

Deal Points

The Newsletter of the Mergers and Acquisitions Committee

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FROM THE CHAIR

By Leigh Walton

I trust that many of you are planning to attend (in person or by phone) the ABA's Annual Meeting to be held in Chicago, August 3-5, 2012. Our meetings will be held at the Chicago Marriott Downtown Magnificent Mile, located at 540 North Michigan Avenue.

The full Committee meeting will be held Sunday afternoon, beginning at 12:30 p.m. (Central Time). Most of our meetings will be available by conference telephone. The dial-in information for the full Committee meeting and the subsequent Committee Forum is as follows:

U.S. and Canada: (866) 646-6488

International: (707) 287-9583

Conference Code: 722-787-6294

Dial-in information for Subcommittee and Task Force meetings is included in this issue of *Deal Points* beginning on page 29.

Full Committee Meeting

We have planned an impressive array of presentations for our full Committee meeting. Daniel Glazer, Fried, Frank, Harris, Shriver & Jacobson LLP, will present on the key IP and IT considerations that arise in M&A transactions. The careful handling of intellectual property issues arising in M&A transactions is more important than ever. A recent Ocean Tomo analysis indicates that IP, information technology, and similar intangible assets comprise 80% of the market value of the S&P 500, up from 32% in 1985. Dan will address the concerns that buyers and sellers should consider in M&A transactions, including identifying, mitigating, and allocating the risks of unasserted IP infringement claims, IP ownership disputes, the use of open source software, and restrictions on the transfer of IP and licenses.

Sherry Cefali and Chris Janssen, Managing Directors of Duff & Phelps, will present "Trends and Considerations in Leveraged Dividend Transactions." Dividend transactions have continued to be a popular

alternative to M&A, IPOs, and other liquidity options. Especially when exits are either impractical or when exit values fail to meet owner expectations, private equity sponsors, public companies, and private owners often turn to dividends to realize current return on their investment. Furthermore, with the cost of debt close to historic lows, paying a dividend funded by additional debt has become a powerful and cost effective tool to gain liquidity and still retain control. Leveraged recapitalizations require special considerations for boards of directors under state laws governing the payment of dividends and fraudulent transfers. This presentation will summarize market trends in leveraged dividend transactions including transaction volume, lending standards, solvency opinion requirements, and data on leverage ratios and dividend amounts.

As always, a highlight of our meeting will be remarks by The Honorable Myron T. Steele, Chief Justice of the Delaware Supreme Court. The Chief Justice will address investment banking conflict issues, and will present his thoughts on *Del Monte Foods*, *El Paso* and *Southern Peru*. Wally Dietz and Eli Richardson, Bass, Berry & Sims, will address the impact of the Foreign Corrupt Practices Act on M&A transactions. Kevin Ryan will present J.P. Morgan Escrow Services' 2012 report "M&A Indemnification Escrow Study." Our Committee Forum is entitled "Selected Ethical Issues in M&A Transactions."

Task Force and Subcommittee Meetings

We have a full schedule of substantive Task Force and Subcommittee meetings planned for Chicago. The schedule for our Task Force and Subcommittee meetings is included at the end of this issue of *Deal Points*. I advise that you follow it rather than the printed materials from the ABA in that there were a few changes decided upon too late for the ABA's deadline.

The Task Force on the Revised Model Asset Purchase Agreement has made working group assignments and is poised to begin drafting. Thanks to Mr. Jor Law and NES Financial, the Task Force is in the process of setting up a virtual data room for use by all Task Force members. The data room will house the original Model Asset Purchase Agreement and Revised Model Stock Purchase Agreement. The site will also be used to share the working product during drafting. In addition to the drafting kickoff, the Task Force meeting will feature a presentation by Jeff Litvak of FTI Consulting on disputes in M&A transactions relating to accounting issues. Ed Deibert, Arnold & Porter, and John Clifford,

McMillan, welcome volunteers to this new project. In my estimation, being involved from start to finish in producing one of our Committee's seminal model agreements is one of the most rewarding experiences we offer.

The M&A Market Trends Subcommittee reports a packed agenda, including presentations from Rich Lacher, Houlihan Lokey, who will update the Subcommittee on state of the M&A market. Tricia Vella, Morris Nichols, Wilmington, will present "Tales from the Trenches," sharing the Delaware perspective on how buyers can ensure they are indemnified above the escrow amount. Simon Raftopolous and Stephen James, Appleby, Grand Cayman, will discuss fiduciary duties in Cayman and BVI.

The International M&A Subcommittee plans a program on the subject of the practice of seller's counsel being asked to provide a due diligence report to the buyer or to the providers of financing for a transaction. This is quite common in the U.K., but is not in the U.S., with the possible exception of private equity acquisitions. Joel Greenberg, Kaye Scholer, will speak about U.S. practice, with special emphasis on private equity transactions. Daniel Rosenberg, Speechly Bircham, will address U.K. practices, and Hermann Knott, Luther, will focus on Germany and the balance of the E.U.

Chicago will be the home of the first meeting of the Task Force on Legal Project Management. Please attend if you have an interest in this cutting edge topic.

Thanks to Our Sponsors

Thanks to David Bronner's input, we have planned what we hope will be a memorable dinner on Saturday evening at Cité Restaurant, 505 North Shore Drive. Our dinner is sponsored by J.P. Morgan Escrow Services. Cocktails and dessert are sponsored by Thomson Reuters. We will cap our evening on the terrace of the Skyline room at the Shakespeare Theatre on Navy Pier. Duff & Phelps is sponsoring this nightcap event featuring cocktails, live music, and a breathtaking view of fireworks over the skyline and beautiful Lake Michigan. What an evening this should be!

Programs

The Mergers & Acquisitions Committee is the lead sponsor of two CLE programs at the Annual Meeting. First, on Sunday, from 8:00 a.m. until 10:00 a.m., we will produce, "When People Issues Become Deal Issues: Understanding and Negotiating Employment

Obstacles In Cross-Border Transactions," co-chaired by Rachel Solyom, McCarthy Tetrault, and Katrien Vorlat, Stibbe. This program will address the labor and employment issues that are encountered in cross-border M&A transactions, including non-competition clauses, successor employer obligations, and integration and severance issues. Using a case study approach, the panelists will provide practical guidance on strategies to address (and surmount) these challenges in a deal context and will provide useful negotiation and drafting tips.

On Sunday, from 10:30 a.m. until 12:30 p.m., we will sponsor a program entitled "Common Mistakes of M&A Lawyers." This program will draw from the M&A Committee's various subcommittees and publications to illustrate some of the more common traps that M&A practitioners face in their practice. For those who are not active M&A Committee members, the program will serve as an introductory survey to both key issues faced by M&A practitioners and our Committee's resources and activities. For active M&A Committee members, the program will serve as a compilation and reminder of key issues discussed throughout the M&A Committee's various Subcommittees and Task Forces. The panel is co-chaired by David Albin and George Taylor; panelists include Wilson Chu and Diane Holt Frankle.

Additionally, our Committee is co-sponsoring a number of interesting programs, including the following:

- "Cross-Border M&A: Critical Issues for U.S. Counsel," August 3, 8:00 a.m. until 10:00 a.m., sponsored by International Business Law; Richard E. Clark and Nestor J. Belgrano, Co-Chairs.
- "Corporate Litigation Problems that Keep General Counsel Awake at Night and How to Solve Them," August 3, 2:30 p.m. until 4:30 p.m., sponsored by Corporate Counsel Committee; Robert L. Haig, Chair.
- "What Every M&A and Private Equity Transactional Lawyer Needs to Know About the Foreign Corrupt Practices Act," August 4, 8:00 a.m. until 10:00 a.m., sponsored by White-Collar Crime; Alan Brudner, Chair.
- "The Tax Gobblegook in LLC Agreements: How Business Lawyers Can Make Sense of 'Capital Accounts' and 'Allocations' and Why IT Matters," August 4, 8:00 a.m.

until 10:00 a.m., sponsored by Taxation; L. Andrew Immerman, Chair.

- "Embracing Conflict: Ethics and The Lawyer For The Deal," August 4, 10:30 a.m. until 12:30 p.m., sponsored by Professional Responsibility; Charles McCallum, Chair.
- "Two's Company, Three's A Crowd: Novation, Assignment Or Pledge Of Contract Rights, Third-Party Beneficiaries, Subordination Agreements, Escrows, Control Agreements and Other Triangular Arrangements," August 5, 10:30 a.m. until 12:30 p.m., sponsored by Uniform Commercial Code; Penny Christophorou, Chair.

Passing the Torch

This meeting will be my last as Chair of our Committee. It has been a terrific three-year term, for it has given me the opportunity to work with many of you who contribute your talent and time to our Committee. The contribution our Committee makes to our profession is something of which we can all be proud. As I relate some of our activities over the last three years, I especially thank our Vice Chairs Wilson Chu, Keith Flaum, and Mark Morton for their hard work. And I thank my predecessor, Joel Greenberg, our "intellectual leader," for his continuing support and leadership, Rick Climan for his unending encouragement and contributions, and Nat Doliner for his steady guidance and efforts to enhance our stature in the Business Law Section.

As I reflect over the last three years, the following events and achievements stand out:

- We have upgraded the location of our Committee's stand-alone meeting. We scheduled the first stand-alone during my tenure in October 2009 in Washington. We were in the midst of the great recession, and your leadership determined it was not the time for a glitzy locale. We upscaled the next year (January 2011) to the Ritz in Coconut Grove. For our last stand alone we discovered Laguna Beach. If you ask me, we have found our home. In order, we have gathered in Washington, Denver, San Francisco, Coconut Grove, Boston, Toronto, Laguna Beach, Las Vegas, and now in Chicago.
- Our membership has increased to well over

4,000 members from 49 states and 55 countries on five continents. Our Membership Committee (Mireille Fontaine, Tracey Washburn, and Ryan Thomas) has worked tirelessly to increase our numbers by enhancing our relationship with the ACG and other non-lawyer organizations. Further, we have increased the ranks of our active membership and young lawyers. We made a special effort to attract non-lawyers investment bankers, members of the business press, valuation experts, insurers, and many others. We have increased our diverse membership – thanks in part to the efforts of our Diversity Committee, comprised at various times of Fraziska Ruf, Jennifer Muller, Ed Deibert, and Eric Wilensky. We have much remaining work to do in this realm.

- Chief Justice Myron T. Steele has, I believe, been present at each of the meetings during the last three years, never failing to keep us updated on the latest Delaware developments. We are indebted to him for his volunteer work. He has spoken on issues ranging from changes in proxy access and constituent directors, fiduciary duties related to risk management, the impact of forum selection clauses in bylaws and charters, defending poison pills, the distinctions between Delaware and Nevada law, M&A sales processes involving financial and strategic buyers, fiduciary duties in limited liability companies, and the continued utility of staggered boards as a tool for board supremacy and shareholder rights.
- We have produced impressive content during the last three years. Very few disagree with the proposition that our works are the most significant ever authored by the M&A community. The hours of effort, the diversity of contributors, and strong quality control have combined to showcase the amazing talent of our membership.
- In 2010, we published a revision of our seminal Model Stock Purchase Agreement. The book is the result of nine years of work by hundreds of practitioners from dozens of international jurisdictions and lawyers from most U.S. states. In addition to well-crafted contractual provisions, the second edition contains extensive, updated commentary that explicates the purpose and

meaning of the provisions, often suggesting alternative approaches that could be employed in negotiating a particular facet of a deal. Particular thanks go to our dear, departed friend Bob Harper as well as co-chair Murray Perelman for their leadership in this massive endeavor.

