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Litigation is all but inevitable these days. If there is a deal, there is a suit–often more than one and often in multiple jurisdictions. Lawyers from Mayer Brown discuss tips, traps, trade-offs, and the state of play in M&A deals and shareholders.

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Good Deals Gone Bad

U.S. Public M&A Class Actions

In 2013, 94 percent of all deals valued at over $100 million were challenged in one or more shareholder class actions, a rise from 44 percent as recently as 2007. The percentage was the same for those transactions valued at over $1 billion and those valued at between $100 million and $1 billion. Nearly two-thirds of these deals attracted multiple suits, often in more than one jurisdiction. Deals valued over $100 million had an average of 5 suites filed. Deals valued over $1 billion, had an average of 6.2 suits filed. Sixty-two percent of deals were litigated in more than one jurisdiction. In 2013, the first suit was filed an average of 11.7 days after the announcement of the deal. [*Cornerstone Research, Shareholder Litigation Involving Mergers and Acquisitions, Review of 2013 Litigation.*]

The typical allegations in these suits include the claim that directors of the target company breached fiduciary duties they owed the plaintiff (the target's shareholders), usually, it is alleged, including the following: the directors failed to negotiate an adequate price; the directors failed to structure the sale process so as to maximize sales value and then locked up the deal through preclusive such deal protection terms as matching rights and break-up fees; the directors omitted material information from the document soliciting the shareholders' consent to the transaction, usually in the proxy statement, the 14D-9, among others. Also, the allegations usually include the assertion that the purchaser aided and abetted the directors' breaches, and an injunction against the deal closing is sought.

The resolution of these cases have also become familiar. There is usually no adjustment to the deal price, no change to the deal terms, and no rebidding process. Instead, there is "enhanced" disclosure, which involves more detail describing the Background of the Merger, as well as more detail about the analyses performed by the target's financial adviser supporting its fairness opinion. With that, there is usually broad release of all claims relating to the transaction, a MOU is reached quickly with confirmatory disclosure after that. Then there is the discussion of the fees.

There has been a backlash, particularly in Delaware where most of these cases are brought. Vice Chancellor Laster, for example, in the 2013 case of *In re Complete Genomics S'holder Litig.*, C.A. No. 7888-VCL, Tr. at 54, expressed his outrage as follows: "Do I think the CEO disclosure is worth 10 families' annual household incomes? I mean, you're talking 10 families. The annual household income in this country is about $50,000. Is the CEO disclosure worth 10 people, you know, people who actually go out and build things, who, you know, work hard in blue collar jobs? Is it really worth one year's work from 10 of those folks? No, I can't get there. Teachers in this country make about $30,000. Is the CEO disclosure worth putting $50,000 worth of teachers in classrooms? I'm sorry $500,000 worth of teachers in classrooms? Absolutely not."

Then-Chancellor Strine has expressed similar views in the February 2014 case of *In re Medicis Pharmaceutical Corp. S'holders Litig.*, C.A. No 7857-CS, Tr. at 18-19, 21, 24: "I am not comfortable approving the settlement . . . . [N]one of the information that was disclosed is anything that the defendants would have been worried about disclosing because

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it didn't contradict anything they had already told the stockholders . . . . I just don't see enough value here that it's worth the release . . . . [G]iving out releases lightly, I think, is something we've got to be careful about, and I just can't there on this one."

The following is a transcript of a recent discussion by Mayer Brown partners Jonathan Medow, a partner in the Litigation & Dispute Resolution practice, Andrew Noreuil, a partner in the Corporate & Securities practice, and William Kucera, co-chair of the firm's Mergers & Acquisitions practice, on the disputes that often arise in transactions, complete with tips to assist deal professionals in planning for, and mitigating the risk of, what has become the inevitability of litigation.

Jonathan Medow

I will talk about the current state of play in litigation in the public M&A space. In a word, the lawsuits are everywhere. If there is a deal, there is a suit, and often more than one suit. The most recent statistics are published by Cornerstone Research. These deal with 2013. The 2014 numbers are not yet out, but I don't think they are going to materially change. As of 2013, 94 percent of all deals once you are at the $100 million valuation level attract litigation. That's the same whether or not the deal is simply at a hundred million or billion. Nearly two-thirds of these deals—in fact, 62 percent—get more than suit. And the suits come very quickly. In 2013, the first suit was filed on average less than 12 days after the deal announcement.

The suits tend to come in a typical package, if you will. The allegations often look very much the same from case to case. These are class actions. The class is of the target shareholders. The principal defendants are the target's directors who are alleged to have breached their fiduciary obligations. The price is too low. The process was inadequate. The disclosures were insufficient. For good measure, the plaintiff often also joins the purchaser on an aiding-and-abetting theory; the theory being that by negotiating the terms of the deal, the directors in fact aided and abetted the underlying breaches. At least on paper, virtually every case also seeks an injunction against closing.

