Acquisition / Deal Structures

1. **Merger**

    a. **Direct –** two corporations combine to form single entity

    i. Survivor gets assets, liabilities, rights, and obligations of constituent corporations

    ii. Approval Requirements → *check statute AND certificate of incorporation*

    1. Board and Shareholders approval of both parties except in short-form

        a. Board = unanimous

        b. Shareholders

        i. **Delaware** – majority of shares but **not** majority of quorum at shareholder meeting

        ii. **California** – majority shares of each class

        iii. **MBCA** – majority quorum [at meeting]

    iii. Vote Buying (***Schreiber v. Carney***)

    1. Per se void if

        a. Defrauds or disenfranchises other shareholders

        b. When potential injury or prejudicial impact to other stockholders

    2. Swing votes → possibility of holdout

        a. A swap contract allows the shareholder to transfer the economic risk of the shares he holds

        b. Crown v. EMAK Partners – When economic interests are aligned with voting rights, a shareholder can sell his or her shares to a buyer, and such sale would not be void

        i. SH with swing votes sold his shares to bidder for higher than market price

    iv. **MBCA § 11.07** – Effects of merger

    1. Corporation designated in merger agreement as surviving entity continues its existence

    2. Separate existence of corporation or corporations that are merged into survivor ceases

3. All property owned by, and every contract right possessed by, each constituent corporation is vested in the survivor

4. All liabilities of each constituent corporation are vested in the survivor

5. Surviving corporation's name may be substituted in any pending legal proceeding for the name of any constituent corporation that was a party to the proceeding

6. Articles of incorporation and bylaws of survivor are amended to the extent provided in merger agreement

7. Articles of incorporation documents of any entity created by merger becomes effective

8. Shares of each constituent corporation are converted into whatever consideration was specified in the merger agreement and the former shareholders of the constituent corporations are entitled only to the rights provided them in the merger agreement or by statute

v. **Filing with Secretary of State** specifying who and how they've been merged if they've merged with a foreign corporation

b. **Triangular –** acquiring corporation sets up a shell subsidiary

i. Shell is capitalized with consideration to be paid to target shareholders in acquisition

1. Shell then merged with target corporation

ii. Non-tax benefits – maintain target company as continuing entity under different ownership and a separate entity for liability limitation

iii. Acquiring company is not one of the constituent parties to transaction BUT the target and the acquirer subsidiary with which target is merged

iv. Acquiring company makes a subsidiary *and then* subsidiary forms with target company

1. **Consent:** subsidiary and target company

a. **Weird:** Acquiring Company gives its stock to the Merger Subsidiary → requires SH approval for issuance of additional stock

i. SH approval where acquiring Company issues 20% or more → shareholder approval

2. **Approval:** BOD + Shareholders

v. **Compare variations**

1. **Reverse Triangular –** target company survives

   a. Ex: target's name maintained because there's some good will

2. **Forward Triangular –** merger subsidiary [shell] is surviving entity

c. **Short Form -** shareholders of both corporations that are parties to a statutory merger must vote to approve the merger

d. Special Veto Rights in Mergers

   i. Vote required for merger: check the statute <u>and</u> the certificate of incorporation

   ii. Dissenting Minority – shareholders who vote against the merger may exercise dissenters/appraisal rights

   iii. Advance that overcame the holdout problem

   iv. Usually in public-public merger: shareholders of target <u>do not</u> get appraisal rights (DE rule)

2. **Asset Purchase –** selected assets of target are purchased by acquiring company

   a. Approval

      i. BOD – both sides

      ii. Shareholder

         1. Target – when all or <u>substantially all</u> assets are sold

            a. Substantially all is difficult to achieve

         2. Buyer – only when assuming more than 20% of shares

            a. Using cash **does not** need to go because it's a board issue

      iii. Dissenter Rights – at most fiduciary

   b. Best Practices

      i. An acquisition subsidiary;

      ii. Adequate capitalization of the subsidiary;

      iii. Observe formalities of the subsidiary:

         1. Note: to avoid veil piercing

   c. Insurance up to the amount of the initial capital contribution

d. BOD essentially maintains an unconstrained authority to sell, lease, mortgage, or otherwise dispose of corporate assets **except** where the board attempts to dispose of all or substantially all of the corporate assets – ***see defacto merger doctrine***

   i. ***Gimbel v. Signal Companies*** (turns quantitative test into qualitative test)

      1. Quantitatively vital to the operation of the corporation

      2. Out of the ordinary, and

      3. Substantially affects the existence and purpose of the corporation

      4. **Implications**

         a. Small, non-diversified businesses will likely trigger the shareholder approval requirements in a sale of assets.

         b. The accumulation of businesses – conglomeration – can result in no shareholder approval requirement when those businesses are later spun-off

   ii. ***Katz v. Bregman*** **–** taken together, the nature of the transaction plus the fairly high percentage of assets being sold, satisfied all or substantially all and therefore required shareholder approval

      1. Turning to qualitative measures, the switch would be a radical departure by which the corporation would sell off the core part of its business in order to go into an entirely new line of business

e. **Liabilities**

   i. **Successor** - Where one company sells or transfers all of its assets to another, the second entity does not become labile for the debts and liabilities including the torts of the transferor (***Antiphon***) **EXCEPTIONS**

         a. Assumes liability

            i. Express

            ii. Implied – relies on intention on part of buyer to pay debts of seller . . . factors:

               1. Effect of transfer on creditors of predecessor corporation

               2. Admissions of liability on part of officers or other spokespersons of successor corporation

         b. ***Ramirez*** **–** strict tort liability succeeds to purchaser for defects in units of the same **product line previously** manufactured and distributed by the seller (minority0

         c. Rationale: remedies destroyed by the sale of assets

d. Transaction amounts to consolidation or **merger**

e. Transaction is **fraudulent** and intended to provide an escape from liability

f. Purchasing corporation is **a mere continuation** of selling company

g. **Policy Consideration**

i. Whether innocent tort victims bear business risks of others (i.e. "externalities")

1. Victims left without a remedy always raise questions about the virtue (or non-virtue) of limited liability regimes → personal injury

ii. **Statutory** (will follow acquirers of property, assets, or employers, and any agreement between the merger parties will not be effective against the government or the affected employees)

1. Environmental

a. Note: impose transaction costs and therefore deter

2. Potential continuity of union agreements or requirement to recognize union

3. Certain countries may have their own statutory liability – severance obligations

iii. **CLEANSE –** wash an asset sale though a bankruptcy proceeding

iv. **Effect of Non-Negotiable Liabilities**

f. Taxable events

i. Mergers may not necessarily tax

g. **De Facto Corporation Doctrine**

i. Situation: shareholders say it's a merger (dissenters' rights) vs. company says it's an asset purchase

1. ***Farris v. Glen Alden* –** substance over form

2. ***Hariton* –** form over substance (DE)

ii. Sale achieves same result as a merger

iii. ***Does the transaction so fundamentally change the nature of the business as to cause the shareholder to give up his shares in one company and against his will accept shares in a different enterprise?***

1. Sale of more than 75% of balance sheet assets by market value vs. 25%

iv. **Factors**

1. Distribution of consideration to SH
2. Change in board composition
3. Change in shareholder composition
4. Significant changes in share value
5. Significant changes in company's line of business

h. **Compare to Merger**

i. Bidder buying assets does not assume the liabilities of the selling corporation

ii. Asset sales are taxable events, while most mergers will not necessarily be recognized as taxable events

3. **Tender Offer –** purchase of shares from shareholders

a. Acquiring company goes directly to target company's shareholders

i. **Friendly** – made through the board to the SH

ii. **Hostile** – directly to the SH

iii. Consideration is paid directly to target company's SH, not dealing with target's directors

b. Acquiring company owns stock so **target becomes subsidiary**

c. Premium – acquiring company has to pay above market price to get shareholders to budge

d. Without all SH approval – dissenters become minority SH

i. To whom majority owe fiduciary

ii. Get rid of them via squeeze-out merger

4. Payment in Acquisition

a. Cash
b. Stock
c. Notes
d. Mere promises

e. Earnouts – payments based on performance of the company/people after the deal closes

f. Other rights

5. Major Themes

    a. **Regulation:** Does corporate law serve regulatory function or enabling function

        i. Should consent requirements apply equally to any transaction that achieves the same result?

