

GETTING THE DEAL THROUGH

Mergers & Acquisitions

in 66 jurisdictions worldwide

2014

Contributing editor: Alan M Klein



Published by
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Mergers & Acquisitions 2014**Contributing editor:****Alan M Klein****Simpson Thacher & Bartlett LLP**

Getting the Deal Through is delighted to publish the fully revised and updated fifteenth edition of *Mergers & Acquisitions*, a volume in our series of annual reports, which provide international analysis in key areas of law and policy for corporate counsel, cross-border legal practitioners and business people.

Mergers & Acquisitions 2014 examines the law and regulation of business combinations and addresses the most important issues for international deals.

Following the format adopted throughout the series, the same key questions are answered by leading practitioners in each of the 66 jurisdictions featured. New jurisdictions this year include Angola, Mozambique, Panama, Portugal and Spain. Global and EU overviews are also provided.

Many legal disciplines come into play in large M&A deals. In particular, advisers must take account of competition regulation. This volume contains an appendix covering merger control rules across the world. For a more detailed analysis please refer to another volume of the *Getting the Deal Through* series: *Merger Control*.

Every effort has been made to ensure that matters of concern to readers are covered. However, specific legal advice should always be sought from experienced local advisers. *Getting the Deal Through* publications are updated annually in print. Please ensure you are referring to the latest print edition or to the online version at www.GettingtheDealThrough.com.

Getting the Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise in this field. We would like to thank Casey Cogut of Simpson Thacher & Bartlett LLP for his stewardship of the title over the last fifteen years. We would especially like to thank and acknowledge Alan M Klein as contributing editor of this and future editions.

Getting the Deal Through

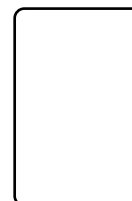
London

May 2014

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subscriptions@gettingthedealthrough.com**Business development managers**George Ingledew
george.ingledew@lbresearch.comAlan Lee
alan.lee@lbresearch.comDan White
dan.white@lbresearch.comPublished by
Law Business Research Ltd87 Lancaster Road
London, W11 1QQ, UK
Tel: +44 20 7908 1188
Fax: +44 20 7229 6910© Law Business Research Ltd 2014
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First published 1999
Fifteenth edition
ISSN 1471-1230

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Printed and distributed by
Encompass Print Solutions
Tel: 0844 2480 112

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1 Types of transaction

How may businesses combine?

Corporations and other business entities may combine a number of ways under Delaware law. Section 251 of the Delaware General Corporation Law (DGCL) expressly permits mergers (one or more constituent corporations merge into and become part of another constituent corporation that continues its existence) and consolidation (two or more constituent corporations are combined to form a new corporation). The DGCL specifically permits the merger or consolidation of:

- domestic (Delaware) and foreign (non-Delaware) corporations (section 252);
- a parent corporation and its subsidiary or subsidiaries – a so-called ‘short-form merger’ (section 253);
- domestic corporations and partnerships (section 263);
- domestic corporations and limited liability companies (section 264); and
- domestic corporations and joint-stock or other associations (sections 255–258).

In addition, a limited liability company, partnership or business trust may be converted into a corporation (section 265) and a corporation may be converted into a limited liability company, limited partnership or business trust (section 266). Section 271 sets forth the requirements for a corporation to sell all or substantially all of its assets.

The requirements for mergers between Delaware limited partnerships and mergers between Delaware limited liability companies are subject to separate statutes – the Delaware Revised Uniform Limited Partnership Act and the Delaware Limited Liability Company Act. It is beyond the scope of this chapter to discuss in detail business combinations of these types of entities except to note that many of the issues discussed below that arise in connection with the combination of corporations are also pertinent to the combination of alternative entities.

The consideration for business combinations can be cash, stock or a mixture of both and may be accomplished through asset purchases, stock purchases, tender offers for cash, or exchange offers for securities. Mergers may be accomplished through a number of structures. Typical structures include:

- a two-party merger, in which Corporation A (acquirer) acquires Corporation T (target) by merging T into A, with A becoming the surviving corporation;
- a three-party merger, in which two corporations merge into a third corporation, which is the surviving corporation. The third corporation is often created solely for the purpose of the transaction;
- a triangular merger, in which A forms a new Delaware subsidiary (S) into which T is merged. This permits A to acquire control of T without A being a constituent corporation; and
- a reverse triangular merger, in which S is merged into T, with T as the surviving corporation.