Not only are the allegations very similar, but the resolution as well is similar in these cases. In the typical resolution, there is no adjustment to the deal price, no adjustment to the deal terms, no rebidding. What you see are so-called enhanced disclosure, additional disclosures, in the case of a merger, to the proxy statement; in the case of tender offer, to the target's filing on Schedule 14D-9. Enhanced disclosures typically provide more detail regarding the background of the transaction, the analyses performed by the target's financial adviser, or other scattered items.

These settlements come typically very quickly. The process is usually documented in a memorandum of understanding prior to the closing of the deal. The plaintiff at that point in time usually has not had much discovery so they often negotiate for provisions that allow them to take confirmatory discovery and allow them to opt out of the settlement if they discover the case is worth more than they thought. And of course there is the issue of fees. The discussion of the fees is typically deferred to the back end. This is because it is considered improper to put the plaintiff, who is after all a fiduciary of the class, in a conflict situation where they are simultaneously negotiating merits issues and fees. The concern is they would have an incentive to trade one off for the other. So

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it is very common to defer fee discussions post MOU and, in fact, in a number of jurisdictions, you postpone that discussion not only until after the MOU but until confirmatory discovery is completed and you actually negotiate the definitive agreement. You leave a blank for the fees and only then address the issue.

Now, why have these cases got to this level? We said 94 percent of deals attract litigation. That wasn't always the case. As recently as 2007, according to Cornerstone, the number was 44 percent, which is still significant but obviously quite a bit different than 94 percent. I've never been a plaintiff in these cases so I am just taking my observations of what I've seen and plaintiffs might have a different view. For my take, I think what explains is it has become increasingly difficult for plaintiffs on the federal side, in the federal securities realm, both because of the PSLRA [the Private Securities Litigation Reform Act] enacted by Congress as well as the tenor of decisions in the federal courts, from the Supreme Court on down.

In addition, these lawsuits of the type we're talking about and the types of settlements we're talking about do not pose much risk to the plaintiff firms. They will always say there is risk when they go in to justify their fee. They will emphasize that they took the case on a contingency, but in fact from our perspective there is not a lot of risk for them. The reason is because they have figured out a way to make it very attractive for defendants to settle. For what I call the one-off defendants—the non-repeat defendants—for example, the target in a given transaction—when the target's management finds out they can make the suit go away by adding a few words to their proxy statement, they usually find that attractive. Repeat players are present, principally the D&O carriers. You might think they would want to put their foot down on this, but often from our experience, their judgment is it's cheaper to turn the meters off sooner, get a deal, pay the plaintiffs rather than paying defense counsel for whatever period of time the litigation takes, and perhaps ending up paying the plaintiffs as well. These cases also do not require extensive investments from the plaintiffs. In fact, if you go back to the fact that most cases are filed within less than two weeks after the announced deal, it's kind of hard to have a significant investment.

The types of fees that are awarded here are nothing like what one sees in the federal realm, where seven, eight and even nine figure fees are not unknown. We're talking in this world more like mid-six figures, so to get their returns up that necessitates high volumes. The last point is there is not a coordinating process. Again, compare the federal side. First of all, the MDL [multi-district litigation] process makes sure all the cases end up in the same district. Most districts then have local rules that require centralization of related cases before one judge, and then that one judge, under the PSLRA, picks lead counsel and lead plaintiffs, as a result of which there is one team in charge of the litigation. Here, we're dealing with state court claims often, and as a result you can have the very same claim brought by the very same class represented by different lawyers, with the same class and same defendant claiming about the same thing going simultaneously in numerous state courts. The result is we have a system where the plaintiffs' bar, in effect, acts a self-appointed review agency and they vet all or 94 percent of all deals. On the defense side, once the settlement is reached, the defendants achieve court-approved closure through the settlement process.

As you can imagine, this system is controversial. And we have started to see in the last few years in particular a backlash starting in Delaware where, as you probably know, many of these cases are brought. In any disclosure-only case, once the discussion does turn to fees, you can be sure the plaintiffs will always tell you that the starting point is four or five hundred thousand dollars. The reason is that's their reading of a case a few years ago called *Sauer Danfoss* from Vice Chancellor Laster. While in the Gen-Probe case, Vice Chancellor Laster rejected that reading of his own decision and said this notion that we start at four or five hundred thousand is just wrong. In this case, even though the defendants had agreed to pay $450,000, the court awarded only a hundred. Then-Chancellor Strine, now Chief Justice Strine, said virtually the same thing, also in 2013, in the Talbots case, once again rejecting the notion of an automatic start at four or five hundred thousand. Here he accepted the agreed fee of $237,500—which is relatively modest for these cases—but did say that if you're in effect writing on a blank slate, he could have come in as low as fifty thousand.

In another case from Vice Chancellor Laster, also in 2013, *Complete Genomics*, he, too, accepted the agreed fee of $300,000 and said he could have come in below that himself. But what the case is known for is the rhetoric. The vice chancellor compared the type of fee awards in these cases with the annual household income in the country, which he said is about $50,000, so you're talking about, for one of these cases, in the plaintiffs' view that every case is worth $500,000, ten families' worth annual household income, a compari-

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son he found not compelling.

