Deal Points

The Newsletter of the Mergers and Acquisitions Committee

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FROM THE CHAIR

With the upcoming meeting in San Francisco now less than a week away, many of you are finalizing your itinerary for the trip. If you plan to arrive on Thursday or early Friday, please join us for our program on Friday from 2:30 to 4:30 pm entitled "***Tender Offers: The New Paradigm and SEC M&A Update.***" In addition to discussing the latest developments concerning tender offers (including the impact of new Section 251(h) of the Delaware General Corporation Law), the panel will hear from Michelle Anderson, Chief of the SEC's Office of Mergers and Acquisitions, who will provide her perspective on changes in M&A practice. Our second program, "***Private Company M&A: A Potpourri of Practical Pointers***," will be held on Saturday from 2:30 to 4:00 pm. Jessica Pearlman will moderate a panel of seasoned M&A lawyers with practical takeaways for private company M&A deal lawyers. I hope that you will be able to attend one or both of our programs.

The M&A Committee and the San Francisco chapter of the Association of Corporate Growth are joining forces to host a happy hour on Friday from 5-7 pm at The University Club of San Francisco located at 800 Powell Street (4th floor). Please mark your calendar and join us for this event. Thanks to the generous support of JPM Escrow Services and CVF Capital Partners, tickets for this event are only $10!

Our subcommittees and task forces will meet throughout the day on Saturday and during the morning on Sunday, followed by our full Committee meeting Sunday afternoon. **PLEASE NOTE** - we have a couple of late changes to the schedule. First, the Private Equity M&A Subcommittee and the M&A Jurisprudence Subcommittee have swapped time slots. Second, the Task Force on Financial Advisors will not meet in San Francisco. An update schedule of all meeting time and locations is set forth at the end of this issue of Deal Points.

As with prior meetings, if you are unable to attend in person, please consider participating by teleconference. You can find the dial-in information for each task force, subcommittee and the full Committee meeting at the end of this issue of Deal Points.

A special note of thanks to our sponsors for Saturday night's activities at Kokkari. Thomson Reuters and Practical Law Company are sponsoring cocktails and dessert, Houlihan Lokey is sponsoring appetizers and JPM Escrow Services has graciously agreed to sponsor the dinner. On behalf of the Committee, THANK YOU!

Full Committee Meeting

Our full Committee will meet on Sunday from 1:00 to 3:30 pm. During the meeting, we will have several short substantive presentations (rather than the traditional forum) on a number of topics, including (among others) a presentation led by Reid Feldman on the forthcoming European M&A Deal Points study and a presentation led by Doug Weaver of JPM Escrow Services on their annual Escrow Study.

Task Force and Subcommittee Meetings

In San Francisco, our Task Forces and Subcommittees also will host a number of substantive programs and discussions. For example, the Acquisitions of Public Companies Subcommittee will host presentations by Jen Muller (on the latest Houlihan Lokey Termination Fee Study) and by Rick Alexander (on recent Delaware developments, including the recent *MFW* and *Chevron* decisions and the recently enacted public benefit corporation statute). In addition, the Private Equity M&A Subcommittee will host two important presentations, one by Chris Young, Managing Director, Head of Contested Situations at Credit Suisse (on the intersection of private equity, activism and contested situations) and a second by Mark Bradley, co-founder and partner at Dean Bradley Osborne (on the current private equity environment). If you have time, please attend one or more of these presentations.

Planning for the Montage

Please mark your calendar now for our third trip to The Montage in Laguna Beach, California, on Friday, January 31st and Saturday, February 1st. The Committee attendance for this standalone meeting has been spectacular in the past and we expect to sell out quickly, so please sign up as soon as the ABA registration goes live. More details to come!

* * *

If you have any questions concerning our upcoming meeting in San Francisco (or ideas for our standalone meeting in Laguna Beach), please reach out to me. I look forward seeing all of you in San Francisco.

Mark A. Morton
Chair

FROM THE CO-EDITORS

This is now the second issue of Deal Points that we have published as co-editors. (Yes, we will keep a running tab!) We are again grateful to each of the authors of our Featured Articles and of the Task Force and Subcommittee Reports for making the publication of the newsletter run smoothly.

As we stated in the last issue, it is our goal to have Deal Points be as informative and functional for you as possible. To that end, beginning this issue we will include the information regarding Task Force and Subcommittee meetings in the relevant Reports in addition to the presentation of that information in chronological order at the back of the issue. As always, please do not hesitate to contact either of us if you have thoughts or suggestions for future issues. And, of course, we would be extremely grateful for any Featured Article submissions!

With our best regards,

Eric S. Klinger-Wilensky
Ryan D. Thomas
Co-Editors

FEATURE ARTICLES

CANADIAN SECURITIES REGULATORY AUTHORITIES PROPOSE TWO NEW APPROACHES TO THE REGULATION OF SHAREHOLDER RIGHTS PLANS – A CLASH OF PHILOSOPHIES

By: Paul Davis and John Clifford[1]

Canada does not have a national securities regulator. Rather, each province and territory regulates capital market activity within its jurisdiction, and provincial and territorial regulators coordinate many of their activities through a national organization called the Canadian Securities Administrators ("CSA").

On March 14, 2013, the CSA[2] and Québec's Autorité des marchés financiers ("AMF")[3] (the AMF also is a member of the CSA) issued alternative proposals to revamp the regime regulating shareholder rights plans (or so called "poison pills") in the context of defensive tactics. The AMF proposal went further in advocating a new approach to regulating all defensive tactics, while the CSA indicated that it would address other defensive tactics as part of an ongoing CSA review.

The Canadian Landscape

In Canada, a board of directors can adopt a shareholder rights plan at any time without prior shareholder approval. Under the rules of the Toronto Stock Exchange and the TSX Venture Exchange, a rights plan adopted in the absence of an existing or impending takeover bid is required to be approved by shareholders within six months of adoption. A rights plan adopted in the face of an actual or announced takeover bid is generally regulated directly by a Canadian securities regulatory authority.

Regardless, when faced with a rights plan, hostile bidders generally seek to effectively terminate rights plans by asking Canadian securities regulatory authorities to exercise statutory powers allowing them to cease trade rights that are issuable under rights plans if to do so would be in the public interest. This public interest discretionary authority (i) is limited by the regulatory objectives of securities legislation in Canada, which is to provide protection to investors from unfair, improper or fraudulent practices and to foster fair and efficient capital markets and confidence in capital markets, and (ii) has been exercised in the context of rights plans pursuant to the guidance outlined under the CSA's National Policy 62-202 – *Take-Over Bids – Defensive Tactics* ("NP 62-202") and its predecessor.[4]

Past decisions of securities regulators under NP 62-202 and the recent proposals of the CSA and the AMF reflect three philosophical approaches to the regulation of rights plans in the context of defensive tactics:

- Current Principal Approach: Currently, the overriding principle is that the only legitimate purpose of a rights plan is to allow a target board to seek an improved or alternative offer, as each shareholder has an absolute right to accept or reject a bid. As a result, Canadian securities regulators have typically been willing to cease trade rights plans of target companies within 45 to 60 days following the launch of a hostile bid, thereby ensuring that shareholders have the right to tender to a bid. The customary effect of this approach is that the target company is forced into a process which, depending on the time available to the target prior to expiry of the initial bid as well as market and specific industry conditions, usually results in a sale by auction;

- CSA Proposal: The CSA proposal recognizes that a rights plan may be adopted for broader, longer-term purposes when approved by a majority of shareholders (represented to some extent by NP 62-202 itself, which provides that "shareholder approval of corporate action would, in appropriate circumstances, allay"

1 Messrs. Davis and Clifford are partners at McMillan LLP. The views expressed are solely those of the authors and do not necessarily represent the views of their firm or its clients.

2 Proposed National Instrument 62-105 Security Holder Rights Plans, CSA Notice, (2013) 36 OSCB 2643 (14 March 2013).

3 An Alternative Approach to Securities Regulators' Intervention in Defensive Tactics, Autorité des marchés financiers Consultation Paper (14 March 2013).

4 Take-Over Bids – Defensive Tactics, OSC National Policy Statement No 38, 9 OSCB 4255 (1986), repealed by 20 OSCB 3525 (1997).

concerns that actions of a board are abusive of the capital markets;[5] and also represented by a few recent securities regulators' decisions[6]); and

- AMF Proposal: The AMF proposal may be considered to be board-centric or corporate-centric, whereby regulators would defer to the decision of a target board in responding to a takeover bid, provided that the board has in place appropriate safeguards to manage conflicts of interests (an approach more consistent with that of the Delaware courts and the even more deferential approach of the Supreme Court of Canada in *BCE Inc. v. 1976 Debentureholders*[7], which examined the duties owed by directors).

In moving away from historical approaches and principles, the CSA and the AMF proposals would provide directors and shareholders of public companies in Canada with greater flexibility in negotiating with hostile bidders or simply defeating hostile takeover bids.

CSA Proposal

The key aspects of the CSA proposal are as follows:

- rights plans will be effective when adopted by the board of directors but must be approved by security holders within 90 days from the date of adoption or, if adopted after a takeover bid has commenced, within 90 days from the date of commencement of the bid,
- to remain effective, rights plans must be approved annually by majority vote of shareholders,
- material amendments to rights plans must be approved by security holders within 90 days of the date of adoption of such amendments,
- shareholders must be able to terminate a rights plan at any time by majority vote,
- shares held by a bidder and its joint actors are to be excluded from a security holder vote to adopt, maintain, amend or terminate a rights plan,
- a rights plan cannot be triggered as a result of a shareholder vote,
- if a rights plan is waived or modified with respect to a takeover bid, it must be waived or modified with respect to any other takeover bid, and
- enhanced public disclosure will be required at the time of adoption of, and material amendment to, a rights plan.

The impact of the CSA proposal would be dramatic:

- The CSA recognizes that, as a result of its proposal, disputes related to rights plans should rarely be brought before a securities regulatory authority. This should result in a higher level of certainty in the market than is currently the case, as securities regulatory authorities have recently taken conflicting views on when a rights plan "should go" and in some limited instances[8] whether it "should go" at all. Nevertheless, the CSA notes that the securities regulators may intervene if a target issuer engages in conduct that undermines the principles underlying the proposed rule or there is a public interest rationale for the intervention not contemplated by the proposed rule.
- We expect that there would be an increase in proxy fights in connection with takeover bids, more akin to the current situation in the United States.
- While litigation before securities regulatory authorities may diminish, there is little doubt that litigation before the courts related to proxy solicitation/fights would increase.
- Under the current regime, rights plans generally only remain in place for 45 to 60 days following a hostile bid. Under the CSA proposal, one would

5 Notice of National Policy 62-202 and Rescission of National Policy Statement No 38 Take-Over Bids – Defensive Tactics, 20 OSCB 3525 (1997).

6 The Ontario Securities Commission in Neo Material Technologies Inc., Re, (2009), 32 OSCB 6941 [Neo Material], the Alberta Securities Commission in Re Pulse Data Inc. 2007 AB ASC 895 [Pulse Data], and the minority reasons of the British Columbia Securities Commission in Lions Gate 2010 BCSCECCOM 494.

7 The Supreme Court held that as long as the directors' decision is found to have been within the range of reasonable choices that they could have made in weighing conflicting interests, the court will not go on to determine whether their decision was the perfect one (2008 SCC 69 at para 112).

8 See *Neo Material* and *Pulse Data*, *supra* note 6.

expect that right plans would remain in place for a minimum period of 90 days and shareholders together with the board of an issuer may well be able to "just say no." At a minimum, boards would be provided with more time to canvass and consider alternatives.

AMF Proposal

The basic elements of the AMF proposal are as follows:

- provided that the board has in place appropriate safeguards to manage conflicts of interest (such as the establishment of a committee of independent directors being advised by independent financial and legal advisors), deference will be given to the decision of a board, absent unusual circumstances that demonstrate an abuse of shareholders' rights or that negatively impact the efficiency of capital markets; and
- takeover bids will be required to provide for a minimum tender condition similar to that currently required for so called "permitted bids" under rights plans in Canada; that is, shares will not be permitted to be taken up under a takeover bid unless more than 50% of the outstanding securities owned by shareholders, other than the offeror and those acting jointly or in concert with the offeror, have been tendered and if such condition is met, the bid will be required to be extended for an additional 10 days following the public announcement that such condition has been met.

The AMF proposal is an unambiguous rejection of NP 62-202, and its impact would be to give boards significantly more flexibility. The AMF proposal would allow boards to fully consider the long-term interests of a corporation and, subject to the ability of shareholders to persuade the board otherwise or to simply remove a sufficient number of directors, the board of a target issuer would at least in theory be able to "just say no." We note, however, that the protection of investors and fostering fair and efficient markets and confidence in the markets are the overlying principles that securities regulatory authorities consider in connection with the exercise of their public interest discretionary power to cease trade rights plans. The regulators' focus largely will continue to be on the impact that a decision of a board will have on the capital markets or shareholders. Accordingly, while a target board could follow a proper process and reach a decision to adopt a rights plan consistent with the exercise of its fiduciary duties, such a decision could still be challenged as impacting negatively on the efficiency of the capital markets or possibly as effecting an abuse of security holders' rights. As a result, it may well be that additional criteria will be required to be enumerated in order to ensure that the AMF's corporate/board centric approach is effective.

Put another way, if a board of a target issuer determines, after adopting and adhering faithfully to a pristine process, that it should "just say no" and this goes on for several months, what would the AMF do? It is interesting to note that a senior representative of the AMF in a discussion of the impact of the AMF proposal was quoted as saying: "This does not mean in my mind that a board would be in a situation to just say no and just say no forever."[9] Market participants may well need additional guidance in order to better understand the basis upon which regulators would cease trade a rights plan under the AMF proposal or, in other words, when "unusual circumstances" might exist that would require the imposition of a cease trade order that would effectively terminate the rights plan.

Conclusion

The CSA and AMF proposals provide a forum for discussion on the issues relating to the regulation of defensive tactics in Canada. This presents a unique opportunity to Canadian market participants and practitioners to shape a key aspect of the regulation of the capital markets. While we have no doubt that there will be significant debate and disagreement among market participants on the way forward, we are hopeful that sufficient consensus can be reached in order for a new approach to be adopted on a timely basis that better protects investors and fosters fair and efficient capital markets and confidence in such markets. McMillan LLP submitted a comment letter to both the CSA and AMF proposals and copies are available upon request.

* * *

9 Jeff Gray, "Canada's Securities Regulators Plan A More Potent Poison Pill" (February 2013) online: The Globe and Mail http://www.theglobeandmail.com/report-on-business/canadas-securities-regulators-plan-a-more-potent-poison-pill/article9050871/.