2 Statutes and regulations

What are the main laws and regulations governing business combinations?

The main sections of the DGCL governing the voting and formal requirements and mechanics of business combinations are found in subchapter IX, Merger Consolidation or Conversion (sections 251–267) and section 271 concerning the sale, lease or exchange of assets. Also relevant is section 141, which sets forth the duties of boards of directors. Director duties are also shaped by the extensive body of judge-made fiduciary duty law generated by the Supreme Court of Delaware (the highest appellate court) and the Delaware Court of Chancery (a court that specialises in business disputes, including those arising in the M&A context). Other frequently relied-upon sections of the DGCL relevant to business combinations include:

- section 144, which permits transactions between a corporation and interested parties;
- section 109, which concerns the adoption, amendment and repeal of a corporation’s by-laws;
- section 102, which concerns the contents of a corporation’s certificate of incorporation;
- section 242, which concerns changes to a corporation’s certificate of incorporation; and
- section 262, which concerns appraisal rights of stockholders in a corporation undergoing a merger.

In the United States, issues related to the internal affairs of corporations are matters of state law – such as the DGCL – and issues related to the issuance of securities, regulation of securities markets, investor protection and disclosure are matters of the national law of the United States, often referred to as ‘federal law’. As a result, mergers of publicly held corporations are also subject to extensive requirements under the federal securities laws, sections 13 and 14 of the Securities Exchange Act of 1934 being the most relevant to M&A transactions. The requirements of federal securities law relevant to M&A are discussed in the chapter on the United States contained in this volume.

3 Governing law

What law typically governs the transaction agreements?

Because Delaware law governs the internal affairs of a Delaware corporation, issues such as the voting requirements to effect a merger or the conduct of the board of directors in connection with the merger are governed by Delaware law for a Delaware corporation. The parties to a business combination may select the applicable law for the key transactional documents such as the merger agreement, stock purchase agreement, support agreements and employment agreements. Parties to these agreements often select Delaware law. For certain types of agreements, in particular, financing commitments, it is not unusual for parties to select New York State law as the governing law.

4 Filings and fees

Which government or stock exchange filings are necessary in connection with a business combination? Are there stamp taxes or other government fees in connection with completing a business combination?

The completion of a merger under Delaware law requires the filing of a Certificate of Merger with the Delaware Secretary of State's office. The fee for such filing is nominal (currently \$239). Delaware does not impose a stamp or similar tax on mergers.

Business combinations in regulated industries (such as banking or insurance) may require additional filings with their primary state or federal regulator. In addition, publicly held corporations are typically required to make filings under the federal securities laws. Transactions involving securities or assets of greater than \$75.9 million are required to make a pre-merger filing under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 with the Federal Trade Commission and the United States Department of Justice.

5 Information to be disclosed

What information needs to be made public in a business combination? Does this depend on what type of structure is used?

For a publicly traded Delaware corporation, the Securities Act and Exchange Act set forth comprehensive disclosure requirements. A business combination will typically require a stockholder vote. Publicly traded companies are required to provide a proxy statement that discloses material information concerning the proposed transaction so that the stockholder vote can be informed. Proxies typically include the background of the transaction, the principal terms of material transaction documents as well as copies of those documents, historical financial information about the company and the details of investment bankers' fairness opinions. The disclosure requirements under section 251 and section 262 of the DGCL are modest by comparison. In addition, under Delaware law, directors have a fiduciary duty of disclosure to provide stockholders with information that is material to their decision to approve or disapprove the transaction or to seek appraisal. Failure to make adequate disclosure, interpreted as disclosure that would be material to stockholders, has been the basis for enjoining transactions so that curative disclosures may be made.

6 Disclosure of substantial shareholdings

What are the disclosure requirements for owners of large shareholdings in a company? Are the requirements affected if the company is a party to a business combination?