- Representing well over a decade of collaborative work, the Model Merger Agreement for the Acquisition of a Public Company was released to critical acclaim and healthy sales in 2011. The work is both a practical and a pedagogical tool on a topic that we had not comprehensively addressed. Diane Holt Frankle and Steve Knee led this effort. And after the publication, we converted the Task Force into the Acquisitions of Public Companies Subcommittee, ably led by Lorna Telfer and our current chair Jim Griffin. Our Acquisitions of Public Companies Subcommittee sponsored during each of our last three years a meeting with the Delaware judiciary in Wilmington providing a unique platform for the exchange of ideas between our members and the key U.S. decision makers.
- Our largest group, the M&A Market Trends Subcommittee, continues to publish our ever-popular deal trends studies. Led by Wilson Chu, Jim Griffin, Jessica Pearlman, and Hal Leibowitz, the Subcommittee's works cover public, private, and international deals and are followed closely by deal professionals everywhere. The Subcommittee follows developments in the M&A world on a real-time basis.
- We continued our focus on International M&A, a hallmark of our Committee. Under the leadership of Daniel Rosenberg and Jim Walther, we expanded our programming and membership. Freek Jonkhart and Nat Doliner have joined the Subcommittee's leadership as vice-chairs. The Subcommittee has undertaken multiple projects, including the Public Company Takeovers Project, the International Due Diligence Project and the International JV Agreement Project (with contributors from 40 countries). We were sponsors of and major content providers to the London Global Business Law Conference held in September 2011 and led by our own Daniel Rosenberg.

- We created an Executive Council, comprised of members of our Committee's past leadership, chaired by Byron Egan. The Executive Council identified emerging trends, suggested new endeavors, and worked to enhance our position in the Section.
- Our Private Equity Subcommittee, chaired by John Hughes, and earlier co-chaired by Henry Lesser, has continued to provide quality programming along with a multitude of exceptional guest speakers.
- The M&A Jurisprudence Subcommittee, led by Jon Hirschoff, Scott Whittaker, Jim Melville, and Michael O'Bryan, unveiled the M&A Lawyers' Library and produced three Annual Surveys for *The Business Lawyer*. The Subcommittee continues to follow judicial developments nationwide and further afield, and reports interesting (often frightening) developments to the Committee at meetings and in *Deal Points*.
- The M&A Dictionary Task Force continues to explore creative ways to deliver content that we believe will have a popular audience. Thanks to the direction of David Katz and Rick Climan, we plan to have a valuable deliverable soon.
- We instituted an industry focus segment at our Committee meetings, thus far having addressed healthcare, entertainment, technology, manufacturing, and gaming.
- We created the Task Force on Distressed M&A to explore an area that regrettably continues to be very active. Hendrik Jordaan, Jennifer Mueller, and Peter Fishman have provided invaluable management. Importantly, the Task Force has undertaken the "Bankruptcy Code Section 363 Transaction Study," focused on completed transactions authorized under Section 363 of the Bankruptcy Code.
- We have produced dozens of programs – led by our Programs Subcommittee – Yvette Austin Smith, David Albin, and Robert Copeland. Speakers from the SEC, private equity, general counsels, and lawyers willing to share their knowledge have added to the quality content we deliver.
- Upon completion of several of our big projects, we created a Task Force on New Projects. Chaired by Bruce Cheatham and assisted by John Clifford, this group considered dozens of ideas and shaped many of them into new endeavors. I am happy to report that this Task Force was so successful it has been disbanded.
- We created the Task Force on Financial Advisor Disclosures – with a goal of developing practice tools for M&A and corporate attorneys advising companies and their financial advisors on disclosures regarding capital markets transactions. The fine work of this Task Force has been led by Yvette Austin Smith and Stephen Kotran. Vice Chancellor Laster donated his valuable time in a New York stand-alone meeting of this Task Force. A database is under construction.
- We kicked off the Revised Model Asset Purchase Agreement under the leadership of Ed Deibert and John Clifford. Drafting assignments have been allocated, and the work begins in earnest in Chicago.
- We launched the Task Force on Two-Step Auctions, chaired by Michael O'Bryan and Rick Alexander. The initiative will create a model form of tender offer agreement along the lines of what a public company seller might distribute at the beginning of an auction.
- In conjunction with the Business Law Section's Corporate Governance Committee, we are sponsors of a new Joint Task Force on Governance Issues in Business Combinations. Led by Diane Holt Frankle and Tricia Vella, we are producing a handbook providing an analytical framework, with practical examples, for identifying and dealing with governance issues commonly arising in the planning and implementation of business combinations.
- With the organizational efforts of Den White, we are kicking off the Task Force on Legal Project Management in Chicago. Increasingly, M&A lawyers are using, and general counsel are insisting upon, sophisticated project management methods. This Task Force will explore technologies and protocols to ensure

that nothing is dropped, that responsibilities are coordinated, and that deals progress smoothly.

- We have continued to sponsor and largely staff the speakers of the annual National Institute on Negotiating Business Acquisitions.
- We were supported by many sponsors over the last three years – including Appelby Global Group Services Limited, Duff & Phelps, Houlihan Lokey, J.P. Morgan Escrow Services, Merrill Datasite, Practical Law Company, Shareholder Representative Services, and Thomson Reuters Accelus. Their generous contributions have allowed us to feature our meetings at a price point more affordable to our members.
- All of these accomplishments have been ably tracked by our publication *Deal Points*, edited by Michael Reilly. Not an insubstantial task, having been involved in the final push to get this out before every meeting. Thanks to the many contributors of articles and reports. And our website, managed by George Taylor, has allowed our members timely access to materials between meetings.
- We have had fun. Networking has always been the code word for our conviviality. But in the end, it has been plain fun. We have continued to maintain a network through which Committee members can serve their clients by their ability to refer them to competent counsel personally known to them to meet their needs in any jurisdiction in the world.

Thanks to all of you who have chosen to give back to our profession through the Mergers & Acquisitions Committee. You have much to be proud of.

I am delighted that Mark Morton will succeed me as Chair following the Annual Meeting. His dedication to and involvement with the Committee has been unparalleled for many years. Please share your ideas with him. I look forward to the next three years of the Committee's growth and success under his leadership.

Leigh Walton
Chair

FEATURE ARTICLES

M&A Deal Structuring: Why Setoff Rights Matter

By Melinda Davis Lux¹

When negotiating M&A agreements, buyers and sellers focus heavily on indemnification provisions, escrows, and guaranties. In contrast, setoff rights usually receive much less attention. Yet setoff rights can provide buyers with significant deal protection.

Setoff rights give a buyer the right to set off amounts due from the seller – typically under the indemnification provisions in the purchase agreement – against payments that the buyer otherwise owes to the seller. Frequently, setoff rights are tied to the buyer's payment obligations under a promissory note or earn-out arrangement. Setoff rights give a buyer the right to withhold funds already held by the buyer. In that respect, setoff rights are more advantageous than an escrow arrangement.

To protect their clients, M&A attorneys need to be aware of the ramifications of the decision to include or not to include express setoff rights in a purchase agreement. If express setoff rights are not included in a purchase agreement, common law setoff rights may be available under equitable principles. Equitable setoff rights, however, are subject to the discretion of the courts and vary by state.

This article examines key court decisions in the M&A context involving setoff rights. This article also suggests lessons that M&A attorneys can learn from those decisions.

Express Setoff Rights

Very few cases address the enforceability of setoff rights in M&A purchase agreements. Those cases that address contractual setoff rights, however, generally

¹ Melinda Davis Lux is a member of the Wyche law firm in Greenville, SC. The views expressed are solely those of the author and do not necessarily represent the views of the firm or its clients.

find contractual setoff rights to be enforceable.²

For example, in *Centurion Air Cargo, Inc. v. United Parcel Service Co.*,³ United Parcel Service Co. (“UPS”) argued that it properly exercised its contractual rights under a purchase agreement by setting off liabilities resulting from a pre-closing litigation matter against amounts due to Centurion Air Cargo, Inc. (“Centurion”). UPS purchased substantially all of the assets of Centurion. Under the purchase agreement, Centurion retained liabilities arising from a pending action against Centurion in Costa Rica (the “Costa Rica litigation”). The purchase agreement further provided that Centurion would indemnify UPS for liabilities incurred by UPS as a result of the Costa Rica litigation.

At the closing, UPS and Centurion entered into a transition services agreement. Pursuant to the transition services agreement, UPS agreed to make monthly payments of \$871,518.00 to Centurion.

The purchase agreement expressly included setoff rights. Section 11.04 of the purchase agreement provided that if UPS obtained a final, nonappealable judicial order or binding arbitral decision in UPS’ favor that Centurion was obligated to indemnify UPS, UPS would have the right to offset the amount ordered or decided against amounts otherwise due by UPS to Centurion under the transition services agreement.

Moreover, the transition services agreement specifically contemplated that the setoff provision in the purchase agreement would apply to monthly payments under the transition services agreement. The transition services agreement provided that the monthly payments were not “subject to set-off, reduction, or claim of any kind, including without limitation pursuant to Section 11 of the Purchase Agreement, except as set forth in Section 11.04 of the Purchase Agreement.”⁴

² Contractual setoff rights are not available in bankruptcy proceedings. Courts have held that there is no “contract” exception to the mutuality requirement for the exercise of setoff rights in bankruptcy. See, e.g., *In re Lehman Brothers Inc.*, 458 B.R. 134 (Bankr. S.D.N.Y. 2011). In addition, there may be other special circumstances in which setoff rights are not available. For example, setoff rights may not be effective against the Federal Deposit Insurance Corporation or holders in due course of a note that has been in the possession of the Federal Deposit Insurance Corporation. See *D’Oench, Duhme & Co., v. FDIC*, 315 U.S. 447 (1942).

³ 420 F.3d 1146 (11th Cir. 2005).

⁴ *Id.* at 1150.

After the closing, the plaintiff in the Costa Rica litigation attached UPS’ Costa Rican assets and garnished UPS’ Costa Rican revenues. UPS obtained an arbitrator’s order requiring Centurion to post a bond in the amount of \$821,106.09 or any lesser amount that would dissolve the attachment and garnishment. Centurion failed to post the bond. In July 2002, when UPS’ monthly payment became due under the transition services agreement, UPS informed Centurion that it was setting off the amount of \$821,106.09 against the July payment. UPS then posted a bond in the Costa Rican court in the amount of \$821,106.09 in Centurion’s name.

Centurion filed suit against UPS for breach of contract based on UPS’ failure to make the July payment. The district court granted UPS’s motion for summary judgment, finding that UPS acted within its contractual rights under the purchase agreement in exercising its setoff rights.

Centurion appealed. The Eleventh Circuit stated that:

UPS must prove two things in order to offset an indemnity against its payments to Centurion without breaching the agreement: (1) that it obtained a “binding arbitral decision” against Centurion and (2) that the decision obligated Centurion to indemnify UPS.⁵

Centurion claimed that the arbitrator’s order was not a binding arbitral decision when UPS exercised its setoff rights because the order had not been confirmed by the district court. The Court rejected that argument and held that an arbitrator’s order does not require affirmation from a court to take effect.

The Court found that UPS proved both that it obtained a binding arbitral decision against Centurion and that the arbitrator’s decision obligated Centurion to indemnify UPS. As a result, the Court held that UPS acted within its contractual rights under the purchase agreement in exercising its setoff rights.

The *Centurion Air Cargo* decision is reassuring because it affirms the expectation that express setoff rights in purchase agreements are enforceable. However, like all contractual provisions, setoff rights must be thoughtfully drafted to provide meaningful protection.

⁵ *Id.* at 1149.

Drafting Setoff Rights: Don't Overlook Affiliates

When drafting setoff rights, M&A attorneys should analyze the scenarios in which their clients may want to assert setoff rights after closing. If setoff rights are not tailored to cover those specific scenarios, setoff rights may not be available when needed.

*Bichler v. DEI Systems, Inc.*⁶ illustrates this point. In *Bichler*, the Utah Supreme Court found that a corporation was not entitled to exercise setoff rights because an affiliate of the corporation, rather than the corporation, was the party to which setoff rights were granted in the purchase agreement.

The appellant in *Bichler*, DEI Systems, Inc. ("DEI"), entered into a lease agreement with one of its shareholders, Benedict Bichler. Pursuant to the lease agreement, Bichler leased real property to DEI. DEI made monthly rental payments to Bichler.

One year after Bichler and DEI entered into the lease agreement, DEI, Bichler, and David Bevan entered into a purchase agreement with Environmental Services Group, Inc. ("ESG"). Pursuant to the purchase agreement, ESG purchased 80% of the DEI shares owned by Bichler and Bevan. The purchase agreement provided that ESG had the right to set off amounts due to ESG, by Bichler and Bevan pursuant to the purchase agreement, against any amounts due and payable by ESG to Bichler and Bevan. Bichler and Bevan also entered into employment agreements with DEI at closing.