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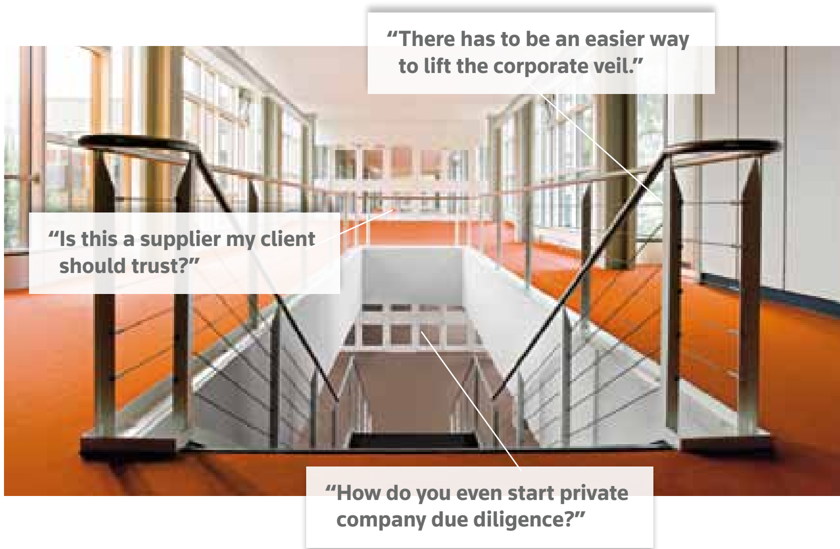

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MANAGING M&A DEALS WITH UNDERLYING DERIVATIVE CLAIMS

By Bradley R. Aronstam and S. Michael Sirkin[1]

Delaware corporate law charges directors with managing the business and affairs of the corporation. Subsumed within that charge is the power to decide whether initiating suit for corporate wrongdoing is in the best interests of the corporation. Stockholders, however, can assert claims derivatively on behalf of the corporation upon a particularized showing that a pre-suit litigation demand was wrongfully refused or that demand would have been futile. Whether initiated by the board or derivatively by stockholders, a corporation's legal claims are assets of the corporation that pass to the acquiror in a merger. This article proposes best practices for planning transactions involving target corporations with pending or potential derivative claims.

* * *

As a general matter, "[a] plaintiff who ceases to be a shareholder, whether by reason of a merger or for any other reason, loses standing to continue a derivative suit."[2] Although there are limited equitable exceptions enabling target stockholders to maintain derivative standing post-merger,[3] target stockholders may also state a direct claim by "challeng[ing] the validity of the merger itself, usually by charging the directors with breaches of fiduciary duty resulting in unfair dealing and/or unfair price."[4] Indeed, target stockholders in certain circumstances have standing to challenge a merger directly on the basis that the transaction failed to achieve adequate value for the target's derivative claims, which pass to the acquiror in a merger.

Claims of this type were at issue in two recent Delaware Court of Chancery decisions – *In re Massey Energy Co. Derivative & Class Action Litigation*[5] and *In re Primedia, Inc. Shareholders Litigation*[6] – that reached opposite conclusions. Together, the factual and procedural nuances highlighted by these cases provide guidance for transactional planners considering an acquisition in which the target has pending or potential derivative claims. This article synthesizes *Massey* and *Primedia* and proposes specific recommendations for practitioners navigating such transactions.

In re Massey Energy Co. Derivative & Class Action Litigation

Massey involved a stockholder challenge to a proposed $8.5 billion merger in which mining giant Massey Energy Company agreed to be acquired by industry rival Alpha Natural Resources. The proposed transaction arose in the wake of a catastrophic explosion at Massey's Upper Big Branch Mine in West Virginia. Twenty-nine fatalities made this America's worst mining accident in 40 years.

Regulatory and wrongful death actions ensued, followed by numerous stockholder derivative actions. "In broad strokes," the derivative plaintiffs claimed that Massey's directors and officers breached their fiduciary duties in (i) "'chronically disregarding mining safety regulations'" and (ii) "'consistently failing to adequately address poor safety conditions of its mines."[7] In fact, Massey and its CEO had a well-chronicled acrimonious relationship with regulators and a history of safety issues.[8]

In response to the derivative actions, the Massey board created an "Advisory Committee" of two

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2 *Lewis v. Anderson*, 477 A.2d 1040, 1049 (Del. 1984).

3 *See id*. at 1046 n.10 (recognizing the "fraud" and "reorganization" exceptions to the general rule); *see also Lambrecht v. O'Neal*, 3 A.3d 277 (Del. 2010) (addressing double derivative suits by target stockholders who receive acquiror stock in connection with a merger).

4 *Parnes v. Bally Entm't Corp*., 722 A.2d 1243, 1245 (Del. 1999).

5 2011 WL 2176479 (Del. Ch. May 31, 2011).

6 67 A.3d 455 (Del. Ch. 2013).

7 *Massey*, 2011 WL 2176479, at *9 (citation omitted).

8 *Id*. at *5. A subsequent government investigation found numerous safety violations, that "the responsibility for the explosion . . . lies with the management of Massey," and that the accident was "a completely predictable result for a company that ignored basic safety standards and put too much faith in its own mythology." *Id*. at *9.

newly appointed independent directors. The Advisory Committee, which retained independent legal counsel, was "charged with making recommendations to the full Board regarding: (i) whether Massey should pursue the Derivative Claims resulting from the Upper Big Branch mine explosion; and (ii) whether Massey should undertake any changes in 'management, operations, practices and/or policies.'"[9]

Alpha, which had previously approached Massey about a possible business combination as early as 2006, reengaged Massey about a possible transaction less than a month after the accident. Massey's CEO and board were initially cool to the idea of a deal, believing that Massey's stock price was artificially depressed following the accident. In the ensuing weeks, however, the board came to the view that remaining independent might not be the best course for the company. A strategic alternatives review committee of four independent directors was formed "to consider Massey's strategic opportunities and further to make recommendations to the full Board about potential transactions."[10]

In addition to soliciting bids from three potential strategic acquirors that had previously expressed interest in acquiring Massey, the company publically announced it had undertaken a formal review of strategic alternatives. The board eventually concluded that a strategic transaction was the optimal path forward and instructed Alpha and Arch (the only company other than Alpha to have submitted a preliminary bid and conduct due diligence) to submit best and final offers. While Arch reduced its bid, the board was able to achieve "a further increase in Alpha's already higher bid."[11] Alpha's final bid was 1.025 Alpha shares plus $10.00 in cash for each Massey share, representing $69.33 per share and a 25% premium based on Alpha's stock price at the time.[12] The board unanimously approved the proposed transaction with Alpha.

Notably, the Advisory Committee had not yet reached a conclusion regarding the strength or value of the derivative claims at the time the board considered and approved the merger. "[A]t most," the board "assumed either that their value was baked into the total purchase price to be paid by an acquiror, or that the Derivative Claims had no independent value to an acquiror."[13] Importantly, the record did not support an inference that the board was concerned over personal liability arising from the derivative claims or, more specifically, that the merger was motivated by a desire to alleviate such exposure. In this regard, the Court dilated on two critical points: first, that the board and the CEO had initially resisted the notion of a merger and, second, that the board entered into a merger agreement with Alpha containing indemnification obligations that were coterminous with Massey's existing indemnification obligations.

The plaintiffs subsequently moved to preliminarily enjoin the Massey stockholder vote. Their only serious challenge to the deal was an argument that the directors breached their fiduciary duties by agreeing to the merger without extracting fair value for the pending derivative claims.

Then-Vice Chancellor Strine had "little doubt" that the underlying derivative claims—i.e., Caremark-style oversight claims that the Massey board had failed to make good faith efforts to ensure that Massey complied with the law – would have survived a motion to dismiss.[14]

But this conclusion did "not equate to a belief . . . that those Claims are a material asset that Alpha is not paying fair value for in the Merger Agreement with Massey."[15] In valuing the derivative claims for purposes of a merger, the relevant figure was not "the aggregate negative financial effect on Massey that the Upper Big Branch Disaster and its Fall-Out ha[d] caused," but rather the risk-adjusted, expected value of the claims as a litigation asset.[16] And the plaintiffs here failed to seriously argue that the derivative

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9 *Id*. at *11.

10 *Id*. at *12.

11 *Id*. at *14.

12 It also represented a 95% premium to Massey's closing price before a news report that Massey was exploring strategic transactions, and a 27% premium to Massey's stock price prior to the accident.

13 *Id*. at *15.

14 *Id*. at *20.

15 *Id*. at *21.

16 *Id*. at *22. As explained by the Court, "[t]he Derivative Claims [we]re, in essence, just one part of the calculation of how big a liability Alpha [wa]s purchasing" because any post-merger exposure by Alpha for claims arising from the accident might be offset by pursuit of the derivative claims. *Id*. at *23.

claims were "of material value in the context of a [$8.5 billion] transaction like the Alpha Merger."[17]

Importantly, the Court noted that "[t]o the extent that the direct actions against Massey result in findings that Massey, as a corporation, consciously violated the law, Alpha has a rational incentive to shift as much of that liability to the former Massey directors and officers as can efficiently and realistically be achieved."[18] Post-merger, "Alpha's board will have a fiduciary duty to all its stockholders, including the former Massey stockholders who . . . will become Alpha stockholders, to use all of its assets in a good faith pursuit of profit and its actions will be subject to great scrutiny."[19] Acknowledging that certain classes of buyers (e.g., private equity firms historically dependent on target management to run the post-merger entity) might be reluctant to sue former target fiduciaries, the Court rejected the argument that Alpha could not be expected to pursue claims here. As a result, the Court was unconvinced that the merger would decrease the defendants' litigation exposure.

The Court nevertheless expressed reservations over the board's handling of the derivative claims in the sale process given the enormity of the accident and the resulting regulatory and civil exposure. Also troubling to the Court was that the same counsel defending the directors against the derivative claims counseled the board as to the effect the merger would have on those claims going forward. While the Court found that the underlying advice (i.e., to assume that the derivative claims would survive a combination) was designed to have the directors consider the transaction without regard to its potential liability-reducing effects on themselves, the better practice would have been to have the Advisory Committee's counsel provide independent advice on the issue, including "the extent to which the Derivative Claims were an economic asset (even in the sense of arguing to Alpha that its concerns about ongoing liability were overstated because of the possibility to shift costs to the derivative action defendants) . . . ."[20]

17 *Id*. at *28.

18 *Id*. at *24.

19 *Id*.

20 *Id*. at *25.

Turning to the irreparable harm inquiry, the Court noted four potential paths to monetary relief post-closing that, while admittedly difficult, precluded a finding of such harm. First, a post-closing direct action against Massey's directors for money damages was available upon proof "that the directors acted in bad faith to approve the sale of Massey at a materially inadequate and therefore unfair price to Alpha because the Merger did not reflect the value of the Derivative Claims."[21] Second, appraisal was available to the extent a dissenter could prove the merger consideration did not reflect fair value because the price did not adequately account for the value of the derivative claims. Next, plaintiffs would have continued equitable standing to pursue the derivative claims post-merger upon proof "that the Merger with Alpha was undertaken 'merely' to deprive the Massey stockholders of their standing to sue derivatively."[22] And finally, Massey stockholders who became stockholders of Alpha could "press Alpha to bring the derivative claims on Alpha's behalf" and, subject to the demand requirement, "they may be able to proceed in a double derivative action on Alpha's behalf."[23]

In balancing the equities, the Court was reluctant to "risk the benefits the Alpha Merger promise[d] to Massey stockholders by enjoining the Merger"[24] given, among other things, the difficulties associated with recovering a judgment on the derivative claims and that "Massey stockholders who are persuaded that they will yield more value if the company remains independent and the Derivative Claims proceed are free to take action even more formidable than a preliminary injunction, by casting their ballots against the Merger and defeating it at the polls."[25] The Court also declined plaintiffs' invitation to require that Alpha "transfer[] the rights to the Derivative Claims to a litigation trust on behalf of the Massey stockholders" because such blue-penciling would upset Alpha's expectations and enable it to walk away.[26]

21 *Id*. at *29 (citing *Parnes*, 722 A.2d at 1245-46).

22 *Id*. at *30 (citing *Lewis v. Ward*, 852 A.2d 896, 902 (Del. 2004)).

23 *Id*. (citing *Lambrecht*, 3 A.3d at 282, 286 & n.31).

24 *Id*. at *31.

25 *Id*. at *32.

26 Id. at *31.

In re Primedia, Inc. Shareholders Litigation

Primedia, Inc. was an internet media company controlled by private equity firm Kohlberg Kravis & Roberts & Co., L.P. ("KKR"). In the mid-2000s, Primedia's board determined that the company would buy back outstanding shares of its preferred stock, which were trading at a steep discount to their par value. At the same time, a KKR-controlled investment fund was buying Primedia preferreds for its own account. When Primedia began redeeming its preferred stock at par value plus accumulated dividends, the KKR-controlled fund's trades became immensely profitable, to the tune of approximately $190 million. This gave rise to a *Brophy* claim,[27] asserted derivatively by Primedia stockholders, against the company's directors and KKR. Specifically, the plaintiffs alleged that Primedia directors and KKR breached their fiduciary duties in connection with trades made by the KKR-controlled fund that were allegedly motivated by material nonpublic information about Primedia.

In response to the derivative action, Primedia's board formed a special litigation committee (the "SLC"), which moved to terminate the litigation. Although Vice Chancellor Laster held that the *Brophy* claim would "blow by" a motion to dismiss "like a 100+ mile per hour fastball,"[28] he nevertheless concluded that the SLC's termination decision was reasonable because of the limited scope of damages available on a Brophy claim. The plaintiffs appealed.

With the appeal pending, Primedia explored strategic alternatives. It hired a financial advisor and canvassed the market, reaching out to 117 potential acquirors. This process culminated in a merger agreement with an affiliate of private equity firm TPG Capital, L.P. to acquire Primedia for $316 million in cash, a 39% premium to the company's unaffected stock price. Notably, the board did not attempt to extract value for the derivative claim, which was then on appeal. Indeed, the derivative action was not discussed at all during the process until the meeting at which the Primedia board approved the proposed merger. KKR provided the requisite stockholder approval by written consent, and the merger closed.

Approximately one month later, the Delaware Supreme Court reversed the Court of Chancery's decision granting the SLC's motion to terminate, holding that the damages potentially recoverable on the plaintiffs' Brophy claim were not limited to harm done to the corporation.[29] But with the TPG merger having stripped plaintiffs of their Primedia stock ownership (and with it their derivative standing),[30] the parties agreed to dismiss the pending derivative action in favor of a direct action challenging the fairness of the merger.

In the direct action, the plaintiffs argued that the KKR-controlled Primedia board breached its fiduciary duties in failing "to obtain value for the *Brophy* claim," which "in turn rendered the Merger unfair to Primedia's minority stockholders, because they only received value for their share of Primedia's operating business and not for their share of the Derivative Action."[31] The defendants subsequently moved to dismiss.

Following *Parnes* and *Massey*, the Court applied a three-part test to determine if the plaintiffs had standing to challenge the merger directly on the ground that the board failed to achieve fair value in the merger for the pending derivative claims:

First, the plaintiff must plead an underlying derivative claim that has survived a motion to dismiss or otherwise could state a claim on which relief could be granted.[[32]] Second, the value of the derivative claim

27 The term "*Brophy* claim" refers to the seminal case of *Brophy v. Cities Service Co.*, 70 A.2d 5 (Del. Ch. 1949), which established a duty of loyalty-based insider trading claim that exists under state law alongside the "arguably parallel remedies grounded in federal securities law." *Kahn v. Kohlberg Kravis Roberts & Co., L.P.*, 23 A.3d 831, 840 (Del. 2011).

28 *Primedia*, 67 A.3d at 471.

29 *See Kahn*, 23 A.3d at 839-40.

