are registered under Section 12 of the Exchange Act, or to issuers who are required to make periodic reports under Section 15(d) of the Exchange Act. Issuers whose securities are registered under Section 12 of the Exchange Act are subject to the filing, disclosure and dissemination requirements, as well as the antifraud requirements of Rule 13e-3. Issuers who are required to report to the SEC under Section 15(d) of the Exchange Act are only subject to the filing, disclosure and dissemination requirements of Rule 13e-3.

b. Covered Persons

Rule 13e-3 applies to transactions between issuers and their affiliates. For purposes of the rule, an "affiliate" is defined as "a person that directly or indirectly through one or more intermediaries controls, is controlled by, or is under common control

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141 In re Sec. Act of 1933, Exchange Act Release No. 33-6100, Fed. Sec. L. Rep. (CCH) ¶ 82,166 (Aug. 2, 1979), *codified at* 17 C.F.R. § 240.13e-3.

142 *Id.*

with such issuer," and "control" is defined as "possession, direct or indirect, of the power to . . . cause the direction of the management and policies of a person."[143]

Acquirors and targets should be aware that the SEC's interpretation of "control"—and thus the determination of affiliate status that triggers the Rule 13e-3 requirements—may be broader than what has been determined under Delaware law. For example, "control" has been found where an acquiror has ownership of substantially less than 50% of the target company, and transactions where the acquiror has greater than 10% ownership in the target company or has the right to appoint a director to the company's board may be subject to SEC scrutiny.[144] Other factors that may determine whether control exists include (i) whether the target and the acquiror have common board members, officers or directors, (ii) the composition of the target's board committees and their relationship to the acquiror, (iii) contractual relationships between the acquiror and the company, (iv) whether there are other large stockholders in the target, and (v) the nature of the relationships between the acquiror and the target.[145]

In determining affiliation, the SEC looks to whether the acquiror has the power to influence the decision-making of the target. The SEC has indicated that, once established, affiliation cannot be removed through the establishment of arm's-length negotiation.[146] As such, establishing a special committee of the target board will not exempt a transaction with an affiliate from the requirements of Rule 13e-3.

Going private transactions that involve the management of a target company will typically be subject to Rule 13e-3, as members of a company's senior management are almost always considered to be affiliates of the company.[147] In determining whether senior management is engaged in the transaction, the SEC will look to factors such as (i) the role of the management in the company before and after the proposed transaction, (ii) any favorable changes in the compensation or employment agreements pertaining to management, (iii) whether members of the management will own a material amount of the surviving company's securities, (iv) whether members of the management serve on the boards of the acquiror or surviving company after the transaction, and (v) whether senior management is involved in the negotiation and execution of the transaction.[148]

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143 17 C.F.R. § 240.12b-2.

144 *See* Inv. Co. Inst., SEC No-Action Letter, 2009 WL 659141 (Mar. 12, 2009); Am.-Standard, SEC No-Action Letter, 1972 WL 16928 (Oct. 4, 1972).

145 *See* SEC Compliance & Disclosure Interpretations, *Going Private Transactions, Exchange Act Rule 13e-3 and Schedule 13E-3* (2009) [hereinafter *CD&I Going Private Transactions*].

146 *See* Tech. for Commc'ns Int'l, Inc., SEC No-Action Letter, 1988 WL 233718 (Feb. 22, 1988).

147 *See* In re Sec. Act of 1933, Exchange Act Release No. 33-6100; *CD&I Going Private Transactions*, Question 201.05 ("The staff consistently has taken the position that members of senior management of the issuer that is going private are affiliates of that issuer.").

148 *See* In re Sec. Act of 1933, Exchange Act Release No. 33-6100; *CD&I Going Private Transactions*, Questions 201.05-06 (2009).

2. Covered Transactions

Rule 13e-3 applies to the following types of transactions:

- transactions which involve the purchase of covered securities by the issuer or an affiliate of the issuer;

- transactions which involve a tender offer for covered securities by the issuer or an affiliate of the issuer; or

- transactions involving a proxy, consent solicitation or distribution of information statements to any shareholder of the issuer by the issuer or an affiliate of the issuer in connection with: (i) a merger, consolidation, reclassification, recapitalization, reorganization or similar corporate transaction of an issuer (or between an issuer and its affiliate); (ii) a sale of substantially all of the assets of an issuer to its affiliate(s); or (iii) a reverse stock split of any class of securities of the issuer involving the purchase of fractional interests.

In addition, the above transactions must have a reasonable likelihood or purpose of producing either of the following effects:

- causing any class of covered security to become eligible for termination of registration or to become eligible for termination or suspension of its periodic reporting requirements; or

- causing any class of covered security which is either listed on a national securities exchange or authorized to be quoted in an inter-dealer quotation system of a registered national securities association to become delisted or removed from the quotation system.

Rule 13e-3 also applies to a series of transactions, which, when considered as a whole, would satisfy the elements of the rule. Such transactions may include transactions where non-affiliates become affiliates after the completion of a going private transaction; and transactions where issuers use the proceeds from an initial sale of assets to finance a subsequent going private transaction.[149]

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[149] *See* Interpretive Release Relating to Going Private Transactions Under Rule 13e-3, Exchange Act Release No. 34-17719, Fed. Sec. L. Rep. (CCH) ¶ 23,709, at 17,245-32 (Apr. 13, 1981).

3. Exceptions to Rule 13e-3

Rule 13e-3, however, exempts from its disclosure obligations certain transactions that the SEC has determined do not implicate the same concerns as to self-dealing and unfair treatment as other affiliate transactions. These include the following:

- Second-step mergers which occur within one year of the expiration of the initial tender offer, even where the acquiror has become an affiliate as a result of the tender offer. The SEC regards two-step mergers as a single transaction by an unaffiliated party. To be eligible under this exemption, the acquiror must offer consideration "at least equal to the highest consideration offered" during the tender offer. The acquiror must also disclose its intent to effect a back-end merger when making its initial tender offer.

- Equivalent equity transactions where stockholders of the target company are offered or receive common stock or another equity security, provided that (i) the securities offered are registered under or subject to the periodic reporting requirements of the Exchange Act, (ii) have substantially the same rights as the exchanged security (including voting, dividend, redemption and liquidation rights), and (iii) if the exchanged security was listed on a national securities exchange or quoted on an inter-dealer quotation system, the security received as consideration must also be similarly listed or quoted. Parties may also invoke the exception if the target's stockholders are offered the opportunity to elect either cash or stock consideration, if (i) cash, when first offered, is substantially equivalent to the value of the security offered, and (ii) both options are offered to the target's stockholders.

- Redemptions, calls or similar purchases of securities by the issuer pursuant to the provisions set forth in the instrument creating or governing that class of securities.

- Any solicitation of the issuer with respect to a plan of reorganization under Chapter 11 of the Bankruptcy Act, if made after the entry of a court order approving the plan.

- Certain cross-border transactions.

4. Disclosure Requirements under Rule 13e-3

A going private transaction requires the same SEC filings as any other public company acquisition, but the SEC also mandates special, enhanced disclosure under Rule 13e-3 of the Exchange Act. A parent of a majority-owned subsidiary would normally be an "affiliate" of the subsidiary (the issuer).

Where a going private transaction is concerned, documents filed in connection with the transaction (whether tender offer documents, proxy solicitations or information statements) must contain the disclosure described in the SEC's Schedule 13E-3. Even if

no filings would otherwise be required (for instance, as in an open-market purchase program), a Schedule 13E-3 must be filed with the SEC and disseminated to record holders prior to initiating the purchases.

The required disclosure is extensive. It is intended to give minority stockholders a comprehensive and detailed history of the proposed transaction and of preliminary contacts and negotiations (including those with third parties in certain cases) preceding and leading up to it. This fact, and the types of disclosure that will be required, must be kept in mind by all participants during the process of considering a possible transaction.

Among other things, in the context of a proposed acquisition of an issuer's common stock, Schedule 13E-3 disclosure includes the following:

- The number of shares of the issuer outstanding, the principal market in which they trade, and the high and low sales prices of those shares for each quarter during the past two full fiscal years (and any subsequent interim period) preceding the filing of the Schedule 13E-3 disclosure.