            1. Substances over form

               OR

            2. Sophisticated parties knowing forms can select to restrict or allow certain transactions

        ii. Should exchange or SEC add further approval requirements to state corporate law?

    b. **Consent**– see pg. 68-69 for appraisal rights and majority voting requirements

        i. Statutory

            1. CA Corp.

                a. § 1101

                b. § 1200

                c. § 1201

                d. CA requires vote for each class of stock for merger

            2. Del. Corp. §

                a. Put everyone together and get the majority

        ii. Agreements are **contractual BUT <u>cannot</u>** vary statutory

6. Options and Rights to Acquire Stock

    a. Usually requirement to notify option-holders some time before closing

    b. Notice period may be after record date for determining which shareholders have a right to vote

i. Option-holders may not have notice to exercise to become shareholders in order to vote

c. No statutes or anything for option-holders (just contractual)

7. Preferred Stock

   a. Silicon Valley Preferred Stock (Venture Preferred) almost always has a veto of some kind on mergers, asset sales, and sales of control

   b. Traditional Preferred is usually a debt-like instrument and does not usually have a veto on mergers

Standard of Review For Arms Length Mergers

8. Court will defer to judgment of board

   a. If board acted in

      i. Good faith

      ii. Informed manner

      iii. Disinterested

   b. Unless decision is shown to be irrational (not attributable to any business purpose) or there was a conflict of interest

      i. Motive to remain in office is one that pervades all directors' decisions and is not by itself enough to prove conflict

Delaware uses three basic tests for judging the actions of a selling firm's board in an acquisition:

1. Business Judgment Rule: Applied in Smith v. Van Gorkom.
2. Enhanced Scrutiny (Unocal): Applies to actions when a seller favors one bidder over another, and in other circumstances. See Revlon.
3. Intrinsic Fairness Test: Applies when directors are operating under conflicts of interest. (Mills Acquisition Co. v. Macmillan & Cede & Co. v. Technicolor.)

Buyer's Search for Information: Due Diligence

1. **Overview**

   a. Determining what the seller really owns and what rights and obligations it has, and what the buyer is buying

   b. Having seller make accurate representations

      i. Have buyer make representations when buyer stock is being issued in the transaction

   c. What are the consequences to seller of misrepresentation

   d. Ideally, the buyer will "see the business through the eyes of the seller

   e. Buyer wants information to be symmetrical so it knows what it is buying and can properly price the assets

   f. Parties want to determine what is known and what is not known about the business

   g. Parties **may** want to negotiate the known liabilities, and allocate the risks of unknown liabilities

   h. If the seller is getting stock of buyer, then buyer will want information on seller

   i. During diligence process, the definitive agreement is being drafted;

   j. Multiple diligence investigations are going on (technical, financial, legal, business);

   k. Communication is imperative among the team;

   l. There may an international or specialized component to the investigation;

   m. The prospects of the business are crucial, and will impact the "material adverse change" provision of the acquisition agreement

2. **Process**

   a. Begins with a confidentiality agreement (NDA), or a letter of intent

      i. Seller agrees to grant access to buyer (certain conditions may apply)

      ii. Parties may agree on non-solicitation of employees/consultants

         1. May also agree on "no shop" or exclusivity for some period of time

      iii. If LOI → a tentative price and some terms of the acquisition are established

      iv. Definitive agreement is being drafted;

v. Multiple diligence investigations are going on (technical, financial, legal, business);

vi. Communication is imperative among the team;

vii. There may an international or specialized component to the investigation;

viii. The prospects of the business are crucial, and will impact the "material adverse change" provision of the acquisition agreement

b. Negotiating points

i. Facts can be represented and unknown risks can be allocated by warranties and through covenants

ii. Two main qualifications that are negotiated in representations and warranties:

1. To the knowledge of seller… (e.g. page 1146, fn 35).

2. Materiality

3. Due Diligence Defense

a. No person other than the **issuer**, shall be liable . . . who shall **sustain the burden of proof**

i. (3)(A) as regards any part of the registration statement not purporting to be made on the authority of an expert he had **after a reasonable investigation, reasonable ground to believe** <u>**and**</u> **did so believe** at such part of the registration statement became effective, that the statement became effective, that the statements therein **were true** and that there was **no omission** to state a **material fact** required to be stated therein or necessary to make other statements therein not misleading **and** re: registration statement – he had **no reasonable ground to believe and did not believe** at such the time the registration statement became effective **had no reasonable ground to believe and did not believe** that the statements therein were **untrue**

b. **Red Flags**

i. Contingent liabilities;

ii. Off-balance sheet obligations;

iii. Inter-company transactions.

iv. Concept: The representations and warranties are intended to bring out this information to price the purchase accurately; they do this by providing a remedy for misrepresentation

v. Materiality is for securities but not in M&A context except where there's a security sale within the M&A deal

The Acquisition Agreement

1. **Overall Structure**

   a. Price
   b. Closing Mechanics
   c. Rep/Warranties
   d. Conditions to Closing
   e. Covenants between Signing and Closing
   f. Post-Closing Covenants
   g. Termination Events
   h. Miscellaneous

PRICING

2. **Generally**

   a. Information can be obtained so the price can be based on all material information

   b. Main Issue: parties may have different perceptions of value of target company

3. **Earnouts** - buyer agrees to pays the valuation of business as it stands now in the buyer's estimation and agree to pay more if the earnings increase as much as the seller projects

   a. Creates post-closing contingent payment obligation that becomes effective in the event the seller meets certain targets or exceeds predetermined thresholds with respect to revenue, profitability, market acceptance, technical achievements, or regulatory approvals

   b. Traditional way to bridge the "valuation gap"

   c. Where buyer and seller have differences over their respective expectations of the seller's future performance or differences over the relevant period in time over which the value will be generated, these differences can lead to significant divergences in the valuation of seller

      i. By agreeing to defer resolution of these differences until the future after the seller's actual performance becomes known the earnout can help the buyer and the seller align their time horizons, thereby permitting the parties to efficiently price the asset for sale

   d. Trouble – create incentive for acquirer to hold down earnings during the earnout period and only take full advantage of its newly acquired business once the earn out period ends

      i. Difficult to ensure the target's former shareholders can effectively monitor compliance with its obligations

   e. **Example:** In the one year period after the acquisition, the key employees will receive 10% of all gross revenue from the sale of the target companies products up to $20M

i. **Issues:** Should the earnout be for the key employees only or for all shareholders of the target? Is this a shift in value away from shareholders?