30 There was no argument that either of the two equitable exceptions in *Lewis v. Anderson* should apply. The double derivative avenue to recovery discussed in *Lambrecht v. O'Neal* and referenced in *Massey* was likewise unavailable given the all-cash deal.

31 *Primedia*, 67 A.3d at 475-76.

32 *Id.* at 477; see also *Massey*, 2011 WL 2176479, at *21 ("[C]andor requires acknowledging that the plaintiffs have likely pled Derivative Claims that would survive a motion to dismiss, even under the heightened pleading standard applicable under Rule 23.1.").

must be material in the context of the merger.[33] Third, the complaint challenging the merger must support a pleadings-stage inference that the acquirer would not assert the underlying derivative claim and did not provide value for it.[34]

Applying this test, the Court first reaffirmed its earlier assessment that the underlying *Brophy* claim appeared strong, and easily would have survived a motion to dismiss.[35]

Next, the Court examined whether the value of the derivative *Brophy* claim was material in the context of the merger. With full disgorgement of transaction-related profits now available in light of the Supreme Court's decision, the Court estimated that the upper bound of a potential recovery on the *Brophy* claim approached $200 million, an amount sure to be material in the context of a $316 million merger.

On the third and final part of its standing analysis, the Court examined whether TPG as the acquiror was likely to litigate the *Brophy* claim post-merger. The Court noted generally that "there is ample reason to think that an acquirer would not assert, and therefore would not pay for, at least some claims for breach of fiduciary duty against sell-side fiduciaries."[36] Here, the absence of any discussions about the derivative action during the sale process permitted the inferences that (1) TPG did not intend to sue its fellow private equity stalwart, KKR, and, consequently, (2) TPG did not provide value in the merger for a claim it did not intend to assert. Moreover, and in contrast to *Massey*, the underlying derivative claim was not in the nature of an indemnity suit to recover losses for which the corporation otherwise would be held responsible. The Court therefore concluded that it was "reasonably conceivable that no potential acquirer, including TPG, incorporated the value of the *Brophy* claim into its bid for Primedia."[37]

Having found that the plaintiffs had satisfied this three-part standing test, the Court turned its attention to whether the complaint stated a claim. Because the Court inferred at the pleadings stage that TPG was unlikely to assert the derivative claims post-merger, the transaction would effectively extinguish both the minority stockholders' share of a litigation asset and also KKR's potential liability.[38] "The Merger effectively diverted the value of the minority stockholders' equitable interest in the Brophy claim – $80 million – from the minority to KKR," making it "reasonably conceivable that KKR received a unique benefit in the Merger not shared with other stockholders."[39] The Court concluded, therefore, that "the standard of review for purposes of evaluating whether the complaint states a claim is entire fairness,"[40] and it denied the motion to dismiss the plaintiffs' direct challenge to the merger.

Transaction Planning Considerations

Massey and *Primedia* illustrate the multifaceted issues that the Court of Chancery will consider when facing a challenge to a merger based on a target board's alleged failure to obtain fair value for derivative claims. Below are specific considerations for transaction planners in this setting designed to reduce the risk of an

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33 *Primedia*, 67 A.3d at 477; *see also Massey*, 2011 WL 2176479, at *28 ("In this regard, I also note the absence of any substantial argument from the plaintiffs that the Derivative Claims are really of material value in the context of a transaction like the Alpha Merger.").

34 *Primedia*, 67 A.3d at 477; *see also Massey*, 2011 WL 2176479, at *26 ("The record does not support an inference that Alpha has made any commitment to Massey Board members not to pursue the Derivative Claims if that is in Alpha's best interest.").

35 *Primedia*, 67 A.3d at 477-81. Notably, the Court tested the derivative claims against the lenient 12(b)(6) standard rather than the heightened pleading standard of Rule 23.1, which applies to derivative actions brought by a stockholder, rather than the corporation itself. *Id*. at 477-78. The Court did so because "[t]his aspect of the *Parnes* inquiry focuses on whether the corporation possessed a viable claim that the board could have caused the corporation to assert." *Id*. at 478; *but see Massey*, 2011 WL 2176479, at *21 ("[C]andor requires acknowledging that the plaintiffs have likely pled Derivative Claims that would survive a motion to dismiss, *even under the heightened pleading standard applicable under Rule 23.1*.") (emphasis added).

36 *Primedia*, 67 A.3d at 484.

37 *Id*. at 485.

38 *Id*. at 487 ("It is reasonably conceivable that because KKR could be confident that no acquirer would have any interest in pursuing the *Brophy* claim post-Merger, and because the individual defendants acceded to KKR's wishes without extracting any value for or taking steps to preserve the value of the *Brophy* claim, KKR received a unique benefit equal to the minority's share of any potential recovery in the Derivative Action.").

39 *Id*.

40 *Id*.

otherwise run-of-the-mill merger litigation turning into a risky entire fairness case.

- Pre-Merger Settlement: The only surefire way to eliminate the post-closing litigation risk associated with target derivative claims is to eliminate the claims before a merger. The heightened pleading requirements of Rule 23.1 and the practical obstacles to post-merger recovery likely provide settlement leverage to defendants at this stage as well.

- Value the Claims: The target board should be fully informed concerning the risk-adjusted net present value of derivative claims. This analysis should be performed by competent legal and/or financial professionals and should be presented to the board in a straightforward way. If the board is also obtaining a fairness opinion, the board should consider the value of the claims as a litigation asset in conjunction with the range of values ascribed to the operating business in the opinion. Understanding the value of the claims in the context of a merger will help determine if a stockholder is likely to have standing under Parnes. More discussion of the claims in the context of the merger is always better. And the more evidence that the board separately valued the claims, the more deferential a reviewing court will be in evaluating a subsequent challenge.

- Independence at Every Turn: If the deal size is large enough to warrant the expense, the financial advisor engaged to sell the company might not be ideally suited to also opine on the value of a derivative claim. Likewise, the law firm defending the directors in the underlying derivative action might not be ideally suited to give advice concerning potential outcomes, including the effect that a transaction will have on the derivative action.

- Defendants not the Best Negotiators: Where less than the full target board has exposure in a pending derivative suit, consider having the unaffected directors lead the sales process or, as in *Massey*, appoint new independent directors who can objectively evaluate the claims. This will negate two dangerous inferences: (1) that the defendants steered the company into friendly hands to escape liability, and (2) that the buyers will be less likely to sue sell-side fiduciaries with whom they bargained. These effects are amplified if the directors leading the sales process are not going to join the post-closing company.

- Consider Paying in Stock: Where the merging parties are indifferent between a cash deal and a stock-for-stock transaction, the latter will leave open the possibility of a post-closing double derivative action. This carries post-closing litigation risk, but also the benefit of eliminating an argument that the transaction would, in effect, terminate the derivative claims.

- Contract Carefully: It has become customary for acquirors to agree to indemnify target directors and officers in a merger. As in *Massey*, buyers in this setting should consider not agreeing to indemnification obligations beyond the target's indemnification obligations (i.e., those subject to the limitations of Section 145 of the DGCL).

- Post-Merger Cleansing Committee: In a case like *Primedia*, where interpersonal dynamics might lead a court to conclude that the acquiror is unlikely to litigate a derivative claim post-merger, a well-intentioned acquiror could establish an independent committee of its board with full authority to evaluate and act on the claims acquired in the merger.

- Litigation Trust: Where a derivative claim is extraordinarily difficult to value, merging parties could agree to the acquiror establishing a litigation trust, a vehicle referenced in *Massey*, for the benefit of the target stockholders. Lead counsel in the existing derivative case could continue to litigate, thereby blunting any argument that defendants received a litigation-related benefit in the merger.

- Potential Claims: While *Massey* and *Primedia* involved pending derivative claims, the concerns animating those decisions logically would extend to potential derivative claims that may not yet have ripened into litigation. Target boards and their advisors who are on notice of conduct giving rise to a potential claim by the corporation should therefore also consider the above issues.

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BOARD SALES PROCESSES:
A "WEAK" FAIRNESS OPINION HIGHLIGHTS THE IMPORTANCE OF IDENTIFYING STRATEGIC INFLECTION POINTS IN DEALS

By: John K. Hughes[1]

Introduction; Background

The Delaware Chancery Court recently handed down another decision finding the actions of a board of directors lacking when it pursued the sale of the company.

The latest case is *Koehler v. NetSpend Holdings, Inc.*[2] It arose out of NetSpend's agreement to sell itself to Total Systems Services, Inc. for $1.4 billion. The Court's ruling was issued in the context of Plaintiff's motion to preliminarily enjoin the acquisition, which was scheduled to close about a week after the Court's decision. In brief, the Chancery Court held that Plaintiff had demonstrated a reasonable likelihood of succeeding at trial in establishing that "the sales process undertaken by the NetSpend Board . . . was not designed to produce the best price for the stockholders," and probably resulted in breach of the directors' *Revlon* duties.[3]

Even though the Court found the Board likely violated the Revlon standard – requiring a board to use a process to attain the highest price reasonably available – the Court didn't enjoin the deal from going forward. It noted there was no alternative bid under consideration, and acknowledged, as it has done in prior transactional situations, that enjoining the deal under those circumstances could result in shareholders losing a premium price (here, a 25% one-day premium and a 45% one-week premium).[4] As a result, the Court determined that, on balance and notwithstanding the shortcomings it observed, the Plaintiff had failed to carry its burden of demonstrating that the equities involved in the matter favored injunctive relief – even for a temporary period where a go-shop process could be carried out.[5]

Two days after the decision, NetSpend issued a statement saying that it "believes that its Board . . . acted appropriately and pursued a process intended to achieve the best price for the Company. The Company intends to vigorously defend itself in the litigation."[6] Notwithstanding staking out that position, six days thereafter NetSpend announced it had entered into a Memorandum of Understanding to resolve the litigation, and that it had modified certain terms of the merger agreement.[7]

NetSpend isn't the first decision where a board of directors has been criticized for how it went about a sales process. It surely won't be the last. The decision adds to a list of cases where the Court has found that a board came up short on a sales process exercise, and failed to meet the *Revlon* standard. With the

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2 *Koehler v. NetSpend Holdings, Inc.*, No. 8373-VCG, 2013 WL 2181518 (Del. Ch. May 21, 2013) [hereinafter "*NetSpend*"].

3 *Id*. at *1.

4 *Id*. and at *2 ("In a case challenging a merger or acquisition, in order to justify injunctive relief, where no competing bidder has emerged 'despite relatively mild deal protection devices,' the plaintiff's showing of a reasonable likelihood of success on the merits must be particularly strong." (citing *In re Plains Exploration & Prod. Co. S'holder Litig.*, No. 8090-VCN, 2013 WL 1909124, at *4 (Del. Ch. May 9, 2013)) [hereinafter "*Plains*"].

5 *NetSpend*, 2013 WL 2181518, at *24. *Cf. In re Del Monte Foods Co. S'holders Litig.*, 25 A.3d 813 (Del. Ch. 2011) (enjoining the closing of transaction temporarily so that go-shop process could be conducted (after one go-shop period had already transpired), notwithstanding that no alternative bidder had surfaced) [hereinafter "*Del Monte*"].

6 *See* NetSpend Holdings, Inc., Current Report on Form 8-K, at 1 (May 23, 2013).

7 The amendment to the merger agreement, reflecting the terms of the Memorandum of Understanding entered into by the litigation parties, provided that: (i) the break-up fee payable to Total Systems upon termination of the merger agreement in order to accept a Superior Proposal (as defined in the merger agreement), would be reduced from $52.6 million to $44.0 million; (ii) in the event stockholders failed to adopt the merger agreement at the special meeting and the merger agreement were subsequently terminated, the tail period for certain transactions that could trigger a termination fee would be reduced from 12 months to 8 months after termination; (iii) the matching period for notice to Total Systems before the Company could enter into a Superior Proposal was reduced from 5 business days to 3 business days; and (iv) Total Systems waived its rights under a provision in the merger agreement that would permit it to delay the closing for up to 12 business days after the stockholder vote even if the other conditions to closing were satisfied. The settlement further provided that, prior to stockholder approval of the merger agreement, the Company could furnish information to, and engage in discussions and negotiations with, third parties who made unsolicited bona fide acquisition proposals if certain conditions were met and, in that regard, NetSpend also announced it would adjourn the special meeting of stockholders for 18 days to see if any other offers surfaced. None did. See NetSpend Holdings, Inc., Current Report on Form 8-K, at 1-3 (May 29, 2013).

decision, boards, individual directors, and others in the deal community who scout such situations for pattern recognition or scenario analysis purposes, or to develop tendency charts, understand the M&A world a little better, or generally just try to make sales processes work a little better, have yet another case study around which to ask: "What went wrong here?" "What goes wrong in these deals?" "Why can't *some* boards seem to 'Get It Right' on sales processes without getting criticized in Delaware?"

During sale-of-the-company transactions, boards invariably meet with and hear from legal counsel early-on. The board is briefed on the legal responsibilities of directors in considering such transactions, and in evaluating the associated acquisition proposals that arise related to those matters. The discussions around legal parameters are revisited during the course of a transaction, where counsel continues to offer advice and counseling as events unfold, and a board is faced with a variety of choices as the decision tree grows.[8] So, it's clearly not a situation where boards are not being informed of or just not getting the message around their fiduciary duties and responsibilities. Nor is it that directors or boards are simply lax or intentionally trying to skirt those duties or responsibilities (barring the relatively few self-dealing scenarios that may arise from time-to-time), since clearly boards and directors work very hard to try to do what's best for the company and stockholders involved.

The logical question arises then in terms of why this seems to be a recurring theme?[9] One explanation may be that the *intended strategy* a board starts to pursue as it heads out toward "*Revlon*-Land"[10] – getting the highest price reasonably available – begins to blend with (if not get blurred by) the *emergent strategies* a board may find itself needing to adopt as the arc of the deal narrative is drawn; deal terms are proposed, counter-proposed, modified, and agreed along the way; strategies and supporting tactics morph; complexities multiply, and all the deal ingredients start interacting and influencing one another as the deal evolves. In the process, directors may sometimes not adequately juxtapose or see the impact that certain deal terms or developments may be having on the other elements of the transaction. In the heat of the deal, they may not adequately pause to recalibrate their own analyses and assessments of the information and the data points in light of the ever-changing face of the deal and the evolving contextual setting. This despite every good intention, effort and belief that they are building the right strategic scheme (and record) under the circumstances to get the best deal they can, and that they are, indeed, "Getting it Right" and fulfilling *Revlon*.

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8 A casual review of the "Background of the Merger" section of virtually every merger proxy will find multiple statements to the effect that, as part of various board sessions taking place as a transaction process unfolds, the board of directors of the company involved met with counsel and, as part of those deliberations, counsel reviewed the legal responsibilities of the directors. For example, in *NetSpend*, the Proxy Statement there makes clear that the Board was advised of its fiduciary duties on several occasions. *See e.g.*, Proxy Statement of NetSpend Holdings, Inc. on Schedule 14A, at 37 (April 23, 2013) [hereinafter "*NetSpend Proxy*"].