Delaware law does not provide for specific disclosure requirements for owners of large shareholdings in a company as part of a business combination. That issue is covered by section 13 of the Exchange Act and the regulations promulgated thereunder, which is covered in the chapter on the United States contained in this volume. The fiduciary duty of disclosure may require disclosure of owners of large shareholdings or controlling shareholdings if that information would be material to the shareholders' approval of the merger.

7 Duties of directors and controlling shareholders

What duties do the directors or managers of a company owe to the company's shareholders, creditors and other stakeholders in connection with a business combination? Do controlling shareholders have similar duties?

Legal challenges to M&A transactions under Delaware law come in the form of private lawsuits by hostile bidders or, more often, by stockholders, either derivatively on behalf of the company or on behalf of a class of similarly situated stockholders. As a result, over the last century, the Delaware courts have promulgated an extensive

body of decisional law pertaining to the obligations that directors, controlling stockholders and corporations owe to stockholders in connection with M&A transactions. Although this decisional law often addresses interpretation and application of the statutory provisions of the DGCL, it even more frequently concerns application of judge-made concepts of fiduciary duty and other equitable principles.

At core, Delaware fiduciary duty cases are based on the duty of care (a director's obligation to act with due care and on an informed basis in decision making) and the duty of loyalty (a director's obligation to refrain from self-dealing and to act in the corporation's best interest). However, the complex factual context of M&A transactions and the sheer number of decisions have resulted in the Delaware courts applying these two basic fiduciary duties in a wide variety of ways. It is nonetheless possible to discern four standards of review the Delaware courts are most apt to apply in assessing a legal challenge to an M&A transaction.

First is the business judgment rule, which, if applicable, means the courts will give deference to the business judgements of a corporation's directors, nearly always causing the legal challenge to the M&A transaction to fail.

Second, when a target responds to a proposed M&A transaction, particularly a hostile one, the courts review the defensive manoeuvres the target has employed to see whether those defensive manoeuvres are both reasonable and proportionate responses to a reasonably perceived threat to corporate policy under *Unocal v Mesa Petroleum*, 493 A.2d 946 (Del. 1985). Defensive manoeuvres, such as the poison pill and deal protection measures to lock up a deal (for example, termination fees, superior proposal provisions, and voting covenants found in merger agreements), are typically reviewed under *Unocal*.

Third, when a company has embarked on a transaction that has made a change of control inevitable (whether on its own initiative or in response to an unsolicited offer), the board must seek to get 'the best price reasonably available' for the stockholders under *Revlon, Inc v MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986). In general, Delaware companies are under no obligation to sell themselves and are free to 'just say no' to unwanted suitors. But under *Revlon*, once a change of control becomes inevitable, the directors are transformed into the auctioneers of the company.

Fourth, in transactions between an interested party and a corporation – for example, a controlling stockholder attempting to take a company private through a squeeze-out transaction – the entire fairness doctrine applies. Under the entire fairness doctrine, the courts will look closely at the transaction to determine both whether the transaction was the result of fair dealing and whether it transpired at a fair price. The proponents of the transaction must show that the transaction is entirely fair to the other stockholders. In 2013 and 2014, Delaware courts made clear that through the tandem use of two conflict mitigation devices – an independent special committee empowered to seek its own advisers and to say 'no' to the transaction and a 'majority of the minority' voting requirement – a squeeze-out transaction with a controlling stockholder may be reviewed under the deferential business judgement rule. These recent cases are discussed further in the 'Update and trends' section.

8 Approval and appraisal rights

What approval rights do shareholders have over business combinations? Do shareholders have appraisal or similar rights in business combinations?

Section 251 of the DGCL requires that to approve a merger a majority of the outstanding stock of a corporation entitled to vote must vote in favor of a merger. Section 262 sets forth a shareholder's appraisal rights in a merger in which the shareholder is being cashed out of the target. No appraisal rights are available in a merger in

which the consideration is exclusively stock. Mergers in which the consideration is mixed between stock and cash allow appraisal. Because shareholder approval is not required in the context of a tender offer, no appraisal rights are available in a tender offer. In an appraisal proceeding, the stockholder is entitled to its pro rata share of the going-concern value of the entity, which has been interpreted as the shareholder's proportionate share in the value of the entity exclusive of any synergies created by the merger. Delaware also allows a quasi-appraisal remedy when material facts relating to the stockholder's determination of whether to accept the merger consideration or seek statutory appraisal were not disclosed. Provided such disclosure was insufficient, minority stockholders who did not pursue appraisal are entitled to pursue a quasi-appraisal class action to recover the difference between judicially determined fair value and the merger price.