After the closing, DEI and ESG claimed that Bichler and Bevan breached their duties as officers of DEI, breached their employment agreements, and breached representations, warranties, and covenants in the purchase agreement. DEI and ESG sent letters to Bichler and Bevan demanding that Bichler and Bevan indemnify DEI and ESG for losses caused by those alleged breaches.

Next, DEI informed Bichler and Bevan that DEI was going to exercise its setoff rights under the purchase agreement and set off its losses caused by Bichler's and Bevan's breaches against rent due under the lease agreement. DEI then stopped paying rent to Bichler.

Bichler and Bevan filed an action seeking a declaratory judgment that they did not breach the purchase agreement and that they were not required to

indemnify DEI or ESG. In response, DEI and ESG asserted various counterclaims. DEI also asserted the right to set off losses caused by Bichler against rent owed by DEI to Bichler.

In addition, Bichler filed an action against DEI alleging unlawful detainer, under Utah law, resulting from DEI's failure to pay rent under the lease agreement. DEI asserted its right of setoff as an affirmative defense. Bichler moved for summary judgment, and the district court granted Bichler's motion. The district court found that DEI lacked a valid basis to assert a setoff claim because the setoff rights in the purchase agreement "did not belong to DEI, but rather to ESG."⁷

On appeal, the Utah Supreme Court held that DEI did not have contractual setoff rights. The Court reasoned:

DEI also argues that it has a contractual right of setoff under the terms of the Purchase Agreement. The Purchase Agreement entitles the "Purchaser" to "set-off against any payments due and owing to the Shareholders . . . any and all amounts that may become due and payable from time to time to Purchaser by the Shareholders pursuant to the terms of this Agreement . . ." The Purchase Agreement defines ESG as the "Purchaser" and Bichler and Bevans [sic] as the "Shareholders." DEI, Bichler, and Bevans [sic] are also identified collectively as the "Sellers." Nowhere does the Purchase Agreement define DEI as a "Purchaser." Thus, based on the plain language of the Purchase Agreement, DEI does not have a contractual right to setoff arising from amounts due to its breach. The right belongs solely to ESG as the "Purchaser."⁸

The lesson from the *Bichler* case is that contractual setoff rights, like other contractual provisions, will be interpreted as written unless there is an ambiguity. A buyer takes a risk when it exercises setoff rights if there is

⁷ *Id.* at 1206. The district court also held that DEI's setoff claim was not a proper counterclaim in an unlawful detainer action. *Id.*

⁸ *Id.* at 1207. The Court did find, however, that DEI had a valid basis for asserting equitable setoff rights for alleged breaches by Bichler of his employment agreement with DEI and alleged breaches of his fiduciary duties as a director of DEI. *Id.* at 1208.

any room for the seller to argue that the setoff provisions do not expressly give the buyer the right to assert setoff in that particular situation.

Bichler also serves more specifically as a reminder to M&A attorneys to carefully consider the parties to which setoff rights are granted. In M&A transactions, the buyer, the seller, affiliates of the buyer, and affiliates of the seller often enter into various agreements to evidence both closing and post-closing arrangements. When feasible, setoff rights should be expressly available to both the buyer and all of the buyer's affiliates that will make post-closing payments to the seller or its affiliates.

M&A attorneys should also devote attention to other nuances of contractual setoff rights. For example:

- Does the buyer have the right to set off against any payment owed to the seller or the seller's affiliates? Or is setoff limited to specific payments, such as promissory note payments, earnout payments, or rent payments?
- Is the buyer required to satisfy procedural hurdles, such as obtaining a court order or arbitration order, before the buyer is entitled to exercise setoff rights?
- Does the buyer have to exercise setoff rights against certain obligations, such as promissory note payments, before the buyer can exercise setoff rights against other obligations, such as rent payments?
- What notice is the buyer required to provide to the seller?
- If there are multiple sellers and indemnification is pro rata, is the buyer required to assert setoff rights pro rata against the sellers?
- Are setoff rights tied to the seller's breach of specific provisions of the purchase agreement or more generally to the seller's indemnification obligations? Do damages flowing from the seller's breach of other closing agreements trigger the buyer's right to exercise setoff?
- Is setoff the buyer's exclusive remedy?

When these questions are specifically addressed in the purchase agreement, the buyer is more likely to be on solid footing if the need to exercise setoff rights arises after closing.

Equitable Setoff Rights

When express setoff rights are not negotiated in the purchase agreement, the buyer may nevertheless be entitled to exercise equitable setoff rights. Foregoing contractual setoff rights and relying on equitable setoff rights, however, is a risky strategy.

Under general principles of equity, courts have the discretion to allow setoff. Absent state statutes that provide for setoff, setoff is a matter of equity. Equitable setoff is based on the principle that when two parties owe debts to each other and one party brings an action against the other, the debts should be set off against each other and only the balance should be recovered.⁹

The common law of setoff varies from state to state. Depending on state law, equitable setoff rights usually are available only if there is mutuality of debts and parties. Obligations that arise from different transactions or between parties acting in different capacities may not be considered mutual.¹⁰ In contrast, when contractual setoff rights exist, mutuality is not required. Parties can freely negotiate contractual setoff rights that differ from setoff rights under common law or statute.

As a procedural matter, equitable setoff rights must be asserted as a counterclaim to offset a plaintiff's claim and not as a defense.¹¹ A party may only assert equitable setoff rights as a reduction to an amount otherwise owed.¹² A party may not use setoff rights to recover affirmatively.¹³

This practical difference between express setoff rights in a purchase agreement and equitable setoff rights is illustrated by *Automated Print, Inc. v. Edgar*.¹⁴ In *Automated Print*, Randolph Edgar sold all of the stock of Automated Print, Inc. ("Automated Print") to William Barney. At the closing, Automated Print delivered two promissory notes to Edgar. Barney personally guaranteed the promissory notes.

Paragraph 2.9 of the stock purchase agreement provided that if Larry Cochran, one of Automated Print's

9 80 C.J.S. Set-off and Counterclaim § 5 (2000).

10 *Id.*

11 20 Am. Jur. 2d Counterclaim, Recoupment, Etc. § 6 (2005).

12 *Id.*

13 *Id.*

14 654 S.E.2d 413 (Ga. App. 2007).

account representatives, left Automated Print within 12 months following the closing and one or more specified key accounts was lost to Mr. Cochran's new employer, the principal balance of the promissory notes would be reduced by an amount determined by a formula. The promissory notes expressly stated that Automated Print had setoff rights as set forth in the stock purchase agreement.

Automated Print failed to make some of the promissory note payments, and Edgar sued Automated Print and Barney for unpaid principal and interest. Automated Print and Barney filed a joint answer in which they denied owing the amount claimed in the complaint. They did not assert any counterclaims or defenses except the "failure to state a claim."¹⁵

In its discovery responses, Automated Print admitted that it executed the promissory notes and failed to make payments when they came due. Automated Print argued, however, that it was entitled to recalculate the amount due under the notes pursuant to paragraph 2.9 of the stock purchase agreement.

The court granted summary judgment for Edgar on the issue of liability and reserved the issue of damages for trial. At trial, the court excluded any evidence relating to setoff pursuant to the purchase agreement. The court held that Automated Print waived the argument relating to setoff by failing to assert setoff as a counterclaim in its answer.

The jury returned a verdict against Automated Print for \$76,054 in principal, \$36,444 in interest, and attorneys' fees. Automated Print appealed.

The Georgia Court of Appeals held that the trial court erred in excluding from trial evidence relating to setoff. The court found that "[t]he parties' intent in including paragraph 2.9 was to allow for a reduction in price under a particular specified circumstance, not to provide for a "set-off" as the term is defined by Georgia law."¹⁶ In essence, the court found that Automated Print's setoff rights were contractual setoff rights, not equitable setoff rights. As a result, the court held that Automated Print was not required to plead its setoff rights as a counterclaim.

Automated Print illustrates that asserting equitable setoff rights can be subject to procedural pitfalls. The court's decision in *Automated Print* implies that if Automated Print's setoff rights had been based in equity, the evidence relating to setoff would have been properly excluded at trial because equitable setoff rights must be asserted as a counterclaim. Contractual setoff rights, in contrast, are more easily asserted. Moreover, contractual setoff rights can be drafted more broadly than equitable setoff rights.

Conclusion

M&A attorneys should include express setoff rights in the menu of deal protections that buyers consider requesting from sellers. When a buyer chooses that option, the buyer's attorney must take care to tailor the setoff rights to expressly apply to the situations in which the buyer is most likely to assert them. If the buyer chooses not to pursue contractual setoff rights, the doctrine of equitable setoff can be utilized when state common law requirements are met. Equitable setoff rights, however, should not be relied upon as a substitute for contractual setoff rights.

* * *

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15 *Id.* at 415.

16 *Id.* at 416.

Structuring Going Private Transactions with Controlling Stockholders: Rival Standards of Review

By Matthew B. Farber¹

For more than a decade, the Delaware courts have struggled to craft the appropriate standard of review for going private transactions with a controlling stockholder. Going private transactions that involve freezeouts, in which the controlling stockholder cashes out the minority stockholders, raise fundamental questions about fairness and conflicts of interest. Historically, Delaware courts have employed different standards of review in scrutinizing going private transactions, depending on the transaction's structure and on whether it was negotiated: (i) the entire fairness standard of review for negotiated transactions, which typically involve one-step, long-form mergers ("cash-out mergers") and (ii) the business judgment rule for non-negotiated, non-coercive tender offers accompanied by proper disclosure, which are followed by short-form mergers ("tender-offer freezeouts").² Many commentators were concerned that this arrangement treated transactions with different means, but the same ends, inharmoniously. Debate ensued on whether these transactions should be subject to robust scrutiny

regardless of the transaction's structure.³

Seeking to reconcile these dichotomous standards, Vice Chancellor Laster of the Delaware Chancery Court, in *In re CNX Gas Corporation Shareholders Litigation*, reviewed a tender-offer freezeout under a standard that had been proposed but never applied,⁴ which would merge the standards into a "unified standard."⁵ *CNX Gas* departed from well-established precedent. Nevertheless, the Delaware Supreme Court, after the Court of Chancery's grant of an application by the defendants for the certification of an interlocutory appeal, declined to take up the issue on appeal. As Vice Chancellor Laster recognized, the *CNX Gas* decision conflicted with *In re Cox Radio Inc. Shareholders Litigation*,⁶ a decision that followed the *Pure Resources* line of cases and was decided the same month as *CNX Gas*.⁷ This resulted in a split of authority, each line of cases requiring different safeguards for minority

¹ Mr. Farber practices law in the Chicago, Illinois, office of Winston & Strawn LLP. The views expressed are solely those of the author and do not necessarily represent the views of the firm or its clients. Mr. Farber is formerly the Editor-in-Chief of the *Loyola University Chicago Law Journal*, volume 42; J.D. magna cum laude, Loyola University Chicago School of Law, 2011; B.A. Wheaton College, 2007.

² See *In re Pure Resources, Inc. S'holders Litig.*, 808 A.2d 421 (Del. Ch. 2002); *Glassman v. Unocal Exploration Corp.*, 777 A.2d 242 (Del. 2001); *In re Siliconix Inc. S'holders Litig.*, 2001 WL 716787 (Del. Ch. June 21, 2001). See also *In re Home Shopping Network Inc. S'holders Litig.*, C.A. No. 12868 (Del. Ch. Jan. 24, 1993) ("A tender offer does not require the appointment of a special committee as it is deemed a transaction directly between the acquisition group and individual stockholders. A negotiated merger transaction between the acquisition group and the company, however, will generally require the appointment of a special committee of independent directors where the acquisition group includes executives or directors of the company."). The threshold issue is whether the target company *negotiates and agrees* to the transaction. When there is a bargain, the controlling stockholder has the opportunity to leverage its influence, and consequently allows the target board to extract value on behalf of the minority stockholders.

³ Concerning those who argue that tender-offer freezeouts do not pose the same risks as a cash-out merger, see Jon E. Abramczyk, Jason A. Cincilla, & James D. Honaker, *Going-Private Dilemma? Not in Delaware*, 58 Bus. LAW. 1351 (2003). For those who contend they pose similar risks, see Kimble C. Cannon, *Augmenting the Duties of Directors to Protect Minority Shareholders in the Context of Going-Private Transactions: The Case for Obligating Directors to Express a Valuation Opinion in Unilateral Tender Offers after Siliconix, Aquila and Pure Resources*, 2003 COLUM. BUS. L. REV. 191 (2003).

