Selling the company: A practical guide for directors and officers

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Introduction

Delaware, as the state of incorporation for two-thirds of the Fortune 500 and half of all publicly traded companies, is the center of merger and acquisition (M&A) litigation. Nearly all public company mergers and acquisitions, and a significant number of private company transactions, are challenged by shareholders in the courtroom. These cases are brought predominately in the Delaware Court of Chancery, often as a result of the widespread adoption of forum selection provisions in corporate charters and bylaws mandating that such litigation be filed in Delaware. Importantly, the M&A litigation process does not begin with the filing of a lawsuit. It occurs throughout the lifespan of a transaction, from preliminary negotiations to closing and thereafter, because not only will each aspect of the deal terms be scrutinized and evaluated by stockholders and their attorneys, but so too will the conduct of directors, officers, advisors and other fiduciaries.

The foundation of Delaware's long-standing preeminence as the corporate capital of the world is its corporate code, the Delaware General Corporation Law, and alternative entity statutes, each of which are amended and developed to reflect the needs and concerns of corporate and financial America on an ongoing basis. The state's foremost position in the realm of business law is further bolstered by the Court of Chancery and Delaware Supreme Court, which, utilizing a robust body of corporate law, strive to provide efficient resolutions to business disputes and challenges to actions by the board of directors, including those stemming from mergers and acquisitions.

The Delaware judiciary's handling of M&A litigation is renowned for its timely, competent, impartial and reasonable resolution of deal challenges. With strict adherence to fiduciary duties, respect for the business judgment of well-informed and conflict-free directors and officers, enforcement of articles of incorporation, bylaws and merger agreements, and recognition of wealth maximization as guiding principles, Delaware has distinguished itself as the paramount jurisdiction for the resolution of complex, bet-the-company transactional litigation. In fact, Delaware's judicial system is frequently ranked at the top of the United States Chamber of Commerce ranking of states in an assessment based on fairness, reasonableness, competency and impartiality, as well as the timeliness of dispute resolution. The Delaware judiciary's motto is that it moves at "the speed of business."

Transactions often raise difficult questions of Delaware law and many mergers and acquisitions involve significant litigation risk. As a result, fiduciaries should carefully examine and understand the value of the corporation and transaction being proposed as well as other options available, fully inform themselves by asking questions, employing advisors, receiving presentations from management and their advisors, examining and approving financial information including management projections and discussing the merits of the transaction at board meetings.

This guide is intended to provide in-house counsel, directors, officers and other fiduciaries with the tools to effectively approach mergers and acquisitions involving Delaware entities. In particular, this guide provides sufficient detail on the full spectrum of frequently arising aspects of mergers and acquisitions which have resulted in litigation, but it is written in such a way that it is easily understandable and accessible for those unfamiliar with the legalese in the lengthy and complex business law decisions issued by the Delaware courts.

John L. Reed

Ronald N. Brown, III

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Getting the company to sale

In the landscape of mergers and acquisitions, a heavily negotiated and frequently litigated portion of the deal is the preliminary negotiation and pre-signing phase. Prior to an agreement on the broader transaction being reached, potential deal parties often exchange a variety of documents setting forth the foundational deal terms and their views, objectives and requirements for the deal. Delaware courts have, in recent years, provided guidance on the consequences of entering into these preliminary agreements in the M&A context and how they implicate and can run afoul of the underlying principles in Delaware's corporation law.

Confidentiality agreements and standstill provisions

"When a corporation is running a sale process, it is responsible, if not mandated, for the board to ensure that confidential information is not misused by bidders and advisors whose interests are not aligned with the corporation, to establish rules of the game that promote an orderly auction, and to give the corporation leverage to extract concessions from the parties who seek to make a bid."[1]

In a negotiated M&A transaction, the first binding agreement to be exchanged by the parties is typically the confidentiality agreement, often referred to as a nondisclosure agreement or NDA. Like many preliminary agreements in the realm of M&A, confidentiality agreements appear relatively inconsequential on their face, but contain a multitude of provisions that function as the selling company's first line of defense against suitors feigning interest merely to gain access to a company's proprietary and confidential information. Indeed, the confidentiality agreement is the instrument which shields a seller's valuable materials from exploitation by interested parties granted access to nonpublic information in furtherance of a contemplated transaction.

Sell-side advisors should carefully consider the breadth and impact of the form of confidentiality agreement it offers to potential buyers. That is to say, although certain provisions cannot be used to impermissibly "favor one bidder over another,"[2] the best practice is to tailor confidentiality agreements to suit each potential buyer on an individual basis, confirming that what constitutes "confidential information" under the agreement adequately captures the information to be provided to potential purchasers. Furthermore, confidentiality agreements not only limit the sharing of information obtained via the sale process to certain individuals, they often curtail the ability of the potential buyer to utilize the information obtained in the preliminary negotiation phase.

In Delaware, perhaps the most comprehensively litigated provision in the confidentiality agreement is the so-called standstill. A standstill provision, in the public company space, prevents the recipient of the confidential information from utilizing such materials to commence a hostile bid for the selling company. Standstills may also be employed as a standalone agreement. Nonetheless, as a general matter, standstills explicitly prohibit the use of information to purchase the seller's stock, engage in a tender offer for the seller's securities and participate in proxy contests to replace the seller's directors and managers, among other things. Clever suitors, apprised of the obligations of sell-side fiduciaries and the impact a public request to negotiate has on a seller's shareholder base and stock price, have been known to make private and public overtures to selling companies to induce the waiver of standstill agreements. The sell-side response has been to include "don't ask, don't waive" provisions in standstill agreements, which proscribe bidders from requesting the waiver of the standstill, either publicly or privately, thereby incentivizing

bidders to make their initial approach with their best offer and protecting sellers from undue influence by the public markets.

The permissibility of "don't ask, don't waive" provisions is unclear under Delaware law, with case law scrutinizing whether they are consistent with the obligations of fiduciaries engaged in a sale process. As will be discussed later in this guide, sell-side directors in a sale process are tasked with obtaining the best price reasonably attainable for the company for the benefit of the stockholders, and "don't ask, don't waive" provisions potentially jeopardize their ability to meet this burden by hampering the ability of bidders to make topping bids after their receipt of confidential information. Nonetheless, because there is no *per se* rule against "don't ask, don't waive" provisions, and Delaware courts have recognized their valuable import in the sale process, they continue to be employed in some standstills, typically with exceptions that minimize the ability of the suitor to publicly pressure the target board to grant the waiver. Selling directors must both be aware of and take care to utilize "don't ask, don't waive" provisions only to incentivize effective and efficient auction processes in a manner that is consistent with their fiduciary duties such as where their use is as a "gavel" to incentive bidders to bid their fullest.[3]

In addition to standstills and provisions requiring the return or destruction of provided materials (which are in almost every NDA), sellers should consider whether they think it valuable to incorporate provisions in their confidentiality agreements, preventing the solicitation or employment of employees, outreach to customers and other stakeholders, transaction process and, particularly in the public company context, prohibiting the disclosure of the fact that discussions took place between the parties with respect to the possibility of a transaction. Delaware courts have acknowledged the potency and import of confidentiality agreements, even in the absence of express standstill provisions, and have used them to enjoin hostile bids by interested parties who, at one time, had access to and used materials protected by such agreements.[4]

The term of a confidentiality agreement is also of the utmost importance. Sell-side advisors should consider whether to permit residual knowledge clauses, enabling buyers to use the information retained in the memory of their employees subsequent to the receipt of the seller's confidential materials. To the extent possible, the selling company should negotiate for an indefinite term, preventing buyers from utilizing proprietary information to the detriment of the seller down the road, regardless of whether an acquisition has been consummated.

Letters of intent

A letter of intent (LOI) is the document in which the potential parties to a transaction can preliminarily record the terms and conditions of a complex merger or acquisition, and which often touches on transactional structure, consideration to be exchanged and conditions to closing. Crucially, in the M&A context, the import of an LOI is whether, taken as a whole, it is a binding or non-binding expression of interest to enter into a definitive agreement on certain defined terms. As a general matter, LOIs are non-binding "agreements to agree," which incorporate otherwise binding provisions. However, due to the presence of binding provisions in LOIs, parties to such an instrument should carefully consider whether the express and implied terms and conditions housed in the document are binding or non-binding. Delaware law will hold parties to "agreements to agree" and expectation damages for a party's failure to negotiate in good faith are available.[5]

The Court of Chancery has held, and the Delaware Supreme Court has affirmed, that enforceability of an LOI turns on "(1) whether the parties intended to be bound by the document; and (2) whether the document contains all the essential terms of an agreement."[6] Because of the ambiguity necessarily tied to intent, parties to an LOI would do well to expressly state their intention to be, or not to be, bound by certain provisions of the document. The Delaware courts, in determining intent, look to "overt manifestations of assent, rather than [] subjective desires," in addition to "an objective manifestation of intent to be bound."[7] Whether an LOI contains the essential terms of the agreement is dependent on "all of the surrounding circumstances, including the course and substance of the negotiations, prior dealings between the parties, customary practices in the trade of business involved and the formality and completeness of the document (if there is a document) that is asserted as culminating and concluding the negotiations."[8]

In addition to expressly stating that an LOI as a whole, or certain provisions of an LOI, are to be non-binding, the foregoing suggests that parties should cautiously consider whether their actions and statements are reflective of an intent to be bound. The Delaware courts, in considering the parties' universe of statements and actions together with the terms of an LOI, have previously suggested that, in the absence of express language to the contrary, a party may be bound by the terms and conditions of a preliminary agreement, such as an LOI, regardless of whether the document incorporates a fiduciary out. In that regard, one Delaware Vice Chancellor has explicitly stated that contracts notably "do not have inherent fiduciary outs."[9] Therefore, in accordance with its guiding philosophies, Delaware has taken the position that LOIs are bespoke documents, which parties can explicitly tailor to be binding or non-binding, either in whole or in part, but, as a general matter, will be subject to contractarian principles absent clear statement otherwise.

When is the company in sale mode?

The threshold matters of the duties of care and loyalty

As will be discussed below, the business judgment rule is at the foundation of Delaware's corporation law. The business judgment rule is a judicially created presumption that provides substantial deference to the ordinary business decisions of corporate management. The effect is that Delaware courts will not second-guess the business decisions of directors who are both fully informed and disinterested/independent. However, a plaintiff can overcome the presumption of the business judgment rule by showing a breach of fiduciary duty.

Under Delaware law, the duty of care requires that the decisions of a board be based on adequate information. "[D]irectors have a duty to inform themselves, prior to making a business decision, of all material information reasonably available to them."[10] There is no formula or pattern that directors must follow to appropriately inform themselves under Delaware law, and the parameters of the fiduciary obligation are set forth in case law as opposed to being housed in the Delaware General Corporation Law.

The judicial standard for a breach of the duty of care is gross negligence, such that a director will be liable for a breach of the duty of care only if he or she is recklessly indifferent to, or intentionally disregards, material information pertaining to the business decision at hand. In accordance with this relatively high standard for liability, the Delaware judiciary will not second-guess directors who make a good faith effort to undertake an investigation or gather pertinent information pertaining to the corporate decision. That which is considered to be materially pertinent information may only be determined on a case-by-case basis, depending on the factual scenario underlying the decision.

Directors of a Delaware corporation also owe a duty of loyalty. Like the duty of care, to overcome the presumption of the business judgment, a plaintiff must establish a breach of the duty of loyalty. A director should be both disinterested and independent with respect to a given business decision. Generally, a director is disinterested if he or she does not have a pecuniary interest in the decision at hand and a director is independent if he or she is not beholden to someone with a pecuniary interest in the decision. Fundamentally, the duty of loyalty obligates directors to act in the best interests of the corporation and its stockholders and not in their own interest or in the interest of another person or entity to which the directors may be beholden.

A director is interested when he or she is on both sides of a transaction or stands to receive a material personal financial or other benefit from a transaction that is not shared equally by the corporation's stockholders. With respect to independence, directors who are beholden to a person or entity that has a material personal or financial interest in the corporate action are generally deemed not to be "independent." A director may be deemed to be "beholden to" another where, as a result of a

personal, professional or financial relation or dependence, he or she cannot reasonably be thought capable of acting in the best interests of the corporation. While casual social ties and friendship generally will not lead to a lack of independence under Delaware law, close familial or financial ties or extensive professional and social ties may. To avoid potential, unexculpated liability for a breach of the duty of loyalty, directors who are interested or suffer from a lack of independence, even potentially, should carefully consider whether they need to abstain from the decision-making process or take other steps aimed at ensuring that the potential conflict does not taint an otherwise valid exercise of directorial discretion. Any potential conflicts should be raised with counsel as soon as they arise.

The duty of good faith is not an independent fiduciary obligation itself.[11] Rather, it is a subsidiary component of the duty of loyalty, in view of the fact that a director cannot act with loyalty to the corporation absent a "good faith" belief that the actions being taken and the decisions being made are in the "best interests" of the company. The case law regarding what action or inaction constitutes an act not in good faith, or in bad faith, is fact intensive.

The Delaware Supreme Court has identified bad faith as being the intentional dereliction of a duty or a conscious disregard for one's responsibilities.[12] Furthermore, bad faith claims also arise following conduct that is so far outside of the realm of reason that it cannot be explained on any other grounds. Acts in violation of the law fall under the auspices of bad faith. Indeed, "sustained or systematic" inattention to significant corporate issues or red flags resulting in harm to the company may also be deemed to be action not in good faith.[13] Often, directors can preempt bad faith claims by establishing internal reporting and control mechanisms to remain apprised of events and issues impacting the company on a specified material level.

Notably, under Section 102(b)(7) of the Delaware General Corporation Law, a corporation may, in its certificate of incorporation, provide for the elimination of directors' personal liability to the corporation or its stockholders for breaches of directors' fiduciary duties. Section 102(b)(7) provisions protect directors from breaches of the duty of care and preclude claims for director personal monetary liability for grossly negligent decisions falling outside of the confines of the business judgment rule. It is important to note that this elimination of liability for certain breaches of the duty of care does not extend to breaches of the duty of loyalty, including violations involving improper personal benefits for directors, bad faith conduct or intentional misconduct, and certain unlawful issuances of dividends, stock purchases and stock redemptions. Further, a provision in the certificate of incorporation exculpating directors under Section 102(b)(7) only precludes monetary damages and does not prevent a court from issuing an injunction to prevent the closing of a transaction found to be the product of a breach of the duty of care.

Section 102(b)(7) provisions are most frequently used to shield directors from personal monetary liability for claims involving alleged waste of corporate assets, failure to act on adequate information, alleged inadequate disclosure of information to stockholders and other claims relating to decisions involving mergers and acquisitions. Often, the presence of a Section 102(b)(7) provision will result in a disinterested and independent director being dismissed at the outset of the case. Nonetheless, Delaware courts have been increasingly focused on actual or perceived conflicts of interest and that may fall within the duty of loyalty and bad faith exceptions to exculpation under section 102(b)(7). Therefore, while Section 102(b)(7) can be a powerful shield from personal liability, directors must take care to perform each of their fiduciary duties conscientiously and should carefully review any potential conflicts. A Section 102(b)(7) provision will protect directors for monetary liability for a breach of the duty of care, but, as previously noted, it does not preclude injunctive relief based on such a breach. Finally, by its terms, Section 102(b)(7) protects only directors, not officers, and does not protect directors acting in their capacity as officers.[14]

The applicability of the business judgment rule in the M&A context

For directors and officers contemplating a sale of their company, perhaps the most difficult, challenging and consequential aspect of the process is identifying when the company has entered into "sale mode," thereby triggering enhanced judicial scrutiny of their actions. In reviewing the everyday business decisions of directors, the Delaware courts apply the business judgment rule. Fundamentally, the business judgment rule is the presumption that "in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company."[15] That is to say, the Delaware courts will not second-guess business decisions made by directors on a fully informed and non-conflicted basis, regardless of whether, and even with the benefit of hindsight, the decision is objectively a "poor business decision." The underlying rationale for the rule is to enable – and incentivize – directors to engage in entrepreneurial risk taking with the goal of maximizing shareholder value and corporate welfare without fear of repercussion from their shareholder base for decisions resulting in less-than-optimal outcomes.

Importantly, to obtain the protections of the business judgment rule in the context of the sale of the company, such as in a cash-out merger or when other market conditions make the

sale of the company an inevitability, directors have the burden of showing that they acted reasonably to obtain the best value reasonably available. This is the so-called *Revlon* zone.

The *Revlon* standard of review

In a seminal 1986 decision, the Delaware Supreme Court articulated the unique obligations of directors once their company has entered sale mode. In *Revlon*,[16] the court held that a selling board is charged with maximizing the company's value for the benefit of the stockholders when the company is put up for sale. Upon triggering the *Revlon* standard of review, the role of directors shifts from "defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders at a sale of the company."[17] However, there is "no single blueprint" that must be adhered to in order to satisfy *Revlon*. Once a company is put up for sale and operates in *Revlon*-mode, the court reviewing the sales process will apply enhanced judicial scrutiny to the corporate decision-making process, reflecting a narrower judicial deference to the business decisions of the board. *Revlon* requires only that the selling board act within a range of reasonableness under the circumstances, effectively obligating the selling board to perform its fiduciary duties of care and loyalty with the objective of obtaining the best price realistically attainable.