Then Chancellor Strine went a step further in the Medecis Pharmaceutical case from last year, where he not only rejected the agreed fee award of $400,000, but he rejected the settlement in its entirety and said, "I just don't see enough here to warrant the release. The disclosures are too insignificant to serve as that consideration," recognizing that this was not good news for the defense side as well.

The backlash is not limited to Delaware. In New York, there have been a few recent cases just from the last month—one is the City Trading Fund case—where the court, dealing with the type of settlements we're talking about—in the court's words, "immaterial disclosure; no money for the class; just money for the lawyers." I don't care, the court said that the defendants have agreed to settle. I don't care that they've agreed to five hundred thousand. This court is not going to award that kind of money and is not going to permit this settlement. The court is serving as a gatekeeper.

There have also been developments in Texas that are a little bit different. Texas has by rule—Rule 42 of its civil procedure rules—a provision that says when a class settlement involves both monetary and non-monetary elements, the fee must be paid, if at all, in the same proportion; which means if the class only gets non-monetary relief in the form of enhanced disclosures, the plaintiff's attorneys get nothing, at least in cash. That was the ruling the Rocker case out of Dallas, and in the Kazman case out of Houston. We ourselves had a recent case in Waco that reached a similar result. As you can see, the landscape on the class action side is prevalence of litigation, but increasing resistance from the judiciary, questioning the utility of these cases.

There has been a parallel development in the appraisal field. Appraisal is a statutory remedy. A stockholder may, in the words of the statute, may dissent from a merger; not vote for it; not accept the money; and instead go into court and ask the Court of Chancery to appraise the fair value of the stock. What has developed in Delaware is what has been called "appraisal arbitrage" where investors in fact buy the stock after the record date of the merger and then seek appraisal. They are in effect investing, not to invest in the company but to invest in a lawsuit. This has been allowed.

Traditionally there were not many claims brought for appraisal for several reasons. There is a delay in getting the consideration. You don't simply get the money when the merger closes. You have to litigate. And on top of it, by statute, fair value did not include any element of value arising out of the transaction itself, such as synergies. And if you assume most deal prices reflect some sharing of synergies and deal elements between buyer and seller, you would think a challenge to the deal price would start out at a disadvantage.

But there are advantages to appraisal. There is no requirement to establish wrongdoing. The issue is not whether there was a breach of fiduciary duty. It is solely whether or not there was fair value. There is a very favorable interest rate in Delaware—five hundred basis points over the Fed discount rate. Most people believe it's not a coincidence that these cases began to become more prevalent when the interest rate environment went very low. And the last point is there is no presumption in favor of the deal price. Now, plaintiffs will tell you that's an understatement. They would argue that the deal price is in fact irrelevant. That view has been rejected at least twice by Vice Chancellor Glasscock in Delaware, most recently [in early 2015] in the Ancestry.com case, but it is true that the typical valuation methodology in appraisal cases is DCF—discounted cash flow—and you don't have to change the assumptions much in the DCF analysis to have a big impact on the value. And that has driven some of these results in appraisal cases, particularly where the courts might have reasons to question the deal price because it was an insider deal, or the like.

That is the state of play in litigation.

Andrew Noreuil

After having a good view of the landscape there, I think what Bill and I would like to do is maybe set people's minds a little more at ease. What we'd like to talk about is steps you can take and things you can do in the period prior to entering deal mode, and of course some practice suggestions as to what to do as you go through the deal to put yourself in the best position with respect to the inevitable litigation. So I'd like to start by talking about some structural protections and considerations and practical steps you can take prior to entering active deal mode.

The first thing is that you should confirm the corporation's exculpatory charter provisions. The base line defense for directors in these types of suits is going to be the exculpatory provision in the charter. All corporations should have these and in effect they protect directors from mon-

etary damages for breach of a duty of care. So, the relevant authorizing provision of the DGCL permits corporations to put in their charter, provisions that eliminate the personal liability of the directors for monetary damages for the breach of fiduciary duty, except for breach of the directors' duty of loyalty and also breaches of good faith or intentional misconduct. There are a few other exceptions as well, but those are the big ones. So, outside of a breach of the duty of loyalty context, a breach of the duty of care would be covered.

There are two points I think to note here with regard to this Delaware exculpatory provision. It does not cover officers or advisers, for that matter. It covers the directors of the corporation. And secondly, even if you do have the provision in your charter, again, which all corporations should, you still might be in a situation or suit where the court will have to go through and determine whether there was a breach of the duty of care. So even if the directors are not going to be liable for that breach, there may be other liability which is based off of that, most notably adviser liability for an aiding and abetting breach of fiduciary duty claim, such as in the most recent Rural/Metro case.

