The Mergers & Acquisitions Review

Fourth Edition

Editor
Simon Robinson

Law Business Research

The Mergers & Acquisitions Review

FOURTH EDITION

The Mergers & Acquisitions Review

Fourth Edition

Editor
Simon Robinson

Law Business Research Ltd

PUBLISHER
Gideon Roberton

BUSINESS DEVELOPMENT MANAGER
Adam Sargent

MARKETING ASSISTANT
Hannah Thwaites

EDITORIAL ASSISTANT
Nina Nowak

PRODUCTION MANAGER
Adam Myers

PRODUCTION EDITOR
Joanne Morley

SUBEDITOR
Charlotte Stretch

EDITOR-IN-CHIEF
Callum Campbell

MANAGING DIRECTOR
Richard Davey

Published in the United Kingdom
by Law Business Research Ltd, London
87 Lancaster Road, London, W11 1QQ, UK

ISBN 978-1-907606-03-8

Printed in Great Britain by
Encompass Print Solutions, Derbyshire
Tel: +44 870 897 3239

ACKNOWLEDGEMENTS

The publisher acknowledges and thanks the following law firms for their learned assistance throughout the preparation of this book:

ADVOKATFIRMAET HJORT DA

ÆLEX

ALLENS ARTHUR ROBINSON

AMARCHAND & MANGALDAS & SURESH A SHROFF & CO

ANDERSON MŌRI & TOMOTSUNE

ARIAS & MUÑOZ

ARIAS, FÁBREGA & FÁBREGA

BATLINER WANGER BATLINER ATTORNEYS AT LAW LTD

BERNOTAS & DOMINAS GLIMSTEDT

BOWMAN GILFILLAN

BREDIN PRAT

BRIGARD & URRUTIA ABOGADOS

CAMILLERI PREZIOSI

CHARLES ADAMS RITCHIE & DUCKWORTH

COULSON HARNEY

CRAVATH, SWAINE & MOORE LLP

DITTMAR & INDRENIUS

DRYLLERAKIS & ASSOCIATES

ELIG ATTORNEYS AT LAW

EUBELIUS

F CASTELO BRANCO & ASSOCIADOS

FONTES & TARSO RIBEIRO ADVOGADOS

GLATZOVÁ & CO., v.o.s.

GLIMSTEDT & PARTNERS

GLIMSTEDT STRAUS & PARTNERS

GORRISSEN FEDERSPIEL

HENGELER MUELLER

KHAN & ASSOCIATES

KIM & CHANG

LAWCASTLES

MAKES & PARTNERS LAW FIRM

MANNHEIMER SWARTLING ADVOKATBYRÅ

MARVAL, O'FARRELL & MAIRAL

MATHESON ORMSBY PRENTICE

MIRO SENICA AND ATTORNEYS, d.o.o.

MONDINI RUSCONI STUDIO LEGALE

MORAVČEVIĆ VOJNOVIĆ ZDRAVKOVIĆ OAD in cooperation with SCHÖNHERR

MORENO BALDIVIESO ESTUDIO DE ABOGADOS

NAGY ÉS TRÓCSÁNYI ÜGYVÉDI IRODA

NAUTADUTILH

NOBLE & SCHEIDECKER

OSLER, HOSKIN & HARCOURT LLP

PAYET, REY, CAUVI ABOGADOS

PENKOV, MARKOV & PARTNERS

QUEVEDO & PONCE

RUŽIČKA CSEKES s.r.o.

S HOROWITZ & CO

SANTAMARINA Y STETA, SC

SCHELLENBERG WITTMER

SCHÖNHERR RECHTSANWÄLTE GMBH

SLAUGHTER AND MAY

STAMFORD LAW CORPORATION

SULLIVAN & CROMWELL LLP

TORRES, PLAZ & ARAUJO

URÍA MENÉNDEZ

VASIL KISIL AND PARTNERS

WINKLER PARTNERS

YOUNG CONAWAY STARGATT & TAYLOR, LLP

CONTENTS

EDITOR'S PREFACE

In response to the financial crisis, the past year has been spent cutting costs and restoring balance sheets while governments have set about overhauling the regulatory landscape. Whether as a result of this approach or in spite of it, we have seen the first signs of a recovery in the second half of 2009. During the financial meltdown, many strong businesses focused on assessing their strategy and restructuring. As the signs of recovery began to emerge, such businesses tentatively started to re-engage in M&A transactions as a means of achieving growth.

Currently, buyers are conscious of scrutiny from shareholders with regards to how much is being paid for assets and whether the deals that are going ahead represent value for money (particularly in light of Warren Buffett's publicly voiced concerns during the course of Kraft's bid for Cadbury and shareholder reaction to the proposed acquisition of part of AIG by Prudential). Consequently, most potential buyers are treading carefully. On the other hand, there were also a number of quick deals in 2009 where a speedy resolution was necessary to allow distressed sellers to obtain cash promptly but the number of these should decrease throughout 2010 if we continue through to recovery.