The Delaware Supreme Court has reiterated that there is no "specific route that a board must follow when fulfilling its fiduciary duties" upon entering *Revlon*-land.[18] Along those lines, *Revlon* created no fiduciary duties in excess of the duties of loyalty and care, but simply requires that such fiduciary obligations be performed with the objective of maximizing the sale price of the enterprise when the company is put up for sale. The Delaware courts, thus, do not look for a set of judicially prescribed actions required to satisfy the heightened standard of review that applies to director decisions once the company is on the market. Once in *Revlon*-mode, "the board must perform its fiduciary duties in the service of a specific objective: maximizing the sale price of the enterprise."[19]

When is *Revlon* review triggered?

While *Revlon* and the multitude of cases that have followed in its path have shed light on when a selling board may trigger *Revlon* enhanced scrutiny. At base, "[t]he duty to seek the best available price applies only when a company embarks on a transaction – on its own initiative or in response to an unsolicited offer – that will result in a change of control."[20] A target company and its board of directors may be subjected to enhanced judicial scrutiny under *Revlon* in at least three scenarios:

First, the doctrine applies where a company commences an "active bidding process" with the goal of selling itself or reorganizing the business with a "clear break-up of the company."[21] In this instance, *Revlon* applies as a result of the board affirmatively deciding to put the company in play, with the ultimate goal of completing a sale or effecting a reorganization.

Second, when a target company "abandons its long-term strategy and seeks an alternative transaction involving the break-up of the company" as a response to a bidder's advance, the company enters sale mode.[22] Here, the board's decision to pursue an alternative transaction involving the break-up of the company, the obligation to obtain the best price for the stockholders nonetheless arises. Directors must conscientiously determine whether their actions in response to unsolicited offers for the company will be subject to a narrowed judicial scrutiny requiring not only adherence to the duties of care and loyalty, but also the maximization of shareholder value as an end result of such actions.

Third, where the corporation enters into a transaction resulting in a change of control. As in *Revlon* itself, a complete cash-out of the selling company's stockholders will trigger a narrowed judicial deference to the decisions of the directorship. Given that the stockholders of the selling company will no longer maintain an interest in the seller if they are to be cashed out, the Delaware courts take the approach that, as a whole, the primary interests of the stockholders transform into a singularity: maximized value for their equity. Consequentially, the company and board enter *Revlon* mode, necessitating that the directors perform their fiduciary duties with the goal of obtaining the highest enterprise value reasonably attainable at a sale of the company. Similarly, where control of the company is transferred from unrelated stockholders to a controlling stockholder, the company and the selling directors enter *Revlon* land, such that the decision to pass control from the broader shareholder population to a controller will be subject to narrowed judicial deference. This transaction form, because it vests a controlling shareholder with the ability to shape the long-term strategy of the company and deprives unaffiliated stockholders of that same capability, triggers heightened review by the Delaware judiciary.

While the principle that the board must affirmatively decide to pursue a transaction wherein their company will be sold before it will enter *Revlon* mode remains true, the Delaware courts have suggested that a board's decision to put the company in play should only be made when the directorship is adequately informed as to deal price and the value of the company to be sold. In addition, the Delaware courts will look to whether the board engaged in an "effective" market check, such that "interested bidders have a fair opportunity to present a higher-value alternative, and the board has the flexibility to eschew the original transaction and accept the higher-value deal."[23] Concomitantly, in the event the company is approached by an unsolicited or hostile bidder, *Revlon* will not apply to that singular offer provided the

company is otherwise not on the market, in view of the fact that the board did not undertake to engage in a sale of the company.

Ultimately, the preceding scenarios are not a comprehensive list of the circumstances through which *Revlon* may be triggered, and directors should assiduously consider whether their actions suggest that the company has entered sale-mode, thereby dictating that the directors perform their fiduciary duties with the goal of maximizing shareholder value and subjecting their decisions to a narrowed judicial deference.

Structuring the sales process

As noted, there is "no single blueprint" a board must follow in structuring a sales process.[24] In furtherance of its reverence for the nuances of the business atmosphere, the Delaware judiciary "recognize[s] that the conduct of a corporate auction is a complex undertaking both in its design and execution," which requires that the sellers maintain "broad negotiating authority…to achieve the best price available to the stockholders."[25] In short, the primary condition for running an acceptable auction process is that directors "observe the significant requirement of fairness for the purpose of enhancing general shareholder interests."[26] Although the protection of the business judgment rule presides over director decision-making in the sales processes, there is no formulaic equation to ensure that a sale process is properly performed. Directors have the freedom to structure the sale process for the benefit of the corporation and its stockholders in virtually any manner that is consistent with their fiduciary obligations.[27]

The business judgment rule will shield directors who put together sales processes on a fully informed and good faith basis, provided that they are also disinterested in the sale. To the extent that they believe doing so would advance the welfare of the corporation and its stockholders, directors are free to favor one bidder over another in the sales process, although any such favoritism must be "justified solely by reference to the objective of maximizing the price stockholders receive for their shares."[28]

The Delaware Supreme Court recently reaffirmed the latitude of directors to "pursue the transaction [that the board] reasonably views as most valuable to stockholders…."[29] At the initial stages of the sales process, how the auction is structured and which bidders are favored are protected by the business judgment rule. The Delaware courts will uphold the fully informed, good faith, and disinterested business decisions of directorships in a sales process, so long as the decision to terminate the auction and sell the company to a bidder is subject to, among other things, an effective market check and that board is adequately informed as to both the deal and its company's value. In addition to the foregoing, Delaware courts typically will not undermine a board's decision to end a sales process and pursue a transaction with a specific bidder where stockholders are free to participate in an uncoerced vote on the transaction and third-party bidders are posed only with reasonable obstacles in making a superior offer for the selling company.

What is not required under *Revlon*? The misleading value maximization norm and the absence of a sales blueprint

Unlike the rationality standard of the business judgment rule, Delaware reviews the directors' decision to sell the company under *Revlon* under a reasonableness standard. While *Revlon* requires that directors perform their fiduciary duties with the objective of maximizing shareholder value at a sale of the company, it "does not require a board to set aside its own view of what is best for the corporation's stockholders…."[30] In that sense, *Revlon* is similar to the business judgment rule insofar as that the judiciary will not seek to substitute its view of a business decision for that of the directors. Rather, when applying enhanced scrutiny to the decision to sell the company, a Delaware court will decide "whether the directors made a *reasonable* decision, not a *perfect* decision."[31]

Delaware law permits directors latitude in deciding whether and when to the sell the company and how to go about implementing that process under *Revlon*. Somewhat paradoxically, the requirement that directors attain the highest price reasonably available at a sale of the company does not demand that the board accept the highest monetary offer. Instead, the reasonableness of a decision requires that the board assess the relative reputation and perceived responsibility of a bidder. "In assessing the bid and the bidder's responsibility, a board may consider, among various proper factors, the adequacy and terms of the offer; its fairness and feasibility; the proposed or actual financing for the offer, and the consequences of that financing; questions of illegality; the impact of both the bid and the potential acquisition on other constituencies, provided that it bears some reasonable relationship to general shareholder interests; the risk of non-consummation; the basic stockholder interests at stake; the bidder's identity, prior background and other business venture experiences; and the business plans for the corporation and their effects on stockholder interests."[32] Directors therefore need not simply take the highest bid on the table, but may search the foregoing factors to determine the attractiveness of an offer from a stockholder perspective.

When in sale mode, *Revlon* ultimately requires that directors faced with multiple bids select only a reasonable alternative amongst a host of offers.[33] The Delaware judiciary will uphold a board's business decision on the condition that it is reasonable under the facts presented, and will "not substitute their business judgment for that of the directors."[34] Thus, "in the wake of *Revlon*, Delaware courts have made clear that the enhanced judicial review *Revlon* requires is not a license for law-trained courts to second-guess reasonable, but debatable, tactical choices that directors have made in good faith,"[35] effectively providing directors with both a level of comfort and degree of flexibility in approaching their decision to sell the company.

In addition to not requiring that directors engaging in a sale of their company uncritically accept the highest price offered, *Revlon* and its progeny are perhaps misunderstood as calling for directorships to perform certain actions to avoid liability for a breach of their fiduciary duties while conducting a sale. The Delaware Supreme Court's holding in *Revlon*, and the cases that have followed and developed its guidance, for example, do not create affirmative obligations to conduct an auction process.[36] That is to say, "*Revlon* does not demand that every change in control of a Delaware corporation be preceded by a heated bidding contest,"[37] and directors operating in compliance with their fiduciary duties have the general discretion to approach the sales process by means of the method they perceive as optimizing the welfare of the corporation and its stockholders. In short, there is no duty to auction a company once the board has traveled to *Revlon* land and it is not unescapably unreasonable for a board to fail to "do a canvass of all possible acquirors before signing up an acquisition agreement…."[38]

Similarly, *Revlon* does not require that a selling board retain the right to terminate an agreed-upon transaction upon the arrival of a topping bidder presenting a better deal. While a decision to do so must be done carefully and with appropriate justification, "Delaware entities are free to enter into binding contracts without a fiduciary out so long as there was no breach of fiduciary duty involved when entering into the contract in the first place."[39] As will be discussed later in this guide, fiduciary-out provisions are often incorporated into merger agreements and sometimes in other corporate contracts, effectively permitting a board of directors to back out of the applicable arrangement if failing to do so would result in the directors breaching their fiduciary duties, especially in light of a higher offer.

In sum, once a corporation enters sale mode, a special form of enhanced judicial review will be used to scrutinize a decision to sell the company, appropriately characterized by two key features: "(a) a judicial determination regarding the adequacy of the decision[-]making process employed by the directors, including information on which the directors based their decision; and (b) a judicial examination of the reasonableness of the directors' action in light of the circumstances then existing. The directors have the burden of proving that they were adequately informed and acted reasonably" in a sale of the company.[40] As the Court of Chancery has made clear, *Revlon* "is not the standard of conduct but the standard of review."[41]

Attempting to avoid sale: defending against unsolicited and hostile bids for the company

Defensive measures subject to *Unocal* scrutiny – a variation of enhanced judicial review of board action more fully discussed below – are both large in number and profound in complexity. The menu of defensive measures available to boards defending against unwanted suitors and corporate raiders has developed since the initial, widespread adoption of such mechanisms during the groundswell of takeover activity in the 1980s. A board that reaches the decision to adopt a single defensive measure or multiple defensive measures in the face of a hostile attempt, activist approach or other risk will bear the burden of demonstrating that the action taken was reasonable in relation to the threat to the corporation and proportional to that threat to the corporation and its business objectives. This section of the guide sets forth some of the panoply of defensive mechanisms available, examines the *Unocal* standard of review and its consequences and discusses the Delaware courts' fact-intensive review of the adoption and maintenance of defensive measures.

The *Unocal* standard of review

The receipt of a hostile or unsolicited offer does not thrust a company and its board into sale mode, unless, in response to such offer, the "target abandons its long-term strategy and seeks an alternative transaction involving the break-up of the company."[42] However, if the board wishes to reject an unsolicited offer and takes defensive actions in furtherance of that goal, the Delaware courts will apply a heightened standard of review to such extraordinary business decisions. In the seminal case of *Unocal Corp. v. Mesa Petroleum Co*., the Delaware Supreme Court set forth the *Unocal* standard, which governs a board's decision to take defensive action in the face of an attempted hostile takeover, activist advance or a similar unsolicited risk.

The enhanced standard of review applied to defensive measures by the Delaware courts is a two-part reasonableness and proportionality inquiry, with a bifurcated second pong. The first prong searches whether the action taken was on reasonable grounds to believe that there is a threat posed to corporate policy and effectiveness. The second prong initially asks whether the defensive measure is reasonable in relation to the threat posed, such that it is neither "preclusive" nor "coercive"; and, secondarily, if the action is not draconian under the first part of the divided analysis, the court will determine if it is within a permitted "range of reasonableness."[43]

With respect to the first part of the *Unocal* standard, "directors must show that they had reasonable grounds for believing that a danger to corporate policy and effectiveness [was present]...[and they can] satisfy that burden 'by showing good faith and reasonable investigation....'"[44] As to the second part of the enhanced standard of review, the Delaware Supreme Court has stated that a defensive measure is coercive where it is "'aimed at cramming down' on its shareholders a management-sponsored alternative."[45] Furthermore, "[a] defensive measure is preclusive where it 'makes a

bidder's ability to wage a successful proxy contest and gain control either 'mathematically impossible' or realistically unattainable."[46] The Delaware judiciary will not, in evaluating the reasonableness of a corporate decision subject to *Unocal* review, substitute their business judgment for that of the directorship. Assuming the presence of an adequate threat to the company and that the defensive measure adopted is proportional and not draconian, the conclusion to deploy a defensive measure in the face of an attempted hostile offer, an activist approach or other risk need only be within a range of reasonableness to pass *Unocal* muster, and such decision need only be a reasonable response – not a "perfect" response – to the unsolicited offer to engage the company in a business combination or a break-up of the company.[47]

Stockholder rights plans/poison pills

Stockholder rights plans, colloquially referred to as poison pills, are perhaps the most well-known and effective defensive mechanism available to defending boards. Poison pills function by enabling directors to issue rights to purchase securities to existing stockholders of a target company at a discount. Upon initial receipt, stockholders are practically able to do very little with their rights. However, once an unwanted suitor or hostile attacker crosses a specified ownership level of the company's securities – generally, 10-percent, 15-percent or 20-percent ownership – the pill is "triggered," and stockholders are then permitted to convert their rights into additional shares of the company. The key aspect of the poison pill is that the unsolicited bidder is not granted similar conversion rights and, upon breaching the rights plan's specified ownership level, the hostile's ownership position in the target is meaningfully diluted. Consequently, the bidder is able to affect less control over the company and will suffer greater financial hardships in attempting to purchase additional shares. While pills attractively do not require stockholder approval, do not directly impact the company's stock price and impose no burdens on the conduct of company business, including the ability to enter into acquisition and other corporate agreements, corporations may only properly adopt such defensive mechanisms consistent with the Delaware General Corporation Law and the board's fiduciary duties, although stockholders and proxy advisory firms may take a negative view of a decision to adopt a pill.

Assuming a board has the authority to adopt a rights plan and issue new securities, the final step of the poison pill is, in some instances, to grant the privileged stockholders what are referred to as flip-in or flip-over rights. Pills, as a general matter, enable stockholders to exchange their issued rights for additional stock of the target corporation and grant the corporation the authority to exchange stock for issued rights to prevent the uncertainty that attends stockholder discretion. A flip-in pill is one whereby management offers rights to qualified stockholders to purchase discounted securities of the target company. A flip-over pill, on the other hand, enables rights holders to purchase securities of the surviving entity or the acquiror following an acquisition, merger or hostile takeover of the target.

The value of poison pills in the face of unsolicited and hostile attempts to purchase a target company is further bolstered by the fact that pills are redeemable under Delaware law. That is to say, provided that the acquiring person does not cross the rights plan's specified ownership threshold, a pill may be redeemed by the board of directors if, say, stockholder support for a given offer is overwhelming or the offeror has otherwise presented an attractive acquisition proposal that the board deems desirable while adhering to its fiduciary duties. Conversely, in addition to the dilutive and other defensive effects of poison pills, the Delaware Supreme Court has declared the acceptability of reloadable pills, such that, once an acquiror breaches a specified ownership level, the board of directors at a target can simply adopt another pill on top of the preexisting pill, thereby re-multiplying the cost of attempting to complete an acquisition for unwanted suitors willing to swallow the initial pill.[48]

Pills can be tailored to terminate after a specified period of time without requiring director action. Sunset provisions terminating pills after a certain time period have increased in popularity in recent years, although the sunsets have shortened in duration, ensuring that rights plans do not create an indefinite cloud over a company and its securities.

Delaware has long viewed the poison pill as a permissible defensive instrument under the Delaware General Corporation Law, and the adoption of such a mechanism on a clear day – that is to say, not in the face of a threat to the company – is typically is upheld by the Delaware courts under *Unocal*.[49] Pills receive enhanced scrutiny regardless of whether they are (a) established prior to the arrival of an unwanted suitor or activist investor and the board decides to keep the pill in place in connection with the unsolicited approach, and (b) adopted in response to a threat to corporate policy or effectiveness. Importantly, adopting boards cannot "arbitrarily reject" offers for the company and corresponding requests to redeem a well-positioned pill.[50] Rather, directorships "will be held to the same fiduciary standards any other board of directors would be held to in deciding to adopt a defensive mechanism…."[51]

With respect to the *Unocal* standard of review, there are generally three types of threats justifying the adoption or maintenance of a pill as a defensive measure: "(1) structural coercion – 'the risk that disparate treatment of non-tendering shareholders

might distort shareholders' tender decisions' (ie, the situation involving a two-tiered offer where the back end gets less than the front end); (2) opportunity loss – the 'dilemma that a hostile offer might deprive target shareholders of the opportunity to select a superior alternative offered by target management; and (3) substantive coercion – 'the risk that shareholders will mistakenly accept an underpriced offer because they disbelieve management's representations of intrinsic value."[52] In each of the foregoing factual scenarios, Delaware courts have viewed the pill as a reasonable response to a specific threat to a corporation and its stockholders. However, a board's decision to adopt or maintain a pill, subject to *Unocal* scrutiny, will undergo a fact-intensive investigation that is narrowly tailored to the factual details presented. Such inquiry is especially in-depth in the context of a pill justified on the basis of price – substantive coercion. In short, in order to withstand enhanced judicial review, a board's decision to adopt or maintain a rights plan must be made on reasonable grounds to believe that there is a threat posed to corporate policy and effectiveness, reasonable in relation to the threat posed, such that it is neither preclusive nor preclusive, and within a permitted range of reasonableness.