- A description of any transaction occurring during the preceding two full fiscal years (and any subsequent interim period) between the bidder and the issuer or its subsidiaries, directors or officers (except for *de minimis* transactions).

- A description of any contacts, negotiations or transactions that have been entered into, or that have occurred, during the preceding two full fiscal years (and any subsequent interim period) between the bidder (including any subsidiary of the bidder and any executive officers and directors of the bidder) and the issuer concerning acquisitive activity, including a merger, tender offer or other acquisition, the election of directors or a disposition of material assets of the issuer.

- A description of any contacts or negotiations regarding such acquisitive activity during the preceding two full fiscal years (and any subsequent interim period) that were between any of the issuer's affiliates (*e.g.*, directors, executive officers and large stockholders), or between the issuer or its affiliates, on the one hand, and any unaffiliated person who would have a direct interest in such matters, on the other hand. The person initiating these contacts or negotiations is required to be identified.

- A description of any plan regarding post-transaction activities that would result in a merger or other extraordinary corporate transaction, a sale of material assets, a change in the board of directors or management, a material change in dividend policy or capitalization, any material change in corporate structure or business, and anything that would permit the issuer's securities to be de-registered under the Exchange Act or permit the issuer to stop filing periodic and other reports under the Exchange Act.

- A statement of purposes and reasons for the Rule 13e-3 transaction, including a description of any alternative means that the issuer or bidder considered to accomplish those purposes and a description of the effects (including tax effects, and describing both benefits and detriments) of the Rule 13e-3 transaction on the issuer, its affiliates, and the minority stockholders. Conclusory statements are not acceptable, and the disclosure normally must include a statement of the effect of the transaction on the bidder's interest in the book value and earnings of the issuer.

- A reasonably itemized statement of expenses incurred or to be incurred in connection with the going private transaction, and a statement of the sources and total amount of funds to be used in the transaction.

- An affirmative statement by the bidder and each affiliate as to whether the bidder or affiliate, respectively, believes the going private transaction is fair to minority stockholders (with detailed description of the factors underlying that conclusion) and the reasons for any director of the issuer dissenting from the transaction or abstaining from any vote for it. The bidder or affiliate is required to make "reasonable inquiry" as to these reasons. The disclosure must state whether or not the transaction requires the approval of minority stockholders, and whether or not the independent directors of the issuer have retained an independent representative to negotiate on behalf of minority stockholders or to provide a fairness opinion.

- The SEC takes the position that the important factors in arriving at the fairness conclusion that must be disclosed would normally include known firm offers made by any unaffiliated person during the prior two years with respect to a merger, substantial asset sale or a controlling block of securities. Such firm offers, and the reason for any rejection thereof, need to be described.

- Extensive disclosure regarding any report, opinion (other than an opinion of counsel) or appraisal received by the bidder or issuer from an outside party that is materially related to the transaction. This requirement is much broader in the Rule 13e-3 context than it is in arm's-length unaffiliated merger transactions, and the SEC takes the view that *all* presentations, reports, appraisals and other materials prepared by financial advisors for the bidder, including materials presented to the board, special committee or senior management, must be disclosed (and filed as exhibits to the bidder's Schedule 13E-3). The bidder must also undertake to make the opinion or report available for inspection and copying and to send it to any equity security holder upon request.

  While, generally, draft documents are not required to be filed, where the draft version differs materially in substance from the final written version, the SEC may take the position that it should be filed. Likewise, the SEC may take the view that oral reports supporting written materials need to be summarized in

the relevant disclosure document if the substance materially differs from the written work product.

- A description of the ownership of, and any transaction in, the issuer's common stock during the preceding 60 days by a broad range of affiliates and associates, including the bidder and its executive officers, directors and pension/profit plans.

- Contracts, relationships and arrangements in connection with the going private transaction between the bidder (or its executive officers and directors) and any other person regarding any securities of the issuer (including those related to the transfer or voting of the securities or joint ventures). The material provisions of these contracts, relationships and arrangements need to be described, and any document setting forth the terms of the foregoing must be filed as an exhibit to the Schedule 13E-3. The form requires such items to be described "whether or not legally enforceable."

In light of these comprehensive disclosure requirements, participants involved in the consideration and planning of a Rule 13e-3 transaction should use exceptional care with respect to the documentation of all stages of the transaction, with particular care paid to initial discussions and negotiations before management decisions have been taken and specific terms and intentions crystallized, because they may eventually become public.

A company contemplating a transaction involving an affiliate that may be a Rule 13e-3 transaction should be aware of certain considerations in this context:

- Care should be taken with written transaction summaries and term sheets. Written communications between the parties, or between each party and its respective financial advisor, may be subject to disclosure even if hypothetical and preliminary. Since such transactions are frequently subject to stockholder litigation, it is worthwhile to consider that many documents, including drafts and notes, prepared by or for a special committee may be discoverable in litigation.

- When written documents and communications are required prior to reaching final agreement on terms, such documents and communications should be prominently marked as "draft," "preliminary" or the like and should otherwise make clear that their contents are not definitive.

- Special care should be exercised with respect to written valuation analyses, payback scenarios, affordability/dilution studies and the like, whether prepared internally or by the parties' respective financial advisors, which may need to be publicly filed. Written materials prepared for preliminary discussion of these matters could, in hindsight, give the erroneous impression that particular exploratory or provisional scenarios have been adopted by management or by the financial advisors as valuations.

- Consideration should be given as to the proper time to involve the issuer's and bidder's boards of directors in the process. Also, the scope of the project should be carefully defined. If the bidder has determined that it is not interested in selling its shares to a third party, that fact should be made clear from the outset. In such a case, for instance, it would normally not be appropriate for a financial advisor to be developing lists of, contacting or soliciting other potentially interested bidders.

- Similarly, the design of the due diligence process should be approached carefully. Generally, smaller is better when it comes to maintaining control over the process. If a larger team is necessary or persons with special skills need to be brought into the process, it may be advisable for management to meet with team members to discuss preliminary results before reports are drafted.

- Preliminary discussions between the bidder and the issuer's management should be kept informal until many of the specific terms of a proposal have crystallized. Written or other "formal" proposals, if made prematurely, may trigger early disclosure requirements, including disclosure on Schedule 13D, which may complicate pricing, negotiating and other matters after such disclosure has occurred. If a special committee is to be used, consideration should be given to timing (*i.e.*, when a proposal is sufficiently concrete that negotiations will require the committee to be formed and to retain its independent advisors).

- Appropriate confidentiality agreements are usually important at the outset. These agreements usually provide that, without the other party's consent, a party may only make such disclosures relating to a proposed transaction as are required by law or stock exchange rule. It may be advisable to agree that all disclosures must be made in reasonable consultation with the other party, unless not permitted by law. If there have been contacts between the issuer and a third party, the specific identity of the third party may not have to be disclosed if the contracts were made contingent upon the third party's identity being kept confidential and if the contacts were not material.

- The bidder should carefully determine when it is appropriate to consider or formalize plans or intentions for conducting the issuer's business (*e.g.*, plant closures) or management after the going private transaction, giving special consideration to timing of negotiations with management as to their compensation arrangements going forward. Such plans and arrangements can become subject to disclosure. Prematurely formalizing such plans (such that disclosure of such plans becomes necessary) could create morale issues, or even become elements of shareholder litigation regarding the transaction.

In short, given the enhanced risk of litigation, all written communications, including all e-mail communications, should be treated as though they may eventually become public. Because of these extensive disclosure requirements and the high degree

of outside scrutiny that can be expected, the process should be carefully thought out. It should be recognized that such transactions inevitably require the participation of additional parties compared to, and that they may take longer to negotiate and conclude than, comparable arm's-length transactions. Laying the groundwork for each subsequent step before it is taken is often the key to successfully concluding these transactions. This should be taken into account at the outset so that reasonable expectations regarding timing and process are maintained by all involved.

B. Schedule 13D and 13G Disclosure Requirements

In certain instances, the bidder may have disclosure obligations under Section 13(d) of the Exchange Act, which has strategic implications on the nature and timing on the bidder's preliminary approach.