Many are still cautious about the outlook for M&A activity for the remainder of 2010 and beyond. A rise in M&A activity is hugely dependent on the willingness of banks to increase lending. Access to credit plays a vital role in supporting the economy by helping businesses to create jobs and growth, both of which are necessary if we are to find our way out of recession and towards recovery. In the short term, M&A activity will depend heavily on boardroom confidence and such confidence will only be achieved if boards perceive that the few new M&A deals around have proven profitable for shareholders. Such confidence and optimism is slow to build; therefore, while pockets of activity suggest that the worst of the financial crisis is behind us, the signs of recovery are tentative with buyers urging caution. The journey to recovery will be slow and difficult, but as lending increases and confidence rises, economists expect the sluggish growth of 2010 to develop into greater stability into 2011. That said, the recent problems of the euro, European government finances and the European banking sector could yet bring a renewed lapse into recession or worse. Only time will tell which progression turns out to be correct.

I wish again to thank all the contributors for their continued support in producing this book – one would hope that in this uncertain time the following chapters should at least provide some food for thought.

Simon Robinson
Slaughter and May
London
July 2010

Chapter 61

DELAWARE

Rolin P Bissell and Elena C Norman[*]

I OVERVIEW OF RECENT M&A ACTIVITY

Although one of the smallest of the 50 United States in both size and population, Delaware plays an outsized role in US corporation law. Delaware corporations comprise more than 60 per cent of the Fortune 500 companies and more than 50 per cent of the corporations listed on the NYSE, NASDAQ and AMEX. Delaware's market share seems to be growing, as more than 80 per cent of the corporations that went public in the United States between 2003 and 2007 were Delaware corporations. As one law professor put it: 'The Delaware brand is to corporate law what Google is to search engines.'[1]

2009 and the first five months of 2010 reflected both the end of the last M&A cycle and the beginning of a new one. 2009 began with the tail end of the wave of 'busted deal' cases that involved transactions agreed to prior to the credit crisis beginning in the second half of 2007. With the shift from easy credit to no credit, those deals had become economically unattractive and in some cases impossible to finance.[2] When the credit crisis was followed by a full-blown recession in the first half of 2009, private equity and hedge funds were more likely to be exploring the law governing investor

* Rolin P Bissell and Elena C Norman are partners at Young Conaway Stargatt & Taylor, LLP.

1 Simmons, Omari Scott, 'Branding the Small Wonder: Delaware's Dominance and the Market for Corporate Law', 42 *University of Richmond Law Review* 1129 (May 2008).

2 See, e.g., *Alliance Data Systems Corporation v. Blackstone Capital Partners V, LP*, 963 A.2d 746 (Del. Ch.), aff'd, 976 A.2d 170 (Del. 2009); *Hexion Specialty Chems, Inc v. Huntsman Corp*, 965 A.2d 715 (Del. Ch. 2008); *United Rentals, Inc v. Ram Holdings, Inc*, 937 A.2d 810 (Del. Ch. 2007). As shown by these cases, the Delaware courts have developed an extensive body of law concerning the interpretation and enforcement of merger agreements and other transactional documents. Unlike in 2008 and early 2009, developments in this area have been less noteworthy in the past 12 months, and are therefore not discussed in this review.

redemptions or liquidation than their next acquisition or play. For a few dark quarters in the middle of 2009, it seemed as though most of the M&A activity was in the form of sales of distressed assets overseen by the bankruptcy court.

The end of 2009 and the first part of 2010 have seen a resurgence in M&A transactions. So once again, traditional disputes about directors' fiduciary duties in selling companies and approving merger transactions are back before Delaware's courts. Perhaps reflecting the belief that the recession has caused many companies to be undervalued, 2009 and 2010 saw a number of significant judicial decisions concerning freeze-out transactions through which a controlling shareholder sought to take a company private by buying out the minority shareholders. Because the M&A market is still not at a boil, judicial decisions involving defensive techniques to ward off unwanted offers were less frequent.

II GENERAL INTRODUCTION TO THE LEGAL FRAMEWORK FOR M&A

The framework of Delaware law related to mergers and acquisitions has two main sources: Delaware state statutes and judicial decisions handed down by the Delaware courts, chiefly the Delaware Court of Chancery (a court that has unmatched experience and expertise in resolving corporate disputes) and the Delaware Supreme Court. The Delaware General Corporation Law ('the DGCL') is a broad enabling statute that governs the formation and internal affairs of Delaware corporations. The statutory framework for director and shareholder approval of mergers can be found in Section 251 of the DGCL.

Legal challenges to M&A transactions under Delaware law come in the form of private lawsuits by hostile bidders or, more often, by shareholders, either derivatively on behalf of the company or on behalf of a class of similarly situated shareholders. 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 shareholders and corporations owe to shareholders 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 their 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 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 judgments of a corporation's directors, typically causing the legal challenge to the M&A transaction to fail.

Second, in transactions between an interested party and a corporation – for example, a controlling shareholder attempting to take a company private through a freeze-out transaction – the entire fairness doctrine applies. Under the entire fairness doctrine, the courts will look more closely to determine both whether the transaction was the result of fair dealing and whether it was at a fair price. As discussed *infra*, because the decision whether an M&A transaction should be reviewed under the deferential business judgment rule or the more searching entire fairness standard will often be determinative of the legality of an M&A transaction, the issue of which standard a court should apply in reviewing an M&A transaction is a frequently litigated and hotly contested issue.