Classified boards

The classified board – sometimes referred to as the staggered board – has rapidly declined in prominence in public companies. Nonetheless, the board structure is such that a corporation, through its charter or bylaws, or by a stockholder bylaw, may divide its board into as many as three classes of directors. Only one class comes up for election on an annual basis, as a result of the fact that directors serve more than one year. Furthermore, directors who sit on staggered boards may only be removed for cause.

The defensive impact of the classified board and the presence of a poison pill is that, in combination, they necessitate a multi-year takeover process. Should a hostile party or an activist seek to take control of the board and, with it, the corporation, it will take, at a minimum, two consecutive annual meetings to replace the incumbents and insert their selected directors. The "for cause" removal requirement prevents hostiles from engaging in a proxy contest to replace a majority of a company's directorship with a sympathetic slate.

In combination with the poison pill, the classified board is an effective takeover defense because an unwanted suitor cannot quickly obtain a majority of the boardroom seats and, with them, redeem the pill. Delaware courts have, in recent years, reaffirmed not only the vitality of the stockholder rights plan, but have upheld the permissibility of a defensive menu that combines a staggered board and poison pill. Together, the pill and the classified board significantly "delay" an unwanted suitor's process of "obtaining control" of the target board or building a significant holding of the company's securities.[53]

Despite the impact of the poison pill and staggered board defensive platform, the Delaware courts have suggested that the combination of the two is acceptable under the *Unocal* standard of review, given that "a classified board would delay – but not prevent – a hostile acquiror from obtaining control of the board, since a determined acquiror could wage a proxy contest and obtain control of two thirds of the target board over a two year period" to ultimately redeem the rights plan.[54] In short, presuming compliance with fiduciary duties, a classified board that reaches the corporate decision to adopt a poison pill as a response to an unsolicited offer, an activist approach, or a hostile attempt on the company will survive *Unocal* scrutiny, because "[t]he fact that a combination of defensive measures makes it more difficult for an acquiror to obtain control of a board does not make such measures realistically unattainable."[55]

Limitations on board size

As a corollary to the discussion of classified boards, limitations on the size of a company's board may also function to protect a company from unwanted takeover, activist influence, or other corporate risk.[56] Under Delaware law, the size of a corporation's board can be modified by either the stockholders or the directors. Absent a charter or bylaw provision granting sizing authority to the directors exclusively, stockholders can act through a bylaw to insert directors to fill vacancies and newly created director positions.

Advance notice bylaws

Advance notice bylaws are commonly employed by public companies and, particularly in the activist context, are an effective way for boards to prepare for advances made on the boardroom and company. These bylaws require, as a predicate to a stockholder proposing a corporate action requiring stockholder approval (such as the nomination of a director), that the proposing stockholder give advance notice to the company prior to the meeting at which the matter will be voted on. The bylaw will set forth the window within which the proposing stockholder must notify the company of its intentions, and failure to give notice within the window generally precludes the stockholder from raising the matter until the next meeting for which it has met the notice requirement.

The defensive impact of advance notice bylaws is such that incumbent management can heed the warning shots of unfriendly stockholders and take measures to defeat a stockholder's proposed course of corporate action. In the context of a proxy

contest, advance notice bylaws give board members the ability to prepare a campaign in support of their board position and against the unfriendly stockholder's slate of directors.

The Delaware courts have recognized advance notice bylaws as "commonplace" and "often construed and frequently upheld by Delaware courts," in view of the fact that they are "useful in permitting orderly shareholder meetings."[57] However, these bylaws are struck down when the "notice requirements 'unduly restrict the stockholder franchise or are applied inequitably'….The clearest set of cases providing for support for enjoining an advance notice bylaw involves a scenario where a board, aware of an imminent proxy contest, imposes or applies an advance notice bylaw so as to make compliance impossible or extremely difficult, thereby thwarting the challenger entirely."[58]

Often, in reviewing the propriety of an advance notice bylaw and a board's decision to refuse to waive its requirements, a Delaware court will ask the following: "[A]lthough the [bylaw] notice requirement is facially valid and was equitable at the time it originally became applicable, was the [company's] directors' subsequent refusal to waive the [bylaw] requirement inequitable?"[59] Thus, prior to adopting an advance notice bylaw, directors should consider whether doing so changes the facts and circumstances of the stockholder franchise in a material way, where the adoption or modification of such an instrument could be interpreted as inequitably interfering with stockholder voting rights.

Advance notice bylaws can be attacked from a substantive prospective, in addition to a procedural prospective. Ultimately, with respect to advance notice bylaws, the Delaware Supreme Court has stated "inequitable action does not become permissible simply because it is legally possible."[60] While boards are generally free to adopt advance notice bylaws, they may only do so in a manner that does not undermine the stockholder franchise.

Blank-check preferred stock

In Delaware, blank-check preferred stock is a special class of security, memorialized in a company's certificate of incorporation, that often carries enhanced voting and conversion rights, among other things. Section 151(a) of the Delaware General Corporation Law permits the inclusion of a blank-check provision in a company's charter, enabling a board of directors to issue a new class of stock on such terms and with such voting powers, designations, preferences, qualifications and special rights as the directorship deems appropriate, provided such authority is outlined in the certificate of incorporation. The specific rights granted to the preferred stockholders need be set out in a certificate of designation, which is filed with the Delaware Secretary of State. Because the privileges attached to such preferred stock are

bespoke, the directors have the discretion to tailor the rights, preferences and convertibility of the newly issued preferred stock such that it makes an unwanted takeover more difficult to complete.

A board's decision to issue preferred stock for ordinary business purposes is generally subject to the protections of the business judgment rule. However, where used primarily to defend against unwanted advances on the company and its business, courts that have considered the issue have suggested that a board's decision to utilize its blank-check authority to fend off a potential hostile acquiror, activist or other unwanted threat may be subject to *Unocal* scrutiny[61] or an enhanced standard of review requiring that the directors show a "compelling justification" for interfering with the stockholder franchise.[62]

Indeed, if a board makes the decision to issue preferred stock in connection with a self-dealing or conflicted transaction in violation of the duty of loyalty, the Delaware case law suggests that such action will be subject to entire fairness review,[63] such that the directors "must establish to the court's satisfaction that the transaction was the product of both fair dealing and fair price. Not even an honest belief that the transaction was entirely fair will be sufficient to establish entire fairness. Rather, the transaction itself must be objectively fair, independent of the board's beliefs."[64]

White knights and white squires

In Delaware takeover parlance, a "white knight" is a third-party bidder sought after by target companies faced with the threat of hostile takeover. In seeking a white knight, boards hope to find

a friendly bidder uninterested in controlling the company and replacing the incumbent directors, but who is capable of and interested in making a competing financial offer for the business relative to that of the hostile party.

While the pursuit of a white knight might appear to be an attractive defensive mechanism, it also triggers fiduciary duty obligations under the *Revlon* standard of review which the directors must carefully consider. In short, the Delaware courts have viewed the pursuit of a white knight in the face of an offer for the company as an event triggering a heightened standard of review, requiring that a selling board obtain the highest price for the company reasonably attainable for the benefit of the stockholders.[65]

Similar to the white knight is the "white squire." While white knights acquire the company as a whole, without seeking control or the replacement of incumbent management, white squires are management-friendly stockholders, either new or existing, who acquire in the public markets or are issued a significant block of the target company's voting securities. The federal securities laws incentivize white squires not to exceed a certain percentage in holdings, and often all that white squires purchase is that which is necessary to prevent a hostile takeover or prevent activists, and other corporate threats, from exerting their influence over the company and its affairs. Directors seeking white squires as a defensive measure must also carefully consider whether their decisions will be subject to a heightened standard of review in the Delaware courts.[66]

The "just say no" defense

The aptly named "just say no" defense in Delaware permits a "well-informed board acting in good faith in response to a reasonably perceived threat" to simply just say no to a hostile offer for the company.[67] Significantly, the ability of a board to "just say no" to an offer for their company is limited by its fiduciary duties. Where the corporation is up for sale and otherwise in *Revlon* mode, the board may not simply say no to an offer to purchase the company.[68]

Case law with respect to the just say no defense endorses Delaware's "respect for reasonably exercised managerial discretion, so long as boards are found to be acting in good faith and in accordance with their fiduciary duties (after rigorous judicial fact-finding and enhanced scrutiny of their defensive actions)."[69] Indeed, the Delaware courts have carefully distinguished the ability to "just say no" from the ability to "just say never"; the difference between the two defensive positions being that "just say no" implies a single well-informed board decision in compliance with the board's fiduciary duties on an instance-by-instance basis, while the "just say never" defense suggests that the board's defensive position is to flatly reject any and all offers from a particular suitor, regardless of the offers' quality and reasonableness. To survive scrutiny in a Delaware courtroom, a decision to just say no ultimately must be well informed and made as a good faith response to a reasonably perceived threat to the company, but the defense cannot be employed if the company is up for sale or is otherwise in sale mode.

Pac-Man defense

The Pac-Man defense, where the company initially subject to an unsolicited offer from an unwanted suitor responds by making a counteroffer to acquire the original offeror, has returned to prominence. In 2013, two men's apparel companies, Jos. A. Bank and Men's Wearhouse, made competing offers for one another, with the smaller of the two, Jos. A. Bank, making the initial, unsolicited offer to purchase the larger company. In response to Jos. A. Bank's unsolicited approach, Men's Wearhouse made a counteroffer to purchase Jos. A. Bank, ultimately succeeding in both defending itself against the initial unsolicited proposal and acquiring the smaller unsolicited offeror.

The Delaware case law underlying the use of the Pac-Man defense is undeveloped. While it seems clear that the use of the defense could subject a board to *Unocal* scrutiny, given that it is a response to a reasonably perceived threat from an unwanted suitor, the Delaware courts have yet to speak to the issue. Perhaps a more complex question still to be answered in Delaware is whether employment of the defense weakens a defending company's defensive profile through the implicit suggestion that a business combination with the unsolicited offeror is in the best interests of the company's stockholders. Presumably, for example, if a company responds to an unsolicited offer by using the Pac-Man defense, it likely can no longer "just say no" to follow-on offers from the initial offeror, because the board, via its counteroffer, has implicitly suggested that a business combination with the initial offeror is in the company's best interests. Directors, at a minimum, should be prepared to thoroughly evaluate subsequent offers from unsolicited offerors while upholding their fiduciary obligations after employing the Pac-Man defense in Delaware.

Supermajority voting requirements

The Delaware General Corporation Law permits a corporation to specify in its charter provisions that an affirmative vote of more than a majority of the outstanding stockholders is required for any corporate action. Typically, supermajority voting requirements require the affirmative vote of anywhere between 66.67 percent and 80 percent of the stockholders to carry out specified corporate actions. This means that when a corporation is confronted with an issue requiring approval of a supermajority of the outstanding stockholders, large stockholders are vested with meaningful influence and significant ability to shape the company's business.

Directors considering the use of supermajority provisions should therefore be mindful of the consequences of requiring supermajority approval for certain corporate actions, despite such provisions being attractive additions to corporate defense profiles.

From a defensive perspective, in addition to the procedural hurdles associated with amending, repealing or modifying a company's charter, supermajority voting requirements are used to make the consummation of business transactions with a target company more complicated. In Delaware, supermajority provisions are often used as an approval requirement for transactions involving controlling stockholders owning a specified percentage of the company's stock. Supermajority arrangements are also used to solidify other instruments in a company's defensive arsenal by making them more difficult to remove or waive. Supermajority voting schemes have additionally been developed as a method to require the affirmative vote of greater than a majority of the outstanding shares to remove a director.

Akin to the adoption of many defensive measures, a board's decision to implement supermajority voting provisions in its charter or bylaws on a clear day will receive the protection of the business judgment rule. However, when implemented as a defensive play in connection with a threat to corporate policy or effectiveness, supermajority voting provisions will be subject to *Unocal* scrutiny, such that they must survive a Delaware court's reasonableness and proportionality inquiry.[70] Notably, supermajority voting arrangements have been diminished by stockholder votes in recent proxy seasons, and have been frequently removed from corporate governance documents along with board classification provisions.

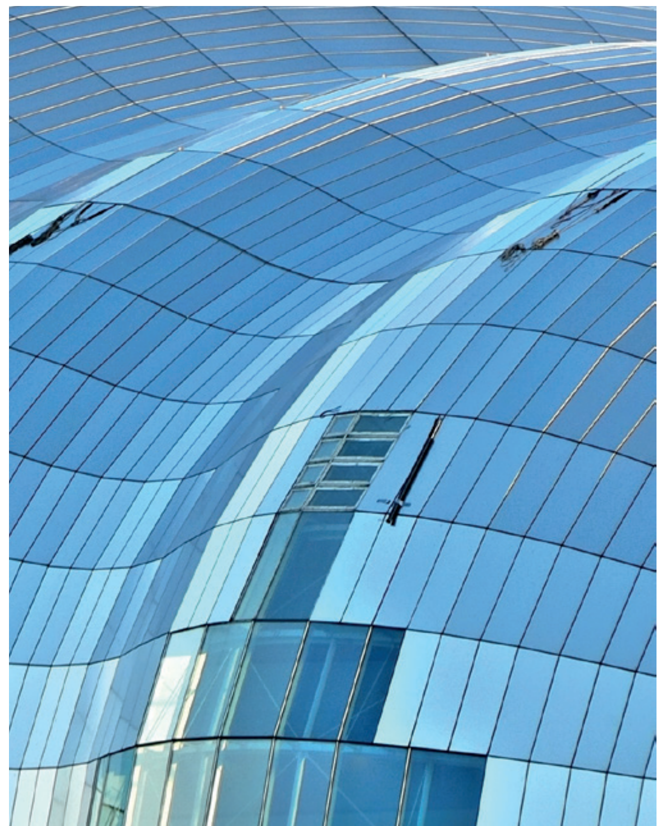
Special meeting limitations

The under Section 211(d) of Delaware General Corporation Law "[s] pecial meetings of the stockholders may be called by the board of directors or by such person or persons as may be authorized by the certificate of incorporation or by the bylaws." As a result, without a provision in the certificate of incorporation or the bylaws of a company providing that stockholders or another person may call a special meeting, the board of directors has the exclusive authority to call a special meeting to vote on a corporate decision. "Corporate bylaws commonly contain a provision conferring the power to call a special meeting on either the Chairman of the Board, the senior-most corporate officer, such as the CEO or President, or both."[71] Unsurprisingly, corporate stockholder populations and proxy advisory firms have moved to strike special meeting limitations at corporations utilizing them with the effect of a defensive measure, despite their proper purpose as a means to promote orderly stockholder participation in the corporate democracy.

Special meeting limitations typically take the form of minimum ownership thresholds, timing limitations and substance restrictions. With respect to minimum ownership thresholds, provisions granting stockholders the right to call a special meeting often contain a requirement that a certain percentage of the outstanding shares must request the special meeting in order for one to be duly called. Predominantly, companies require that at least 25 percent of their outstanding shares request a special meeting before one is called, such that corporations are not saddled with numerous meetings called be holders of a *de minimis* number of shares.

As to timing limitations, a common special meeting limitation is that no special meeting request will be granted if it is made within a specified period of time prior to or subsequent to any previous special meeting of the stockholders, regardless of the percentage of shares requesting the meeting. Similarly, provisions granting stockholders the right to call special meetings also restrict the substance of what can be voted upon at such meetings to that which is included in the initial request to hold the meeting. The board typically grants itself the authority to raise any issues for a vote it deems fit for the stockholder meeting, as well.

Special meetings serve the important defensive purpose of minimizing the ability of a hostile bidder, activist stockholder



or a similar outside threat to corporate policy or effectiveness from using the special meeting forum to, among other things, remove directors; expand the board; redeem or cancel defensive instruments; and modify, implement or repeal bylaws. Indeed, such substance restrictions prevent unwanted third parties from continuously raising their agendas, even if they were otherwise voted upon at a special meeting or annual meeting, to the detriment of a corporation's business strategy.

Despite stockholder movements against their usage, special meeting limitations remain stalwart provisions in the corporate charters and bylaws of Delaware entities. The Delaware courts, in examining special meeting limitations adopted as defensive measures, have stated that certain circumstances involving threats to corporate policy and effectiveness and the stockholder franchise will "'necessarily [invoke] both *Unocal* and *Blasius'* because both tests 'recognize the inherent conflicts of interest that arise when shareholders are not permitted free exercise of their franchise."[72] "In these circumstances, a board's unilateral decision to adopt a defensive measure 'touching upon issues of control' that 'purposefully disenfranchises its shareholders' will be evaluated under *Unocal*. However, even within that framework that board decision will be viewed as 'strongly suspect…and cannot be sustained without a 'compelling justification.'"[73]

The *Blasius* standard of review requires directors to show a compelling justification for taking an action "for the principal purpose of impeding the effective exercise of the stockholder franchise" and, absent such a justification, the action will be deemed "inequitable and will be restrained or set aside in proper circumstances."[74] However, the *Unocal* standard of review, in the special meeting limitation context, requires that the directors demonstrate that they had reasonable grounds to believe a danger to corporate policy and effectiveness existed and that their decision to adopt special meeting limitations was reasonable in relation to the threat posed.

Dual-class capitalization

The distinguishing feature of dual-class stock structures is that they differentiate the voting authority of insiders from that of the public, effectively concentrating corporate control in the hands of a few. Essentially, dual-class structures function by granting to a small group of stockholders shares with the privilege of carrying multiple votes, while restricting the public float to shares entitled to only one vote per share. Vesting a few stockholders with stock containing a majority of the voting power functionally precludes hostile bidders and activist stockholders from cramming their agendas down on corporate boards without the support of controlling insiders.

