Nuts and Bolts of Oregon Business Law Practice

Cosponsored by the Business Law Section

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7 General CLE credits and 1 Ethics credit
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OREGON STATE BAR
16037 SW Upper Boones Ferry Road
P.O. Box 231935
Tigard, OR 97281-1935
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SCHEDULE

7:30  Registration

8:25  Welcome and Opening Remarks

8:30  Recent Developments in Delaware Corporate Law
     Michael Allen, Richards Layton & Finger PA, Wilmington, DE

9:30  Drafting Contracts to Minimize Litigation Risks
     Keith McIntire, Stoel Rives LLP, Portland
     Jeremy Sacks, Stoel Rives LLP, Portland

10:30 Break

10:40 Breakout A: Recent Developments in Washington LLC Laws
     Chris Brown, Karr Tuttle Campbell, Seattle, WA

     Breakout B: Earn-Outs, Escrows, and Post-Closing True-Ups in M&A
     Charmin Shiely, Schwabe Williamson & Wyatt PC, Portland

11:25 Transition Break

11:30 Breakout C: Tips for Representing Startups and Emerging Companies
     Jonathan Norling, Emerge Law Group PC, Portland

     Breakout D: The Sale Process (Including Auctions and Single-Bidder Sales)
     Kenneth Haglund Jr., Lane Powell PC, Portland
     M. Christopher Hall, Perkins Coie LLP, Portland

12:30 Lunch
     ✦ James B. Castles Leadership Award Ceremony
     ✦ Outstanding Corporate Law Student Scholarship Award
     ✦ Business Law Section Annual Business Meeting
     Kenneth R. Haglund, Jr., Chair, Oregon Business Law Section, and Shareholder, Lane Powell PC

2:00 IP for the General Business Lawyer
     Leigh Francis Gill, Immix Law Group PC, Portland

3:00 Mandatory Elder Abuse Reporting for Oregon Lawyers
     Mark Johnson Roberts, Deputy General Counsel, Oregon State Bar, Tigard

4:00 Break

4:15 Legal Ethics for Business Lawyers
     Nellie Barnard, Holland & Knight LLP, Portland
     Calon Russell, Holland & Knight LLP, Portland

5:15 Adjourn
FACULTY

Michael Allen, Richards Layton & Finger PA, Wilmington, DE. Mr. Allen is a director in the firm’s Corporate Department and a member of the department’s Corporate Advisory Group. He counsels corporations, officers, directors, board committees, and stockholders in connection with a wide variety of transactional and advisory matters, including mergers and acquisitions, divestitures, recapitalizations, proxy contests, stockholder meetings, and corporate governance issues. His practice also involves rendering legal opinions on Delaware corporate law issues. Mr. Allen is a frequent speaker regarding Delaware law practice and developments.

Nellie Barnard, Holland & Knight LLP, Portland. Ms. Barnard’s practice focuses on advising lawyers, law firms, and corporate legal departments on legal ethics and professional responsibility matters. She also maintains a commercial litigation practice. She is a member of the Multnomah Bar Association Professionalism Committee, the Federal Bar Association board, Oregon Women Lawyers, the Multnomah Bar Association, the American Bar Association Young Lawyers Division, the Association of Professional Responsibility Lawyers, and the Campaign for Equal Justice Associates’ Committee.

Chris Brown, Karr Tuttle Campbell, Seattle, WA. Mr. Brown is a member of the firm’s Business and Finance practice group. His practice focuses on tax law; he also serves as general counsel to a number of businesses, providing guidance in corporate law matters, and he has extensive experience in LLC and partnership law. Mr. Brown also represents taxpayers in disputes with the IRS and Washington Department of Revenue. Mr. Brown is a member of the Washington State Bar Association Partnership and LLC Law Committee, Taxation Section, and Creditor/Debtor Rights Section and the American Bar Association Tax Section.

Leigh Francis Gill, Immix Law Group PC, Portland. Mr. Gill’s technology law and business practice has grown from his business and software experience to include contracts and licenses, intellectual property, taxation, hiring and employment, and general business advising. He is a member of the American Bar Association Young Lawyers Division Member Services committee and Publications Subchair of the ABA IP Young Lawyers Action Group. He is the 2013 Small Business Legal Clinic Pro Bono Champion. Mr. Gill is admitted to practice in Oregon and Washington.

Kenneth Haglund Jr., Lane Powell PC, Portland. Mr. Haglund focuses his practice on public and private business corporations and financial institutions, with a concentration on securities and regulatory compliance, corporate governance, mergers and acquisitions, and corporate and real estate finance. In addition, he is active in ongoing securities compliance for publicly traded companies, including securities disclosure obligations, periodic reporting and EDGAR filing requirements. Mr. Haglund is chair of the Oregon State Bar Business Law Section.

M. Christopher Hall, Perkins Coie LLP, Portland. Mr. Hall focuses his practice on serving clients in such areas as corporate finance and acquisitions and dispositions. He manages complex transactions having strategic importance to a company’s future. He has extensive experience with transaction structuring and has completed a number of acquisitions and dispositions, leveraged buyouts, recapitalizations, and reorganizations, as well as a wide range of public and private capital markets transactions and negotiated investments. Mr. Hall also represents private equity firms in fund formation and capital deployment.

Mark Johnson Roberts, Deputy General Counsel, Oregon State Bar, Tigard. Mr. Johnson Roberts is Deputy General Counsel to the Oregon State Bar. He provides prospective ethics advice to Oregon lawyers and provides counsel to the bar on regulatory, employment, and business matters. He practiced family law in Portland for 26 years before joining the bar’s staff in 2016. Mr. Johnson Roberts is chair of the American Bar Association Commission on Sexual Orientation and Gender Identity, past president of the Oregon State Bar, past president of the National LGBT Bar Association, and past chair of the Oregon State Professional Responsibility Board. He is the 2014 recipient of the Multnomah Bar Association Professionalism Award in recognition of his many years of service to the bench and bar. Mr. Johnson Roberts holds an LL.M. in International Law from the Willamette University College of Law.
Keith McIntire, *Stoel Rives LLP, Portland.* Keith McIntire is of counsel in the firm’s Litigation Group and advises clients in a variety of litigation matters. He focuses his practice on complex business litigation and environmental and white-collar criminal and regulatory matters. He regularly represents clients in state and federal courts across the country, in arbitration and mediation, and before state and federal prosecutors and regulators. He also has substantial experience in conducting internal investigations concerning allegations of bribery and related violations of the Foreign Corrupt Practices Act, money laundering, and accounting fraud. He is admitted to practice in Oregon and New York.

Jonathan Norling, *Emerge Law Group PC, Portland.* Mr. Norling is a corporate lawyer with a practice focused on the development and financing of business ventures. He represents emerging growth companies on business and commercial matters, including project development and finance. He has significant experience advising clients with respect to corporate governance, regulatory compliance, securities matters, entity formation, structured finance, and renewable energy and real estate project development matters.

Calon Russell, *Holland & Knight LLP, Portland.* Mr. Russell advises lawyers, law firms, and government and corporate legal departments on legal ethics and professional responsibility matters. He assists clients at the organizational level with law firm formation and operations, dissolution, and lateral lawyer moves; counsels on regulatory compliance issues such as the unauthorized practice of law, litigation financing, fee splitting, conflicts of interest, and state bar admissions; handles state bar disciplinary defense, sanctions motions, and legal malpractice claims; and advises on confidentiality duties, steps to avoid criminal liability, and strategies to lessen risk in law firms of all sizes. Mr. Russell also focuses on civil litigation, primarily at the appellate level, and has a background in constitutional law, labor and employment matters, construction defect litigation, foreclosure proceedings, premises liability, and the representation of public officials. Mr. Russell is a member of the Multnomah Bar Association and is admitted to practice in Oregon and Washington.

Jeremy Sacks, *Stoel Rives LLP, Portland.* Mr. Sacks focuses his practice on complex litigation in a variety of businesses, including the energy and health care industries. He has experience litigating business torts, contract disputes, securities fraud, False Claims Act issues, shareholder disputes, class actions, licensing disputes, and antitrust claims, as well as conducting internal corporate investigations and handling export and import matters. Mr. Sacks is a member of the American Bar Association Litigation Section and Antitrust Section and the Multnomah Bar Association.

Charmin Shiely, *Schwabe Williamson & Wyatt PC, Portland.* Ms. Shiely works with prominent businesses in a number of industries, including real estate development, senior housing, and maritime. She acts as lead counsel for Oregon real estate development projects, apartment complexes, a single-family housing development, and senior housing projects. She is a leader in structuring equity and executive compensation arrangements that comply with the myriad applicable corporate, tax, and securities laws. She also frequently represents both employers and executives in negotiating and drafting executive employment agreements. Ms. Shiely is a member of the Oregon Health Care Association, the Washington Health Care Association, the NAIOP Commercial Real Estate Development Association, and the Maritime Law Association of United States. Ms. Shiely is admitted to practice in Oregon and Washington.
Chapter 1
Recent Developments in Delaware Corporate Law

Michael Allen
Richards Layton & Finger PA
Wilmington, Delaware

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1 Michael D. Allen is a director of Richards, Layton & Finger, P.A., Wilmington, Delaware. Although Richards, Layton & Finger acted as counsel in some of the cases discussed herein, the views expressed do not necessarily represent views of the Firm or its clients. Portions of this outline are drawn from materials prepared by other members of Richards, Layton & Finger and have been used in other presentations and continuing legal education workshops.
Chapter 1—Recent Developments in Delaware Corporate Law

Introduction

These materials summarize and explain the significance of various recent (decided in the last three years) decisions of the Delaware Supreme Court, Delaware Court of Chancery, Delaware Superior Court and U.S. District Court for the District of Delaware regarding Delaware corporate law. These materials also highlight amendments to the Delaware General Corporation Law that became effective in 2013, 2014 and 2015.

I. RECENT DECISIONS OF DELAWARE COURTS.

A. Business Combinations.


In In re EZCORP Inc. Consulting Agreement Derivative Litigation, 2016 WL 301245 (Del. Ch. Jan. 25, 2016), the Court of Chancery denied a motion to dismiss derivative claims challenging a series of payments between a corporation and its controlling stockholder, even though those payments had been approved by the Audit Committee of the corporation's board. After review of extensive case law, the Court concluded that the weight of authority called for application of the entire fairness standard at the pleading stage, with the possibility that an evidentiary showing of independent committee approval could support a shift in the burden of proof later in the case. The Court determined that such transactions could be subject to dismissal at the pleading stage under the business judgment rule only where the transaction is approved by both an independent committee of the board and a majority of the minority stockholders.

Headquartered in Austin, Texas, EZCORP Inc. ("EZCORP" or the "Company") provided instant cash solutions through a variety of products and services, including pawn loans, other short-term consumer loans, and purchases of customer merchandise. The plaintiff stockholder brought suit challenging the fairness of three advisory service agreements between the Company and defendant Madison Park, LLC, an affiliate of the Company's controlling stockholder, Phillip Cohen. Cohen was the sole stockholder of the general partner of the limited partnership that held all of the Company's voting common stock. Thus, Cohen held 100% of EZCORP's voting power, but only 5.5% of its equity.

In May 2014, the Audit Committee terminated the renewal of one of the service agreements, allegedly due in part to the committee's concern about the fairness of the relationship between the Company and Madison Park. In early July, the stockholder-plaintiff made a demand under Section 220 of the Delaware General Corporation Law to inspect the Company's books and records relating to the service agreements. Nine days after the books and records demand arrived, Cohen responded to the termination by removing three directors (including two members of the Audit Committee that had terminated the agreements and the Company's CEO) from the board; another director resigned the same day.
The Court considered at length the appropriate standard of review for transactions in which a corporation's controlling stockholder receives a non-ratable benefit. The Court noted that, in an ordinary case involving self-dealing between a corporation and its controlling stockholder, the standard of review is entire fairness and the burden of proof rests on the defendants. However, in the context of a cash-out merger, the Delaware Supreme Court has held that application of the business judgment rule is appropriate if, but only if, the transaction is conditioned *ab initio* on both the affirmative recommendation of a sufficiently authorized, independent and disinterested committee of the board and the affirmative vote of a majority of the minority stockholders. See *Kahn v. M & F Worldwide*, 88 A.3d 635 (Del. 2014). If the controlling holder agrees to use only one of these protections, however, "then the most that the controller can achieve is a shift in the burden of proof such that the plaintiff challenging the transaction must prove unfairness."

The Court then considered a controversy posed in the case law: whether challenges to controlling-stockholder transactions other than cash-out mergers may be dismissed under the business judgment rule where the transaction is conditioned on *either* approval by an independent and disinterested board committee or approval by a majority of the minority stockholders, but not both. After an extensive review of cases taking both sides of that issue, the Court concluded that the weight of the authority called for a broader application of the entire fairness framework.

The Court also considered the tension between that conclusion and the demand futility analysis articulated in *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984), a case in which the Delaware Supreme Court had reversed (on discretionary interlocutory review) the Court of Chancery's denial of a motion to dismiss a derivative suit challenging a transaction with a 47% stockholder that had been approved by a majority disinterested and independent board, but not by the corporation's stockholders. The Supreme Court in *Aronson* held that, unless a stockholder plaintiff pleads particularized facts calling into question the board's ability to exercise properly its independent and disinterested business judgment in responding to a demand to institute suit, a board's refusal to sue is subject to business judgment review. After extended discussion of post-*Aronson* case law, the Court determined that *Aronson* applies only to the demand-excusal context and does not provide an independent basis for changing the substantive standard of review of controlling stockholder transactions.

After finding that the operative standard of review was entire fairness with possible burden shifting based on the Audit Committee's approval of the service agreements, the Court held that the complaint supported a reasonable inference that the agreements were not entirely fair. Among the factors that the Court found to raise such inference were: (i) Cohen's voting control despite having only a 5.5% equity stake; (ii) the long history of advisory service agreements between the Company and Cohen's affiliates; (iii) the amount and timing of the payments; (iv) the minimal resources of Madison Park; (v) the duplication between the services Madison Park provided and the capabilities of the Company management; (vi) the lack of similar service agreements at any of EZCORP's peer companies; (vii) the decision by two members of the Audit Committee to cancel the renewal of one agreement; and (viii) Cohen's retaliation against those board members.
The Court added that at the motion to dismiss stage, the involvement of the Audit Committee in the transactions does not defeat the fiduciary duty claim because a determination of whether an independent committee is "well-functioning" requires a "fact intensive inquiry."

The Court next turned to its analysis under Court of Chancery Rule 23.1. The Court found that reasonable doubt existed as to the ability of a majority of the directors to exercise independent and disinterested business judgment over a demand, and thus that demand was excused. Notably, the Court found demand excused as to a retired board member whom Cohen brought out of retirement and reappointed after removing three directors in July 2014. While the Court acknowledged the general rule that a director's nomination or election by an interested party is, by itself, insufficient to raise a reasonable doubt about his independence, "it is not necessarily irrelevant." The Court found that this director's alleged "eagerness to be of use," combined with his participation as an Audit Committee member in approving some of the challenged agreements, could support the reasonable inference that "Cohen wanted to bring back a cooperative member of the placid antebellum regime."

b. **Corwin v. KKR Financial Holdings LLC**, 125 A.3d 304 (Del. 2015).

In **Corwin v. KKR Financial Holdings LLC**, 125 A.3d 304 (Del. 2015), the Delaware Supreme Court affirmed a ruling by the Court of Chancery granting the defendants' motions to dismiss a suit challenging the acquisition of KKR Financial Holdings LLC ("KFN") by KKR & Co. L.P. ("KKR"). The Court held that the business judgment rule is the appropriate standard in post-closing damages suits involving mergers that are not subject to the entire fairness standard and that have been approved by a fully informed, uncoerced majority of the disinterested stockholders, even where such approval is statutorily required.

In December 2013, KKR and KFN executed a stock-for-stock merger agreement, which was subject to approval by a majority of KFN shares held by persons other than KKR and its affiliates. The merger, which was priced at a premium of 35% to market, was approved in April 2013 by an independent board majority and by a majority of disinterested stockholders.

Following the merger, nine lawsuits challenging the merger were brought in the Court of Chancery and consolidated. Plaintiffs alleged that (i) the members of the KFN board breached their fiduciary duties by agreeing to the merger, and (ii) KKR breached its fiduciary duty as a controlling stockholder by causing KFN to enter into the merger agreement. Plaintiffs' control claims focused on the facts that a KKR affiliate managed the company's day-to-day operations and that KFN's primary business was financing KKR's leveraged buyout activities.

The Court of Chancery dismissed the complaint, finding that KKR, which owned only 1% of KFN's stock, was not a controlling stockholder. Additionally, the Court of Chancery held that the business judgment rule would apply to the merger because the merger was approved by a majority of the shares held by the disinterested, fully informed stockholders of KFN.

The Supreme Court, sitting en banc, unanimously affirmed the judgment of the Court of Chancery. With respect to the control issue, the Court found that the plaintiffs had not alleged sufficient facts to support the argument that KKR had effective control of the board and could
therefore prevent KFN's board from exercising its own independent judgment in determining whether to approve the merger. To support this finding, the Court noted that KKR "owned less than 1% of the stock, had no right to appoint any directors, and had no contractual right to veto any board decision." Accordingly, the Court rejected the plaintiffs' control claims.

The Court further held that the business judgment standard of review would apply to the merger "because it was approved by a majority of the shares held by disinterested stockholders of KFN in a vote that was fully informed." The Court also declined to review the Court of Chancery's holding on the non-applicability of Revlon, finding that even if Revlon applied to the merger, the voluntary approval by an informed majority of disinterested stockholders was sufficient to support application of the business judgment rule. The Court stated that Revlon and Unocal were not designed to address post-closing claims for money damages, but rather to provide stockholders and the Court of Chancery the ability to address merger and acquisition decisions before closing.

In so holding, the Court agreed with the Court of Chancery's interpretation of Gantler v. Stephens, 965 A.2d 696 (Del. 2009). In Gantler, the Supreme Court stated that ratification is limited to circumstances where a fully informed stockholder vote approves director action that does not legally require stockholder approval in order to become effective. Using this interpretation, plaintiffs argued that the merger should be subject to heightened scrutiny regardless of the statutorily required stockholder vote approving the merger. The Court rejected this argument, finding that Gantler was a narrow decision that focused on the meaning of the term "ratification," and was not meant to overturn Delaware's "long-standing body of case law" regarding the effect of fully informed stockholder approval.

The Supreme Court noted, however, that its holding applies only to fully informed and uncoerced votes of disinterested stockholders. Thus, the business judgment rule is not invoked if material facts regarding the merger are not disclosed to the voting stockholders.


Delaware courts have consistently held, in the context of Delaware limited partnerships, that clear, express and unambiguous language modifying default fiduciary duties will be enforced. As demonstrated by the post-trial decision in In re El Paso Pipeline Partners, L.P. Derivative Litigation, 2015 WL 1815846 (Del. Ch. Apr. 20, 2015), however, even where default fiduciary duties have been modified or eliminated, a conflict of interest transaction may still run afoul of the contractual standards set forth in the partnership agreement.

In El Paso, the transaction at issue was the second of two so-called dropdown transactions by which El Paso Pipeline Partners, L.P. ("El Paso MLP") acquired all of the business involving the liquefied natural gas terminal on Elba Island, Georgia, from El Paso Corporation ("Parent"). Parent owned the general partner of El Paso MLP, and thus controlled El Paso MLP. El Paso MLP's partnership agreement eliminated default fiduciary duties and replaced them with a contractual standard requiring that the persons approving an action on behalf of El Paso MLP subjectively believe that the action is in the best interests of El Paso MLP. Here, the conflicts committee responsible for approving the dropdown transaction was
composed solely of independent directors, had engaged its own legal and financial advisors, had received from its financial advisor an opinion that the challenged transaction was fair from a financial point of view to the unaffiliated unitholders of El Paso MLP, and ultimately approved the transaction.

The Court ruled that under El Paso MLP's partnership agreement each conflicts committee member had an affirmative duty to conclude that the challenged transaction was "in the best interests of [El Paso MLP]." The Court found several flaws with the conflicts committee's process and the valuation analysis. More significantly, the Court found that, despite trial testimony to the contrary, the conflicts committee members did not actually conclude that the challenged transaction was in the best interests of El Paso MLP. The Court found that the conflicts committee had focused extensively on the expected accretion from the challenged transaction—i.e., the amount by which the cash distributions for common unitholders of El Paso MLP would be expected to increase—but failed to take sufficiently into account the valuation of the assets being acquired under traditional valuation analyses. As a result of these findings, the Court awarded damages of $171 million, which the Court determined to be the difference between what El Paso MLP actually paid for the assets acquired in the challenged transaction and the fair value of the assets. Notably, only the general partner entity was held liable for the award, as none of the other defendants was a party to the partnership agreement and the plaintiff did not present a meaningful theory of secondary liability.

The El Paso decision is a reminder that, although contractual flexibility afforded to Delaware limited partnerships can be used to provide general partners with significant protections, there is still room for courts to scrutinize compliance with contractual standards.

d.  


In C&J Energy Services, Inc. v. City of Miami General Employees' and Sanitation Employees' Retirement Trust, 107 A.3d 1049 (Del. 2014), the Delaware Supreme Court reversed the Court of Chancery's decision to grant an "unusual" 30-day preliminary injunction of the merger between C&J Energy Services, Inc., a Delaware corporation ("C&J"), and a division of Nabors Industries Ltd., a Bermuda company ("Nabors"). As an inversion transaction, the merger was structured such that C&J would acquire a subsidiary of Nabors, with Nabors retaining a majority of the surviving company's equity. Although it was the buyer, C&J bargained for a passive, post-signing "fiduciary out" to accept a superior proposal and for a relatively low termination fee.

Although the Court of Chancery found that C&J's board was fully informed as to C&J's value, and there was no finding that the board was conflicted, the Court of Chancery found it was "plausible" that the board had violated its duties under Revlon to seek the highest immediate value reasonably available, because the board did not engage in an active pre- or post-signing market check. The Court of Chancery enjoined the stockholder vote for 30 days and required C&J to shop itself, stating that the solicitation of proposals during that period would not breach the merger agreement.
The Delaware Supreme Court held that the Court of Chancery had misapplied the standard for issuance of a preliminary injunction, which requires the moving party to establish a "reasonable probability of success on the merits," and not (as the Court of Chancery formulated its finding) "a plausible showing of a likelihood of success on the merits." The Supreme Court also ruled that the Court of Chancery's analysis was based on the incorrect proposition that a company selling itself is required to conduct an active marketing process for its board to satisfy its duties under Revlon. After reiterating that there is no "single blueprint" that a board must follow when conducting a sales process, the Supreme Court stated that "when a board exercises its judgment in good faith, tests the transaction through a viable passive market check, and gives its stockholders a fully informed, uncoerced opportunity to vote to accept the deal, [the Court] cannot conclude that the board likely violated its Revlon duties."

Finally, the Supreme Court held that the Court of Chancery's mandatory preliminary injunction was improper because it was not issued on a factual record made after trial or on undisputed facts and because it stripped an innocent third party (Nabors) of its contractual protections while simultaneously binding that party to consummate the transaction.