f. Considerations

i. Measuring period (shorter the better);

ii. Measuring criteria (simpler the better);

iii. Budget control (clearer the better);

iv. Decision-making (clearer the better);

v. Type of agreement – general principles or detailed operating plan (depends on trust between the parties);

vi. Who receives the payments

g. ***O'Tool v. Genmar –*** earnout agreements must be carried out in good faith and with fair dealing

i. Buyer must refrain from arbitrary or unreasonable conduct that deprives the former target shareholders of the fruits of its bargain

ii. Good Faith

1. Court will look at the spirit of the agreement

2. Seller should be given a fair opportunity to operate the company to maximize the value of the earnout

4. **Stock Price Movements**

a. When payment is in stock, parties deal with movements in the price:

i. No adjustment

ii. Fix a value and issue a number of shares at that that required value

iii. Provide for an adjustment with limits (collars)

1. A collar on the price is used in public company transactions based on stock of one or both of the parties

a. Ensure that a certain value of stock is delivered at closing

b. Public Companies: press release issued on transaction immediately after signing a material definitive acquisition/merger agreement

c. Big Changes between signing and closing

5. **Proceed Distribution**

    a. Liquidation Preferences

        i. Preferred (C) gets first, then Series B and then Common – it's a waterfall down

        ii. Conversion – preferred holders have conversion rights to convert their Series C stock into Common Stock

    b. Options and Warranties

        i. Stock transactions vs. cash

        ii. Options – buyer assumes options

            1. Option vesting accelerates

            2. Exercisable

        iii. Always inquire how the options and warrants are being treated.

            1. Not like stock where their treatment is "automatic."

        iv. In the Money vs. Out the Money

            1. **In the Money** – options where the stock price is greater than the exercise price

                a. **Cerberus Int'l v. Apollo Mgmt** - Absent any provision, the options and warrants would be exercised and share in the Merger Consideration (thus, diminishing the amount for each share, and the cash from exercise would just add to the company's cash at closing

            2. **Out of the Money** – options where the stock price is less than the exercise price

        v. Assumption of options compared to non-assumption of opinions

            1. **Assumption of Options** – buyers assumes options of seller and converts them into the options of the buying company

            2. Buyers assume options

                a. Option vesting accelerates and options are exercisable

                b. No acceleration and options are exercisable

                    i. If options are not exercised → terminate

BETWEEN SIGNING & CLOSING

6. Generally

   a. Representations can become untrue;

   b. Consents may not be received;

   c. Litigation may commence;

   d. Employees may quit;

   e. Customers may leave;

   f. The economy may worsen

7. **Material Adverse Changes -** Should the buyer have to buy something at the original price if the item has materially worsened?

   a. Give effect to intent of parties

      i. From language of contract and without respect to parol evidence unless there is ambiguity

   b. When words are clear and unambiguous and lead to no absurd consequences, no further inquiry may be made into the parties' intent

      i. Fact that in hindsight, create dispute as to meaning does not render provision ambiguous

      ii. Court must give ordinary meaning of words and may not create an ambiguity where none exists

   c. **Burden of Proof:** acquirer has heavy burden to establish existence of material adverse change

      i. **DE Courts** have <u>never</u> found material adverse effect to have occurred in merger agreement context

   d. ***John Borders v. KRLB*** – contract said "adverse changes which would *impair the operations* of the radio stations" <u>but</u> since contract did not specifically mention the decline in Arbitron ratings, no material adverse changes found

      i. Court interpreted the paragraph to address matters in control of management, not external matters like ratings

   e. ***Esplanade Oil v. Templeton Energy*** – condition said "<u>no</u> adverse material change to properties or seller's interest therein"

      i. Properties were not unchanged by oil price change – NO material adverse change

ii. Letter of Intent

1. Non-binding LOI can be enforced

a. Non-executed ones may pass because may implicate oral agreement

2. Usually require corporate approval (BOD + SH)

f. ***IBP v. Tyson Foods –*** The provision is to be interpreted "in context" – a company's long-term strategy Best Efforts

i. **Consequential** to the company's earnings power over a commercially reasonable period

1. Blips do not count - One bad financial quarter

ii. **Standard: Buyer can walk away:** A general provision protects a buyer from an unknown event that "substantially threatens the overall earnings potential of the target in a durationally-significant manner

g. **Solutions to MACs**

i. Buyer can simply pay a termination fee and terminate the transaction ("no cause" termination).

1. **Termination Fee** usually upheld via liquidated damages test – damages amount must be uncertain and amount agreed upon has to be reasonable

a. Objective test for liquidated damages vs. penalty:

i. If damages must be uncertain ex ante in order for it to be liquidated damages

b. Damages must also be reasonable.

i. The real anticipated losses by the parties if the deal falls through, and

ii. The difficulty in calculating the loss

2. "Reverse termination fees" because they were paid by buyer rather than seller terminating a deal to take a higher price

8. **Best Efforts Clauses**

a. Generally require target boards to use their best efforts to secure SH approval of mergers and sales, subject to their fiduciary duties to keep SH informed if a better offer appears

b. Other areas

        i. For target board's to secure shareholder approval;
        ii. For buyer or target to obtain third party consents;
        iii. For buyer to consummate the transaction
    c. Requirements Generally
        i. All reasonable means for obtaining the promised goal;
        ii. Commercially reasonable efforts.
        iii. Some courts have held
            1. Illusory provisions (good faith/fair dealing)
            2. Factual matters for the jury
    d. Breach Damage Claims
        i. Asset sale: claim is made by the corporation,
            1. NOT shareholders
        ii. Merger agreement is an agreement between two entities

REPRESENTATIONS & WARRANTIES

9. **Generally**
    a. **Representation –** a statement of a past or current fact about an aspect of the business;
    b. **Warranty –** seller's promise that the thing being sold is as represented or promised
        i. Promise that an existing fact or future fact is or will remain true, or will be of a certain character or quality.
        ii. For a matter on which the facts are not known, what is often given is a warranty
    c. **Survival –** period when party receiving representation or warranty may make a claim of misrepresentation or breach of warranty
        i. Period for which claims may be asserted post-closing:
        ii. But based on the state of affairs when represented (typically when the acquisition is signed and at closing).
        iii. Public company acquisitions, representations/warranties expire at closing.
        iv. Note: buyer wants longest possible survival period vs. seller is shortest
        v. If the target is a privately-held company, then the reps and warranties can survive for some negotiated period of time

vi. **Negotiable**

1. Effect of qualifiers on the representations and warranties – "material" and "knowledge"

10. **Knowledge Qualifier**

a. All about disclosure and risk allocation

b. Examples

i. "None of seller's intellectual property or products being sold infringes the rights of third parties."

ii. "To the seller's knowledge, none of seller's intellectual property or products being sold infringes the rights of third parties."

iii. "There is no litigation threatened against the company."

iv. "To the seller's knowledge, there is no litigation threatened against the company."