Dual-class stock structures are typically in place prior to the arrival of hostile bidders and activist investors; therefore, the instances in which a board adopts such a structure as a defensive platform are few and far between. Nonetheless, in view of the fact that more than half of all companies whose securities trade on public exchanges are incorporated in Delaware, management of publicly traded companies with dual-class voting structures should be mindful that Delaware judges are generally unreceptive to the "utiliz[ation of] the corporate machinery and the Delaware Law for the purpose of [management's] perpetuating itself in office."[75]

Constituency statutes

Many states have adopted constituency statutes, which permit directors to account for the impact a corporate decision might have on non-shareholder constituencies, such as employees, suppliers, the community, the environment and customers, among other stakeholders. Delaware, however, has no such statute. A Delaware public benefit corporation requires that managers of such entities direct the business and affairs of the company in a manner that balances the pecuniary interests of the stockholders, the best interests of those materially affected by the corporation's conduct and the specific public benefit or public benefits identified in the certificate of incorporation. Directors of Delaware-incorporated, traditional corporate entities have no such obligations to the foregoing non-shareholder constituencies.

There is Delaware legal precedent suggesting that directors considering a sale of the company may validly consider "promoting, protecting, or pursuing nonstockholder considerations" while in sale mode, provided that doing so leads to stockholder value.[76] The Delaware corporation law is otherwise undeveloped on the issue of whether a board can justify defensive measures on the basis that such actions are taken in furtherance of interests extrinsic to stockholder welfare and value. The Delaware Supreme Court has upheld defensive actions taken as part of a "good faith effort to protect a specific corporate culture,"[77] but subsequent case law has suggested that board protection of non-stockholder-based concerns must nonetheless lead to the promotion of shareholder value. To the extent that directors consider attempting to justify defensive actions on the basis of non-stockholder considerations, the board likely must ensure that such considerations lead to long-term stockholder value and that the defensive measure satisfies *Unocal's* two-part reasonableness and proportionality inquiry.

What duties are owed and to whom are they owed?

As outlined in the discussion of *Revlon* and its progeny, a selling board, at a sale of its company, need only act within a range-of-reasonableness under the circumstances, effectively obligating the selling board to perform its fiduciary duties of care and loyalty with the objective of obtaining the best price for the company realistically attainable. However, the common stockholder population is, in reality, one of multiple groups interested in a company's decision to sell itself. For example, in addition to the stockholders of the corporation, employees, suppliers and customers have an interest in the outcome of a sale or merger, both directly and indirectly. Similarly, business combinations impacting the broader community and the environment often attract interest from third parties without a financial stake in a transaction.

In addition to non-financial stakeholders, alternative equity holders and creditors of a corporation maintain material interests in a board's decision to sell the company. This section of the guide will touch upon the duties owed by corporate management to preferred stockholders, creditors and non-financial stakeholders at a sale of the company, discussing, in each instance, how such duties intersect with those owed to common stockholders once the company enters sale mode.

Duties owed to preferred stockholders

Preferred stock is "a stock which in relation to other classes enjoys certain defined rights and privileges."[78] The preferred stockholders' rights and privileges are typically contained in "'the [certificate] of incorporation, the preferred share designations, or some other appropriate document' such as a registration rights agreement, investor rights agreement, or stockholder agreement."[79] In other words, the rights and privileges of preferred stockholders are contractual and, in the event that the governing instrument is silent with respect to a particular issue, then "the preferred stock and the common stock have the same rights."[80]

When considering the contractual rights of preferred stockholders once a company enters sale mode, directors owe no fiduciary duties to preferred stockholders.[81] Rather, "[p]referred stockholders are owed fiduciary duties only when they do not invoke their special contractual rights and rely on a right shared equally with the common stock.…[T]he standard of conduct for directors requires that they strive in good faith and on an informed basis to maximize the value of the corporation for the benefit of its residual claimants, the ultimate beneficiaries of the firm's value, not for the benefit of its contractual claimants."[82] In other words, when standing as equity holders of the corporation, preferred stockholders are owed fiduciary duties by a board in sale mode just as common stockholders. Where, however, the preferred stockholders stand in their right as a party to a contract with the corporation, the board has no fiduciary obligation to the preferred.

Consequently, in view of the foregoing relationship between directors, preferred stock and common stock, "generally it will be the duty of the board, where discretionary judgment is to be exercised, to prefer the interests of the common stock – as the good faith judgment of the board sees them to be – to the

interests created by the special rights, preferences, *etc*....of preferred stock."[83] Therefore, a selling board may appropriately consider the "contractual promises owed to the preferred" when taking a corporate action obligating it to "pursue the best interests of the corporation and its common stockholders,"[84] but such promises are ultimately of secondary import in view of the fiduciary duties owed to the firm's common equity holders. "When...the rights of the preferred in a particular transactional context are articulated, it is those rights that the board must honor. To the extent that the board does so, it need not go further and extend some unspecified fiduciary beneficence on the preferred at the expense of the common. When...there is no objective contractual basis for treatment of the preferred, then the board must act as a gap-filling agency and do its best to fairly reconcile the competing interests of the common and preferred."[85]

The Court of Chancery, in considering the possibility of fundamental conflict between the interests of the preferred and common at a sale of a company, has held that "it is *possible* that a director could breach her duty by improperly favoring the interests of the preferred stockholders over the common stockholders."[86] Thus, once *Revlon* is triggered, the primary concern of the board of directors need be the maximization of the value of the company for the benefit of the stockholders, which must be completed in accordance with their fiduciary duties. "[I]f that can be done faithfully with the contractual promises owed to the preferred," then the board must, of course, honor such promises while meeting their fiduciary obligations to the common.[87]

Obligations owed to creditors

The Delaware Supreme Court, in *North American Catholic Education Programming Foundation, Inc. v. Gheewalla,*[88] clarified that "[w]hen a corporation is *solvent*, [fiduciary duties] may be enforced by its shareholders, who have standing to bring *derivative* actions on behalf of the corporation because they are the ultimate beneficiaries of the corporation's growth and increased value. When a corporation is *insolvent*, however, its creditors take the place of the stockholders as the residual beneficiaries of any increase in value. Consequently, the creditors of an *insolvent* corporation have standing to maintain derivative claims against directors on behalf of the corporation for breaches of fiduciary duties."[89] The Delaware Supreme Court's justification for permitting creditors of *insolvent* corporation's to bring derivative actions is that insolvency "makes the creditors the principal constituency injured by any fiduciary breaches that diminish the firm's value."[90]

As to the fiduciary duties owed by directors to creditors, the Delaware Supreme Court held that "[w]hen a solvent corporation is navigating in the zone of insolvency, the focus for Delaware directors does not change: directors must continue to discharge their fiduciary duties to the corporation and its shareholders by exercising their business judgment in the best interests of the corporation for the benefit of its shareholder owners."[91] Nonetheless, despite the fact that creditors of an *insolvent* corporation have standing to sue derivatively, the Delaware Supreme Court in *Gheewalla* refused to impose upon directors direct fiduciary duties to creditors, on the theory that such obligations "would create uncertainty for directors who have a fiduciary duty to exercise their business judgment in the best interest of the insolvent corporation. To recognize a new right for creditors to bring direct fiduciary duty claims against those directors would create a conflict between those directors' duty to maximize the value of the insolvent corporation for the benefit of all those having an interest in it, and the newly recognized direct fiduciary duty to individual creditors."[92]

Duties owed to non-financial stakeholders

As shown throughout this guide, at a sale of the company, the board of directors of a Delaware corporation is tasked with maximizing the sale price of the enterprise for the benefit of the stockholder owners while adhering to their fiduciary duties. As a corollary, while non-financial stakeholders, such as the community, employees, customers and suppliers,may have an interest in a board's decision to sell the company, directors owe no fiduciary duties to such groups. Nonetheless, "[w]hen director decisions are reviewed under the business judgment rule, [courts] will not question rational judgments about how promoting non-stockholder interests – be it through making a charitable contribution, paying employees higher salaries and benefits, or more general norms like promoting a particular corporate culture – ultimately promote stockholder value."[93]

Revlon itself discusses the consideration of the interests of non-financial stakeholders at a sale of the company. There, the Delaware Supreme Court provided that "[a]lthough such considerations [of non-stockholder corporate constituencies and interests] may be permissible, there are fundamental limitations upon that prerogative. A board may have regard for various constituencies in discharging its responsibilities, provided there are rationally related benefits accruing to the stockholders."[94] In other words, once a company enters sale mode, the foundational and primary responsibility of the directorship is to maximize the sale price for the benefit of the stockholders while adhering to their fiduciary duties of care and loyalty. To the extent that the interests of non-financial stakeholders are aligned with and further to stockholder value, the board may properly consider them in reaching their decision to sell the company. Accordingly, as suggested by the Delaware Court of Chancery in *eBay Domestic Holdings, Inc. v. Newmark,* "[p]romoting, protecting, or pursuing nonstockholder considerations must lead at some point to value for stockholders."[95]

Delaware sale structures

The Delaware General Corporation Law provides parties to a contemplated business combination with a variety of ways for consummating the transaction. As aforementioned, the state's corporate statute is amended and developed on an ongoing basis to reflect the needs and concerns of Delaware corporations, their management and their stockholder owners. Sale structures are the mechanical foundation by which one company may acquire, be acquired by, or merge with or into another entity. Sale structures are, in each instance, statutory creatures with diverse requirements and preconditions for their use in a given contemplated business combination. This section of the guide sets forth some of the mechanisms by which Delaware corporations may complete a merger or acquisition.

Classical mergers

A classical merger, also known as a statutory or long-form merger, is the archetypal merger in which two or more corporations combine to produce a single surviving corporation. Within the Delaware General Corporation Law, classical mergers are governed by Section 251. Under Section 251, two or more Delaware corporations "may merge into a single corporation, which may be any [one] of the constituent corporations or [] a new corporation formed by the consolidation."[96] The statutory provision requires that boards of both entities party to a classical merger approve the governing merger agreement,[97] which must articulate certain material aspects of the combination,[98] including, among other things, the terms and conditions of the merger or consolidation,[99] the method by which such terms and conditions will be carried into effect,[100] and information with respect to changes or a lack thereof to the surviving corporation's certificate of incorporation.[101] To the extent that the entities are consolidating to form a new corporation, the merger agreement must contain a statement that the certificate of incorporation of the resulting entity shall be attached to the governing transaction instrument.[102]

Further, under Section 251, the contemplated merger or consolidation must be approved by a vote of the majority of the outstanding shares of each entity entitled to vote on the transaction, and such vote may take place at either an annual or special meeting of the stockholders.[103] Stockholders must be apprised of the time, place and purpose of the meeting at least 20 days in advance, and must be provided with either a copy of the merger agreement or a brief summary of the instrument.[104] Voting and non-voting stockholders must be notified of the meeting at which the applicable vote will be taken, as a result of the fact that non-voting stockholders must be able to perfect their demand for appraisal rights under Section 262(d)(1) of the Delaware General Corporation Law prior to the meeting, as will be discussed later in this guide.

Alternatively, stockholder approval may be obtained through written consents. Under Section 228, an action requiring approval by vote at an annual or special meeting "may be taken without a meeting, without prior notice and without a vote, if a consent or consents in writing, setting forth the action so taken, shall be signed by the holders of outstanding stock having not less than the minimum number of votes that would be necessary to authorize

or take such action at a meeting at which all shares entitled to vote thereon were present and voted."[105] As a practical matter, approval by written consent is difficult to obtain at corporations with large shareholder bases, but is otherwise an efficient method of gaining stockholder approval at closely held entities with few shareholders. The merger agreement is typically approved through a proxy solicitation, which, in the case of a publicly traded company, is filed with the Securities and Exchange Commission, along with a copy of the governing merger instrument.

Subsequent to the necessary approvals, the parties to the business combination must file with the Delaware Secretary of State either a copy of the governing instrument or a certificate of merger or consolidation, certifying as to certain information related to the transaction, for the merger or consolidation to be effective.[106] Once the transaction is rendered effective, all rights and liabilities carry forward, meaning that the newly formed or surviving entity benefits from or is responsible for the rights and liabilities of its predecessor entities.[107]

Short-form mergers

Section 253 of the Delaware General Corporation Law establishes procedures for so-called short-form mergers. Where an acquiror owns at least 90 percent of the outstanding shares of each class of the target's stock, the acquiring company may effectuate a merger of the target company into itself by executing and filing a certificate of ownership and merger, containing a copy of the resolution of the board of the acquiring company with respect to the combination, with the Delaware Secretary of State.[108] However, to the extent that the acquiror does not own all of the outstanding stock of the target, the aforementioned resolution of the board must state the terms and conditions of the merger, including the securities, cash, property or rights to be issued or granted by the surviving entity.[109]

Crucially, from an efficiency perspective, short-form mergers under Section 253 require approval from neither the acquiror's stockholders nor the target's stockholders. The merger can be effected simply be resolution of the board of the acquiror. Moreover, as provided by Section 262(b)(3), appraisal rights always obtain for stockholders of the target in a short-form merger, regardless of the consideration, in view of the fact that such holders do not have the ability to vote on the transaction. However, it is important to note that the acquiror's stockholders do not receive voting or appraisal rights in connection with a transaction completed using Section 253.

Triangular mergers

Triangular mergers involve the formation of a new subsidiary entity to be merged with a target company. Triangular mergers take two forms: forward and reverse. In a forward triangular merger, the acquiring corporation forms a subsidiary and the subsidiary acquires the target corporation. In a reverse triangular merger, the acquiring corporation forms a subsidiary, which is then merged with and into the target corporation. In each instance, the merger of the acquisition subsidiary and the target corporation makes the target a subsidiary of the acquiror parent.

Mechanically speaking, the acquiring corporation creates a shell acquisition subsidiary and places merger consideration in that subsidiary in exchange for all of the subsidiary's stock. Thereafter, the board and stockholders of the target must approve the transaction, as must the acquisition subsidiary's board. At this step in the forward triangular merger process, the target company merges with the acquisition subsidiary and the consideration is that which was placed in the acquisition subsidiary by the parent. With respect to the reverse triangular merger process, at this point the acquisition subsidiary would merge with and into the target company, with the target surviving. All of the previously outstanding shares of the target are converted into shares of the acquisition subsidiary, and all of the acquisition subsidiary's shares are converted into target shares. In effect, the acquisition subsidiary ceases to exist as a legal entity and the target is the subsidiary of the acquiror.

In triangular mergers, the acquiring parent corporation is constituently not a party to the transaction. Therefore, under Delaware law, the stockholders of the acquiror generally do not receive a vote, nor do they get appraisal rights following the transaction. However, because in triangular mergers the target stockholders receive merger consideration placed in the acquisition subsidiary by the acquiror, which may potentially be acquiror shares or cash, the target stockholders receive appraisal rights, unless the consideration to be paid is shares of the parent corporation that are traded on a national securities exchange. It is possible to structure the triangular merger as a classical merger, entitling the stockholders of the target to a vote on the transaction, in addition to the stockholders of the acquisition subsidiary, although the vote at the acquisition subsidiary is merely a formality as a result of the fact that the acquiring parent corporation is typically the sole stockholder of the acquisition subsidiary. To the extent that the merger of the acquisition subsidiary and the target is completed using the short-form merger, the target stockholders will not receive a vote on the advisability of the transaction.

Asset sales

Under Section 271 of the Delaware General Corporation Law, a corporation may effectuate a sale of all or substantially all of its assets. Functionally, asset sales enable the acquisition of a portion of the corporation's assets and liabilities, such that the acquiror

is free to pick and choose the property of the target it wishes to assume, including money, personal or real property and securities. Section 271 requires that the board of directors of the selling company deem it "expedient and for the best interests of the corporation" to sell all or substantially all of its assets.[110] To that end, the directors must adopt a resolution to proceed with a sale of substantially all of the assets of the corporation and, similarly, such a sale must be approved by a majority of the outstanding stock of the company, after the holders of such stock have been notified by the board of their intention to sell the entity's assets.

Importantly, however, not all asset sales constitute a sale of "substantially all" of a corporation's assets under Section 271 thereby requiring a stockholder vote. As discussed by then-Vice Chancellor Strine in *Hollinger Inc. v. Hollinger Intl., Inc,*[111] asset sales require a stockholder vote "if the assets to be sold 'are quantitatively vital to the operation of the corporation' and 'substantially affect[] the existence and purpose of the corporation.'"[112] In other words, absent a sale meeting the foregoing test, a vote of the stockholders is "never… required for a transaction in the ordinary course of business and [] the mere fact that an asset sale [is] out of the ordinary ha[s] little bearing on whether a vote [is] required."[113] To be sure, an asset sale that strikes "'at the heart of the corporate existence and purpose[]' in the sense that it involve[s] the 'destruction of the means to accomplish the purposes or objects for which the corporation was incorporated and actually performs"[114] requires the affirmative approval of the majority of the company's outstanding stock. Perhaps more concretely, the Delaware Court of Chancery has reaffirmed the Delaware legislature's "approximately half" test, which suggests that an asset sale does not constitute a sale of substantially all of the assets of a corporation if the assets sold amount to less than half of the corporation's total assets.[115] In fact, recent decisions have gone even further and, focusing on the plain language of the statute and dictionary definitions of the words "substantially" and "all," have concluded that "[a] fair and succinct equivalent to the term 'substantially all' would . . . be 'essentially everything.'"[116]

For the purposes of Section 271 asset sales only, the property and assets of a corporation include the property and assets of any subsidiary of the corporation that is wholly owned and under the control of the corporation.[117] Accordingly, to the extent a parent corporation drops assets into a wholly owned and controlled subsidiary that seeks to sell all or substantially all of its assets, the holders of a majority of the parent corporation's outstanding stock must approve the sale.