In Houseman v. Sagerman, 2014 WL 1600724 (Del. Ch. Apr. 16, 2014), the Court of Chancery, by Vice Chancellor Glasscock, in addressing defendants' motion to dismiss claims related to the 2011 acquisition of Universata, Inc. ("Universata") by HealthPort Technologies, LLC ("HealthPort"), held that the failure to obtain a fairness opinion in connection with the acquisition did not rise to the level of bad faith on the part of the board of directors of Universata (the "Board") and did not support an aiding and abetting claim against the Board's financial advisor.

In 2006, plaintiffs (husband and wife) sold their business to Universata for a seven-year stream of payments totaling $9 million. Several years later, in 2009, when Universata had difficulty satisfying its payment obligations, plaintiffs agreed to convert some of their debt into shares of Universata common stock. As part of the transaction, Thomas Whittington, a director and stockholder of Universata, granted plaintiffs a put right obligating Whittington, under certain circumstances, to pay plaintiffs $2.10 for each share of plaintiffs' common stock (the "Put Contract"). In late 2010, HealthPort, and at least one other party, indicated an interest in acquiring Universata. At the suggestion of its legal counsel, Universata hired KeyBanc Capital Markets, Inc. ("KeyBanc"), an investment bank familiar with Universata's business, to assist the Board in conducting due diligence and identifying potential buyers. After considering the relative costs involved, the Board decided not to obtain a fairness opinion in connection with the merger, but did receive an informal recommendation from KeyBanc as to whether the merger consideration was within a range of reasonableness. On May 10, 2011, the Board approved a merger with HealthPort for consideration substantially less than the $2.10 per share that plaintiffs were, under certain circumstances, entitled to under the Put Contract.

After the merger closed, plaintiffs filed a lawsuit in Minnesota state court against Whittington for breach of the Put Contract. The Minnesota court dismissed the case with prejudice, finding that, upon the merger with HealthPort, the shares of Universata common stock
ceased to exist, and thus the Put Contract was no longer enforceable. Unsatisfied with the result, plaintiffs brought an action in the Delaware Court of Chancery attempting to re-litigate their claims related to the Put Contact and also alleging, among other things, breach of fiduciary duty for approving the merger and for failing to obtain consideration in the merger for certain "litigation assets" against the Board, and aiding and abetting breach of fiduciary duty against KeyBanc. The Court held, however, that the doctrine of issue preclusion prevented the re-litigation of the Put Contract claims and, accordingly, dismissed those claims.

In addressing plaintiffs' breach of fiduciary duty claim, the Court noted that because Universata's charter contained a Section 102(b)(7) provision exculpating the directors for breaches of the duty of care and because it was undisputed that a majority of directors were disinterested in the merger, plaintiffs were required to allege facts sufficient to show that a majority of the directors acted in bad faith in approving the merger. Plaintiffs pled that the Board acted in bad faith by "knowingly and completely" failing to undertake its responsibilities in connection with the merger. While acknowledging that the Board "did not conduct a perfect sales process," the Court found that the Board did not "utterly fail to undertake any action to obtain the best price for stockholders" by undertaking "some process," including (i) consulting with legal counsel, (ii) hiring KeyBanc to assist in shopping Universata and to provide an informal recommendation that the consideration was in a range of reasonableness, (iii) considering and deciding, due to the costs, not to obtain a fairness opinion, (iv) considering offers from various bidders, and (v) negotiating with HealthPort. Thus, the Court dismissed the breach of fiduciary claims against the Board.

The Court then turned to the aiding and abetting breach of fiduciary duty claim against KeyBanc. Relying on In re Rural Metro Corp., 88 A.3d 54 (Del. Ch. 2014), the Court held that the Section 102(b)(7) provision did not protect KeyBanc against claims for aiding and abetting breaches of fiduciary duty by the Board. However, the Court determined that plaintiffs had failed to allege that KeyBanc "knowingly participated" in any breach of duty. The Court distinguished Rural Metro, finding that plaintiffs had failed to allege that KeyBanc "actively concealed information to which it knew the Board lacked access, or promoted the failure of a required disclosure by the Board," or that KeyBanc had misled the Board or created an "informational vacuum" sufficient to support a finding that KeyBanc knowingly participated in a breach of fiduciary duty. The Court also rejected a claim that the limited services provided by KeyBanc supported an inference that KeyBanc knew of a breach by the Board. Again distinguishing Rural Metro, the Court found that the evidence suggested that it was the Company's interest, not KeyBanc's, that drove the structure of the financial services provided in connection with the merger. Accordingly, the Court dismissed plaintiffs' aiding and abetting claims against KeyBanc.

The Court then addressed plaintiffs' claim that the Board failed to obtain consideration for certain "litigation assets" under In re Primedia, Inc. Shareholders Litigation, 67 A.3d 455 (Del. Ch. 2013). According to plaintiffs, the "litigation assets" included, among other things, latent derivative claims based on the Board's decisions, on the day the merger was approved, to amend Universata's equity incentive plan to treat all employee stock options like outstanding shares of common stock in the merger and to vest certain warrants (including those that plaintiffs alleged were invalidly issued to certain directors). The Court noted that as a threshold matter, under Primedia, plaintiffs were required to plead that a derivative claim existed at the time Universata and HealthPort negotiated the merger price. Because the Court found that the alleged
derivative claims came into existence, if at all, on the day the merger was approved, the Board
could not have negotiated a merger price that considered those claims. However, the Court
determined that plaintiffs stated a claim for diversion of assets under Golaine v. Edwards, 1999
WL 1271882 (Del. Ch. Dec. 21, 1999), by pleading facts supporting an inference that the Board's
actions "represented an improper diversion and that, absent the impropriety, the consideration
would have gone to the stockholders."


In Chen v. Howard-Anderson, 87 A.3d 648 (Del. Ch. 2014), the Court of Chancery, by
Vice Chancellor Laster, ruling on a motion for summary judgment, held that, in a change of
control case where the standard of review is enhanced scrutiny, directors and officers could be
found liable for acting in bad faith (and thus breach their fiduciary duty of loyalty) if plaintiffs
cite evidence sufficient to support an inference that the directors and officers acted unreasonably
in conducting the sale process and allowed interests other than the pursuit of obtaining the best
price reasonably available to influence their actions. In so holding, the Court distinguished the
Delaware Supreme Court's decision in Lyondell Chemical Co. v. Ryan, 970 A.2d 235 (Del.
2009).

Viewing the facts in the light most favorable to plaintiffs for purposes of defendants' motion
for summary judgment, the Court found that the record supported the inference that the
directors and officers of Occam Networks, Inc. ("Occam") acted unreasonably in conducting the
sale of Occam to Calix, Inc. ("Calix"). The Court next considered defendants' argument that,
under Lyondell, the directors were nonetheless protected from liability by the corporation's
exculpatory provision unless plaintiffs could show that the directors had acted in bad faith by
"knowingly and completely failing to undertake their responsibilities." The Court rejected this
argument. The Court explained that the Lyondell decision addressed a situation in which plaintiffs
sought to show bad faith by alleging that the directors had consciously disregarded
known duties to act. However, this was not the only theory that a plaintiff could assert in an
effort to show bad faith conduct outside the scope of an exculatory provision. In particular, the
Court of Chancery noted that plaintiffs may attempt to establish bad faith conduct by asserting
that the directors were influenced by interests other than obtaining the highest price reasonably
available for the stockholders. The Court found that the Lyondell decision did not address, and
therefore was inapplicable to, situations in which plaintiffs attempted to make the bad faith
showing through such allegations.

Turning to the evidence presented by the Chen plaintiffs, the Court concluded that the
evidence was insufficient to support an inference that the outside director defendants acted in bad
faith by allowing interests other than the pursuit of obtaining the best price reasonably available
to influence their decisions. Accordingly, the Court granted summary judgment with regard to
the process-based claims in favor of the outside directors. The Court, however, found that the
evidence was sufficient to support such an inference against the officers of Occam. The Court
further noted that Section 102(b)(7) of the Delaware General Corporation Law does not
authorize exculpation of officers. Therefore, the Court declined to grant summary judgment with
regard to the claims against the Occam officers.
Occam was a publicly traded Delaware corporation that developed, marketed and supported products for the broadband access market. From early 2009 to mid-2010, Occam, with the assistance of its financial advisor, Jefferies & Company, Inc. ("Jefferies"), engaged in a series of discussions with two broadband access companies, Calix and Adtran, Inc. ("Adtran"), regarding a potential sale of Occam, and also engaged in discussions with a third broadband access company, Keymile International GmbH ("Keymile"), regarding an acquisition of Keymile by Occam as part of a "standalone" alternative to a sales transaction. By June 2010, Occam had submitted a proposal to purchase Keymile for approximately $80 million, Calix had submitted three proposals to acquire Occam (the latest of which had an offer price of $7.72 per share to be paid in a mix of cash and stock), and Adtran had sent Occam a letter of intent proposing an all-cash offer for Occam at a price of $8.60 per share, representing a premium of approximately 11% over Calix's latest offer. After meeting to consider the three alternatives on June 30, 2010, the board of directors of Occam (the "Board") directed management and Jefferies to give Adtran a 24-hour deadline to submit a revised bid and instructed Jefferies to conduct a 24-hour market check to determine whether any other third parties might be interested in a transaction with Occam.

Neither Adtran nor any of the third parties contacted by Jefferies submitted a revised proposal to acquire Occam by the deadline set by the Board. Five of the seven parties contacted by Jefferies did, however, express some degree of interest in a transaction, but noted that the timeframe was too short for a meaningful response. Shortly thereafter, the Board directed management to enter into an exclusivity agreement with Calix based on its offer of $7.72 per share. Despite Occam's improved financial performance during the exclusivity period (which the parties subsequently extended), on September 15, 2010, the Board approved the merger with Calix for consideration then valued at $7.75 per share, consisting of a mix of 49.6% cash and 50.4% stock. The Occam stockholders approved the merger agreement, and the merger closed in February 2011.

In post-closing litigation, plaintiffs alleged that the directors and officers of Occam breached their fiduciary duties during the sale process by unreasonably favoring Calix over Adtran and by failing to develop or pursue other alternatives to the merger that could have generated higher value for Occam's stockholders. Plaintiffs also claimed that the proxy statement contained materially misleading information regarding the sale process and projections prepared by Occam's management during the sale process.

The Court held that the transaction was subject to the enhanced scrutiny standard of review. Applying enhanced scrutiny review on defendants' motion for summary judgment, the Court found that the record supported the inference that the process employed by defendants fell outside the range of reasonableness by, among other things, unreasonably favoring Calix over Adtran and other potential bidders during the sale process, by giving Adtran a 24-hour ultimatum to revise an offer that was already at a premium to Calix's best offer, and by instructing Jefferies to conduct a 24-hour market check over a holiday weekend and then not following up with third parties that expressed interest. In light of the exculpation provision in Occam's charter that insulated the director defendants from liability for breaches of the duty of care and the Court's determination that plaintiffs failed to establish that a majority of the directors were not independent and disinterested, the director defendants argued that they could not be found liable under enhanced scrutiny review unless their actions were motivated by bad faith. They argued
that, under *Lyondell*, bad faith requires evidence that the director defendants had an actual intent to do harm or had consciously disregarded their obligations by utterly failing to attempt to obtain the best price reasonably available for Occam.

The Court rejected the argument that the category of bad faith conduct that was at issue in *Lyondell* is the only type of bad faith claim available to plaintiffs, and concluded that plaintiffs could survive summary judgment under other recognized theories of bad faith, including plaintiffs' claim that defendants had acted in bad faith by intentionally acting with a purpose other than advancing the best interests of Occam. However, the Court concluded that the record did not support an inference that the outside directors had acted with such an improper purpose, and for that reason granted summary judgment in favor of the outside directors as to the process-based claims. The Court denied summary judgment on the process-based claims as against the officer defendants on the grounds that there was greater evidence of self-interest with respect to the officers and that the officers, when acting in such capacity, were not covered by the exculpatory provision.

The Court also declined to grant summary judgment with regard to plaintiffs' disclosure-based claims. The Court noted that it was not clear at the summary judgment stage whether the alleged disclosure violations resulted from a breach of the duty of loyalty or the duty of care and therefore that a trial was necessary to determine whether, and to what degree, the exculpatory provision insulates the director defendants from potential liability related to such claims. The Court also noted that it could not infer that the directors acted in good faith due to evidence in the record that supported a finding that the directors knew about certain projections for the year 2012 that were not disclosed, that they were in a position to know that certain statements in the fairness opinion relating to those projections were false, and that the defendants had engaged in questionable conduct during discovery relating to the projections.

**g. In re Rural Metro Corporation Stockholders Litigation, 88 A.3d 54 (Del. Ch. 2014); 102 A.3d 205 (Del. Ch. 2014).**

In a 91-page post-trial opinion in *In re Rural Metro Corporation Stockholders Litigation*, 88 A.3d 54 (Del. Ch. 2014), the Delaware Court of Chancery held RBC Capital Markets, LLC liable for aiding and abetting breaches of fiduciary duty by the board of directors of Rural/Metro Corporation in connection with Rural's acquisition by Warburg Pincus LLC. The case proceeded against RBC even though Rural's directors, as well as Moelis & Company LLC, which had served as financial advisor in a secondary role, had settled before trial.

The Court found that RBC, in negotiating the transaction on behalf of Rural, had succumbed to multiple conflicts of interest. According to the Court, RBC, motivated by its contingent fee and its undisclosed desire and efforts to secure the lucrative buy-side financing work, prepared valuation materials for Rural's board that made Warburg's offer appear more favorable than it was. Because those valuation materials were included in Rural's proxy statement, the Court found that RBC was also liable for aiding and abetting the board's breach of its duty of disclosure.

Despite its finding of liability, the Court stated that it is not yet in a position to determine an appropriate remedy. The Court also deferred ruling on plaintiffs' request for fee-shifting, but it
noted that, "given the magnitude of the conflict between RBC's claims and the evidence, it seems possible that the facts could support a bad faith fee award."

In an opinion assessing damages in *In re Rural/Metro Corp. S'holders Litig.*, 102 A.3d 205 (Del. Ch. 2014), the Court of Chancery held that RBC, which had been held liable in the earlier opinion for aiding and abetting breaches of fiduciary duty by a board of directors in connection with approving a merger and related disclosures, would be required to pay 83% of the damages to the stockholder class. Relying on a discounted cash flow analysis, the Court determined that the fair value of Rural/Metro on a quasi-appraisal basis fell short of the merger price by $4.17 per share, and that the damages to the class of stockholders not affiliated with the defendants totaled approximately $91.3 million.

Rural/Metro, its directors and the company's other financial advisor had settled before trial and obtained "joint tortfeasor" releases, under which the plaintiff class agreed that the damages recoverable against other tortfeasors would be reduced to the extent of the settling defendants' respective pro rata shares, as permitted by the Delaware Uniform Contribution Among Tortfeasors Law, 10 Del. C. § 6301, *et seq.* The Court held that the unclean hands doctrine barred the non-settling financial advisor from claiming a settlement credit as to claims involving that financial advisor's adjudicated "fraud upon the board," but that it could claim a settlement credit as to other claims. The Court determined that the record at trial supported a finding that two of Rural/Metro's directors were joint tortfeasors, but did not support such a finding as to the other directors or the settling financial advisor. Allocating responsibility for the various claims on which liability had been previously found, the Court entered judgment for approximately $75.8 million against RBC.


In *In re Answers Corporation Shareholders Litigation, 2014 WL 463163 (Del. Ch. Feb. 3, 2014)*, the Court of Chancery, by Vice Chancellor Noble, granted summary judgment in favor of defendants in an action brought by stockholder plaintiffs challenging the merger by which Answers Corporation ("Answers") was acquired by AFCV Holdings, LLC ("AFCV"), a portfolio company of private equity firm Summit Partners, L.P. (together with AFCV, the "Buyout Group"), for $10.50 per share (the "Merger"). In so ruling, the Court found that there was no evidence that the board of directors of Answers (the "Board"), which was made up of a majority of independent and disinterested directors, acted in bad faith or was controlled by the alleged conflicted directors on the Board, and thus reaffirmed the Court's deference to boards composed of a majority of independent and disinterested directors in conducting a sales process.

Answers was a public corporation that operated the website answers.com, a leading question and answer website that was dependent, in large part, on Google for its traffic and advertising revenue. Prior to the merger, Answer's largest stockholder was the venture capital firm Redpoint Venture ("Redpoint"), which had the right to designate two directors to the Board (the "Redpoint-Designated Directors"). It was undisputed that four of the seven directors — those other than Answers' chief executive officer and founder, Robert Rosenschein, and the two Redpoint-Designated Directors—were independent. In early 2010, Redpoint received an unsolicited expression of interest from AFCV concerning a potential acquisition of Answers.
Shortly thereafter, the Board decided to engage a financial advisor to assist it in considering the proposed transaction with AFCV and exploring other strategic alternatives for Answers. Over the next approximately nine months, the Board considered various strategic alternatives for Answers, considered other unsolicited expressions of interest, and negotiated with AFCV regarding a potential acquisition.

By December 2010, after months of negotiations with AFCV and the Board's repeated rejections of AFCV's requests for exclusivity, the Board succeeded in obtaining a price increase from the originally proposed range of $7.50 to $8.25 per share to $10.25 per share. Around this time, the Board authorized its financial advisor to conduct a market check of ten other possible strategic buyers, which did not result in any other offers. By the end of 2010, the financial performance of Answers appeared to improve. The Board was aware, however, that Answers' dependence on Google and the possibility that Google might begin a competing business could affect Answers' financial performance in the future. Regardless, the Board used the improved financial performance to obtain another increase in price from $10.25 to $10.50 per share. Thus, following receipt of a fairness opinion as well as advice from its financial advisor that another bidder was unlikely to emerge, the Board approved the Merger.

Following announcement of the merger agreement, plaintiffs unsuccessfully sought a preliminary injunction to prevent the stockholder vote on the Merger. In earlier post-closing litigation, the Court held that plaintiffs' breach of fiduciary duty of loyalty claims against the Board were sufficient to survive a motion to dismiss. In addressing defendants' motion for summary judgment, the Court noted that, because the Merger was approved by a board composed of a majority of disinterested and independent directors, and because Answers' certificate of incorporation contained an exculpatory provision, plaintiffs "must rely on claims that the Board acted in bad faith or that it was controlled by an interested party to survive" summary judgment. Accordingly, plaintiffs alleged that Rosenschein and the Redpoint-Designated Directors were conflicted and controlled the negotiation process with AFCV and that the Board acted in bad faith by agreeing to sell Answers before its stock price exceeded AFCV's offer by (i) purposefully engaging in a limited shopping process, (ii) failing to act in the interests of Answers' public stockholders by accepting an offer price that was too low, and (iii) intentionally ignoring alternatives to the Merger.

The Court rejected plaintiffs' claims of bad faith in the sale process. The Court held that defendants had established that the Board, among other things, considered a variety of transactions, rejected AFCV's requests for exclusivity, rejected several of AFCV's offers as inadequate, performed a market check through Answers' financial advisor, attempted to increase the price obtained until the deal was approved, and received advice from its financial advisor that additional bidders were unlikely to come forward. In response to plaintiffs' objections to the two-week duration of the market check and the Board's decision to pursue only ten strategic acquirers, the Court found that "even this limited market check does not constitute a complete abandonment of fiduciary duty" and is sufficient to defeat a bad faith claim. In addition, plaintiffs contended that the Board did not respond to changed circumstances and gain an adequate increased price after Answers achieved better-than-expected fourth-quarter results. The Court found, however, that the Board had plausible business concerns about the stability and future success of Answers, including its dependence on Google, and that AFCV did in fact increase its offer price after being provided with the fourth-quarter results.
In addressing plaintiffs' claims that Rosenschein and/or the Redpoint-Designated Directors controlled the Board, the Court found that the record demonstrated that there was no evidence that Rosenschein and/or the Redpoint-Designated Directors applied pressure to the other members of the Board in connection with the transaction. The Court further found that the Board's decision to sell the Company was supported by various reasons cognizable under the business judgment rule (such as concern over future competition from Google and an uncertain future revenue stream). As a result, the Court concluded that the Board did not act in bad faith and that Rosenschein and the Redpoint-Designated Directors did not control the Board, and therefore granted summary judgment in favor of defendants.


In May 2012, the board of directors of BioClinica formed a special committee to explore a sale of the company. During an eight-month process, the financial advisor of the special committee, EP Securities LLC ("Excel"), reached out to 21 potential bidders, and the special committee entered into non-disclosure agreements with fifteen. Initially, the special committee decided to approach only financial sponsors in an effort to avoid disclosing certain confidential information to competitors, but it later approached potential strategic buyers. JLL initially declined to make a bid, but later expressed an interest at $7.00 to $7.25 per share. Then, after the only other serious potential buyer (a strategic buyer) decided not to make a final bid, the special committee agreed, at JLL's request, to grant exclusivity to JLL, so long as its final offer would be at least $7.25 per share.

Near the end of this process, BioClinica's projected capital expenditures increased to $11.9 million for 2013 from an earlier estimate of $6-8 million. In light of the change, JLL raised concerns about offering $7.25 per share. Nonetheless, on January 29, 2013, the board of directors of BioClinica approved a transaction with JLL, structured as a tender offer, at a price of $7.25 per share in cash, which represented a 23.2% premium over the stock's average closing price for the previous 90 days. The merger agreement contained several deal-protection devices, including a no-solicitation provision, a $6.5 million termination fee, information rights and a top-up option.

Several stockholders of BioClinica sued to enjoin the transaction. In February 2013, Vice Chancellor Glasscock denied plaintiffs' motion to expedite proceedings for failure to state a colorable claim, thus foreclosing their attempt to enjoin the deal. The following month the transaction closed, and thereafter, plaintiffs amended their complaint in an effort to plead a non-exculpated claim for damages.

In considering a motion to dismiss the amended complaint, the Court rejected plaintiffs' argument that the vesting of stock options meant the directors had a self-interest in the transaction, and noted that Delaware courts have consistently held that stock ownership aligns
the interests of directors and stockholders. The Court further found that allegations regarding the claimed interestedness of two of the directors were insufficient because those directors were not on the special committee and they were not alleged to dominate or control the members of that committee.

The Court also rejected the claim that the directors breached the duty of loyalty by failing to act in good faith. The Court found that "without a story of why the directors would artificially inflate expenditures," such an allegation was "purely conclusory."

Similarly, plaintiffs failed to allege facts showing that the directors failed to satisfy their Revlon duties in a non-exculpated manner because plaintiffs failed to show that the board of directors "knowingly and completely failed to satisfy those duties." The board's strategy to approach financial sponsors before strategic buyers was a reasonable way of protecting BioClinica's confidential information, especially where strategic buyers were later brought into the process. Moreover, the Court distinguished the case from Koehler v. NetSpend Holdings, Inc., 2013 WL 2181518 (Del. Ch. May 21, 2013), where the Court held that directors were reasonably likely to be found to have breached their fiduciary duties in part because of their reliance on a "weak" fairness opinion. The Court noted that, unlike in NetSpend—where there was no market check, potential bidders were subject to a don't-ask-don't-waive provision, and plaintiff sought injunctive relief such that breaches of the duty of care could support viable claims—the board of directors of BioClinica employed a full market check, the board did not agree to don't-ask-don't-waive provisions, and plaintiffs were reduced to seeking post-closing money damages. The Court, in response to plaintiffs' allegations that the board of directors of BioClinica relied on a weak fairness opinion, clarified NetSpend by noting that "[t]he board's reliance on a 'weak' fairness opinion is relevant where the fairness opinion provides the only equivalent of a market check," and that a purportedly weak fairness opinion "does not create a new basis to challenge every sales process."