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 shareholders under the *Revlon*[3] line of cases. 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, when a target responds to a proposed M&A transaction, particularly a hostile one, the courts review the defensive manoeuvres a target has employed to see whether those defensive manoeuvres are both reasonable and proportionate responses to a reasonably perceived threat to corporate policy under the *Unocal*[4] line of cases. Defensive manoeuvres, such as the poison pill and deal protection measures to lock up a deal (for example, termination fees, superior proposal provisions, voting covenants found in merger agreements), are typically reviewed under *Unocal*. [5]

With this overview in mind, we turn to the developments of the past year and a half.

III DEVELOPMENTS IN CORPORATE AND TAKEOVER LAW AND THEIR IMPACT

Developments concerning transactions with controlling shareholders

Freeze-out mergers involve an inherent conflict of interest because the controlling shareholder would prefer to pay the minority as little as possible for their stock and thus is said to stand on both sides of the transaction. As a result, freeze-out mergers are judged under the entire fairness doctrine and not the business judgment rule. Under *Kahn v. Lynch*,[6] the burden of showing a freeze-out transaction accomplished through a

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

4 *Unocal v. Mesa Petroleum*, 493 A.2d 946 (Del. 1985).

5 In addition, defensive and other actions in response to a proposed transaction that interfere with the shareholder franchise must have a compelling justification under *Blasius Industries, Inc v. Atlas Corp*, 564 A.2d 651 (Del. Ch. 1988). Over the past several years, Delaware courts have questioned the analytic force of *Blasius* and have suggested that issues arising out of directors' actions affecting the shareholder franchise can be properly analysed under *Unocal*. See e.g., *Mercier v. Inter-Tel (Delaware), Inc*, 929 A.2d 786 (Del. Ch. 2007). There were no significant developments in the *Blasius* doctrine in 2009 and the first four months of 2010.

6 638 A.2d 1110 (Del. 1994).

negotiated merger is (or is not) entirely fair may shift from the controlling shareholder to the plaintiffs if certain procedural protections were put in place, such as a special committee of disinterested directors who could negotiate on behalf of the minority and a shareholder vote that was conditioned upon approval by a majority of the minority shareholders. How to determine whether the procedural protections set forth in *Lynch* are effective and how a freeze-out transaction can be structured as a tender offer to avoid entire fairness review have been the subject of significant judicial commentary over the past 12 months.

i *Absence of procedural safeguards*

There is no requirement that a controlling shareholder employ the procedural safeguards set forth in *Lynch*. However, two recent cases – *Louisiana Municipal Police Employees' Retirement System v. Fertitta*[7] and *In re Sunbelt Beverage Corp Shareholder Litigation*[8] – show the dangers of allowing the controlling shareholder to pursue a freeze-out merger unchecked. In *Fertitta*, the court found there was sufficient pleading to support a claim that the board had preferred the interest of the controlling shareholder to the interests of the corporation and its minority shareholders in allowing the controlling shareholder to pursue a creeping takeover. In particular, the court found that the board's decisions (1) not to deploy a poison pill despite the fact it knew that the controlling shareholder intended to engage in a creeping takeover, (2) to waive a $15 million fee due from the controlling shareholder, and (3) to acquiesce to the controlling shareholder's negotiation of a refinancing commitment to buy half of the company as part of the amended debt commitment letter for financing his merger, taken together, showed that the board was favouring the controlling shareholder's interests over the minority's. As a result, the minority shareholders had a claim for the breach of the duty of loyalty, not merely a claim for breach of duty of care, against the board.

Sunbelt Beverage not only shows the danger of not adopting procedural safeguards to protect the minority in a freeze-out transaction; it also shows the difficulty of demonstrating to a court's satisfaction that the freeze-out merger was the product of fair dealing when no procedural safeguards have been employed.

Describing the majority shareholder's tactics as 'strong-armed,' the court provided a laundry list of the defects in the process leading up to the freeze-out transaction. The majority shareholder had first tried to convince the minority shareholder to sell her Sunbelt shares to it at a formula price contained in a shareholder agreement. When that failed, the majority sought to call the minority's stock even though the majority had no right to do so. Ultimately, the majority put forth a freeze-out merger that included no procedural protections to insure arm's-length bargaining or to approximate a fair valuation procedure. Specifically, there was no special committee, no opportunity for genuine negotiations regarding the merger consideration, no majority of the minority vote, and no dissemination of material information that would have levelled the playing field between the minority shareholder and the majority. The court also found that a

7 2009 Del. Ch. LEXIS 144 (Del. Ch. 28 July 2009).

8 2010 Del. Ch. LEXIS 1 (Del. Ch. 10 January 2010).

hastily prepared 'fairness opinion' was 'a mere afterthought, pure window dressing' intended by the majority to justify a merger at the formula price. After reviewing both sides' valuation testimony, the court found that the minority stock was worth two and a half times the consideration paid in the merger.

ii Ineffective procedural safeguards

Two other cases, *In Re Revlon, Inc Shareholders Litig*ation ('*Revlon II*')[9] and *In re John Q Hammons Hotels Inc Shareholder Litigation*,[10] show that procedural protections, when half-heartedly employed as window dressing, will be of little utility to the controlling shareholder or board seeking to defend a freeze-out transaction.