Here is a sample of what one of these provisions looks like:

> *A director of the Corporation shall not be liable to the Corporation or its stockholders for monetary damages for any breach of fiduciary duty s a director, except to the extent such exemption from liability or limitation thereof is not permitted under the DGCL. If the DGCL is amended after approval by the stockholders of this Article to authorize corporate action further eliminating or limiting the personal liability of directors, then the liability of a director shall be eliminated or limited to the fullest extent permitted by the DGCL, as so amended. Any repeal or modification of this Article shall be prospective only and shall not affect the rights of any person under this Article in effect at the time of the alleged occurrence of any act or omission to act giving rise to any alleged liability or indemnification.*

Let's take a look at the salient elements in the charter provision. The first thing to note in the first sentence here is that exculpation applies basically to the full extent possible, except as not permitted under the DGCL. Often, particularly in the older forms of these charters, there will be a list of all the categories. The cover-all approach makes clear that except as what is not permitted by the DGCL, directors would be exculpated. In addition, the second sentence here makes clear that if there is an amendment to the DGCL that there would also be exculpation for that. So just to avoid the argument that at the time the provision was adopted in the charter, there was a certain level of coverage that was not available. This avoids an argument from a plaintiff that that was all that was intended, the level of coverage that was available at the time the provision was adopted. Finally, the last sentence makes clear that any repeal or any change to the exculpation provision is prospective only and would not affect the rights of a director for anything that occurred up to that time.

The next thing is you should confirm director and officer indemnification rights under the state law as well as other places where those rights might be contained, such as charter, bylaws and indemnification agreements. In Delaware, the statute permits the corporation to indemnify directors and officers against the reasonable expenses, which includes attorneys' fees, of defending and settling suits brought against them as directors and officers, subject to meeting the applicable standards for indemnification. So, those standards generally are that the person will have acted in good faith and in a manner that the person reasonably believed to be in or not opposed to the best interests of the corporation. There is also a permissive statute in Delaware that allows the corporation to indemnify other persons such as employees and agents, subject to similar standards.

Now, another part of that statute in Delaware contains a permissive provision allowing a corporation to advance payments to directors and officers for defense of the claims, subject to those people putting up an undertaking. This is, again, is a permissive provision. It's not required that the corporation do so. It is often a subject of directors' rights under indemnification agreements and other provisions to secure a requirement that the corporation advance them their expenses.

The statute also allows corporations to obtain D&O insurance and that coverage can apply to matters that even the corporation is not permitted to indemnify for, so, again, if a director or officer were to fail to qualify for indemnification under the statute, there could be situations where an insurance policy would still pay them and the corporation is allowed to carry that type of insurance.

Finally, in the context of transactions, indemnification rights apply to constituent corporations in a merger that cease to exist after the transaction closes. So, this would be particularly useful in a forward merger transaction; that is, where

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the company to be acquired actually would cease to exist after the merger. These are not the norm. Most public company transactions are structured as reverse subsidiary merger transactions. But forward merger transactions are used in certain cases, including in structuring certain tax-favorable transactions.

So, the indemnification right, again, typically included in charter and bylaw provisions, it's not atypical to be in both. Often the bylaws would contain provisions relating to more procedural matters for directors and officers to obtain indemnification. Again, as mentioned before, a mandatory right to the advancement of expenses is typically the most important element of these additional provisions that directors and officers look for, again, not having to front the legal defense on the director's or officer's part out of their own personal funds is a big point. As the statute is permissive, directors and officers should push to get a mandatory requirement that the expenses be advanced to them as they're incurred. Another point we mention here is that you should ensure that indemnification rights survive amendment or repeal of the charter or bylaws as to anything that's happened prior to the time of amendment or repeal. Finally, indemnification agreements are often used to provide additional details and mechanics relating to how directors and officers obtain indemnification, usually more detailed than what would be contained in a bylaw. It could be something as mundane as the process for paying the bills of legal counsel as they become periodically due. Forms of director indemnification agreements are filed as exhibits on the Form 10-K as well, so those are publicly available.

Here is an example of an indemnification charter provision:

> *Each person who is or was a director or officer of the Corporation, while a director or officer of the Corporation, is or was serving at the request of the Corporation as a director, officer, employee or agent of another corporation, partnership, limited liability company, joint venture, trust, employee benefit plan or other enterprise (including the heirs, executors, administrators or estate of such person), shall be indemnified and advanced expenses by the Corporation, in accordance with the by-laws of the Corporation, to the fullest extent authorized by law, as the same exists or may hereafter be amended (but, in the case of any such amendment, only to the extent that such amendment permits the Corporation to provide broader indemnification rights than said law permitted the Corporation to provide prior to such amendment), or any other applicable laws as presently or hereinafter in effect. The right to indemnification and advancement of expenses hereunder shall not be exclusive of any other right that any person may have or hereafter acquire under any statute, provision of this Certificate of Incorporation or the by-laws of the Corporation, agreement, vote of stockholders or disinterested directors or otherwise. The Corporation may, by action of the Board of Directors, provide indemnification to employees and agents of the Corporation with the same or lesser scope and effect as the foregoing indemnification of directors and officers.*

Again, in particular, a charter provision is preferred as being a stronger provision to avoid amendment or repeal. The first sentence and the underlying text make clear that the Corporation *shall* indemnify and advance expenses to the directors and officers to the fullest extent authorized by law. One other thing to note here about the way this provision is drafted is that it doesn't go through and recite what are rather lengthy provisions in the DGCL as to the circumstances under which the Corporation may or shall indemnify. It just says that the directors and officers will be indemnified to the fullest extent possible.