Addressing the disclosure claims, the Court explained that for plaintiffs to recover more than nominal damages on the post-merger claims, they must demonstrate both that the non-disclosures involved a breach of the duty of good faith and causation, i.e., that the vote necessary to approve the merger would not have been obtained had the alleged undisclosed information been disclosed. Relying on its findings in the earlier opinion on the motion to expedite, the Court held that plaintiffs did not plead sufficient facts demonstrating that the failure to disclose why capital expenditure forecasts were adjusted upward or to disclose certain inputs in Excel's fairness opinion constituted material omissions supporting a finding of bad faith.

Moreover, the Court rejected the claim that the board of directors of BioClinica should have disclosed whether the non-disclosure agreements signed by potential bidders contained don't-ask-don't-waive provisions because plaintiffs had not alleged that they did contain such provisions, and "no disclosure could, or should attempt to, describe all clauses not included in NDAs."

The Court also dismissed plaintiffs' challenge to the combination of deal-protection devices, including a no-solicitation provision, a selective poison pill exception, a reasonable termination fee, information rights and a top-up option.
Finally, the Court rejected plaintiffs' aiding and abetting claims against JLL on the grounds that plaintiffs had not pled either a predicate breach of the duty of loyalty or knowing participation in a breach of the duty of care.

\[ \text{j. In re Trados Shareholders Litigation, 73 A.3d 17 (Del. Ch. 2013).} \]

In a 115-page post-trial opinion in \textit{In re Trados Inc. Shareholder Litigation, 73 A.3d 17 (Del. Ch. 2013)}, the Court of Chancery found entirely fair the decision to approve a merger in which common stockholders received no consideration.

In 2000, TRADOS Inc. ("Trados") obtained venture capital to support a growth strategy intended to lead to an initial public offering. The venture capital firms received preferred stock and placed representatives on the Trados board of directors.

In July 2005, Trados was acquired by SDL plc for $60 million in cash and stock. The preferred stockholders received $52.2 million of that amount in their liquidation preference, and management received $7.8 million as part of an existing management incentive plan. The common stockholders received no merger consideration. Plaintiff, a common stockholder, sought appraisal and sued the Trados directors for breach of fiduciary duties. In 2009, then-Chancellor Chandler denied in part a motion to dismiss, ruling that the plaintiff had sufficiently alleged that the venture firms' directors were interested in the decision to pursue the merger.

The Court reviewed the transaction for entire fairness and found that, although the process was not fair, the decision to approve the merger was entirely fair because the common stock had no economic value before the merger and its appraised value was zero. The Court also ordered the parties to enter into a schedule for briefing the issue of attorneys' fees.

2. \textbf{Aiding and Abetting Liability.}

\[ \text{a. RBC Capital Markets, LLC v. Jervis, 129 A.3d 816 (Del. 2015).} \]

In \textit{RBC Capital Markets, LLC v. Jervis, 129 A.3d 816 (Del. 2015)}, the Delaware Supreme Court affirmed a post-trial decision by the Court of Chancery holding that a financial advisor was liable for aiding and abetting breaches of fiduciary duty by directors of a corporation during a sale of control transaction. In doing so, the Court held that the evidence supported a finding that the advisor had the necessary \textit{sciente} for an aiding and abetting claim; that is, the financial advisor "knowingly participated" in the breach by "exploiting its own conflicted interests to the detriment of [the corporation] and by creating an informational vacuum." The Court refused to require contribution from directors (who had previously settled with the stockholder-plaintiffs), because the board was exculpated from monetary liability under the Company's Section 102(b)(7) provision. The Court confirmed, however, that Section 102(b)(7) protections do not extend to third parties.

In December 2010, the board of Rural/Metro Corporation ("Rural" or the "Company") formed a Special Committee to explore strategic alternatives. While the Special Committee was authorized to hire a financial advisor to help explore these options, it was not expressly authorized to initiate a sale process. After interviewing two other financial advisors, the Special
Committee engaged RBC Capital Markets ("RBC") as its primary financial advisor. In its presentation to the Special Committee, RBC had recommended a sale of the Company in a coordinated effort with the sale of Rural's competitor, Emergency Medical Services Corporation ("EMS"), because "healthcare was 'strong'" and selling the Company at that point in time was "opportunistic." But RBC "did not disclose that proceeding in parallel with the EMS process served RBC's interest in gaining a role on the financing trees of bidders for EMS." RBC sought to use as an "angle" its role as a sell-side advisor to secure a buy-side financing role for the EMS deal, which could entitle RBC to "$60.1 million in fees from the Rural and EMS deals."

After contacting several private equity firms, six submitted indications of interest, and ultimately, Warburg Pincus LLC submitted the highest bid of $17.25 per share. RBC unsuccessfully solicited a "buy-side financing role from Warburg," but did not disclose its attempt to the Special Committee. RBC and Moelis & Company ("Moelis"), the Special Committee's secondary financial advisor, provided fairness opinions. The Court of Chancery found that "RBC worked to lower the analyses in its fairness presentation so Warburg's bid looked more attractive. Specifically, the trial court found that RBC made a series of changes to its fairness analysis" without disclosing these changes to the Special Committee. That analysis was sent to the board just three hours before its meeting to decide on the deal. The board approved the merger with Warburg in March 2011, and in June 2011, the merger closed, after approval by the Company's stockholders.

The class plaintiffs sought relief against Rural's directors for breaches of fiduciary duty and against RBC and Moelis for aiding and abetting those breaches. Rural's directors and Moelis settled, and RBC went to trial. Post-trial, the Vice Chancellor held that RBC was liable for aiding and abetting breaches of the directors' duty of care and duty of disclosure. Specifically, the trial court held that the board breached its duty of care under Revlon's enhanced scrutiny standard after an unreasonable sales process, and that the board failed to disclose material information in its proxy statement regarding RBC's valuation process and conflicts. Concluding that RBC had knowingly aided and abetted these breaches, the Court of Chancery found RBC liable for $75.7 million. This represented 83% of the damages, which the Court determined was reasonable, given the Delaware Uniform Contribution Among Tortfeasors Act and RBC's responsibility as a joint tortfeasor.

The Delaware Supreme Court affirmed. First, after concluding that Revlon applied, the Court reviewed the trial court's holding that Rural's board breached its duty of care under enhanced scrutiny. The Court of Chancery had found that the board's pursuit of the transaction was outside the range of reasonableness, because "RBC did not disclose that proceeding in parallel with the EMS process served RBC's interest in gaining a role on the financing trees of bidders for EMS," and that these actions "impeded interested bidders from presenting potentially higher value alternatives." The board, according to the Court, should have been aware of the negative implications of this dual-track structure and should have had a mechanism to identify RBC's conflicts. "[D]irectors need to be active and reasonably informed when overseeing the sales process, including identifying and responding to actual or potential conflicts of interest," and "the board should require disclosure of, on an ongoing basis, material information that might impact the board's process" when there is a conflicted advisor.
The Court of Chancery also had found that Rural's board was not "adequately informed as to Rural's value," including that the "Company's value on a stand-alone basis exceeded what a private equity bidder willingly would pay." And because the directors were not "well-informed" as to the value, their decision was "devoid of important efforts" necessary to "to protect . . . stockholders and to ensure that the transaction was favorable to them." The "informational vacuum created by RBC" also made it impossible for stockholders to check the board and ensure that they had diligently contemplated the decision to sell the Company. This informational vacuum also contributed to the Court of Chancery's holding that Rural's board had violated its duty of disclosure by failing to disclose RBC's conflicts fully and characterize RBC's analysis accurately. The Supreme Court affirmed these rulings.

Next, the Court held that RBC had aided and abetted the board's breaches. The Court affirmed the trial court's "narrow holding" that "if [a] third party knows that the board is breaching its duty of care and participates in the breach by misleading the board or creating the informational vacuum, then the third party can be liable for aiding and abetting." Even though "the requirement that the aider and abettor act with scicnter makes an aiding and abetting claim among the most difficult to prove," the Court found that the requisite scicnter had been shown because RBC "intentionally duped" the board into breaching its duty of care and engaged in "fraud on the Board" by knowingly creating the informational vacuum.

Finally, the Court rejected RBC's argument that it had a right to contribution from joint tortfeasors, noting that the settlement agreements barred such a right. Importantly, the Court also held that Rural's Section 102(b)(7) exculpatory provision did not shield RBC from liability. "While Section 102(b)(7) insulates directors from monetary damages stemming from a breach of the duty of care, its protection does not apply to third parties such as RBC." The intended legislative purpose of Section 102(b)(7) was not to "safeguard third parties and thereby create a perverse incentive system wherein trusted advisors to directors could, for their own selfish motives, intentionally mislead a board only to hide behind their victim's liability shield."

3. Deal Protection Devices.


In In re Comverge, Inc. Shareholders Litigation, 2014 WL 6686570 (Del. Ch. Nov. 25, 2014), the Delaware Court of Chancery granted in part the defendants' motion to dismiss a post-closing shareholder challenge to the acquisition of Comverge, Inc. ("Comverge") by H.I.G. Capital, L.L.C. ("HIG"), which acquisition the Court had previously declined to enjoin. The plaintiffs alleged that Comverge's board of directors (the "Board") breached its fiduciary duties by: (i) failing to bring suit against HIG for an alleged breach of a non-disclosure agreement ("NDA") between the parties; (ii) conducting a flawed sale process that failed to maximize value for Comverge's stockholders; and (iii) agreeing to preclusive deal protection measures that prevented Comverge from soliciting alternative bidders. The plaintiffs also claimed that HIG had aided and abetted the Board in breaching its fiduciary duties.

Comverge had lost money every year of its existence and had long sought, to no avail, to solve its liquidity problems through various types of transactions. In November 2011, HIG
contacted Comverge to express an interest in acquiring the company. In February 2012, the Board declined HIG's offer to buy the company for $2.25 per share, in part because another bidder had suggested interest in a transaction with Comverge at a higher price. An affiliate of HIG thereafter acquired certain notes issued by Comverge, which allegedly violated the two-year standstill provision of the NDA. Following notification of HIG's actions, the Board considered, but ultimately decided against, suing HIG for breach of the NDA. The notes gave HIG significant leverage over Comverge because they carried the right to accelerate Comverge's debt and provided HIG with prior approval rights over any acquisition transaction. HIG promptly took advantage of its leverage by notifying Comverge that it was in default under the notes and indicating that it would accelerate the debt under the notes unless the Board accepted HIG's new, lower-priced offer to acquire the company for $1.50 per share. After further negotiation with HIG, the Board agreed to a merger with HIG at a price of $1.75 per share. At the time of the Board's approval of the merger, Comverge's stock was trading at $1.88 per share. The merger agreement included a go-shop period during which HIG agreed not to exercise its blocking rights under the notes. During the go-shop period, Comverge had the right to terminate the transaction to pursue a superior proposal by paying HIG a total fee of 5.55% of the deal's equity value. After the go-shop period, the total payment required to terminate the agreement rose to 7% of the deal's equity value. In addition, Comverge entered into a $12 million bridge financing agreement with HIG pursuant to which Comverge issued HIG notes that were convertible at HIG's election into shares of Comverge common stock at a conversion price of $1.40 per share, which was $0.35 lower than the deal price and $0.48 lower than the then-current trading price of Comverge's shares.

The Court granted the defendants' motion to dismiss in part, finding that the Board's decision not to sue on the NDA and the Board's sale process did not violate the Board's fiduciary duties. The Court held that the Board's decision to pursue a sale transaction rather than uncertain, costly and potentially time-consuming litigation against HIG based on a possible violation of the NDA was reasonable, especially in light of Comverge's dire financial situation. With respect to the plaintiffs' sale process claims, the Court found that the Board had engaged in "hard-fought" negotiations with HIG, and had canvassed the market and considered alternatives to the transaction over an 18-month period before agreeing to the merger. While the sale process ultimately resulted in a lower deal price than HIG's initial offer due to HIG's superior bargaining position after acquiring the notes, the Court found that the Board's conduct at most amounted to a breach of the duty of care and did not support a claim for a non-exculpated breach of the duty of loyalty.

The Court also dismissed the aiding and abetting claims against HIG. The Court noted that Delaware case law recognizes an aiding and abetting claim if the acquirer in a merger induces the target board to breach its fiduciary duties "by extracting terms which require the opposite party to prefer its interests at the expense of the shareholders." While recognizing that HIG's "hard-nosed and aggressive" negotiating strategy was designed to take advantage of Comverge's precarious financial position, the Court concluded that HIG had not exploited self-interest on the part of the members of the Board in a manner that would give rise to liability for aiding and abetting a breach of fiduciary duty.

Finally, the Court found that it was conceivable that the combined effect of the termination fee, the expense reimbursement and the convertible bridge loan could have had an
impermissibly preclusive effect on potential alternative bidders. The Court noted that, even at the lower end, the combined termination fee and potential expense reimbursement would be 5.55% of the equity value of the transaction and would test the limits of what the Court had found to be within a reasonable range for termination fees in its past decisions. At the higher end, the Court noted that the plaintiffs had contended that the combined fees and Comverge stock issuable under the notes upon termination of the merger agreement could amount to as much as 11.6% to 13.1% of the equity value of the transaction. In light of the potential magnitude of the combined fees and in the context of a deal with a negative premium to market, the Court held that it was reasonably conceivable that the Board had acted unreasonably in adopting the potentially preclusive deal protection measures and refused to grant the defendants' motion to dismiss in respect of the plaintiffs' claim that the Board breached its fiduciary duties in agreeing to such measures.

4. Disclosures.


In *In re Trulia, Inc. Stockholder Litigation, 2016 WL 325008 (Del. Ch. Jan. 22, 2016)*, the Delaware Court of Chancery refused to approve a class action settlement that called for marginal disclosures in exchange for a broad release of stockholder claims. In so doing, the Court announced that moving forward it would review such "disclosure settlements" with increased scrutiny.

The case arose from the stock-for-stock merger between online real estate companies Zillow, Inc. and Trulia, Inc. Shortly after the merger was announced in July 2014, four plaintiffs filed class action complaints seeking to enjoin the merger and alleging that the directors of Trulia breached their fiduciary duties by including misleading disclosures in the joint proxy statement. Within days, however, the plaintiffs agreed to release their claims if Trulia would provide supplemental disclosures about the financial opinion the Trulia directors relied upon when approving the transaction. Trulia provided the disclosures, and the stockholders of both companies subsequently adopted the merger agreement. A formal settlement agreement was then submitted to the Court for approval, which (i) sought certification of a class consisting of all Trulia stockholders as of the date the merger was first announced through the closing date; (ii) included a broad release of "any claims arising under federal, state, statutory, regulatory, common law, or other law or rule" held by members of the proposed class relating in any way to the merger (with a limited carve-out for antitrust claims); and (iii) permitted plaintiffs' counsel to seek an award of attorneys' fees totaling $375,000.

The Court rejected the proposed settlement because the supplemental disclosures failed to provide a material benefit to the Trulia stockholders and were insufficient to justify the broad release of claims. In reaching this decision, the Court held that certain disclosures were immaterial because they contained information that was already publicly available, while other disclosures, which restated specific data points used by Trulia's financial advisor, were immaterial because Delaware law only requires companies to provide a summary of the financial advisor's opinion and not every detail necessary to recalculate the advisor's analysis.
In addition to its ruling, the Court unambiguously announced its intention to review "disclosure settlements" in the future with heightened scrutiny. The Court acknowledged that defendants involved in deal litigation have strong incentives to settle quickly—particularly if such settlements can be obtained by offering minimal disclosures in exchange for a broad release of stockholder claims. The Court explained, however, that its prior willingness to approve settlements calling for marginal disclosures, sweeping releases of stockholder claims and six-figure attorney fees had led to an explosion of lawsuits that "serve[] no useful purpose." Stressing how it can be problematic to adjudicate disclosure claims in the context of settlement-approval proceedings, the Court further explained that such proceedings are non-adversarial, leaving the Court to determine the materiality of supplemental disclosures without the benefit of a full record or consulting opposing briefs. Given the surge in deal litigation and the risk that stockholders are losing potentially valuable claims that have not been adequately investigated, the Court proposed two solutions.

First, the Court recommended that disclosure claims be litigated outside of a settlement-approval proceeding and in an adversarial context. One such context would be a preliminary injunction motion, where plaintiffs would bear the burden of showing that disclosure of the omitted fact would likely have been material to a reasonable investor. Another context is when plaintiffs' counsel apply to the Court for an award of attorneys' fees after defendants voluntarily decide to supplement their proxy materials by making one or more of the disclosures sought by plaintiffs, thereby mooting some or all of their claims. In this situation, defendants are incentivized to oppose excessive fee requests.

Second, to the extent parties continue to pursue disclosure-based settlements, the Court warned that such settlements are "likely to be met with continued disfavor" by the Court unless the supplemental disclosures address a "plainly material misrepresentation or omission," and the subject matter of the proposed release is narrowly circumscribed to encompass nothing more than disclosure claims and fiduciary duty claims concerning the sale process.

Should supplemental information not be "plainly material," the Court recommended appointing an amicus curiae, paid for by both parties, to assist the Court in evaluating the alleged benefits of the supplemental disclosures. Finally, to mitigate the risk that parties will seek out forums willing to approve disclosure settlements of no genuine value, the Court also called on its sister courts in other states to adopt similar practices.

Following the settlement hearing, the Court noted that the parties agreed to narrow the release to exclude unknown claims, foreign claims, and claims arising under state or federal antitrust law. However, the Court held that this narrowed release was still overbroad as it was not limited to solely disclosure claims and fiduciary duty claims concerning the decision to enter into the merger.
5. **Merger Agreement Construction.**


   In *Cigna Health & Life Insurance Company v. Audax Health Solutions, Inc.*, 107 A.3d 1082 (Del. Ch. 2014), the Delaware Court of Chancery found invalid features of a private company merger agreement that required stockholders, as a condition to receiving their merger consideration, to submit a letter of transmittal agreeing to provide a release of all claims against the acquirer and that further required stockholders to indemnify, for an indefinite period of time, the acquirer for claims arising from the seller's breach of representations and warranties.

   The opinion arose from the acquisition of Audax Health Solutions, Inc. ("Audax") by Optum Services, Inc. ("Optum"). In connection with the merger, certain stockholders of Audax executed support agreements that included: (i) a release of all claims against Optum and its affiliates, (ii) an agreement to be bound by the terms of the merger agreement, specifically including the provisions indemnifying Optum and its affiliates for any breaches of the representations and warranties, and (iii) an appointment of a stockholder representative. In order to receive the merger consideration under the merger agreement, stockholders who did not execute the support agreements were required to execute the letter of transmittal containing the release. Following the merger, Cigna Health and Life Insurance Company ("Cigna"), a holder of preferred stock of Audax who did not execute a support agreement and refused to execute the letter of transmittal, challenged, among other things, the validity of the release in the letter of transmittal and the indemnification provisions of the merger agreement.

   On Cigna's motion for judgment on the pleadings, the Court held that the purported release in the letter of transmittal was unenforceable due to a lack of consideration. In so holding, the Court rejected the defendants' argument that the release was integral to the overall transaction, noting that provisions in the merger agreement that required the letter of transmittal to be in form and substance reasonably acceptable to the acquirer did not indicate that the stockholders would be required to agree to the release. The Court further explained that endorsing the defendants' position would permit buyers to force post-closing conditions or obligations not referenced in the merger agreement on the stockholders in a letter of transmittal. Accordingly, the Court found that the release constituted a new obligation that was unenforceable absent consideration. The Court held that the merger consideration could not constitute consideration for the release because the stockholders had already become entitled to it by operation of law upon the closing of the merger.

   The Court also held that the indemnification provisions were unenforceable against stockholders who had not executed the support agreements. In response to Cigna's challenges to the indemnification provisions, the defendants argued that the indemnification obligation was substantively no different from an escrow arrangement, which is common in private company mergers and has previously been recognized by the Delaware courts as enforceable. Despite noting the economic similarities between the indemnification provisions and an escrow arrangement, the Court found that "the merger consideration here more aptly can be described as cash, subject to an open-ended post-closing price adjustment." In this connection, the Court explained that such price adjustments are permissible under Delaware law if they comply with
Section 251 of the General Corporation Law of the State of Delaware (the "DGCL"), which requires a merger agreement to set forth a determinable merger consideration by stating the cash, property, rights or securities which the stockholders are entitled to receive in the merger.

In determining whether the indemnification provisions violated Section 251 of the DGCL, the Court distinguished the facts at hand from those in *Aveta, Inc. v. Cavallieri*, 23 A.3d 157 (Del. Ch. 2010). In *Aveta*, the Court of Chancery found that the post-closing price-adjustment procedures in a merger agreement (which included an earn-out, adjustments based on the company's financial statements, and a potential claw-back) were permissible under Section 251 of the DGCL. The Court noted that, unlike the merger agreement in *Aveta*, the indemnification provisions in the Audax-Optum merger agreement were not limited in terms of the amount of money that might be subject to a claw-back or the time period during which Optum could potentially bring a claim for indemnification. Rather, the indemnification structure in the Audax-Optum merger agreement continued indefinitely and made the value of the merger consideration indeterminable. Accordingly, the Court held that the merger agreement failed to set forth the value of the merger consideration as required by Section 251 of the DGCL because of the open-ended and unlimited indemnification provisions. The Court further held that the indemnification provisions were unenforceable against stockholders who did not specifically agree to such obligations by executing the support agreements or the merger agreement itself.

The Court specifically noted the narrow scope of the opinion and clarified that it was not deciding issues relating to (i) escrow agreements generally, (ii) the general validity of post-closing price adjustments requiring direct repayment from stockholders, (iii) whether a time-limited price adjustment that covers all of the merger consideration may be valid, or (iv) whether an indefinite adjustment period as to a portion of the merger consideration may be valid. Instead, the Court explained that it was the combination of the indefinite and contingent nature of the entirety of the consideration payable under the Audax-Optum merger agreement that resulted in the violation of Section 251 of the DGCL.


In *Cooper Tire & Rubber Company v. Apollo (Mauritius) Holdings Pvt. Ltd, 2014 WL 5654305* (Del. Ch. Oct. 31, 2014), the Delaware Court of Chancery found that Cooper Tire & Rubber Company ("Cooper") had not satisfied all of the conditions to closing its merger with Apollo (Mauritius) Holdings Pvt. Ltd ("Apollo") as of the trial date, and thus was likely barred from seeking a $112 million reverse termination fee under the merger agreement.

Cooper and Apollo entered into a merger agreement pursuant to which Apollo would acquire Cooper. Shortly thereafter, a series of events occurred that precipitated the deal's demise. First, a labor union at Chengshan Cooper Tires ("CCT"), a Chinese facility that was majority owned by Cooper, publicly stated its opposition to the merger and commenced an employee strike in protest. The union also physically barred Cooper-appointed managers from entering the facility or obtaining access to CCT's financial data entry systems. It was alleged that the parties later determined that the CCT strike had been initiated by Cooper's minority partner at CCT, who opposed the merger. At the same time, Cooper encountered resistance from its domestic union, the United Steel Workers ("USW"), which claimed that the merger triggered Cooper's
obligations to renegotiate its collective bargaining agreements. Apollo attempted to negotiate with the USW, but was unsuccessful in resolving the dispute.