⁴ *In re Cox Commc'n, Inc. S'holders Litig.*, 879 A.2d 604, 607 (Del. Ch. 2005).

⁵ *In re CNX Gas Corp. S'holders Litig.*, 4 A.3d 397, 400 (Del. Ch. 2010).

⁶ *Cox Commc'n*, 879 A.2d 604.

⁷ The Delaware Supreme Court also denied interlocutory relief in *In re Cox Radio Inc. Shareholders Litigation*.

stockholders.⁸ How, then, given this split of authority, should transactional lawyers structure freezeouts?

When advising clients in the face of these competing standards, deal lawyers should, at the very least, use the traditional procedural mechanisms that simulate an arm's-length negotiation with a third party. A more cautious approach would be to prepare to meet the unified standard unless the attendant risks outweigh the costs of proving entire fairness in court. The subsequent sections of this article explain the traditional and unified standards of review and provide a short analysis of their comparative advantages.

Going Private Transactions and Controlling Stockholders

A going private transaction with a controlling stockholder is a transaction whereby a controlling stockholder acquires all of a public company's outstanding shares that it does not already own. To accomplish this, the minority stockholders' equity interests in the corporation are cashed out. When a company reduces its stockholder base to fewer than 300 stockholders, the company can terminate its public company status and reporting obligations.

Under Delaware law, a controlling stockholder is a person or entity that owns more than 50% of a

corporation's voting power, or exercises control of the business and affairs of a corporation.⁹ Because of the controlling stockholder's leverage, controlling stockholders might seek private benefits at the expense of minority stockholders. Consequently, controlling stockholders owe fiduciary duties to minority stockholders; however, the standard of review that applies to a going private transaction with a controlling stockholder depends on the transaction type.¹⁰

Traditional Standards of Review for Controlled Going Private Transactions

Cash-Out Mergers

In a going private transaction with a controlling stockholder structured as a cash-out merger, the controlling stockholder negotiates directly with the target board and requires stockholder approval to consummate the merger. These transactions usually follow the typical merger format, such as that provided for under Section 251 of the General Corporation Law of the State of Delaware ("DGCL"), permitting long-form mergers with the approval of a majority of the outstanding voting power of the stockholders.¹¹ The controlling stockholder first forms a merger subsidiary. A merger agreement is then approved by the boards of directors of each of the target company and merger subsidiary, and is thereafter adopted by the holders of at least a majority of the voting power of the stockholders of each such constituent corporation. When an entity has a controlling stockholder, this approval may be a formality, because of the controlling stockholder's control over the voting power of the target corporation.¹² With stockholder approval, the merger subsidiary typically is merged with and into the target corporation, leaving the latter as the surviving corporation and the controlling

⁸ Recent cases that have followed the unified standard, albeit in transactions different from that considered in *CNX Gas*, include *Reis v. Hazelett Strip-Casting Corporation*, 2011 WL 303207 (Del. Ch. Jan. 21, 2011) and *Krieger v. Wesco Financial Corporation*, C.A. No. 6176-VCL (Del. Ch. May 10, 2011) (transcript). In *Reis v. Hazelett Strip-Casting Corporation*, the CEO and controlling stockholder froze out minority stockholders with a reverse stock split. The transaction was completed without procedural protections, such as an independent special committee or a majority of the minority approval. Vice Chancellor Laster reviewed the transaction under the entire fairness standard and concluded that the transaction was not entirely fair, while noting that the transaction could have avoided the entire fairness standard of review if certain procedural protections had been employed, pursuant to *CNX Gas*. Similarly, in the transcript decision of *Krieger v. Wesco Financial Corp.*, Vice Chancellor Laster denied a motion to enjoin a contemplated merger between Berkshire Hathaway Inc. and its subsidiary, Wesco Financial Corporation. The Court held that it would review the proposed merger under the unified standard, as set out in *CNX Gas*. In denying the motion, the Court held that both prongs of the unified standard were met—approval by an independent special committee and subject to a non-waivable majority-of-the-minority voting condition. Importantly, however, *CNX Gas* is the only case in which the Delaware Court of Chancery applied the unified standard to a non-negotiated transaction.

⁹ It is important to note that a stockholder lacking majority control is not a controlling stockholder unless he or she has "such formidable voting and managerial power that [the stockholder], as a practical matter, [is] no differently situated than if [the stockholder] had majority voting control." *In re PNB Holding Co. S'holders Litig.*, 2006 WL 2403999 (Del. Ch. Aug. 18, 2006).

¹⁰ *Kahn v. Lynch Comm'n Sys., Inc.*, 638 A.2d 1110 (Del. 1994).

¹¹ The General Corporation Law of the State of Delaware is codified at 8 Del. C. §§101 *et seq.*

¹² When the controlling stockholder has less than a majority of the outstanding voting power, the approval is not guaranteed, but the controlling stockholder certainly has an advantage in obtaining approval.

stockholder as its sole stockholder (reverse triangular mergers are common to avoid due diligence issues, such as third-party consents). In connection with the merger, minority stockholders receive the merger consideration or, if available, seek appraisal rights. Because a controlling stockholder may have the power and influence to cause a going private transaction to occur, the possibility of self-dealing exists, which could lead to the potential for abuse of minority stockholders.¹³

Because of this potential for unfairness, the Delaware Court of Chancery has historically reviewed cash-out mergers under the entire fairness standard, requiring the directors to prove fair dealing and fair price.¹⁴ Underlying the adoption of the entire fairness standard is the view that the court's substantive entire fairness review is necessary to ensure minority protection. The controlling stockholder and board of directors have some refuge, however. By utilizing one of two procedural protections for minority stockholders, either of which is sufficient, they can shift the burden of proving entire fairness to the plaintiff.¹⁵

The first mechanism for shifting this burden involves the negotiation of the transaction by a special committee of independent and disinterested directors.¹⁶ When this committee approves the transaction and the court finds that the process reflects an arm's-length negotiation and that the committee had "real bargaining power,"¹⁷ the burden shifts. To mirror an arm's-length negotiation, these directors should be fully informed,

have the capacity to hire independent financial and legal counsel at the company's expense, have a clear mandate defining the special committee's responsibility and authority and otherwise be fully-functioning.¹⁸ The special committee's requisite authority arguably ends there; it may not necessarily need the authority to bind the corporation, seek alternate transactions or employ a stockholder rights plan.¹⁹

Second, the board can also seek the ratification of the transaction by subjecting it to a non-waivable majority of the outstanding minority stockholders' approval condition ("majority of the minority"). Such a procedural protection is only effective if the vote is non-coerced and the board provides the minority stockholders with all the material facts relevant to the transaction.

Even when both of these procedural protections are utilized, the defendant still cannot escape the strictures of the entire fairness review (*"Kahn v. Lynch* standard").²⁰ It does, however, make the plaintiff's burden—the burden of showing that the price or dealings were unfair—more difficult.²¹

Tender-Offer Freezeouts

An alternative vehicle for a controlling

¹⁸ *Rabkin v. Olin Corp.*, C.A. No. 7547 (Del. Ch. Apr. 17, 1990), *aff'd on other grounds*, 586 A.2d 1202 (Del. 1990); *Kahn*, 638 A.2d at 1117; *In re Southern Peru Copper Corp. S'holders Litig.*, 30 A.3d 60, 89 (Del. Ch. 2011).

¹⁹ In recent years, however, there has been a trend toward requiring more vibrant committee authority. See *In re Pure Resources, Inc. S'holders Litig.*, 808 A.2d 421 (Del. Ch. 2002) (holding that a special committee's performance must reflect an arm's-length negotiation, and that the committee should consider implementing a shareholder rights plan).

²⁰ *Kahn*, 638 A.2d at 1117 ("An approval of the transaction by an independent committee of the directors or an informed majority of the minority stockholders shifts the burden of proof on the issue of fairness from the controlling or dominating stockholder to the challenging stockholder-plaintiff."). *Weinberger*, 457 A.2d at 711 ("[T]he test for fairness is not a bifurcated one as between fair dealing and price. All aspects of the issue must be examined as a whole since the question is one of entire fairness."). *Id.*

²¹ *Emerald Partners v. Berlin*, 787 A.2d 85, 95 n.63 (Del. 1999). But the *Lynch* standard "makes it impossible for a controlling stockholder to structure a going private merger in any fashion that will enable a successful attack on a complaint that alleges financial unfairness on a notice pleading basis." *Cox Commc'n's*, 879 A.2d at 605. The jurisprudence prioritizes the protection of minorities at the expense of some directorial and majority power.

¹³ "[T]he rationale for imposing the 'entire fairness' burden is that in a self-dealing transaction, the minority stockholders' interests are not being adequately safeguarded because the fiduciaries charged with protecting the minority have a conflicting self-interest." *Pinson v. Campbell-Taggart, Inc.*, 1989 WL 17438 (Del. Ch. Feb. 28, 1989).

¹⁴ *Weinberger v. UOP, Inc.*, 457 A.2d 701, 711 (Del. 1983). Fair dealing "embraces questions of when the transaction was timed, how it was initiated, structured, negotiated," while fair price relates to the "economic and financial considerations of the proposed merger and all relevant factors: assets, market value, earnings, future prospects, and any other elements that affect the intrinsic or inherent value of a company's stock." *Id.* Moreover, "the test for fairness is not a bifurcated one as between fair dealing and price." *Id.*

¹⁵ *Kahn*, 638 A.2d at 1117 ("An approval of the transaction by an independent committee of the directors or an informed majority of the minority stockholders shifts the burden of proof on the issue of fairness from the controlling or dominating stockholder to the challenging stockholder-plaintiff.").

¹⁶ *Id.* at 1120-21.

¹⁷ *Kahn v. Tremont*, 694 A.2d 422, 429 (Del. 1997).

stockholder to take a company private is through a tender offer followed by a short-form merger under Section 253 of the DGCL.²² Under this approach, the controlling stockholder bargains directly with the minority stockholders by announcing a tender offer. Unlike a cash-out merger, the controlling stockholder unilaterally controls the offering price and avoids both a board negotiation and a stockholder vote. Here, the stockholders, not the court, decide whether the price and process are fair. If the controlling stockholder gains 90% voting control of the target through its tender offer, then it can freeze out the non-tendering stockholders through a short-form merger. If 90% voting control is not achieved, and the controlling stockholder negotiates with the target board to exercise a top-up option, the transaction would no longer fit the non-negotiated construct sanctioned under *Pure Resource* and would accordingly be reviewed under the entire fairness standard.

The business judgment rule is available for tender-offer freezeouts when two procedural safeguards are employed. These safeguards include sufficient disclosure and a non-coercive tender offer, which means it is:

- 1) Subject to a non-waivable majority of the outstanding minority tender condition;
- 2) The controlling stockholder promises to consummate a prompt short-form merger at the same price if it gains more than 90% of the shares;
- 3) The controlling stockholder has made no retributive threats; and
- 4) The controlling stockholder must provide the special committee sufficient time to consider and recommend the tender offer, including time to seek guidance from independent financial and legal counsel.²³

Full disclosure for tender offers requires all information that a reasonable investor would consider important when considering whether to tender stock.²⁴

If adequate information is not provided, or if the tender offer is coercive, the target board assumes the burden of proving that the transaction was entirely fair.

The rationale underlying the disparate treatment of cash-out mergers and tender-offer freezeouts is that stockholders in tender-offer freezeouts, unlike stockholders in cash-out mergers, can refuse to tender. Recently, however, a competing line of cases challenges this rationale and unifies the standards.

The Unified Standard for Cash-Out Mergers and Tender-Offer Freezeouts

Under the unified standard, which Vice Chancellor Laster applied in *CNX Gas*, the Court will not enjoin a deal, and the business judgment standard will apply, if a:

- 1) Fully empowered special committee of independent and disinterested directors affirmatively recommends the transaction, and the
- 2) Majority of the minority of stockholders approve the transaction in a non-waivable vote that preserves the minority stockholders' negotiating leverage (for cash-out mergers), or the transaction is conditioned on a non-waivable affirmative tender of a majority of the minority shares (for tender-offer freezeouts).²⁵

Concerning the latter element, the Court in *CNX Gas* frowned on a pre-tender lock-up agreement between the controlling stockholder and a significant portion of the minority stockholders. The Court reasoned that the agreement decreased the minority stockholders' leverage in negotiations because the majority-of-the-minority provision was then likely to succeed.