In *Revlon II*, Revlon's controlling shareholder offered to acquire 100 per cent of Revlon's publicly traded common stock through a negotiated merger. The public shareholders would not receive cash for their stock. Instead, they would receive preferred stock that would have no voting rights and would not be listed on any securities exchange. As part of the merger, the controlling shareholder would modify the terms of the $170 million term loan between one of Revlon's operating subsidiaries and the controlling shareholder. The stated rationale was that the modification of the loan would help Revlon deal with liquidity issues.

Following the announcement of the merger, several shareholder lawsuits challenging the transaction were filed. At the same time, Revlon created a special committee to consider the controlling shareholder's merger proposal. After negotiations in which the special committee proved more difficult than the controlling shareholder thought was desirable, the controlling shareholder modified its merger proposal to an exchange offer. By recasting the merger proposal into an exchange offer, the controlling shareholder became able to take the transaction to the shareholders without a recommendation from the special committee or the Revlon board.

Counsel representing the minority shareholders in the lawsuits ('Class Counsel') negotiated some minor changes to the exchange offer and entered into a memorandum of understanding ('MOU') to settle the shareholder lawsuits. In reviewing the settlement, the court concluded that the Class Counsel had not been vigorous in advancing the minority shareholders' interests. In particular, the court was puzzled by an amendment to the exchange offer agreed to in the MOU that seemed to work against the minority shareholders' interests. The exchange offer was subject to a non-waivable condition that at least the majority of the common stock not owned by the controlling shareholder tender their shares. A majority of the common stock not owned by the controlling shareholder did not tender. Nonetheless, Class Counsel had agreed to waive the non-waivable majority of the minority provision.

The court granted a motion disqualifying Class Counsel and replacing it with new counsel. In reaching this decision, the court found that 'this is not the type of voluntary non-coercive tender offer that has provided a mechanism for avoiding entire fairness review[…]'. Consistent with prior precedent, the court noted that 'a Delaware

9 2010 Del. Ch. LEXIS 48 (Del. Ch. 16 March 2010).

10 2009 Del. Ch. LEXIS 174 (Del. Ch. 2 October 2009).

court should treat a controller's exchange offer as non-coercive and not subject to entire fairness review if, among other things, it receives an affirmative recommendation from an independent committee of the target board and is subject to a non-waivable condition that a majority of the outstanding unaffiliated shares tender and there is a commitment by the controller to effect a prompt back-end merger'. Here, the exchange offer did not receive a recommendation from an independent committee, the Revlon board declined to recommend the exchange offer, the outside directors believed they could not obtain a fairness opinion for the deal, and Class Counsel had waived the majority of the minority condition.

The court also ordered new counsel for the shareholders to investigate the fairness of the settlement and the negotiations leading up to the MOU. In short, the court had questions not only whether the special committee had been able to negotiate effectively on behalf of the minority shareholders; it had doubts whether Class Counsel had be able to do so as well. As a result, the court was willing to look behind the surface of both a special committee process and settlement of a litigation to determine whether the freeze-out transaction had been unfair to the minority.

Hammons shows the Delaware courts' wariness about a controlling shareholder's power to shortchange minority shareholders in transactions that do not even involve a freeze-out. In *Hammons*, the court wrestled with what standard should apply to a controlling shareholder that is supporting a merger with a third-party acquirer. The court found that *Lynch* did not apply when a third party seeks to acquire a company with the controlling shareholder's support. Accordingly, the entire fairness standard did not necessarily apply to the *Hammons* transaction.

Nonetheless, the court did not hold that the business judgment rule applied. The court held that although the controlling stockholder did not stand 'on both sides' of the transaction, he was going to receive consideration that the minority shareholders would not. Thus, the court reasoned, the controlling stockholder was competing with the minority shareholders for the consideration the third-party acquirer was willing to pay to acquire the company. Because the controlling shareholder had an effective veto over the transaction, it was necessary that there be robust procedural protections in place to insure that the minority shareholders had sufficient bargaining power and the ability to make an informed choice of whether to accept the third-party offer. The court found that the business judgment rule would be the applicable standard of review if the transaction were (1) recommended by a disinterested and independent special committee, and (2) approved by a non-waivable vote of the majority of all the minority shareholders.