Once it became clear that the deal was in danger of failing, Cooper sued Apollo in the Court of Chancery seeking specific performance or damages for breach of contract based on Apollo's alleged failure to negotiate with the USW in good faith. The Court of Chancery, in an earlier opinion, *Cooper Tire & Rubber Company v. Apollo (Mauritius) Holdings Pvt. Ltd*, 2013 WL 5977140 (Del. Ch. Nov. 9, 2013), ruled against Cooper, which then sought interlocutory appeal of the Court's decision to the Delaware Supreme Court. While the appeal was pending, Cooper notified the Delaware Supreme Court that it intended to terminate the merger agreement and seek a reverse termination fee under the merger agreement rather than pursue its appeal. Apollo then sought to prevent Cooper from collecting the reverse termination fee by seeking a declaratory judgment from the Court that Cooper had not satisfied all conditions to closing the merger. Specifically, Apollo alleged that Cooper was, at the time of trial, in breach of its obligation under the merger agreement to cause each of its subsidiaries to operate in the ordinary course of business. Cooper argued that the interim covenant only applied to actions within Cooper's complete control and that the alleged breaches involved third parties, such as CCT's employees and the USW, that were outside the scope of the interim covenant.

The Court rejected Cooper's interpretation of the interim covenant and held that the events that had occurred at the CCT facility prevented Cooper from complying with its contractual obligations necessary to close the merger. The Court stated that "ordinary course" means "the normal and ordinary routine of conducting business," and that the cessation of CCT's production of Cooper-branded tires, the physical exclusion of Cooper employees from CCT's facilities, and limitation of Cooper's access to CCT's financials did not comply with that standard. While stating that its opinion only addressed whether Cooper had satisfied its obligations under the merger agreement and the conditions to closing, the Court noted that the effect of the opinion likely would be dispositive of Cooper's ability to collect a reverse termination fee.


In *Great Hill Equity Partners IV, LP v. SIG Growth Equity Fund I, LLLP*, 80 A.3d 155 (Del. Ch. Nov. 15, 2013), the Court of Chancery interpreted Section 259 of the General Corporation Law of the State of Delaware to hold that all privileges—including the attorney-client privilege—pass in a merger from the acquired corporation to the surviving corporation. Specifically, the Court held that, without a contractual provision to the contrary, even the seller's pre-merger attorney-client communications with respect to the merger itself would pass to the surviving corporation. The Court suggested that parties concerned about this issue should "use their contractual freedom in the manner shown in prior deals to exclude from the transferred assets the attorney-client communications they wish to retain as their own."

In a fact-intensive, 76-page motion to dismiss opinion, *Great Hill Equity Partners IV, LP v. SIG Growth Equity Fund I, LLLP*, 2014 WL 6703980 (Del. Ch. Nov. 26, 2014), the Delaware Court of Chancery largely denied the defendants' motions to dismiss fraud claims arising out of
the sale of Plimus, a private Delaware corporation (the "Company"), to Great Hill, a private equity fund. The Court analyzed the specific factual allegations of a complaint that had been amended following the Court's earlier opinion holding that the Company's privileges, including pre-sale communications with counsel, passed to Great Hill in the merger by which it acquired the Company. See Great Hill Equity Partners IV, LP v. SIG Growth Equity Fund I, LLLP, 80 A.3d 155 (Del. Ch. 2013). The Court found that the amended complaint stated a claim for civil conspiracy and aiding and abetting fraud against a private equity fund that before the sale was the Company's single largest stockholder and had two designees on the Company's five-person board of directors. The Court also held that the amended complaint stated a claim for fraud against the selling private equity fund's two director designees.

The Great Hill opinion provides significant insight into issues arising in connection with private company M&A transactions, applying well-established law in the context of detailed factual allegations of fraud.

6. **Definition of Business Combination.**

   a. *Activision Blizzard, Inc. v. Hayes, 106 A.3d 1029 (Del. 2013).*

   In *Activision Blizzard, Inc. v. Hayes, 106 A.3d 1029 (Del. 2013)*, the Delaware Supreme Court addressed the question of whether the purchase by Activision Blizzard, Inc. ("Activision") of shares of its own stock, as well as net operating loss carryforwards ("NOLs"), from Vivendi, S.A. ("Vivendi") constituted a "merger, business combination or similar transaction" under Activision's amended certificate of incorporation and, as a result, required the approval of stockholders. The Court held that, despite its form as the combination of two entities, the transaction at issue did not require the approval of stockholders. "Indeed," observed the Court, "it is the opposite of a business combination. Two companies will be separating their business connection."

   The dispute reached the Court as an interlocutory appeal from entry of a preliminary injunction by the Court of Chancery, halting consummation of the stock purchase agreement ("SPA") between Activision, a global developer and publisher of video games, and Vivendi, a French digital entertainment company, with video game and other businesses. On July 25, 2013, Vivendi, which before the transaction at issue had owned 62% of Activision's stock, entered into the SPA with Activision, under which Activision agreed to pay Vivendi $5.83 billion for 429 million shares of Activision stock, as well as $675 million for NOLs. This part of the SPA was to be effectuated through the acquisition of a newly created and wholly owned subsidiary of Vivendi, New VH (referred to as "Amber"), whose only purpose was to hold the Activision stock and NOLs. Activision would acquire Amber, and the stock acquired would be treated as treasury shares, reducing the total number of Activision shares outstanding. Further, the SPA provided that Vivendi would sell an additional 172 million shares of Activision stock to ASAC II, LP, a limited partnership owned in part by two Activision directors.

   Following the announcement of the stock purchase, Douglas Hayes, an Activision stockholder, filed a class action and derivative complaint in the Court of Chancery on September 11, 2013, alleging, *inter alia*, that Section 9.1(b) of Activision's certificate of incorporation,
which required approval of the holders of a majority of stock unaffiliated with Vivendi "with respect to any merger, business combination or similar transaction," was triggered by the SPA.

In a bench ruling on September 18, 2013, the day before the scheduled closing of the SPA, the Court of Chancery entered a preliminary injunction enjoining consummation of the SPA. See Hayes v. Activision Blizzard, Inc., 2013 WL 5293536 (Del. Ch. Sept. 18, 2013) (TRANSCRIPT). Relying on Martin Marietta Materials, Inc. v. Vulcan Materials Co., 56 A.3d 1072 (Del. Ch. 2012), the trial court held that the term "business combination" was inherently ambiguous and should be interpreted "expansively," including within its meaning the purchase of the stock of a wholly owned subsidiary. Further, the Vice Chancellor maintained that the proposed transaction fell "squarely within Section 9.1" of Activision's certificate of incorporation because the purchase was a "value-transfer transaction," which was bound to impact minority stockholders. "This is an $8 billion reorg. of Activision. Value is moving. Value is moving to the former controller. Value is moving to management," the Vice Chancellor reasoned.

The Delaware Supreme Court vacated the preliminary injunction entered by the Court of Chancery and remanded for further action. The Supreme Court held that the phrase "business combination" in Section 9.1(b) was not ambiguous and clearly did not apply to the transactions contemplated in the SPA. The Court observed that, "technically, Activision would combine with Amber" and the size of the transaction would be considerable, but the Court reasoned that "[n]either the form of the transaction nor its size changes its fundamental nature." That fundamental nature, the Court found, was of the two businesses (Activision and Vivendi) "separating"—not of "Vivendi having a greater connection with and/or control over Activision's business," as the Court concluded would happen in a "business combination or similar transaction."

Moreover, Amber could not be considered a business, the Court found. It was merely a company created to effectuate this transaction. Therefore, its acquisition by Activision was not a "business combination." Additionally, the Court found nothing in the language of Section 9.1(b) to suggest that a transaction qualified as a "business combination or similar transaction" simply based on its magnitude. Finally, the Court pointed out that the general protection of minority stockholders, which was a concern of the Court of Chancery, was addressed elsewhere in Activision's bylaws, not in Section 9.1(b) of the certificate of incorporation.

7. **Implied Covenant of Good Faith and Fair Dealing.**


In *Lazard Technology P'rs, LLC v. QinetiQ North America Operations LLC, 114 A.3d 193 (Del. Apr. 23, 2015)*, the Delaware Supreme Court affirmed the Court of Chancery's post-trial bench ruling and held that defendant-below did not breach an earn-out provision in a merger agreement or the implied covenant of good faith and fair dealing.

In 2009, QinetiQ North America Operations, LLC (the "buyer"), a defense and security technology company, acquired Cyveillance, Inc. (the "company"), a cyber-technology company. The buyer paid $40 million for the company up front and was obligated to make additional earn-
out payments of up to $40 million if the company achieved certain revenue targets over a defined period. Section 5.4 of the merger agreement prohibited the buyer, post-closing, from "tak[ing] any action to divert or defer [revenue] with the intent of reducing or limiting the Earn-Out Payment." At the close of the earn-out period, revenues had not reached the level required to generate an earn-out.

Lazard Technology Partners, LLC, which represented former stockholders of the company (collectively, the "seller"), filed suit in the Court of Chancery on August 29, 2011 (C.A. No. 6815-VCL) against the buyer. The seller alleged that the buyer breached both Section 5.4 of the merger agreement and the implied covenant of good faith and fair dealing by failing to take actions to achieve revenue sufficient to generate an earn-out. In a bench ruling following post-trial argument, the Court of Chancery entered judgment in favor of the buyer on both claims. With respect to the breach of contract claim, the Court concluded that the literal terms of Section 5.4 required a showing of intent, which the seller could not establish. The Court construed the implied covenant of good faith and fair dealing to prohibit only conduct undertaken with intent to reduce or avoid an earn-out payment altogether, consistent with the language of Section 5.4.

The Delaware Supreme Court affirmed. The Court agreed that Section 5.4 employed an intent standard, not a knowledge standard, and rejected the seller's assertion that the contract precluded conduct by the buyer that the buyer knew would compromise the seller's ability to receive an earn-out payment. On the implied covenant claim, the Court noted both the specific standard in Section 5.4 and the negotiating history (in which the seller had sought tighter objective controls on the buyer's post-closing conduct, but had failed to obtain them), stated that the Court of Chancery "was very generous in assuming that the implied covenant of good faith and fair dealing operated at all as to decisions affecting the earn-out," and held that the Court of Chancery had correctly concluded that the implied covenant "did not inhibit the buyer's conduct unless the buyer acted with the intent to deprive the seller of an earn-out payment."


In **Orckit Communications Ltd. v. Networks3 Inc. et al., C.A. No. 9658-VCG (Del. Ch. Jan. 28, 2015) (TRANSCRIPT),** the Delaware Court of Chancery granted defendant Networks3’s motion to dismiss a claim that it had wrongfully terminated an agreement to purchase patents from plaintiff Orckit. The purchase of the patents was contingent upon the issuance of an approval by an Israeli government agency, and the agreement provided that "the terms in the ... Approval shall be satisfactory in the sole discretion (which for purposes of this condition shall not, to the extent permitted by law, be subject to the implied covenant of good faith and fair dealing) of Networks3." The Court held that, under the agreement, whether the terms of the approval were satisfactory to Networks3 was "a decision that is unreviewable in the sense that, if it is timely taken, the defendant could then...terminate."

Plaintiff Orckit had alleged that, under the agreement, Networks3’s exercise of its sole discretion was qualified by either (i) a "commercially reasonable efforts" standard appearing elsewhere in the contract, or (ii) a default good faith standard that could not be disclaimed, and that, under either standard, Networks3 had breached the agreement. The Court rejected both
arguments. In regard to the first, the Court found it unreasonable to assume that the parties would expressly disclaim the application of the implied covenant of good faith and fair dealing only to impose a higher standard. Further, the Court held that basic "canons of construction" provided that a specific discretionary standard in a particular provision controls over a general one elsewhere in a contract. In regard to the second, the Court, emphasizing that "Delaware is a contractarian state" and that "the language that the parties have agreed to ... governs the enforcement of contracts," stated that the provision's "language ... could not be any clearer," and that it was, in fact, "as clear as it gets."

B. **Stockholder and Creditor Litigation.**

1. **Stockholder Rights Plans.**


   In *Third Point LLC v. Ruprecht, et al., 2014 WL 1922029 (Del. Ch. May 2, 2014)*, the Delaware Court of Chancery denied preliminary injunctive relief against Sotheby's annual meeting, scheduled for May 6, 2014. Plaintiffs, including Third Point LLC and other stockholders, claimed that the board had violated its fiduciary duties by (1) adopting a stockholder rights plan with a two-tiered trigger, capping stockholders who file Schedule 13Ds at 10% of the outstanding stock, but permitting passive investors who file Schedule 13Gs to acquire up to 20% of the outstanding stock; and (2) refusing to grant Third Point, the company's largest stockholder, a waiver enabling it to acquire up to 20% of the outstanding stock. Claiming that the board had acted for the primary purpose of inhibiting Third Point's ability to wage a successful proxy contest, Third Point asked the Court to apply the *Blasius* standard, and argued alternatively that the board's actions were impermissible under the *Unocal* standard. The board argued, among other things, that Third Point's accumulation of Sotheby's stock posed a legally cognizable threat to Sotheby's and that the board's actions in response were proportionate to the threat.

   The Court held on a preliminary basis that *Unocal*, rather than *Blasius*, provides the appropriate framework of analysis. Applying the *Unocal* standard, the Court held on a preliminary basis that the majority-independent board had shown that it acted reasonably in identifying a legally cognizable threat—that Third Point, alone or with others, might acquire a controlling interest in the company without paying Sotheby's other stockholders a premium—and that its response to the threat was reasonable. The Court wrote that the issue of the board's refusal of Third Point's request for a waiver presented "a much closer question" than the original adoption of the rights plan, but determined that the board made a sufficient showing as to the threat that Third Point might be able to exercise "negative control" if permitted to accumulate up to 20% of the outstanding stock. Accordingly, the Court denied the application for preliminary injunction.

   On May 5, 2014, Sotheby's and Third Point announced a resolution of the dispute, under which Third Point will be allowed to increase its ownership to 15% of the outstanding stock, the board will expand from twelve members to fifteen, and Third Point's three nominees will be appointed to the board and added to the company's slate of nominees at the 2014 annual meeting, which will be convened and adjourned to allow updated solicitation materials to be distributed.
Chapter 1—Recent Developments in Delaware Corporate Law


   In In re Appraisal of Dell Inc., C.A. No. 9322-VCL (Del. Ch. May 11, 2016), the Court held that fourteen mutual funds sponsored by T. Rowe Price & Associates, Inc. (“T. Rowe”) as well as institutions that relied on T. Rowe to direct the voting of their shares (the “T. Rowe Petitioners”) were not entitled to an appraisal of their shares of Dell Inc. in connection with Dell’s go-private merger, because the record holder had voted the shares at issue in favor of the merger, thus failing to meet the “dissenting stockholder” requirement of Section 262 of Delaware’s General Corporation Law. The T. Rowe Petitioners held their shares through custodians. The custodians, however, were not record holders of the shares; they were participants of the Depository Trust Company, which held the shares in the name of its nominee, Cede & Co., which, for purposes of Delaware law, was the record holder. As the record holder, Cede had the legal right to vote the shares on the Dell merger and to make a written demand for an appraisal of the shares.

   The Court noted that, through a “Byzantine” system, Cede was constrained to vote the T. Rowe Petitioners’ shares in accordance with T. Rowe’s instructions. Although T. Rowe had publicly opposed the merger, due to its internal voting processes, it had in fact submitted instructions to vote the T. Rowe Petitioners’ shares in favor of the merger. To assist in its voting processes, T. Rowe had retained Institutional Shareholders Services Inc. (“ISS”). On matters on which a stockholder vote was sought, the voting system generated default voting instructions. In the case of management-supported mergers, such as Dell’s merger, the default voting instructions were to vote in favor of the merger.

   The special meeting of Dell’s stockholders to vote on the merger was originally scheduled for July 18, 2013. For that meeting, T. Rowe confirmed that its shares were to be voted against the merger. Dell opened the July 18 meeting for the sole purpose of adjourning it. After a series of subsequent adjournments, the special meeting was held on September 12, 2013. Shortly before the meeting, the voting system generated a new meeting record, which had the effect of replacing the prior instructions (i.e., “against”) with new default instructions (i.e., “for”). After the switch, no one from T. Rowe logged into the ISS system to check the status of its voting instructions. As a result, the T. Rowe Petitioners’ shares were voted in accordance with the new default instructions—that is, they were voted in favor of the merger, a fact that came to light after certain of the T. Rowe Petitioners submitted filings required by federal law disclosing their vote.

   Section 262 of Delaware’s General Corporation Law confers appraisal rights upon a stockholder of record who holds shares on the date an appraisal demand is made, continuously holds the shares through the effective date of the merger, submits a demand for appraisal in compliance with the statute, and has not voted in favor of the merger or consented to it in writing. The Court noted that Section 262’s requirements could be read as “all-or-nothing propositions,” such that a stockholder of record, like Cede, would be foreclosed from asserting appraisal rights if it voted a single share in favor of the merger. The Court observed that the Delaware Supreme Court, recognizing that a broker or nominee may hold shares of record on
behalf of multiple clients, has permitted a stockholder of record to split its vote and seek appraisal for shares not voted in favor of the merger. The key consequence of such vote splitting, the Court stated, is that a record holder can only seek appraisal for the specific shares that were not voted in favor of the merger. The key consequence for the T. Rowe Petitioners is that their shares held of record by Cede, having been voted in favor of the Dell merger, were not entitled to appraisal rights.

In arriving at its holding, the Court noted that language in several of its recent “appraisal arbitrage” opinions, if read literally, would preclude it from considering anything other than Cede’s aggregated votes on the merger. The Court stated, however, that there was no evidence in those cases regarding how the particular shares were voted. The Court concluded that the appraisal arbitrage cases deal only with the situation involving the absence of proof; they do not stand for the proposition that, where evidence as to how the shares were voted exists and the parties can introduce it, the Court is precluded from considering it.

The Court’s solution was to provide that, once an appraisal petitioner has made out a prima facie case that its shares are entitled to appraisal (which, where the shares are held of record by Cede, it can meet by showing that there were sufficient shares held by Cede that were not voted in favor of the merger to cover the appraisal class), the burden shifts to the respondent corporation to demonstrate that Cede actually voted the shares for which appraisal is sought in favor of the merger. The Court noted that the corporation could introduce public filings or other evidence from providers of voting services, such as internal control numbers and voting authentication records. If the corporation demonstrates that Cede (or any other record holder) actually voted the shares for which appraisal rights have been asserted in favor of the merger, the requirements of Section 262 will not have been met, and the petitioner will not be entitled to an appraisal of those shares.


In two recent post-trial opinions in appraisal cases under § 262, the Court of Chancery addressed the importance of merger price and process as well as the reliability of discounted cash flow (DCF) analyses in determining fair value. In *Merlin Partners LP v. AutoInfo, Inc.*, 2015 WL 2069417 (Del. Ch. Apr. 30, 2015), Vice Chancellor Noble found that, where there was an adequate sale and negotiation process conducted at arm's length and there were no reliable cash flow projections from which to make a DCF analysis nor available alternate valuations, the price received in the merger, $1.05 per share, was the best indication of fair value at the time of the merger. Two months later, in *In re LongPath Capital, LLC v. Ramtron International Corporation*, 2015 WL 4540443 (Del. Ch. June 30, 2015), Vice Chancellor Parsons similarly determined that there were no reliable means of appraisal valuation other than the merger price, but also found that the fair value at the time of the merger was $0.03 below the deal price of $3.10 per share after accounting for synergies.

Under Section 262, stockholders who choose not to participate in certain merger transactions may petition the Court to determine the fair value of their stock. "Fair value"
represents "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." To determine fair value, the Court independently evaluates the evidence and may consider techniques or methods that are generally considered acceptable in the financial community and otherwise admissible in court. Depending on the case, the Court may rely upon a DCF analysis, a comparable transactions analysis, a comparable companies analysis, or the merger price itself. Delaware courts tend to favor a DCF model over other available methodologies in an appraisal proceeding. However, a DCF analysis has "much less utility" in cases where the transaction was an arm's-length merger or where the data inputs used in the model are not reliable.

After struggling financially, AutoInfo began a sale process. As part of the process, Stephens Inc., AutoInfo's financial advisor retained to assist with the sale process, asked management to prepare five-year financial projections that were "aggressively optimistic" for use in marketing AutoInfo. AutoInfo's management had never prepared multi-year projections before, and the company's CEO described the process as "a bit of a chuckle and a joke." Despite this, AutoInfo engaged in an extensive sales process, with Stephens contacting 164 potential strategic and financial buyers, 70 of which entered into non-disclosure agreements. Several bidders submitted letters of intent, including Comvest, which signed a letter of intent at $1.26 per share but eventually reduced its price to $1.05 per share after discovering problems with the reliability of AutoInfo's financial information.

Merlin Partners filed an appraisal action and, relying on two comparable companies analyses and a DCF analysis prepared by its financial expert, argued that the fair value of the company was $2.60 per share. The Court first found that Merlin's DCF analysis deserved little deference because Merlin had failed to establish the credibility of the management projections upon which it relied. Not only were they AutoInfo's first attempt at such projections, they had also been specifically prepared to "paint the most optimistic and bright current and future condition of the company" possible in connection with the sales process. The Court also gave no weight to Merlin's comparable companies analyses because the companies used for comparison differed significantly in size from AutoInfo (from more than twice to 300 times its size) and also used store-based business models rather than AutoInfo's riskier agent-based model. Conversely, AutoInfo's expert relied on merger price, and the Court found that it could place "heavy weight" on a merger price in the absence of any other reliable valuation analysis. Finding that fair value was the deal price, the Court noted that the merger was the result of a competitive and fair auction because AutoInfo: (1) retained an investment bank experienced in the transportation industry using an incentive-based fee structure; (2) contacted numerous companies in the sales process; (3) formed a special committee; (4) was sold at a premium to market; and (5) had no other topping bid emerge between announcement and closing of the merger.

In Ramtron, after rejecting Cypress Semiconductor Corporation's bear hug letter to acquire all of its shares, as well as engaging in a subsequent sales process that involved its advisor contacting twenty-four potential buyers and executing nondisclosure agreements with six of those potential buyers, Ramtron engaged in negotiations with Cypress. After rejecting two more offers from Cypress, Ramtron agreed with Cypress on a final transaction price of $3.10 per share. LongPath, which acquired its shares after announcement of the merger, demanded appraisal and argued that fair value was $4.96 per share. The Court determined that LongPath's DCF analysis was not appropriate because it relied on management projections prepared by
newer employees who were creating multi-year projections for the first time, which also utilized a point-of-sale revenue recognition methodology rather than Ramtron's historic point-of-purchase method. As further evidence of the unreliability of the projections, the Court noted that they were created after Cypress's bear hug letter, in anticipation of potential litigation or a hostile takeover bid, and that Ramtron, which already had a questionable track record at forecasting, prepared separate projections to provide to its bank. The Court also afforded no weight to LongPath's comparable transactions analysis, as the petitioner's expert had a "dearth of data points" and could only point to two comparable transactions with vastly different multiples. Instead, the Court found it could give "one-hundred percent weight" to merger price as evidence of fair value when the merger resulted from a proper process. Here, only one company, Cypress, ever made a bid even after an active solicitation process, and Ramtron could and did repeatedly (and publicly) reject Cypress's overtures, after which Cypress raised its price. In addition, the Court determined that it was appropriate to subtract LongPath's estimate of net synergies of $0.03 per share (which was reached by netting negative revenue synergies and transaction costs from Ramtron's estimate of positive synergies) from the merger price to reach a fair value determination of $3.07 per share.