Moving further down in this provision, the penultimate sentence makes clear that the rights contained in the charter are not the exclusive rights of directors and officers to be indemnified. So again, opening the possibility for agreements, or anything that might be contained in a bylaw, or otherwise. And the final sentence deals with the point I raised earlier, which goes to employees and agents and mentions that it expressly authorizes the Corporation to provide that permissive level of indemnity but on terms that are not better than what other directors and officers get.

The next step is to confirm the coverage under the corporation's D&O insurance policies. Just briefly, a description of how these policies work: Side A coverage in the policy would cover directors and officers personally for claims for which they're not indemnified by the corporation. So, again, whether it's an issue of the corporation not being authorized by law to indemnify them for the matter, or if the corporation might be insolvent, or in capable of making those payments, the Side A coverage would protect directors and officers personally. Side B coverage goes to reimbursing the corporation for amounts the corporation

pays to its directors and officers as indemnification. The difference here is that there is a deductible that applies so the corporation will have to retain a certain portion of that indemnification prior to getting reimbursed under the policy. Side C covers a corporation for amounts paid to defend securities claims like shareholder suits in connection with the kinds of transactions we've been talking about. And, again, there is an applicable deductible. Typically, these policies have exclusions which apply against the directors and officers indemnification—for fraud, intentional violations and other particularly bad conduct. So they don't indemnify for everything under the sun that a director or officer might do. There are some baseline types of exclusions. Finally, we note that most corporations will have primary coverage under one policy and then one or more excess policies. And again, multiple tranches coverage will often be with different insurers.

So now I'd like to talk about a couple of more recent developments in the law and things to consider potentially in connection with getting prepared for a transaction. The first recent development is forum selection bylaws. These come out of the 2013 Boilermakers decision by then-Chancellor Strine at the Delaware Chancery Court. A forum selection bylaw is a provision in a corporation's bylaws that would designate a forum as the exclusive venue for various types of inter-corporate litigation. That type of litigation would cover the types of suits we're talking about in connection with a deal transaction. Basically, these types of litigation are breach of fiduciary duty suits, derivative litigation, any litigation under the internal affairs doctrine—basically, suits that are in the corporate family, or what you might call domestic disputes. It tries to address and specify the venue for those kinds of suits.

Now, by requiring these suits to go only to a certain forum. these provisions are attempting to discourage forum shopping by the plaintiffs bar in particular, and to reduce the cost of duplicative multi-forum litigation and the risk of inconsistent litigation outcomes in those areas. Referring to the Cornerstone study that Jon mentioned before, Cornerstone notes that for the period 2010 to 2013 Delaware courts awarded 80 percent of requested attorneys' fees on average in settlements for these kinds of suits, while other courts—that is, non-Delaware courts—awarded on average 90 percent. So the forum you're in can make a difference. Now, if the board is authorized to adopt the bylaws, it can unilaterally adopt a forum selection bylaw. This is authority that is granted Delaware corporations in their charter and almost all Delaware corporations have that authority.

The real issue is enforceability, then. So, while a bylaw might be validly adopted, is it enforceable in the situation as it is a forum selection provision similar to and construed in the same way as a contractual forum selection provision? Courts in California, New York, Illinois, Louisiana, Ohio and Texas have gone on to recognize and enforce the forum selection bylaws of Delaware corporations. A forum selection bylaw adopted by a board in connection with a corporation is also not necessarily unenforceable. So, some of these suits—the Illinois case in particular—involved the Beame transaction, and the bylaw was adopted during the deal process and the Illinois court enforced the forum selection bylaw. There was also a case, however, in Oregon where a corporation adopted a forum selection bylaw on the same day it resolved to enter into a merger transaction, and the Oregon court did not enforce the bylaw.

The most recent case, however, coming down from a Delaware court, from Chancellor Buchard, is City of Providence versus First Citizens Bancshares. In that case, the Chancery Court found that the corporation's forum selection bylaw was valid and enforceable, even though it was adopted on the same that the corporation agreed to enter into a merger agreement. So, while the bylaw was adopted on what you often see in these types of cases and decisions referred to as a "cloudy day" and not a "clear day," because there was on this "cloudy day" litigation in the offing, the court did not find that as a reason not to enforce it. Interestingly, in that case, the forum selected in the bylaw of the Delaware corporation was North Carolina, and that's because the company was based and headquartered in North Carolina and it wanted to have its suits heard in North Carolina. So the Delaware court said that it would enforce it and the suits could be heard in North Carolina and not in Delaware.

One thing we've noticed actually is we've received LOIs in the context of parties just starting to negotiate public deals where a buyer is requiring a target company to implement a forum selection bylaw in connection with the run-up to the announcement of the transaction, so this is an area that, again, is evolving.