Fully Empowered Special Committees

In *CNX Gas*, the Court spoke at length about the requisite authority of a special committee, signaling that it must have "authority comparable to what a board would

²² *Pure Resources*, 808 A.2d 421; *Glassman v. Unocal Exploration Corp.*, 777 A.2d 242 (Del. 2001); *In re Siliconix Inc. S'holders Litig.*, 2001 WL 716787 (Del. Ch. June 19, 2001).

²³ *Pure Resources*, 808 A.2d at 445.

²⁴ *Id.* at 449.

²⁵ *CNX Gas Corp.*, 4 A.3d at 413. The unified standard was first proposed by Vice Chancellor Strine in the 2005 case of *In re Cox Communications*. 879 A.2d 604 (Del. Ch. 2005). The unified standard has subsequently been applied in *Krieger v. Wesco Financial Corporation*, C.A. No. 6176-VCL (Del. Ch. May 10, 2011) (transcript) (requesting a motion for preliminary injunction to enjoin a proposed merger).

possess in a third-party transaction.”²⁶ Presumably, a properly empowered special committee would have the following attributes:

- **Negotiation Tools.** The board should endow the special committee with the authority of a similarly situated board of directors in third-party transactions. This includes having the power to consider alternative transactions and to deploy defensive measures, such as commencing litigation against the controlling stockholder or a poison pill.
- **Engagement of Legal and Financial Advisers.** The special committee should engage independent financial and legal advisers at the target company’s expense.
- **Replicate Arm’s-Length Negotiations.** The special committee should have adequate time to evaluate the offer and negotiate with the controlling stockholder.
- **Independence.** Directors must not be interested, meaning they cannot stand on both sides of the transaction or gain private benefits at the expense of minority stockholders. Directors must also be independent, which means they cannot base their decisions on extraneous considerations or influences.
- **Membership.** Best practices suggest that special committees should have more than a single member, because “when a special committee is comprised of only one director, Delaware courts have required the sole member, ‘like Caesar’s wife, to be above reproach.’”²⁷

Summary and Analysis

The recent evolution of Delaware jurisprudence on going private transactions has significant implications for practitioners. The unified standard, if sanctioned

by the Delaware Supreme Court, would allow legal practitioners engaging in negotiated cash-out mergers to benefit from the protections of the business judgment rule, a benefit that was unavailable under *Kahn v. Lynch*.

But the unified standard would also add a menu item to the requirements of a tender-offer freezeout—namely, to negotiate with and get approval from independent and disinterested directors.²⁸ Adding this condition reduces transactional certainty and speed. The controlling stockholder also potentially forfeits the capacity to acquire control directly from stockholders if the merger talks collapse.

Until the Delaware Supreme Court either rejects or sanctions the unified standard, prudent deal lawyers should prepare to meet the unified standard unless the need for deal certainty outweighs the costs of proving entire fairness. If this need does outweigh the risk of litigation exposure, deal lawyers might instead focus on ensuring a fair process and price to improve the defendant’s prospects at trial. After all, both the traditional and unified standards seek to ensure that the controlling stockholder stands on only one side of the transaction—the buyer’s side—but the unified standard will give deference when the process simulates an arm’s-length third-party transaction.²⁹

* * *

26 *CNX Gas*, 4 A.3d at 414.

27 *Gesoff v. IIC Indus.*, 902 A.2d 1130, 1146 (Del. Ch. 2006) (“The court necessarily places more trust in a multiple-member committee than in a committee where a single member works free of the oversight provided by at least one colleague. But, in those rare circumstances when a special committee is comprised of only one director, Delaware courts have required the sole member, ‘like Caesar’s wife, to be above reproach.’”). See generally Antony Page, *Unconscious Bias and the Limits of Director Independence*, 2009 U. ILL. L. REV. 237 (2009).

28 This assumes the Delaware Supreme Court would effectively overturn *Kahn v. Lynch* in order to adopt the unified standard.

29 *CNX Gas*, 4 A.3d at 413, n.8.

TASK FORCE REPORTS

Joint Task Force on Governance Issues in Business Combinations

Our Task Force is preparing a handbook on the governance issues that arise in business combination transactions. We met in Las Vegas and discussed the handbook outline in detail, taking further comments on topics and order of the chapters. We then talked about the status of the assignments for the handbook chapters and the timetable for the handbook. It was noted that we have already received several draft outlines of chapters.

The Task Force then discussed three of the chapter outlines—Chapter 2: Fiduciary Duties of Directors Generally in a Business Combination (prepared by Jamie Snelson and John Houston from Fredrikson and Byron), and Chapters 9 and 10: Formation of Special Committee and Special Committee Process Issues (prepared by Steve Haas from Hunton & Williams and Lewis Lazarus from Morris James). The authors reviewed their approach and substantive points in the chapters and task force members provided detailed comments on each.

We already have nine chapters in draft form and have distributed these drafts to all Task Force members. There are four chapters left without an author volunteer, and we are looking for authors to complete our assignments. In addition, there are many other opportunities to join a drafting team or provide other input to this important and exciting project.

Our next meeting is in Chicago at the ABA Annual Meeting on August 3, from 3:00 p.m. until 4:30 p.m. (Central Time). At our meeting, we will be discussing several pending chapter outlines, including Chapter 3: Spotting and Anticipating Conflicts and Chapter 8: Governance Issues in the Negotiation of NDA and Standstill. It is likely that we will have later drafts of these two outlines circulated closer to the meeting and we plan to have copies available at the meeting for discussion. We hope you will join us to discuss the issues raised by these chapters, as our group discussion enriches the drafting immeasurably and we value your experience and input. If you would like copies of the current drafts of the chapter

outlines or the handbook outline, please contact any of the Co-Chairs. Please join us in Chicago!

Diane Holt Frankle
Michael Halloran
Larry Hamermesh
Patricia O. Vella
Co-Chairs

Task Force on Financial Advisor Disclosures

The Task Force on Financial Advisor Disclosures has undertaken multiple initiatives during the first-half of 2012. Below is a review of our key activities and a preview of our upcoming meeting at the ABA Annual Meeting.

We were fortunate to be joined by the Honorable J. Travis Laster at our first stand-alone meeting in April 2012. The Vice Chancellor presented his views, and engaged in discussion with attendees, regarding disclosures of financial analysis in the context of M&A transactions. After receiving numerous requests (and with the permission of the Vice Chancellor), the Task Force has prepared a written summary of the meeting. This summary is available on the Task Force website. (<https://apps.americanbar.org/dch/committee.cfm?com=CL560045&edit=0>).

In June 2012, members of the Task Force presented at the meeting of the Acquisitions of Public Companies Subcommittee in Wilmington, Delaware. There was an excellent discussion, led by Eric Wilensky (Morris Nichols) and Brad Davey (Potter Anderson), of *Skeen versus Pure Resources*, as a framework to compare and contrast disclosure requirements under Delaware law. The group, which included judges from the Delaware Supreme Court, also discussed various impacts of the current disclosure debates on M&A deal-making. A copy of the presentation used in connection with this discussion is available on the Task Force website. Eric also updated the compendium of Delaware disclosure cases he presented in February at Laguna Beach. This update is also available on the Task Force website.

Our Task Force will meet during the ABA Annual Meeting. Our Task Force is scheduled to meet on August 4, from 9:30 a.m. until 10:30 a.m. (Central Time). We will review industry and caselaw updates, discuss multiple

possible collaboration opportunities with Bloomberg Law, and plan our upcoming meetings. We hope you are able to join us in Chicago.

Stephen M. Kotran
Yvette Austin Smith
Co-Chairs

Task Force on Legal Project Management

The Task Force on Legal Project Management will hold a kick-off organizational meeting in conjunction with the ABA's Annual Meeting in Chicago. The Task Force meeting is scheduled for August 4, from 10:00 a.m. until 11:00 a.m., in the Denver Room, 5th Floor, of the Chicago Marriott Downtown. A strong contingent of private practitioners and general counsel have already signed up to attend.

The Task Force meeting is a follow-up to a Committee Forum on Legal Project Management at the February stand-alone meeting of the M&A Committee in Laguna Beach. That Forum featured Task Force Co-Chairs Dennis J. White of Verrill Dana, LLP and Bryon S. Kalogerou of McDermott Will and Emery LLP, along with Aileen Leventon, Esq., President of QLex Consulting.

The Forum highlighted the extent to which general counsel and other sophisticated purchasers of legal services are insisting that their outside counsel implement LPM tools and approaches to enable them to work together more effectively and efficiently.

It is envisioned that the LPM Task Force will among other things:

- Develop "deliverables" such as an "intelligent engagement letter" and task-based checklists as companions to the Committee's model agreements;
- Develop post-closing report methodologies and forms to promote continuous feedback and improvements;
- Survey LPM software tools, literature, and other resources; and
- Survey best LPM practices being adopted by firms around the world

We look forward to seeing you in Chicago. If you cannot attend but are interested in joining private practitioners and general counsel who have already expressed an interest in this exciting and path-breaking Task Force, please contact the co-chairs Den White (dwhite@verrilldana.com) or Byron Kalogerou (bkalogerou@mwe.com).

Den White
Byron Kalogerou
Co-Chairs

Task Force on the Revised Model Asset Purchase Agreement

The Task Force on the Revised Model Asset Purchase Agreement, now known as MAPA2, had its second meeting during the Business Law Section meetings in Las Vegas. We continue to be excited by all of the interest of people to work on the project.

At the meeting, we continued to discuss how to structure drafting of the agreement and to start enlisting people to volunteer on small working groups on various sections. We've now assigned all of the people who have volunteered at this point to the small working groups. It is not too late if anyone is still interested in helping out. Just send me an email at Edward.Deibert@aporter.com and we can get you added to a working group.

In Chicago, we will be meeting August 5, from 10:00 a.m. until 11:30 a.m., in the McHenry Room, 3rd Floor of the Chicago Marriott Downtown. At our meeting, we will be receiving reports from the various small working groups. We will then have a presentation led by Jeff Litvak and Basil Imburgia of FTI Consulting on accounting disputes in acquisition transactions.

Hope you can join us.

Ed Diebert
Chair

* * *

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SUBCOMMITTEE REPORTS

Acquisitions of Public Companies Subcommittee

We had a great meeting in March during the Spring Meeting in Las Vegas. Rick Alexander led a discussion on the *El Paso* and *Compellent* decisions from the Court of Chancery. Rick Climan and Mark Morton, both of whom were involved in the *Compellent* transaction, also provided commentary from their perspectives as deal counsel in that transaction. We had a very good discussion.

In May, our Subcommittee made its annual trip to Delaware to meet with the members of the Delaware judiciary. We began our weekend with a wonderful dinner on Friday evening at the Wilmington Club, which was attended by the Delaware Secretary of State, the entire Delaware Supreme Court, members of the Court of Chancery, and members of the Delaware Superior Court. 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. This year's hypothetical involved some interesting issues that can arise in a sale process involving a public company target. Special thanks to Tricia Vella for drafting a thought-provoking hypo for the meeting, and to John Hughes, Ed Deibert, Steve Bigler, and Mark Morton for participating in the panel. Following our discussion with the Delaware judiciary, Steve Kotran moderated a panel with Eric Wilensky, Brad Davey, and Yvette Austin Smith focusing on judicial developments in Delaware concerning disclosures of the financial advisor's analysis in sale transactions, as well as certain issues faced by counsel for buyers, targets, and financial advisors in responding to increased stockholder litigation in this area. 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 coordinating the meeting with the members of the Delaware judiciary and for hosting our evening at the Wilmington Club, 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 what has come to be the highlight of the year for the Subcommittee.

Our Subcommittee meeting is currently scheduled to be held on August 4, from 12:30 p.m. until 2:30 p.m., in the Chicago Ballroom E, 5th Floor, of the Chicago Marriott Downtown. During our meeting, Jim Walther, Keith Flaum, and Steve Bigler will be leading a discussion on recent developments involving confidentiality agreements in public company acquisitions, and discussing the recent decisions in the *Vulcan* and *RAA* litigation and how those decisions from Delaware impact certain provisions traditionally found in those agreements. We will also hear from the leaders of our various Task Forces – Financial Advisor, Governance Issues in Business Combinations, and the Two-Step Task Force – as to the status of their projects.