As these decisions illustrate, even though Delaware courts "tend to favor a DCF model in appraisal proceedings," they will be willing to rely entirely upon or afford substantial weight to the merger price to determine fair value where there is reason to question the reliability of the underlying management projections and where no other viable alternate valuation technique exists.


In two opinions issued the same day, the Delaware Court of Chancery addressed standing requirements under Delaware's appraisal statute, Section 262 of the General Corporation Law of the State of Delaware. In both *Merion Capital LP v. BMC Software, Inc.*, 2015 WL 67586 (Del. Ch. Jan. 5, 2015), and *In re Appraisal of Ancestry.com, Inc.*, 2015 WL 66825 (Del. Ch. Jan. 5, 2015), the Court found that a 2007 amendment to the appraisal statute did not impose a "share-tracing" requirement on an appraisal petitioner's right to demand appraisal of shares acquired after the record date for determining the stockholders entitled to vote on a merger. In so doing, the Court rejected a potential obstacle to so-called "appraisal arbitrageurs" that seek to use Delaware's appraisal process to capitalize on potentially undervalued transactions by purchasing shares of the target company's stock after announcement of a merger.

In *BMC Software*, petitioner Merion Capital LP ("Merion") sought appraisal for 7.6 million shares of common stock of BMC Software, Inc. ("BMC") that were purchased after the record date for a going-private merger. Merion, the beneficial owner of the shares, requested its broker to direct the nominee record holder of its shares to demand appraisal with respect to the purchased shares on Merion's behalf, but the broker refused. Merion then transferred record ownership of the shares into its own name and delivered a formal demand for appraisal to the company. BMC argued that, in order to have standing to pursue its appraisal claims, Merion had the burden of showing that each share it acquired after the record date had not been voted in favor of the merger by the previous holders. The Court rejected this contention and held instead
that the unambiguous language of the appraisal statute required Merion to show only that the record holder of the shares that made the demand (in this case, Merion itself) had not voted the shares in favor of the merger.

In *Ancestry.com*, Merion sought appraisal for 1,255,000 shares of common stock of Ancestry.com, Inc. ("Ancestry") purchased after the record date for a cash-out merger. Unlike in *BMC Software*, Merion never transferred its shares into record name, but instead directed Cede & Co., the nominee record holder of the shares, to demand appraisal on Merion's behalf. As permitted by a 2007 amendment to the appraisal statute, Merion, in its capacity as the beneficial owner of the shares, filed a petition for appraisal in the Court of Chancery. Ancestry.com argued that since Merion, as the beneficial owner of the shares, filed the petition for appraisal, Merion was required to show that it (rather than the record holder, Cede & Co.) did not vote the shares in favor of the merger. Moreover, Ancestry.com argued that because Merion acquired beneficial ownership of its shares after the record date, Merion was also required to show that its predecessor beneficial owners did not vote in favor of the merger. The Court rejected this argument as well, holding that an appraisal petitioner is only required to show that the record holder held of record at least as many shares not voted in favor of the merger as the number for which appraisal demands were submitted.

In both *BMC Software* and *Ancestry.com*, the Court identified, but declined to address, the potential for a theoretical "over-appraisal" scenario, in which a record holder (such as Cede & Co.) would hold shares as nominee for many beneficial owners, would follow those beneficial owners' voting instructions, and would end up owning of record fewer shares not voted in favor of the merger than the number of shares as to which the record holder demanded appraisal. The Court noted that such a theoretical problem at most threatened the policy goals of the appraisal statute, but did not render the statute absurd or inoperable.

3. **Advance Notice Bylaws.**


   In *Hill International, Inc. v. Opportunity Partners L.P.*, 119 A.3d 30 (Del. 2015), the Delaware Supreme Court affirmed the Court of Chancery's grant of mandatory injunctive relief enjoining Hill International, Inc. ("Hill") from conducting any business at its 2015 annual meeting, other than convening the meeting for the sole purpose of adjourning it for a minimum time period, in order to permit Opportunity Partners ("Opportunity"), the stockholder-plaintiff, to present certain items of business and director nominations at Hill's 2015 annual meeting.

   The key issue in the case was whether Opportunity had complied with Hill's advance notice bylaw in submitting its proposed business and nominations. On April 30, 2014, Hill publicly disclosed in its 2014 definitive proxy statement that it anticipated that its 2015 annual meeting would be "on or about June 10, 2015" and that stockholders who wished to submit a proposal for the 2015 annual meeting must submit their proposal no later than April 15, 2015. The following year, on April 13, 2015, Opportunity delivered to Hill a notice of its intent to propose business and nominate two directors at Hill's 2015 annual meeting. On April 30, 2015, Hill filed its definitive proxy statement for its 2015 annual meeting and announced that its 2015
annual meeting would be held on June 9, 2015. Subsequently, on May 5, 2015, Hill asserted that Opportunity's April 13 notice was defective because it failed to include information about the director nominees required by the bylaws. On May 7, Opportunity delivered another notice to Hill of its intent to present at the 2015 annual meeting two different proposals than had been included in its April 13 notice as well as nominations for election to Hill's board of the same two nominees as had been named in the April 13 letter. On May 11, Hill notified Opportunity that its notice was untimely under Hill's advance notice bylaw and that its proposals and nominations would not be presented at the 2015 annual meeting. Opportunity brought suit in the Court of Chancery claiming its notice was timely under Hill's bylaws.

Unlike many advance notice bylaws where stockholder notice of intent to make nominations or propose business is required to be delivered some number of days prior to the anniversary of the prior year's meeting or the mailing of the prior year's proxy statement, Hill's advance notice bylaw provides:

To be timely, a stockholders' notice must be delivered to or mailed and received at the principal executive offices of the Corporation not less than sixty (60) nor more than ninety (90) days prior to the meeting; provided, however, that in the event that less than seventy (70) days' notice or prior public disclosure of the date of the annual meeting is given or made to stockholders, notice by a stockholder, to be timely, must be received no later than the close of business on the tenth (10th) day following the day on which such notice of the date of annual meeting was mailed or such public disclosure was made, whichever first occurs.

In support of its contention that Opportunity's notice was untimely, Hill argued that the disclosure in its 2014 definitive proxy statement that the annual meeting would be "on or around June 10, 2015" constituted prior public disclosure of the date of the meeting such that Opportunity was required to notify Hill of its intent to propose business and nominations not less than 60 days prior to the meeting. In response, Opportunity claimed that the first notice of the date of the meeting – June 9, 2015 – was not given until April 30, less than 70 days prior to the date of the annual meeting, such that its May 7 notice was timely.

The Court of Chancery agreed with Opportunity, explaining that, although Hill could have triggered the requirement for at least 60 days' advance notice of proposals and nominations by announcing the specific date of the meeting prior to the filing of its definitive proxy statement, because it did not, Opportunity had 10 days from the date of the filing to submit its notice to Hill. Therefore, because the May 7 notice was timely, the Court of Chancery held that Hill was violating the plain language of its bylaws and that, because Opportunity would suffer irreparable harm absent injunctive relief and the balance of hardships favored Opportunity, Opportunity was entitled to mandatory injunctive relief.

Reviewing the bylaws de novo, the Delaware Supreme Court held that Hill's "clear and unambiguous" advance notice bylaw required Hill to provide notice of the specific day – and not a range of possible days – on which the annual meeting was to occur in order to trigger the time periods under the advance notice bylaw. In particular, the Court explained:
The plain meaning of "the date" means a specific day – not a range of possible days. The 2014 Proxy Statement's reference to "on or about June 10, 2015" does not refer to "the date" of Hill's 2015 Annual Meeting. Rather, "on or about" refers to an approximate, anticipated, or targeted time frame that is intended to encompass more than one "date" – i.e., June 10 – apparently in order to give Hill some flexibility in scheduling. Thus, the 2014 Proxy Statement did not provide "prior public disclosure of the date" of Hill's 2015 Annual Meeting.

As such, because Hill did not provide notice of the specific date of its annual meeting until it filed its proxy statement for the 2015 annual meeting on April 30, 2015 announcing the June 9 date, the Court held that Opportunity's May 7 notice was timely.

In affirming the Court of Chancery's grant of mandatory injunctive relief, the Delaware Supreme Court provided additional guidance to practitioners in drafting advance notice bylaws. Notably, the Court suggested that corporations could avoid the situation in which Hill found itself by either pegging the notice period for timely stockholder proposals and director nominees to the anniversary date of the corporation's prior annual meeting or by publicly announcing the specific date of its annual meeting prior to the sending of notice of such annual meeting in the manner required by Section 222 of the Delaware General Corporation Law, which requires, among other things, that such notice be sent not more than 60 days prior to the annual meeting. The Court noted that the Hill board had fixed the June 9, 2015 date of the 2015 meeting on March 12, 2015, but made no announcement when it did so.

Corporations with advance notice bylaws that key the notice period for stockholder proposals and nominations off the current year's meeting date rather than the anniversary of the prior year's annual meeting or the mailing of the prior year's proxy statement should not rely on the statement of anticipated meeting date in the prior year's proxy statement as announcing the meeting date and should make public announcement of the specific meeting date once it has been fixed. Alternatively, to avoid having the window for business proposals and nominations opened after they have filed their proxy materials, corporations may want to consider amending their advance notice bylaws to key the notice period from the anniversary of the prior year's annual meeting or the date of mailing of the prior year's proxy statement.

4. **Forum Selection Bylaws.**


In *City of Providence v. First Citizens Bancshares, Inc.*, et al., 99 A.3d 229 (Del. Ch. 2014), the Court of Chancery granted a motion to dismiss a challenge to a bylaw, adopted by the board of directors of First Citizens Bancshares, Inc. ("FC North"), that requires, to the extent permitted by law, certain intra-corporate claims to be brought exclusively in the United States District Court for the Eastern District of North Carolina, or, if that court lacks jurisdiction, then in any North Carolina state court that possesses jurisdiction. The Court held that the logic and reasoning of *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*, 73 A.3d 934 (Del. Ch.
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2013) ("Chevron"), compelled the decision upholding the facial validity of the forum-selection bylaw, notwithstanding the choice of a non-Delaware forum. The Court also held that the plaintiff had failed to state a claim for breach of fiduciary duty in connection with the adoption of the bylaw and had failed to demonstrate that it would be unreasonable, unjust or inequitable to enforce the bylaw. The Court therefore applied the bylaw to dismiss for improper venue a challenge to the FC North board's decision to enter into a merger agreement with a related party on the same day that it adopted the forum-selection bylaw.

On June 10, 2014, FC North announced both that its board had exercised the authority delegated to it in the certificate of incorporation to adopt several amendments to the bylaws, and that FC North had entered into an agreement to acquire First Citizens Bancorporation, Inc. ("FC South"), a South Carolina corporation under common control with FC North. Among the amendments to the bylaws was a new provision requiring that certain categories of intra-corporate disputes, identical in substance to those covered by the bylaw upheld against facial attack in Chevron, be brought in federal court in North Carolina, or if that court lacks jurisdiction, then in North Carolina state court. Plaintiff, the City of Providence, Rhode Island, filed a complaint challenging the validity of the bylaw, both facially and as-applied, and a separate complaint challenging the fairness of the proposed merger. Defendants, FC North and its directors, moved to dismiss both actions.

The Court of Chancery rejected Plaintiff's challenge to the facial validity of the forum-selection bylaw, holding that the FC North board's choice of a North Carolina forum, rather than a Delaware forum, "does not … call into question the facial validity of the Forum Selection Bylaw." The Court also held that Plaintiff had not stated a claim that the FC North board had adopted the bylaw for an inequitable purpose. Consequently, the Court dismissed the challenge to the bylaw under Rule 12(b)(6).

The Court then applied the bylaw to dismiss the challenge to the proposed merger under Rule 12(b)(3). Applying the test stated in The Bremen v. Zapata Off-Shore Co., 407 U.S. 1 (1972), and adopted in Delaware in Ingres Corp. v. CA, Inc., 8 A.3d 1143 (Del. 2010), the Court held that Delaware does not possess a public policy mandating that claims of the nature asserted in the challenge to the proposed merger be litigated in Delaware. Noting that FC North is based in North Carolina, that most of its deposits and its branches are located in North Carolina, that its directors are subject to personal jurisdiction in North Carolina, and that complete relief is available in North Carolina, the Court held that application of the forum-selection bylaw to the challenge to the merger was reasonable. The Court accordingly dismissed the challenge to the proposed merger under Rule 12(b)(3).


The Court of Chancery has rejected statutory and contractual challenges to forum-selection bylaws adopted unilaterally by the boards of directors of Chevron Corporation and FedEx Corporation. In an opinion deciding motions for partial judgment on the pleadings in Boilermakers Local 154 Retirement Fund, et al. v. Chevron Corp., et al., 73 A.3d 934 (Del. Ch. 2013), and Iclub Inv. P'ship v. FedEx Corp., et al., 73 A.3d 934 (Del. Ch. 2013), Chancellor
Strine determined that a board of directors, if granted authority to adopt bylaws by the certificate of incorporation, has the power under the Delaware General Corporation Law to adopt a bylaw requiring litigation relating to the corporation's internal affairs to be conducted exclusively in the Delaware courts, and that such a bylaw may become part of the binding agreement between a corporation and its stockholders even though the stockholders do not vote to approve it. The Court emphasized, however, that stockholder-plaintiffs retain the ability to challenge the enforcement of such a bylaw in a particular case, either under the reasonableness standard adopted by the Supreme Court of the United States in The Bremen v. Zapata Off-Shore Co., 407 U.S. 1 (1972), or under principles of fiduciary duty. The Court also left open the possibility that the boards' actions in adopting such bylaws could be subject to challenge as a breach of fiduciary duty.

The boards of both Chevron and FedEx had adopted bylaws providing, that the Delaware Court of Chancery would be the sole and exclusive forum for (i) any derivative action brought on behalf of the corporation, (ii) any action asserting breach of fiduciary duty claims, (iii) any action asserting a claim arising under the Delaware General Corporation Law, or (iv) any action asserting a claim governed by the internal affairs doctrine. Chevron subsequently amended its bylaw to permit such suits to be brought in "a state or federal court located within the state of Delaware" and to make the bylaw subject to the relevant court possessing personal jurisdiction over "the indispensable parties named as defendants." Both bylaws allowed litigation in another forum with the corporation's consent.

The Court considered and rejected a claim that these bylaws were not authorized under 8 Del. C. § 109(b), which provides 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." The Court analogized its holding to the Delaware Supreme Court's seminal decision authorizing poison pill rights plans in Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985), and wrote, "that a board's action might involve a new use of plain statutory authority does not make it invalid under our law, and the boards of Delaware corporations have the flexibility to respond to changing dynamics in ways that are authorized by our statutory law." The Court emphasized that forum-selection bylaws, like rights plans, are subject to challenge if applied inequitably, and further noted that, unlike rights plans, bylaws may be repealed by vote of the stockholders.

The Court also rejected plaintiffs' contention that the bylaws were invalid as a matter of contract law because the Chevron and FedEx boards of directors had adopted those bylaws unilaterally, without a vote of the stockholders. The Court wrote, "Stockholders are on notice that, as to those subjects that are subject of regulation by bylaw under 8 Del. C. § 109(b), the board itself may act unilaterally to adopt bylaws addressing those subjects. Such a change by the board is not extra-contractual simply because the board acts unilaterally; rather it is the kind of change that the overarching statutory and contractual regime the stockholders buy into explicitly allows the board to make on its own."

Finally, the Court reiterated that a stockholder-plaintiff is free to sue in a forum other than the one required by the bylaw and to argue, in response to a motion to dismiss, that enforcement of the forum-selection provision would be unreasonable under the circumstances,
under the *Bremen* doctrine, or that the forum-selection provision is being used for an inequitable purpose in breach of the directors' fiduciary duties, under *Schnell v. Chris-Craft Indus., Inc.*, 285 A.2d 437 (Del. 1971).

The Court of Chancery's decision was appealed to the Delaware Supreme Court. The stockholder-plaintiffs challenging these bylaws subsequently dismissed their appeals voluntarily. Accordingly, the Court of Chancery's decision in these cases is no longer subject to appeal.

5. **Fee-Shifting Bylaws.**


   In *Strougo v. Hollander*, 111 A.3d 590 (Del. Ch. 2015), the first opinion of the Delaware Court of Chancery to address the validity of a fee-shifting bylaw since the Delaware Supreme Court's opinion in *ATP Tour, Inc. v. Deutscher Tennis Bund*, 91 A.3d 554 (Del. 2014), the Court held that a corporation's fee-shifting bylaw adopted after the consummation of a 10,000-to-1 reverse stock split did not apply to the stockholders whose entire interest was cashed out in the split. Although noting the "serious policy questions implicated by fee-shifting bylaws in general," the Court based its holding on the timing of the bylaw's adoption. The Court held that the bylaw did not apply to the stockholders whose entire interest had been cashed out in the split, because Section 109 of the DGCL does not authorize a bylaw that "regulates the rights or powers of former stockholders who were no longer stockholders when the bylaw was adopted." The Court clarified, however, that its conclusion does not mean that a stockholder whose interest in the corporation is eliminated ceases to be subject to the corporation's bylaws. Instead, the Court held that, "[i]n determining the bylaw provisions that should apply to a lawsuit initiated by a former stockholder challenging the terms of a cash-out transaction, . . . the governing bylaws are those in effect when the former stockholder's interest as a stockholder was eliminated." After that date, a stockholder ceases to be a party to the "corporate contract" and accordingly ceases to be bound by subsequent amendments to that contract.


   In *ATP Tour, Inc. v. Deutscher Tennis Bund*, 91 A.3d 554 (Del. 2014), the Delaware Supreme Court, by Justice Berger, in responding to certified questions of law from the United States District Court for the District of Delaware (the "District Court"), held that a provision of a Delaware nonstock corporation's bylaws that shifted litigation expenses to the losing party in intra-corporate litigation was facially valid under Delaware law and may be enforced if the provision was adopted through appropriate corporate procedures and for a proper corporate purpose.

   ATP Tour, Inc. ("ATP") is a Delaware nonstock corporation that operates a professional tennis tour. The dispute arose from litigation filed in District Court by plaintiffs, two members of ATP, against ATP and six of its seven directors challenging ATP's decision to downgrade a tournament owned and operated by plaintiffs. Following a jury trial, judgment was entered in favor of ATP on all claims. Because plaintiffs did not prevail on any of their claims, ATP sought to recover its litigation expenses from plaintiffs pursuant to a provision in ATP's bylaws
providing that, in intra-corporate litigation, a plaintiff who "does not obtain a judgment on the merits that substantially achieves, in substance and amount, the full remedy sought" is obligated to reimburse ATP "for all fees, costs and expenses of every kind and description." Because the validity and enforceability of a fee-shifting bylaw presented a novel question of Delaware law, the District Court certified questions to the Delaware Supreme Court.

The Supreme Court began its analysis by noting that, to be facially valid, a bylaw provision must be authorized by the General Corporation Law of the State of Delaware (the "DGCL"), it must be consistent with the corporation's certificate of incorporation, and its enactment must not be otherwise prohibited. Finding that such a bylaw was not prohibited by the DGCL, any other Delaware statute or common law, the Supreme Court held that a fee-shifting bylaw is facially valid under Delaware law. The enforceability of a fee-shifting bylaw, however, turns on the circumstances under which the bylaw is adopted and applied. Because the Court did not have sufficient facts to determine whether ATP's fee-shifting bylaw was properly adopted or applied and because certified questions by their nature only address questions of law, the Supreme Court did not opine on the enforceability of ATP's fee-shifting bylaw. Rather, the Supreme Court held that a fee-shifting bylaw, like the one adopted by ATP, may be enforceable if adopted by appropriate corporate procedures and for a proper corporate purpose. The Court further noted that bylaws that are facially valid will not be enforced if adopted or applied for an inequitable or improper purpose. Because the intent to deter litigation is not invariably an improper purpose, the fact that a board adopted a fee-shifting bylaw for the purpose of deterring litigation would not necessarily render the bylaw unenforceable. Finally, the Court held that, assuming that a fee-shifting bylaw is otherwise valid and enforceable, members who join the corporation prior to its adoption will be bound by the fee-shifting bylaw.

In 2015, the DGCL was amended to limit the applicability of the ATP Tour decision to nonstock corporations and clarify that, subject to limited statutory exceptions, charter and bylaw provisions may not be used to impose monetary liability on holders of stock in Delaware stock corporations.

6. **For Cause Removal.**


   In *In re Vaalco Energy, Inc. Stockholder Litigation, C.A. No. 11775-VCL (Dec. 21, 2015) (TRANSCRIPT)*, the Court of Chancery granted the plaintiffs' motion for summary judgment and invalidated certain provisions of Vaalco's certificate of incorporation and bylaws, which provided that members of its board of directors could only be removed for cause. The Court held that the default rule under Section 141(k) of the Delaware General Corporation Law (the "DGCL") that directors "may be removed, with or without cause" may be limited to removal only for cause solely in corporations that either (i) have a board classified pursuant to Section 141(d) of the DGCL (i.e., a staggered board), or (ii) provide for cumulative voting pursuant to Section 214 of the DGCL.

   Before its 2010 annual meeting, Vaalco had a staggered board and provisions in its certificate of incorporation and bylaws mandating that directors could be removed only for
cause. In 2010, Vaalco de-staggered its board, but failed to remove the provisions of its certificate and bylaws providing for removal of directors for cause only. After a group of dissident stockholders announced its intention to remove certain members of Vaalco's board in late 2015, Vaalco asserted that these provisions prohibited such action without cause. In response, the group of stockholders brought an action seeking a declaratory judgment that Vaalco's certificate of incorporation and bylaw provisions permitting only for-cause removal of directors were void under Section 141(k).

Section 141(k) provides that "[a]ny director or the entire board of directors may be removed, with or without cause, by the holders of a majority of the shares then entitled to vote at an election of directors" except in the case of a corporation with either (i) a staggered board, or (ii) cumulative voting. The defendants advanced several arguments in favor of the validity of the Vaalco certificate of incorporation and bylaw provisions, including the alleged fact that approximately 175 public Delaware corporations had similar provisions in their governing documents regarding director removal despite lacking a staggered board or cumulative voting. Of these, the Court found most persuasive the defendants' argument that Section 141(d) permits a classified board to "be divided into 1, 2 or 3 classes," and thus allows for a board to be classified into a single class. Accordingly, the defendants argued that a single-class board would be classified for the purposes of Section 141(k), and could properly be subject to removal for cause only.