One additional area, again, the category of recent developments I wanted to discuss is fee-shifting provisions. These are a very recent and evolving area of the law. In May of 2014, the Delaware Supreme Court in the ATP Tour Inc. decision held that bylaws that shift attorneys' fees and costs to unsuccessful plaintiffs in cer-

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tain inter-corporate litigation can be enforceable under the DGCL. Now, this case involved a non-stock membership corporation, but the analysis that the court did and the wording of the opinion suggest to some that this type of bylaw might be permissible for a public corporation to adopt. Again, this area is still evolving. There was an immediate reaction by the Delaware Bar Association, which recommended an amendment to the DGCL as the current session of the legislature was closing. It would be an amendment to prohibit these kinds of bylaws. There was then an immediate and strong reaction from Delaware corporations, the U.S. Chamber of Commerce, and other interested lobbying parties against such an amendment. In the end, the legislature decided to take more time and tabled the consideration of any type of limitation on these kinds of bylaws. So, again, being an area that is evolving right now, we expect something to come out before July, that is, during the current session, and we'll have to see. But if these types of bylaws do, to some extent, get the imprimatur or are permitted by the legislature, these are things that we think you should consider and most public corporations will probably be taking a serious look at whether to adopt them.

Now just a couple of points—board housekeeping items. Make sure that during this period when there is not a deal that the board is at least keeping itself grounded in what's going on in the M&A market and putting itself in the best position to move into deal mode when it is necessary. Obviously boards periodically review strategy and they should do that with regard to the M&A market and the activity in their industry. This should be more than just casual conversations from time to time. This should be an agenda item where management and the board actually have this conversation, have management present perhaps their view of the market, and financial and legal advisers should also be present.

The most important part of this, I think, is to say that the board needs to stay abreast of market developments in this area. One reason is so as not to miss opportunities, strategic opportunities that might be presenting themselves due to current market practices, change in the law, or industry changes. But on the flip side, if the board does receive a proposal that gets lobbed in suddenly, it's not caught flat-footed and it understands the context and the market environment that it is operating in and what the company has been doing and what its position is in that market, and can get out more quickly with a response that is meaningful and appropriate.

Finally, communication protocols are something that all boards have not just with respect to the board itself but also the executive officers of the company. The board should have and should maintain—and make sure everyone is clear on—a policy as to whether any of the directors or officers are permitted to initiate communications with third parties regarding proposals for change-of-control transactions or strategic transactions in general and what the conditions would be for that. If it's a major transaction, the CEO, for example, should not be going forward without the knowledge of the full board. Smaller items perhaps, at a certain threshold level, perhaps the CEO is permitted to initiate communication but then reports back to the board.

Similarly the board should also have a policy—and it should be clear to all the officers of the corporation and the directors—as to how a response to any communication with a third party regarding a strategic transaction is to be handled. And finally, we note that inquiries regarding takeover offers should be immediately communicated to the CEO, and the CEO should immediately notify the board in that situation to make sure that all the right people are aware and can proceed accordingly.

William Kucera

You've now heard from Jon that litigation on a public deal is more or less inevitable, and you just heard from Andrew about certain steps that you can take to prepare for the inevitable litigation, even before you get to the point of having a deal on the table. I'm going to talk about some steps that you can take during the deal process itself to put yourself in the best position to defend against, and hopefully mitigate the consequences of, that inevitable litigation.

First, given that litigation is more or less inevitable, it is pretty clear you will eventually need litigators involved. So it makes sense to involve litigators from the beginning of the transaction. Now, to all you M&A lawyers out there, don't worry—I'm certainly not suggesting that you need your litigators to be sitting next to you at the negotiating table or have them on every call. Rather, I'm just suggesting that it makes some sense to keep your litigators generally informed about the deal and the key developments as the deal progresses, in particular, focusing on any facts that ultimately might find their way into a plaintiff's complaint or otherwise be the focus of litigation. It just makes sense to have the litiga-

tors have a running start on the deal when that inevitable complaint is filed. And also, as the deal progresses, it may make sense to have the litigators review key aspects of the deal that will ultimately be the subject of or focus of litigation or discovery. By that I mean, board minutes, perhaps key proxy disclosures and the like.

Turning to the next step to keep in mind while you're in the deal process is building your record with your potential litigation in mind. There are a few aspects of building a record. First, you should counsel your management and the board so that they know that it's not "if" but "when" they will be sued. Tell them very clearly to expect litigation. That seems to work pretty well. Normally, when you look someone in the eye and tell them they are going to get sued, that gets their attention pretty well.

So, what does that mean? For one, management and the board to be counseled, to be sensitive to what is put in e-mails and other writings. Certainly, nobody wants a smoking-gun e-mail when that inevitable litigation comes out. This includes note-taking at board meetings. Now, there are different schools of thought on this. I'm not one that suggests that notes shouldn't be taken at all, or that after a board meeting the lawyers should walk around the boardroom and collect all notes so that they can be destroyed. In fact, I think in many instances notes can be beneficial, for a number of reasons. For one, the whole goal here is to have a record of showing care and deliberate process, and obviously well-taken notes can do that. Similarly, well-taken notes can refresh memories down the line, which may be months later. But I'm just simply saying that management and directors should be counseled that in taking notes and making other writings, they should be cognizant of the likely litigation and what those notes may or may not say. Approach the situation from the perspective—and counsel your directors and management accordingly—that it is at least likely that the directors and/or management will be either deposed or have to testify at some point.