11. **Materiality Qualifiers**

a. Buyer wants NO materiality qualifiers

i. Seller wants every representation qualified by materiality

12. **Termination Provisions**

a. After signing, but before closing, one party may be able to terminate the agreement ("walk") for a material misrepresentation or breach of warranty by the other party

i. Negotiated provisions

1. May be a cure period

2. Breach may have to be material

b. The may be a provision for the seller to terminate for a higher offer and pay a break-up fee to the buyer, unrelated to a misrepresentation or warranty

c. Mutual "walk-away" rights with a capped termination fee provides certainty

i. But also enables termination

d. ***United Rentals v. Ram Holdings* –** upheld right to terminate and pay a fee

i. Contained specific performance remedy and freedom to termination provision combined with a walkaway fee

POST-CLOSING INDEMNIFICATION

13. **Generally**

a. Conditions to satisfy before closing

b. Deal may be conditional on buyer obtaining financing

c. Usually corresponding covenant to use best efforts to satisfy conditions

    i. ***ConAgra v. Cargill*** **–** parties recognize that there was a continuing fiduciary duty owed by each board of directors to its respective shareholders which could not be contracted away

d. Failure to satisfy condition will allow other party to walk (refuse to close)

e. Misrepresentation gives rise to indemnification

14. **Indemnification**

a. From whom aggrieved party get **remedy** is negotiable:

    i. Usually all parties receiving merger consideration

        1. EXCEPT bankers, lawyers, service providers, and government

    ii. **Joint Liability** – buyer may get entire remedy from one selling SH

    iii. **Several Liability** – buyer gets pro-rata share from all selling SH

b. Recovering from disparate shareholders

    i. Escrow portion of acquisition consideration

    ii. Holdback portion of acquisition consideration

c. Negotiate

    i. Litigation or investigation costs

    ii. Nickel and diming sellers

    iii. Larger than amount of merger proceeds

d. **Baskets –** agreement between the parties that the buyer will bear the first specified dollars of damages, aggregated from all breaches of warranties in the agreement, once the basket is full the seller bears the additional liability

    i. Sellers want to avoid being sued for trivial amounts after the closing and typically want a minimum amount of damages before a buyer can sue

THIRD-PARTY CLAIMS FOR BREACHES OF ACUQISITION AGREEMENT

15. ***Hexion*** **–** Intentional/Knowing Breach

a. Deliberate act intended to breach agreement

b. Illustrative of how to make a deal more likely to close by requiring certain actions of the parties between signing and closing *see* material adverse changes

16. ***Force Majeure*** **–** gives party right to suspend efforts to close or terminate

a. Material adverse change basically

FEDERAL SECURITIES LAWS: REPS & WARRANTIES

17. **Generally**

a. If stock is being purchased, the securities laws attach to that transaction

i. N/A for cash-for-asset sales

b. 10b-5 protection is not waivable

c. ***One Communications v. JP Morgan*** - Buyer sues sellers' major stockholders for alleged misstatements in pre-agreement representations – claim defeated because integration clause demonstrated "no reasonable reliance."

d.

Defensive Measures

1. **Accepting / Rejecting Bids**
    a. DE says BOD

2. **Regular Review Standards**
    a. **Interested director transactions –** burden on directors to prove "fairness" of transaction
        i. Can shift the burden by getting independent approval
    b. **Non-interested director transactions –** business judgment rule protection

3. **Delaware OLD Law: Primary Purpose / Business Purpose**
    a. Directors initially receive benefit of BJR
    b. If π provides evidence for court to infer directors' primary purpose was to preserve their positions → burden shifts to directors show they had reasonable grounds to believe that a danger to corporate to policy and effectiveness existed
        i. Good faith and reasonable investigation
    c. Business Purpose Test
        i. BJR applies
            1. Plaintiff needs to show by preponderance of evidence that directors acted solely or primarily to retain control → BJR REBUTTED
                a. Plaintiff must show sole and primary purpose was to retain control

4. ***Unocal* Standard – Review Standard for Antitakeover Defense Measures**
    a. BOD has authority to <u>oppose takeover</u>
        i. Must not act out of a sole or primary purpose to entrench themselves
        ii. May protect corporate enterprise from harm reasonably perceived
    b. **Applies when board unilaterally (without SH approval) adopts a defensive measure in reaction to a perceived threat**
        i. **DOES NOT APPLY unless there is unilateral board action**
        ii. **NOTE: many states apply BJR instead of *Unocal* so analyze under both**

c. **Test:** judicial examination at the threshold **before** BJR protections apply

i. **Threat –** directors must show that they had **reasonable grounds** for believing a danger to corporate policy and effectiveness existed

1. **Satisfied: Good Faith** – being informed, intention to serve corporation **AND Reasonable Investigation** of true plans of acquiring person

a. Proof enhanced when majority of board is independent

2. **Unreasonable**

a. ***AC Acquisition v. Anderson Clayton* –** when a current shareholder who elects not to tender would experience a substantial loss in market value

b. **SEC Rule 14d-10 –** all holders/best price rule – tender offer open to all holders and all holders get the best price

ii. **Proportionality/Balance** – must be reasonable in relation to threat posed

1. ***Utrin*** – If measure is not draconian/harsh, then the question is whether the defense falls into a range of reasonableness

a. Court has to decide if defensive measures are draconian (coercive or preclusive),

i. Coercive: Causes stockholders to vote in favor of the transaction for some reason other than the merits of the transaction.

ii. Preclusive: Deprives stockholders of the right to receive all tender offers or fundamentally restricts proxy contests.

1. And if not, then as long as it is in the "range of reasonableness" it's ok.

iii. **THEN BJR:** absent showing of fraud, illegality, or conflict of interest, the court must abstain from reviewing the director's decision

1. Directors are entitled to exercise their honest business judgment on information before them and to act within their corporate powers

5. **Golden Parachutes (*Gaillard v. Natomas*)**

    a. Employment K between company and key employees which provides severance payments to employee in event he is fired in a change of control in the company

    b. Money paid to managers who lose their jobs as a result of the corp being taken over

        i. Can be seen as last minute appropriations of corporate assets

    c. Can align interests of managers with shareholders, but not in the midst of takeover negotiations

6. **Nature of the Bidding Market**

    a. Two-tier offers (with different payments) can be made subject to pro rata allocation among tendering shareholders;

    b. "Rush" offers can no longer be made;

    c. Transactions costs for the bidder are thus larger;

    d. If there is a defense by target management, then transactions costs are larger, and an auction is possible (further diminishing the value for the bidder)

    e. Bidder might offer a higher price initially in a friendly offer to avoid an auction

        i. But state law may require an auction or "market check"

    f. Target Side: some corporations used to adopt super-majority provisions for effecting mergers, or fair price provisions to avoid two-tier offers.

        i. Not necessary any longer because Williams Act requires highest price for all shareholders "in the tender offer"

    g. Note: The maker of the offer is still in control of his/her offer, and may offer to purchase only a majority.

    h. Pro rata payments to shareholders required if offer is over-subscribed

7. **Protecting the BOD from Proxy Fights**

    a. ***Blasius* Standard –** There must be a compelling justification for interfering with SH voting rights.

        i. This is a very rigorous and demanding test (like strict scrutiny)

        ii. Board cannot act for the primary purpose of reducing the voting power of a control shareholder

        iii. Must be "compelling justification" for such action

        iv. Board bears the burden of proof when the election machinery appears to have been manipulated

    b. This rule even applies when

        i. Board control is not at stake

        ii. Board makes provisions that a change in control would destroy company

8. **Filling Board Vacancies**

    a. DE – power to fill vacancies unless provided otherwise in charter or bylaws

    b. CA – power to BOD for vacancies except for removed directors

        i. If BOD does not fill position, SH can do so

DEFENSIVE MEASURES: SHARK REPELLENT & POISON PILLS

9. **Standard**

    a. Liability for directors sued by unhappy shareholders is BJR

        i. BOD not liable for ordinary negligence but must be grossly negligent

    b. To get BJR must past *Unocal*

10. **Shark Repellent**

    a. Amendment to firm's articles of incorporation/bylaws designed to get potential bidders to look elsewhere

        i. **Classified / Staggered Board –** divide into class of three where only one is elected annually