The Court, however, rejected this argument, which, in its view, would create a "somewhat oxymoronic concept of a single-class classified board." In so holding, the Court relied upon commentary on the 1974 amendments to the DGCL, which explained that the language in Section 141(d) permitting a board to be "divided into 1, 2 or 3 classes" was intended to clarify that the right of any class or series of stock to elect one or more directors would not create an additional class of directors and did not support the notion of a single-class classified board. Additionally, while Vaalco advanced its interpretation of Section 141(d), it never actually established that its board was classified. Thus, the Court alternatively held that, even if Section 141(d) permitted a single-class classified board, Vaalco did not have such a board.

Following the ruling described above, the plaintiffs' bar began sending demand letters to the 175 companies identified by the defendant in Vaalco. Suits have been filed against several of those companies. For companies that have de-staggered their boards within the last several years, it may be worthwhile to determine whether similar issues exist before the plaintiffs' bar initiates contact.

7. Derivative Actions and Claims.


In In re El Paso Pipeline Partners, L.P. Deriv. Litig., 2015 WL 7758609 (Del. Ch. Dec. 2, 2015), the Court of Chancery denied a motion to dismiss a suit, in which the Court had already entered a $171 million damages award against the defendants, on the grounds that the plaintiff had lost standing as a result of a post-trial merger. In denying the motion to dismiss, the Court
addressed the distinction between direct and derivative claims while offering its view with respect to dual-natured claims.

Through two transactions in 2010, El Paso Corporation ("El Paso Parent"), which owned the sole general partner of El Paso Pipeline Partners, L.P. (the "MLP"), sold two of its subsidiaries to the MLP. The plaintiff filed suit derivatively on behalf of the MLP challenging each of the transactions. After consolidation of the two lawsuits, the Court granted the defendants' motion for summary judgement as to the first transaction. However, trial was held with respect to the second transaction (the "Fall Dropdown"), following which the Court found that the Fall Dropdown did not receive "special approval" (as defined in the MLP's operating agreement) because the members of the MLP's conflicts committee had failed to form a subjective belief that the transaction was in the best interests of the MLP. Accordingly, the Court found that approval of the Fall Dropdown had breached the partnership agreement and awarded $171 million in damages, the amount of overpayment caused by the breach.

During the pendency of the litigation, Kinder Morgan Inc. acquired El Paso Parent. Shortly after trial Kinder Morgan, El Paso Parent, the MLP, and El Paso Pipeline GP Company, L.L.C. ("El Paso General Partner") consummated a related-party merger, which brought an end of the separate legal existence of the MLP. El Paso General Partner then moved to dismiss the lawsuit on the basis that the plaintiff's claims were exclusively derivative and the plaintiff lacked standing to pursue his claims due to the merger.

The Court rejected the motion to dismiss and found that to the extent Delaware law required it to make a choice between construing the plaintiff's claim as either exclusively derivative or exclusively direct, the claim was direct in nature. The Court reasoned that the plaintiff had proved that El Paso General Partner violated certain provisions of the MLP's partnership agreement, a contract to which the plaintiff and the other limited partners of the MLP were parties. The Court stated that "[g]ranting the motion to dismiss would generate a windfall for the general partner at the expense of the unaffiliated limited partners for whose indirect benefit this suit originally was brought." The Court relied on the public policy underlying the limited partnership statute to give maximum effect to the principle of freedom of contract and enforceability of partnership agreements in finding that limited partners can sue directly to enforce contractual constraints in a limited partnership agreement.

However, the Court declined to accept the defendants' "bipolar" view of classification of the plaintiff's claim as either exclusively direct or exclusively derivative. Instead the Court suggested that the "more appropriate way" to view the claim is as dual-natured with aspects that are both direct and derivative. In reaching this conclusion, the Court analyzed the claim under the two-part Tooley test. The Court found the analysis under Tooley straightforward if the claim were considered one for breach of contract: the limited partners suffered a breach of their contract rights and that breach could be remedied appropriately at the limited partner level. The Court also held that, even setting aside the contractual nature of the claim, the claim was both direct and derivative under Tooley. Specifically, the first prong of the Tooley test, adapted for a limited partnership, asks who suffered the alleged injury, the partnership or the limited partners individually. The Court held, in the context of the plaintiff's claim, the answer was both, because the MLP and its limited partners suffered injuries resulting from El Paso General Partner's breach of the MLP's partnership agreement. The MLP suffered by overpaying in the Fall
Dropdown, and the limited partners suffered because the transaction effectively reallocated value from them to El Paso General Partner. The second prong of the Tooley test asks who would receive the benefit of any remedy, the partnership or the limited partners individually. The Court determined the answer to this second question was either, because Delaware law supported both an entity-level remedy and a limited partner-level remedy with respect to overpayment claims. Therefore, the Court concluded that the plaintiff's claim was dual-natured and could be pursued directly or derivatively.

In dicta, the Court also expressed its view that the treatment of dual-natured claims is an area of Delaware law that warrants further development. Specifically, the Court suggested that when considering how a dual-natured claim should be treated for purposes of whether it can be maintained after a merger, Delaware law should prioritize the individual aspects of the claim such that it survives. However, when considering how a dual-natured claim should be treated for purposes of determining demand futility, Delaware law should prioritize the derivative aspects of the claim. This would preserve the policy goals of screening out meritless claims and protecting the primacy of the board's (or other manager's) management of the entity.

Finally, the Court rejected El Paso General Partner's estoppel argument, finding Delaware law is clear that a plaintiff's characterization of its claims as either direct or derivative is not binding on the Court. The Court ruled that the plaintiff can continue to pursue the claim after the merger and can enforce the $171 million judgment. The Court ordered the current general partner to pay the MLP's unaffiliated limited partners as of the time of the merger their pro rata share of the $171 million award, plus pre- and post-judgment interest through the date of payment, less an amount for a reasonable award of attorneys' fees and expenses.


In In re Molycorp, Inc. Shareholder Derivative Litigation, 2015 WL 3454925 (Del. Ch. May 27, 2015), the Court of Chancery granted under Rule 12(b)(6) defendants' motions to dismiss a derivative complaint that alleged breaches of fiduciary duties, among other claims, in connection with a secondary stock offering that was initiated at the request of Molycorp, Inc.'s private equity investors pursuant to the terms of a Registration Rights Agreement.

In 2010, before Molycorp's initial public offering, certain private equity investors executed a Stockholders Agreement and a Registration Rights Agreement with the company. The Stockholders Agreement granted the investors the right, among others, to nominate directors to Molycorp's board. The Registration Rights Agreement granted the investors a contractual right to have Molycorp register their shares for a secondary offering upon demand by the private equity investors. Under the Registration Rights Agreement, the private equity investors were also granted the right to have their shares given priority over any shares offered by the company in a secondary offering.

In 2011, the private equity investors invoked their rights under the Registration Rights Agreement to cause Molycorp to offer their shares in a secondary offering. In the offering, the private equity investors and certain directors of Molycorp sold shares of Molycorp stock at $51 per share, generating approximately $575 million. Molycorp, on the other hand, conducted a
private offering of convertible notes, which raised only $223 million. During this period, as plaintiffs alleged in the complaint, Molycorp was in financial distress and in need of capital. At the time of the challenged secondary offering, the private equity investors owned approximately 44 percent of the company's outstanding stock and had nominated four directors. As result, plaintiffs asserted that the private equity investors and the company's directors breached their fiduciary duties by favoring the interests of certain private equity stockholders over the interests of the company. Among other arguments, plaintiffs asserted that the board should have delayed the secondary offering and allowed Molycorp to make its own offering in order to raise capital.

Defendants moved to dismiss plaintiffs' complaint pursuant to Court of Chancery Rule 23.1 for failure to make a demand on the board of directors and pursuant to Court of Chancery Rule 12(b)(6) for failure to state a claim. Because the Court dismissed the complaint for failure to state a claim, it did not address defendants' Rule 23.1 arguments, nor did it decide which standard of review applied to the breach of fiduciary duty claims. The Court, however, assumed without deciding that a majority of the directors had disqualifying interests by reason of personal gains or fiduciary relationships with the private equity investors and that demand would be excused.

In opposition to the motions to dismiss, plaintiffs asserted that defendants sold their stock and prevented the company from participating in the secondary offering at a time when Molycorp needed funding. The Court rejected plaintiffs' argument and observed that "[a]ppointment by a powerful shareholder does not automatically render a director's decision suspect" and that it is not wrong, without more, for a director to buy or sell company shares. Indeed, the Court noted, "[i]f such conduct were actionable, 'directors of every Delaware corporation would be faced with the ever-present specter of suit for breach of their duty of loyalty if they sold stock in the company on whose Board they sit.'"

In granting defendants' motions to dismiss, the Court observed that the Registration Rights Agreement informed the context in which defendants were acting and could not be ignored. Importantly, plaintiffs did not contend that the Registration Rights Agreement was invalid or unenforceable. Instead, plaintiffs essentially argued that Molycorp's board of directors should have interfered with the private equity investors' contractual rights. The Court declined to accept plaintiffs' argument. Indeed, the Court noted that "[a] finding otherwise could discourage would-be investors from funding start-ups for fear that their investment value will not be preserved despite disclosed, carefully negotiated agreements." Accordingly, the Court granted defendants' motions to dismiss.


In Quadrant Structured Products Company, Ltd. v. Vertin, 115 A.3d 535 (Del. Ch. May 4, 2015), the Delaware Court of Chancery denied defendants' motion for summary judgment, held that Delaware law imposes neither a continuous insolvency nor an irretrievable insolvency requirement, and found sufficient evidence in the record to support a reasonable inference that the debtor corporation was insolvent on the date the complaint was filed. In so holding, the Court provided an in-depth analysis of creditor derivative standing following the Delaware Supreme
The individual defendants are members of the board of directors of the corporate debtor, Athilon Capital Corp. Athilon's equity is wholly owned by defendant Merced Capital LP. Plaintiff Quadrant Structured Products Company, Ltd. is an owner of debt securities issued by Athilon. In this action, Quadrant alleged that following Merced's acquisition of Athilon, the board took numerous actions to benefit Merced at the expense of Athilon's other stakeholders. In February 2015, the defendants moved for summary judgment on the theory that Athilon had returned to solvency and Quadrant therefore had lost standing to pursue any derivative claims.

The Court first analyzed in depth Delaware law on creditor breach of fiduciary duty claims, both before and after Gheewalla. The Court concluded that Gheewalla and the cases following it implemented a new regime in evaluating such claims. The current regime holds that there is no longer any zone of insolvency, no cause of action for deepening insolvency, and no fiduciary duties owed directly to creditors. Therefore, after Gheewalla, there is no need under Delaware law for derivative standing hurdles that may be "unnecessary and counterproductive impediments to the effective use of the derivative action as a meaningful tool for oversight." Directors of Delaware corporations are already sufficiently protected by other aspects of Delaware law.

In addressing defendants' argument that Delaware law should recognize a continuous insolvency requirement, the Court also looked to the purposes of a derivative action. Derivative suits are intended to remedy wrongdoing by directors and allow equitable owners to increase the company's value. Creditors share each of those incentives when a company is insolvent, and continue to have such incentives as long as they remain a creditor of the company. Thus, the Court concluded that the proper analogy in the creditor derivative context is a continuous creditor requirement, not a continuous insolvency requirement. In addition, the Court found that depriving creditors of standing to pursue derivative claims on behalf of a company that goes back and forth over the insolvency line while the equity is owned entirely by one stockholder would lead to a "failure of justice" because conflicted fiduciaries could prevent the corporation or its stockholders from pursuing valid claims.

For these reasons, among others, the Court held that "to maintain a derivative claim, the creditor-plaintiff must plead and later prove that the corporation was insolvent at the time suit was filed. The creditor-plaintiff need not, however, plead and prove that the corporation was insolvent continuously from the time of suit through the date of judgment." Finally, the Court also held that the proper test to assess creditor derivative standing at the time the litigation is filed is to determine whether the company "has liabilities in excess of a reasonable market value of its assets." While this test potentially conflicts with certain passages quoted in Gheewalla, which were originally written in the receivership context, the Court drew a distinction between claims in the receivership setting and fiduciary duty claims of creditors. Using this test, Quadrant's showing that Athilon's GAAP balance sheet showed a $300 million negative equity value was sufficient to create an issue of material fact as to Athilon's solvency at the time suit was filed.
In Quadrant Structured Products Company, Ltd. v. Vertin, 102 A.3d 155 (Del. Ch. Oct. 1, 2014), the Delaware Court of Chancery held that the contemporaneous ownership requirement of Section 327 of the General Corporation Law of the State of Delaware (the "DGCL") does not apply to corporate creditors for purposes of determining whether a creditor has standing to bring derivative claims against the board of directors of an insolvent corporation. The Court also declined to dismiss the creditor's fiduciary duty and fraudulent transfer claims related to certain transactions between the corporation and its controlling stockholder, but granted the motion to dismiss with respect to fiduciary duty claims related to the decision of the board of directors to pursue a "risk-on" business strategy that allegedly favored junior creditors over more senior creditors.

The individual defendants were members of the board of directors (the "Board") of Athilon Capital Corp. ("Athilon") that were allegedly controlled by EBF & Associates ("EBF"). Athilon's sole stockholder and the holder of junior notes issued by Athilon (the "Junior Notes"). The plaintiff, Quadrant Structured Products Company, Ltd. ("Quadrant"), owned debt securities issued by Athilon that were senior to the Junior Notes held by EBF. Quadrant alleged that the EBF-controlled Board took a number of actions while Athilon was insolvent to benefit EBF at the expense of its other stakeholders, including (i) paying interest on the Junior Notes instead of deferring the payments to future periods as permitted by the terms of the Junior Notes, (ii) entering into certain agreements with EBF's affiliates at above-market rates, and (iii) amending the limited purpose provisions in Athilon's certificate of incorporation to allow Athilon to pursue a riskier business model that allegedly preferred the interests of EBF over more senior creditors.

As a preliminary matter, the Court held that Quadrant, as a creditor of Athilon, had standing to pursue its claims derivatively. The Court clarified that the fact of insolvency does not give rise to any special duty that is owed by a board of directors directly to the corporation's creditors, but rather gives the corporation's creditors derivative standing to enforce the general fiduciary duty that the board of directors owes to the corporation to maximize the firm's value for all residual claimants. In addition, the Court declined to extend the contemporaneous ownership requirement of Section 327 of the DGCL to creditors, thereby holding that creditors are not prevented from bringing derivative claims in respect of transactions that pre-date the corporation's insolvency or their acquisition of an insolvent corporation's debt. Although the argument was not raised by the defendants, the Court noted that it is possible that creditors could be required to comply with other substantive principles of derivative actions, such as demand excusal and demand refusal, in order to pursue derivative claims.

With respect to Quadrant's substantive claims, the Court found that Quadrant's allegations adequately stated a claim for breach of fiduciary duty and fraudulent transfer with respect to the payment of interest on the Junior Notes and the agreements with EBF's affiliates. Furthermore, because EBF was a controlling stockholder that allegedly stood on both sides of the transactions, the Court held that the transactions would be subject to scrutiny under the entire fairness standard of review. The Court dismissed Quadrant's claims with respect to the Board's decision...
to pursue a riskier business strategy, finding that the directors had made decisions that appeared rationally designed to increase the value of the firm as a whole rather than impermissibly preferring the interests of EBF, as a junior creditor and stockholder, to the interests of other residual claimants. Finally, the Court concluded that none of the directors could invoke the protections of the exculpatory provision in Athilon's certificate of incorporation because three of the directors were officers of either Athilon or EBF and it was not possible at the motion to dismiss stage of the proceeding to determine whether any breach of fiduciary duty on the part of the other two directors resulted solely from a breach of the duty of care.

In a decision issued less than one month later, the Court of Chancery, in Quadrant Structured Products Company, Ltd. v. Vertin, 2014 WL 5465535 (Del. Ch. Oct. 28, 2014), denied Quadrant's motion for reconsideration of the dismissal of claims related to the Board's risk-on strategy. Quadrant contended that the Court had overlooked the importance of the fact that Athilon was a limited purpose corporation and that pursuing the riskier business strategy was outside the scope of its original purpose, as set forth in its certificate of incorporation. Quadrant also argued that the Court had failed to consider whether its allegations were sufficient to support an inference of bad faith and rebut the business judgment rule with regard to the Board's decision to amend the corporation's certificate of incorporation in order to pursue the riskier strategy. The Court noted that Quadrant's first argument did not present grounds for reconsideration because Quadrant's own complaint established that Athilon's governing documents authorized the Board's risk-on strategy. Specifically, the complaint recognized that the Board had the authority to amend Athilon's certificate of incorporation and, thus, could expand Athilon's limited purpose to make investments involving greater risk. With respect to Quadrant's second argument, the Court noted that the motion to dismiss opinion considered and rejected Quadrant's bad faith claims when it held that the Board had made a rational business decision to pursue a riskier investment strategy.

8. Arbitration.


In Delaware Coalition for Open Government, Inc. v. Strine, et al., the United States Court of Appeals for the Third Circuit considered whether the District Court for the District of Delaware correctly ruled that confidential arbitration proceedings conducted by members of the Delaware Court of Chancery under 10 Del. C. § 349 must be open to the public under the First Amendment to the Constitution of the United States. In a divided decision in which each member of the panel wrote a separate opinion, the Third Circuit held that there is a First Amendment right of access to Chancery arbitrations.

Under 10 Del. C. § 349, the Court of Chancery was granted authority to create a program under which sitting members of the Court would act as arbitrators for certain business disputes. The statute limited the categories of cases eligible for arbitration and required the parties to the dispute to agree to participate in Chancery arbitration. Arbitration petitions and submissions in the arbitration proceeding were to be protected from public disclosure, and the arbitration hearings were to be held in private. The arbitrator's decision was to be entered as a judgment of the Court, with appeal rights limited to grounds similar to those on which a private arbitrator's
decision could be vacated, such as corruption, fraud or misconduct. The Delaware Coalition for Open Government, Inc. sued in the District Court, arguing that the confidentiality of such arbitrations violates the First Amendment. The District Court granted the plaintiff's motion for judgment on the pleadings striking down the entire statute, and the members of the Court of Chancery appealed.

On appeal, the Third Circuit, in a majority opinion authored by Judge Dolores Sloviter, applied the "experience and logic" test and held that a proceeding is subject to the First Amendment right of public access when there has been a tradition of accessibility to that kind of proceeding, and when access plays a significant positive role in the functioning of the particular process. Under the experience prong of the test, the Court noted that there is a long tradition of civil trials and court filings associated with them being open to the public with limited exceptions, but that the tradition as to the openness of arbitration proceedings has been mixed. The Court held that, because Chancery arbitrations take place before active judges in a courthouse, because they result in a binding order of the Court of Chancery, and because appeal rights are limited, the experience prong counseled in favor of making arbitration proceedings open to the press and the public. Under the logic prong of the test, the Court determined that opening Chancery arbitration proceedings to the public would yield numerous benefits (including promotion of informed public discussion, promotion of the public perception of fairness, and checking corruption and fraud) and that the drawbacks did not outweigh the benefits. Accordingly, the Court determined that there is a First Amendment right of access to Chancery arbitrations.

Judge Julio Fuentes joined in the Court's opinion and wrote a concurring opinion, stressing that in his view the problem with the Chancery arbitration statute was that "they are conducted outside the public view, not because of any problem otherwise inherent in a Judge-run arbitration scheme." Judge Jane Roth wrote a dissenting opinion, concluding that the experience test weighed against public access because arbitration proceedings historically have been private and confidential, and that the logic test also weighed against public access because "the resolution of complex business disputes, involving sensitive financial information, trade secrets, and technological developments, needs to be confidential so that the parties do not suffer the ill effects of this information being set out for the public — and especially competitors — to misappropriate."


In Viacom International, Inc. v. Winshall, 72 A.3d 78 (Del. 2013), the Delaware Supreme Court affirmed the Court of Chancery's decision to uphold an arbitration determination resolving a dispute between Viacom International, Inc. ("Viacom") and the stockholders of Harmonix Music Systems, Inc. ("Harmonix"). The disagreement concerned an "Earn-Out" payment provision adopted under the 2006 Agreement and Plan of Merger ("Merger Agreement") between the two companies. The Court held that the arbitrator's decision to exclude evidence that was not identified in Viacom's initial submission, supporting its argument that there should be an inventory write-down, did not constitute misconduct, and that the arbitrability of the inventory write-down dispute was an issue for the arbitrator to decide.
In 2006, Viacom acquired Harmonix for $175 million in cash plus a contingent right to receive uncapped Earn-Out payments based on Harmonix's 2007 and 2008 gross profits. Walter A. Winshall, the designated representative of Harmonix's former stockholders, disputed Viacom's calculation of the 2008 Earn-Out statement, from which Viacom deducted the cost of Harmonix's unsold inventory. In accordance with the Merger Agreement, Winshall presented his disagreements in a Summary of Issues. The parties were unable to resolve the dispute and submitted the Earn-Out disagreement to arbitration, with a nationally known accounting firm serving as the arbitrator.

In its pre-hearing submission, Viacom argued that if it were unable to properly deduct the cost of Harmonix's unsold inventory, it could account for that inventory by taking an inventory write-down deduction. Winshall countered that because this argument was not included in the 2008 Earn-Out statement, it could not be considered in arbitration. As the inventory write-down was not included in the original submission of unresolved items from the Summary of Issues, the arbitrator asked for the parties' consent to consider it in reaching its decision, which Winshall refused to grant. The arbitrator issued its decision in December 2011, agreeing with Winshall that costs of unsold inventory should not be deducted from net revenue. The arbitrator did not address the inventory write-down.

Viacom filed a complaint in the Court of Chancery seeking a declaration vacating the arbitrator's determination. Viacom alleged that the arbitrator disregarded the terms of the Merger Agreement and failed to consider Viacom's arguments in reaching its decision, as well as that Winshall breached the Merger Agreement by refusing to consent to the arbitrator's consideration of Viacom's argument. The Court of Chancery granted Winshall's motion for summary judgment and confirmed the arbitrator's decision.

On appeal, the Delaware Supreme Court considered two issues. First, the Court considered whether the arbitrator's refusal to consider evidence of the inventory write-down amounted to misconduct requiring the Court to vacate its decision. The Court then addressed whether the question of whether to consider the inventory write-down provision in reaching its determination was a question of procedural arbitrability that was properly decided by the arbitrator.

The Court found that the arbitrator properly limited its analysis of the Earn-Out dispute and did not ignore any relevant evidence. The Merger Agreement required the parties' initial submissions to include all matters to be decided by the arbitrator. The question of whether the inventory write-down was an appropriate method of accounting for unsold Harmonix inventory was not identified in the initial submissions. The arbitrator's determination that it could not consider the issue absent the express consent of the parties was thus appropriate and did not constitute misconduct.

In addition, the Court found that the arbitrator's unwillingness to consider the inventory write-down issue constituted a decision that the issue was not arbitrable, a determination that the arbitrator was entitled to make because the question was one of procedural arbitrability.

The Court defined issues of procedural arbitrability as those concerning whether or not the parties have complied with the terms of an arbitration provision; for example, a
determination of whether certain conditions precedent to arbitration have been met. These issues are presumptively handled by arbitrators. In contrast, the Court defined issues of substantive arbitrability as those that necessitate a determination of the scope of a given arbitration provision and its applicability to a given dispute. Answering a question of substantive arbitrability effectively determines whether the parties should be arbitrating at all, a gateway question that is presumptively decided by a court.