Our Subcommittee dinner during our Chicago meeting will be held on August 3, at Gibson's Steakhouse. Cocktails begin at 7:00 p.m., with dinner starting at 7:30 p.m. We hope to see many of you there.

Jim Griffin
Chair

Hal Leibowitz
Vice Chair

International M&A Subcommittee

The International M&A Subcommittee met on Friday, March 23, 2011, in connection with the Spring Meeting of the Business Law Section in Las Vegas.

Euro Crisis

Steve Kotran of Sullivan & Cromwell, New York, introduced his London partner Tim Emmerson who gave a presentation by telephone on the Euro Crisis - An M&A Lawyer's Perspective.

Reports on Current Subcommittee Projects

Daniel Rosenberg of Speechly Bircham, London, gave a short summary of the current state of play on the Subcommittee's *Public Company Takeovers Project* he is leading with Franziska Ruf of Davies Ward Phillips & Vineberg, Montréal.

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.

Frank Picciola of Heenan Blaikie, Montréal, summarized the progress of the Subcommittee's *Foreign Direct Investment Survey Project*.

Measures of Damages in Domestic US and International Transactions

Glenn West, of Weil Gotshal, Dallas, and Hermann Knott of Luther, Cologne gave a panel discussion on "Consequential, Special, Incidental, Direct, General, Actual and Compensatory Damages: What Are They and Who Gets Them," which was followed by a Q&A session.

Programs and Projects

The following subjects were proposed as possible topics:

- Jim Walther of Mayer Brown, Los Angeles, described a previous suggestion by Jim Doub of Miles & Stockbridge, Baltimore, for a program on issues relating to cross-border privilege and proposed that it be presented at the next Subcommittee meeting.
- Jim Walther also mentioned his previous suggestion of a program on director liability issues after the deal is done: You're not in Kansas (London, Toronto) Anymore.
- Freek Jonkhart suggested a program on the increasing use in European private company M&A of agreements without closing balance sheet price adjustment mechanisms, commonly referred to as "lock box" agreements.
- Daniel Rosenberg suggested a program on tax structuring in M&A, using jurisdictions such as Luxembourg and The Netherlands.
- Iain Scott of McCarthy Tétrault, Montréal, suggested a program on directors issues during cross-border deals.
- Jörg Lips of CMS Hasche Sigle, Leipzig, suggested a program on warranty insurance in M&A deals, a topic proposed by Kimmo Mettälä of Krogerus, Helsinki at an earlier meeting.

Other suggestions remaining on the agenda from earlier meetings were:

- Employment law impacts on M&A transactions before, during, and after the deal is done.
- Cross-border distressed company acquisitions.
- The use of MAC clauses in different jurisdictions.
- CIFIUS and/or FCPA issues.
- Changes in the UK Takeover Code/comparison with developing US (and other) takeover practice.
- 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.).
- Return of nationalization risk in cross-border M&A.
- International comparison of disclosure requirements and restrictions on "stake-building."

Current Developments Discussion

The meeting concluded with our customary general discussion by Subcommittee members regarding legal developments in their jurisdictions relevant to M&A practice. Points raised included the following:

- André Perey of Blake Cassels & Graydon, Toronto, referred to a report published earlier in the week by the Securities Commission in Canada in relation to emerging markets companies listed in Canada.
- Daniel Rosenberg referred to major changes announced earlier in the week by the UK Government relating to the merger control regime in the UK.
- Freek Jonkhart referred to proposed changes intended to simplify the law and procedures related to private companies in The Netherlands.
- Cynthia Kalathas of AMMC, New York, referred to the latest developments on the implementation of the Alternative Investment Fund Managers Directive.
- Rick Silberstein of Gómez-Acebo & Pombo, Barcelona, referred to proposed changes

intended to make the Spanish labor law regime more employer friendly as to dismissals and collective bargaining.

Next Meeting

The Subcommittee's next meeting will be held in connection with the ABA Annual Meeting in Chicago that will take place August 3-5, 2012. The Subcommittee meeting will be held on August 5, from 10:00 a.m. until 12:00 p.m., in Ballroom E, 5th Floor, of the Chicago Marriott Downtown.

Subcommittee Website

Our website can be found at the following address: http://apps.americanbar.org/dch/_committee.cfm?com=CL560016. The website contains the following information:

- Presentation notes of Tim Emmerson on the Euro Crisis.
- Presentation notes of Glenn West and Hermann Knott on Measures of Damages in Domestic US and International Transactions.
- Notes from the general discussion section including:
 - a note by Rick Silberstein of Gómez-Acebo & Pombo expanding on his comments on the proposed changes to the Spanish labor law regime; and
 - a note by Daniel Rosenberg expanding on his comments on the proposed changes to the UK merger control regime.
- The latest materials from the Subcommittee's Foreign Direct Investment Project and International Dispute Resolution Project.
- Details of the Subcommittee's publications, future meetings, other work-in-progress, and other past program materials.

We look forward to seeing you in Chicago.

Daniel P. Rosenberg
James R. Walther
Co-Chairs

Membership Subcommittee

The Membership Subcommittee always welcomes your participation and your ideas as it is our mission to continue to grow and attract members to the Mergers and Acquisition Committee.

The Committee's membership has remained stable since January 2012. Our total Committee membership is at 4,144, as of July 5, 2012. The Membership Subcommittee is assisting the Business Law Section in a formal expansion of ties with the Association for Corporate Growth (ACG), including efforts to create synergies and cross-sell our knowledge, contacts, and meeting opportunities. This effort is ongoing and should hopefully create membership momentum! We are creating new promotion tools and participating in various other associations using our contacts to really illustrate the benefits of becoming a member of the Committee. Indeed, we have an ongoing effort with the Business Law Section of the ABA to renew relationships and expand and seek opportunities with other networking or trade groups. We implemented a user-friendly system to address the members' needs in accessing information and contacts to add value to membership in the Committee. In addition, we are working with the larger Membership Committee for the entire ABA to create more incentives to join and recruit new members, such as the member-get-a-member program and others.

Our membership is in 49 states but now in 52 countries! Unfortunately, we are losing a small percentage of our in-house counsel members, now at 380, but our "associate" members (non-lawyers) remain stable at 348 members. We need to continue our efforts to recruit and retain our valuable in-house and "associate" members!

The M&A Market Trends Subcommittee is still our largest group with 1,491 members, but many others are not far behind! Here is a list of some of the other larger subcommittee membership numbers:

Private Equity M&A	1,328
International M&A	833
Acquisitions of Public Companies	824
M&A Jurisprudence	728

All these subcommittees/task forces have seen their membership grow since early 2012. Others who are

relatively new have also clearly demonstrated the need for their creation and how members are interested in getting involved by their rapid growth. A few examples and how their respective membership has increased since early January:

- Task Force on Financial Advisor Disclosures: 53 members, a 96% increase;
- Joint Task Force on Governance Issues in Business Combinations: 76 members, a 117% increase;
- Task Force on New Projects: 130 members, a 202% increase.

The Task Force on Two-Step Auctions was also recently put in place and is already comprised of 31 members. This shows the ability of our Committee to adapt and create new forums of discussions for our members to learn and develop.

Last, but not least, considering the high number of female lawyers entering our profession, we note that women still represent only 17% of the total membership of the Committee. Our Committee is dedicated to seeing this number increase and values your opinions and suggestions on how this could be achieved in the short term. We are also looking at working with the Diversity Subcommittee to achieve this goal.

As our economy continues to be in a state of chaos and our profession requires constant adaptation to the new needs and demands of clients, it is important to get involved and bring new ideas, debates, and solutions to the table. We strongly encourage you to invite new people to join our Committee and appreciate your involvement in our recruitment efforts. As we become more and more diversified, let's work together to energize our Committee and make sure our profession evolves and adapts to our changing global economy.

Farewell and Thank You to Leigh Walton, our Chair

One person has lead the way in the growth and diversification of the Committee, our Chair, Leigh Walton. She has, throughout her tenure, promoted new ideas, new leadership, and respected the history of our Committee and what it stands for, including its high quality standards as they relate to the practice of M&A. In a world where so much is changing at a rapid pace, through her responsiveness and dedication she

led the way, grew, and diversified the membership, and expanded the scope and prestige of our Committee and subcommittees.

We thank you, Leigh, on behalf of all the members and we know you join us in welcoming Mark Morton to continue your legacy.

Tracy Washburn
Ryan Thomas
Mireille Fontaine
Vice Chairs

M&A Jurisprudence Subcommittee

The M&A Jurisprudence Subcommittee has two working 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*. 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 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 at the following address: <http://apps.americanbar.org/dch/committee.cfm?com=CL560000>.

The Annual Survey Working Group will meet in Chicago on Saturday, August 4, from 10:30 a.m. until 11:30 a.m., in the Chicago Ballroom C, Fifth Floor, at the Chicago Marriott Downtown. The Judicial Interpretations Working Group will meet immediately thereafter, from 11:30 a.m. until 1:00 p.m., in the same room. Dial-in information for both meetings is in the schedule at the end of this issue of *Deal Points*.

Annual Survey Working Group

The ninth Annual Survey of Judicial Developments Pertaining to Mergers and Acquisitions was published

in the February 2012 issue of *The Business Lawyer*. We thank all Committee members who participated in that effort. At the Committee meeting in Chicago we will discuss *Martin Marietta Materials, Inc. v. Vulcan Materials Company*, summarized below, and other cases of sufficient interest identified during our working group meeting. At the Working Group meeting, we will continue our efforts to select cases for inclusion in the 2012 annual survey.

We are asking all members of the Committee to send us significant judicial decisions for possible inclusion in the survey. Submissions can be sent by email either to Jon Hirschoff at jhirschoff@fdh.com or to Michael O'Bryan at mobryan@mofo.com. Please state in your email why you believe the case merits inclusion in the survey.

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.

To join our working group, please email Jon Hirschoff at jhirschoff@fdh.com with a copy to Michael O'Bryan at mobryan@mofo.com, or simply attend the working group meeting in Chicago.

Decision to be Discussed at the Chicago Committee Meeting

The Meaning of NDAs -- *Martin Marietta Materials, Inc. v. Vulcan Materials Co.*, 2012 Del. Ch. LEXIS 93 (Del. Ch. May 4, 2012), aff'd, 2012 Del. LEXIS 342 (Del. July 10, 2012).

Overview

Two aggregates companies, Martin Marietta and Vulcan, signed confidentiality agreements to facilitate discussion of a possible merger. When they failed to agree, Martin Marietta used the information it had obtained from Vulcan to make an unsolicited public exchange offer for all Vulcan shares. Vulcan claimed that Martin Marietta's use of Vulcan's confidential information and disclosure of such confidential information and of the parties' negotiations in connection with its hostile bid breached the confidentiality agreements.

The Court of Chancery found that, although certain language of the confidentiality agreements was ambiguous, Martin Marietta had breached the confidentiality agreements, and enjoined Martin Marietta's exchange offer for a period of four months. Martin Marietta appealed to the Delaware Supreme Court, which affirmed the Court of Chancery's judgment.¹

Background

In spring 2010, Martin Marietta and Vulcan began discussing the possibility of a merger.² The companies signed two confidentiality agreements, each governed by Delaware law:

- A general non-disclosure agreement (the "NDA"), requiring each party to use the other's confidential information (defined in more detail as "Evaluation Material") "solely for the purpose of evaluating a Transaction," with "Transaction" defined as "a possible business combination transaction . . . between" the two companies,³ and prohibiting disclosure of the other party's Evaluation Material and of the parties' negotiations except as provided in the NDA. The NDA had a term of two years.⁴
- A joint defense and confidentiality agreement, intended to facilitate antitrust review (the "JDA" and, together with the NDA, the "Confidentiality

¹ *Martin Marietta Materials, Inc. v. Vulcan Materials Co.*, 2012 Del. LEXIS 342 (Del. July 10, 2012).

² *Martin Marietta Materials, Inc. v. Vulcan Materials Co.*, 2012 Del. Ch. LEXIS 93, at *7 (Del. Ch. May 4, 2012) [hereinafter *Martin Marietta I*].