The second part about building a record is to both steer the management and board to actually take deliberate and careful actions as they're considering the deal, and then, secondly, to make a written record, a clear written record, of such deliberate and careful deliberate actions. So, we like to say, Rule Number One is "Do the right thing," and Rule Number Two is "Make a record that you did the right thing." In this regard, there is a recent white paper stemming from an ABA speech by now-Delaware Supreme Court Justice Leo Strine, that is directly on this point. The title of the speech is *"Documenting The Deal: How Quality Control and Candor Can Improve Board Decision-Making and Reduce the Litigation Target Zone"*—obviously exactly what we're talking about here.

The speech starts as follows: "If you take to heart my remarks today, you will upset some of my good friends in the plaintiffs' bar. In other words, if you want to make the lives of the plaintiffs' lawyers more difficult, listen up." In the speech and the white paper, which will be published in an upcoming issue of *The Business Lawyer*, the speech is just full of practical tips on these exact topics: building a better record; mitigating the risk of the inevitable shareholder litigation. If you haven't read it yet, I would highly recommend that it's one you throw into your briefcase and read it on the commute home one of these days. I think it's well worth the thirty minutes of your time.

Strine offers many practical tips. He says that you should think of yourself as having the ability to write the play. By this he means the advisers are there to build the record, which is the theme I'm discussing. A well-written play, according to Strine, can do a lot of things, not the least of which is to help to refresh memories down the road about what exactly was and was not done in that boardroom. Again, it's likely that some directors or officers may ultimately have to be deposed or testify.

In his piece, Strine also gets into the use of modern technology and when it is and isn't appropriate. In one instance where Strine thinks modern technology should be used, he says that advisers, in providing documents to directors, should think about red-lining changes between those documents, particularly in the context of banker books. Now, banker books, as you may know, tend to be long and thick and detailed documents, and sometimes these banker books change over the course of the transaction. Now, oftentimes with frequent board meetings, bankers will be asked to effectively refresh their presentation, which often means re-circulating the banker book. Every time the book is re-circulated, there are often some changes to the book to reflect updates and the like. And what Strine is saying is: Look, when you re-circulate an 80-page banker book that the directors have now seen three times before, doesn't it make sense to send around a red-line of the updated book? That way the directors can very quickly and easily see the changes that they need to focus on. It also serves the written record—you now have a written record of exactly what was updated, and you will be able

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to highlight down the road those things that the board focused on and discussed with the bankers in detail at that particular meeting.

In another instance, Strine is less convinced about the use of modern technology. This is the instance of the now widely used technique of posting director materials to an electronic or online portal. As you probably know, many large companies now do this. What Strine is saying is that at least in the deal context—again, with the likelihood of litigation—at least some of the deal documents should be sent to the directors in hard copy so as not just to rely on the electronic portal for delivery. Now, again, I think this makes perfect sense from a record/litigation standpoint if you think it through. If you just send out electronic copies, you are exposing yourself to the possibility of a director getting busy and not opening their download document. Now hopefully that doesn't happen, but we also all know that in the real world it's at least possible.

If the fact of who opened documents and for how long is not currently known from a technological standpoint, and is something that could be discovered after the fact by a plaintiff's lawyer, it certainly will be soon. So you expose yourself to the possibility of having actual evidence that a particular director or two did not actually open or read the document. Certainly you can imagine the field day the plaintiffs' lawyers would have if they are able to factually establish that a director, or two, or three did not actually read the documents. If you send around a hard copy of at least the key documents, you're able to avoid that. The Strine piece has many other practical tips. Again, I think it's well worth a read.

The next issue I'd like to discuss in connection with steps that can be taken during the deal process to mitigate the inevitable litigation is the careful vetting of conflicts. Now this is probably the most important step to be taken because conflicts have emerged as perhaps the one thing that can turn ordinary course shareholder litigation from oftentimes a nuisance suit into what can be a real suit with real dollars. I'm sure most of you have heard about several recent high-profile examples of very substantial settlements or judgments in the case of M&A deals. The reason behind many of these judgments and settlements was indeed conflicts.

Conflicts can arise in a couple of different settings, the most traditional of which is there being a conflict between certain members of the target company, either the management or directors, and the buyer. The classic example is a management-buyout where management is literally the buying group, or, perhaps more common these days, where there is a financial sponsor take-private that wants to and/or needs to keep management around, and oftentimes, as a way to incent management, management is asked to or wants to roll over certain of their equity into the new buying entity such that in these instances, the members of management or directors are literally on both sides of the table. They are both a seller and a buyer.

Certainly, in situations like a management buyout, the conflicts are obvious. But it's important to peel the onion a bit further. It may not be perfectly obvious where all the conflict lies. Take the management buyout situation in which the CEO is made an offer by the company. Obviously the CEO is conflicted. But you need to look at this further. What about the CEO's childhood friend who happens to sit on the board? Is that 30-year friendship such that that director is so close or beholden to the CEO that that director is conflicted? It's a fact-and-circumstances analysis but it's one that absolutely needs to be done because you're sure that the plaintiffs will be doing it.