9 It is also worth reminding that, currently and in the recent past, just about every M&A deal announced, regardless of transaction format or whether strategic or financial sponsor parties are involved, has had litigation following in its trail. *See* Cornerstone Research, *Shareholder Litigation Involving Mergers and Acquisitions* (February 2013) (illustrating that, for 2012, plaintiff law firms filed lawsuits on behalf of shareholders in 96% of M&A deals valued over $500 million and 93% of such transactions valued over $100 million, with deals valued over $100 million attracting an average of 4.8 lawsuits per deal and deals valued over $500 million attracting an average of 5.4 lawsuits) [hereinafter "*Shareholder Litigation*"]. Invariably, one of the primary claims made by shareholder plaintiffs in these actions (in addition to failure to obtain a fair price) is that the board and the directors breached their fiduciary duties by failing to run a fair sales process and failing to meet the *Revlon* standard, asserting, in effect, the board got it all wrong. Thus, the high frequency with which such claims are made admittedly may serve to reinforce and color the general perception that directors regularly aren't "Getting it Right" when it comes to sales processes, when, in fact, the perception around the topic far outstrips the reality given the relatively small percentage of deals where the Court actually reaches such a determination. When Chancery Court decisions do get handed down that are critical of sales processes undertaken by boards, they also tend to receive significant attention and commentary within the deal ecosystem, perhaps reinforcing a perception.

10 *See generally,* Bainbridge, Stephen M., *The Geography of Revlon-Land*, 81 FORDHAM L. REV. (forthcoming 2013), UCLA School of Law, Law-Econ Research Paper No. 12-13 (available at http://blogs.law.harvard.edu/corpgov/2012/08/20/the-geography-of-revlon-land/).

After a deal is announced (if not before), plaintiffs' counsel comes in and puts every inch of the deal, and everyone in the deal, under a klieg light, scratching and clawing to uncover any possible anomalies, asymmetries, or separation points between a board's nuanced, real-time, decision-making on this-or-that deal feature or development when the deal was in full flight, as mapped-out against the board's fiduciary duty standards in general, and the cannon of relevant Delaware case law in particular.[11] All the while pushing a deal narrative re-write that may make some wonder if they had been participants in the same deal that is getting described.

NetSpend

The brew of design features in the NetSpend deal that caused, in the Court's view, the Defendant directors to stumble included: lack of a pre-signing market canvass; negotiating with a single potential purchaser; reliance on a fairness opinion the Court described as "weak;" agreeing to buyer's demand to forgo a post-signing market check *via* a go-shop; and "don't ask-don't waive" provisions within certain standstill agreements (with a couple of private equity parties and that had been entered into in the context of an earlier possible transaction around the purchase of a (large) minority interest in NetSpend).[12] The Court noted that several of the referenced deal features, alone, were not outside the range of reasonable actions a Board could take as part of a sales process, and which features have been approved by the Court in other rulings on other deals in other contexts. But the Court determined that, in the aggregate, and in this deal, the actions of NetSpend's Board "indicate a process that is unreasonable."[13]

Any number of the deal features in *NetSpend* and the Court's analysis of the Board's actions around them merit review by deal planners and deal designers alike when M&A sales processes are on the anvil.[14] This article, however, is not an attempt to look at the entirety of the deal infrastructure, or review the Court's assessment of each of those features in detail, as neither time nor space permits that kind of review here. Nor is this an effort to review many of the broader questions that might arise when considering the decision, such as: whether auctions work better than negotiated transactions;[15] whether the Court's *Revlon* analysis here – which necessarily involves balancing the need

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11 A recent proposed transaction serves as an example. On June 11, 2013, Dole Food Company announced receipt of a proposal by David H. Murdock to acquire, for $12.00 per share in a going-private transaction, the approximately 60% of the outstanding common stock of the company that he and his family did not already own. *See* Dole Food Company, Current Report on Form 8-K, at 1 (June 11, 2013). The per share consideration indicated an enterprise value of approximately $1.5 billion, which represented a 10.2x multiple of Dole's anticipated EBITDA. The announcement further indicated the board of directors would be meeting "in coming days" to establish a special committee of independent directors to consider the proposal. *Id*. The same day as Dole's announcement, no fewer than 10 plaintiff law firms issued public statements announcing that they were "investigating" the proposed transaction and possible breaches of fiduciary duty. The number of firms grew to 16 by one week later (June 18, 2013). *See* Reuters (U.S. Edition), Markets – Key Developments: Dole Food Company, available at http://www.reuters.com/finance/stocks/DOLE.N/key-developments?pn=1.

By June 14, 2013, just three days after the company's public announcement, and before the special committee had even been appointed or any decisions had been made about anything, litigation was filed in Delaware Chancery Court. *See Setrakian Family Trust v Dole Food Company Inc.*, C.A. No. 8644-VCL (Del. Ch. filed June 14, 2013). Other suits have followed in Delaware. By June 19, 2013, again before the special committee had been seated or any decisions made, a pair of class actions were filed in California challenging the transaction, saying the offered price was "egregiously low" and the board was conflicted. *See Maureen Collier v. Dole Food Co. Inc. et al.*, No. BC512380 (Cal Super. Ct. filed June 14, 2013); *Maxine Phillips v. Dole Food Co. Inc. et al*., No. BC512381 (Cal Super. Ct. filed June 14, 2013). Again, nothing had even been negotiated let alone decided yet at the time litigation commenced.

12 *See NetSpend*, 2013 WL 2181518, at *1.

13 *Id*. at *19. There were also other deal protection provisions included in the merger agreement (e.g., no shop, match rights, 3.9% break-up fee, voting agreements for 40% of the stock) that Plaintiff had challenged as unreasonable and "too strong" in the context of NetSpend never having solicited other offers via a pre-signing market check or post-signing go-shop, and instead pursuing a single bidder sales process. The Court determined these other deal protections, on their own, were fairly routine and would not have deterred another bidder. The Court did note, however, that when viewed in the context of the other process design features referenced above that it did criticize, and combined with such features, they contributed to the Court's overall determination that the Board's sales process was unreasonable as a means to meet the Revlon standard. *See id*. at *12, 17-18, 19-21.

14 It's also important to note that the Court's decision in *NetSpend* is more about process design than it is about the sales price actually obtained by the Board, since no evidence was presented to suggest there were any bidders willing to pay more than the $16.00 the Board ultimately obtained.

15 *See, e.g.*, Subramanian, Guhan, *Negotiauctions: New Dealmaking Strategies for a Competitive Marketplace* (W.W. Norton & Company, Inc.) (2010) [hereinafter "*Negotiauctions*"]; Subramanian, Guhan, *Deal Making: The New Strategy of Negotiauctions* (W.W. Norton & Company, Inc.) (2010).

for director accountability on the one hand, with the authority directors have to best determine the path for achieving the highest price available on the other hand – stands up;[16] or what pathologies can interfere with a successful sales process, free from Court criticism.

Instead, the following focuses on just one of the deal features contributing to the Court's finding that the Board's actions, in the aggregate, were lacking. That feature involved the fairness opinion the Board received, including the Court's description – eight times – that the fairness opinion relied on by the Board was "weak."[17]

Although the Court did not characterize it as such in its ruling, the Court essentially viewed the fairness opinion as a *strategic inflection point* that rendered the deal design inadequate, and that should have caused the Board, as process-setter, to re-think its strategic approach and determine if there were other, additional maneuvers it could deploy (in combination with the other tactics) to safely navigate itself through *Revlon*-Land. Given other perceived infirmities with the Board's design process that the Court identified, it's unknowable whether, even if the Board had modified the design features at that time in light of the fairness opinion received, the Board would have earned a different result in the Chancery Court. But it may have had a better chance.

In any diagnostic exercise like this, it's difficult in hindsight and based solely on the Chancery Court's ruling and some of the publicly available pleadings involved, to try to climb back inside of a deal to suss-out all that was happening when; figure out what was being discussed by whom and what discussion occurred inside of other discussions; and determine all the considerations and complexities that went into the decision-making processes along the way. As with all things in life, behind every deal is a story that only those at the center of the action will truly know. Articles like this can't begin to tease out all the hidden engineering. So it's acknowledged up front that this is just one person's take of things, while also fully recognizing there could well be facts in the record (or that never got focused on in the record), or that are not in the public record, that could point an analysis and conclusions in another direction.

Reliance on Investment Bankers is "Pale Substitute" for a Market Check[18]

One thing that is clear is that, as noted, one of the design features in the NetSpend deal was that the Board had decided not to undertake a pre-signing market check. The Board had made this decision purposely given the circumstances involved.[19] There clearly have been transactions in the past where no pre-signing market check was performed and that survived Chancery Court scrutiny under *Revlon*.[20] The Court in *NetSpend* reminded, however, that in such a context, the fairness opinion the Board's financial advisor was to supply (and the supporting analyses) was critical in providing the Board with a reliable body of evidence and knowledge to support a determination that the price the stockholders would be receiving was the best price the Board could reasonably obtain.[21]

And when the Court looked more closely, it found that "the evidence confirmed that the fairness

16 Delaware courts have often repeated the bedrock principle that there is no one path or blueprint for the board of a target company to fulfill its *Revlon* duties of seeking the highest value reasonably available in a sale transaction. *See, e.g., Lyondell Chem. Co. v. Ryan*, 970 A.2d 235, 242 (Del. 2009) ("No court can tell directors exactly how to accomplish [the] goal [of maximizing shareholder value], because they will be facing a unique combination of circumstances, many of which will be outside their control.)"; *Barkan v. Amsted Indus., Inc.,* 567 A.2d 1279, 1286 (Del. 1989) ("[T]here is no single blueprint that a board must follow to fulfill its [*Revlon*] duties. A stereotypical approach to the sale and acquisition of corporate control is not to be expected in the face of the evolving techniques and financing devices employed in today's corporate environment.") [hereinafter "*Barkan*"].

17 *NetSpend*, 2013 WL 2181518, at *1, 11, 16, 19-20, and 20-21.

18 *Id*. at *17 (citing *Barkan* at 1287 (holding that reliance on a fairness opinion is a "pale substitute" for a market check).

19 *Id*. at *3-9. In brief, the decision was made as part of the Board's overall strategic approach given, among other factors, prior failed sales processes that the Board believed had consumed significant time and effort, and the Board's attempt to maintain a posture that the Company was "not for sale" when dealing with the ultimate purchaser in an effort to try to get that party to pay up if it wanted to complete an acquisition. For a discussion of factors to be considered generally when deciding whether to pursue an auction process or negotiate privately, see *Negotiauctions* at 37-56.

20 *See, e.g., In re Smurfit- Stone Container Corp. S'holder Litig.,* 2011 WL 2028076 (Del. Ch. May 20, 2011, revised May 24, 2011).

21 *See NetSpend*, 2013 WL 2181518, at *12-14.

opinion was, in fact, weak."[22] The Court criticized the Board's reliance on the financial advisor's analysis as a "particularly poor simulacrum" of a pre-signing market check, which was a fact available to the Board when it approved the merger, and thus it presumably had time to try to fix it.[23] The Court pointed to the following elements to support its view that the opinion was "unreliable" and "ambiguous:"[24]

- Premium-Based Analyses. The Court noted that two of the five financial analyses performed or metrics identified to support the fairness opinion were based on NetSpend's stock price (*52 Week High & Low Closing Price; Analyst Share Target Price Range*).[25] The Court observed, however, that NetSpend's stock price had been volatile since its IPO in 2010 (swinging between $3.90 and $16.00). It also noted the Board had expressed its view for some time that the public marketplace was substantially undervaluing NetSpend's stock, and that the stock price was not a good indicator of NetSpend's underlying long-term potential value. The Court further noted the Board also had put a stock buyback program in place to try to address the depressed stock price, further evidencing its concern around the stock market as an arbiter of value. In addition, NetSpend's Proxy Statement noted that the Board's concern around the stock price was one of the reasons why the financial advisor was first brought in to talk to the Board.[26] Given this background, and where the low stock price had led the Board to consider strategic options in the first place, the Court determined that premium-based analyses performed off of those depressed metrics were "uninformative" and not strong indicators of value for the Board to rely on;[27]

- Comparable Company and Comparable Transaction Analyses. The Court also reviewed the Selected Publicly Traded Companies Analysis and the Selected Precedent Transaction Analysis that had been performed. The Court found that the companies presented as "comparable" were, in fact, dissimilar to NetSpend, "which greatly reduced their utility."[28] The Court pointed out that the financial advisor's lead banker had himself testified that 14 of the 15 companies used in the comparable company analysis were dissimilar.[29] The Court also highlighted that, as NetSpend had referenced in its merger proxy, most of the comparable transactions selected for

22 *Id.* at *16 (citing *In re Vitalink Commcn's Corp. S'holders Litig.*, No 12085, 1991 WL 238816, at *1328–32 (Del. Ch. Nov. 8, 1991)) (reviewing a DCF and two comparables-based analyses to determine if a fairness opinion was "reliable").

23 *Id.* at *13, 16. Of course, there are timing considerations involved here. At the time the Board decided to forego a pre-signing market check (during the period September-October 2012), the fairness opinion and the final associated financial analyses supporting the opinion had not yet been provided to the Board (which only occurred February 5, 2013), although presumably the analyses had been getting shared with the Board along the way. *See NetSpend Proxy*, at 37-44. It also could be more than a little awkward, with unknown economic consequences on any deal in hand, if once a board has received a fairness opinion that it determined might contain some shortcomings, to roll the deal back from the launch pad and into the workshop so as to restart a market survey exercise. Admittedly, such consequences would be different depending on where along the time line of a deal such a determination were made.

24 *See NetSpend*, 2013 WL 2181518, at *13, 16.

25 The Court referenced five financial analyses, although Defendants referenced six financial analyses. The disparity appears to exist because Defendants were counting a selected public company analysis the financial advisor conducted ("*Selected Public Companies (based on EPS)*" and "*Selected Public Companies (based on EBITDA)*") as two separate analyses, whereas the Court looked at these analyses as one analysis (with two components).

26 *See NetSpend Proxy*, at 34.

27 *NetSpend*, 2013 WL 2181518, at *16. *See also* Matthews, Gilbert E., *Valuation Methods in Fairness Opinions: An Empirical Study of Cash Transactions*, Business Valuation Review: Summer/Fall 2012, Vol. 31, Nos. 2-3, 55-74 (2012) [hereinafter "*Valuation Methods*"] (analyzing empirically the valuation methods used in 352 fairness opinions in US cash transactions during two 12-month periods (September 2007-August 2008; September 2010-August 2011), and noting, among other things, that "the validity of using average premiums [paid] has been questioned by numerous writers for more than two decades," although admittedly this comment appears aimed more at premium paid analyses used when comparing a transaction at hand to comparable marketplace transactions as opposed to stand-alone stock price performance). *Id*. at 61 (internal citations omitted).

28 *See NetSpend*, 2013 WL 2181518, at *16 (citing *In re Radiology Assocs., Inc.*, 611 A.2d 485, 490 (Del. Ch.1991)) ("The utility of the comparable company approach depends on the similarity between the company the court is valuing and the companies used for comparison. At some point, the differences become so large that the use of the comparable company method becomes meaningless for valuation purposes.").

29 *See NetSpend*, 2013 WL 2181518, at *16-17.

comparison were, in fact, "quite old, predating the financial crisis, and the target businesses of the comparables were not particularly similar to NetSpend."[30] As a result, the Court determined that these analyses also were uninformative and not indicative of value.[31] At that point, the Court had found flaws with four of the five financial analyses that had been presented to the Board.