³ *Id.* at *24.

⁴ *Id.* at *23.

Agreements”), signed about two weeks after the NDA, requiring each party to use the other’s confidential information (defined in more detail as “Confidential Materials”) “solely for the purposes of pursuing and completing the Transaction,” with “Transaction” defined as “a potential transaction being discussed by” the parties, and restricting disclosure of Confidential Materials.⁵

Neither agreement contained an express standstill provision.

When the merger discussions fell through, Martin Marietta commenced an exchange offer for all outstanding Vulcan shares and a proxy contest to elect new directors to Vulcan’s board. Martin Marietta made various filings with the SEC and other public disclosures, which included the fact that Martin Marietta and Vulcan had discussed the possibility of a merger as well as details from Vulcan’s confidential information.⁶ Martin Marietta filed suit seeking declaratory judgment that its actions did not violate the Confidentiality Agreements, and Vulcan counterclaimed for the opposite. (The parties also sued each other in other courts, but over other issues, so that’s a different story.)

Opinion

Martin Marietta Used Vulcan’s Confidential Information

The Court found that Martin Marietta had used in connection with its unsolicited bid information it had obtained under the Confidentiality Agreements.⁷ The Court noted, among other things, that Martin Marietta made no attempt to use a “clean team” of individuals who had not seen the information, and that Martin Marietta’s management team and advisors acknowledged in internal memos concerns about using Vulcan’s confidential information.⁸ The Court acknowledged that Martin Marietta had attempted to segregate Vulcan’s confidential information and re-create some of its prior findings based on independent sources, but noted that “[o]nce things are learned and done, it is difficult to

unlearn and undo them.”⁹

Use of Confidential Information in Connection with a Hostile Bid Violated the Confidentiality Agreements

The Court found that Martin Marietta’s use of Vulcan’s confidential information in the exchange offer and proxy context violated both Confidentiality Agreements.

Ambiguity of NDA’s “Business Combination Transaction Between” the Parties. The Court found that the meaning of “business combination transaction,” as used in the NDA’s definition of Transaction, could range from narrow (as used in Delaware’s anti-takeover statute) to broad (as under the SEC’s regulatory rules).¹⁰ The Court reviewed the NDA text as well as similar provisions in treatises and model agreements (including the ABA M&A Committee’s Model Confidentiality Agreement and a working draft of the ABA M&A Committee’s M&A Dictionary) and determined that, given all of these potential interpretations, there was no clear interpretation of “business combination transaction” based on the plain language of the NDA.¹¹

The Court then considered whether the word “between” might sufficiently qualify the phrase “business combination transaction.”¹² The Court noted, among other things, that the Ontario Superior Court of Justice, in its 2009 *Certicom* decision, had determined that a confidentiality agreement’s requirement to use information only in connection with a transaction “between” the parties to the agreement acted to restrict use of that information to only a transaction to which the target had consented, and accordingly the Ontario court enjoined a hostile bid by one party for the other.¹³ The Court also noted, though, that the *Certicom* confidentiality agreements contained additional contextual language not found in the Confidentiality Agreements.¹⁴ The Court further noted Martin Marietta’s argument that the parties could have used the word “negotiated” rather than “between” if they intended that meaning, especially

9 *Id.* at *71.

10 *Id.* at *95-98.

11 *Id.* at *109 n.156, *117.

12 *Id.* at *118.

13 *Id.* at *119-20.

14 *Id.* at *120.

5 *Id.* at *24.

6 *Id.* at *74-76.

7 *Id.* at *64-69.

8 *Id.* at *72-74.

in light of the advice in treatises and model agreements after the *Certicom* case.¹⁵ Finding both parties' proposed interpretations to be reasonable, the Court found its meaning to be ambiguous.¹⁶

Impact of Extrinsic Evidence. The Court next looked to extrinsic evidence. The Court reviewed the drafting history of the NDA, and noted, among other things, that Martin Marietta took measures to strengthen the NDA's protections of confidential information, such as by replacing the term "involving" with the narrower term "between."¹⁷ In addition, the Court found that Martin Marietta's conduct indicated that it believed the use of Evaluation Material in connection with an unsolicited bid might violate the Confidentiality Agreements: its legal and financial advisors "expressed concern" about using confidential information in the process of forming the hostile bid, and the board minutes and first draft of the bear hug letter reflected an initial wariness about using information covered by the NDA.¹⁸ The Court also noted the "gloss" provided by the definition of Transaction in the JDA, including the references in the JDA to "the" Transaction rather than to "a" Transaction.¹⁹ The Court thus found that a "business combination transaction between" the parties was meant to refer only to a negotiated transaction "agreed upon ... by the sitting boards of both companies...."²⁰

JDA. The Court did not find any ambiguity in the JDA's definition of "the Transaction," noting that Martin Marietta's unsolicited bid "was not 'the' transaction that was 'being discussed'" when the parties negotiated the JDA.²¹

Therefore, the Court found that Martin Marietta's use of Vulcan's confidential information in connection with its unsolicited bid amounted to a breach of both of the Confidentiality Agreements.²²

Supreme Court Affirmation. The Delaware

Supreme Court confirmed this analysis with respect to the JDA, finding that Martin Marietta's use of Vulcan's Confidential Materials in connection with its unsolicited bid violated the JDA.²³ The Court did not address the Court of Chancery's conclusions as to Martin Marietta's violation of the NDA's use restrictions.²⁴

Disclosure of Confidential Information and Transaction Information Violated the Confidentiality Agreements

NDA's Ambiguous Terms. According to Vulcan, the NDA allowed the parties to disclose information when "legally required" to do so, where "required" was defined in paragraph four ("Required Disclosure") to mean only when in response to an external demand.²⁵ The preceding paragraph that provided for the non-disclosure of that information (paragraph three, "Non-Disclosure of Discussions; Communications") referenced paragraph four but did not itself define "legally required."²⁶ While the Court found reasonable Vulcan's argument that both paragraphs should be read together to harmonize the agreement,²⁷ it also considered plausible Martin Marietta's position that "legally required" had a broader meaning, including all legal requirements regardless of their source, with paragraph four's "external demand" requirements only applicable to the conditions therein.²⁸

Impact of Extrinsic Evidence. The Court thus again turned to the extrinsic evidence and found that Vulcan's interpretation was correct.²⁹ Among other things, the drafting history showed that Martin Marietta added to paragraph three the language "[s]ubject to paragraph (4)" to link the two paragraphs where they were not previously expressly connected.³⁰ The Court also reviewed treatises and model agreements, including again the ABA M&A Committee's Model Confidentiality Agreement.³¹

23 *Martin Marietta Materials, Inc. v. Vulcan Materials Co.*, 2012 Del. LEXIS 342, at *32-34 (Del. July 10, 2012).

24 *Id.* at *21 n.42.

25 *Martin Marietta I*, 2012 Del. Ch. LEXIS 93, at *148-51.

26 *Id.*

27 *Id.* at *151-57.

28 *Id.* at *157-59.

29 *Id.* at *163.

30 *Id.* at *165.

31 *Id.* at 180, n. 232.

Violation of Vetting/Advance Consent Requirement. The Court also found that, even if otherwise “legally required,” Martin Marietta violated the NDA by not complying with the requirement to notify Vulcan prior to disclosing the information. Similarly, failure to obtain the Vulcan’s advance consent also violated the JDA.³²

The Court also noted that, given its findings, the Court did not need to address the question of whether Martin Marietta, by agreeing not to disclose confidential information, had effectively also agreed not to “embark on [a] discretionary course of action if it knew that the course of action would trip a legal obligation to make public disclosure,” as advanced by Vulcan.³³

Supreme Court Affirmation. Without reaching the issue of interpreting an ambiguous contract, the Delaware Supreme Court affirmed the Court of Chancery’s holding on this point by finding that the NDA did not allow disclosure of Evaluation Material unless triggered by an external demand, and that the JDA required advance consent in all events.³⁴

Even if Required to Make Certain Disclosures, Martin Marietta Exceeded Legal Requirements

The Court found that Martin Marietta had disclosed not just the information that was arguably “legally required,” but rather went beyond that and disclosed subjective information about Vulcan in its S-4 to make its bid more likely to be successful, which constituted an independent breach of the Confidentiality Agreements.³⁵ Likewise, even if all of the SEC disclosures qualified as “legally required,” the Court found that neither of the Confidentiality Agreements could be read to suggest that Martin Marietta could disclose Vulcan’s additional confidential information to the media or to investors, as Martin Marietta had done.³⁶ Consequently, the Court found for Vulcan on its arguments that these subsequent disclosures were independent breaches of the Confidentiality Agreements.³⁷

³² *Id.* at *195.

³³ *Id.* at *186 n. 241.

³⁴ *Martin Marietta Materials, Inc. v. Vulcan Materials Co.*, at *29, *46-47 (Del. July 10, 2012).

³⁵ *Martin Marietta I*, 2012 Del. Ch. LEXIS 93, at *190-200.

³⁶ *Id.* at *205-06.

³⁷ *Id.* at *207.

Conclusion

Following this case, both buying and selling companies should take note of certain drafting pitfalls that created ambiguity in the Confidentiality Agreements.

If a buyer wants to keep open the possibility of an unsolicited bid, it should keep that in mind at the early stages of the process to avoid the appearance that it is changing its mind later on. Keeping language broad helps keep this option open. For instance, had it defined “Transaction” as one “involving” rather than “between” the parties, Martin Marietta might have had a stronger argument for its position that any type of business combination, even an unsolicited one, would fall under that definition. A buyer also might want to address more specifically the allowed disclosure, particularly disclosures required because of actions of the buyer.

A potential seller generally should make the contract language as narrow as possible. For example, the Court noted that it would have been less likely to find the definition of Transaction ambiguous had it included language like “negotiated” or “mutually agreeable” rather than “between,” a statement that the information could not be used “in any way detrimental” to the providing party, or language limiting the use of confidential information to within the specifically contemplated transaction.

While a confidentiality agreements restrictions on use and disclosure of confidential information, as well as on disclosure of transactional information, can indeed act as a “backdoor standstill,” a party that wants to prohibit unsolicited bids also should consider negotiating an express standstill.

Before proposing changes, however, a party should consider the other party’s likely reaction and the potential impact on negotiating history if the change is rejected.

Judicial Interpretations Working Group

The current focus of our Working Group is to add content to the M&A Lawyers’ Library, which we launched prior to our August meeting in Toronto, and which can be accessed through the M&A Committee page of the ABA website. To that end, at our meeting in Las Vegas in March we discussed the memo on Fraud Claims and Non-Reliance and Exclusive Remedy Clauses, authored

by Patrick Leddy, Joseph Kubarek, Nicholas Dietrich, and Craig Menden, which we plan to add to the library soon.

We welcome all interested Committee members to join our Working Group. The Judicial Interpretations Working Group is a good way to become involved in the Committee, especially for younger Committee members, because extensive M&A transactional experience is not necessary. We have working group teams in various stages of preparation of memoranda regarding additional acquisition agreement provisions and M&A issues, and we have a virtually unlimited pool of topics to work on in the future.

As indicated above, the Chicago meeting of the Judicial Interpretations Working Group will be held on Saturday, August 4, from 11:30 a.m. until 1:00 p.m., in the Chicago Ballroom C, Fifth Floor, at the Chicago Marriott Downtown, immediately following the Annual Survey Working Group meeting. We plan to discuss (i) the index of cases that have been summarized in the Annual Survey of M&A Jurisprudence, which we intend to add to the M&A Lawyers' Library, (ii) the memo on the judicial interpretation of "best efforts" clauses in Canada, authored by Carl M. Ravinsky, and (iii) the status of other memos in progress.

To join our working group, please email Scott Whittaker at swhittaker@stonepigman.com, or simply attend the working group meeting in Chicago.