Now, while affiliations with buyers are probably the traditional conflict, perhaps the feisty newcomer in the world of M&A conflicts is banker conflicts. These have been getting a lot of press recently and it's essentially a situation where buyers are at least deemed to be on both sides of the transaction, perhaps giving deal advice to the target and maybe arranging financing in connection with the buyer group, or somehow trying to earn fees on both sides of the transaction.

Conflicts is certainly a complicated topic and it's beyond the scope of this presentation to take a deep dive into conflicts. What we do want to leave you with is it's certainly important to have at the very top of your deal checklist that potential conflicts need to be carefully vetted in the deal process. They need to be vetted at the beginning of the process when things kick off, but also notably throughout the process. We all know that deals are fluid and that the facts changes. It may be that halfway through the process the buyer determines to partner with a new private equity group, or arrange financing through a new financing source. That may give rise to a whole new round of conflicts which need to be vetted and considered, so it's important to keep the conflicts analysis fluid.

My last point on conflicts is that while certainly it's the target and the target's advisers that

do the vetting of the conflicts, conflicts are just as much a buyer's issue as a target's issue. Again, target conflicts are probably the one key thing that can make litigation "real." Buyers certainly want to pay attention to conflicts and make sure they are vetted.

Next: all else being equal, optics matter. Now, I'm certainly not saying that thinking about how a particular decision may be viewed in litigation should drive the business deal or decision-making in the context of a deal. But I do think it's important to keep optics in mind, particularly when you're on the buy side of the deal. One area where this comes up frequently is deal protections. Again, a buyer should certainly negotiate for the deal protections it thinks it needs from a business standpoint, but it's also not clear that in this instance more is necessarily more. At some point, the marginal benefit of additional deal protections will need to be balanced against the potential detriment in litigation.

I'll use an example to illustrate the point. I once did a deal representing the target, in which the target was effectively precluded from doing a market check. What happened was the five-hundred-pound gorilla in the industry showed up, made a very strong offer to our client and insisted on an immediate exclusivity arrangement. When we made the point, "Well, gosh, I wish we could but we haven't at all done a market check. We really would like to before entering into an exclusivity arrangement."

The five-hundred-pound gorilla effectively said, "Well, you can do what you want, but we've got ten other deals on the table. We may or may not be there when you get back after your market check. Take it or leave it." We got comfortable with this for a variety of reasons. There were some very good facts in the context of that deal that the board was very educated about the space and the M&A market, and the like. But one of the things we did in connection with moving forward is that we insisted that the breakup fee, once we got to that point—and, again, this was reasonably early in the process, and the breakup was in the context of a traditional no-shop—the buyer certainly wouldn't let us have a go-shop in that instance—but we said upfront when we agreed to move forward that we wanted or needed the breakup fee to "start with a one."

What we meant by that was when we actually got down to doing the math and putting the number in the merger agreements, we wanted the math to show that it was less than two percent of the deal consideration, which, as most of you probably know, is at the low end of the spectrum for breakup fees. We did that to give us another arrow in our quiver, so to speak. If and when a plaintiff challenged the fact that the company was not shopped, we wanted to be able to, among other things to point at, be able to say, "Gosh, look how low our breakup fee was. It even started with a one. It certainly wasn't preclusive." And in that particularly instance, the buyer and its counsel, which were both quite sophisticated, quickly understood the point, didn't fight it, and agreed to give us a breakup fee that started with a one.

Then, lastly on optics, it may seem a little silly but it is probably worthwhile in most instances if you're representing a target to do the dance, so to speak, in terms of deal protections and other deal terms. What I mean by that is to be able to show a record of some negotiations even if this is the greatest deal with a high premium, and you know you're going to accept, you've got no other options. This is not the instance to quickly high-five with the buyer and cut to the chase, but rather to build a record. You asked for a lower breakup fee; the buyer came back with a higher breakup fee; you danced around a little bit. It's worthwhile after the fact to show you tried and that, frankly, this was the only way—the *quid pro quo* for accepting this great deal was to agree to these terms.

Lastly, disclosures. Prepare your disclosures knowing that the plaintiffs will be asking for more disclosures. A lot of the settlements these days are disclosure-only settlements. And that makes sense because when all else fails—you've done your job perfectly as an adviser; you've followed the tips we've laid to a "t"; you had good facts; there's nothing else for the plaintiffs to challenge—the plaintiffs will fall back on more disclosure. Because no matter how fulsome your disclosure is, a plaintiff can always say there should have been more. Deals are very complicated. They go on for months. And so it's really low-hanging fruit for plaintiffs to say, "Gosh, there should have been more disclosure." There are several hot-button topics to keep in mind in the Background to the Merger section, Projections, and the like. Keep it in mind.

Lastly, there was, and maybe still is, a school of thought that you should purposefully hold back certain items from the initial draft of disclosure documents so you have something as trade bait. You can say, "Okay, here's the lawsuit, I'll quickly give you projections and you'll go away." In our experience, that's not necessarily a good idea as it always results in plaintiffs demanding more and being able to beat the drum louder that the disclosure was not particularly fulsome.

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