9 Hostile transactions

What are the special considerations for unsolicited transactions?

Delaware law allows several structural defences to unsolicited or hostile transactions.

Section 141(d) of the DGCL permits a corporation to have a staggered board of up to three classes of directors. Because it can take three years to unseat a staggered board, this structure makes an attempt to replace the directors of the target board with individuals nominated by the acquirer more difficult and time-consuming. Over the past three years, corporations with staggered boards have faced increasing pressure from shareholder rights activists (most notably the Shareholder Rights Project at Harvard Law School) to de-stagger their boards and allow for annual election of the entire board of directors.

Section 203, the so-called 'control share' statute, regulates certain business combinations with 'interested stockholders'. The statute was enacted to balance the benefits of unfettered market for corporate shares with the need to limit abusive takeover tactics. Unless a corporation opts out of section 203, business combinations between a public corporation and a stockholder of a large percentage of its shares (15 per cent or more) are subject to high voting requirements (66 per cent of the disinterested shares) for a period of three years subsequent to the interested stockholder achieving that status. Although section 203 has exceptions that hostile acquirer can potentially satisfy, it provides an effective means for a target to slow down the hostile acquirer.

Delaware law also permits corporations to adopt stockholder rights plans (also known as the 'poison pill'). The poison pill grants stockholders of the target corporation special rights to purchase or sell securities under favourable or preferential conditions in the midst or as the result of a hostile takeover. The rights plan has been held to serve the legitimate purpose of giving the board issuing the rights the leverage to prevent transactions it does not favour by diluting the buying proponent's interest. The typical pill sets a threshold (typically a 10 per cent to 20 per cent ownership stake) beyond which the potential acquirer will be subject to substantial dilution.

Delaware corporations may enact 'advance notice' by-laws that require shareholders to give notice in advance of a meeting of their intention to nominate directors or submit proposals to a shareholder vote. Advance notice by-laws typically require that notice be given 30 to 60 days before the meeting and they often require shareholders to provide detailed information concerning the proposed nomination or proposal the shareholder wishes to submit to a vote. The purpose of an advance notice by-law is to permit orderly solicitation of votes in advance of a meeting. But such by-laws also may serve as a restriction on the shareholders' right to nominate candidates for director.

10 Break-up fees – frustration of additional bidders

Which types of break-up and reverse break-up fees are allowed?

What are the limitations on a company's ability to protect deals from third-party bidders?

Delaware law permits reasonable break-up, reverse break-up or termination fees. Whether a break-up fee is 'reasonable' or not is determined under Delaware common law. In determining the appropriate size of termination fee, factors a reviewing court would consider include the overall dollar size of the termination fee, the size of the termination fee and percentage terms (compared to both the equity value and enterprise value of the target), the size of the termination fee relative to the premium being offered in the transaction, and the degree to which the acquirer found the deal protection to be crucial to the deal. Delaware courts will also examine to what extent the target board has conducted either a pre-signing or post-signing market check on the transaction in determining whether *Revlon* and *Unocal* have been met. Termination fees measured as 3 per cent of the equity value of the target or lower have generally been found to be reasonable.

Other types of deal protections that the Delaware courts have approved, in particular circumstances, include:

- 'no-shop' and 'superior proposal' provisions (which limit the target board's ability to solicit and negotiate with other potential acquirers);
- 'force the vote' provisions under section 146 of the DGCL (which allow the merger transaction to be put to a shareholder vote even if the board withdraws its recommendation in favour of the transaction);
- matching rights (which give the prospective acquirer the right to match any offer made by a third party);
- standstill agreements (under which potential acquirers agree in non-disclosure agreements not to make offers for the target without the target's permission);
- support agreements (under which a stockholder commits to vote for a proposed transaction); and
- top-up options (under which the target grants an option to the acquirer that permits the acquirer to purchase the target's authorised but unissued shares after the acquirer has obtained voting control of the target in a tender offer).