The court found that the procedural protections employed in the *Hammons* transaction were insufficient and thus the entire fairness standard applied. Specifically, the majority of the minority provision 'was not sufficient both because the vote could have been waived by the special committee and because the vote only required approval of a majority of the minority shareholders voting on the matter, rather than a majority of all the minority shareholders.' The court held:

> *The majority of the minority vote, however, provides the stockholders an important opportunity to approve or disapprove of the work of the special committee and to stop a transaction they believe is not in their best interests. Thus, to provide sufficient protection to the minority stockholders, the majority of the minority vote must be non-waivable, even by the special committee.*

Revlon II and *Hammons* show that Delaware courts will not tolerate a lackadaisical approach to procedural safeguards in controlling shareholder transactions. The courts will look to see if the procedural safeguards were, in fact, meaningful.

iii Standard applicable to freeze out transactions

Lynch involved a negotiated merger, and does not address the issue of when and how the entire fairness standard applies to a controlling stockholder freeze-out structured as a first step tender offer to be followed by a second step short form merger. Two cases decided within weeks of each other, *In re Cox Radio, Inc Shareholders Litigation*[11] and *In re CNX Gas Corporation Shareholder Litigation*,[12] suggest that the applicable standard for reviewing a freeze-out through a tender offer remains unresolved under Delaware law.

In *Cox Radio*, in the context of reviewing the settlement of a shareholder class action challenging a freeze-out tender offer, Vice Chancellor Parsons agreed with the defendants that *Lynch* did not apply to a freeze-out tender offer and that *Lynch* only applied to transactions involving a negotiated merger between the target and its controlling stockholder. The court found that *In re Pure Resources, Inc Shareholders Litigation*[13] governed transactions involving a tender offer by the controlling shareholder. Under *Pure Resources*, the court should not apply the entire fairness standard when the tender offer is 'non-coercive' and 'the independent directors of the target are permitted to make an informed recommendation and provide fair disclosure'. A tender offer is non-coercive when '(1) it is subject to a non-waivable majority of the minority tender condition; (2) the controlling stockholder promises to consummate a prompt Section 253 [short-form] merger at the same price if it obtains more than 90 per cent of the shares; and (3) the controlling stockholder has made no retributive threats'. In addition, the independent directors must be given 'the free reign and adequate time to react to the tender offer, by (at the very least) hiring their own advisors, providing the minority with a recommendation as to the advisability of the offer and disclosing adequate information for the minority to make an informed judgment.' *Id.*

In *Cox Radio*, the court also found that the tender offer at issue met the requirements of *Pure Resources*. The transaction was subject to a non-waivable majority of the minority condition. The controlling stockholder promised to consummate a prompt short form merger at the same price offered in the tender offer if it obtained more than 90 per cent of the Cox Radio shares. There was no allegation of retributive threats made by the controlling stockholder. To the contrary, the court found that the special committee fulfilled its duties under *Pure Resources* and negotiated vigorously with the controlling stockholder.

A few weeks later in *CNX*, Vice Chancellor Laster addressed the question of the appropriate standard of review for a freeze-out tender offer in the context of a request for a preliminary injunction. Instead of finding that *Pure Resources* applied, the court indicated that it would apply the 'unified standard' for reviewing controlling stockholder

11 2010 Del. Ch. LEXIS 102 (Del. Ch. 6 May 2010).

12 2010 Del. Ch. LEXIS 119 (Del. Ch. 25 May 2010).

13 808 A.2d 421 (Del. Ch. 2002).

freeze-outs Vice Chancellor Strine described in *In re Cox Communications, Inc Shareholders Litigation*.[14] Under the *Cox Communications* standard, the business judgment rule applies when a freeze-out – whether by merger or tender offer – is conditioned on both the affirmative recommendation of a special committee and the approval of a majority of the unaffiliated stockholders.

The *CNX* court reasoned that the important question was not whether the freeze-out transaction was a negotiated merger or a tender offer, but 'what transactional structures result in the controlling stockholder not standing on both sides of a two-step freeze-out?' The court found that the uniform standard set forth in *Cox Communications* harmonised the standards for negotiated mergers and tender offers and made them coherent by explaining that the business judgment rule should apply to any freeze-out transaction that is structured to mirror both elements of an arm's-lengths merger. Thus, under *Cox Communications*, if a freeze-out merger is both (1) negotiated and approved by a special committee of independent directors, and (2) conditioned on an affirmative vote of a majority of the minority stockholders, then the business judgment standard of review presumptively applies. In this regard, *Cox Communications* is a departure from *Lynch*, which merely shifts the burden of proof under the entire fairness standard. Likewise, under *Cox Communications*, if a first step tender offer is both (1) negotiated and recommended by a special committee of independent directors and (2) conditioned on the affirmative tender of a majority of the minority shares, then the business judgment standard of review presumptively applies. If both requirements are not met, a freeze-out transaction is subject to an entire fairness review.

Next the court found that the tender offer in *CNX* did not pass muster under the *Cox Communications* standard. First, the special committee did not recommend in favour of the transaction. Second, the special committee was not provided with authority comparable to what a board would possess in a third-party transaction. In particular, initially the special committee was not authorised to negotiate or to consider alternatives to the tender offer. Third, there were questions about the effectiveness of the majority of the minority tender condition because T Rowe Price, a minority shareholder, owned 6.5 per cent of the controlling stockholders' common stock and 6.3 per cent of the target stock, and thus might have materially different incentives than the other minority holders of the target.

Although *CNX* argues forcefully for the adoption of the unified standard under *Cox Communications* for both negotiated mergers and tender offers, it leaves unresolved the issue of what standard actually applies. As the *CNX* court acknowledged, its holding differed from that in *Cox Radio*, which opted to follow *Pure Resources*, and, as it further acknowledged, only the Delaware Supreme Court could bring clarity to the choice among the *Lynch*, *Pure Resources* and *Cox Communications* standards.