Overruling certain earlier decisions of the Court of Chancery, the Court explained that, whether an arbitration provision is broad or narrow, the only issue of arbitrability that should be decided by the court is "whether the subject matter in dispute falls within it." Where the subject matter generally in dispute (e.g., in this case, the calculation of an earn-out) falls within the arbitration provision, subsidiary questions like "what financial or other information should be considered in performing the calculation" are questions of procedural arbitrability and are properly decided by the arbitrator. Finally, the Court determined that whether or not the Court of Chancery was correct in agreeing with the arbitrator's decision was irrelevant, as the decision was properly made by the arbitrator.

9. **§ 205 Actions.**


Two recent decisions by the Delaware Court of Chancery have helped to define the contours of the Court's authority in proceedings under Section 205 ("Section 205") of the General Corporation Law of the State of Delaware (the "DGCL"). In *In re Genelux Corporation,* 126 A.3d 644 (Del. Ch. 2015), the Court of Chancery held that a corporation cannot use Section 205 to invalidate prior corporate acts, and in *In re Baxter International Inc.,* C.A. No. 11609-CB (Del. Ch. Jan. 15, 2016) (TRANSCRIPT), the Court of Chancery held that a corporation cannot use Section 205 as a means to ensure the validity of future corporate acts.

Section 205, which became effective April 1, 2014, and was amended effective August 1, 2015, confers jurisdiction on the Court of Chancery to determine the validity of defective corporate acts and stock issuances. Since Section 205 was enacted in 2014, the Court of Chancery has used its powers under Section 205 to resolve issues relating to a corporation's valid existence, including confirming the identity of the members of the corporation's board of directors (*see In re Trupanion,* C.A. No. 9496-VCP (Del. Ch. Apr. 28, 2014) (ORDER)), and to validate defective stock issuances (*see In re Numoda Corporation Shareholders Litigation,* C.A. No. 9163-VCN (Del. Ch. Jan. 30, 2015) and *In re CertiSign Holding, Inc./*, C.A. No. 9989-VCN (Del. Ch. Aug. 31, 2015)). However, both *Genelux* and *Baxter* involved unique petitions that had the potential to expand the scope of the Court of Chancery's authority under Section 205 beyond the validation of past defective corporate acts.

In *Genelux,* Genelux Corporation ("Genelux") petitioned the Court of Chancery to invalidate 1.5 million shares of Genelux's Series A Preferred shares (the "Disputed Shares") that Genelux purportedly issued to Aladar Szalay, one of Genelux's founders ("Szalay"), under Section 205 and to declare the elections of two directors invalid under Section 225 of the DGCL.
as a result of the invalid issuance of the Disputed Shares. Genelux claimed that the Disputed Shares were invalid because, among other things, (i) the Disputed Shares were allegedly issued in exchange for shares of Genelux common stock that were invalid; (ii) Szalay released his claim to the Disputed Shares in a settlement of litigation with a third party; (iii) the issuance of the Disputed Shares was not supported by valid consideration; and (iv) Genelux was fraudulently induced by Szalay to issue the Disputed Shares.

Before reaching the merits of Genelux's claims with respect to the validity of the Disputed Shares, the Court of Chancery addressed the threshold issue of whether Section 205 can be used to invalidate purportedly defective corporate acts. Genelux argued that because Section 205(a)(4) authorizes the Court of Chancery to determine the validity of any stock (and not just putative or defective stock), the Court of Chancery should have the ability to determine that the stock subject to the petition is invalid. Szalay argued that Section 205, when read as a whole, only granted the Court of Chancery the power to validate defective stock issuances, not stock issuances that have been treated by the corporation as valid as evidenced by, in this case, the issuance of stock certificates, entries in the corporate stock ledger and board resolutions. The Court of Chancery found that the plain language of Section 205 was ambiguous as to whether the Court of Chancery is permitted to invalidate corporate acts. Accordingly, the Court looked to extrinsic evidence—including the legislative synopsis of House Bill 127 (which became Section 205 and Section 204 of the DGCL), the other provisions of Section 204 and Section 205, and commentary in Delaware law treatises concerning Section 205—to resolve the ambiguity.

After reviewing these materials, the Court of Chancery concluded that Section 205 is a "remedial statute" that was only designed to "cure otherwise incurable defective corporate acts, not a statute to be used to launch a challenge to stock issuances on grounds already available through the assertion of plenary-type claims based on alleged fiduciary duty or common law fraud or a Section 225 action, if the stock had been voted." Thus, the Court of Chancery dismissed for failure to state a claim Genelux's petition under Section 205 seeking a declaration that the Disputed Shares were invalid. The Court of Chancery also dismissed Genelux's Section 225 claims, concluding that (i) Genelux had failed to prove by a preponderance of the evidence that it did not approve the issuance of the shares of common stock for which the Disputed Shares were exchanged; (ii) the settlement did not include a general release of claims that Szalay may have against Genelux; (iii) the exchange of the shares of common stock and Szalay's release of his claims to additional shares of Genelux constituted valid consideration for the issuance of the Disputed Shares; and (iv) Szalay's conduct in pressing Genelux to issue the Disputed Shares in connection with an unrelated third-party financing did not rise to the level of fraud.

In Baxter, the certificate of incorporation of Baxter International Inc. ("Baxter") contained a provision that stated that Article SIXTH of the certificate of incorporation could not be amended without the vote of at least "two-thirds of the holders of all the securities of [Baxter] then entitled to vote on such change" (the "voting provision"). Baxter planned to seek an amendment of Article SIXTH at its upcoming annual meeting, and its board of directors adopted a resolution (the "voting resolution") stating that the board had determined to count votes on the amendment on a "per share basis, rather than on a per capita basis," even though the voting provision, on its face, seemed to call for a per capita vote and previous public disclosures indicated that Baxter had counted votes subject to the provision on a per capita basis in the past. Baxter filed a petition with the Court of Chancery under Section 205 requesting that the Court
validate the voting resolution as well as the voting standard set forth in the voting resolution. In effect, Baxter requested the Court to declare that the voting resolution properly provided that the upcoming vote on the amendment to the certificate should be determined on a per share basis, rather than a per capita basis. Although Baxter's Section 205 petition was initially unopposed, the Court of Chancery appointed Richards, Layton & Finger, P.A. as special counsel to file an opposition brief if no stockholder came forward to oppose the petition after notice was given.

The Court of Chancery, issuing its ruling from the bench after oral argument, distinguished between determining the validity of the voting resolution itself and determining the proper voting standard for the proposed certificate amendment. The Court of Chancery indicated that it could address under Section 205 the validity of the voting resolution if there had been some defect in its adoption (for example, if it was not adopted by a sufficient number of directors), but that Section 205 did not permit the Court to provide an opinion on the underlying contents of the voting resolution.

Moreover, the Court of Chancery determined that Section 205 did not empower the Court to validate future corporate acts. While Baxter argued that a corporate act had already occurred because the board had adopted the voting resolution, the Court of Chancery pointed out that the annual meeting where the vote on the amendment was to occur had not been held and might never occur. The Court of Chancery likened Baxter's Section 205 petition to a request for an advisory opinion on an unripe issue and dismissed the case. However, the Court of Chancery acknowledged that Section 205 is a flexible statute "intended to promote equitable outcomes and to provide certainty to stockholders," and that relief under Section 205 may be possible under appropriate circumstances. The Court of Chancery noted that if Baxter held its annual meeting, received sufficient votes counted on a per-share basis to amend, and actually amended its certificate of incorporation on that basis, Baxter would have a stronger argument that the Court should validate the amendment under Section 205 because a corporate act would have actually occurred.

C. Corporate Governance Issues.

1. Removal of Officers


   In Gorman v. Salamone, 2015 WL 4719681 (Del. Ch. July 31, 2015), the Delaware Court of Chancery held that a stockholder-adopted bylaw amendment that purported to grant stockholders the authority to remove corporate officers over the objection of the corporation's board of directors was invalid under Delaware law. In so holding, the Court found that the amended bylaw, which permitted stockholders to remove and replace officers without cause, would allow stockholders to "make substantive business decisions" for the corporation and thereby "unduly interfere with directors' management prerogatives" under Section 141(a) of the General Corporation Law of the State of Delaware (the "DGCL").

   The Court of Chancery's opinion in Gorman is the most recent installment in an ongoing dispute over the composition of the board of directors of Westech Capital Corp. (the "Company"
See In re Westech Capital Corp., 2014 WL 2211612 (Del. Ch. May 29, 2014) (designating a four-member board and determining the composition thereof), aff’d in part, rev’d in part sub. nom. Salamone v. Gorman, 106 A.3d 354 (Del. 2014) (designating a five-member board and determining the composition thereof). Critical to both the Court of Chancery's earlier post-trial opinion (the "Chancery Post-Trial Opinion") and the Delaware Supreme Court's opinion on appeal was the operation of a voting agreement that required the stockholders party thereto to vote, or cause to be voted, their shares of stock to elect as directors the individuals designated in the manner provided in the agreement. In this respect, the voting agreement provided, among other things, for the election of the Company's chief executive officer as a director, provided that if for any reason the chief executive officer were to cease to serve as the chief executive officer, the stockholders party to the agreement were required to vote their shares to remove the chief executive officer from the board and to elect the new chief executive officer to the board.

Following the Chancery Post-Trial Opinion, John Gorman, as the Company's majority stockholder, acted by written consent to amend the bylaws of the Company to provide, among other things, that "[a]ny officer may be removed, with or without cause, at any time by the Board or by the stockholders acting at an annual or special meeting or acting by written consent pursuant to Section 2.8 of these Bylaws. The Board shall, if necessary, immediately implement any such removal of an officer by the stockholders." In reliance on the amended bylaw, Gorman then removed Gary Salamone as the Company's chief executive officer and elected himself to fill the resulting vacancy. Following his appointment as chief executive officer, Gorman sought to appoint a new director to serve in his newly vacant director seat. Thereafter, Gorman filed suit in the Court of Chancery seeking confirmation that, among other things, Salamone was no longer the chief executive officer or a director of the Company.

The Court of Chancery held that the amended bylaw was invalid, stating that "Delaware law does not allow stockholders to remove directly corporate officers through authority purportedly conferred by a bylaw." The Court of Chancery rejected Gorman's argument that Section 142(b) of the DGCL (providing that "[o]fficers shall be chosen in such manner . . . as [is] prescribed by the bylaws or determined by the board of directors") and Section 142(e) of the DGCL (providing that "[a]ny vacancy occurring in any office . . . shall be filled as the bylaws provide") permitted the adoption of a bylaw that would allow stockholders to remove and replace officers. In this regard, the Court explained that neither Section 142(b) nor Section 142(e) expressly provided guidance on how officers may be removed, but only on the manner in which officers could be selected and the manner in which any vacancy in an office could be filled. Thus, the Court found that the amended bylaw was not authorized by Section 142 of the DGCL. In reaching this conclusion, the Court noted that, prior to its 1967 revision, the DGCL explicitly authorized directors or stockholders to elect corporate officers, and notes that Professor Earnest Folk, in the first edition of his treatise on the DGCL, commented that the 1967 revision intended no substantive change. That commentary stated that, while the phrase "by directors or officers" was deleted and the phrase "in the manner provided by the bylaws" was added, the changes were not intended to effect any substantive change as to who may choose the officers.

Turning to the argument that stockholders generally have the power under Section 109 of the DGCL to adopt and amend bylaws "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," the Court nonetheless held that the amended bylaw was outside the scope of bylaws permitted by Section 109. In particular, the Court noted that the amended bylaw required the board to "immediately implement any such removal of an officer by the stockholders," thereby allowing the stockholders to remove an officer over the objection of the board. Explaining that such a directive, if enforceable, "could compel board action, potentially in conflict with its members' fiduciary duties," the Court held that the "stockholders' right to remove officers for any (or no) reason would unduly constrain the board's ability to manage the Company." As a result of such undue constraint, the Court held that the amended bylaw was invalid and that any actions taken in reliance thereon, including the removal of Salamone as chief executive officer, were of no effect.

Notably, the amended bylaw also provided that "[a]ny vacancy occurring in any elected office of the Corporation may be filled by the Board except that any such vacancy occurring as a result of the removal of an officer by the stockholders shall be filled by the stockholders." The Court of Chancery expressly declined to address the validity of this provision, stating that "[t]he Court need not (and does not) analyze [the vacancy-filling] aspect of the Amended Bylaw because its validity is irrelevant to the matter at hand." The Court noted, however, that "[p]ermitting stockholders to set the mode for officer replacement would allow them to dictate a procedure, and would not necessarily step unduly on management's toes."

2. § 220 Actions.


In a post-trial decision, the Court of Chancery ordered respondent Yahoo! Inc. to produce additional documents in response to plaintiff Amalgamated Bank's demand to inspect Yahoo's books and records pursuant to 8 Del. C. § 220. Amalgamated Bank v. Yahoo! Inc., 2016 WL 402540 (Del. Ch. Feb. 2, 2016). In doing so, the Court interpreted Section 220 to provide for the production of electronically stored information in addition to physical documents.

The facts centered on Yahoo's hiring of Henrique de Castro as its chief operating officer in October 2012 and de Castro's subsequent termination just 14 months later. The Court of Chancery examined the details surrounding: (i) the involvement of Yahoo's board of directors and Compensation Committee in the hiring process, (ii) the value of de Castro's compensation package, (iii) the termination of de Castro, (iv) the payout de Castro received upon termination, and (v) the alleged unilateral involvement of Yahoo's CEO, Marissa Mayer, in the hiring and firing of de Castro and the construction of his compensation package.

Amalgamated filed its first demand for inspection of Yahoo's books and records on February 24, 2014, for the purpose of investigating "potential mismanagement, including mismanagement in connection with the payment of compensation to a corporation's officers and directors." Throughout 2014, Amalgamated and Yahoo engaged in negotiations surrounding the demand, and Yahoo eventually produced 677 pages of documents. When Yahoo denied Amalgamated's demand for additional categories of documents, Amalgamated filed suit on March 10, 2015.
The Vice Chancellor's opinion offers clarification on what is sufficient to meet the statutory "form and manner" requirements necessary for bringing a books and records demand under 8 Del. C. § 220. Yahoo argued that Amalgamated failed to prove that it owned Yahoo stock at the time the demand was filed because the proof submitted by Amalgamated was dated three days before the date demand was made—as opposed to being dated the same day as the demand—but the Court rejected that argument. The Vice Chancellor ruled that Section 220 only requires "documentation sufficient in time to the date of demand as to be consistent with and corroborate the averment of stock ownership made in the demand itself." Additionally, the Court found that Amalgamated was not required to provide Yahoo with an ongoing stream of ownership records to confirm continuous ownership of stock.

The Court also analyzed the sufficiency of Amalgamated's stated purpose of demanding inspection of Yahoo's books and records to investigate potential corporate wrongdoing in connection with de Castro's hiring and firing. Distinguishing Se. Pa. Transp. Auth. v. Abbvie, Inc., 2015 WL 1753033 (Del. Ch. Apr. 15, 2015), aff'd, 2016 WL 235217 (Del. Jan. 20, 2016), the Court held that Amalgamated had not limited its stated purposes to investigating potential causes of action that would be subject to exculpation, but rather had met the "credible basis" standard with respect to its potential claims for breach of the duty of good faith and waste.

The Court then turned to the scope of inspection. Amalgamated sought production of emails and other files of Yahoo's CEO, Marissa Mayer. The Court found that "[t]he evidence establishes that the Mayer Documents are necessary for a meaningful investigation of de Castro's hiring," due to the direct and personal involvement Mayer had with the negotiations and hiring of de Castro. The Court reached a similar conclusion with regard to Mayer's documents relating to de Castro's termination. The Court ruled that the "scope of the production of the Mayer Documents will include email and other electronic documents, which count as corporate books and records." The Vice Chancellor rejected Yahoo's argument that such documents are not subject to 8 Del. C. § 220 because the language of the statute does not explicitly mention electronic information. The Court reasoned that "[a]s with other categories of documents subject to production under Section 220, what matters is whether the record is essential and sufficient to satisfy the stockholder's proper purpose, not its source." The Court further clarified that the production of Mayer's emails should include emails from any personal account she may have used to conduct Yahoo business.

The Vice Chancellor also ordered Yahoo to produce emails and other electronically stored documents in the possession of the members of Yahoo's Compensation and Leadership Development Committee, to the extent those documents related to de Castro's hiring or termination. The Court also ordered additional production of documents relating to Yahoo's director recruitment process.

The Court rejected Amalgamated's request for production of documents reflecting consultations with counsel. Recognizing that those documents could be subject to production, notwithstanding the attorney-client privilege and work-product doctrine, under Garner v. Wolfinbarger, 430 F.2d 1093 (5th Cir. 1970), the Court determined that it would require Yahoo to log communications with counsel relating to the subjects of the inspection, to the extent those communications were identified in searching for documents produced pre-litigation or in
response to the Court's order. The Court left open the possibility that Amalgamated might later show that these privileged documents might be essential to the proper purpose of inspection.

Finally, on an issue of first impression, the Vice Chancellor found that any further document production by Yahoo "is conditioned on Amalgamated agreeing that the entirety of Yahoo's production in response to the Demand is incorporated by reference in any derivative action complaint it files relating to the subject matter of the demand." The Court explained the basis for this condition as a means to protect Yahoo and the Court from the filing of a complaint based on "cherry-picked documents," and to prevent Amalgamated from forging a complaint based on a few documents taken out of context.

3. § 225 Actions.


In *Klaassen v. Allegro Development Corporation*, 2013 WL 5739680 (Del. Ch. Oct. 11, 2013), Eldon Klaassen, the former CEO of Allegro Development Corporation ("Allegro"), brought an action under Section 225 of the Delaware General Corporation Law, requesting that the Court of Chancery declare that he: (1) was still the CEO of Allegro, (2) had validly removed two of Allegro's directors and appointed their replacements, and (3) had validly filled a preexisting director vacancy. Klaassen claimed that his removal as CEO of Allegro by the board of directors (the "Board") was void. If he was indeed still CEO, he had the power to remove directors and appoint new ones under Allegro's governing documents. In a post-trial opinion, the Court of Chancery found that Klaassen was barred from challenging his removal as CEO by the equitable doctrines of laches and acquiescence. Regarding his changes to the Board, the Court of Chancery determined that Klaassen did succeed in removing one director and filling the preexisting vacancy on the Allegro Board, but that he did not remove the second director and new CEO, nor validly appoint a replacement for the removed director.

Klaassen, founder and nearly 100% stockholder of Allegro, sought outside investment in Allegro and obtained it from two outside investors (the "Series A Investors") in exchange for shares of Series A Preferred Stock of Allegro (the "Series A Preferred"). The parties agreed to a corporate governance structure where Klaassen and the Series A Investors shared control at both the director and stockholder levels of Allegro. In an amended certificate of incorporation, Klaassen and the Series A Investors agreed to a seven-member board. The holders of the Series A Preferred would elect three directors, the holders of the common stock (a majority of which was held by Klaassen) would elect one director (the "Common Director"), and the holders of a majority of Allegro's outstanding voting power (also held by Klaassen) would elect the remaining three directors (the "Remaining Directors"). In a separate Stockholders' Agreement, Klaassen and the Series A Investors agreed that one Remaining Director seat would be occupied by the CEO, and that the other two Remaining Directors seats would be occupied by outsiders designated by the CEO and approved by the Series A Investors (the "Outside Directors").

On November 1, 2012, the Board removed Klaassen as CEO during a regular Board meeting, and replaced him with Raymond Hood (then serving as an Outside Director), because of operational and managerial failures. The Board chose not to give Klaassen advance notice that
they were removing him as CEO, although the Outside Directors had warned Klaassen that his position was in jeopardy. Instead, the Outside Directors procured the attendance of Allegro's CFO and general counsel through the admitted "ruse" of telling Klaassen that their attendance was necessary to discuss redemption of the Series A Preferred. After his removal, Klaassen seemed to accept his termination (even if he was displeased by it). Then, on June 5, 2013, seven months after his termination, Klaassen for the first time asserted that he was still CEO and, in his purported capacity as CEO, claimed that he was removing the two Outside Directors (Hood and George Simpkins) from the Board without cause and filling the vacant Common Director seat with non-party John Brown.

In the Court of Chancery, Klaassen argued that because a majority of the directors breached their duties of loyalty and good faith in removing him as CEO, the removal was void. As support, he claimed that the Outside Directors (1) improperly "tricked" him by concealing the purpose of the meeting at which he was terminated, thereby preventing him from taking preemptive action, (2) bribed Hood with the offer of a CEO position, and (3) threatened Klaassen's removal only to convince Klaassen to buy them out at a higher price.

Disagreeing, the Court of Chancery held that because Klaassen was attempting to use equitable principles to invalidate the Board's actions—even if Klaassen succeeded on these equitable theories—his removal was only potentially voidable, not void. That is, because Klaassen never contended that the Board violated a mandatory bylaw, he was relying on equity and thus his claims were subject to equitable defenses.

The Court of Chancery held that Klaassen was barred from challenging his removal as CEO under the equitable doctrines of laches and acquiescence. Laches applied because Klaassen had understood the material facts surrounding his removal and obtained legal advice about his rights, but still waited seven months to assert any claims. In the meantime, the new management had made many changes, such that the company would be thrown into chaos if Klaassen returned. In addition, acquiescence applied because, even though Klaassen did eventually express displeasure over his removal, his overall conduct had made it reasonable for the Board to believe that he accepted Hood's installation as CEO. Accordingly, the Court found Klaassen could not contest his removal as CEO.

Next, the Court turned to Klaassen's alleged Board changes. Klaassen had served as the CEO Director until his termination as CEO. The defendants urged that upon Klaassen's termination, he was no longer qualified to be the CEO Director and was not qualified to be an Outside Director, and hence had become the Common Director. The Court rejected this claim and held that Klaassen continued as a Remaining Director and that the Common Director seat had remained vacant until Klaassen validly filled the seat with Brown. The Court noted that the result could have been different had the qualifications for the various Board seats appeared in a clear, self-executing provision of the certificate of incorporation. However, because the qualifications appeared in the Stockholders' Agreement, Klaassen's cessation to satisfy the qualifications could not affect his continuing status as a director.

Regarding Klaassen's attempt to remove Hood and Simpkins, the Court held that the Stockholders' Agreement limited Klaassen's ability to remove Outside Directors. However, the Court held that Klaassen retained the right under that agreement to remove without cause
directors whom he had originally been entitled to designate, but whom he was no longer entitled to designate. The Court held that Klaassen was the person originally entitled to designate Simpkins as an Outside Director and hence retained the power to remove him even after Klaassen's removal as CEO. However, the Court held that Hood had ceased to be an Outside Director and instead filled the CEO Director seat, and thus that Klaassen could not remove him without cause. Finally, the Court found that although Klaassen had validly removed Simpkins from the Board, he had not validly replaced him because the Stockholders' Agreement required that Outside Director seats be filled by nominees designated by the CEO and approved by the Series A Directors. Because Klaassen was no longer the CEO when he attempted to alter the composition of the Board, neither of his nominees validly became a director.

On December 18, 2013, on expedited appeal, the Delaware Supreme Court heard argument and soon thereafter affirmed the Court of Chancery's decision, noting that a formal opinion would be forthcoming. The Supreme Court issued its formal opinion affirming the Court of Chancery's decision on March 14, 2014. Klaassen v. Allegro Development Corporation, C.A. No. 583, 2013 (Del. Mar. 14, 2014).