Jon T. Hirschoff
Subcommittee Chair

Michael G. O'Bryan
Chair - Annual Survey Working Group

Scott T. Whittaker
Chair - Judicial Interpretations
Working Group

M&A Market Trends Subcommittee

At our meeting in Las Vegas in March we heard from Steve Obenski of Thomson Reuters on current trends in the M&A market; Mark Danzi (Hill Ward Henderson, Tampa) discussed the difference it makes to the stats in our 2011 Private Target Deal Points Study when the deals involve financial sellers; Rob DelPriore (Baker Donelson, Memphis) provided our first "Tales from the Trenches" presentation on real world negotiations on diminution

in value; Eric Wilensky (Morris Nichols, Wilmington) and Iain Scott (McCarthy Tétrault, Montréal) conducted a mock negotiation of the target board's right to change its recommendation, with data points from our 2011 Strategic Buyer/Public Target Deal Points Study; and Steve Kotran (Sullivan & Cromwell, New York) discussed Practical Law Company's reverse break-up fee study.

Our next meeting is in Chicago on August 4, from 2:30 p.m. until 4:00 p.m. (Central time). At that meeting, we will hear from the following:

- Steve Obenski (Thomson Reuters, Washington) will update us on the state of the M&A market;
- Tricia Vella (Morris Nichols, Wilmington) will give us our latest "Tales from the Trenches" presentation with the Delaware perspective on how buyers can ensure they are indemnified above the escrow amount;
- Simon Raftopolous (Appleby, Grand Cayman) and Stephen James (Appleby, Grand Cayman) will discuss fiduciary duties in Cayman and BVI; and
- Kevin Ryan (J.P. Morgan, Chicago) will share indemnity claims statistics from J.P. Morgan's most recent study.

The dial-in number and passcode for the meeting for those of you who cannot join us in Chicago in person are as follows:

*Domestic: (866) 646-6488
International: (707) 287-9583
Passcode: 380-053-3645*

I look forward to seeing you in Chicago.

Jessica Pearlman
Chair

Hal Leibowitz
Vice Chair

Private Equity M&A Subcommittee

The Private Equity M&A Subcommittee met in Las Vegas, Nevada on Friday, March 23, 2012, as part of our Committee's meetings held in conjunction with the Spring Meeting of the ABA Business Law Section. Presentation materials were available for Subcommittee

members and the Subcommittee discussed events and developments affecting the Private Equity market during the past two months since the Subcommittee last gathered in Laguna Beach, California. The following segments took place at the session with the speakers referenced: (i) "Comments on Current Selected Topics Under Delaware Case Law," with Myron T. Steele, Chief Justice, Delaware Supreme Court; (ii) "Overview of the Current Market Environment: Private Equity and M&A," with Mathew S. Clark, Managing Director, Mergers and Acquisitions, Moelis & Company; and (iii) "Review of Selected Current Private Equity Topics," with Philip B. Bass, Partner and Global Private Equity Sector Leader, and Peter Witte, Partner, Global Private Equity, Ernst & Young. The Subcommittee meeting was well-attended, and the Subcommittee Chair thanks all participants and Subcommittee members for contributing to the session.

John K. Hughes
Chair

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DEAL PEOPLE

Welcome to **Deal People**, a new feature in *Deal Points* that will highlight members of the Mergers and Acquisitions Committee and things that interest them, other than doing deals. I hope you enjoy getting to know more about the deal people on our Committee and that you will contribute your ideas and experiences for future issues.

Which App?

There was a noticeable increase in iPad users at the Spring Meeting in Las Vegas. And, not everyone was surfing the Net during the Committee meetings ... work and Committee business was getting done too!

Of course, with iPads come Apps. And there are so many to choose from, for both business and pleasure. So I thought I would ask two well-known deal people to share their ideas of the best/most useful/most fun Apps:



Hal Leibowitz (Vice Chair of the Corporate and Transactional Department at WilmerHale (Boston)) suggests four "must-have" Apps for business:

For note-taking – In terms of balancing ease of use and features, Hal thinks **Notability** is the best. It's great for both typing notes and taking them by hand (especially with a stylus, like the **Jot Pro**). The outlining tool is also quite good.

For reading and annotating PDFs – **iAnnotate** is great for reading and marking-up PDFs. You can hand write or type notes, highlight text in different colors, and search for key words.

For creating, reading and revising Word, Excel, and PowerPoint documents -- There is currently no perfect solution out there (although there is a rumor that Microsoft will release an iPad version of the Office suite later this year). The best interim alternative that Hal has found is **DocsToGo**. You can create, read, and revise documents in each of these formats -- PLUS it will show track changes that someone has made and sent to you.

As an organizational tool – Hal notes that although each of the programs listed above will to some extent allow you to save and organize documents you receive and create, none of them is nearly as good as **OrganiDoc HD**. This program allows you to create and organize folders and subfolders and store documents in all formats. And it's terrific for keeping handy all the documents you want on the road -- your deal points studies, your favorite articles, and agreement precedents, etc.

As for Hal's fun Apps well, they're listed above. And, when he's not using his iPad for work, Hal likes to watch lots of TV shows and movies and to listen to music. Hal also uses and likes **Dropbox** (for productivity) and **TriplIt** (for travel).



Jen Muller (Managing Director in Houlihan Lokey's San Francisco office, where she heads Financial Opinions & Advisory Services for the San Francisco Bay Area, as well as the firm's Technology Group), also is an avid App user:

For note-taking – Jen uses the embedded **Notes** App and prefers it over the handwritten note-taking Apps. Jen likes to have all of her notes in one place and data on **Notes** is searchable.

For reading and annotating PDFs – Although there are several Apps that allow users to view and mark-up PDF documents using a stylus, Jen prefers **UPAD**. It allows a user to read, mark up, and send documents. Some of her colleagues also use **GoodReader**.

For creating and editing Microsoft Office documents, Jen uses **QuickOffice Pro HD**.

Perhaps we should have a mock negotiation between Hal and Jen to determine which of their favorite Apps is best? Better yet; let's determine the current market trend: **What's Your App?** Do you have a favorite App (or two)? Let me know if you do; I'll report on the most popular responses in a future issue of *Deal Points*.

Are you a Runner? In the next issue of *Deal Points*, I will introduce the M&A Committee to some of our members who like long-distance running. Please let me know if you've run a half- or full marathon sometime within the last years.

And, I'd welcome any other ideas for future features in **Deal People**.

Many thanks to Wilson Chu for his suggestion that we write about the M&A Committee's deal people.

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COMMITTEE MEETING MATERIALS

BUSINESS LAW SECTION SUMMER MEETING

CHICAGO MARRIOTT DOWNTOWN
CHICAGO, IL

AUGUST 3-5, 2012

SCHEDULE OF MEETINGS AND OTHER ACTIVITIES

FRIDAY, AUGUST 3, 2012

Program: Cross-Border M&A: Critical Issues for U.S. Counsel

8:00 a.m. – 10:00 a.m.
Indiana/Iowa Rooms, 6th Floor

Program: Corporate Litigation Problems That Keep General Counsel Awake at Night and How To Solve Them

2:30 p.m. – 4:30 p.m.
Chicago Ballrooms G/H, 5th Floor

Joint Task Force on Governance Issues in Business Combinations

3:00 p.m. – 4:30 p.m.
Los Angeles Room, 5th Floor

U.S. and Canada: (866) 646-6488
International: (707) 287-9583
Passcode: 459-761-3352

SATURDAY, AUGUST 4, 2012

Program: What Every M&A and Private Equity Transactional Lawyer Needs to Know About the Foreign Corrupt Practices Act

8:00 a.m. – 10:00 a.m.
Chicago Ballrooms A/B, 5th Floor

Program: The Tax Gobbledygook in LLC Agreements: How Business Lawyers Can Make Sense of “Capital Accounts” and “Allocations” and Why it Matters

8:00 a.m. – 10:00 a.m.
Addison Room, 4th Floor

Task Force on Distressed M&A

8:30 a.m. – 9:30 a.m.
Kansas City Room, 5th Floor

*U.S. and Canada: (866) 646-6488
International: (707) 287-9583
Passcode: 630-478-3957*

Task Force on Financial Advisor Disclosures

9:30 a.m. – 10:30 a.m.
Los Angeles Room, 5th Floor

*U.S. and Canada: (866) 646-6488
International: (707) 287-9583
Passcode: 459-761-3352*

Task Force on Legal Project Management

10:00 a.m. – 11:00 a.m.
Denver Room, 5th Floor

*U.S. and Canada: (866) 646-6488
International: (707) 287-9583
Passcode: 819-297-2741*

Annual Survey Working Group of the M&A Jurisprudence Subcommittee

10:30 a.m. – 11:30 a.m.
Chicago Ballroom C, 5th Floor

*U.S. and Canada: (866) 646-6488
International: (707) 287-9583
Passcode: 178-633-2268*

Private Equity M&A Subcommittee

10:30 a.m. – 12:30 p.m.
Chicago Ballroom E, 5th Floor

*U.S. and Canada: (866) 646-6488
International: (707) 287-9583
Passcode: 380-053-3645*

Program: Embracing Conflict: Ethics and the Lawyer for the Deal

10:30 a.m. – 12:30 p.m.
Chicago Ballrooms A/B, 5th Floor

Judicial Interpretations Working Group of the M&A Jurisprudence Subcommittee

11:30 a.m. – 1:00 p.m.
Chicago Ballroom C, 5th Floor

*U.S. and Canada: (866) 646-6488
International: (707) 287-9583
Passcode: 178-633-2268*

Acquisition of Public Companies Subcommittee

12:30 p.m. – 2:30 p.m.
Chicago Ballroom E, 5th Floor

*U.S. and Canada: (866) 646-6488
International: (707) 287-9583
Passcode: 380-053-3645*

M&A Market Trends Subcommittee

2:30 p.m. – 4:00 p.m.
Chicago Ballroom E, 5th Floor

*U.S. and Canada: (866) 646-6488
International: (707) 287-9583
Passcode: 380-053-3645*

Meeting of Committee Chair and Vice Chairs, Subcommittee, Task Force and Working Group Chairs

4:00 p.m. – 5:00 p.m.
Chicago Ballroom E, 5th Floor

*U.S. and Canada: (866) 646-6488
International: (707) 287-9583
Passcode: 380-053-3645*

Committee Dinner

Cité Restaurant
505 N. Lake Shore Drive
Chicago, IL 60611

Reception: 7:00 p.m. – 8:00 p.m.
Sponsored by: Thomson Reuters

Dinner: 8:00 p.m. – 10:00 p.m.
Sponsored by: JPMorgan Escrow Services

M&A Committee Night Cap

Shakespeare Theater on Navy Pier
9:45 p.m. – Midnight
Sponsored by: Duff & Phelps

SUNDAY, AUGUST 5, 2012

Program: When People Issues Become Deal Issues: Understanding and Negotiating Employment Obstacles in Cross-Border Transactions

8:00 a.m. – 10:00 a.m.
Salons I and II, 7th Floor

Task Force on M&A Dictionary

8:30 a.m. – 9:30 a.m.
Houston Room, 5th Floor

*U.S. and Canada: (866) 646-6488
International: (707) 287-9583
Passcode: 496-164-9712*

Task Force on Two-Step Auctions

9:30 a.m. – 10:30 a.m.
Purdue/Wisconsin Rooms, 6th Floor

*U.S. and Canada: (866) 646-6488
International: (707) 287-9583
Passcode: 655-080-9121*

Task Force on the Revised Model Asset Purchase Agreement

10:00 a.m. – 11:30 a.m.
McHenry Room, 3rd Floor

*U.S. and Canada: (866) 646-6488
International: (707) 287-9583
Passcode: 144-619-6893*

International M&A Subcommittee

10:00 a.m. – 12:00 p.m.
Chicago Ballroom E, 5th Floor

*U.S. and Canada: (866) 646-6488
International: (707) 287-9583
Passcode: 380-053-3645*

Program: Two's Company, Three's a Crowd: Novation, Assignment or Pledge of Contract Rights, Third-Party Beneficiaries, Subordination Agreements, Escrows, Control Agreements and Other Triangular Arrangements

10:30 a.m. – 12:30 p.m.
Chicago Ballrooms G/H, 5th Floor

Program: Common Mistakes Made by M&A Lawyers

10:30 a.m. – 12:30 p.m.
Salons I and II, 7th Floor

Mergers and Acquisitions Full Committee Meeting

12:30 p.m. – 3:00 p.m.
Salons I & II, 7th Floor

*U.S. and Canada: (866) 646-6488
International: (707) 287-9583
Passcode: 722-787-6294*

Committee Forum:

Selected Ethical Issues in M&A Transactions

3:00 p.m. – 4:00 p.m.

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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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