- DCF Range and Projections. The Court then turned to the final financial analysis performed, which was the *Discounted Cash Flow Analysis*. The Court found the DCF illustrated that the agreed-to $16.00 per share cash merger price "was grossly inadequate and the analysis was based on projections that were outside the range of management's customary projections."[32] The Court noted that the DCF revealed that the agreed merger price was "20% *below* the bottom range of values implied by the DCF" (which range was $19.22 - $25.52).[33] The Court determined that the "presence of an anomalous DCF valuation makes the [fairness opinion] a less reliable substitute for a market check."[34] Defendants sought to distinguish the DCF by noting it represented an "outlier," and was "just one of six" valuation analyses, and that they were justified in not giving it significant weight.[35] Delaware courts have long looked to the DCF analysis as a core valuation tool in a variety of circumstances, including appraisal situations, damages calculations, and in the takeover context.[36] The Court added to its concerns around the DCF by noting that management typically had prepared projections no further out than three years, making the five year DCF used as part of the fairness opinion process as "speculative."[37] This aspect of the opinion also raises considerations for financial advisors where five years of projections (commonly required when doing DCF analyses) for the target

30 *Id*.

31 *Id*.

32 *Id*.

33 *Id*. (emphasis in original).

34 *Id*.

35 *See* NetSpend Defendants' Answering Brief In Opposition to Plaintiff's Motion For Preliminary Injunction, at 37 [hereinafter "*NetSpend Defendants' Answering Brief*"]. *See also supra* note 25 and accompanying text.

36 *See, e.g., Crescent/Mach I Partnership, L.P. v. Turner,* 2007 WL 2801387, at *10 (Del. Ch. May 2, 2007) ("Although it is appropriate to consider all accepted methodologies, the Court tends to favor the discounted cash flow method."); *Cede & Co. v. JRC Acq. Corp*., No. 18648-NC, 2004 WL 286963, at *2 (Del. Ch. Feb. 10, 2004) ("In recent years, the DCF valuation methodology has featured prominently in this Court because it 'is the approach that merits the greatest confidence' within the financial community.") (quoting *Ryan v. Tad's Enterprises, Inc*., 709 A.2d 682, 702 (Del. Ch. 1996)). *See also Valuation Methods* at 58 (finding, among other things, that the most common valuation methods used by investment banks and valuation firms in the fairness opinions for the transactions reviewed were the income approach (DCF) and the market approach (comparable company and comparable transactions), and that such methodologies were found to have been used in the transactions included in the data set 91% and 96%, respectively.

37 *NetSpend*, 2013 WL 2181518, at *17. Defendants, meanwhile, had noted that NetSpend produces only one-year projections in the ordinary course, but for purposes of considering a possible transaction, the Company had prepared three-year projections, whereas the DCF analysis performed relied on (and heavily emphasized) five-year projections. *See NetSpend Defendants' Answering Brief*, at 38. Plaintiff had also raised a disclosure claim around differences between how management and the Board's financial advisor calculated free cash flow, seeking to compel disclosure of a chart illustrating such differences that was included in presentation materials that the financial advisor prepared for the Board. The Court determined, however, that while the chart had not been disclosed, there was a narrative description in the NetSpend proxy and this was not a material deficiency. *NetSpend*, 2013 WL 2181518, at *10. Plaintiff also had asserted that the financial advisor had presented two DCF analyses to the Board, the second of which indicated significantly lower implied values as compared to the first, and that only the second DCF analysis had been disclosed in the *NetSpend Proxy*. The Court noted Plaintiff failed to raise this argument in its Opening Brief (which would generally result in the argument being waived). Regardless, the Court found the argument to be meritless since Defendants had noted the discrepancies between the two DCF analyses appeared to be caused "by a computer glitch or spreadsheet error that may have artificially inflated the first DCF." *Id*. Defendants also acknowledged that, notwithstanding the "outlier" label they sought to attach to the financial advisor's DCF analysis, they sought to use the higher indicative values contained in that analysis opportunistically in negotiations with Total Systems to try to get Total System to increase its bid. *See NetSpend Defendants' Answering Brief*, at 39.

company are not available.[38] There were also questions raised in the pleadings around whose cash flow projections (management's or the financial advisor's) had been used in performing the DCF, which further clouded the dependability of the analysis.

The Court highlighted that the directors are certainly entitled to rely on fairness opinions since directors clearly are entitled under Delaware precedent to rely in good faith on expert opinions.[39] The Court determined, however, that, when considering all of the other facts of this case and the actions by the Board in pursuing the sales process, the Board's reliance on the fairness opinion involved here, with the weaknesses it identified, pushed the totality of the decisions the board had made around the sales process "farther towards the limits of the range of reasonableness."[40]

Selected Observations

The Court's broader ruling here was similar to the Court's approach elsewhere, such as *Del Monte*[41] and *El Paso*[42]: board actions around a sales process are viewed as flawed and criticized, but the deal is allowed to proceed to a vote and closing because there is no viable alternative and the Court doesn't want to stand in the way of stockholders receiving a significant premium-to-market, while the Court also acknowledges directors will likely not face personal liability as a result of the exculpation provisions found under Delaware law.[43] As such, *NetSpend* contributes to the debate over whether Delaware courts have a proper remedy for board or director performance that is judged to be sub-par – but that is clearly short of disloyalty (where monetary damages might be available).

Beyond that larger issue, it's unclear whether the fairness opinion and the supporting financial analyses provided to the Board in *NetSpend* would have been criticized by the Court – or at least criticized in the same tones – if the Board's decision-making around other design features in the sales process had been different from that before the Court.[44] As noted, the Board's reliance on the weak opinion was just one of the several substantive areas where the Court found the Board's actions wanting. And commentary here is not meant to suggest that, but for the issues the Court focused on with respect to the fairness opinion, the Board's deliberations on the other features would have gone uncriticized.

So what then might be some of the takeaway lessons flowing from *NetSpend* for boards, directors, financial advisors, and other advisors? There would appear to be several:

For Financial Advisors

- Chancery Court's Continued Scrutiny of Fairness Opinions. The Court continues to demonstrate – as it has done over the years – that it will closely scrutinize different aspects of the financial analyses commonly performed to support fairness opinion determinations

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38 *See generally Valuation Methods*, at 58 (noting that the results of the survey referenced therein indicated that DCF analyses were utilized in all 307 situations where management had disclosed that it had made projections for three or more years, and that there were 45 opinions where the companies involved had not made projections or had only made them for one or two years. In 13 of those situations, DCF calculations were performed utilizing projections extrapolated by the valuator. In the remaining 32 opinions that lacked adequate projections (or any projections at all), DCF was not applied. For 12 of those, the disclosure explicitly stated that DCF was not used because adequate projections were not available. The other 20 opinions did not contain an explicit explanation as to why a DCF was not included. *Id*.

39 *NetSpend*, 2013 WL 2181518, at *16 (citing 8 Del. C. § 141(e)).

40 *Id*. at *16, n 211 (citing *See Ryan v. Lyondell Chem. Co.,* No 3176-VCN, 2008 WL 2923427, at *23 (Del. Ch. July 29, 2008)) ("When control of the corporation is at stake . . . directors of a Delaware corporation are expected to take context-appropriate steps to assure themselves and, thus, their shareholders, that the price to be paid is the 'best price reasonably available.'").

41 *See Del Monte, supra* note 5. Although in *Del Monte* the deal was enjoined for a period so as to allow for a second go-shop to be conducted by an investment bank viewed as nonconflicted.

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

43 *See 8 Del. C.* § 102(b)(7) (allowing Delaware corporations to shield board members from liability for breaches of duty of care, but not breaches of duty of loyalty).

44 Notwithstanding the Court's criticism of the Board's reliance on the fairness opinion, the Court stated it found it noteworthy that, while the Plaintiff pointed out the flaws in the fairness opinion analysis, it did not offer any competing evidence around value that was different from that presented by the financial advisor. *See NetSpend*, 2013 WL 2181518, at *22-23.

(among other business valuation exercises). In general, Delaware courts have developed a large body of law looking at the proper analytics for valuing businesses. *NetSpend* is just one of the latest reminders of the Court's willingness to look under the hood to check the wiring, and evidencing the Court's attitude toward certain valuation analyses underlying fairness opinions. As such, fairness opinion providers may want to add the viewpoints expressed to whatever guidelines they may or may not maintain around techniques and assumptions that the Delaware courts have determined to be reasonable or unreasonable, as the case may be, and the context in which those determinations are made.

- Plaintiffs' Review of the Analyses. Financial advisors (deal team members and fairness opinion committees) are already very well aware – or should be – that plaintiffs' counsel (and their own expert advisors) closely inspect each financial analysis performed by financial advisors to test how appropriate it is for the transaction and context involved, how "comparable" certain companies, transactions, and situations may or may not be to a transaction at hand, and how solid the component parts of the DCF are. They will look to highlight each and every anomaly in pleadings, will probe in depositions the rigor of the analyses undertaken by financial advisors and the degree to which boards understand the data. The Court, of course, will factor any actual findings in this regard into its overall deliberations when it stacks up Good Facts and Bad Facts.

- Stress Testing Analyses. Banker deal teams and the fairness opinion committees that typically review opinions and presentation materials before they are delivered to a board need to ensure (and fairness opinion committee policies, procedures, and processes already typically require) that all such financial analyses in any board presentations are fully vetted, stress-tested, and contextualized for the deal at hand so that potential analytical questions are addressed up-front in a deliberative process (with in-house and/or outside counsel as warranted), rather than running the risk of having perceived shortcomings exposed when the analyses are put under the microscope in Chancery Court proceedings or depositions. The latter may put bankers (and possibly their fees), as well as the board they represent, in a gloomy spot and become an unwanted learning experience if it proves difficult to rationally explain subjective judgments underlying analyses. As noted above and below, this is not to suggest that such stress testing did not happen in *NetSpend* since the record does not address this. The Court's ruling also raises other questions around what course a financial advisor can consider taking when certain aspects of the financial analyses may not – for whatever reason – be as supportive as might otherwise be the case.

- Discuss Any Weaknesses. If a financial advisor were to find itself in a situation where it believes aspects of any of the financial analyses contains – for whatever reason – inherent weaknesses or shortcomings, those observations should be identified and reviewed with the board so that the board can factor them into its deliberations and determinations, and decide whether it needs to recalibrate its strategy scheme accordingly. Any such notations made to a board should be reflected in the record, although the second-order implication of that is that it can serve as a double-edged sword and perhaps be a road-map in plaintiff claim development. It is unclear the degree to which this did or did not happen in *NetSpend*. There appears to be no statements in the Court's opinion to suggest that specific discussions were held around the relevant matters related to the financial analyses.

For Boards

- Fairness Opinion is No Panacea. *NetSpend* is but the latest reminder for boards and directors that fairness opinions are just one device in the M&A toolbox that can assist directors in establishing that they have sought to satisfy their fiduciary duty to act with due care and in an informed manner when involved in a sale-of-the-company transaction. As the decision illustrates, however,

a fairness opinion is not a panacea. Nor does such an opinion offer any kind of automatic defense to a fiduciary duty claim. Directors and boards (with the assistance of counsel if necessary) need to closely review the supporting analyses behind such opinions, and make sure they understand the various inputs. It is not and should not be simply a check-the-box exercise.

- Courts Review Directors' Understanding of Fairness Opinions. Courts regularly examine the circumstances surrounding the obtaining of fairness opinions to determine if directors and boards are justified in relying upon them in satisfaction of applicable fiduciary duties. As referenced above, the Court in *NetSpend* did not specifically address whether, or to what degree, any of the NetSpend directors questioned the financial analyses, including the DCF, highlighted any perceived deficiencies, and/or factored that thinking into their decision-making when setting their strategic course or evaluating other proposed deal terms. There is reference in the oral argument transcript that the Board actively discussed the DCF aspects.[45] Leaving aside what may or may not have happened in *NetSpend*, directors (and counsel representing them) should be probative around such matters, and not be reluctant to ask: "What's up with X?" "Tell us more about this or that" "How is that going to play?" "What should the board be looking at or thinking about in light of that?" Boards and directors should fully expect that every anomaly or aberration will surface in litigation, so it is advisable to build as strong a record around clearly illustrating a board's reasonable deliberations and probity of such matters.[46]

- Context is Key. *NetSpend* reinforces that directors must bear in mind that their deliberations around all deal features, including a financial advisor's fairness opinion, is – or should be – a highly contextualized one. A board and its advisors should review, evaluate, and assess the different process design features and other moving pieces in the transaction concurrently as they evolve, seeking to understand how each of the ingredients is working with, influencing, and flavoring the other moving pieces.

- Single Bidder Situations Can Heighten the Focus on Fairness Opinion. In single bidder scenarios, where other design features do not include a pre-signing market check and/or a post-signing go-shop, there is a heightened focus on what a board is looking at and relying on in its effort to fulfill its duties and responsibilities. *NetSpend* reinforces that, in such a situation, a board is required to rely more extensively on its own knowledge and that of its financial advisor in determining whether the proposed transaction is priced fairly. The weaker the knowledge base or sophistication as to financial matters of the directors themselves, the more reliable the fairness opinion must be. If the reliability of one or more of the financial analyses supporting the fairness opinion (assuming they are appropriate for the transaction at hand) is questionable

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45 In the record from the Oral Argument on the Preliminary Injunction, Defense counsel appears to suggest that discussions occurred around the DCF analysis, although the scope and contours of any such discussions is not clearly discernible from the comments in terms of who was saying what to whom and when, or the degree to which the financial advisor was included in those deliberations. *See NetSpend Preliminary Injunction Transcript*, at 68 (May 10, 2013). In addition, the financial advisor's presentation materials that were provided to the Board, as well as the minutes of various Board sessions where aspects of the transaction were discussed, are listed as exhibits in the pleadings in the case, but presumably were filed under seal as they are not publicly available as part of the docket, so it is unclear whether those materials might include facts germane to the discussion around the DCF. *See also NetSpend Defendants' Answering Brief*, at 20 (which also appears to address the issue to a certain degree, noting that the Board "discussed the fact that the price was below the DCF range, but concluded that the premium transaction was nonetheless in the best interests of stockholders, because, among other things, the DCF analysis was based on five-year projections that the Company did not prepare in the ordinary course of business and did not account for the substantial regulatory risks (such as the Durbin Amendment) and competitive risks (including well financed existing and potential competitors) faced by the Company.").

46 One difficult aspect for counsel, where the board or individual directors have not otherwise locked-on to the issue, is to ensure that the issue is raised and discussed adequately with the board and the financial advisor, which effort may be challenging given that certain directors may have more probity and patience around exploring such issues than others, who may want to move on rather than get bogged-down in the details.

or seen as flawed, that is clearly going to put a hotter light on other features in the board's process design in terms of whether they were in a position to achieve the best reasonably available transaction and fulfill their *Revlon* obligations.[47]

- <u>When Faced with a Weak(er) Fairness Opinion</u>. When and if a board is faced with a fairness opinion that – for whatever reason – is viewed as not particularly strong, it provides context for the board to look at its other deal process decisions in that light. In that setting, a board should consider whether it needs to or can modify other deal terms (and try to persuade the bidder of the potential mutual benefits of such modification), as well as take steps to gather other current information around value (such as market-based information), as part of its process of determining whether the deal in front of them affords the opportunity to attain the highest price reasonable available.[48] Otherwise, they will cede to others the ability to control the narrative once they get to the Chancery Court.