Developments relating to *Revlon*, *Unocal* and other defensive issues

Perhaps reflecting the subdued financial and merger markets, 2009 and the first months of 2010 did not yield significant developments concerning a board's duties under *Revlon*

14 879 A.2d 604 (Del. Ch. 2005).

or *Unocal*, or defensive measures in general. Nonetheless, the Delaware courts did take several opportunities to review and confirm the established contours of *Revlon* and *Unocal*.

i Revlon duties

Lyondell Chem Co v. Ryan[15] provides guidance on when *Revlon* duties apply and shows the flexibility that directors enjoy in meeting those duties. In *Lyondell*, the Delaware Supreme Court reiterated that *Revlon* duties do not arise simply because the company is 'in play'. A duty to seek the best price reasonably available applies only when a company embarks on a transaction on its own initiative or in response to an unsolicited offer that will inevitably result in a change in control. In *Lyondell*, the fact that an acquirer, Basell, had expressed an interest in acquiring Lyondell in public filings and elsewhere did not trigger *Revlon* duties on the part of the Lyondell board.

In addition, *Revlon* and its progeny do not create a set of specific requirements that must be satisfied during the sale process. The *Revlon* line of cases has set forth a number of procedures directors may undertake to help meet their *Revlon* duties. Examples of these procedures include pre-market or post-market checks for competing offers and obtaining the opinion of a financial advisor that an offer is the best offer reasonably available. *Lyondell* made clear that *Revlon* does not require that any of these specific steps be taken in striving to get the best price. In M&A transactions, directors will be facing unique combinations of circumstances, many of which are outside of their control, and thus the courts will not impose a 'single blueprint that a board must follow to fulfil its [*Revlon*] duties'.[16]

Moreover, determining whether directors have met their *Revlon* duties is a question of whether those directors have met the duty of care. Since the Lyondell charter (like most corporate charters under Delaware law) contained an exculpation clause that insulated the Lyondell directors from claims for monetary damages for breaches of the duty of care, there could be no claim for monetary damages against the Lyondell directors absent a showing that the directors had acted disloyally or in bad faith. Showing bad faith requires showing the directors had an utter and conscious disregard for their duty to seek the highest reasonably available price. Because there is no 'single blueprint' for carrying out *Revlon* duties, even an imperfect or botched attempt to carry out *Revlon* duties will not constitute a knowing disregard for those duties and thus bad faith. The practical result of this ruling is that it will be very difficult to show a breach of *Revlon*

15 970 A.2d 235 (Del. 2009), rev'g 2008 Del. Ch. LEXIS 105 (Del. Ch. 29 July 2008).

16 Section 102(b)(7) of the DGCL permits a Delaware corporation to include an 'exculpation' provision in its charter that eliminates or limits the personal liability of directors for monetary damages for breaches of fiduciary duty so long as such breaches are not the product of (1) a breach of the duty of loyalty, (2) an act or omission not taken in good faith or which involves intentional misconduct or a knowing violation of law, (3) an unlawful dividend or repurchase or redemption of stock or (4) a transaction from which the director derived an improper personal benefit.

duties in an M&A transaction involving a corporation whose charter has an exculpation clause unless the M&A transaction involves a conflict of interest.

The holding in *Lyondell* was echoed in *In re NYMEX Shareholder Litigation*,[17] in which the court dismissed a *Revlon* claim because there were no allegations of either bad faith or breach of the duty of loyalty. Similarly, in *Wayne County Employees' Retirement System v. Corti*,[18] the court dismissed *Revlon* claim, finding that the directors were not required to take any specific steps prior to selling control.

ii Unocal, pills and other defensive measures

Reflecting the paucity of hostile M&A activity, last year's cases discussing the *Unocal* doctrine and other defensive tactics were sparse. Those few cases that did discuss *Unocal* generally affirmed directors' power and discretion to take defensive action.

Termination of sales process

In *Gantler v. Stephens*,[19] the Delaware Supreme Court concluded that the board's decision to terminate and abandon a sales process was not subject to heightened scrutiny under Unocal. 'Enhanced judicial scrutiny under *Unocal* applies "whenever the record reflects that a board of directors took defensive measures in response to a perceived threat to corporate policy and effectiveness which touches on issues of control"'. Rejecting an acquisition offer, without more, is not defensive action under *Unocal*. Similarly, in deciding a books and records action, the court in *City of Westland Police & Fire Retirement System v. Axcelis Techs Inc*[20] confirmed that 'rejecting an acquisition offer, without more, does not constitute a "defensive action" under *Unocal*'.

NOL pills

In *Selectica, Inc v. Versata Enters*,[21] the court affirmed that a poison pill may be used to protect the value of corporate assets, including net operating losses ('NOLs') that may have value if they can be used to reduce future tax payments. Under US tax laws, NOLs may lose value if there is a change of control. Applying *Unocal*, the court held that the protection of NOLs was a proper use of a poison pill even though the value of the NOLs was unknowable. After finding that the NOLs were a permitted subject of protection, the court found that the NOL pills used by *Selectica* were a proportionate response to the perceived threat to the NOLs and were neither coercive nor preclusive. The court found that the NOL pills did not render a successful proxy contest an impossibility or

17 2009 Del. Ch. LEXIS 176 (Del. Ch. 30 September 2009).