            1. Two annual meeting cycles before it elects majority of board

        ii. Super Majority Vote Requirement

11. **How Poison Pills Work**

a. A right to purchase a unit of a new series of stock is issued to current stockholders, and the right has a high (out-of-the-money) exercise price.

b. Rights are not immediately exercisable, and they trade with the common stock during this time

    i. For the time being, the rights are redeemable on target Board approval for a nominal amount.

c. The rights separate from the common stock, become exercisable, and trade separately, upon a "distribution event" – typically when a bidder becomes the owner of (e.g.) 20% of the target Company's stock, or a tender offer is made for (e.g.) 30% or more of the target Company's stock.

d. The rights are typically redeemable when just a bid is made, but not redeemable when an actual purchase beyond the threshold is made.

e. The rights become exercisable at a discount to the market price, for Company stock ("flip-in") or stock of bidder ("flip-over") upon the bidder acquiring a certain percentage of the Company's stock (e.g. 50%).

f. The rights are <u>inactive in the hands of the bidder</u> (discriminatory treatment against the bidder – OK under <u>Unocal</u>)

12. What is a Poison Pill?

a. Takeover defense giving target company shareholders' right to purchase additional target or bidder stock at a discount if a change in control takes place.

    i. Deterrent effect comes from resulting increase in bidder's acquisition cross and/or dilution of bidder's existing shareholders' holdings.

    ii. Target BOD typically can cancel its defensive tactics by resolution to permit the acquisition to go forward

b. <u>Key Element</u>: The rights are void in the bidder's hands.

c. Effect of Pill if triggered: dilutes bidder's ownership; makes acquisition more expensive.

d. Grants holders the option to purchase new shares of stock in the issuing corporation

    i. **Flip In** – permitting rights holders, except Acquiring Persons, to purchase stock and/or debt of the <u>issuer</u> at a bargain price prior to, or regardless of, a subsequent business combination

        1. Buyer acquires specified percentage of the stock

        2. Enable common stockholders of the issuer, except for Acquiring Persons, to purchase stock and/or debt in the issuer at a discount following certain triggering events (e.g., acquisition of a specified

amount of the issuer's common stock), in the absence of or prior to certain business combinations involving the issuer

3. Rights become exercisable for the target's common stock and at a discount to the market price

4. Existing shareholders, but not acquiring shareholders, are allowed to purchase shares in the target company at a discount.

    a. Dilutes the value of the shares purchased by the acquiring company by flooding the market with new shares, while also allowing investors who purchase the new shares to profit instantaneously from the difference between the discounted purchase price and the market price

ii. **Flip Over** – permits rights holders to purchase stock in an Acquiring Corporation at a bargain price following a merger

1. Common stockholders of the issuer typically receive a pro rata dividend consisting of a right or warrant to purchase common or preferred stock, or both, of the issuer.

2. Prior to triggering event – redeemable by the board of directors for a nominal price, trade with the underlying common stock and cannot be exercised.

iii. **Redemption** – articles or bylaws will probably say that only the continuing (sitting) directors can redeem the pill. Redeeming the pill = the board gets cashed out

1. ***Quickturn -*** Pill redemptions are a board decision, and the board is held to the same fiduciary standard as when adopting the pill

2. **Dead Hand** – deprive any such newly elected directors of the power to redeem the pill

e. Pills only rarely triggered: Crown Zellerbach partially triggered, and Selectica was triggered (p.370 of casebook).

f. **Consequences of triggering event:**

i. Cash would come into the target on exercise of the rights attenuating somewhat the cost of the dilution;

ii. The pill dilutes the bidder, but it might not be enough to deter the bidder

13. **Variations on the Pill**

a. **Poison Put Plan –** gives shareholders right to have their shares redeemed at a certain premium price after a triggering event

b. **Chewable Pill –** gives shareholders ability to terminate pill or automatic termination of pill if certain criteria are met

OTHER DEFENSES MEASURES

14. **White Knights -** Person or entity friendly to target company that makes a tender offer in competition to the initial bidder

15. **Standstill Agreements -** once the acquirer gets confidential info, can oust target management, so has to enter agreement that will not initiate hostile takeover for some period of time

    a. ***Ivanhoe Partners v. Newmont Mining -*** found no breach of duty, target board was entitled to enter into that kind of agreement, actions were reasonable given threats faced and entitled to BJR

        i. Goldfields signed standstill agreement with Newmont – would not acquire over 33% unless a third party acquired 9.9%+; Ivanhoe acquires 9.95%, makes hostile bid, attempts to enter deal with Goldfields; Newmont board modifies standstill agreement so Goldfields can buy more stock (up to 49%) and board releases dividends to all SH

VOID DEFENSES

16. Ability of hostile bidder to wage successful proxy contest for control of board

    a. ***Quickturn v. Shapiro* –** dead hand provisions that completely disable new board from ever waiving a poison pill are presumably void

        i. Invalid a poison pill plan that could not be waived by a newly elected board for six months after election

        ii. Infringement of board's statutory power to manage affairs of firm

    b. ***Blasius* –** invalidates any takeover defense that impairs target SH right to vote unless the board can show a compelling justification

STATE TAKEOVER LAWS

17. **State Takeover Laws**

18. **Other Constituencies**

19. **Requirement Board to be Informed**

WHEN DEFENSE IS NOT AN OPTION

20. **Generally (*Smith v. Van Gorkom*)**

    a. Court applies the BJR to evaluate the conduct of the BOD of the selling corporation in a negotiated acquisition

        i. If rule applies, BOD decision are protected from second-guessing by court

ii. BJR does <u>not</u> apply if there is proof of fraud, bad faith, or self-dealing, or uninformed decision making

iii. If BJR is not available, court evaluates the merits of the deal under the intrinsic fairness test

1. Deal must be entirely fair to the shareholders

2. Investigation into procedure and investigation into fair price

b. To overcome BJR, plaintiff must alleged sufficient facts to create an inference of gross negligent with respect to the board being informed

i. Burden then shifts to Δ to show they were not grossly negligent

1. If gross negligent → usually dispositive of entire case

c. It's all about board process because BOD duty to negotiate a merger

i. Valuation information

ii. Market tests

d. A corporation is worth what someone will pay for it. The market value reflects the price for a share of stock; a buyer's price would reflect a "control premium" to acquire the entire company

e. Speed is justified if there is a crisis or emergency, and that might excuse less than perfect process

***Revlon* & *Paramount* confront the issue of when and how a target board can favor one bidder over another in an auction for a firm.**

21. **Duty to Auction Company: *Revlon* Duties**

a. When break-up of a company is inevitable or change in control

i. BOD duty changes from defenders of corporate bastion to auctioneers charged with getting the best price for the stockholders at the sale of the company

ii. Corporation puts itself up for sale when it initiates an active bidding process, when it initiates a bust-up of the company's divisions, or when it initiates a transaction that results in a change of control

1. When there is no longer a threat to corporate policy and effectiveness or to stockholder interests, question of defensive measures becomes moot.