Delaware General Corporation Law Section 262 does not confer appraisal rights upon the stockholders of a Delaware corporation selling all or substantially all of its assets, unless the selling corporation provides for such rights in its certificate of incorporation. Otherwise, asset sales, by definition, do not enable stockholders of a selling corporation to seek independent judicial determination of the fair value of their shares in connection with a sale of all or substantially all of the subject company's assets.

Tender offers

Tender offers are offers to purchase shares of a corporation's stock directly from the company's stockholders. In essence, tender offers are solicitations to purchase stock, conditioned upon the satisfaction of certain prerequisites prior to the offer to purchase becoming binding upon the offeror. The consideration passed from offeror to offeree in the tender offer context may be cash, offeror securities, or a mix of the two. The most robust definition of what constitutes a tender offer stems from a case outside of the Delaware court system, *Wellman v. Dickinson,*[118] wherein the court provided that there are "seven elements [] characteristic of a tender offer: (1) active and widespread solicitation of public shareholders for the shares of an issuer; (2) solicitation made for a substantial percentage of the issuer's stock; (3) offer to purchase made at a premium over the prevailing market price; (4) terms of the offer are firm rather than negotiable; (5) offer contingent on the tender of a fixed number of shares, often subject to a fixed maximum number to be purchased; (6) offer open only a limited period of time; [and] (7) offeree subjected to pressure to sell his stock. These characteristics were [] accepted as appropriately describing the nature of a tender offer."[119] Ultimately, the Securities Exchange Act of 1934 and subsequent regulations promulgated by the Securities and Exchange Commission establish several requirements in relation to tender offers. Sections 13(d) and 14(d), as well as corresponding Rules 13d and 14d, outline both disclosure and filing requirements for bidders seeking to commence tender offers for more than 5 percent of a class of securities in a corporation.

Bidders employ tender offers in both hostile and negotiated acquisition contexts. In the hostile context, the tender offer is an efficient manner by which to circumvent unproductive negotiations with and refusals to negotiate by unsupportive target management and to put pressure on a target company. In the friendly context, tender offers facilitate efficient acquisitions, which may be completed in as few as 20 days, depending on the consideration used to complete the purchase. The use of the tender offer form in negotiated transactions provides numerous advantages to the offeror and selling stockholders, including efficient disbursement of consideration, reduced risk of closing impediments and expedited consummation of the transaction.

However, tender offers often contain conditions which must be satisfied or waived, most notably with respect to the number of shares tendered into the offer. That is to say, because the purpose

of the tender offer is typically to acquire control of a target company, offerors often condition consummation of the offer on a specific number of shares submitting to the offer in return for the proposed consideration. As will be discussed further in the "Two-step mergers" portion of this guide, tender offers are generally conditioned on the offeror holding 50 percent plus one share or 90 percent of the target company's outstanding voting stock subsequent to completion.

Two-step mergers

Acquirors employ the two-step merger structure in order to simplify the acquisition process. A two-step merger is comprised of two distinct phases. The first step involves the acquiror making a tender offer to stockholders of the target corporation in order to gain a specific voting interest in the target corporation. Pursuant to the two-step merger form, following the tender offer and the offeror's receipt of the requisite number of shares of the target necessary to approve the transaction, a merger is completed pursuant to either Section 251, 253 or 251(h) of the Delaware General Corporation Law. The second step of the merger cashes out the non-tendering stockholders, resulting in the offeror owning 100 percent of the target's stock.

If the bidder acquires voting control but less than 90 percent of the target's outstanding stock, the second step merger may be completed using the Section 251 classical merger form. Effectively, in view of the fact that the acquiror owns, subsequent to the tender offer, the requisite number of shares necessary to approve the transaction on its own, the vote of the target stockholders with respect to the advisability of the transaction is a foregone conclusion. Similarly, if the acquiror, subsequent to the tender offer, holds 90 percent or more of the target's outstanding stock, the acquiror may complete the second step merger utilizing the Section 253 short-form merger. As with a short-form merger that is not preceded by a tender offer, approval of the non-tendering minority stockholders is not required to consummate the second step merger, and the sole remedy for such holders is appraisal of their shares.

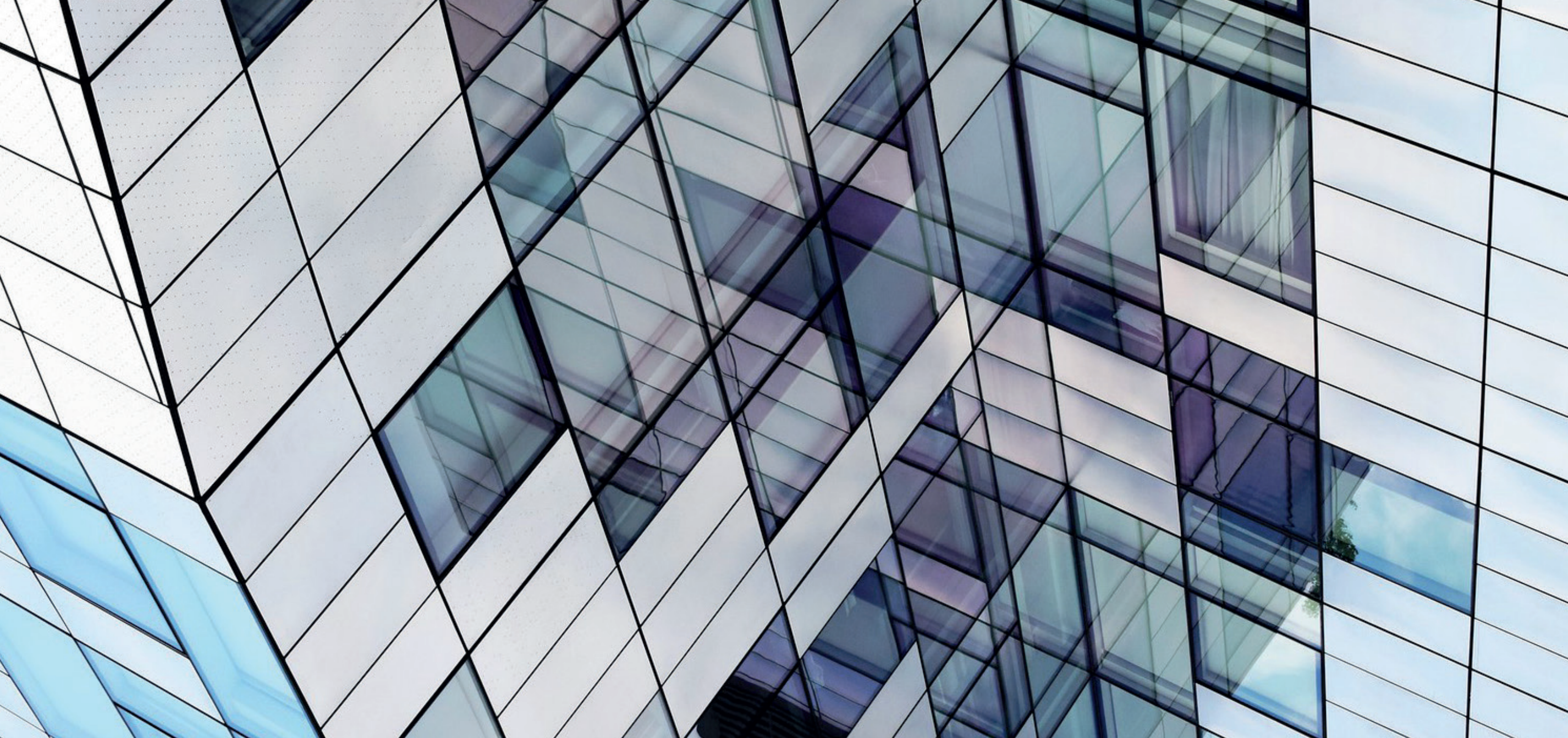
In addition to Section 251 and 253, subsection (h) of Section 251 Delaware General Corporation Law is popular method of competing second step mergers. Section 251(h) became effective on August 1, 2013. The statutory provision was adopted by the Delaware legislature to incentivize efficient deal consummation, enabling acquirors and targets from suffering the time and expense of a target stockholder vote on the advisability of a transaction subsequent to the acquiror obtaining voting control of the target via a tender offer. Acquirors are, under Section 251(h), able to effect a back-end merger following a tender or exchange offer without a stockholder meeting to approve the merger, provided that the acquiror has obtained voting control. While the impact of the statutory provision has been to render certain deal protection mechanisms, such as top-up options, largely unneeded, not all transactions benefit from Section 251(h), as there are limitations on the categories of deals that may benefit from its streamlining efficiencies.

In order for a transaction to qualify under Section 251(h), the target shares must be listed on a national securities exchange or otherwise be held of record by more than 2,000 stockholders in the period immediately preceding the execution of the merger agreement between acquiror and target.[120] Section 251(h) also requires that the tender or exchange offer be made available to all of the outstanding shares of the target company, that the merger agreement must expressly demand that the combination between acquiror and target be effected "as soon as practicable following the consummation" of the tender or exchange offer,[121] and that the language of the merger agreement must explicitly state that the transaction between the parties is to be governed by Section 251(h). Nonetheless, if a target's certificate of incorporation requires that a vote of the stockholders is necessary to approve a second-step merger, then Section 251(h) is inapplicable to any transaction involving that target, regardless of whether the agreement of merger expresses both parties' desire for the streamlining provision to apply. Thus, although the purpose of the section is to facilitate deal-making by avoiding the foregone conclusion that is the target shareholder vote on a combination after the acquiror has obtained voting control, the new statutory provision carefully protects the stockholder franchise. Ultimately, subsection (3) of Section 251(h) is perhaps of the greatest import, as it requires that subsequent to the close of the tender or exchange offer, the acquiror must own enough target stock as would be necessary to adopt the merger agreement, both under the terms of the Delaware General Corporation Law and the target's certificate of incorporation, such that the acquiror could complete the merger, even if Section 251(h) was inapplicable.

Freeze-outs and squeeze-outs

A "freeze-out" or "squeeze-out" merger is not an independent sale structure, but merely refers to the use of a merger to eliminate minority stockholders. By cashing them out, majority stockholders employ freeze-outs to deprive minority stockholders of their equity position in a target company. In the context of standard cash-out mergers, "the exclusive standard of judicial review in examining the propriety of an interested cash-out merger transaction by a controlling or dominating shareholder is entire fairness."[122] While the initial burden of demonstrating entire fairness rests on the party seeking to freeze out the minority shareholders, if the merger is approved by an independent special committee or a majority of minority shareholders the burden of proof shifts to the minority shareholder challenging the fairness of the merger.[123] A properly functioning special committee must be disinterested and well informed, in addition to the requirement that such committee possess the power and authority to reject the transaction and negotiate at arm's length.[124] Similarly, where the proposed transaction is submitted to a vote of the majority of the minority, the minority shareholders must be disinterested and well informed in order to shift the burden of proof.[125]

For freeze-outs accomplished by tender offer, the Delaware Court of Chancery held in *In re Siliconix, Inc. Shareholders Litigation* that defendants need not demonstrate entire fairness "unless coercion or disclosure violations can be shown."[126] Additionally, as the Delaware Supreme Court held in *Glassman v. Unocal,* where a minority shareholder is subject to freeze-out through a short-form merger, entire fairness does not apply, as a result of the fact that the statutory scheme established in Section 253 does not require the procedural protections necessary to show fair dealing.[127] Although, a tender offer by a controlling shareholder followed by a short-form merger is only considered non-coercive and permissible if it is subject to certain procedural protections specified by the court in *In re Pure Resources Shareholders Litigation*. A Delaware court will only consider such a tender offer non-coercive if "(1) it is subject to a nonwaivable majority of the minority tender condition; (2) the controlling stockholder promises to consummate a prompt [Section] 253 merger at the same price if it obtains more than 90% of the shares; and (3) the controlling stockholder has made no retributive threats."[128] As discussed below, Delaware courts have applied a unified standard which later evolved into the *MFW* standard to controlling stockholder squeeze-out transactions.[129]



Interested mergers

Under Delaware law, both directors and controlling shareholders of corporations are fiduciaries, endowed with duties of loyalty and care, which they must perform in good faith. These duties preclude them from placing their personal interests before those of the corporation and its minority stockholders when making business decisions, including those related to business combinations. Where directors or controlling shareholders have a personal interest in a transaction, the deal is not automatically voidable, however. The transaction will be upheld if it meets the so-called entire fairness standard, first articulated by the Delaware Supreme Court in *Weinberger v. UOP, Inc.,* and which has been subsequently been robustly developed by the Delaware courts. If the business judgment rule is at one end of the spectrum, granting directors the highest degree of deference with respect to their decisions, entire fairness is at the other, requiring that the corporate fiduciaries satisfy an exacting standard wherein they are obligated to prove fairness as to price and fairness as to process.

The entire fairness standard

For an interested transaction to be nonvoidable, the defendant directors or controlling stockholder must demonstrate the entire fairness of the transaction. The entire fairness test is a two-pronged, non-bifurcated examination, whereby the Delaware courts will blend the analytical course, examining the adequacy of the process and the sufficiency of price holistically. From a fiduciary perspective, even if entire fairness is triggered, directors are still required to perform their fiduciary duties of loyal and care in good faith, and the Delaware courts will "consider carefully how the board of directors discharged all of its fiduciary duties with regard to each aspect of the non-bifurcated components of entire fairness…."[130] In other words, the most exacting standard of review under Delaware law, entire fairness, requires directors not only to comply with their fiduciary duties, but to prove fair price and fair process, as well.

As aforementioned, "[t]he concept of entire fairness has two basic aspects: fair dealing and fair price. The former embraces questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained. The latter aspect of fairness related to the economic and financial considerations of the proposed merger, including 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. However, the 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."[131]

A fair price is merely a reasonable price. That is to say, it must fall within a "range of fairness."[132] A fair price is therefore one "that a reasonable seller, under all of the circumstances, would regard as within a range of fair value; one that such a seller could reasonably accept."[133] "In a non-fraudulent transaction, 'price may be the preponderant consideration outweighing other

features of the merger.' Evidence of fair dealing has significant probative value to demonstrate the fairness of the price obtained. The paramount consideration, however, is whether the price was a fair one."[134] Despite the Delaware Supreme Court's reiteration of the importance of a fair price, it has stated that "a fair process usually results in a fair price."[135] Fair dealing is often demarcated by independent directors; the structure of the transaction; the quality, robustness, and wholesomeness of the negotiations; the information disclosed to the decision-makers; and the means by which stockholder approval is obtained. The proponents of interested transactions would ultimately do well to ensure that a fair process leads to a fair price, in their efforts to shield themselves from the exacting entire fairness standard.

Interested-director transactions

The Delaware law as to what fact patterns trigger entire fairness review is relatively amorphous and lacks clear delineation, particularly with respect to interested-director transactions. What is clear, however, is that entire fairness review requires Delaware courts to "reach a 'unitary' conclusion. What unites the resulting range of explications of this area of Delaware law is the principle that the entire fairness standard of review is principally *contextual*. That is, there is no bright-line rule on what is entirely fair."[136] Nonetheless, entire fairness may apply where a director is "beholden" to a controlling party "or so under [the controller's] influence that [the director's] discretion would be sterilized"[137]; where the board has a transactional interest not extending to the corporation or its shareholders[138]; and where director "stands on both sides" of a transaction or decision.[139]

The Delaware law, as aforementioned, makes clear that the mere fact that "directors are friendly with, travel in the same social circles as, or have past business relationships with the proponent of a transaction or the person they are investigating, are not enough to rebut the presumption of independence" and trigger entire fairness review.[140] "Rather, the [Delaware] Supreme Court has made clear that a plaintiff seeking to show that a director was not independent must meet a materiality standard, under which the court must conclude that the director in question's material ties to the person whose proposal or actions she is evaluating are sufficiently substantial that she cannot objectively fulfill her fiduciary duties."[141]

Similarly, "[t]he material interest of a number of directors *less* than a majority [of the board] may rebut the presumption of a disinterested board if 'an interested director fail[s] to disclose his interest in the transaction to the board *and* a reasonable board member would have regarded the existence of the material interest as a significant fact in the evaluation of the proposed transaction."[142] That is, entire fairness may be triggered where a singular director with a material interest in the transaction fails to disclose such interest to the remainder of the board, provided that such interest breaches a contextual materiality threshold.