18 2009 Del. Ch. LEXIS 126 (Del. Ch. 24 July 2009), appeal accepted, No. 483, 2009 (3 September 2009) (Supreme Court oral argument held on 13 January 2010, argument *en banc* held on 31 March 2010, decision pending).

19 2009 Del. LEXIS 33 (Del. 27 January 2009), rev'g motion to dismiss granted by Court of Chancery at 2008 Del. Ch. LEXIS 20 (Del. 14 February 2008).

20 2009 Del. Ch. LEXIS 173 (Del. Ch. 28 September 2009).

21 2010 Del. Ch. LEXIS 39 (Del. Ch. 26 February 2010).

utterly moot, given the specific threat at hand. Thus, the NOL pills were not coercive under *Unocal*.

Reaching this decision, the court noted that:

a the board engaged in an internal debate before putting the NOL pills in place;

b a committee was established to monitor the effect of the NOL pills;

c the challenger to the NOL pills had failed to suggest a meaningful different manner of protecting the NOLs; and

d the low threshold for triggering the NOL pills was imposed by an objective standard.

Thus, the NOL pills protected Selectica from an inadvertent change in ownership triggered by the actions of the careless or unknowing shareholder. Because the record also showed that a long-time competitor sought to employ the shareholder franchise potentially to impair Selectica's corporate assets, or else coerce Selectica into meeting certain business demands under the threat of such impairment, the use of the NOL pills was reasonable.

Duty to deploy a pill?

In *Fertitta*, the court considered a board's obligation to employ a poison pill in the face of a creeping takeover by a controlling shareholder. Although the court acknowledged that there is no per se duty to employ a poison pill, it found that the board's failure to employ the pill, together with other suspect conduct, supported a reasonable inference that the board had breached its duty of loyalty in permitting the creeping tender offer. As a result, the court denied a motion to dismiss and permitted a challenge to the merger to go forward.

Challenge to 'poison put'

In *San Antonio Fire & Police Pension Fund v. Amylin Pharmaceutical Inc*,[22] the court rejected a challenge to a change of control covenant in a bond indenture permitting the noteholders of Amylin Pharmaceutical Inc to redeem their notes at face value if Amylin underwent a fundamental change of control. Under the indenture, a 'fundamental change' would occur if 'the continuing directors do not constitute a majority of the company's board of directors.' The term 'continuing directors' was defined as the members comprising the board of directors on the date of the indenture's issuance or new directors whose election and nomination for election 'was approved by at least a majority of' the continuing directors. Two of Amylin's major shareholders each nominated a slate of five directors to the twelve-person board. At first, Amylin refused to approve the directors, noting the adverse effect their election might have under the change of control provision. Amylin did later approve the slate, but the indenture trustee would not.

Although the case was not analysed under *Unocal* or cases involving poison pills, critics of the change of control covenant dubbed it a 'poison put,' suggesting that it created an unreasonable entrenchment of Amylin's current directors. The shareholders'

22 2009 Del. Ch. LEXIS 83 (Del. Ch. 12 May 2009), aff'd, 2009 Del. LEXIS 519 (Del. 2009).

challenge ended up centring on the contention that the board was grossly negligent in agreeing to the change of control covenant. The court rejected the breach of the duty of care argument and entered judgment in Amylin's favour. *Amilyn* suggests that change in control provisions, which are found in employment contracts, loan documents and other agreements, are not *per se* illegal, even if they may hamper a change of control, and will be permitted absent egregious circumstances or a totally preclusive effect.

Developments concerning buying shareholder votes

Delaware's merger statute requires a shareholder vote to approve a merger.[23] Delaware law requires a majority of all stock entitled to vote on a merger to vote for it, not just a majority of a quorum. Acquirers often seek to lock up votes in favour of a transaction to create more deal certainty. Vote buying is not *per se* illegal under Delaware law, and Section 218(c) of the DGCL specifically permits voting agreements. But vote buying that serves to disenfranchise other shareholders or is found to be for a fraudulent or inequitable purpose has been found to be illegal. The line between legal and illegal vote buying is a fuzzy and undeveloped one under Delaware law.

In *Crown EMAK Partners, LLC v. Kurz*,[24] the court reviewed whether a group of insurgent shareholders' attempt to purchase proxies from other shareholder's constituted impermissible vote buying. In an extensive and thoughtful analysis, the court concluded that it did not. In *Emak*, two competing factions battled for lawful control of the board of directors of Emak Worldwide, Inc through a series of consent solicitations that turned on a very slim margin of votes. The insurgents had 48.4 per cent of the shares they needed to win, and they obtained what they (and the court below) believed was the winning margin by buying 175,000 shares of restricted stock from a former Emak Worldwide employee. Although the court expressed concern about situations where the voting interest in shares is not aligned with the economic ownership interests, it found that in *Emak* there was no improper vote buying because the economic interest and the voting interests of the shares remained aligned. The court also found, however, that the purchase agreement through which the insurgents purchased the critical block of votes ran afoul of a restricted stock grant agreement that applied to those shares, so the insurgents could not vote the shares in any event. Although *Emak* arises in the context of an election of directors and approval of by-law changes, it is also helpful in understanding how the vote buying issue might be analysed in a merger context. It also suggests that absent fraud, a decoupling of voting power and economic interest, or violation of some other contractual right, vote buying will be permissible.