In most cases, the Exchange Act requires that persons or groups who acquire beneficial ownership of more than 5% of a class of equity securities file beneficial ownership reports with the SEC on either a Schedule 13D or Schedule 13G. The obligation to file a beneficial ownership report is triggered by the acquisition of a class of equity securities that is registered under Section 12 of the Exchange Act. In addition, amendments to Schedules 13D or 13G must be made when certain changes occur (Schedule 13D/A and Schedule 13G/A, respectively).

1. Schedule 13D Disclosure Requirements

If a controlling stockholder or other beneficial owner of more than 5% of a class of equity securities is a Schedule 13D filer and proposes a going private transaction, it must amend its Schedule 13D filing to indicate that change in intent. Specifically, Item 4 of Schedule 13D requires each reporting person to disclose (i) its purpose in acquiring or holding subject company stock (*e.g.*, passive investment, acquisition of control), and (ii) any plans or proposals that it has with respect to certain matters affecting or involving the subject company. The matters with respect to which plans or proposals must be disclosed consist of the following actions:

(a) the acquisition by any person of additional securities of the issuer, or the disposition of securities of the issuer;

(b) an extraordinary corporate transaction, such as a merger, reorganization or liquidation, involving the issuer or any of its subsidiaries;

(c) a sale or transfer of a material amount of assets of the issuer or any of its subsidiaries;

(d) any change in the present board of directors or management of the issuer, including any plans or proposals to change the number or term of directors or to fill any existing vacancies on the board;

(e) any material change in the present capitalization or dividend policy of the issuer;

(f) any other material change in the issuer's business or corporate structure;

(g) changes in the issuer's charter, bylaws or instruments corresponding thereto or other actions which may impede the acquisition of control of the issuer by any person;

(h) causing a class of securities of the issuer to be delisted from a national securities exchange or to cease to be authorized to be quoted in an inter-dealer quotation system of a registered national securities association;

(i) a class of equity securities of the issuer becoming eligible for termination of registration pursuant to Section 12(g)(4) of the Exchange Act; or

(j) any action similar to any of those enumerated above.

A critical question for purposes of disclosure required by Item 4 is at what point ideas or intentions concerning the subject company become sufficiently concrete to constitute "plans" that must be disclosed. With respect to this question, the SEC has commented that disclosure of plans of a Schedule 13D filer "is necessary even when the plans or proposals are not yet fixed and even when it was argued that such plans were to be executed in the future."[150]

Courts, however, have been reluctant to require disclosure of "tentative" or "inchoate" plans, potentially guided by concerns that requiring disclosure of speculative or tentative ideas would be misleading. In *Electronic Specialty Co.* v. *International Controls Corp.*, the U.S. Court of Appeals for the Second Circuit stated in an opinion that "[i]t would be as serious an infringement of these regulations to overstate the definiteness of the plans as to understate them."[151] Similarly, the U.S. Court of Appeals for the Eighth Circuit has stated that "disclosure of plans for specific corporate changes can be misleading until these assume definite, non-contingent form."[152] Thus, whether or not there is a legal requirement to disclose what could fairly be characterized as a tentative plan is necessarily a fact-intensive, circumstance-specific determination: as one commentator has noted, "the safest conclusions are that a shareholder must absolutely disclose all definitive plans and that any undisclosed plans had better not show up in the

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150 In the Matter of Butcher Venture Mgmt. Co., Keystone Venture Capital Mgmt. Co., & George Kenneth Macrae, Respondents, Exchange Act Release No. 32,757, 54 S.E.C. Docket 1688 (Aug. 17, 1993) (quoting In the Matter of Douglas, Exchange Act Release No. 31,046, 52 SEC Docket 990 (Aug. 17, 1992)).

151 *Elec. Specialty Co.* v. *Int'l Controls Corp.*, 409 F.2d 937, 948 (2d Cir. 1969).

152 *Chromalloy Am. Corp.* v. *Sun Chem. Corp.*, 611 F.2d 240, 247 (8th Cir. 1979) (citing *Mo. Portland Cement Co.* v. *Cargill, Inc.*, 498 F.2d 851, 872 (2d Cir. 1974); *Susquehanna Corp.* v. *Pan. Am. Sulphur Co.*, 423 F.2d 1075, 1084-85 (5th Cir. 1970); *Elec. Specialty Co.*, 409 F.2d at 948).

garb of outwardly seeming definitiveness when discovery occurs and depositions are taken."[153]

While courts have provided guidance as to when a plan or proposal is required to be disclosed, they have provided little guidance as to the level of detail that should be disclosed regarding such plan or proposal. Since the intent of Schedule 13D is to protect investors through full disclosure, where the disclosure of plans or proposals is required, the reporting person should accurately describe such plans, disclosing all material details of such plans or proposals, to the extent that such plans or proposals have been adopted. However, some courts have expressed concern about overstating the definitiveness of plans, finding that where plans are not sufficiently definitive it "is sufficient to merely identify those matters not fully determined."[154] Consequently, where the details of potential plans have not been fully developed, disclosure is not required.

A Schedule 13D filer is required to amend its Schedule 13D "promptly" after any material change in its purpose or its adoption of any plan or proposal with respect to the extraordinary corporate transactions enumerated above. The SEC has cited "strong policy considerations" for the use of a flexible as opposed to an objective standard in connection with the timing of amendments.[155] As a result, it has not defined the term "promptly," but it has taken the position that, depending on the particular facts involved, an amendment may be required to be filed as soon as the day after the change in circumstances that triggers the amendment (*i.e.*, the first day an amendment reasonably could be filed).[156]

When a change in purpose will be deemed to have occurred, or when a plan or proposal will be deemed to have been adopted, is a factual question that is dependent on a number of factors, including evidence that a purpose, plan or proposal has been developed or adopted. The SEC has recently been vigilant in enforcing the requirement for "prompt" amendment, and in several instances has brought enforcement action against reporting persons for failing to amend their Schedule 13D.[157] For example, in

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153 Thomas W. Briggs, *Corporate Governance and the New Hedge Fund Activism: An Empirical Analysis*, 32 J. CORP. L. 682, 689 (2007). *See also Trane Co.* v. *O'Connor Secs.*, 561 F. Supp. 301, 307-09 (S.D.N.Y. 1983) (finding that a filer need not disclose the possibility of making a tender offer, as the offer was so remote as to be misleading, while also concluding that a Schedule 13D that disclosed that filers "may" acquire additional shares was false and misleading in view of concrete evidence that additional acquisitions were planned).

154 *Todd Shipyards Corp.* v. *Madison Fund, Inc.*, 547 F. Supp. 1383, 1387 (S.D.N.Y. 1982).

155 In the matter of Cooper Labs., Inc., Exchange Act Release No. 22,171, 33 SEC Docket 647 (June 26, 1985).

156 *Id.*

157 *See, e.g.*, Press Release, Securities and Exchange Commission, *Corporate Insiders Charged for Failing to Update Disclosures Involving "Going Private" Transactions* (Mar. 13, 2015), https://www.sec.gov/news/pressrelease/2015-47.html.

First Physicians Capital Group,[158] one of several similar enforcement actions during 2015 that involved a "take-private" transaction, the SEC faulted certain of FPCG's stockholders for failing to amend their Schedule 13Ds until the day that the plan to go private was publicly disclosed. In bringing an enforcement action against such stockholders, the SEC alleged that the stockholders had been considering a take-private three years prior, and six months prior to amending their Schedule 13Ds had materially changed their intention, as evidenced by their communicating to FPCG management that they would support a take-private and obtaining registration rights waivers from certain holders of preferred stock. The SEC noted specifically (i) that generic disclosure must be updated when a plan has been formulated, and (ii) that depending on the facts and circumstances, an amendment may be required before a plan has been formulated because of an obligation to revise after a "material change occurs in the facts set forth" in the prior Schedule 13D. In another enforcement action around the same time, *In the Matter of Shuipan Lin*,[159] the SEC alleged that a stockholder who had previously reported that he "may acquire or dispose of the Shares in market transactions or negotiated purchase transactions from time to time but does not have current plans or proposals that relate" to the items enumerated in Schedule 13D was required to amend his Schedule 13D because, among other things, he had begun "studying the feasibility of such a transaction and reviewing other going private transactions involving China-based issuers," and had also discussed a going private transaction with two other shareholders. These enforcement actions, and the SEC's deliberate publicity efforts surrounding the contemporaneous announcement of several similar enforcement actions, indicate the SEC's focus on enforcement in the area of Schedule 13D disclosures that are implicated by going private transactions.