2. Directors' role changes from defenders to auctioneers

a. Target directors are not passive observers in a takeover contest

b. Defensive measures are moot when company is for sale

3. Central duty then is obtaining highest price for the stockholders.

4. Directors cannot play favorites with contending bidders

    a. Duty to stockholders not bidders

5. In a sale, considering interests of noteholders (or other impermissible considerations) constituted a breach of the duty of loyalty

iii. "When a board ends an intense bidding contest on an insubstantial basis, and where a significant by-product of that action is to protect the directors against a perceived threat of personal liability for consequences stemming from the adoption of previous defensive measures, the action cannot withstand the enhanced scrutiny which Unocal requires of director conduct."

b. There is no single blueprint that a board must follow to fulfill its duties

c. *Revlon* does not demand that every change in the control of a Delaware corporation be preceded by a heated bidding contest

d. **Revlon duties apply where:**
    i. **Target initiates an active bidding process in which the target sells itself in a clear attempt at a breakup of the corp.**
    ii. **Target abandons a long-term strategy and seeks an alternative transaction involving the breakup of the corp., or**
    iii. **Approval of the transaction results in a sale or change of control of the corp.**

e. **The Revlon duties:**
    i. **Target corp cannot favor one bidder over another**
    ii. **Target corp must maximize SH value.**
    iii. **If Revlon duties are not imposed, then BJR applies**

22. **Methods to Satisfy *Revlon***

a. **Auction and Market Tests –** Not essential, although a "market check" enhances the good faith of the board in seeking the best price

b. ***Dollar Thrifty*** – allows for post-signing topping bids

    i. Selecting the best overall deal, not necessarily the highest price if that price has additional risk:

        1. Dollar Thrifty had anti-trust and termination fee risk that Hertz addressed

        2. "Closing certainty" is valuable

c. **Favoring One Bidder (Compare Situations)**

    i. ***Novell*** – charges of favoring one bidder state a claim of bad faith

    ii. ***BJ's Wholesale Club*** – excluding bidder who was channel competitor and who had no history of acquisitions is OK

d. ***Pennaco*** – CEO conducted all face-to-face negotiations and no BOD members were directly involved in negotiations

    i. OK to allow officers to negotiate

    ii. OK to not have pre-signing market check, provided there is no lock-up

    iii. Strong deal protections could tilt an analysis to a conclusion that board's negotiations were unreasonable

23. Sales Trigger *Revlon*

a. A corporation puts itself up for <u>sale</u> when it initiates

    i. An active bidding process

    ii. Bust-up of the company's division

    iii. Transaction that results in a <u>change of control</u>

        1. Does <u>not</u> occur merely because a diffuse body of SH of purchasing party in a merger ends up with a majority of the stocks in the surviving entity

b. Once a firm has put itself up for sale, the standard for favoring one bidder over another is high

    i. Firm must meet entire fairness test, which usually means it must sell to the highest bidder unless

        1. Boards actions can satisfy *Unocal* standard

            a. Threat + Proportionality

24. ***Paramount* - Is Company for <u>Sale</u> → *Revlon* applies in at least two situations**

a. In an auction context when a board puts the corporation up for sale;

    i. When a target seeks an alternative transaction that demonstrates the break-up of the company is inevitable.

Definitive Agreements

1. Letters of Intent

    a. Intermediate agreements that memorialize the terms of the deal as agreed to thus far, not binding unless there is a formal agreement

    b. Usually say parties contemplate negotiating a definitive agreement

2. Definitive Agreements

    a. Agreement still requires recommendation by BOD to SH and SH approval before closing

3. Conditions to closing

4. No-Talk Provisions

5. Bonding Performance

6. **Lock-Ups** – any arrangement or transaction by which the target corporation gives the favored bidder

7. Break-up Fees – specified payments on termination of agreement

    a. Can be structured in a variety of ways

        i. Pay legal fees associated with failed bid

        ii. Specified fee

        iii. Topping fee – usually based on the value of the new bid over the disappointed buyer's bid

        iv. Crown Jewel lock-up

8. ***Brazen v. Bell Atlantic*** - the definitive agreement provided for a two-tier break-up fee if stockholder approval were not obtained and/or the agreement was terminated.

    a. Termination fees are contractual liquidated damages provisions .

    b. Note that the law disfavors penalties for breach of contract.

    c. Structures

        i. Liquidated damages,

            1. Will be upheld if the damages are uncertain and the amount is reasonable

ii. BJR is <u>not</u> used to evaluated liquidated damages

1. **Reasonableness = test → NOT BJR (NO more than 3-4%)**

a. **Expected loss if merger does not occur AND**

b. **Difficulty of calculating loss**

2. **Is it coercive?**

a. **Vote for transaction other than on merits!**

iii. **Termination fees that are reasonable (usually no more than 3-4% of value of target) can be agreed upon as remedies for breach or termination**

1. Give certainty to damage remedy

2. Allow for company to accept higher bid

3. Compared to exclusive agreement: termination fees are less restrictive

iv. Certain deal protection measures are OK if they do not prevent the board from recommending a higher bid

1. Do not prevent SH approving a higher bid

d. Test for Wrongful Coercion

i. Action taken have effect of causing stockholders to vote in favor of proposed transaction for some reason other than the merits of the transaction

ii. Termination fee reasonable in amount is not wrongful coercion

9. **Exclusivity**

a. *Unocal* is the appropriate standard even in connection with deal protection devices include in a negotiated acquisition – standard for reviewing exclusivity agreements

b. Under *Unocal*, court must find the protective devices not preclusive or coercive before looking at a range of reasonableness under proportionality prong of *Unocal*

c. DE – hostile to exclusivity agreements

d. CA – allows board to enter into binding merger agreements and exclusivity agreements until SH vote does not conflict with BOD's fiduciary duties

i. SH still free to accept or reject agreement (***Jewel v. Payless***)

1. ***Jewell –*** if court finds that second bidder induces selling firm to breach valid and enforceable contract with initial bidder, second bidder is liabile to the frustrated first bidder

a. BOD may lawfully agree in a merger agreement to not seek a competing offer until SH vote on the first offer occurs

10. ***Unocal* Standard for Deal Protection Devices**

a. [*Unocal* Threat] Reasonable grounds to perceive a threat – loss of the deal

b. [*Omnicare* Additional Step] Two step analysis

    i. Need to establish that devices adopted are NOT preclusive or coercive

        1. Coercive: Causes stockholders to vote in favor of the transaction for some reason other than the merits of the transaction.

        2. Preclusive: Deprives stockholders of the right to receive all tender offers or fundamentally restricts proxy contests.

c. [*Unocal* Proportionality] THEN demonstrate response was within a range of reasonable responses

Shareholder Conflicts

1. **Majority Shareholder – Control**
   a. Majority shareholders can influence sale decisions in at least two principle ways
      i. Board representation – it may have elected majority of board
      ii. May control shareholder vote needed for transaction
   b. Informal influence over the board

2. **Majority Shareholder Influence**
   a. Shareholders (minority too) can sell their stocks as they see fit
      i. Risk of being minority is that one is subject to being dragged along by majority
      ii. Exceptions: selling to a looter, fraud, misuse, confidential information, or wrongful appropriation of corporate assets

3. **Influence: Board**
   a. Board's duties are still the same in a sale even when there is a majority shareholder
      i. **Except** – when majority shareholder is buying, board's decision should be independent
         1. *Revlon* does not attach because no sale of control

4. **Influence: Conflicts, Board Duties**
   a. Holders of large blocks of stock complicate target board's duties to other SH
      i. Major holders often direct or significantly influence sale process, impacting board's process
      ii. Major holders often have a seat on the board and thus board must operate through a special committee

5. **Sales by Majority Shareholders**

    a. ***Orman v. Cullman*** – voting agreements are permissible in spite of *Ominicare*

        i. Threat to losing the deal but

            1. NO coercion by something other than merits of transaction

                a. Board free to recommend against the transaction and public shareholders free to reject the transaction