When a proposed transaction will result in a change in control, deal protection measures are potentially subject to review under the *Revlon* standard to determine whether the deal protection measure frustrated the target board's ability to obtain the best price reasonably available for the target's stockholders. In addition, deal protection measures may be subject to *Unocal* review as defensive measures. Accordingly, Delaware courts will examine whether the deal protection measures taken together have a 'preclusive or coercive power' in preventing an alternative transaction.

11 Government influence

Other than through relevant competition regulations, or in specific industries in which business combinations are regulated, may government agencies influence or restrict the completion of business combinations, including for reasons of national security?

Delaware law does not influence or restrict the completion of business combinations for reasons other than compliance with the DGCL or fiduciary duties. Federal restrictions, such as review by the Committee on Foreign Investment in the United States (CFIUS), are covered in the chapter on the United States contained in this volume.

12 Conditional offers

What conditions to a tender offer, exchange offer or other form of business combination are allowed? In a cash acquisition, may the financing be conditional?

Delaware law allows the conditioning of tender offers on the financing condition or other condition precedent. However, tender offers may not be structured in a manner that would make the tender offer coercive. In particular, under case law, a going-private tender offer must be subject to a non-waivable majority of the unaffiliated minority tender condition, include a promise by the controlling shareholder to complete a prompt short form merger if the acquirer obtains 90 per cent of the shares of the target, and not involve any retributive threats by the controlling shareholder (eg, threats to eliminate the dividend or delist the stock if the offer fails).

13 Financing

If a buyer needs to obtain financing for a transaction, how is this dealt with in the transaction documents? What are the typical obligations of the seller to assist in the buyer's financing?

Delaware law does not speak to how the acquirer will obtain financing. Financing issues are dealt with in transaction documents, and the acquirer and target are generally free to contract for whatever obligations to assist in financing that they wish. However, Delaware courts have scrutinised the use of 'staple financing' in transactions. In staple financing, the investment bank advising the target agrees to provide all or part of the financing to the acquirer. The availability of staple financing may enable the acquirer to pay a higher price to the seller. But the banking fees from providing the staple financing to the acquirer can often exceed the banking fees from providing advice to the target. As a result, Delaware courts have shown concern about how a banker's participation in staple financing can affect the incentives of investment bank providing advice to the target to get the highest price from the acquirer. To avoid conflict of interest, bankers advising targets should avoid participation and discussions about staple financing until after a merger agreement has been entered into and should seek permission from the target's board of directors before participating in discussions about providing staple financing to the acquirer.

14 Minority squeeze-out

May minority stockholders be squeezed out? If so, what steps must be taken and what is the time frame for the process?

Section 253 of the DGCL provides for a minority squeeze-out (a so called short-form merger) if a party owns or acquires 90 per cent or more of the target stock. To effectuate a short-form merger, a board of directors of the acquiring party need only resolve to merge the target into the acquiring party. A short-form merger does not require a vote by either company's stockholders or approval by the target's board. In a short-form merger, a minority stockholder's protection is limited to its appraisal rights.

On 31 October 2013, section 251(h) of the DGCL became effective. Section 251(h) permits a 'medium form' merger that allows an arm's-length third-party acquirer of a public company to complete a back-end short-form merger upon acquiring 50 per cent or more of company stock in a tender or exchange offer for 'any and all' of the target's outstanding voting stock. This change is designed to eliminate the need for acquirers to use a top-up option in connection with a tender offer to move from a plus 50 per cent tender to a plus 90 per cent tender, and thus allows a back-end short-form merger. Although top options had been widely used before section 251(h) was enacted, their use has not been without complications. The legislative synopsis submitted in support of Section 251(h) makes clear that it 'does

not change the fiduciary duties of directors in connection with such mergers or the level of judicial scrutiny that will apply to the decision to enter into such a merger agreement, each of which will be determined based on the common law of fiduciary duty, including the duty of loyalty'. Section 251(h) excludes 'interested stockholders' (defined under section 203) and, therefore, its protections are unavailable to a shareholder or group of shareholders holding more than 15 per cent of the target's shares.