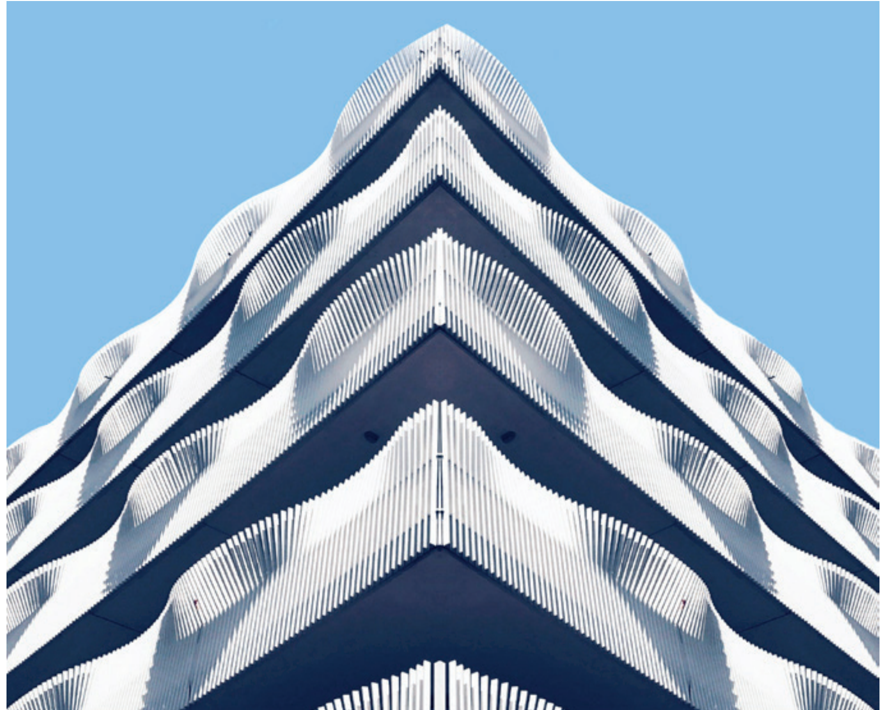
Controlling stockholder transactions

Controlling stockholders owe fiduciary duties to the non-controlling shareholder population. Importantly, however, controllers have the freedom to sell their shares at a premium without sharing any surplus with the non-controlling stockholders. They can also vote their control blocks as any other shareholder might, and can therefore use their position within a company's securities to influence whether a merger is consummated, without consideration of the minority shareholder base's inclination towards the same. Therefore, as a general matter, the Delaware courts will not undertake a review of a controlling stockholder's sale of its securities, where the controller is acting in its capacity as a stockholder.

Nonetheless, interested controlling shareholder transactions trigger entire fairness scrutiny. Where the controlling shareholder is on both sides of a transaction, the most onerous form of scrutiny under Delaware law will apply, and the controller will be required to prove fairness as to price and fairness as to process.[143] Entire fairness will also apply when "a controller has an interest with respect to a transaction that conflicts with the interest of the minority shareholders."[144] The Delaware courts have found entire fairness to be the applicable standard in transactions where the controlling stockholder "receives different consideration from the minority" and "in a sense 'compet[es]' for portions of the consideration [the acquiror is] willing to pay…and [the controller] could effectively veto any transaction."[145] Finally, entire fairness applies to controlling stockholder transaction where the minority is "squeezed out" or "cashed out," in view of the omnipresent threat of self-dealing in deals where the controller takes a different form or amount of consideration than the minority.[146]

In transactions involving an interested controlling stockholder buyout, the Delaware Supreme Court has held that "the business judgment standard of review will be applied *if and only if:* (i) the controller conditions the procession of the transaction the approval of both a Special Committee and a majority of the minority stockholders; (ii) the Special Committee is independent; (iii) the Special Committee is empowered to freely select its own advisors and to say no definitively; (iv) the Special Committee meets its duty of care in negotiating a fair price; (v) the vote of the minority is informed; and (vi) there is no coercion of the minority."[147] Notably, however, if the foregoing conditions are not satisfied prior to the commencement of negotiations with respect to a buyout transaction, then a controller cannot receive the protections of the business judgment rule.

Burden shifting in interested transactions



The Delaware Supreme Court has provided that "when the entire fairness standard applies, the defendants may shift the burden of persuasion by one of two means: first, they may show that the transaction was approved by a well-functioning committee of independent directors; or second, they may show that the transaction was approved by an informed vote of a majority of the minority shareholders."[148] It is often overlooked, but important to note, that the dual protection is disjunctive, such that an interested party need only establish that there was either approval by a well-functioning committee of independent directors *or* a fully informed, uncoerced vote of the majority of the minority stockholders.

The special committee must "function in a manner which indicates that [the interested party] did not dictate the terms of the transaction and that the committee exercised real bargaining power 'at an arms-length.'"[149] An effective special committee is typically characterized by the inclusion of multiple independent members; "a clear mandate setting out its powers and responsibilities in negotiating the interested transaction"; and "access to knowledgeable and independent advisors, including legal and financial advisors."[150] As to the affirmative vote of a majority of the minority stockholders in a controlling transaction, the Delaware law has long held that "the uncoerced, fully informed vote of disinterested stockholders is entitled to substantial weight…[and] in the [interested] merger context, it is settled that an uncoerced, informed majority-of-the-minority vote, without any other procedural protection, is itself sufficient to shift the burden of persuasion to the plaintiff under the entire fairness standard."[151]

Additional interested transaction safeguards

A fairness opinion is a statement as to the evenhandedness of a transaction delivered by a corporate outsider, typically an investment bank or other financial advisor. The Delaware courts do not mandate fairness opinions when entire fairness is invoked by an interested merger. Nonetheless, the Delaware judiciary has previously stated that such opinions function as "procedural safeguards" that evidence the fairness of a transaction.[152] Aside from the role fairness opinions play in establishing whether a transaction meets the entire fairness standard, they are also employed as a mechanism to shield directors from liability pursuant to Delaware General Corporation Law Section 141(e), which establishes that: "A member of the board of directors, or a member of any committee designated by the board of directors, shall, in the performance of such member's duties, be fully protected in relying in good faith upon…opinions, reports or statements presented to the corporation by any of the corporation's officers or employees, or committees of the board of directors, or by any other person as to matters the member reasonably believes are within such other person's professional or expert competence and who has been selected with reasonable care by or on behalf of the corporation."

Effective market checks either pre-signing or post-signing also function as procedural safeguards and are suggestive of the general fairness of an interested transaction, although they are not dispositive. The Delaware Supreme Court has recently reiterated that market checks need not be either active or passive, but simply must be effective.[153] An effective market check, according to Delaware's highest court, is one that permits third parties interested in making superior proposals the opportunity to do so prior to the closing of an alternative transaction. Furthermore, the fairness of an interested transaction is meaningfully reinforced when market checks are used in conjunction with fully informed, uncoerced votes of the majority of the minority stockholders.

Merger agreement provisions: process and deal protection

The Delaware Supreme Court and Court of Chancery will often expand their review of the propriety of a transaction's process and terms by scrutinizing the provisions of a merger agreement on an individual basis and considering the reasonableness of deal protection mechanisms in transactional documents. Deal protection mechanisms, which are negotiated terms used to mitigate the likelihood of deal failure and bolster closing certainty, are among the most heavily litigated, carefully scrutinized and frequently targeted aspects of M&A litigation in the Delaware courts.

The body of Delaware corporation law underlying directors' decisions to adopt deal protection mechanisms in furtherance of a negotiated transaction is robust, and therefore guidance as to the means by which directors should reach their decision to implement transaction preservation provisions is prevalent. In reviewing deal protection devices, the justices and chancellors of the Delaware courts will "undertake a nuanced, fact-intensive inquiry" that examines the "reasonableness" of such deal terms in a manner "contemplated by the *Unocal* and *Revlon* standards…."[154] In accordance with Delaware's reverence for reasonableness in director decision-making, the aforementioned nuanced "inquiry examines whether the board granting deal protections had a reasonable basis to accede to the other side's demand for them in negotiations. In that inquiry, the court [will] attempt, as far as possible, to view the question from the perspective of the directors themselves, taking into account the real-world risks and prospects confronting them when they agreed to deal protections."[155]

This section of the guide will discuss some of the numerous deal protection mechanisms that have worked their way into merger agreements in recent years and have been subsequently litigated in Delaware. In addition to discussing the mechanical foundations of the deal protection device itself, this section will elaborate upon the case law pertaining to individual deal protections and how the Delaware courts, in the past, have reviewed directors' decision to adopt them.

Termination fees

Termination fees, or break-up fees, are monetary amounts payable to deal parties in the event that one such party decides to back away from an otherwise agreed-upon transaction. There are two types of break-up fees: (1) termination fees and (2) reverse termination fees. A termination fee is an amount payable by the seller to the buyer in the event that the seller terminates the agreement. A reverse termination fee is an amount payable by the buyer to the seller in the event that the buyer terminates the agreement. Using the above-referenced "nuanced" and "fact-intensive" inquiry, Delaware courts have differentiated between the two forms of break-up fees, determining that what constitutes a reasonable termination fee does not necessarily constitute a reasonable reverse termination fee.

With respect to termination fees, the Delaware courts have stated that "[t]he preclusive aspect of any termination fee is properly measured by the effect it would have on the desire of any potential bidder to make a topping bid."[156] That is to say, because the effect of a termination fee is to "reduc[e] the value" of what a topping bidder "is acquiring in any transaction with the target," boards in sale mode making the decision to accept a termination fee in their transaction agreements must be wary that the reasonableness of their conclusions will be subject to an enhanced level of scrutiny.[157] The reasonableness of a board's decision to accept a termination fee will be called into question where a termination fee is so substantial that it deters third-party bidders from making topping bids for the company and thereby negatively impacting the ability of directors to satisfy their obligation to maximize the value of the enterprise at a sale of their company for the benefit of the stockholders. A termination fee will also be called into question when it is so substantial that it coerces the stockholders into voting in favor of a transaction for reasons other than the economic merits of that transaction.

Delaware courts will consider in the termination fee context are: (1) the size of the termination fee and what percentage of the overall deal value it represents; (2) "the benefit to shareholders, including a premium (if any) that directors seek to protect"; (3) the general size of the transaction and its parties; (4) "the degree to which a counterparty found such protections to be crucial to the deal, bearing in mind differences in bargaining power"; and (5) "the preclusive or coercive power of all deal protections included in a transaction, taken as a whole."[158] The Delaware courts, taking into consideration the foregoing as a whole and not individually, have suggested that termination fees as high as 4 percent may be viewed as reasonable.[159]

Reverse termination fees pose a disparate set of challenges to boards and transaction parties, and, of course, to the Delaware courts. Fundamentally, reverse termination fees provide certainty to sellers, who, by putting their company on the market, undertake a variety of business risks, which could be magnified in the event that a merger or acquisition cannot be consummated. Consistent with their fiduciary duties, sell-side directors, needless to say, seek the largest reverse break-up fee reasonably attainable in a given transaction, but are otherwise unaffected by reverse termination fees that principally bear upon the buyer. A reverse termination fee may be appropriate to allocate the risk of regulatory approval or other deal risks however, it cannot be so large as to constitute a penalty as liquidated damages.[160] Moreover, to the extent the transaction requires a vote of the buyer's stockholders, the same issues of coercion of the stockholder vote apply to a reverse termination fee as would apply to a termination fee.

Although the Delaware courts have seldom reached the issue, buyer boards must adhere to their fiduciary obligations of care and loyalty prior to agreeing to a reverse termination fee. Notably, while reverse termination fees seemingly implicate an outflow of capital with no perceived return, their practical import and potential value for buyers is that such mechanism enables buyers to retreat from an agreement that might cause more economic damage to the buyer through consummation or specific performance than through a one-time fee. If a seller, for example, was to suffer a material adverse change to its business, as will be discussed later in this guide, a buyer may find it economically more advantageous to suffer the loss associated with the reverse termination fee as opposed to the negative effects of completing a business combination with a weakened seller suffering from risky externalities that detract from the buyer's value proposition.

Go-shop provisions

Go-shop provisions enable selling boards to affirmatively shop the company subsequent to entering into a business combination agreement with a potential acquiror and are thus the opposite of a no-shop provisions which is discussed below. Both go-shop provisions, as well as no-shop provisions with a fiduciary out, allow boards to consider an alternative bid in good faith and determine whether it is a superior proposal to that of the initial bidder or reasonably likely to lead to one.[161] The difference is that a go-shop provision permits the seller to actively solicit additional offers for a period of time while a no-shop provision prohibits soliciting additional offers. Buyers require that the ability of a selling board to actively shop the company and solicit third party bids be limited to a specified period of time, such that sellers restrict the shopping process to a window of time wherein interested third parties have the freedom to appear with a potential topping bid facing reasonable obstacles. During go-shop periods, selling directors are generally able to seek out potential topping bidders, exchange confidential information, permit the potential topping bidder to perform due diligence and enter into a superior merger agreement where applicable.

The typical buy-side response to go-shop provisions is to require that the initial suitor be granted a matching right in the event that a topping bid is agreed upon or the seller executes an alternative merger agreement based on a superior proposal. To the extent that a selling board is free to exercise its rights in a go-shop and a buyer requires that it be granted matching rights, selling directors should limit the matching period to a specified window of time, on the theory that such a time restriction is reciprocal, in view of that imposed on the seller with respect to the shopping period. Additionally, buyers often seek termination fees where a seller finds a superior proposal in connection with the marketing period

provided by a go-shop provision, although such termination fees are typically smaller than in transactions without go-shop provisions.

From a fiduciary duty perspective, in accordance with the duty of care, go-shop provisions position selling boards to make well-informed decisions as to the value of the company and the adequacy of a given offer utilizing an effective post-signing market check. This is particularly true where the selling board entered into an initial merger agreement with a potential buyer prior to canvassing the market for alternative transactions potentially offering superior value to stockholders.

If a selling board is to rely upon the go-shop process to satisfy its fiduciary obligations, it must ensure that it engages in a fulsome shopping process, wherein the board actively markets the company to potential, alternative buyers in good faith and utilizing legal and financial advisors during the go-shop period. Along those lines, to the extent that a conflict of interest exists creating bias in favor of completing a transaction with the initial purchaser, both the selling advisors and outside advisors must consider whether the implementation of independent decision-makers and counselors to oversee the go-shop process is necessary.[162] The Delaware Court of Chancery has suggested that it will, at the very least, enjoin mergers polluted by buy-side conflicts without procedural safeguards for the benefit of the stockholders.[163]

When in sale mode, selling boards have the freedom structure the sale process as they fit, within the bounds of their fiduciary obligations. The Delaware courts will apply enhanced scrutiny to a board's decision-making process and the reasonableness of the conclusion reached based on the facts at the time of the decision, and go-shop periods provide a directors with a meaningful picture as to the reasonableness of a decision to sell the company to a specific bidder on specific terms.

No-shop provisions and fiduciary outs

A no-shop or no-solicitation provision is one whereby the seller agrees not to be active solicit additional bidders once the seller enters into an agreement with the buyer. No-shops often require that sellers terminate any existing negotiations with interested parties and refrain from engaging in or initiating similar discussions with later-arriving suitors. While no-shop provisions may seem to be in conflict with a selling board's obligation to obtain the highest value for the enterprise reasonably attainable for the benefit of the stockholders while adhering to their fiduciary duties of care and loyalty once the *Revlon* standard of review is triggered, they are routinely upheld and have become commonplace in merger agreements.

In view of this, the Delaware courts have suggested that, at minimum, a selling board must have a "reasonable basis upon which to judge the adequacy of a contemplated transaction" prior to accepting a no-shop restriction.[164] A buyer "cannot importune a target board into entering into a deal that effectively prevents the emergence of a more valuable transaction or that disables the target board from exercising its fiduciary responsibilities."[165] In other words, it is generally unacceptable for a buyer to lock up a transaction without granting the selling board the ability to consider, in good faith, alternative proposals arising subsequent to an agreement being reached with the initial buyer. Selling boards, accordingly, are challenged to ensure that their acceptance of a no-shop provision does not proscribe their ability to meet their fiduciary obligation to make well-informed decisions regarding the company. Where a no-shop provision takes the form of a "no-talk" provision, preventing sellers from considering potential superior proposals, the Delaware courts are likely to review the board's decision to sell the company to a particular bidder with a skeptical eye.

Directors of Delaware companies should, prior to accepting a no-shop provision, require fiduciary-out provisions, which permit selling boards to navigate around an obligation not to negotiate with certain third parties in order to act in accordance with their fiduciary duties of care and loyalty, in addition to the enhanced obligations associated with director decision-making once a company in sale mode. Selling directors should not – and practically cannot – bind themselves to a transaction in manner that implicates a potential breach of fiduciary duty, and fiduciary outs enable selling boards to consider in good faith the offers of credible third-party bidders.

Fiduciary-out provisions allow selling boards to take actions in accordance with their fiduciary duties should a superior proposal arise after reaching an agreement containing a no-shop provision, including holding a shareholder meeting to vote on the proposals, changing the board's recommendation as to a given transaction in light of a new proposal, and terminating an agreement with one party to pursue an agreement with a party offering a superior proposal. In addition, merger agreements typically permit a board to change its recommendation regarding a transaction if there is an intervening event such that the transaction is no longer in the best interests of the stockholders.

Delaware courts may uphold agreements by directors not to pursue alternative transactions subsequent to reaching an agreement with an interested acquiror where the selling board has a reasonable basis upon which to judge the adequacy of transaction, or where the sellers retain the authority to circumvent restrictions on their ability to negotiate with credible bidders offering potentially superior proposals.[166] Well-informed selling boards in Delaware

have the latitude to refuse to negotiate with late-arriving third parties, but, as a general matter, selling directors should seek a fiduciary out if confronted with a constricting no-shop obligation in connection with a contemplated transaction. As the Delaware Supreme Court has repeatedly stated, there is no one blueprint for selling a company and the Delaware judiciary will not second-guess business decisions at a sale made by directors on a fully informed and non-conflicted basis as to how to extract the highest value reasonably attainable for the benefit of the stockholders.

Force-the-vote provisions

Under Delaware law, force-the-vote provisions are yet another way that selling directors can ensure that their decision to sell the company is made in accordance with their fiduciary obligations while simultaneously enhancing deal certainty for the buyer. Force-the-vote provisions require, regardless of a board's recommendation as to a specific transaction, that the board submit the deal to the selling company's stockholders for a vote. Therefore, pursuant to Section 146 of the Delaware General Corporation Law, if a board has reached the decision that a particular transaction is advisable or inadvisable, force-vote-provisions included in merger agreements may properly require that the board submit the proposed deal to the stockholders for a vote, regardless of a topping bidder or change in board recommendation. Force-the-vote provisions are more likely to be used in connection with intervening events.