In *NetSpend*, the board appeared to face a Hobson's Choice: accede to the buyer's attempted shut-down move that under no circumstance would it agree to a post-signing go-shop despite repeated efforts by NetSpend and its advisors to try to get that term into the deal (and thereby obtain the cover that deal term might afford in the inevitable litigation to follow [49]), or insist on a go-shop and run the risk of cratering the deal and losing the premium payment for stockholders. The Board took the deal in hand, running the risk it might well get shoved around in Chancery Court. Looking back over its shoulder now, that trade appears to be the far better one than what the result may have been if the Board had to torpedo the deal because it couldn't get a market-based "simulacrum" in the form of a go-shop (the utility of which the Board may have clearly analogized to the lack of benefit to be derived from running a pre-signing process in the first place) given deal-negotiation realities, and instead the Board ended up with a pile of litigation papers stacked on the boardroom table for having let a premium deal get away and with the Company stock price depressed even further as a result. In effect, it looks like the Board essentially made the same determination the Court did: perhaps the process turned out to be a little less than clinical; but this deal should go forward and get done.

- <u>NetSpend's Potential Larger Lesson</u>. On one level, *NetSpend* can be viewed as simply another in a line of cases analyzing a board's sale process and design features as measured against its *Revlon* obligations. Here, it was against the backdrop where there may not have been an active, competitive bidding pool, nor had there been a pre-signing market check. It is an interesting case on a number of levels, including the mix of deal features. But in the grand scheme of things, and when the history of M&A litigation

47 *NetSpend* contrasts with another Chancery Court decision handed down the month prior to *NetSpend*, and that also involved a single bidder negotiation strategy where there was no pre-signing market check and no go-shop. *See Plains, supra* note 4. There, various aspects of different financial analyses underpinning the fairness opinion provided to the board of directors by the board's financial advisor had been challenged as had occurred in *NetSpend*. In *Plains*, however, the Court did not find fault with the board's decision to pursue a single bidder strategy, found the board was experienced and sophisticated in financial matters, did not find a breach of the board's *Revlon* duties, and denied challenges plaintiffs' counsel had made with respect to aspects of the financial advisor's financial analyses. *Id*. In short, the fairness opinion (and accompanying financial analyses) was viewed as a much stronger linchpin to support the board's decision to forego a pre-signing market check and a post-signing go-shop.

48 *NetSpend* also raises interesting questions around what course a Board can or should pursue in a single bidder scenario where the bidder flatly refuses to agree to a go-shop provision, despite repeated attempts to negotiate such a term. *See NetSpend Defendants' Answering Brief,* at 15 ("We are simply unprepared to move forward . . . with a merger agreement with that provision. Accordingly, TSYS' offer is contingent upon your withdrawing your request that the merger agreement include a 'go-shop' provision."). It is somewhat incongruous that Total Systems flatly refused to include a go-shop at the same time it was arguing that there were no other bidders interested, although it did suggest that the Company run a go-shop before the deal was signed up. If it truly believed there were no other potential bidders for NetSpend, how much execution risk would a go-shop have presented?

49 Inevitable given recent statistics around the likelihood of litigation in M&A transactions. *See Shareholder Litigation, supra* note 9.

is written, *NetSpend* will not make the Top 10 list. On another level, however, the case serves to illustrate perhaps a broader lesson that directors and boards should bear in mind. That is that, at certain times in certain deals, developments may arise that amount to strategic inflection points. These pivot points are more than garden variety changes or hiccups that occur in the normal deal process. In *NetSpend*, such an inflection point was receipt of a fairness opinion the Court viewed as "weak." It had the effect of re-contextualizing the process design features of the deal involving the pre-signing market canvas and the post-signing go-shop (leaving aside what one may think of the utility of go-shops as a proxy for a pre-signing market check). In other deals, it could be other events or developments. The broader thematic lesson from *NetSpend* may be that boards need to be able to identify these types of developments as strategic inflection points when they occur, stare hard at them and assess, debate, and understand their dimensions, and determine *if* they call for any re-thinking and/or re-calibration of any other deal design features, tactics, or maneuvers of the game, so as to allow them to better fulfill their fiduciary duties.

TASK FORCE REPORTS

Joint Task Force on Governance Issues in Business Combinations

We had a well-attended (okay, actually, crowded!) meeting in Washington D.C. at the Spring Meeting of the Business Law Section. We discussed some key points in Chapter 2 (Fiduciary Duties of Directors Generally in a Business Combination) with John Houston and Jamie Snelson. We also discussed Chapter 13 (Negotiation of Deal Protection Provisions) with Tom Mullen, and Chapter 4, Section G (Due Diligence Issues) with Mike Halloran and Brian Buck. One major theme for all the authors was to make the handbook more conversational and less treatise-like, while retaining the key case citations in footnotes.

In San Francisco, we will meet 4:30-5:30pm on Friday, August 9, 2013, in what we hope will be a bigger room! Check the schedule for the latest room assignment. Danielle Gibbs, Young Conaway, will discuss the recent opinion by Chancellor Strine in *In Re MFW Shareholders Litigation* (Del. Ch. May 29, 2013), which held that a controlling stockholder who conditions an offer for a controlled target from the beginning of a process on both the approval of an independent special committee and a majority of the unaffiliated stockholder may be entitled to the business judgment review standard, subject to judicial review of the independence and proper empowerment of the special committee and the disclosure to the unaffiliated stockholders. This case will have ramifications in a number of our chapters and we look forward to an interesting discussion of the likely impact of this case on deal-making.

We also will discuss the issues raised in Chapter 6 (Unsolicited Approaches and Pressures to Sell and Deciding to Explore a Sale), and former Chapters 15 (Post-Announcement Developments) and 21 (Special Issues in Hostile Transactions and in Dealing with Activists) with authors Tatjana Paterno and Ryan Thomas of Bass Berry, and Rolin Bissell of Young, Conaway. We are combining Chapters 15 and 21 into a new Chapter 20, and so there will be some renumbering [groan!] and we want to review the issues we plan to highlight in each of the two chapters. There is a lot to discuss in these chapters, and current deals like the Dell/Silver Lake deal make this topic more relevant than ever. We look forward to your input and an interesting discussion.

Ron Janis and Tom Zalewski of Day Pitney will join us by phone to talk about the substantial progress they are making on Chapter 23, Unique Governance Issues in Non-Delaware Jurisdictions, including some of the interesting issues they will be highlighting in the chapter from some of the key jurisdictions. Time permitting, we will also continue our discussion of the two chapters on special committees, with revised chapters to be circulated by Lewis Lazarus and Steve Haas, and a discussion of Richard De Rose's chapters on Engaging Financial Advisors and the Auction Process.

Thanks to Richard De Rose for redrafts of Chapters 11 (Engaging Financial Advisors) and 12 (The Shopping/Auction Process), to Brandee Fernandez

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and Rama Padmanabhan for an initial draft of Chapter 8 (Non Disclosure Agreements and Standstills), to Tatjana Paterno and Ryan Thomas for a revised outline of Chapter 6 and to Rolin Bissell for a draft outline of the new combined Chapter 20 on Post-Announcement Developments. We will circulate drafts of outlines or chapters we plan to discuss to the Task Force via email and we will have copies on hand for those attending in person. We value the participation of M&A Committee members in discussing the real world issues raised by our draft chapters and look forward to a robust discussion of current issues as always.

We will be meeting on Friday, August 9 from 4:30 pm -5:30 pm Pacific Time in the Fountain Room, Lobby Level of the Fairmount Hotel. Off-site participants can dial-in to the meeting using the following numbers/ passcode:

(866) 646-6488 (US and Canada)
(707) 287-9583 (International)
Conference Code: 2458399301

We look forward to seeing many of you in beautiful San Francisco.

Diane Frankle
Michael Halloran
Larry Hamermesh
Patricia Vella
Co-Chairs

Task Force on Financial Advisor Disclosures

Our task force – comprised of deal counsel, Delaware counsel, litigators and financial advisors – continues to grow in number. In fact, we have seen a 22% increase in membership since the last stand alone meeting! At the Spring Meeting of the Business Law Section, Stephen Ehrenberg led an excellent discussion of the developments in the credit rating agency litigation. We also staged a mock negotiation of a banker engagement letter - special thanks to Jim Smith, Jim Griffin and Jeff Rothschild for leading that portion of our meeting. On May 22nd, the Task Force co-presented, with Bloomberg Law, a CLE program entitled: Examining the Board's Role in Retaining, Managing and Relying on Financial Advisors in M&A Transactions. Please see the Task Force website for materials from this well-received event. Unfortunately, the Task Force will not be meeting at the Annual Meeting in San Francisco. We will resume our meetings at the next M&A Committee standalone meeting in late January. However, we continue to welcome new members – please feel free to contact either of us if you would like to get involved.

Stephen M. Kotran
Yvette R. Austin Smith
Co-Chairs

Task Force on Legal Project Management

The Task Force on Legal Project Management held an in-person session in April in conjunction with the Spring Meeting of the Business Law Section in Washington, D.C. Joining the group as a featured guest was Catherine Moynihan of the Association of Corporate Counsel, who heads up ACC's Value Challenge initiatives. She together with several general counsel in attendance shared their views on legal project management from the perspective of in house counsel.

Subsequent to the Spring meeting there have been several meetings of Task Force working groups:

- A working group on task coding for M&A deals held a telephonic meeting to discuss a path forward for developing improved transactional task coding that builds upon existing model ABA task coding and focuses on the different phases of an M&A deal.
- A small working group convened in person to discuss the development of a "Deal Scorecard" as an adjunct to the previously discussed "Compact" between opposing counsel. The

Deal Scorecard would identify and facilitate the up-front negotiation of major deal terms that are sometimes not reflected in a letter of intent, and left to negotiation through the exchange of multiple drafts of the acquisition agreement. Even if not used for this purpose, the Scorecard would serve as a handy checklist of important deal issues to discuss with the client.

- Initial steps were taken toward generating a stock purchase agreement checklist (similar to the previously circulated asset purchase agreement checklist). These checklists would be adjuncts to the "smart" scoping plan.

We will be meeting on Friday, August 9 from 2:30 pm -3:30 pm Pacific Time in the Vanderbilt Room, Terrace Level of the Fairmount Hotel. Off-site participants can dial-in to the meeting using the following numbers/ passcode:

(866) 646-6488 (US and Canada)
(707) 287-9583 (International)
Conference Code: 3199473460

If you are interested in legal project management and joining the Task Force, you are most welcome.

Hope to see you in San Francisco.

Byron Kalogerou
Den White
Co-Chairs

Task Force on the Revised Model Asset Purchase Agreement

The Task Force on the Revised Model Asset Purchase Agreement (MAPA2) had an engaging discussion and a productive meeting at the Spring Meeting of the Business Law Section in Washington, DC.

Since the Task Force was formed in 2012, members have broken into small groups and started their work to update specific sections of the model asset purchase agreement. At the Spring Meeting, we received progress reports from a representative of most working groups and debated issues relating to a number of provisions in the indemnity section of the model agreement. We also discussed some complications that have arisen updating the model agreement based on the draft Fact Pattern, resulting in refinements to the Fact Pattern. And, new members to the Task Force were welcomed, each of whom has now been assigned to a working group.

At the Annual Meeting in San Francisco, Ed looks forward to welcoming Task Force members to his hometown, and we look forward to several groups presenting their proposed updates to the MAPA provisions on which they are focused and to raise drafting questions or issues for discussion by the larger working group.

We will be meeting on Saturday, August 10 from 11:30 am - 12:30 pm Pacific Time in the Crown Room, 24th Floor of the Fairmount Hotel. Off-site participants can dial-in to the meeting using the following numbers/ passcode:

(866) 646-6488 (US and Canada)
(707) 287-9583 (International)
Conference Code: 9101063640

We hope you can join us.

Ed Deibert
John Clifford
Co-Chairs

* * *

SUBCOMMITTEE REPORTS

Acquisitions of Public Companies Subcommittee

We had a great meeting in April during the ABA Business Law Section Spring Meeting in Washington DC. We were fortunate to have with us Michele Anderson, Chief of the Office of Mergers & Acquisitions of the SEC, as well as members of her staff. Michele and her team discussed with us various issues encountered by the OMA staff in the context of public company acquisitions. Mark Morton also previewed for the Subcommittee the new Section 251(h) of the DGCL and how that new provision may impact public company deals structured as two-step transactions. We had an excellent discussion.

In May, our Subcommittee made its traditional trip to Delaware to meet with the members of the Delaware judiciary. We began our weekend with cocktails and dinner on Friday evening in Dover, which was attended by members of the Delaware Supreme Court and members of the Court of Chancery. On Saturday, we held our traditional meeting using a fact pattern discussion format with members of the Delaware Supreme Court and the Court of Chancery. Special thanks to Tricia Vella for again drafting a thought-provoking hypo for the meeting, and to Steve Bigler, Jen DiNucci, John Grossbauer and Mike O'Bryan for participating in the panel. Following our discussion with the Delaware judiciary, Mike Pittenger moderated a panel with Jon Abramczyk and Cathy Dearlove focusing on practical things deal lawyers need to know about deal litigation. We finished off the weekend's activities with a dinner hosted by Mark and Liza Morton at their home. Special thanks to Chief Justice Steele for again coordinating the meeting with the members of the Delaware judiciary, Mark and Liza for once again hosting our Subcommittee at their home, as well as the members of the Delaware Bar who were involved in putting together a fantastic weekend.

We will be meeting on Saturday, August 10 from 1:00 pm -2:30 pm Pacific Time in the Crown Room, 24th Floor of the Fairmount Hotel. Off-site participants can dial-in to the meeting using the following numbers/passcode:

(866) 646-6488 (US and Canada)
(707) 287-9583 (International)
Conference Code: 9101063640

During our meeting, Rick Alexander will be leading a discussion on recent Delaware developments, including the recent *MFW* and *Chevron* cases, as well as "B-Corps." Jen Muller will review with us the latest Houlihan Lokey Termination Fee Study. We will also hear from the leaders of various Task Forces – Financial Advisor, Corporate Governance in M&A Transactions, and the Two-Step Task Force – as to the status of their projects.

Our Subcommittee dinner during our San Francisco meeting will be held on Friday, August 9, 2013 at Farallon. Cocktails begin at 6:30pm, with dinner starting at 7:00pm. I hope to see many of you there.

Jim Griffin
Chair

Jen DiNucci
Jim Melville
Vice Chairs

International M&A Subcommittee

The International M&A Subcommittee met from 11 a.m. to 12:30 p.m. on Saturday, April 6, 2013, in connection with the Spring Meeting of the ABA Business Law Section in Washington, DC.

FCPA M&A Update

Mara Senn of Arnold & Porter, Washington, DC, gave an update on Foreign Corrupt Practices Act issues

in the context of cross-border M&A, which was followed by a Q&A session.