6. **Sales of Control**

    a. ***Abraham v. Emerson Radio*** – majority owner can sell control for premium

        i. If sale is known looter, major owner (seller) may be held liable

        ii. No statutory common law tag along right for minority SH

APPRAISAL REMEDY

7. **Shareholder Appraisal Rights**

    a. All states give shareholders who dissent a right to petition a state court for fair cash value of their shares in certain types of acquisitions

    b. If substantial minority block of SH demands cash in these proceedings and constituent firms in a stock swap acquisition are cash poor . . .

        i. Mere notice by dissenting shareholders that they might assert their appraisal rights can terminate acquisition

    c. Give shareholders who dissent from a merger the right to have the fair value adjudicated and paid to them in cash (even if the merger only promises stock).

    d. However, dissenting shareholders must follow statutory procedures.

    e. Appraisal statutes vary greatly. State law is varied in this area.

        i. In many states, appraisal is available for a number of fundamental corporate changes, sometimes even certain amendments to the articles.

        ii. DE however provides appraisal in only statutory mergers, but not all such mergers

            1. If the stock is publicly traded and the company has more than 2,000 record shareholders, no appraisal rights are available, subject to certain qualifications (e.g. the consideration is something other than stock or cash).

f. Appraisal is “almost always” the <u>exclusive</u> remedy after an acquisition.

    i. An exception is if the proxy or stockholder voting materials is materially misleading or inaccurate.

8. **Scope**

    a. DE – dissenting SH in statutory mergers, in which minority SH do not have right to vote, have appraisal right

    b. CA – appraisal rights to selling firm SH in stock-for-asset acquisitions but not cash-for-asset acquisitions, regardless of whether selling firm dissolves

9. **Procedures**

    a. A shareholder must “perfect” his/her appraisal rights by following certain steps:

        i. In some jurisdictions a shareholder must send a notice to the corporation stating his/her intention to invoke appraisal rights and not vote in favor of the transaction;

        ii. In some jurisdictions, the shareholder must actually vote against the transaction.

        iii. Appraisal in most jurisdictions is the shareholders’ exclusive remedy after the merger, absent fraud, non-disclosure, etc.

    b. Delaware

        i. Corporation contemplating transaction that gives rise to SH appraisal rights <u>must notify</u> SH of these rights <u>20 days before corporation submits transaction for SH approval</u>

            1. Then each dissenting SH demanding appraisial rights must so notify the corporation <u>before</u> the vote on the transaction

        ii. If SH ratify transaction, corporation must notify dissenting SH that right to appraisal is avaialable

            1. <u>Must</u> occur within <u>10 days of transaction’s effective date</u>

                a. Then SH <u>must within 20 days of second notice</u> demand corporation appraisal of shares

        iii. If SH is unsatisfied, <u>must within 120 days of transaction’s effective date</u>, file petition in court of chancery demanding determination of value of his stock

10. **Valuation & Pricing**

    a. Valuation results in a range, and the court should find the valuation within a reasonable range

b. Court recognizes that the courts are not very good at these types of determinations because the judicial task is to find a reasonable valuation within a range.

c. Fair value

   i. Judges value shares using proof of value by any techniques or methods which are generally considered acceptable in the financial community and otherwise admissible in court

      1. Apportioned pro rata among SH

d. Market price isn't correct

   i. DE courts have said that fair value is measured by "fair value of the business" divided by number of shares outstanding

11. **Exclusivity**

a. DE courts allow SH to file additional requests for relief if they uncover evidence in course of discovery of pending appraisal case to support claims beyond those of garden-variety fiduciary breaches (***Technicolor***)

   i. ***Weinberger*** – appraisal remedy is <u>not</u> appropriate where fraud, misrepresentation, self-dealing, deliberate waste of corporate assets, or gross or palapable overreaching are involved

b. Remedy in non-appraisal proceedings is limited

   i. Injunctive relief

   ii. Recissory damages – put SH in same financial position they would have occupied had transaction not taken place

12. **Control Premiums**

a. Paying a premium for the control of the company

   i. Boards have enhanced duty to trade the premium carefully

13. **Non-Traded Stock Marketability**

a. When valuing non-traded stock, courts may recognize a discount for lack of marketability.

   i. Since there is no market, any premium to "market" is not readily apparent. A premium to the "last round price" is the only immediate metric.

   ii. What is the right lack of marketability discount?

14. **Freeze-Out Mergers**

a. Where subsidiary has minority SH → controlling SH may wish to force minority to sell their stock

i. Accomplished by merging subsidiary with parent or with a wholly owned subsidiary of a parent pursuant to a merger agreement

1. By which minority SH receive cash or securities of parent

b. Controlling shareholder causes the corporation to buy out minority through a merger, even if minority objects.

c. Mergers converts the shares into whatever consideration is specified in the merger agreement

i. Usually cash, notes, or contingent consideration

d. Minority may not block the merger *assuming* sufficient majority obtained

e. Freeze-out mergers always involve the majority buying out the minority.

i. Entire fairness is the standard of review.

ii. Burden of proving unfairness can be shifted to plaintiffs if independent committee approves transaction or majority of minority vote is obtained, with full disclosure (i.e. candor).

iii. Buyer Board can get business judgment rule protection with independent Committee and non-waivable majority-of-the-minority vote.

15. **DE Freeze-Out Rules**

a. Entire Fairness

i. First on plaintiff to demonstrate some basis for attacking the fairness of the transaction;

ii. Then to the majority shareholder (and/or board) to show **entire fairness**

1. Independent director approval is helpful here

iii. Where informed vote of the majority of the minority was obtained, burden entirely shifts to plaintiff to show transaction was ***unfair*** to the minority.

iv. An independent director approval, alone, would also shift the burden under DGCL, Section 144.

1. With both protections, business judgment rule can apply.

b. Cash-out merger, remedy of shareholders in appraisal remedy

    i. Exception: Where there was fraud or misrepresentation, or conflicts of interest, then appraisal remedy may not be adequate

        1. Up to court to fashion remedy if needed

c. ***Kahn v. Lynch* –** approval of transaction by independent director committee or disinterested

    i. Shifts from dominating to minority (Pg. 147)

d. ***Weinberger* –** when directors are on both sides, still must satisfy entire fairness <u>but</u> their remedy must be made my means of appraisal proceeding (statutory bar kicks in)

    i. Same DOL standard applicable in conflicted-director transactions

    ii. In freeze-outs, the court elaborated that **<u>ENTIRE FAIRNESS</u>** means, "fair dealing and fair price."

    iii. <u>FAIR DEALING:</u>

        1. Common directors must be loyal to both corporations, and cannot favor one over the other.

            a. The common directors owe fiduciary duties to both corporations.

            b. Arledge and Chitea used their position on UOP's board to benefit Signal by preparing a report that only Signal used.

        2. Duty of candor: fully disclose all material facts to the minority.

            a. In this case, disclosure of the Arledge-Chitea report was required to the independent directors or to the minority.

            b. What is a "material" fact: the reasonable investor would consider both the information and how it was prepared important in deciding how to vote.