In addition, persons who are not currently Schedule 13D filers may become subject to Section 13(d). For example, a person who owns less than 5% of a class of equity securities that engages in discussions with a greater than 5% beneficial owner about a potential going private transaction may trigger a separate Schedule 13D filing obligation if a "group" (as defined in Rule 13d-5(b)(1)) is formed during the process. Similarly, a potential bidder that enters into a voting agreement with a stockholder or group of stockholders owning greater than 5% of a class of equity securities is required to file a Schedule 13D if the voting agreement gives the potential bidder the power to vote, or to direct the voting of, the shares, which causes the potential bidder to become the beneficial owner of the shares under Rule 13e-3 of the Exchange Act. Note, however, that if a person does not have "beneficial ownership" (as defined in Rule 13d-3 of the Exchange Act) of the company's shares—because it does not have either voting or investment power over any shares—it will not be considered a member of a group for

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158 In the Matter of Anthony J. Ciabattoni, Exchange Act Release No. 34-74500, 111 SEC Docket 144 (Mar. 13, 2015).

159 In the Matter of Shuipan Lin, Exchange Act Release No. 34-74497, 111 SEC Docket 133 (Mar. 13, 2015).

Section 13(d) purposes, even if it enters into an arrangement (short of conferring beneficial ownership) with someone who owns shares.[160]

2. Schedule 13G Disclosure Requirements

Section 13(d) permits three categories of greater than 5% beneficial owners to file a short-form statement on Schedule 13G, which does not include a certification of intent, in lieu of Schedule 13D:

- *Qualified institutional investors* (i) enumerated under Rule 13d-1(b)(1),[161] (ii) who acquired the issuer's securities in the ordinary course of business with no purpose or effect of changing or influencing the control of the issuer, and not in connection with or as a participant in any transaction having such purpose or effect, and (iii) who hold, on a discretionary basis, securities

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[160] *See, e.g.*, *Hemispherx Biopharma, Inc.* v. *Johannesburg Consol. Invs.*, 553 F.3d 1351, 1363 (11th Cir. 2008); *Rosenberg* v. *XM Ventures*, 274 F.3d 137, 145 (3d Cir. 2001); *Mgmt. Assistance, Inc.* v. *Edelman*, 584 F. Supp. 1016, 1019 (S.D.N.Y. 1984); *Todd Shipyards Corp.* v. *Madison Fund, Inc.*, 547 F. Supp. 1383, 1391 (S.D.N.Y. 1982) (brokers without beneficial ownership not group members); *Transcon Lines* v. *A.G. Becker Inc.*, 470 F. Supp. 356, 373-75 (S.D.N.Y. 1979); *see also Rorer Group, Inc.* v. *Oppenheimer & Co.*, 1983 WL 1330, at *4 (S.D.N.Y. June 27, 1983), *aff'd*, 742 F.2d 1440 (2d Cir. 1984) (complaint against broker-dealer that did not beneficially own shares dismissed).

[161] The institutional investors eligible to file on Schedule 13G under Rule 13d-1(b)(1) are the following:

- a broker or dealer registered under Section 15 of the Exchange Act;
- a bank as defined in Section 3(a)(6) of the Exchange Act;
- an insurance company as defined in section 3(a)(19) of the Exchange Act;
- an investment company registered under Section 8 of the Investment Company Act of 1940;
- an investment adviser registered under Section 203 of the Investment Advisers Act of 1940 or under the laws of any state;
- an employee benefit plan, a pension fund that is subject to the provisions of the Employee Retirement Income Security Act of 1974, or any such plan that is not subject to ERISA that is maintained primarily for the benefit of the employees of a state or local government or instrumentality, or an endowment fund;
- a parent holding company or control person, provided that the aggregate amount held directly by the parent or control person, and directly or indirectly by their subsidiaries that are not persons specified in other categories, does not exceed 1% of the securities of the subject class;
- a savings association as defined in Section 3(b) of the Federal Deposit Insurance Act;
- a church plan that is excluded from the definition of an investment company under Section 3(c)(14) of the Investment Company Act of 1940;
- a non-U.S. institution that is the functional equivalent of any of the institutions listed above, so long as the non-U.S. institution is subject to a regulatory scheme that is substantially comparable to the regulatory scheme applicable to the equivalent U.S. institution (the non-U.S. institution must include a special certification in Item 10 of Schedule 13G); and
- a group, provided that all of the members are persons specified above.

exceeding 5% on behalf of another person, and promptly notifies the account owner of any acquisition or transaction that might be reportable by such account owner under Section 13(d);

- *Passive investors*, who (i) hold less than 20% of the issuer's securities, and (ii) have not acquired the securities with any control purpose—namely, the acquisition of securities with the purpose, or with the effect of, changing or influencing the control of the issuer, or in connection with or as a participant in any transaction having that purpose or effect;[162] and

- *Exempt investors*, who own over 5% of a class of an issuer's equity securities *before* the issuer registered the securities under Section 12(g) of the Exchange Act (*e.g.*, pre-IPO), and thus are not considered to have "acquired" any securities of a class registered under Section 12 and subject to reporting on Schedule 13D.[163]

In contrast with a Schedule 13D, which must be updated whenever the information contained in the statement becomes materially incorrect, a Schedule 13G has no such update requirement. While Schedule 13D imposes a continuing reporting obligation on the filer, the Schedule 13G must be filed only yearly to reflect any changes as of that year end in the information filed in the previous report on Schedule 13G.

Participating in a going private transaction—for instance, presenting a preliminary proposal to an issuer's board of directors—may have consequences on a bidder's Schedule 13G filing status. Qualified institutional investors and passive investors lose their exemption and immediately become subject to the provisions of Rules 13d-1(a) and 13d-2(a), which require the filing and amendment of a Schedule 13D, when they cease to hold securities for investment purposes only.[164] Accordingly, if any such investors form an intent to join in a going private transaction, they would be required to file a Schedule 13D to disclose their intent. The Schedule 13D must be filed promptly, but not more than 10 days after such investors become subject to the Schedule 13D filing requirements. In addition, these investors are subject to a "cooling-off period," whereby they cannot acquire any additional securities of the issuer and cannot vote any securities previously held during the period commencing on the date the filer's investment purpose changed and ending 10 days after filing a Schedule 13D. Practically, this cooling-off period has minimal impact on voting, as issuers typically set record dates and send out proxy materials well in advance of stockholder meetings. As a result, investors may be able to execute a proxy card prior to changing their investment purpose or, if they change their investment prior to voting, they may be able to vote as long as the investor files a

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162 17 C.F.R § 240.13d-1(c) (2018); Amendments to Beneficial Ownership Requirements, Exchange Act Release No. 39,538, 66 SEC Docket 596 (Jan. 12, 1998).

163 *See* 17 C.F.R § 240.13d-1(d).

164 *See id.* § 240.13d-1(e).

Schedule 13D at least 10 days prior to the meeting date. As a result, an investor will be disenfranchised only when changing its investment intent on the eve of a meeting date.

Exempt investors, unlike qualified institutional investors and passive investors, do not need to amend their Schedule 13G or file a Schedule 13D by reason of a change in their investment plans.[165] This is because in filing the initial Schedule 13G, exempt investors are *not* required to certify that the shares were acquired or are held in the ordinary course of business or without the purpose or the effect of changing or influencing the control of the issuer of the securities.[166] As a result, there is no initial plan or intent to modify on the Schedule 13G should their investment strategies change.

There are two exceptions to this general rule applicable to exempt investors. *First*, if an exempt investor acquires more equity securities after the issuer becomes a reporting company, it must review its total acquisitions of securities over the past 12 months. As long as such stockholder's most recent acquisition, when added to all other acquisitions of securities of the same class during the 12 months immediately preceding the date of the most recent acquisition, aggregates to no more than 2% of the class of such securities, it can continue to file Schedule 13G and must reflect its acquisitions in an amendment to its Schedule 13G filing within 45 days after the end of the calendar year. But if the stockholder acquires more than 2% of the class of securities over that period, it must report its entire holdings on Schedule 13D.