III RECENT LEGISLATIVE DEVELOPMENTS

Reflecting shareholder activists' campaign to obtain greater shareholder access to the proxy, on 1 August 2009 two new sections (Sections 112 and 113) were added to the DGCL to authorise Delaware corporations to adopt by-laws to grant proxy access to

23 Section 251 of the DGCL.

24 2010 Del. LEXIS 182 (Del. 21 April 2010).

shareholders and to provide expense reimbursement for proxy contests. Both of these new sections are enabling and permissive; they do not require that Delaware corporations provide proxy access or proxy expense reimbursement unless a company's by-laws are amended to do so.

Under new Section 112, a corporation's by-laws may provide that if a corporation solicits proxies for an election of directors, individuals nominated by shareholders may also be included in the corporation's proxy solicitation materials. Significantly, by-laws can define the extent of the proxy access right granted and condition that right through procedures governing its implementation. These limitations may include, for example, minimum stock ownership requirements, limiting the proxy access right to record or beneficial owners, and excluding holders of stock options and other rights. In addition, Section 112 provides that a proxy access by-law may require shareholders seeking to gain proxy access to disclose information that would indicate they have a financial incentive other than maximisation of profit or stock price, such as holding short positions or other financial interests. The right of proxy access may also be limited to nominations of so-called short slates or, conversely, situations in which the shareholder seeks to nominate a majority of the board. The new Section 113 allows corporations to adopt by-laws granting shareholders the right to be reimbursed for proxy expenses. Section 113 also expressly permits reimbursement to be conditioned upon a number of factors.

To date, these new sections do not appear to have been the subject of a proxy fight or litigation. Accordingly, it is too early to say how they may shift the balance of power in the context of a contested or hostile M&A transaction.

IV OUTLOOK

As shown by the decisions in the freeze-out cases, Delaware courts are ready to engage in searching scrutiny of transactions to ensure they are not tainted by conflicts of interest. On the other hand, the courts also appear ready to protect a board's discretion in dealing with or defending against third-party suitors. The current post-crisis deal renaissance is occurring in an environment marked by a renewed push by shareholder activists for a greater say in corporate governance in general. That, together with an eroded confidence in boards of directors and financial institutions, and enthusiasm for increased regulation of both corporate governance and financial markets, cannot help fuelling pressure on Delaware courts to apply even greater scrutiny to M&A transactions. However, the Delaware courts and legislature are not crisis-driven institutions and understand the importance of predictability and stability in legal regimes affecting commercial relations. It is difficult to say with precision how far current political and popular trends will go and how they will affect either Delaware corporation law or specific M&A transactions. Nonetheless, one can predict (as shown by the legislative response to the proxy access issue) that Delaware's reaction to these trends will involve incremental and evolutionary changes to the legal framework that it has developed over decades rather than a wholesale or radical change to its approach.

ROLIN P BISSELL

Young Conaway Stargatt & Taylor, LLP

Rolin Bissell is vice chair of Young Conaway's corporate counselling and litigation section. His practice focuses on corporate litigation in the Delaware Court of Chancery, including disputes about M&A, going private transactions, 'interested party' transactions, proxy contests, valuation and appraisal issues, indemnification and advancement and stockholder access to books and records. He has represented numerous non-US entities in Delaware litigation that needs to be coordinated with proceedings in European and other foreign jurisdictions.

Mr Bissell holds a degrees from Columbia College (BA) and the University of Virginia School of Law (JD). He writes and speaks regularly on corporate law issues.

ELENA C NORMAN

Young Conaway Stargatt & Taylor, LLP

Elena Norman is a partner in the corporate counselling and litigation section of Young Conaway. Her practice focuses primarily on dispute resolution relating to corporate governance and in contested M&A transactions. She also has extensive experience in litigation involving corporate valuation. Many of the cases in which Ms Norman is involved involve cross-border issues. She has also practised law in the New York and Tokyo offices of an international law firm, where she represented numerous US and foreign entities in federal and state courts and arbitration proceedings involving complex business disputes.

Ms Norman holds degrees from the University of Pennsylvania (BA), University College London (MA) and Stanford University (JD). Before attending law school, Elena studied English constitutional law and jurisprudence as a visiting student at Somerville College, Oxford.

Ms Norman regularly lectures on corporate governance and cross-border dispute resolution.

YOUNG CONAWAY STARGATT & TAYLOR, LLP

The Brandywine Building
1000 West Street, 17th Floor
PO Box 391
Wilmington
DE 19801
United States
Tel: +1 302 571 6600
Fax: +1 302 571 1253
rbissell@ycst.com
enorman@ycst.com
www.youngconaway.com