        3. Arm's-length bargaining.

            a. The record should show bargaining as an independent special committee would bargain.

            b. If the process is rapid, there should be a rationale for lack of deliberation.

            c. In this case, four business days with a hurried fairness opinion did not demonstrate deliberation.

    iv. <u>FAIR PRICE</u>

    v. Involves the minority or independent board acting on full information

1. A fairness opinion must be a careful study, not a hurried report
2. In this case, the court provides a broad appraisal remedy for determining a fair price so that all information about the price can be evaluated
    a. This remedy would involve valuation reports
    b. Note: This remedy inclines planners to attempt to arrive at a fair price in the transaction itself rather than through an expensive litigation process post-transaction

e. Conflict of interest is imputed to target-subsidiary board
    i. Merger is treated like a self-dealing transaction

f. DE § 144 – Interested Director Transaction
    i. (a) No contract or transaction between a corporation and 1 or more of its directors or officers, or between a corporation and any other corporation...in which 1 or more of its directors or officers, are directors or officers...shall be void or voidable solely for this reason, or solely because the director or officer is present at or participates in the meeting of the board or committee which authorizes the...transaction...if:
        1. (1) The material facts as to the director's or officer's relationship or interest and as to the...transaction are disclosed or are known to the board of directors or the committee, and the board or committee in good faith authorizes the contract or transaction by the affirmative votes of a majority of the disinterested directors, even though the disinterested directors be less than a quorum; or
        2. (2) The material facts as to the director's or officer's relationship or interest and as to the contract or transaction are disclosed or are known to the shareholders entitled to vote thereon, and the contract or transaction is specifically approved in good faith by vote of the shareholders...
            a. AKA majority of minority vote
                i. Obtaining this vote in most cases will shift the burden of proof to plaintiffs.
                ii. Without this vote, the burden of proving fairness is on the directors;
                iii. With this vote, the complainant bears the proving that the transaction was unfair.
                iv. In a new case in DE – a nonwaivable majority of minority vote with an indep. special committee can confer business judgment rule protection.

v. To be valid:

1. The shareholder vote (or the vote of the disinterested directors if using subsection (1) of Section 144) must be "an informed one."

2. Thus, candor (disclosure of all material facts) is required to validate this vote

16. **BJR as opposed to Entire Fairness**

a. Court holds that business judgment would apply if:

i. The transaction were recommended by a disinterested, independent special committee; and

ii. Approved by a non-waivable majority-of-the-minority stockholders

b. ****When the controlling shareholder is not the buyer, with the right procedures business judgment rule could apply;

c. Otherwise, entire fairness will apply (with the right procedures the burden of proof could be shifted to plaintiffs).

d. Payment of a different form of consideration to the majority holder is not *per se* a breach of a fiduciary duty.

17. **The Appraisal Bar**

a. The statutory appraisal remedy is exclusive (subject to certain narrow statutory exceptions), and there is no ability to collaterally attack the merger.

b. Even most fiduciary duty claims are essentially about price and must be adjudicated through the appraisal process.

c. Fraudulent or deceptive practices could take the issue outside of appraisal, and a court could fashion alternative remedy.

i. E.g. non-disclosure in proxy materials.

18. **Summary**

a. Majority stockholder decision to sell or not sell is up to the majority stockholder (he/she cannot be required to sell).

b. If majority is selling to a third party, the board is the fiduciary to the minority. (JQ Hammons)

i. With the right procedures, the board can obtain business judgment rule protection.

c. If the minority is selling to the majority, board is the fiduciary to the minority, and entire fairness will apply. (Weinberger).

   i. Board may be able to shift burden;

   ii. Board may bet business judgment rule protection.

d. Appraisal may be available for those opposing the transaction.

e. Assuming biz. judgment rule applies, or the transaction is fair, and full disclosure is made, appraisal will be the only remedy for a stockholder opposed to the deal.

f. Appraisal isn't fun because it is a court debate on value.

Securities Laws Overview

1. **Rule 145**
   a. Securities laws apply to issuance of stock in a merger
      i. Register stock
      ii. Exemption
         1. **For companies with a California nexus is the California fairness hearing.**
            a. This provides a federal exemption, and
            b. Constitutes state securities law compliance as well
2. **Mergers with large numbers of target stockholders**
   a. Will require a registration of the shares.
      i. Often done on a "joint proxy/registration statement" on a Securities Act Form called an S-4

3. **Federal Overlay to Takeover Law**
   a. Williams Act – Regulates tender offers (usually cash, but could be any consideration)
      i. Tender Offer – offer to purchase shares made by bidder directly to SH of target company, sometimes subject to minimum/maximum that bidder will accept, communicated to SH by means of newspaper ads and/or general mailing to list of all SH with a view toward acquiring control
         1. Hostile when used to circumvent resistant board
   b. Proxy Regulations – regulates proxy fights (changing the board);
   c. Negotiated Mergers – if for stock, issuer stock registration rules will apply.
   d. A negotiated merger for cash is still largely free of federal regulation except for the shareholder approval process, which will be regulated by the proxy regulations for a public company.
   e. Thus, negotiated merger for cash of a private company is usually free of federal regulation
   f. Securities Law Overview
   g. The Williams Act: Two parts:
      i. Beneficial ownership disclosure (Section 13 of the '34 Act); and

        ii. Tender Offer regulation (Section 14 of the '34 Act).

   h. The Williams Act was passed in 1968 in response to a wave of cash tender offers that constituted the "conglomerate wave".

4. **Williams Act**

   a. Regulated all acquisitions of greater than 5% of the outstanding shares of a target company;

   b. Regulated all tender offers.

   c. Did shareholders need any protection in a cash tender offer?

   d. What kind of protection did they need? Was disclosure needed?

   e. Some risk presented by financing delay in a transaction, especially if the shares were irrevocably tendered.

   f. The Williams Act gave all shareholders revocation rights until closing.

   g. Prevented stampeding shareholders by requiring disclosure and mandatory waiting periods before closing on the tender.

   h. Required pro rata acceptance if the tender was over-subscribed ("all holders"/"best price").

   i. Beneficial ownership regulation:

   j. An acquisition of greater than 5% of the voting securities of a public company required certain disclosures.

   k. "They already thought of that" – even certain voting agreements or options required disclosure if the control exceeded 5%.

5. **Williams Act: Tender Offer Regulation**

   a. Goal: Protect target shareholders, through disclosure and timing of offers.

        i. There is some debate about whether target shareholders are protected and/or whether the mandatory disclosure is a forced transfer of wealth from bidders to target shareholders and subsequent bidders.

        ii. There is some debate this might hurt shareholders overall in that is may deter bids.

   b. What is a Tender Offer

        i. Eight Factor Test

            1. Active and widespread solicitation of public shareholders

            2. Solicitation for substantial percentage of issuer's stock,

3. Offer to purchase made at premium over prevailing market price,

4. Firm terms of offer

5. Offer contingent on tender of fixed number of shares

6. Offer only open for limited period of time

7. Subjecting offerees to pressure to sell

8. Public announcements of a purchasing program concerning the target company precede or accompany rapid accumulation of large amounts of the target company's securities

ii. Two Part Test

1. Do the persons selling need the protection of the rule or can they fend for the themselves - "sophistication" AND

2. Is there a "substantial risk" that the solicitees lack information needed to evaluate the proposal

c. Overview Rules

i. Procedural Rules:

1. Shareholders can withdraw from the tender any time prior to closing;

2. Bidder must keep offer open for minimum 20 days;

3. An additional ten days is required if the bidder raises it price or changes a material term;

4. If a partial tender, the bidder must accept shares on a pro rata basis;

5. All tendering shareholders get the best price

6. Probability Magnitude Test

a. Probability of the event occurring;

b. Magnitude of the event.

c. A merger is a large magnitude event.

7. Materiality

a. Total mix – reasonable shareholder considers it important