Second, an exempt investor may be obligated to file a Schedule 13D if it works with co-bidders who are not eligible to file on Schedule 13G. Under Section 13, a "group" is defined as two or more persons acting together to acquire, hold, or dispose of securities of a reporting company.[167] If the group owns more than 5% of the issuer, each member of the group or the group jointly must file and keep current a Schedule 13D or Schedule 13G reporting the group's ownership. A group can file a joint filing if the members enter into an agreement to file one report jointly and each person on whose behalf the filing is made is individually eligible to use the schedule on which the information is filed. That is, if a Schedule 13G is filed, each individual must be eligible to file a Schedule 13G. If, however, any member of the group is ineligible to file on Schedule 13G, the group, if filing jointly, would have to file a Schedule 13D and make the necessary disclosure on the purpose of acquiring stock and intent on influencing the control of the company. These disclosure obligations are an important consideration when an affiliate determines whether to partner with co-bidders in a going private transaction.

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165 EDWARD F. GREENE ET AL., U.S. REGULATION OF INTERNATIONAL SECURITIES AND DERIVATIVE MARKETS § 6.04(1)(e) (12th ed. 2017).

166 *SEC Compliance & Disclosure Interpretations, Exchange Act Sections 13(d) and 13(g) and Regulation 13D-G Beneficial Ownership Reporting*, Question 101.01 (Sept. 14, 2009).

167 *See* 17 C.F.R. § 240.13d-5(b)(1).

V.

Competing Offers

In a going private transaction, the target's board of directors or the special committee may be required pursuant to their fiduciary duties under state law to seek and evaluate competing offers. Under Delaware law, transactions involving a "sale of control" or "change-of-control" of a corporation (*i.e.*, a merger in which all or a preponderant percentage of the consideration paid to the corporation's stockholders is cash, or a merger that results in a corporation having a controlling stockholder) are subject to enhanced judicial review.[168] In *Revlon, Inc.* v. *MacAndrews & Forbes Holdings, Inc.*, the Delaware Supreme Court held that in a sale of control context, directors must attempt to achieve the highest value reasonably available for shareholders.[169]

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."[170] Under this conception of *Revlon*, provided a board is choosing between two or more capable bidders presenting transactions that are comparable in terms of timing and likelihood of consummation, it must look solely to price. Specifically, a board comparing two or more cash offers cannot, for example, choose the lower one because it has advantages for "constituencies" other than common shareholders, such as employees, customers, management, and preferred shareholders.

However, it is also true that "there is no single blueprint that a board must follow to fulfill its duties" in the *Revlon* context.[171] The Delaware Supreme Court has held that "[i]f a board selected one of several reasonable alternatives, a court should not second-guess that choice even though it might have decided otherwise or subsequent events may have cast doubt on the board's determination."[172] This flexibility is particularly significant in determining a board's *Revlon* obligations when it is considering a friendly merger for cash but does not wish to engage in pre-signing negotiations with more than one partner. The Court has recently stressed that "[w]hen a board exercises its judgment in good faith, tests the transaction through a viable passive market check, and gives its

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168 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).

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

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

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

172 *QVC*, 637 A.2d at 45.

stockholders a fully informed, uncoerced opportunity to vote to accept the deal," the board's *Revlon* obligations are likely met.[173]

A. When Does Revlon Apply?

The *Revlon* "duty to seek the best available price applies only when a company embarks on a transaction—on its own initiative or in response to an unsolicited offer—that will result in a change-of-control."[174] The most common example of this is where the board of a non-controlled company decides to enter into a definitive agreement to sell the company in an all-cash deal. But, where the board does not embark on a change-of-control transaction, such as when it is arguably put "in play" by the actions of outsiders,[175] *Revlon* review will not apply. Accordingly, enhanced scrutiny is not triggered by a board's refusal to engage in negotiations where an offeror invites discussion of a friendly (or unfriendly) deal.[176] Nor does *Revlon* obligate a company that has embarked on a sale process to complete a sale process, even if the offers received are at a substantial premium to the company's current trading value. In addition, *Revlon* will not apply to a merger transaction in which there is no change-of-control, such as in a purely stock-for-stock merger between two non-controlled companies. The Delaware Supreme Court held in its seminal 1989 opinion in *Time-Warner* that in stock-for-stock mergers with no sale of control, the ordinary business judgment rule applies to the decision of a board to enter into a merger agreement.[177] But a stock-for-stock merger is considered to involve a sale of control when a corporation has no controlling stockholder pre-merger but there would exist a controlling stockholder post-merger. This was the case in *Paramount Communications, Inc.* v. *QVC Network Inc.*, where QVC successfully argued that Paramount's decision to enter into a merger agreement with Viacom was subject to *Revlon* review because Paramount's stockholders would become stockholders of a corporation (Viacom) that had a controlling shareholder who would have had voting control over the post-merger combined company, including the power to elect a majority of the post-merger board and the ability to approve or veto major corporate actions.[178] 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

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

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

175 *Id.*

176 *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).

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

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

company's shareholders. This principle applies even if the acquired company in an all-stock merger is very small in relation to the buyer. Despite the formal difference between the standards of review applicable to stock-for-stock transactions, the Delaware courts have indicated in recent decisions that the doctrinal distinction is not absolute, and, even in all-stock transactions, directors are accordingly well advised to consider alternatives for maximizing stockholder value and to take care that the record reflects such consideration.[179]

In addition, the *Time-Warner* decision makes clear that so long as the initial merger agreement did not itself involve a change-of-control transaction, the appearance of an unsolicited second 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, "[d]irectors 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."[180] 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."[181] 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.

There is also no "change-of-control" triggering *Revlon* in the cash (or stock) sale of a company with a controlling shareholder to a third party.[182] 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

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[179] *Steinhardt* v. *Howard-Anderson*, C.A. No. 5878-VCL (Del. Ch. Jan. 24, 2011) (transcript) ("[I]t's just not worth having the dance on the head of a pin as to whether it's 49 percent cash or 51 percent cash or where the line is. This is the only chance that Occam stockholders have to extract a premium, both in the sense of maximizing cash now, and in the sense of maximizing their relative share of the future entity's control premium. This is it. So I think it makes complete sense that you would apply a reasonableness review, enhanced scrutiny to this type of transaction.").

[180] *See Time-Warner*, 571 A.2d at 1154; *accord In re Santa Fe Pac. Corp. S'holder Litig.*, 1995 WL 334258, at *8 (Del. Ch. May 31, 1995) (holding that although a "bidding contest" did occur, *Revlon* duties not triggered where board did not initiate bidding and sought strategic stock-for-stock merger), *aff'd in part, rev'd in part*, 669 A.2d 59 (Del. 1995).

[181] *Time-Warner*, 571 A.2d at 1150; *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* v. *Soc'y for Sav. Bancorp, Inc.*, 650 A.2d 1270, 1289-90 (Del. 1994).

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

Chancery has expressly held, therefore, that the sale of controlled companies does not invoke *Revlon* review.[183]

Although it is clear that all-cash deals invoke *Revlon* review and all-stock deals do not, the standard is less clear with regard to 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 33% of the consideration would not be subjected to *Revlon* review.[184] But the Delaware Court of Chancery has 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."[185]

Revlon applies only once the board actually makes the decision to embark on a change-of-control transaction and not while it is exploring whether or not to do so.[186] Accordingly, the board may change its mind at any time before making the decision to enter into a transaction. However, once a board makes a decision that attracts the heightened *Revlon* level of scrutiny, courts may look back at the board's behavior during the exploration process and may be critical of actions taken that appear unreasonable and inconsistent with the board's duty to maximize stockholder value.[187] For this reason, it is important for boards and their advisors to keep a good record of their reasons for taking the actions they did.

B. What Constitutes Value Maximization?

Revlon does not require boards to simply accept the highest nominal offer for a company. A board may conclude that even a cash offer, although "higher" in terms of price than another cash offer, is substantially less likely to be consummated; the risk of non-consummation is directly related to value. 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

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183 *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. Omni Care, Inc.* v. *NCS Healthcare, Inc.*, 822 A.2d 397 (Del. 2002).

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

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

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

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

value, if feasible, to achieve an objective comparison of the alternatives."[188] 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.[189] Bids that present serious issues concerning regulatory approval or the buyer's ability to close may be viewed as less attractive, although nominally higher, than offers that are more certain of consummation.