Public Company Takeovers Project

Franziska Ruf of Davies Ward Phillips & Vineberg, Montréal, and Daniel Rosenberg of Speechly Bircham, London, gave a short summary of the current state of play on the Subcommittee's Public Company Takeovers Project they are leading. The questionnaire has now been completed by lawyers in almost all of what are now 18 jurisdictions and the editorial team, which in addition to Franziska and Daniel comprises Diane Frankle of Kaye Scholer, Sophie Lamonde of Stikeman Elliott, Rick Silberstein of Gómez-Acebo & Pombo and Patricia Vella of Morris Nichols Arsht & Tunnell, held its first meeting during the Spring Meeting.

International JV Agreement Project

Freek Jonkhart of Loyens & Loeff, Rotterdam, summarized the progress of the Subcommittee's International JV Project he is leading with Mireille Fontaine of Gowlings, Montréal. They have sent the completed material to the ABA for publication and are awaiting editorial comments from the ABA publication team. ABA Publishing aims at releasing the publication before the annual meeting in San Francisco.

M&A in Columbia

Mauricio Questa of Posse, Herrera & Ruiz Abogados, Bogotá, gave a presentation on M&A in Colombia, which was followed by a Q&A session.

Poison Pill Reform in Canada

Nick Dietrich of Gowlings, Toronto, gave a presentation entitled Poison Pill Reform: American "Just Say No"Meet Canadian "Just Not Now".

Knott of Luther, Cologne gave a presentation on the European Court of Justice decision in the VALE case relating to the rights of business entities to migrate (change their jurisdiction of organization) among EU countries.

Programs and Projects

Jim Walther of Arnold & Porter, Los Angeles, led a discussion considering a potential future program on M&A in Africa.

Other suggestions remaining on the agenda from earlier meetings were:

- Annual (or other periodic) discussion of international deal activity (transaction types and volumes by region and across regions);
- Cross-border distressed company acquisitions;
- Return of nationalization risk in cross-border M&A;
- Director liability issues after the deal is done: You're not in Kansas (London, Toronto) anymore;
- FCPA/anticorruption law compliance: How to assess the risks before committing to a transaction and how to fix what you bought;
- The use of MAC clauses in different jurisdictions;
- Developments in Global M&A: Does Anybody Remember the Crisis and What Did We Learn?;
- Use of new supranational corporate entities in M&A (Societas Europaea, etc.);
- International comparison of disclosure requirements and restrictions on "stake-building";
- The increasing use in European private company M&A of agreements without price adjustment mechanisms, commonly referred to as "lock box" agreements;
- Squeezing out minorities in different jurisdictions; and
- IP issues on cross-border M&A.

Current Developments Discussion

The meeting concluded with our customary "open mic" general discussion by Subcommittee members regarding legal developments in their jurisdictions relevant to M&A practice.

Cameron Rusaw of Davies Ward Phillips & Vineberg, Toronto, described amendments recently proposed by Canadian securities regulators to Canadian early warning reporting requirements. The basic proposed change would reduce the threshold at which a shareholder must report its ownership position in a public company from 10% to 5%. This would bring the Canadian

rule in line with the US Regulation 13D requirement and would have significant implications for bidders trying to establish a toe-hold position in a Canadian issuer.

Jeeva Rajagopal of Fox Mandal, Chennai, described changes in India to the procedure for approval of proposals pertaining to foreign direct (brownfield) investment in pharmaceutical companies. These changes pave the way for such approvals to be granted in as less as five weeks (based on one of the most recent and widely reported transactions handled by Fox Mandal), compared to the 12 to 15 month timelines typically encountered in the past.

Jeeva also referred to a slew of changes to the Indian takeover regulations, one of the prominent changes being the entitlement of the acquirer to acquire shares through negotiated deals from public shareholders during the period of the open offer, making public company acquisitions more streamlined.

Cian McCourt of A&L Goodbody, New York, described proposed changes to the Irish Takeover Code which would create a direct duty relationship between a takeover party's lawyers and the Irish Takeover Panel. These changes are being opposed by the Irish legal profession.

Subcommittee Website

Our website at http://apps.americanbar.org/dch/ committee.cfm?com=CL560016 contains:

- Presentation notes of Mara Senn on FCPA issues in the context of cross-border M&A;
- Presentation notes of Mauricio Questa on M&A in Colombia;
- Presentation notes of Nicholas Dietrich on poison pill reform in Canada;
- A note provided by Cameron Rusaw expanding on his comments made during the open mic section on the proposed amendments to Canadian early warning reporting requirements;
- The latest materials from the Subcommittee's Foreign Direct Investment Project;
- The latest materials from the Subcommittee's International Dispute Resolution Project; and
- Details of the Subcommittee's publications, future meetings, other work-in-progress and other past program materials.

Next Meeting

We will be meeting on Sunday, August 11 from 10:30 am -12:00 pm Pacific Time in the Grand Ballroom, Grand Ballroom Level of the Fairmount Hotel. Off-site participants can dial-in to the meeting using the following numbers/passcode:

(866) 646-6488 (US and Canada)
(707) 287-9583 (International)
Conference Code: 4961649712

Change in Subcommittee Leadership

We are delighted to announce that Franziska Ruf, Freek Jonkhart and Keith Flaum will assume the leadership roles for the Subcommittee starting with the Annual Meeting in San Francisco. We have enjoyed our service as Co-Chairs and wish to thank all of the many Subcommittee members who have actively participated in Subcommittee meetings and our many successful programs and other projects over the years. We wish Franziska, Freek and Keith the very best of success in their new leadership roles.

Daniel P. Rosenberg
James R. Walther
Co-Chairs

Membership Subcommittee

We are pleased to report that our total Committee membership as of July 23, 2013 is 4,379, which is an increase of 4% over the numbers from our stand alone meeting in March. We are very pleased with the increase and attribute it to our wonderful members' efforts and our continued focus on programs and events that keep our members engaged and attract new ones.

Our membership is comprised of residents of 49 states which has remained constant for the past couple of years. The same is true about the 51 countries that are present within our member roster.

The increases in our numbers remained constant across the subcommittees, with the most notable jumps occurring with in-house counsel (+7%) and associate (non-lawyer) members (+5%). The number of Canadian members continues to increase and rose from 202 to 211, another 4% increase which was constant from the last report.

A successful partnership has been established with the Association for Corporate Growth (ACG), and the ACG San Francisco chapter partnered with us for a networking reception to bring our organization and theirs together to expand awareness and attract new members. The Diversity Subcommittee has been very active creating opportunities for young lawyers and other minority members of the Bar to join and get to know our Committee.

A word on our Subcommittees: The M&A Trends Subcommittee is still our largest group with 1,534 members up from 1,474 members (+4%), with the private equity subcommittee right on its heels with 1,411 members (up from 1,350 – a 4.5% increase). The International M&A Subcommittee saw its numbers reach over 1,000 for the first time and realized a 28% increase in membership. Two other groups who saw their numbers jump at least 20% were the Financial Advisor Disclosure Task Force, having a 22% increase and Governance Issues in Business Combinations Task Force seeing a 20% increase. Here are some of the other interesting numbers:

Acquisitions of Public Companies	889 (up from 851)
M&A Jurisprudence	772 (up from 739)
Joint Ventures	799 (up from 763)
Dictionary of M&A Terms	675 (up from 653)

We would like to welcome Tatjana Paterno to our subcommittee. Tatjana joins us from Bass Berry and will assist us in our continued efforts to grow and expand our membership base. We also wish Ryan Thomas the best of luck as he takes the role of co-editor of Deal Points, and thank him for all of his help over the years with membership.

We thank you for your involvement and look forward to seeing you all in San Francisco.

Mireille Fontaine
Tatjana Paterno
Tracy Washburn
Co-Chairs

M&A Jurisprudence Subcommittee

The M&A Jurisprudence Subcommittee is currently comprised of the following two working groups and three project groups:

- The Annual Survey Working Group identifies and reports to the Committee on recent decisions of importance in the M&A area, and prepares the Annual Survey of Judicial Developments Pertaining to Mergers and Acquisitions, which is published annually in The Business Lawyer. After publication, the Annual Surveys are posted in an on-line library, called the M&A Lawyers' Library, which members of the Mergers and Acquisitions Committee can access from the Committee's home page on the ABA website (http://apps.americanbar.org/dch/committee.cfm?com=CL560000). The tenth Annual Survey of Judicial Developments Pertaining to Mergers and Acquisitions is included in the February 2013 issue of The Business Lawyer.

- The Judicial Interpretations Working Group examines and reports to the Committee on judicial interpretations of specific provisions of acquisition agreements and ancillary documents, looking not only for recent M&A cases of special interest, but also examining the entire body of case law on the specified type of provision. The work product of the Judicial Interpretations Working Group consists of memoranda summarizing our findings regarding these acquisition agreement provisions and M&A

issues. The memoranda are posted in the M&A Lawyers' Library. Currently, the Library contains twelve memoranda, and we expect to post several more to the Library in the near future.

- The Library Index Project Group is creating a topic index for the M&A Lawyers' Library, which will allow on-line visitors to the library to search the material in the Library by topic.

- The Jurisdictional Project Group is creating a chart, with supporting analysis, comparing the jurisprudence in the federal and state courts of Delaware, New York, California and Texas, concerning some of the more commonly litigated topics in M&A jurisprudence. We believe this will be a very instructive and useful tool for M&A practitioners who are involved in multi-jurisdictional transactions.

- The Damages Project Group is preparing a comprehensive analysis of the types of damages that are recoverable in common M&A litigation contexts, and the methods that courts have used, or allowed the parties to use, to calculate damage awards.

We will be meeting on Saturday, August 10 from 9:45 am -11:30 am Pacific Time in the Crown Room, 24th Floor of the Fairmount Hotel. Off-site participants can dial-in to the meeting using the following numbers/ passcode:

(866) 646-6488 (US and Canada)
(707) 287-9583 (International)
Conference Code: 9101063640

At our meeting in San Francisco, we plan to discuss recent court decisions, including the recent Delaware Supreme Court decision in *Siga Technologies v. PharmAthene*, which is summarized below, the memo on "sandbagging" that is being prepared by David Albin and Rob Dickey, and the memo that is being prepared by Frederic Smith and Mike Pittenger on stockholder representatives and obligations imposed on non-signing shareholders and other parties in M & A transactions. We will also discuss the progress of the Project Groups and future additions to the Library.

We welcome all interested M&A Committee members to join our Subcommittee. The M&A Jurisprudence Subcommittee is a good way to become involved in the Committee, especially for younger Committee members, because extensive M&A transactional experience is not necessary. Not only can our working groups and project groups use additional help on current projects, but we also have a virtually unlimited pool of topics to work on in the future.

We are also asking all members of the M&A Committee to send us significant judicial decisions for possible inclusion in the survey. Submissions can be sent by e-mail either to Scott Whittaker at swhittaker@stonepigman.com or to Mike O'Bryan at mobryan@mofo.com. Please state in your email why you believe the case merits inclusion in the survey. We need you to help identify cases!

The first criterion for inclusion is that the decision must involve a merger, an equity sale of a controlling interest, a sale of all or substantially all assets, a sale of a subsidiary or division, or a recapitalization resulting in a change of control. The second criterion is that the decision must (a) interpret or apply the provisions of an acquisition agreement or an agreement preliminary to an acquisition agreement (*e.g.*, a letter of intent, confidentiality agreement or standstill agreement), (b) interpret or apply a state statute that governs one of the constituent entities (*e.g.*, the Delaware General Corporation Law or the Louisiana Limited Liability Company Law), (c) pertain to a successor liability issue, or (d) decide a breach of fiduciary duty claim. We are currently excluding cases dealing exclusively with federal law, securities law, tax law, and antitrust law. But if you feel a case dealing with an M&A transaction is particularly significant please send it, even if it does not meet the foregoing criteria.

DECISION TO BE DISCUSSED AT THE WASHINGTON D.C. SUBCOMMITTEE MEETING

Delaware Supreme Court Affirms Enforceability of Agreement to Negotiate in Good Faith -- Expectation Damages May Be Available

The Delaware Supreme Court held in *Siga Technologies, Inc. v. PharmAthene, Inc.* (May 24, 2013), that a failure to negotiate in good faith despite an express agreement to do so may lead to expectation damages reflecting the counterparty's lost profits.

Background

SIGA and PharmAthene negotiated a License Agreement Term Sheet ("LATS"). The LATS was not signed and included a footer stating "Non Binding Terms." PharmAthene then decided that it preferred a merger rather than a license. SIGA requested that PharmAthene provide bridge financing while the parties negotiated the merger, and PharmAthene agreed, on the condition that SIGA license the technology to it if the merger fell through. The parties signed a Bridge Loan Agreement (governed by New York law) and, later, a Merger Agreement (governed by Delaware law) that each included an obligation to "negotiate in good faith with the intention of executing a definitive License Agreement in accordance with the terms set forth in the [LATS]".

Over the next several months SIGA experienced a series of positive developments with respect to its drug, causing it to experience "seller's remorse." The merger was not completed by the end date under the Merger Agreement, however, and SIGA terminated the Merger Agreement.

PharmAthene then proposed a license agreement based on the term sheet. SIGA countered with very different terms, including (1) $100 million instead of $6 million in upfront license fees; (2) $230 million instead of $10 million in milestone payments; and (3) running royalties of 18% to 28% instead of 8% to 12%. PharmAthene responded it was willing to consider some adjustments, but objected to SIGA's "radically different" terms. PharmAthene filed suit when the parties reached an impasse.

The Court of Chancery held a trial and found that SIGA was liable for breaching the agreement to negotiate in good faith under the Bridge Loan Agreement and the Merger Agreement and for promissory estoppel (Del. Ch. Sept. 22, 2011). The Court of Chancery awarded PharmAthene an equitable payment stream for PharmAthene's "lost expectancy," including payment of 50% of the net profits in excess of $40 million generated by the drug for the next 10 years.

Supreme Court Holding

Enforceability of Agreement to Agree

The Delaware Supreme Court held that, under Delaware law, "an express contractual obligation to negotiate in good faith is binding on the contracting parties." The Court further held that, even though the license term sheet stated it was non-binding, SIGA and PharmAthene had created an enforceable obligation by expressly agreeing in the Bridge Loan Agreement and the Merger Agreement to negotiate a license in good faith in accordance with the term sheet if the merger fell through. Moreover, the Court noted the Court of Chancery's finding that the incorporation of the LATS into the Bridge Loan and Merger Agreements reflected an intent of the parties to "negotiate toward a license agreement with economic terms substantially similar to the terms of the LATS," rather than to treat the LATS as a "jumping off point," as SIGA characterized it. SIGA had breached this obligation by insisting on different terms in bad faith.

Availability of Expectancy Damages

The Court held that "expectancy" or "benefit-of-the-bargain" damages could be awarded, after noting a split of authority on this issue:

- The New York Court of Appeals held in *Goodstein Construction Corp. v. City of New York* (N.Y. 1992) that "New York law limits a plaintiff to reliance damages for breach of an agreement to negotiate."

- The Eighth Circuit held in *Fairbrook Leasing, Inc. v. Mesaba Aviation, Inc.* (8th Cir. 2008) that *Goodstein* did not clearly preclude expectation damages in a case where such damages could be proven. While the Eighth Circuit declined to award such damages in that case, it did so because the term sheet "was silent on significant issues," and the missing terms could not be determined by "objective criteria in the [t]erm sheet itself or in commercial practice, usage, or custom." Similarly, the Seventh Circuit held in *Venture Assoc. Corp. v. Zenith Data Sys. Corp*.(7th Cir. 1996) that, under Illinois law, "if the plaintiff can prove that … [but] for the defendant's bad faith the parties would have made a final contract, then the loss of the benefit of the contract is a consequence of the defendant's bad faith," and the defendant is liable for that loss if it is foreseeable.