If the majority stockholder has less than 90 per cent of the target, it must pursue a long-form merger. If challenged, a squeeze-out long-form merger will be subject to the exacting entire fairness standard of review, unless the controlling shareholder agrees, ab initio, to the use of a special committee of disinterested directors and a minority of the majority vote provision (see 'Update and trends'). As a result, third-party acquirers will want to proceed under section 251(h) and 'interested stockholders' will want to use the top-up option under which upon acquiring a certain threshold of the target, the target will issue additional shares to the acquirer allowing it to top-up to the 90 per cent mark and thus effectuate a short-form merger under section 253.

15 Cross-border transactions

How are cross-border transactions structured? Do specific laws and regulations apply to cross-border transactions?

Delaware law does not restrict cross-border transactions. However, Delaware law only provides for merger or consolidation of Delaware corporations with corporations incorporated in Delaware or other states in the United States or District of Columbia. Accordingly, a non-US corporation seeking to merge with a Delaware corporation will typically create a Delaware subsidiary to effect the merger with another Delaware entity.

16 Waiting or notification periods

Other than as set forth in the competition laws, what are the relevant waiting or notification periods for completing business combinations?

Following the board's approval of a merger, the agreement of merger is submitted to the stockholders of each of the constituent corporations for a vote. Section 251(c) provides that this requires 20 days' notice of the meeting at which the vote shall be held. If the corporation's certificate of incorporation and by-laws permit action by written consent, the approval can be achieved instantaneously.

However, for public corporations, the requirements of federal proxy rules and stock exchange listing requirements will affect the speed at which a meeting can be held or a consent solicitation conducted.

17 Sector-specific rules

Are companies in specific industries subject to additional regulations and statutes?

Delaware corporation law does not subject companies in specific industries to additional regulations or statutes concerning business combinations. Certain regulated industries such as banking or insurance, however, may be subject to regulatory approvals by their primary state or federal regulators.

18 Tax issues

What are the basic tax issues involved in business combinations?

Delaware law does not speak to tax issues and business combinations. The significant tax issues for a business combination involving a Delaware corporation are a matter of federal tax law.

Update and trends

The most significant development in Delaware M&A jurisprudence in the past year was the Delaware Supreme Court's decision in *Kahn v M&F Worldwide Corp.*, 2014 Del. LEXIS 115 (Del. Mar. 14, 2014) (*MFW*). In *MFW*, the Supreme Court affirmed the May 2013 decision of the Court of Chancery holding that the business judgement rule applies to a controlling shareholder in a going-private merger if the merger is made subject upfront to both approval by an independent special committee with the power to retain its own advisers and to say no to the transaction, and a non-waivable majority-of-the-minority vote.

The *MFW* court summarised the 'new standard' it applied as follows:

[I]n controller buyouts, the business judgment standard of review will be applied if and only if: (i) the controller conditions the procession of the transaction on the approval of both a Special Committee and a majority of the minority stockholders; (ii) the Special Committee is independent; (iii) the Special Committee is empowered to freely select its own advisors and to say no definitively; (iv) the Special Committee meets its duty of care in negotiating a fair price; (v) the vote of the minority is informed; and (vi) there is no coercion of the minority.

In *MFW*, the Supreme Court affirmed that the Court of Chancery was correct in finding that the business judgement rule applied to the squeeze-out transaction that the minority shareholders sought to challenge and that it was appropriate to grant summary judgment and dismiss the minority's claims.

In holding out the possibility that courts will review a properly structured squeeze-out transaction under the business judgement rule (rather than the more onerous entire fairness standard),

MFW is intended to provide controlling shareholders with powerful incentives to consent to the controlled corporation's use of an independent special committee and a majority of the minority vote condition in connection with a squeeze-out transaction. When a court determines that the business judgement rule applies to the review of a transaction, a legal challenge to the transaction will be dismissed absent allegations that the transaction is so irrational that it constitutes waste. In the past, there have been several instances of a controlling shareholder successfully defeating a legal challenge to a squeeze-out transaction by showing that the transaction met the fair process and fair price requirements of the entire fairness standard. But these victories have come at the cost of extensive discovery and trial on the merits. Early application of the business judgement rule to a squeeze-out transaction offers the attractive potential of a quicker, more limited, less costly, and successful defence of the transaction.