An example of judicial deference to a board's strategic decisions when conducting a sale of control is *In re Dollar Thrifty Shareholder Litigation*,[190] where the Delaware Court of Chancery denied a motion to enjoin the completion of Dollar Thrifty's merger with Hertz, finding that the Dollar Thrifty board had not violated its duties in declining a higher bid made post-signing, because the directors concluded that the new bidder lacked the resources to finance the deal, and that the deal was subject to greater antitrust risk.[191] 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."[192] Similarly, the Court of Chancery refused to enjoin a stockholder vote on a proposed merger between Family Dollar Stores, Inc. and Dollar Tree, Inc. when the Family Dollar board turned down a facially higher bid from Dollar General, Inc.[193] The Court held that the independent directors properly complied with their fiduciary duties and were justified in concluding that "a financially superior offer on paper does not equate to a financially superior transaction in the real world if there is a meaningful risk that the transaction will not close for antitrust reasons."[194]

C. What Sort of Sale Process Is Necessary?

Boards have substantial latitude to decide what tactics will result in the best price. As the Delaware Supreme Court recently reaffirmed, "*Revlon* and its progeny do not set out a specific route that a board must follow when fulfilling its fiduciary duties, and an independent board is entitled to use its business judgment to decide to enter into a strategic transaction that promises great benefit, even when it creates certain risks."[195] Directors are not required "to conduct an auction according to some standard formula"

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

189 *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).

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

191 *Id.* at 578.

192 *Id.* at 595-96.

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

194 *Id.* at *16.

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

nor does *Revlon* "demand that every change in the control of a Delaware corporation be preceded by a heated bidding contest."[196] Courts have recognized that, in general, disinterested board decisions as to how to manage a sale process are protected by the business judgment rule. In *Mills Acquisition Co.* v. *Macmillan, Inc.*, the Delaware Supreme Court stated that "[i]n the absence of self-interest . . . the actions of an independent board of directors in designing and conducting a corporate auction are protected by the business judgment rule."[197] 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.'"[198] A board approving any sale of control must also be informed concerning the development of the transaction, alternatives, valuation issues and all material terms of the merger agreement. Thus, even in the change-of-control context reviewed under *Revlon*'s enhanced scrutiny, a board retains a good deal of authority to determine how to obtain the best value reasonably available to shareholders.

The Delaware Court of Chancery's decision in *In re Toys "R" Us, Inc. Shareholder Litigation*, illustrates that well-advised boards have wide latitude in structuring sale processes.[199] The Court's noteworthy holdings included, among others: (1) rejection of the plaintiffs' claims that a 3.75% break-up fee and matching rights unreasonably deterred additional bids; (2) approval of the board's decision to permit two of the competing private equity firms in the deal to "club" together, which potentially reduced the number of competing bidders in later rounds but was designed to facilitate bidding; (3) the rejection of allegations of a conflict of interest on the part of the CEO arising out of his stock and option holdings; and (4) the rejection of claims that the board's financial advisor's advice was tainted by the terms of its engagement letter, which provided for greater fees in the event of a sale of the whole company versus some smaller transaction. The opinion reaffirmed the principle that courts will not second-guess well-informed, good faith decisions that need to be made to bring a sale process to successful conclusion.

A board is permitted to forego a pre-signing market check if the merger agreement permits the emergence of a higher bid after signing and contains reasonable deal protection measures.[200] The Court of Chancery has explained that "there is no bright-line rule that directors must conduct a pre-agreement market check or shop the company," and "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

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196 *Mills Acquisition Co.* v. *Macmillan, Inc.*, 559 A.2d 1261, 1286 (Del. 1989); *Barkan* v. *Amsted Indus., Inc.*, 567 A.2d 1279, 1286 (Del. 1990).

197 *Macmillan*, 559 A.2d at 1287.

198 *Id.* (citations omitted).

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

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

that it had obtained the best transaction reasonably attainable."[201] Similarly, the Delaware Supreme Court has held that a post-signing market check, *i.e.* a "go-shop" period, "does not have to involve an active solicitation, so long as interested bidders have an opportunity to present a higher-value alternative, and the board has the flexibility to eschew the original transaction and accept the higher-value deal."[202] However, as explained in *In re Topps Co. Shareholders Litigation*, if a *bona fide*, financially capable bidder emerges during a "go-shop" period prescribed under the merger agreement, a board must conduct serious negotiations with it.[203] If *Revlon* applies, the board should fully engage, and make an appropriate record of such engagement, with the bidder on both price and non-price terms to determine if a truly "superior" transaction is available.

Although there is no requirement that selling boards shop their companies to all classes of potential bidders,[204] Delaware courts have criticized sales processes in which the board unreasonably failed to consider certain categories of buyers. In *In re Netsmart Technologies, Inc. Shareholders Litigation*, the Court found that the board failed to fully inform itself about possible bidders in its auction process, because management and the company's advisors assumed strategic buyers would not be interested and therefore contacted only potential private equity buyers.[205] The Court held that a fiduciary violation was likely because it found that the private equity route was favorable to management, potentially biasing them toward such buyers.[206] Because no higher bid was pending, the Court refused to enjoin the transaction and risk losing the deal entirely, but it did require more accurate disclosure to stockholders of the board's decision-making process, including its failure to contact potential strategic buyers.[207] Similarly, in *Koehler* v. *NetSpend Holdings Inc.*, the Court of Chancery criticized a board's decision to forego a market check when the deal price was well below the low end of the bankers' valuation, and potential private equity bidders were unable to renew discussions because they had signed standstill agreements containing "Don't Ask, Don't Waive" provisions.[208] Although the Court refused to enjoin the transaction and risk scuttling a

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201 *In re Plains Expl. & Prod. Co. Stockholder Litig.*, C.A. No. 8090-VCN, 2013 WL 1909124, at *5 (Del. Ch. May 9, 2013) (internal quotation marks omitted).

202 *C&J Energy Servs.*, 107 A.3d at 1067-68.

203 *In re Topps Co. S'holders Litig.*, 926 A.2d 58 (Del. Ch. 2007) (entering injunction requiring waiver of standstill agreement with potential bidder during go-shop period to allow potential bidder to make an offer).

204 *See, e.g., In re Cogent, Inc. S'holders Litig.*, 7 A.3d 487, 497-98 (Del. Ch. 2010).

205 *In re Netsmart Techs., Inc. S'holders Litig.*, 924 A.2d 171 (Del. Ch. 2007); *see also* Transcript of Oral Argument on Plaintiffs' Mot. for Prelim. Inj. 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").

206 *Netsmart*, 924 A.2d at 198-99.

207 *Id.* at 209.

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

premium offer, *NetSpend* nonetheless serves as a reminder that boards engaging in single-bidder sales strategies and deploying contractual features such as "Don't Ask, Don't Waive" standstills must do so as part of a robust and carefully designed strategy.

The key thread tying these cases together is that compliance with *Revlon* requires the board to make an informed decision about the path to maximizing stockholder value. As the Supreme Court noted in *Lyondell Chemical Co.* v. *Ryan*, "there are no legally prescribed steps that directors must follow to satisfy their *Revlon* duties," and a board's decisions "must be reasonable, not perfect."[209]

Delaware courts have found *Revlon* violations only in rare cases, usually involving unusual, or unusually egregious, circumstances. In 2015, the Delaware Supreme Court upheld the decision of the Court of Chancery to impose substantial aiding-and-abetting liability on the lead financial advisor of the Rural/Metro ambulance company in that company's sale to a private equity firm.[210] Such aiding-and-abetting liability was predicated on a finding of a *Revlon* violation. The Court found the sales process flawed because the company's lead financial advisor (a) deliberately timed the process to coincide with a strategic process involving another ambulance company to try to obtain lucrative financing work, (b) attempted to provide staple financing to whoever bought Rural, and (c) presented flawed valuation materials.[211] The advisor did not disclose these conflicts to the board. Indeed, the board was not aware of the financial advisor's efforts to provide buy-side financing to the buyer, had not received any valuation information until a few hours before the meeting to approve the deal and did not know that the advisor had manipulated the valuation metrics.[212] Applying enhanced scrutiny under *Revlon*, the Court of Chancery found that the directors had acted unreasonably and therefore violated their fiduciary duties. The Court then held that the financial advisor had aided and abetted this fiduciary breach and was liable for almost $76 million in damages to the shareholders, even though the company that was sold entered bankruptcy shortly afterward.[213] On appeal, the Supreme Court affirmed and ruled that the presence of a secondary financial advisor did not cure the defects in the lead advisor's work, and that the post-signing market check could not substitute for the board's lack of information about the transaction.[214]

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209 *Lyondell Chem Co.* v. *Ryan*, 970 A.2d 235, 243.