The Court held that expectation damages can be awarded for breach of an agreement to negotiate in good faith if the plaintiff proves (1) that the parties would have reached an agreement but for the defendant's bad faith, and (2) the amount of such damages with "reasonable certainty." The court remanded the case for further consideration of damages.

Significance

The Court affirmed that a bad faith breach of a duty to negotiate may expose the breaching party to benefit-of-the-bargain damages. This is significant because Delaware law previously was unclear, and some other courts have allowed reliance damages only. Reliance damages are often limited to minor costs related to participating in the negotiations. In contrast, benefit-of-the-bargain damages can be huge – PharmAthene's expert opined that expectation damages in that case were $400 million to $1 billion.

Actually obtaining expectation damages may be difficult, however, because it requires proof not only of the breach, but also that (1) the parties would have entered into a final contract but for such breach and (2) the amount of expectation damages can be calculated with reasonable certainty.

To join the M&A Jurisprudence Subcommittee, please email either Scott Whittaker at swhittaker@stonepigman.com, Jon Hirschoff at jhirschoff@fdh.com, or Mike O'Bryan at mobryan@mofo.com, or simply come to the Subcommittee meeting in San Francisco.

Scott T. Whittaker
Subcommittee Chair

M&A Market Trends Subcommittee

At our last meeting in Washington we reviewed the status of recent and pending publications; Steve Obenski (Thomson Reuters, Washington) reviewed the state of the M&A market; Paul Koening shared a preview of SRS' Post-Closing Indemnification Study; Reid Feldman (Kramer Levin Naftalis & Frankel, Paris) led a presentation summarizing highlights from the soon to be released 2013 European Private Target Deal Points Study; and former M&A Market Trends Subcommittee chairs (and current K&L Gates partners) Jessica Pearlman and Wilson Chu shared a Tales from the Trenches presentation on indemnification liability for the costs of defending meritless third party claims.

We will be meeting on Sunday, August 11 from 9:00 am -10:30 am Pacific Time in the Grand Ballroom, Grand Ballroom Level of the Fairmount Hotel. Off-site participants can dial-in to the meeting using the following numbers/passcode:

(866) 646-6488 (US and Canada)
(707) 287-9583 (International)
Conference Code: 4961649712

The agenda includes:

- A review of recent and pending publications;
- An update on the state of the M&A market;
- Highlights from JPMorgan's 2013 M&A Holdback Report; and
- A presentation on trends in the treatment of equity awards in M&A transactions.

I look forward to seeing you in San Francisco.

Hal Leibowitz
Chair

Private Equity M&A Subcommittee

The Private Equity M&A Subcommittee met in Washington, D.C. on Friday, April 5, 2013, as part of the Spring meeting of ABA Business Law Section. There was a brief review by the Chair of developments in the Private Equity area since the Subcommittee's gathering in Laguna Beach, California in early February. The Washington session also included the following segments with the presenters referenced:

- Highlights from Bain & Co.'s 2013 Global Private Equity Report. Graham Rose, Partner at Bain & Company, reviewed Bain's 2013 Global Private Equity Report, which analyzed various data points around deal making trends from the prior year, provided commentary on the current state-of-play in the industry, and highlighted emerging trends;
- Current Public Policy Issues Facing the Private Equity Industry. Jason Mulvihill, General Counsel of The Private Equity Growth Capital Council, a Washington, D.C.-based advocacy, communications, and research association engaging public policy makers, regulators, and the media on current legislative, regulatory, and public policy initiatives affecting Private Equity firms, reviewed current public policy issues facing the industry and the industry's views on those matters; and
- Private Equity Exits and Inventory. Adley Bowden, Director of Research at Pitchbook Data, Inc., a leading provider of research and data on the Private Equity industry (and other asset classes), provided highlights from Pitchbook's recent reports on PE Exits and PE Inventory. The Subcommittee meeting was well-attended, and the Subcommittee Chair and Vice Chair thank all presenters and participants and Subcommittee members for contributing to the session.

We will be meeting on Saturday, August 10 from 8:15 am - 9:45 am Pacific Time in the Crown Room, 24th Floor of the Fairmount Hotel. Off-site participants can dial-in to the meeting using the following numbers/ passcode:

(866) 646-6488 (US and Canada)
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Conference Code: 9101063640

John K. Hughes
Chair
Nicholas Dietrich
Vice Chair

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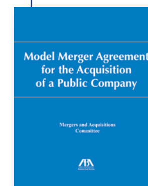

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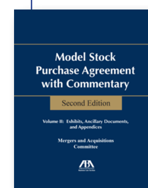

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DEAL PEOPLE

Multilingual with impeccable English, law degrees from the University of Naples (Italy) Law School, Georgetown and Temple University, and years of M&A experience, Mario Abate (Pavia e Ansaldo, Milan) is a perfect addition to a deal team to assist on M&A deals and other corporate transactions that have an Italian dimension. But while studying in the US, Mario picked-up a passion for more than just doing deals.

At age 23, while in his third year at Georgetown, Mario was diagnosed with cancer. Surrounded by the love and support of his parents and other family members, Mario underwent extensive chemo treatments and has been cancer-free for many years. But, while he was in hospital, Mario caught sight of a young little boy, bald and also clearly going through chemo, who was alone and being carried by a nurse. The sight of the child, suffering alone without parents, inspired Mario to commit to a lifetime of giving-back, to help and "adopt" children in need of support and devote time to young and underprivileged children who are sick and or handicapped, but mostly alone.

Now almost three decades later, Mario spends most of his free time working with children in need. This includes a multitude of activities, including:

- Through the Order of Malta, taking part in an annual five-day pilgrimage to the holy shrine of Lourdes in France. In Lourdes, Mario is responsible for a hospital ward where the sick are housed during their stay and, with other colleagues, he organizes an international children's party hosting over one hundred handicapped and sick children from all over the world. Giochi Preziosi, Italy's leading toy manufacturer, provides toys to give out to the children who attend the party.
- Each summer, just before the ABA Annual Meeting, Mario organizes a summer camp for disabled youth. Three years ago, more than 500 children attended from all over the world including the United States, while last year a much smaller camp was organized in Sicily for blind and autistic youth. Mario says you just can't beat the fun of leading a group of blind and autistic children on a trek up the Mount Etna volcano, or witnessing the laughter of disabled children playing on the beach or dancing together at a disco he organized, in wheel chairs or on stretchers.
- Back home in Milan, throughout the year Mario spends time during week days with severely handicapped children at the Istituto Sacra Famiglia who have been institutionalized or abandoned by their parents and are not self-sufficient. These children are well kept by the Institution but they are alone most of the day. Mario says there is not much you can do to alleviate their suffering or handicap, but he tries to help by taking them out, giving them a hug and trying to make them laugh.

And, in case you didn't think he was busy enough, Mario has expanded his outreach to the homeless in Milan and all year round takes part in a program to visit the homeless in the streets, to bring relief and assistance, to make sure they are informed of the existence and whereabouts of the city's shelters and provide food and water and other amenities. Mario's many other activities are frankly too numerous to mention in this short column.

And for all of these causes, Mario also helps to fundraise too.

It's been an inspiration to me to learn about the many great things that Mario does to help needy children and support his communities. He's a Deal Person with a real Point.

About Deal People – **Deal People** is a feature in *Deal Points* that highlights members of the Mergers and Acquisitions Committee and things that interest them, other than doing deals. Ideas for future features in **Deal People** are welcomed.

John F Clifford
McMillan LLP
Toronto, Canada
john.clifford@mcmillan.ca

COMMITTEE MEETING MATERIALS

SCHEDULE OF MEETINGS AND OTHER ACTIVITIES

An Invitation from the Committee on Business Law Education

It seems as if not a day goes by without a newspaper reporting on the failure of legal education. The profession and the academy have been discussing the need for "practice-ready" graduates for decades, but the "new normal" of law practice has brought a greater urgency to the issues. The Committee on Business Law Education is proposing to undertake two projects that we believe will contribute to a solution. We would like to invite ALL INTERESTED MEMBERS of the Business Law Section to participate. We have tasks both large and small that are critical to these projects success. WE NEED YOUR HELP.

The first project is to develop a comprehensive list of the competencies a novice business lawyer should possess. There have been several attempts to catalogue the core competencies of a lawyer. But few have focused on the particular skills and knowledge required of a recent graduate engaged in a transactional practice. By developing an understanding of what a "practice ready" deal lawyer should be able to do, we can better answer the question of how she might learn how. Our goal is to publish a report that can provide a common starting point for efforts to improve the education of the future generation of transactional lawyers.

The second project starts from a simple premise. The job of teaching young lawyers how to practice will rely in some significant way on the expertise of those who do. The challenge then is how to involve expert practitioners in the educational process. Certainly many members of the Section are already "giving back" to the profession by adjunct teaching, guest lecturing, conducting CLE and associate training and so on. But the need is for more involvement at a time when the pressures to do less are only growing. Leaving the job to law schools and professional development staff will not be the answer. So what is needed is not more time but more productive time. We need better strategies for capturing and sharing expertise. Our second project is to explore a select number of such strategies.

If you are interested in helping the Business Education Committee with these projects, even if only to share an idea, please join us at our Committee Meeting at 10:00 a.m. local time on Sunday, August 11 at the Annual Meeting in San Francisco. The meeting will be held at the San Francisco Fairmont Hotel in the Garden Room located on the Lobby Level. If you are unable to attend in person, we encourage you to participate by telephone as follows:

Toll-free dial-in number (U.S. and Canada):
(866) 646-6488

International dial-in number:
(707) 287-9583

Conference code:
4472600718

If you cannot participate in this meeting but would like to be involved, please email either Katherine Koops at Katherine.koops@bryancave.com or Karl Okamoto at ko54@drexel.edu.

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2013 ABA ANNUAL MEETING

**FAIRMONT HOTEL
SAN FRANCISCO, CA**

AUGUST 9-11, 2013

Schedule, Location, Dial In Information

FRIDAY, AUGUST 9, 2013

Legal Process Management
2:30PM - 3:30PM
Fairmont Hotel
Vanderbilt Room, Terrace Level

Toll-free dial-in number (U.S. and Canada):
(866) 646-6488
International dial-in number:
(707) 287-9583
Conference code:
3199473460

Program: Tender Offers: The New Paradigm and SEC M&A Updates
2:30PM - 4:30PM
Fairmont Hotel
Venetian Room, Lobby Level

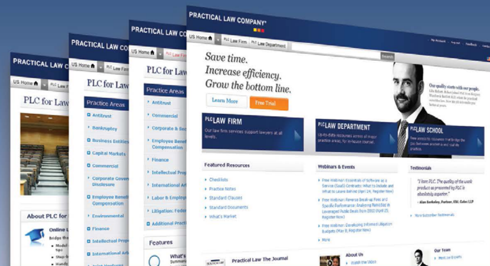
Governance Issues In Business Combinations Task Force
4:30PM - 5:30PM
Fairmont Hotel
Fountain Room, Lobby Level

Practical Law

Online resources to help lawyers work faster and smarter

Coverage across all major practice areas

Support for law firms, law departments and law schools



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Toll-free dial-in number (U.S. and Canada):
(866) 646-6488
International dial-in number:
(707) 287-9583
Conference code:
2458399301

Joint Task Force on M&A Litigation
4:30PM - 5:30PM
Fairmont Hotel
Grand Ballroom Lounge, Grand Ballroom Level

Toll-free dial-in number (U.S. and Canada):
(866) 646-6488
International dial-in number:
(707) 287-9583
Conference code:
6304783957

SATURDAY, AUGUST 10, 2013

Private Equity M&A
8:15AM – 9:45AM
Fairmont Hotel
Crown Room, 24th Floor

Toll-free dial-in number (U.S. and Canada):
(866) 646-6488
International dial-in number:
(707) 287-9583
Conference Code:
9101063640

M&A Jurisprudence
9:45AM – 11:30AM
Fairmont Hotel
Crown Room, 24th Floor

Toll-free dial-in number (U.S. and Canada):
(866) 646-6488
International dial-in number:
(707) 287-9583
Conference code:
9101063640

Task Force on M&A Dictionary
11:30AM - 12:30PM
Fairmont Hotel
California Room, Mezzanine Level

Toll-free dial-in number (U.S. and Canada):
(866) 646-6488
International dial-in number:
(707) 287-9583
Conference code:
6234776971

Revised Model Asset Purchase Agreement
11:30AM - 12:30PM
Crown Room, 24th Floor

Toll-free dial-in number (U.S. and Canada):
(866) 646-6488
International dial-in number:
(707) 287-9583
Conference code:
9101063640

Acquisitions of Public Companies
1:00PM - 2:30PM
Fairmont Hotel
Crown Room, 24th Floor

Toll-free dial-in number (U.S. and Canada):
(866) 646-6488
International dial-in number:
(707) 287-9583
Conference code:
9101063640

Program: Private Company M&A: A Potpourri of Practical Pointers
2:30PM - 4:00PM
Fairmont Hotel
Venetian Room, Lobby Level

Task Force on Two-Step Auction
4:00PM - 5:00PM
Fairmont Hotel
Crown Room, 24th Floor

Toll-free dial-in number (U.S. and Canada):
(866) 646-6488
International dial-in number:
(707) 287-9583
Conference code:
9101063640

Mergers and Acquisitions Subcommittee and Task Force Chairs Meeting
5:00PM - 5:45PM
Fairmont Hotel
Crown Room, 24th Floor

Toll-free dial-in number (U.S. and Canada):
(866) 646-6488
International dial-in number:
(707) 287-9583
Conference code:
9101063640

Mergers and Acquisitions Committee Dinner
7:00PM - 11:00PM
Kokkari, 200 Jackson Street

SUNDAY, AUGUST 11, 2013

M&A Market Trends
9:00AM - 10:30AM
Fairmont Hotel
Grand Ballroom, Grand Ballroom Level

Toll-free dial-in number (U.S. and Canada):
(866) 646-6488
International dial-in number:
(707) 287-9583
Conference code:
4961649712

International M&A
10:30AM - 12:00PM
Fairmont Hotel
Grand Ballroom, Grand Ballroom Level

Toll-free dial-in number (U.S. and Canada):
(866) 646-6488
International dial-in number:
(707) 287-9583
Conference code:
4961649712

Mergers and Acquisitions Committee
1:00PM - 3:30PM
Fairmont Hotel
Grand Ballroom, Grand Ballroom Level

Toll-free dial-in number (U.S. and Canada):
(866) 646-6488
International dial-in number:
(707) 287-9583
Conference code:
6989852466

American Bar Association, Section of Business Law, Mergers and Acquisitions Committee. The views expressed in the Mergers and Acquisitions Committee Newsletter are the authors' only and not necessarily those of the American Bar Association, the Section of Business Law or the Mergers and Acquisitions Committee. If you wish to comment on the contents, please write to the Mergers and Acquisitions Committee, Section of Business Law, American Bar Association, 321 N. Clark Street, Chicago, Illinois, 60610.

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