Although *MFW* provides a controlling shareholder with a clear roadmap on how to obtain the protections of the business judgement rule, controllers may find the cost of getting there higher than hoped. In dicta, the *MFW* court indicated that a controller may not be able to invoke the protections of the business judgement rule at the motion to dismiss stage and that non-conclusory allegations of inadequate price may be enough to entitle minority stockholders to discovery before a court can determine whether the business judgement rule applies. For the controller, dismissal of the minority's claims at the summary judgment stage is preferable to a trial on the merits on process and price. Nonetheless, the costs incurred and discovery endured to get to the summary judgment stage are significant. Time will tell how often the path laid out in the *MFW* road map will be travelled.

19 Labour and employee benefits

What is the basic regulatory framework governing labour and employee benefits in a business combination?

Delaware law does not provide a regulatory framework for governing labour and employee benefits in a business combination. Executive compensation issues often arise in connection with shareholder challenges to business combinations. In particular, Delaware courts are frequently asked to review the propriety of change in control payments to officers and directors of the target as well as the indemnification of target officers and directors provided in connection with a business combination. In particular, Delaware courts will scrutinise these arrangements in the going private transactions to address the concern that an acquirer is using the promise of future employment, ownership interest, or compensation arrangements to skew the incentives of the seller's management in a merger negotiation. As a result, discussions about future employment, compensation or ownership by target management should wait until after board approval of the merger agreement.

20 Restructuring, bankruptcy or receivership

What are the special considerations for business combinations involving a target company that is in bankruptcy or receivership or engaged in a similar restructuring?

For Delaware corporations, Delaware law continues to govern the internal affairs of the corporation following its entry into bankruptcy or receivership. However, companies going through reorganisation are subject to United States bankruptcy laws and subject to the oversight of the United States Bankruptcy Court. Business combinations of bankrupt entities are typically achieved through a sale pursuant to section 363 of the United States Bankruptcy Code in which the debtor's assets are auctioned under the supervision of the Bankruptcy Court. Typically, the auction involves the identification of a stalking horse bidder at or around the time the corporation files for bankruptcy. The debtor corporation will typically enter into an asset purchase agreement with the stalking horse bidder, but competing bidders are permitted to come forward in the auction process. Although break-up fees and other deal protections are permissible,



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deal protections will receive greater scrutiny from the Bankruptcy Court than would similar protections in the context of a solvent company. In a section 363 sale, competing bidders and creditors of the debtor will be allowed to challenge the sale. Ultimately, the Bankruptcy Court will need to approve the section 363 sale.

Although section 363(b) does not specify a standard for determining when a sale is appropriate, bankruptcy courts routinely approve sales of a debtor's assets if the sale is based upon the sound business judgment of the debtor. When a valid business judgment exists, the law vests the debtor's decision to sell assets with a strong presumption that 'in making a business decision, the directors of a corporation acted on an informed basis, in good faith, and in honest belief that the action taken was in the best interests of the company'. Once a court is satisfied there is a sound business judgment for the proposed sale, the court must then determine whether the debtor in possession has provided the interested parties with adequate and reasonable notice and the sale price is fair and reasonable, and the purchaser is proceeding in good faith.

21 Anti-corruption and sanctions

What are the anti-corruption, anti-bribery and economic sanctions considerations in connection with business combinations?

Anti-corruption, anti-bribery and economic sanctions in connection with business combinations are not issues explicitly addressed by Delaware law. Those matters are the subject of federal law. More generally, the fiduciary duties of care and loyalty require that the directors of a Delaware corporation have oversight responsibility to ensure that the corporation has systems in place to monitor for excessive risk and illegal activity – so-called 'Caremark duties'. In 2013 in three cases involving Delaware corporations with operations in China – *In re Puda Coal, Inc. Stockholders Litig.*, C.A. No. 6476-CS (Del. Ch. Feb. 6, 2013) (TRANSCRIPT), *Rich v Chong*, 66 A.3d 963 (Del. Ch. 2013), and *In re China Agritech, Inc. S'holder Deriv. Litig.* 2013 Del. Ch. LEXIS 132 (Del. Ch. May 21, 2013) – the Court of Chancery emphasised that directors of a Delaware corporation have duties of oversight with respect to the corporation's foreign operations and refused to dismiss claims against directors.

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