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

211 *Id.* at 830-31.

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

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

214 *RBC Capital Mkts.*, 129 A.3d at 860.

And in 2018, the Court of Chancery found a *Revlon* violation in the sale of the circuit company PLX Technology, Inc.[215] The Court found that the sales process was undermined by the conflicting interest of an activist hedge fund and its designee on PLX's board who vocally advocated for a near-term sale of PLX. The Court found that the hedge fund and its designee's conflict ultimately "undermine[d] the Board's process and led the Board into a deal that it otherwise would not have approved."[216] The key facts the Court relied on in reaching this conclusion included that the Board allowed the hedge fund to take control of the sales process and instructed management to generate lower revenue projections so as to support a sale at the deal price.[217] As in *Rural/Metro*, the Court also emphasized that the Board's decision was not fully informed, noting that the Board agreed to the final deal price before receiving a standalone valuation of PLX, and that the hedge fund and the company's financial advisor failed to advise the Board that the buyer had informed the company's financial advisor of its plans to bid for PLX and that it was willing to pay a higher price than PLX's Board ultimately approved.[218] The Court of Chancery's opinion underscores that activists who join boards must adhere to the same fiduciary duties as other directors and must place the interests of the company and all its stockholders above any personal, fund-specific, or short-sighted interests.

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215 *In re PLX Tech. Inc. S'holders Litig*, C.A. No. 9880-VCL, 2018 WL 5018535 (Del. Ch. Oct. 16, 2018).

216 *Id.* at *47.

217 *Id.* at *45-47.

218 *Id.* at *47.

VI.

Partnering with Other Investors

It is not uncommon for interested bidders to partner with other bidders and form a consortium when pursuing a going private transaction. The decision to form a consortium can be driven by a number of factors, including the desire to benefit from risk-sharing, to acquire the capacity to undertake larger transactions or to engage particular financial or industry expertise. For example, if the investment is large enough, financial sponsors may partner with other financial sponsors, or syndicate their investments among various minority investors, in order to write the equity check needed to acquire the company. Alternatively, in a management-led buyout, management may seek private equity or other financial sponsors to provide necessary capital. And most typically, in take-private transactions involving financial buyers, ensuring the retention of a company's management becomes critical to ensure that after the closing of the transaction, there is a senior management team with company- and industry-specific expertise in place to run the day-to-day operations.

Consortium bids often raise complex legal, strategic and economic considerations that are not present in M&A transactions involving a single buyer. As consortiums often involve partnerships between parties with different strategic goals and time horizons, issues can often arise with respect to governance and admission and exit from the consortium, as well as the allocation of fees, expenses and liabilities. Consortium bidders and their advisors would also want to set guidelines for coordination between the parties to avoid delays and errors that could cause their bid to fail. To address potential disagreements that may arise during and subsequent to a going private transaction, co-bidders often consider negotiating and executing arrangements and agreements between themselves, such as consortium agreements, that set forth the terms on which the investors bid, acquire and manage the target.

A. Confidentiality Agreements

Targets usually require potential bidders to execute confidentiality agreements before receiving company information, not only to protect commercially sensitive information but also to encourage competing bids. A standard provision in confidentiality agreements restricts bidders from sharing evaluation material and transaction information with potential equity sources absent the target's express consent, which enables the target to assert control over the process by requiring co-bidders to seek permission to join a group. In addition, targets may request that a bidder agree not to enter into exclusivity agreements that may reduce competition, for example with other bidders, debt providers or management teams. In some cases, the confidentiality agreement entered between the target and an acquiror may require the acquiror to seek the permission of the target before forming a consortium. If a company waives the confidentiality agreement with respect to dealings between consortium members, the consortium agreement between co-bidders, to the extent one is put in place, will govern how due diligence would be shared among the consortium's members.

B. Consortium Agreements

When negotiating with the target's board of directors, it is important for the consortium to be aligned on the terms of a proposed transaction not only before any formal proposal is submitted to the target company but also when any terms are determined. To coordinate this process, it is not uncommon for members of the consortium to enter into a consortium agreement, which sets out the terms upon which the investors will agree to work together to bid for and acquire the target company. Terms in an interim consortium agreement may include, among others, provisions for (i) determining governance and decision making between the signing and closing of the acquisition, (ii) confirming the transaction structure and relative equity contributions among the consortium members, (iii) providing for exclusivity with respect to information sharing among the consortium members, (iv) setting out the responsibilities of each consortium member's legal and financial advisors, (v) agreeing to the sharing of the bidders' fees and expenses, (vi) regulating public disclosures and confidentiality and (vii) ensuring legal compliance by all members of the consortium. The interim consortium agreement may also set out the key terms of the definitive post-closing investor agreements that will be entered into between and among the consortium members following the closing of the transaction.

An initial issue that needs to be addressed when negotiating an interim consortium agreement is the decision-making and dispute resolution framework. Over the course of the acquisition process, a number of issues may arise which will require the consortium to reach decisions that will have an effect on the deal and the future operations of the target's business under a compressed timeline. Common decisions that members of the consortium will have to make include deciding on the purchase price (including any increases to the purchase price to secure the transaction or in response to competing bidders), the terms of the acquisition agreement and ancillary agreements (including the granting of consents or waivers), debt financing terms, and the enforcement of equity commitment letters among the members of the consortium.

The decision-making framework used in the consortium agreement is also often the basis for the permanent arrangements that are implemented after the acquisition. As a result, it is important for consortium members to carefully weigh how decision-making authority is allocated and implemented, such that it would be appropriate during the interim period between the signing and closing of a transaction and, potentially, after closing.

While there are many ways to design the decision-making framework, bidders commonly start with the presumption that bidders should have influence in proportion to the amount of equity they have invested. As a result, deals with two equal partners generally require the approval of both partners to take action. In larger consortiums with three or more bidders, unanimity requirements may prove unattractive, as they may enable a single bidder to block or stall the decision-making process. Many consortium agreements deal with this issue by requiring a supermajority approval rather than unanimous approval. In other cases, lead investors who have made the largest equity

contribution may hold sole decision-making authority, subject to certain limited protections for the remaining minority co-bidders.

In connection with the decision-making framework, a consortium agreement will generally also address how disagreements and disputes among the co-bidders will be resolved. In deals where a lead investor holds sole decision-making authority, the remaining investors typically will retain consent rights over fundamental issues, such as increases in the offer prices, waivers of fundamental conditions to the merger agreements and actions that may have a disproportionate impact on a particular investor. In addition, consortium agreements should set forth the respective rights of each bidder in the event of a disagreement. Typically, these agreements may provide that the consortium (with the requisite approval of the group) may move forward with an action, and that the participation rights of a non-consenting investor will be terminated. Because a minority investor may be loath to have its participation terminated, such provisions can reduce the frequency in which disagreements arise and allow disagreements to be resolved in an efficient manner. In the event that a bidder terminates its participation in the consortium, the consortium agreement should include terms by which the remaining investors fill the equity gap left by the departing bidder. Typically, this issue is resolved by allowing the remaining investors to increase their investment or by allowing new investors to participate in the consortium.

In addition to the decision-making and dispute resolution framework, a consortium agreement typically includes covenants and other provisions that regulate a consortium member's conduct and responsibilities during a transaction and govern the consequences of breach. Significant provisions typically relate to:

- restricting the ability of consortium members to contact or join a different consortium or make an independent bid;
- restricting members' use of confidential information about the target;
- how members share each other's proprietary information on the target, including financial analyses;
- how the consortium will deal with ownership disclosure requirements under the Exchange Act;
- the efforts and actions members must take to address regulatory concerns, including potential divestitures;
- whether the consortium will share legal and financial advisors, and if so, how such advisors are to be engaged;
- whether any member of the consortium has entered into exclusive financing arrangements;
- how expenses are to be allocated among members;

- how termination fees are to be allocated if the transaction is terminated;

- how to deal with breaches of the consortium agreement, specifically when one or more members of the consortium fail to fund their equity commitment when required; and

- how the consortium members will collaborate on publicity and ensuring the accuracy of any information released.