Voting agreements

Voting agreements are instruments entered into by acquirors with significant shareholders of a target company, wherein the stockholder agrees to vote in favor of the transaction with the acquiror. Particularly when coupled with additional transaction preservation mechanisms, voting agreements can function as meaningful obstacles for potential third-party bidders to overcome when considering whether to enter a competing bid for the company.

The Delaware courts will strike down deal protection mechanisms viewed together when they "unreasonably preclude[] the emergence of a genuine topping bidder willing to make a materially higher bid…."[167] However, under Delaware law, the Court of Chancery has stated that voting agreements "are perfectly legal."[168] "The measure of a deal protection strategy, of course, is the cumulative effect,"[169] but a shareholder voting agreement with an acquiror to vote in favor of a transaction will not, in and of itself, be deemed to violate the *Unocal* standard of review.

The Delaware law surrounding voting agreements and the extent to which they proscribe director adherence to fiduciary obligations is somewhat unclear, despite the foregoing. A Delaware Supreme Court case, *Omnicare, Inc. v. NCS Healthcare, Inc.*, holding that a merger can virtually never be locked up via a voting agreement, force the vote and lack of a fiduciary out has called into question the Court of Chancery's statement that voting agreements are "perfectly legal."[170] However, *Omnicare* has been distinguished in recent years and the extent to which it is still good law is in doubt, although no case directly challenging *Omnicare* has been decided.

Notably, the Delaware Court of Chancery has made a point of distinguishing the import of the *Omnicare* in the shareholder voting agreement context, as opposed to the director voting agreement context. As *Orman v. Culman* acknowledges, the Delaware Supreme Court has provided that "[t]o the extent that a contract, or provision thereof, purports to require a board to act in such fashion as to limit the exercise of its fiduciary duties, it is invalid and unenforceable."[171] As a general matter, a "shareholder has discretion as to when to sell his stock and to whom, a discretion that comes from the…shareholder's right [as a] shareholder."[172] What is perhaps readily apparent is that Delaware directors cannot enter into voting agreements as to how they will vote on a particular transaction, in view of the fact that such an agreement impedes the ability of a directorship to observe in good faith its fiduciary obligations of care and loyalty when contemplating a business combination.

Thus, to the extent that a shareholder voting agreement is neither preclusive nor coercive when read together with the other deal protection devices in a given transaction, a Delaware court is likely to uphold its propriety. Where, however, a voting agreement makes a proposed transaction a *fait accompli* – that is to say, an inevitability or mathematical certainty – or appears to be "impermissibly coercive," a Delaware court will be less likely to sign-off on the deal protection device.[173] In short, the review of deal protection devices is a cumulative process, and a Delaware court charged with such an examination will apply the *Unocal* standard of review to ensure that selling stockholders are freely capable to consider and support competing, superior offers for their interests in the target company.

Stock and asset lockups

A voting agreement is a version of a so-called stock lockup, whereby a certain portion of a target company's securities are committed, in one way or another, to a bidder. White knights often are the beneficiary of stock lockups granting the third party an option to purchase the target company's shares at a specified price typically reflective of the company's market value prior to the arrival of a bid for the company. Provided that a lockup of a company's securities when viewed with the other deal protection measures applicable to a transaction does not rise to the level of preclusiveness and coerciveness contemplated by the *Unocal* standard, the Delaware courts likely will not stand in the way of a decision to lock up target securities in furtherance of a proposed transaction.

Asset lockups, on the other hand, are perhaps less accepted under the Delaware corporation law. Sometimes referred to as crown jewel lock-ups, asset lock-ups are generally structured as options granted to a bidder by a selling board to purchase certain assets of the selling company, regardless of whether a merger is completed. From a deal protection standpoint, crown jewel lockups are powerful deterrents to the arrival of topping bidders, in view of the fact that such topping bidder may not be able to fully realize the value of its target.

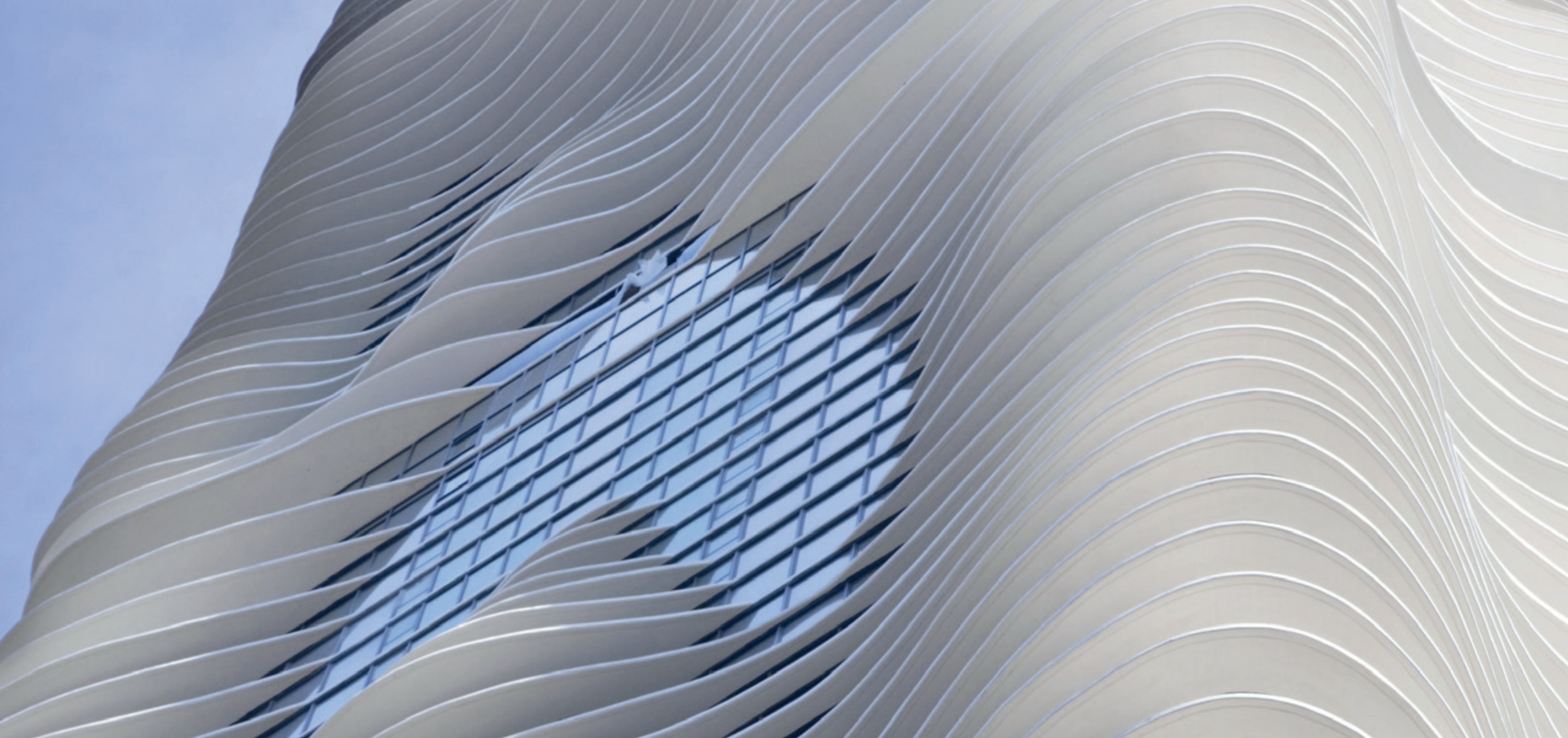
The Delaware Supreme Court, in *Revlon*, held that asset lockups are "not *per se* unlawful under Delaware law."[174] However, their deal protection impact is so substantial that the grant of such options "often foreclose[s] further bidding to the detriment of shareholders, and end[s] active auctions prematurely."[175] The Delaware Supreme Court has stated, consequently, that "[i]f the grant of an auction-ending provision is appropriate, it must confer a substantial benefit upon the stockholders in order to withstand exacting scrutiny by the courts. Moreover, where the decision of the directors, granting the lockup option, was not informed or was induced by breaches of fiduciary duties" they, of course, will not survive the enhanced review that attends director decision-making once their company is in sale mode.[176]

Directors of a selling Delaware corporation are ultimately charged with maximizing the value of the enterprise for the benefit of stockholders and, when a board subject to *Revlon* scrutiny grants an option locking-up a company's crown jewels, "serious questions are raised, particularly where...there is little or no improvement in" the offers the company receives from interested bidders as a result of such lockup.[177] Despite their deterrent impact on topping bidders, the Delaware Supreme Court's holding in *Revlon* suggests that crown jewel lockups, when properly structured and when they confer substantial benefits on selling stockholders, may survive scrutiny in a Delaware courtroom.

Naked no-vote fees

A naked no-vote is "a shareholder vote to decline" a proposed merger agreement "that is not followed by the acceptance of an alternative transaction."[178] Some buyers negotiate for deal protection measures in connection with such no-votes by a selling company's shareholders. Most notably, buyers targeting Delaware corporations have negotiated for "termination fees contingent solely on a 'naked no vote.'"[179] The Delaware Court of Chancery has approved naked no-vote fees "of up to 1.4% of transaction value."[180] Indirectly, through reference, the same court has provided that naked no-vote fees are practically termination fees and have suggested that termination payments of such kind equating to under 4 percent of transaction value are generally "unremarkable."[181]

In reviewing the decision to accede to a naked no-vote fee in connection with a proposed business combination, the justices and chancellors of the Delaware courts will "undertake a nuanced, fact-intensive inquiry" that examines the "reasonableness" of such terms in a manner "contemplated by the *Unocal* and *Revlon* standards...."[182] In searching the reasonableness of a board's decision to agree to a buyer's demand for a naked no-vote fee, "the court [will] attempt, as far as possible, to view the question from the perspective of the directors themselves, taking into account the real world risks and prospects confronting them when they agreed to deal protections."[183] Moreover, because a naked no-vote fee is a deal protection mechanism, it will be viewed in conjunction with any other such measures applicable to a particular merger agreement and, as a whole, cannot be preclusive or coercive if it is to survive enhanced scrutiny in the Delaware courts.



Substantive merger agreement provisions

Exclusive forum provisions

The Delaware General Corporation law provides, in Section 115, the adoption of forum selection bylaws or certificate provisions providing Delaware as the exclusive forum for disputes related "internal corporate claims."[184] Under that section, internal corporate claims "means claims, including claims in the right of the corporation, (i) that are based upon a violation of a duty by a current or former director or officer or stockholder in such capacity, or (ii) as to which this title confers jurisdiction upon the Court of Chancery." It is well settled under Delaware case that boards of directors of Delaware corporations may validly adopt exclusive forum bylaws or incorporate exclusive forum provisions in their corporate charters. As the Court of Chancery has stated, "[i]f boards of directors and stockholders believe that a particular forum would provide an efficient and value-promoting locus for dispute resolution, then corporations are free to respond with charter provisions selecting an exclusive forum for intra-entity disputes."[185] Indeed, many corporations seeking to centralize challenges to corporate actions have adopted exclusive forum provisions as a response to the wave of multijurisdictional litigation in M&A transactions.

In *Boilermakers Local 154 Retirement Fund v. Chevron*, the subject exclusive forum bylaws designated Delaware courts as the sole forum for a diversity of intra-corporate disputes, including derivative actions, breach of fiduciary duty allegations and other claims arising under the Delaware General Corporation Law. These bylaws were upheld under Section 109 of the Delaware corporation statute, which provides, in pertinent part, that a corporation's bylaws "may contain any provision, not inconsistent with law or with the certificate of incorporation, relating to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors, officers or employees."

In view of the fact that exclusive forum provisions directly consider the internal affairs of a corporation, they fall under the auspices of Section 109. *Chevron* also upheld such provisions on contract law grounds, noting that such bylaws are enforceable under principles of contract law, as the Delaware General Corporation Law views bylaws as part of a contract among directors, officers and stockholders, which grant directors the power to unilaterally adopt and amend bylaws, provided such authority is encapsulated in the corporation's charter. Subsequent to *Chevon*, the Delaware legislature adopted Section 115.

In *Strougo v. Hollander,* citing to *Chevron,* the Court of Chancery reiterated "that, for a corporation whose charter authorizes the board to amend its bylaws unilaterally, those bylaws are, in effect, an 'inherently flexible' contract between the corporation and its stockholders."[186] The Delaware courts will apply and uphold "a bylaw in effect at the time that a stockholder's internal affairs

claim" arises, such that "bylaws in effect at the effective time" of a transaction "would continue to bind a stockholder who challenges that transaction post-closing…."[187]

Forum selection provisions adopted in connection with a transaction will likely be upheld in a Delaware courtroom. A forum selection bylaw "merely regulates 'where stockholders may file suit, not whether the stockholder may file suit or the kind of remedy that the stockholder may obtain."[188] Whether a forum selection provision is adopted on an "allegedly 'cloudy' day" – that is, a day on which a company enters into a transaction – "is immaterial" absent "any well-pled allegations…demonstrating any impropriety in this timing."[189]

Integration clauses

Integration clauses – also known as merger clauses, non-reliance clauses and entire agreement provisions – integrate prior agreements, representations and understandings by parties to a contract governed by Delaware law. The function of such provisions is to import an understanding between merger parties into the final, contractual instrument representing that the four corners of the contract are the entire agreement between the parties and, in the event of a dispute, all extrinsic representations should be excluded from consideration. Furthermore, integration clauses often include statements that the provision supersedes all prior agreements, representations and understandings between the parties to the contract.

The Delaware courts have provided that "sophisticated parties to negotiated commercial contracts may not reasonably rely on information that they contractually agreed did not form a part of the basis for their decision to contract."[190] In other words, in accordance with its contractarian principles, Delaware law will reinforce the efficacy of integration clauses which suggest that a contractual instrument is representative of the parties' entire understanding. Using relatively strong language, the Court of Chancery has further suggested that "[t]he enforcement of non-reliance clauses recognizes that parties with free will should say no rather than lie in a contract."[191]

There are, however, limitations to the willingness of the Delaware courts to enforce integration clauses. The judiciary will not "give[] effect to so-called merger or integration clauses that do no clearly state that the parties *disclaim reliance* upon extra-contractual statements."[192] In other words, parties seeking to incorporate fully enforceable integration clauses into their merger agreements must be sure that such provisions "contain language that can be said to add up to a clear anti-reliance clause by which [the parties] contractually promise[] that [they do not and will] not rely upon statements outside the contract's four corners in deciding to sign the contract."[193] In the event that an integration clause lacks explicit language disclaiming reliance on extrinsic representations and understandings, the Delaware courts "will not relieve a party of its oral and extra-contractual fraudulent representations."[194] Consequently, "murky" drafting can result in unforeseen circumstances that threaten a sophisticated party's benefit of the bargain in reaching a business agreement.[195]

Material adverse effect clauses

In the M&A context, material adverse effect clauses (MAE clauses) – also known as material adverse change clauses – enable parties to a merger agreement to walk away from a deal upon the occurrence of a specified set of circumstances meeting an identified materiality threshold, either in terms of a party's results of operations and financial conditions or the ability of the party to perform the obligations imposed on it by the merger agreement. In other words, MAE clauses are conditions to closing that permit parties to contract over unforeseeable events by enabling a party to claim that an otherwise final agreement is unenforceable. While MAE clauses are frequently included in merger agreements, it is important to note that a Delaware court has never found a material adverse effect to have occurred, thereby permitting a party to wash its hands of an agreed-upon corporate transaction.

In an attempt to allocate the risks associated with a transaction, MAE clauses vary in breadth and substance. Naturally, buyers and sellers have disparate negotiating preferences with respect to what an MAE clause contains and, perhaps most importantly, how an MAE is defined so as to determine what kinds and degrees of events breach a specified materiality threshold and permit a party to walk away from its agreement to acquire the target company. Buyers often seek comprehensive MAE clauses covering the seller's financial condition, results of operations, assets, liabilities, properties and overall business. Conversely, sellers typically seek to narrow MAE clauses as much as possible, limiting the ability of buyers to back away from a deal.

MAE clauses are typically bifurcated in merger agreements. First, a material adverse effect is typically defined through a more complex variation of the following: any fact, circumstance, occurrence, event, development, change or effect which constitutes or results in, or reasonably may be expected to constitute or result in a material adverse change in or material adverse effect on, either individually or in the aggregate, the assets, liabilities, financial condition, prospects, business, properties, operations, results of operations, performance or ability to perform of the selling company. Second, the MAE clause sets forth numerous carve-outs from the definition – such as changes in the financial markets or world economy, economic or regulatory conditions

impacting a particular industry or geography, changes in the political atmosphere, the occurrence of terrorism or natural disasters, and changes in applicable law or regulations, among other things – and which function to create exceptions to what constitutes a material adverse effect under the agreement. Interestingly, parties generally leave "material" undefined, leaving the interpretation of what is material to the Delaware courts.