Consortium agreements generally include an exclusivity provision to guard against the possibility that confidential information exchanged between members of the consortium may be used to the detriment of the consortium. Consortium members who are concerned that confidential information may be leaked to competing investors may be less inclined to share information. The exclusivity provision generally prohibits the consortium members from communicating with or joining another group of investors or from making their own separate bid for the target, even after their participation in the consortium has ended. Targets, to help ensure a competitive bidding process, may sometimes require co-bidders to represent in the acquisition agreement that they have not entered into any exclusive financing arrangements.

Consortium members may also wish to negotiate the efforts standard each consortium member will need to meet in order to satisfy regulatory approvals. At a minimum, the regulatory approvals covenant in the consortium agreement should require each co-bidder to meet the efforts standard and take actions that would permit the acquisition vehicle to meet its regulatory covenants under the acquisition agreement with the target. In short, the efforts standard aims to ensure that no one member of the consortium can jeopardize the entire transaction.

C. Management Equity Incentives

In take-private transactions, bidders generally wish to ensure that senior management and other key employees have "skin in the game," in the form of some kind of equity-based incentive compensation in the post-closing company, if not an actual investment in the post-closing company equity. In connection with the foregoing, some financial sponsors may agree to negotiate the key terms of a management equity investment and/or incentive program to be put into place after the closing of the acquisition. As discussed in Section I.D above, such negotiations must be carefully timed. If a target's board of directors chooses to permit negotiations to be held regarding management's post-closing equity participation and compensation, these discussions generally should not be commenced until after the economic terms (*e.g.*, the per share deal price) of the overall acquisition have been firmly agreed on by the acquiring entity and the target's board of directors, so as to minimize claims of management self-dealing and other breaches of fiduciary duty in any deal litigation, of the type discussed in Section III.B.3. Additionally, if the going private transaction is being effectuated through a tender offer and back-end merger, all appropriate steps should be taken to avoid the application of the best price rule, as discussed in Section II.C.3.

VII.

Financing the Deal

Going private deals often require substantial financing transactions involving the incurrence of new bank debt or new issuance of debt securities to finance the purchase price, and the amendment or replacement of existing debt (including working capital facilities) that may be required to be repaid in connection with, may be defaulted by or otherwise have terms that are inconsistent with, the transaction. In addition, the need for new financing or amendments to existing financing arrangements may introduce risk of closing certainty to the going private transaction. That is, if the consummation of the requisite financing transactions is subject to one or more conditions that are different from those in the acquisition documents (such as receipt of consents from existing lenders, the health of the relevant financing markets or a different measure of the company's performance than the material adverse change condition in the acquisition agreement), then there is a risk that the acquiror will be obligated to close the transaction pursuant to the acquisition agreement but will not have the wherewithal to do so. Therefore, the board or the special committee will generally require the acquiror to (and the acquiror may independently desire to) obtain financing commitment letters from reputable financing sources concurrently with the signing of the acquisition agreement, the conditions of which would be matched as closely as possible to those in the acquisition documentation.

The company (rather than the acquiring persons or entities) will typically incur any required financing, and in some circumstances, the acquiror will seek to use the company's available cash to finance a portion of the payment to existing shareholders; therefore, the company is likely to become meaningfully more leveraged after giving effect to the transaction than it was beforehand. This increased leverage profile has a number of implications, including that:

- the pricing, financial and operating covenants, required guarantees and collateral support and other terms of the new financing can be dramatically different from those in the company's pre-deal debt documents (which may have profound implications on the company's debt service expenses and ability to incur debt and liens, make investments, sell assets or, perhaps of more particular concern to the acquiror, pay dividends or engage in transactions with their affiliates (including the acquiror));

- rating agencies may downgrade the company's credit ratings, including by downgrading the former public company from investment-grade ratings to high-yield ratings (which may, among other things, impact the company's access to certain types of financing markets, such as the commercial paper market or, when combined with the consummation of the going private transaction, trigger an obligation for the company to offer to repay certain outstanding debt or other obligations);

- contractual counterparties may begin to demand letters of credit, deposits, guarantees or other credit support (which may in turn increase the company's liquidity needs in the ordinary course); and

- financing and derivatives contracts may be defaulted or other rights may be triggered thereunder as a result of a decrease in creditworthiness coupled with a change of control (which may increase the company's new financing needs and further increase its financing costs).

In addition, the structure of the transaction, whether as a one-step merger or a two-step merger, may affect the structure and terms of the proposed financing. In particular, the federal margin rules, which restrict a company's ability to borrow (and a lender's ability to lend) debt used to fund the acquisition of certain types of public equity securities, to the extent such debt is secured directly or indirectly by certain types of such securities, may impose restrictions on the terms of the acquisition debt in a two-step merger until the closing of the second step. The increasing prevalence of 8 *Del. C.* § 251(h) transactions, in which the second step occurs immediately following the consummation of the tender offer, has inevitably mitigated many of these concerns; however, where that structure is unavailable, the margin rules may impose substantive restrictions on the borrower's ability to provide its lenders full and immediate pledges of its assets and, even in the context of unsecured financings, covenant protections of the type that the lender might ordinarily expect. More often than not, these issues create complexities in, rather than material impediments to, the arrangement of the financing, but working through them requires time and consideration. In addition, the satisfaction of a financing condition in a tender offer may be deemed a material change requiring that the tender offer be extended for an additional five business days.

Because of the considerations, as well as the fundamentally different nature of this type of deal financing from regular way financing transactions, negotiation and execution of these arrangements can take substantially more time than such a company may have been accustomed to spending on financing transactions in the past. And assuming a commitment letter is obtained, many of these issues will need to be fully addressed at the time of signing. As a result, the company and the board or the special committee should be clear with the acquiror early in the process if they are going to demand committed financing at signing, and acquirors should initiate their analysis of financing issues and begin to engage with potential lenders early in the process. Such an analysis should consider:

- any issues presented by the company's existing debt documents—including defaults that may be created by the transaction or restrictions on the payment of dividends or transactions with affiliates that might impact the company's relationship with the acquiror following the transaction—and strategies for addressing them;

- the company's optimal financing structure, including ensuring that no obligations are incurred unless and until closing;

- the ideal terms of its new debt instruments; and

- requiring representations regarding the solvency of the company (in order to protect the company's directors).

Furthermore, notwithstanding the fact that the company's equity interests may be privately held following the consummation of the take-private transaction, the terms of the company's outstanding indebtedness may require continued public company-style reporting and not permit the company to "go dark" and terminate its public reporting obligations. And even if the contractual terms of that debt do not require the company to continue to publicly report, then securities laws may so require, if such debt is registered. While workarounds may be available in each of these situations, planning for their implementation can be complex and may need to be integrated with the overall financing plan.

Finally, the acquiror's need for this type of financing (as well as, perhaps, the company's existing cash) and the other considerations described above will require special attention in the acquisition agreement. Because the acquisition agreement is unlikely to include a closing condition relating to the acquiror's actually obtaining the proceeds of its debt financing, the acquiror is likely to bear meaningful risk in the case of a financing failure. Therefore, the acquiror may require assurance from the company, in the form of a covenant in the acquisition agreement, that the company will cooperate with the acquiror in its efforts to arrange the new financing (including the company's preparation of certain financial statements required in connection with the debt offering, participation in due diligence and marketing activities with respect to the debt, and assistance in negotiating, drafting and executing the debt documents), address any issues in the company's existing financing (including the company's participation in or leading pre-closing tender offers or exchange offers for or taking certain pre-closing steps relating to the redemption or repayment of the company's existing debt) and, in some circumstances, give the acquirors sufficient time to arrange and market the financing prior to a closing. The company and the board or the special committee, on the other hand, will want to ensure that the acquiror is working diligently to execute its financing plan (which may manifest itself in the form of a covenant of the acquiror in the acquisition agreement) and that any of the company's cooperation obligations, notably, any cooperation covenants put forth by the acquiror, are not unduly burdensome or costly.