In determining whether an event rises to the level of a material adverse effect, the Delaware courts will examine "changes in corporate fortune…in the context in which the parties were transacting….The important consideration therefore is whether there has been an adverse change in the target's business that is consequential to the company's long-term earnings power over a commercially reasonable period, which one would expect to be measured in years rather than months."[196] Therefore, as suggested by the fact that a Delaware court has never found a material adverse effect to have occurred, buyers seeking "to avoid [their] obligation to close" are "face[d with] a heavy burden."[197] Delaware courts have also suggested that parties to a merger agreement should view the utilization of an MAE clause as a "backstop protecting the acquiror from the occurrence of unknown events that substantially threaten the overall earnings potential of the target in a durationally significant manner. A short-term hiccup in earnings should not suffice: rather [an adverse change] should be material when viewed from the longer-term perspective of a reasonable acquiror."[198]

A Court of Chancery case carefully elaborated upon the interplay between ordinary course of business covenants and MAE clauses in merger agreements. In *Cooper Tire & Rubber Co. v. Apollo (Mauritius) Holdings,*[199] the Delaware court permitted a buyer to avoid its obligations under the merger agreement by relying upon an ordinary course of business covenant, successfully claiming that the seller did not continue with business as usual subsequent to reaching a business combination agreement with the buyer. In short, such covenants often require that a seller and its subsidiaries conduct business in the ordinary course consistent with past practice while using commercially reasonable efforts to preserve the present state of the selling company's business. The difference between ordinary course of business covenants and MAE clauses is that the former is an affirmative obligation of the seller to conduct business as usual without consideration of extrinsic factors, while the latter is risk-allocating catchall provision used to protect a buyer's benefit of the bargain, but which often shifts the consequences of unforeseeable events from one party to the other.

In *Akorn, Inc. v. Fresenius Kabi AG,* the Delaware Court of Chancery in a 246-page opinion for the first time upheld a buyer's ability to terminate a merger based upon a determination that an MAE had occurred along with breaches of other provisions of the merger agreement by the seller.[200] *Akorn* involved a relatively easy case for finding the existence of an MAE given the extensive deterioration and questionable conduct of the seller and, thus, can be viewed as the exception that proves the rule that MAE are challenging to prove.

Financing and due diligence outs

Sophisticated parties to a negotiated transaction, recognizing the potential uncertainty surrounding a buyer's ability to finance a given transaction, sometimes incorporate so-called financing-out provisions in merger agreements. Financing outs permit buyers to avoid their obligation to close a merger, "if the financing the buyer arranged (or equivalent alternative financing) is not available at the closing…."[201] In other words, where a buyer is reliant upon a third party to fund an acquisition, the absence of such capital in the context of a financing out enables the acquiror to walk away from an otherwise agreed-upon transaction. Private equity buyers often seek the inclusion of financing outs, given their sensitivity to the availability of capital and their return on investment. Today, some financial buyers "will agree to no [financing] out but only if their liability is capped at the amount of a reverse break-up fee. Meanwhile, strategic buyers continue to be asked to accept full liability for damages caused if they fail to close, even if the reason for not closing is based on financing, not a risk unique to a strategic buyer."[202]

Due diligence outs entitle buyers to condition closing on their satisfaction subsequent to the review of information requested by the acquiror and provided by the target company. That is to say, if a buyer uncovers significant information negatively impacting upon its decision to acquire the target, the buyer need not close the deal. Where a due diligence out is imported into a merger agreement, sellers frequently require that the information meet a certain materiality threshold if the buyer is to rely on it in its attempt to retreat from a transaction.

Financing and due diligence outs meaningfully reduce closing certainty. Consequently, sellers often negotiate strongly for such provisions to be excluded from merger agreements and, when they are included, tie them to significant fees associated with a buyer's failure to close. The Delaware courts have infrequently reached questions pertaining to the propriety or impropriety of a party's reliance on financing and due diligence outs. Nonetheless, prior to accepting such closing conditions in a merger agreement, sell-side directors should consider the risks associated with granting buyers the authority to walk away from a transaction in the event that they discover something that is not to their liking in the diligence process or where financing is unavailable. In the former circumstance, permitting a buyer to back away from a deal through a due diligence out, in many ways, leaves a selling

company vulnerable to both "known unknowns" and "unknown unknowns." In the latter circumstance, financing outs create third-party contingencies and tie the consummation of a deal to extrinsic factors often outside the control of the transactional parties. Buy-side directors should seek concessions, such as reduced reverse break-up fees, in the event that they are unable to negotiate for the inclusion of financing or due diligence outs, thereby mitigating the risks associated with failing to close a deal due to extrinsic circumstances.

Best efforts clauses

Best efforts and reasonable best efforts clauses require that a board use its best efforts or reasonable best efforts to obtain stockholder approval for a contemplated merger, subject to the fiduciary duties of care and loyalty. Directors of Delaware buyers may also subject themselves to best efforts clauses, which typically require that they use their reasonable best efforts to obtain merger consent from third parties, such as lenders, licensors and landlords.

In considering reasonable best efforts clauses, the Delaware courts have suggested that there are few, if any, cases where "a party acted in good faith but did not use its best efforts."[203] Furthermore, as to the difference between "best efforts" and "reasonable best efforts," the Delaware courts have not set forth a clear distinction, other than to suggest that "'best efforts' is implicitly qualified by a reasonableness test – it cannot mean everything possible under the sun."[204] Accordingly, "[a]lthough it does not have a specific meaning, 'reasonable best efforts' is, at least, understood by transactional lawyers to be less than an unconditional commitment."[205] Where ambiguity presides over the definition of reasonable best efforts in a merger agreement, a Delaware court may look to the intent of the parties when agreeing to such a provision or extrinsic evidence suggesting their mutual understanding of what reasonable best efforts entails. However, as the Delaware Supreme Court recently affirmed, there are limits to the equitable authority of the Delaware courts to "blue-pencil" merger agreements. In short, the Delaware judiciary is of the mind that "[i]t is not the job of the court to relieve sophisticated parties of the burdens of contracts they wish they had drafted differently but in fact did not."[206]

The takeaway from the foregoing ruminations by the Delaware courts as to best efforts clauses is that, like much of the state's corporation law, a board's acceptance of and adherence to a best efforts provision will be qualified by a reasonableness restriction. To the extent that a best efforts clause precludes a directorship from satisfying its fiduciary obligations, the Delaware courts will likely hold such a provision unenforceable. Indeed, where a best efforts clause impinges upon the ability of a board to manage and direct the affairs of the corporation, as mandated by Delaware General Corporation Law Section 141, it likely will not be enforceable in a Delaware courtroom.

Specific performance

Specific performance is an equitable remedy whereby a court issues an order that a party perform a specific act, the nature of which, in the M&A context, is typically set forth in the merger agreement. As in other jurisdictions, the Delaware courts view specific performance as an extraordinary remedy and its availability is limited to scenarios where the party seeking compulsory performance of a contract is itself able to "demonstrate, among other things, that it was 'ready, willing, and able to perform under the terms of the agreement'" at issue.[207] In addition, specific performance is "unavailable unless there is no adequate remedy at law, and the enforcement of the requested relief must be sufficiently precise to be practicable."[208] That is to say, to compel the consummation of a merger or acquisition, the party seeking performance need show that other remedies, such as cash, are insufficient. "Further [to the foregoing], specific performance is an equitable remedy normally applicable only in exigent circumstances, for example, in situations where an assessment of money damages would be impracticable or would somehow fail to justice."[209]

Delaware, on more than one occasion, has contemplated the applicability and enforceability of specific performance in the merger context. Generally, "an acquiror argues that it cannot be made whole unless it can specifically enforce the acquisition agreement, because the target company is unique and will yield value of an unquantifiable nature, once combined with the acquiring company."[210] Indeed, in certain circumstances, target companies take the same line of argumentation, on the theory that a combination with an acquiror advances the interests of the company and its stockholders to such a degree that cash is insufficient. Sellers may also take the position that specific performance is necessary to do justice in the event that a merger agreement is broken, given the business impact that such an agreement has on the company's stockholder base, customers and employees. Target companies might also take the position that specific performance is a necessary remedy, in view of the fact that failure to consummate the agreement makes the seller vulnerable to unsolicited advances from unwanted third parties.

Appraisal rights

The availability of appraisal rights to stockholders

Appraisal rights are "a limited legislative remedy developed initially as a means to compensate shareholders of Delaware corporations for the loss of their common law right to prevent a merger or consolidation by refusal to consent to such transactions. The remedy is intended to provide those shareholders who *dissent* from a merger on the basis of inadequacy of offering price with an independent judicial determination of the fair value of their shares."[211] The limitation of the statutory remedy stems not only from what is available in appraisal, but also from the kinds of transactions that permit stockholders to seek appraisal of their shares. That is to say, in classical mergers consummated using Section 251 of the Delaware General Corporation Law, it is generally understood that appraisal is unavailable where the merger consideration is shares of the acquiror, provided that such shares are traded on a national securities exchange. Similarly, to the extent that a combination is consummated through the use of the tender offer form, appraisal is unavailable to stockholders in view of the fact that the transaction is functionally a market transaction. Finally, because it is not a merger by definition, Section 271 asset sales, wherein an acquiror purchases all or substantially all of the assets of a target company, do not enable stockholders to seek appraisal for their shares, even in the event that such a sale may materially impact the value of such securities.

Section 262 of the Delaware General Corporation governs the means by which shareholders of Delaware corporations may obtain appraisal rights. First, a stockholder seeking appraisal must be the holder of record on the record date – the day on which the corporation's board determines who is entitled to vote on a given transaction. Second, the stockholder must continue to hold the shares for which it is seeking appraisal through the merger's consummation. Finally, in order to be eligible for appraisal rights in Delaware, the shares must either abstain from voting on a transaction or dissent at the vote of the stockholders with respect to the contemplated combination.

Stockholders of Delaware corporations must also satisfy a demand requirement as a prerequisite to eligibility for appraisal rights. Under Section 262(d)(1), "a written demand for appraisal executed by or for the shareholder of record, must be timely filed with the corporation in order to perfect appraisal rights."[212] Practically, however, because the reality of the modern shareholder float is that the Depository Trust Company and Cede & Co. are the record holders of a significant number of shares on the public market, appraisal actions are often brought by these entities on behalf of the beneficial owner of the shares for which appraisal is sought. Beneficial owners of a corporation's shares make a demand on DTC or Cede & Co., which thereafter make a demand on the company. Within 120 days of the effective date of the merger or consolidation, shareholders who have perfected their appraisal

rights may instigate "an appraisal proceeding by filing a petition in the Court of Chancery demanding a determination of the value of the stock of all such shareholders."[213]

Following receipt of demand for appraisal by a stockholder and broader approval of a transaction, the subject corporation is required to deliver written notice of the merger to each shareholder that satisfied the statutory preconditions for appraisal eligibility, including abstaining from a vote on the applicable combination, dissenting at such vote and making a demand on the corporation which encompasses the stockholder's intent to seek an independent judicial determination of the fair value of such holder's shares. The corporation's notice must be distributed to each eligible shareholder seeking appraisal no later than ten days after the corporate action is taken, and such notice must contain a diversity of mechanical information mandated by statute that sets forth, among other things, what the corporation believes to be the fair value of the shares for which appraisal is sought.

The market, however, has transformed the statutory remedy into financial opportunity. In what has developed into seminal Delaware case law, *In re Transkaryotic Therapies, Inc.*[214] laid the groundwork for what has come to be known as "appraisal arbitrage." The Chancery opinion holds that shareholders may purchase shares of a target company subsequent to the record date and thereafter seek appraisal eligibility for such shares, provided that the number of shares ultimately available for appraisal cannot exceed the number of shares that voted against the transaction or abstained from such vote. Consequently, the market response has been to buy up shares of target companies after the record date and then to seek appraisal for such shares. Indeed, the Court of Chancery reiterated the propriety of appraisal arbitrage twice on the same day in 2015, in *Merion Capital LP & Merion Capital II LP v. BMC Software, Inc.*[215] and *In re Ancenstry.com, Inc.*[216]

The significance of Vice Chancellor Glasscock's holdings in both *Merion Capital* and *In re Ancestry.com* is that they collectively undermined a corporation's defensive strategy of suggesting that appraisal arbitrageurs should not receive the benefit of appraisal rights due to the possibility that the subject shares were potentially voted in favor of the applicable merger prior to their sale to the arbitrageur. However, after a close reading of the Delaware General Corporation Law's statutory language, Vice Chancellor Glasscock refused to impose a share-tracing requirement on beneficial shareholders seeking appraisal, writing: "[n]oticeably absent from [the language of Section 262], or any language in the statute, is an explicit requirement that the stockholder seeking appraisal prove that the *specific shares* it seeks to have appraised were not voted in favor of the merger."[217] Therefore, arbitrageurs continue their practice of purchasing shares after the record date with the objective of realizing an additional value over the initial purchase price.

Judicial determination of fair value

If a Delaware court finds that stockholders seeking appraisal of their shares have standing to do so, it will "determine the fair value of the shares exclusive of any element of value arising from the accomplishment or expectation of the merger or consolidation, together with interest, if any, to be paid upon the amount determined to be the fair value."[218] Further, in determining what constitutes "fair value," the Delaware courts will consider "all relevant factors."[219] The Delaware Supreme Court, in *Golden Telecom, Inc. v. Global GT LP,*[220] reiterated that "fair value" is "the value to a stockholder of the firm as a going concern, as opposed to the firm's value in the context of an acquisition or other transaction. Determining 'fair value' through 'all relevant factors' may be an imperfect process,"[221] but it remains the manner by which the Delaware judiciary appraises shares. "As the Delaware Supreme Court explained over 60 years ago in *Tri-Continental Corp v. Battye,* the concept of 'fair value' includes 'market value, asset value, dividends, earning prospects, the nature of the enterprise and any other facts which were known or which could be ascertained as of the date of merger and which throw any light on future prospects of the merged corporation.'"[222]

The Court of Chancery has often "relied on the merger price as an indicia of fair value, 'so long as the process leading to the transaction is a reliable indicator of value and merger-specific value is excluded.'"[223] However, "it is within the Court of Chancery's discretion to select one of the parties' valuation models as its general framework, or fashion its own, to determine fair value in the appraisal proceeding. In doing so, [a Delaware jurist] may consider any valuation methodology that is 'generally considered acceptable in the financial community and otherwise admissible in court.'"[224]

The discounted cash flow (DCF) analysis is also frequently used in the Court of Chancery as part of appraisal proceedings. As the court in *Owen v. Cannon* provided, "[p]ut in very simple terms, the basic DCF method involves several discrete steps. First, one estimates the values of future cash flows for a discrete period . . . . Then, the value of the entity attributable to cash flows expected after the end of the discrete period must be estimated to produce a so-called terminal value, preferably using a perpetual growth model. Finally, the value of the cash flows for the discrete period and the terminal value must be discounted back[.]"[225]

Endnotes

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2 *Id* at 62.

3 In re Ancestry.com S'holder Litig., C.A. No. 7988-CS (Del. Ch. Dec. 17, 2012).

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5 SIGA Techs., Inc. v. PharmAthene, Inc., C.A. No 2627 (Del. 2013).

6 PharmAthene, Inc. v. SIGA Techs., Inc., C.A. No. 2627-VCP (Del. Ch. 2011).

7 *Id*.

8 *Id*.

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22 Paramount Commc'ns , Inc. v. Time Inc., 571 A.2d 1140, 1150 (Del. 1989) (citing Mills Acquisition Co v. Macmillan, Inc., 558 A.2d 1261 (Del. 1988)).

23 *C&J Energy Servs., Inc.,* 107 A.3d at 1067-68.

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28 In re Novell, Inc. S'holder Litig., 2014 BL 337457, 7 (Del. Ch. Nov. 25, 2014).

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30 *Id* at 1068.

31 *Id.*

32 *Mills Acquisition Co.,* 559 A.2d at 1282 n. 29.

33 Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1385-86 (Del. 1995)..

34 *Id.*

35 In re Toys "R" Us, Inc. S'holder Litig., 877 A.2d, 975, 1000 (Del. Ch. 2005).

36 Barkan v. Amstead Indus., Inc., 567 A.2d 1279, 1286 (Del. 1989).

37 *Id.*

38 In re Netsmart Techs., Inc. S'holders Litig., 924 A.2d 171, 192 (Del. Ch. 2007).

39 WaveDivision Holdings, LLC v. Millennium Digital Media Sys., L.L.C., 2010 WL 3706624, at *16 (Del. Ch.).

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74 *Id* at 495.

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82 *Id* at 40-41.

83 *Id* at 41 (citing Equity-Linked Investors, LP v. Adams, 705 A.2d 1040, 1042) (Del. Ch. 1997)).

84 *Id.*

85 LC Capital Master Fund, Ltd. v. James, 990 A.2d 435, 449 (Del. Ch. 2010).

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125 *Id* at 1116.

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139 *See generally* Weinberger v. UOP, Inc., 457 A.2d 701, 710 (Del. 1983).

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225 *Id* at *15.

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DLA Piper is a global law firm with lawyers located in more than 40 countries throughout the Americas, Europe, the Middle East, Africa and Asia Pacific, positioning us to help clients with their legal needs around the world.

We strive to be the leading global business law firm by delivering quality and value to our clients.

We achieve this through practical and innovative legal solutions that help our clients succeed. We deliver consistent services across our platform of practices and sectors in all matters we undertake.

Our clients benefit from a leading global M&A practice that for 11 consecutive years has acted on more M&A transactions than any other law firm. Over the last decade, we have handled more than 5,000 reported M&A transactions globally, valued at a total of more than US$1 trillion. These results consolidate DLA Piper's position as a leading global legal advisor.

Among our clients are multinational, *Global 1000,* and *Fortune 500* enterprises as well as emerging companies developing industry-leading technologies. They include more than half of the *Fortune 250* and nearly half of the *FTSE 350* or their subsidiaries. We also advise governments and public sector bodies.

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For more information

To discuss the implications of the issues covered in this guide, please contact any of the authors:

John L. Reed
Partner
Wilmington
+1 302 468 5635
john.reed@dlapiper.com

Ronald N. Brown, III
Partner
Wilmington
+1 302 468 5665
ronald.brown@dlapiper.com

Joshua Samek
Partner
Miami
+1 305 702 8880
joshua.samek@us.dlapiper.com

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