D. Controlling Stockholder Issues.


In In re Cornerstone Therapeutics Inc. Stockholder Litigation, 115 A.3d 1173 (Del. 2015), the Delaware Supreme Court resolved two consolidated interlocutory appeals. In the underlying cases (In re Zhongpin Inc. Stockholders Litigation, 2014 WL 6735457 (Del. Ch. Nov. 26, 2014) and In re Cornerstone Therapeutics Inc. Stockholder Litigation, 2014 WL 4418169 (Del. Ch. Sept. 10, 2014)), the Court of Chancery refused to dismiss independent directors because the governing standard of review was held to be entire fairness.

The Supreme Court reversed and remanded, holding that a "plaintiff seeking only monetary damages must plead non-exculpated claims against a director who is protected by an exculpatory charter provision to survive a motion to dismiss, regardless of the underlying standard of review for the board's conduct—be it Revlon, Unocal, the entire fairness standard, or the business judgment rule." Therefore, even in a situation where entire fairness applies ab initio, independent directors may seek dismissal under a charter provision authorized by 8 Del. C. § 102(b)(7) where the plaintiffs are solely seeking monetary relief.

In four opinions issued within three months of one another, four different members of the Delaware Court of Chancery have considered, at the motion to dismiss procedural stage, whether allegations in a complaint were sufficient to establish that a minority stockholder constituted a controlling stockholder under Delaware law. In **In re KKR Financial Holdings LLC Shareholder Litigation**, 101 A.3d 980 (Del. Ch. 2014), **In re Crimson Exploration Inc. Stockholder Litigation**, 2014 WL 5449419 (Del. Ch. Oct. 24, 2014), and **In re Sanchez Energy Derivative Litigation**, 2014 WL 6673895 (Del. Ch. Nov. 25, 2014), the Court concluded that the minority stockholder at issue did not constitute a controlling stockholder, while in **In re Zhongpin Inc. Stockholders Litigation**, 2014 WL 6735457 (Del. Ch. Nov. 26, 2014), the Court found that allegations that a minority stockholder controlled a company and its board of directors were sufficient to withstand a motion to dismiss.

**KKR Financial** involved a suit challenging the acquisition of KKR Financial Holdings LLC ("KFN") by KKR & Co. L.P. ("KKR"). The Court held that KKR, which owned less than 1% of KFN's stock, was not a controlling stockholder despite allegations that a KKR affiliate managed the day-to-day business of KFN and that KFN was used primarily as a public vehicle for financing KKR-sponsored transactions. In dismissing the complaint, the Court focused on whether KKR had the ability to control the board of directors of KFN and found that the complaint lacked any allegation that KKR had a contractual right to appoint members of the board of directors, that KKR dictated any specific course of action to the board of directors, or that KKR prevented the members of the board of directors from exercising their judgment in determining whether or not to approve the merger with KKR. Accordingly, the Court held that the plaintiffs had failed to demonstrate that it was reasonably conceivable that KKR was a controlling stockholder under Delaware law and dismissed the complaint.

In **Crimson Exploration**, the plaintiffs alleged that Oaktree Capital Management and its affiliates ("Oaktree") collectively controlled Crimson Exploration Inc. ("Crimson") based on Oaktree's ownership of 33.7% of Crimson's voting stock, its status as a large creditor of Crimson and its designation of a majority of Crimson's directors and senior management (including three directors employed by Oaktree). After reviewing relevant Delaware precedent, the Court explained that a minority stockholder will not be considered a controlling stockholder unless the minority stockholder actually controls the board's decisions about the challenged transaction. The Court then found that the complaint had failed to plead specific allegations that Oaktree controlled the actions of the board of directors during its negotiation of the merger. Thus, although the Court noted its hesitancy to conclude that the complaint's other allegations could not conceivably state a claim that Oaktree was a controller, the Court ultimately decided that the plaintiffs' complaint (which the Court characterized as supplying "little in the way of specific
allegations of control”) nevertheless failed to show that Oaktree was conflicted as to the transaction or received some unique benefit from the transaction, and consequently failed to plead that the entire fairness standard applied to the transaction.

In *Sanchez Energy*, the Court examined the controller issue in the context of a derivative action governed by the stricter pleading requirements of Court of Chancery Rule 23.1. The Plaintiffs argued that the failure to make a demand on the board of directors of Sanchez Energy Company should be excused because two of the company's co-founders and the collective owners of 21.5% of its stock, A.R. Sanchez Jr. (the company's board chairman) and his son A.R. Sanchez III (the company's chief executive officer), were controlling stockholders who exercised direct managerial control over the company, and the transaction at issue involved another company in which they were investors. While the plaintiffs had alleged that the Sanchezes directed the company's management, the Court found that they did not exercise greater control over the company than that typical of a chief executive officer. Further, citing *KKR Financial* and *Crimson Exploration*, the Court held that, absent particularized allegations that the Sanchezes controlled the decisions of the board of directors with respect to the challenged transaction, the plaintiffs failed to plead sufficiently that the Sanchezes were controlling stockholders under Delaware law.

In contrast to *KKR Financial, Crimson Exploration* and *Sanchez Energy*, the Court in *Zhongpin* denied a motion to dismiss, finding that the plaintiffs had sufficiently pleaded indicia of domination to raise an inference that Xianfu Zhu, the founder of Zhongpin Inc. ("Zhongpin"), was a controlling stockholder under Delaware law. Zhu held 17.3% of the outstanding voting stock of Zhongpin and was also Zhongpin's chairman of the board and chief executive officer. The plaintiffs, former stockholders of Zhongpin, challenged a going-private transaction in which Zhu acquired all of the company's outstanding stock, alleging that Zhu was a controlling stockholder that stood on both sides of the transaction. Unlike in *Sanchez Energy*, the Court determined that the plaintiffs' allegations (gleaned primarily from the company's own disclosures in a Form 10-K filed with the Securities and Exchange Commission) supported an inference that Zhu exercised significantly more power over Zhongpin than would be expected of a chief executive officer and 17% stockholder. In addition to crediting the plaintiffs' argument that the alleged controller possessed active control over Zhongpin's day-to-day operations, the Court found that the complaint raised an inference that Zhu possessed latent control over Zhongpin through his stock ownership. The Court noted that disclosure in the company's 10-K cited by the plaintiffs implied that Zhu could exercise significant influence over stockholder approvals for the election of directors, mergers and acquisitions, and amendments to the company's bylaws.

In addition, in *Zhongpin* and another controlling stockholder case recently decided by the Court, *In re Cornerstone Therapeutics Inc. Stockholder Litigation*, 2014 WL 4418169 (Del. Ch. Sept. 10, 2014), rev’d, 115 A.3d 1173 (Del. 2015), a separate issue arose as to whether, assuming entire fairness review applied to claims against a controlling stockholder, claims against the disinterested directors could nevertheless be dismissed at the pleading stage because they were exculpated from personal liability under a company's certificate of incorporation. The disinterested directors in both cases argued that in the absence of any allegations raising an inference that they breached any non-exculpated duty, the exculpation provision in the company's certificate of incorporation mandated dismissal even if the Court concluded that entire fairness was the operative standard of review. In both *Cornerstone* and *Zhongpin*, the Court held
that, despite the persuasive force of the argument, precedent directs that the Court must await a developed post-trial record before determining the liability of the directors.

c.  **In re KKR Financial Holdings LLC Shareholder Litigation, 101 A.3d 980 (Del. Ch. 2014).**

In *In re KKR Financial Holdings LLC Shareholder Litigation, 101 A.3d 980 (Del. Ch. 2014)*, the Court of Chancery granted defendants' motions to dismiss with prejudice a suit challenging the acquisition of KKR Financial Holdings LLC ("KKFN") by KKR & Co. L.P. ("KKR").

In December 2013, KKR and KFN executed a stock-for-stock merger agreement, which was subject to approval by a majority of KFN shares held by persons other than KKR and its affiliates. The merger was approved on April 30, 2014, by the requisite majority vote.

Nine lawsuits challenging the merger were brought in the Court of Chancery and consolidated. The operative complaint alleged that the members of the KFN board breached their fiduciary duties by agreeing to the merger, that KKR breached its fiduciary duty as a controlling stockholder by causing KFN to enter into the merger agreement, and that KKR and its subsidiaries aided and abetted the KFN board's breach of fiduciary duty.

The Court ruled that KKR, which owned less than 1% of KFN's stock, was not a controlling stockholder. Plaintiffs focused on a management agreement by which a KKR affiliate managed the day-to-day business of KFN, but the Court ruled that the plaintiffs' allegations were not sufficient to support an inference that KKR thereby controlled the KFN board "such that the KFN directors could not freely exercise their judgment in determining whether or not to approve and recommend to the stockholders a merger with KKR." Therefore, the Court dismissed the claim premised on KKR's status as an alleged controlling stockholder.

The Court then held that business judgment review applied to the merger because a majority of the KFN board was disinterested and independent. The Court held alternatively that, even if a majority of the KFN directors were not independent, "the business judgment presumption still would apply because of the effect of untainted stockholder approval of the merger." The Court rejected the plaintiffs' disclosure challenges and ruled that the business judgment standard of review would apply to the merger "because it was approved by a majority of the shares held by disinterested stockholders of KFN in a vote that was fully informed." Accordingly, the Court dismissed the claim against the KFN directors. Because the plaintiffs had not pleaded a viable claim against the KFN directors, the Court also dismissed the claim for aiding and abetting.


In *Hamilton Partners, L.P. v. Highland Capital Management, L.P., 2014 WL 1813340 (Del. Ch. May 7, 2014)*, the Court of Chancery, by Vice Chancellor Noble, in connection with a challenge to a going-private transaction whereby American HomePatient, Inc. ("AHP") was acquired by an affiliate of one of its stockholders, Highland Capital Management, L.P. ("Highland"), refused to dismiss breach of fiduciary duty claims against Highland. The Court
held that, for purposes of defendants' motion to dismiss, plaintiff alleged facts sufficient to support an inference that Highland, which owned 48% of AHP's stock and 82% of AHP's debt, was the controlling stockholder of AHP and that the merger was not entirely fair.

Before the challenged transaction, AHP was a publicly traded Delaware corporation that specialized in home health services. In February 2006, Highland, which at the time was AHP's largest secured creditor and owned 9.9% of AHP's stock, proposed to acquire AHP. After its proposal was rejected, Highland began purchasing AHP's stock in the public market and, by April 2007, increased its stock ownership in AHP to 48%. Due to its increased ownership in AHP's stock, Highland became an "interested stockholder" under Section 203 of the General Corporation Law of the State of Delaware ("Section 203"), which limited Highland's ability to consummate a business combination with AHP for a period of three years. In 2009, when AHP struggled to refinance a large line of credit, Highland, which by that time had acquired 82% of AHP's debt, agreed to enter into a series of one-month forbearance agreements with AHP, the last of which expired in May 2010. The last forbearance agreement expired shortly after the expiration of the three-year period applicable to Highland as an "interested stockholder" under Section 203.

In April 2009, Highland made another proposal to acquire AHP. The board of directors of AHP formed a special committee, which retained legal and financial advisors, but did not conduct sales efforts beyond phone calls to two potential suitors. In late 2009, following negotiations with Highland that resulted in an increased merger price, AHP and Highland agreed to a restructuring transaction that involved (i) a small debt purchase by AHP, (ii) a reincorporation by merger of AHP into a Nevada corporation ("New AHP"), (iii) a self-tender offer by New AHP, (iv) a debt refinancing by New AHP, (v) resignations of the directors of New AHP and appointment of directors designated by Highland, and (vi) a merger of New AHP with an affiliate of Highland. Although the parties agreed to the restructuring transaction in late 2009, the parties did not enter into a definitive restructuring agreement (the "Restructuring Agreement") until April 2010, after the three-year waiting period applicable to Highland under Section 203 expired. Part of the special committee's rationale for recommending the transaction was that Highland was unlikely to agree to continued forbearance agreements.

Plaintiff filed a stockholder class action alleging that, in connection with the merger with a Highland affiliate (which was the final step in the restructuring transaction), Highland was the controlling stockholder of AHP and had used its control to cause AHP to agree to an unfair transaction. Plaintiff further alleged that AHP's CEO, who was also a director, breached his fiduciary duties through his actions in connection with the merger. The Court noted that plaintiff made the unusual choice to not plead any claims for breach of fiduciary duty against the AHP directors other than the CEO (and implicitly that plaintiff failed to allege that a majority of the directors were interested in the going-private transaction or lacked independence).

As an initial matter, the Court addressed whether plaintiff's claims arose under Delaware or Nevada law. The Court noted that the "guiding principle" in its determination is the internal affairs doctrine, under which claims relating to a corporation's internal affairs are governed by the law of the state of incorporation. Applying the internal affairs doctrine, the Court found that actions taken by AHP (a Delaware corporation) and actions contractually agreed to in the Restructuring Agreement (which was executed by AHP), including the merger with Highland,
were governed by Delaware law, and actions taken by New AHP (a Nevada corporation), other than those required by the Restructuring Agreement, were governed by Nevada law.

The Court then considered, for purposes of defendants' motion to dismiss, whether plaintiff's allegations supported a reasonable inference that, at the time the parties agreed to the merger as part of the Restructuring Agreement, Highland was the controlling stockholder of AHP, despite holding less than a majority of AHP's stock and having no representatives on the board of directors of AHP. While the Court acknowledged that a corporation's creditor, even one that owns a majority of a corporation's debt like Highland, does not owe fiduciary duties to the corporation's stockholders, the Court held that, when the parties agreed to the Restructuring Agreement, Highland's ownership of 48% of the stock and 82% of the debt (which was in default) of AHP was sufficient to support an inference of control such that Highland owed fiduciary duties to the minority stockholders of AHP. The Court further noted that Highland's alleged willingness to enter into multiple forbearance agreements with AHP only until shortly after the expiration of the three-year waiting period required by Section 203 was further support for an inference of Highland's control over AHP. In addition, the Court found that plaintiff's allegations that the fairness opinion that the board of directors relied upon as support for its approval of the merger was based upon an unreasonable discount rate supported the inference that the price offered in the merger was not entirely fair. As a result, the Court found that plaintiff sufficiently alleged that Highland exercised its control over AHP to facilitate the restructuring on unfair terms and thus declined to dismiss the allegations for breach of fiduciary duty against Highland as AHP's controlling stockholder in connection with the merger.

The Court, however, did dismiss the claims against AHP's CEO under both Delaware and Nevada law. Noting that plaintiff challenged only the actions of the CEO-director in connection with the merger and not the actions of the other four directors, the Court held that under both Delaware and Nevada law, a plaintiff is required to allege facts sufficient to overcome the business judgment rule as against a majority of the directors in order to state a claim. Because plaintiff did not allege facts sufficient to do so as to any of the other four directors, the Court dismissed the breach of fiduciary claims against the CEO-director.


In Kahn, et al. v. M&F Worldwide Corp., et al., 88 A.3d 635 (Del. 2014), the Delaware Supreme Court affirmed the Court of Chancery's decision in In re MFW Shareholders Litigation, 67 A.3d 496 (Del. Ch. 2013), which granted summary judgment in favor of a board accused of breaching its fiduciary duties by approving a buyout by a 43.4% controlling stockholder, where the controller committed in its initial proposal not to move forward with a transaction unless approved by a special committee, and further committed that any transaction would be subject to a non-waivable condition requiring the approval of the holders of a majority of the shares not owned by the controller and its affiliates. Stockholder plaintiffs initially sought to enjoin the proposed transaction, but withdrew their preliminary injunction application and instead sought post-closing damage relief. After extensive discovery, the defendants sought summary judgment.
The Court of Chancery held that the transaction could be reviewed under the business judgment standard, rather than entire fairness, and granted the defendants' motion. On appeal, the Supreme Court affirmed the Court of Chancery's decision and adopted its formulation of the standard, holding that the business judgment standard of review will be applied in controller buyouts if and only if: (i) the controller conditions the process of the transaction on the approval of both a special committee and a majority of the minority stockholders, (ii) the special committee is independent, (iii) the special committee is empowered to freely select its own advisors and to say no definitively, (iv) the special committee meets its duty of care in negotiating a fair price, (v) the minority vote is informed, and (vi) there is no coercion of the minority.

The Court further held, however, that if "after discovery triable issues of fact remain about whether either or both of the dual procedural protections were established, or if established were effective, the case will proceed to a trial in which the court will conduct an entire fairness review." The Court also noted that the complaint in the action would have survived a motion to dismiss based on allegations attacking the fairness of the price, which called into question the adequacy of the special committee's negotiations, thereby necessitating discovery on all of the prerequisites to the application of the business judgment rule.


In In re Orchard Enterprises, Inc., Consol. 2014 WL 811579 (Del. Ch. Feb. 28, 2014), the Court of Chancery, by Vice Chancellor Laster, on cross motions for summary judgment, held, among other things, that the entire fairness standard of review will apply at trial to fiduciary duty claims challenging a squeeze-out merger, with the burden of persuasion on the defendants, notwithstanding that the merger was negotiated by a special committee and approved by a majority of the minority stockholders.

The action arose from a 2010 squeeze-out merger by Dimensional Associates, LLC, then the controlling stockholder of The Orchard Enterprises, Inc., a Delaware corporation ("Orchard"), in which Dimensional paid minority stockholders $2.05 per share. After the Court of Chancery held in an appraisal action that the fair value of Orchard's common stock at the time of the merger was $4.67 per share, former minority stockholders sued Dimensional and Orchard's former directors for breach of fiduciary duty and disclosure violations.

In response to a 2009 going-private proposal by Dimensional, the Orchard board formed a special committee with the exclusive power and authority to (i) negotiate with Dimensional, (ii) terminate consideration of Dimensional's proposal, (iii) solicit interest from third parties, and (iv) retain independent advisors. After preliminary negotiations, the special committee concluded that it would recommend a transaction with Dimensional on three conditions: a price in the range of $2.05 to $2.15 per share (subject to confirmation by the committee's financial advisor that such a price would be fair), approval by a majority of the minority stockholders, and a go-shop period. Dimensional countered with $2.00 per share with a go-shop period, but without a majority-of-the-minority approval condition. After further negotiations and advice from its financial advisor, the special committee accepted an offer of $2.05 per share with a go-shop
period and a majority-of-the-minority approval condition. The merger was approved by the stockholders (including a majority of the minority) in July 2010.

In considering plaintiffs' disclosure claims, the Court granted summary judgment in plaintiffs' favor on their disclosure claim that the proxy materials materially misstated whether the merger triggered a preferred stock liquidation preference (an issue resolved in the negative in the earlier appraisal action). One of the inaccurate disclosures relating to the liquidation preference appeared in the notice of meeting as part of the summary of a proposed amendment to the certificate of incorporation that was sought in connection with the merger. Because this summary is one of the few items required to be included in the notice of meeting pursuant to the General Corporation Law of the State of Delaware, the Court held that the misstatement was per se material.

The Court then addressed the appropriate standard of review for plaintiffs' breach of fiduciary duty claims. Referring to the Court's decision in In re MFW Shareholders Litigation, 67 A.3d 496 (Del. Ch. 2013) (which was affirmed on appeal after the Orchard decision was issued), the Court explained that if "a controller agrees up front, before any negotiations begin, that the controller will not proceed with the proposed transaction without both (i) the affirmative recommendation of a sufficiently authorized board committee composed of independent and disinterested directors and (ii) the affirmative vote of a majority of the shares owned by stockholders who are not affiliated with the controller, then the controller has sufficiently disabled itself such that it no longer stands on both sides of the transaction, thereby making the business judgment rule the operative standard of review." But, the Court continued, if "a controller agrees to use only one of the protections, or does not agree to both protections up front, then the most that the controller can achieve is a shift in the burden of proof such that the plaintiff challenging the transaction must prove unfairness." If a pretrial determination regarding burden shifting cannot be made, the defendants will bear the burden at trial of proving entire fairness.

The Court first held that entire fairness, not business judgment, was the appropriate standard of review because Dimensional "did not agree up front, before any negotiations began," that it would not proceed without a qualified special committee and a majority-of-the-minority condition. The Court next held that the approval of the merger by a majority of the minority was not sufficient to shift the burden of proving entire fairness to plaintiffs before trial because Dimensional did not prove as a matter of law that the stockholder vote was fully informed (due to at least one misstatement that was material as a matter of law and the potential for evidence at trial to show that other disclosures were materially false or misleading). The Court further held that the use of the special committee also was not sufficient to shift the entire fairness burden to plaintiffs before trial because (i) at minimum, the members of the special committee must be independent and disinterested, and triable issues of fact existed as to the independence of the chairman of the special committee from Dimensional, and (ii) plaintiffs "pointed to evidence which raises litigable questions about the Special Committee's negotiation process."

The Court declined to determine on summary judgment whether the merger was entirely fair, as fact issues precluded that determination. The Court noted that, although the disclosure violation "provides some evidence of unfairness," at trial "a single disclosure problem may not be outcome-determinative." In addition, while the appraisal decision, which valued Orchard's
common stock at more than two times the merger price, "is certainly evidence of financial unfairness," the merger price nevertheless may fall within a range of fairness for purposes of the entire fairness determination. As a result, the Court held that the action would proceed to trial with the burden on defendants to prove that the merger was entirely fair. The Court noted, however, that if defendants could prove at trial that one or both of the special committee or the majority-of-the-minority vote "was effective, it will 'significantly influence' the determination of fairness and any potential remedy."

With respect to potential remedies, the Court held that (i) Section 102(b)(7) exculpation could not support a summary dismissal of facially independent and disinterested directors because, in an entire fairness case involving a controlling stockholder, it was not possible to rule as a matter of law that plaintiffs' claims solely implicated the duty of care and not the duty of loyalty; (ii) rescissory damages (i.e., "the monetary equivalent of rescission") are one appropriate measure of damages for a squeeze-out merger and could be imposed in this action "if the merger is found not to be entirely fair and if one or more of the defendants are found to have violated their fiduciary duty of loyalty"; (iii) a "quasi-appraisal" remedy (i.e., "the quantum of money equivalent to what a stockholder would have received in an appraisal") is one possible remedy for breaches of the duty of disclosure and thus one form of possible remedy in this action if defendants fail to prove that the merger was entirely fair; and (iv) under certain circumstances, "Delaware law continues to recognize the possibility of a post-closing award of damages as a remedy for a breach of the fiduciary duty of disclosure."

g. In re Morton's Restaurant Group, Inc. Shareholders Litigation, 74 A.3d 656 (Del. Ch. 2013).

In In re Morton's Restaurant Group, Inc. Shareholders Litigation, 74 A.3d 656 (Del. Ch. 2013), the Court of Chancery granted the director defendants' motion to dismiss, reasoning that the plaintiffs' complaint was "devoid of ... well-pled facts compromising the independence of a supermajority of the board, challenging the adequacy of the board's market check, or suggesting that any bidder received favoritism," and also failed to "plead any facts supporting a rational inference of a conflict of interest" on the part of Morton's largest stockholder or any director.

Morton's Restaurant Group, Inc. had a ten-member board that approved the merger. The board included two executives from the company's 27.7% stockholder, Castle Harlan, Inc. The rest of the board included one insider, CEO Christopher Artinian, and seven independent directors. The board conducted a nine-month search for a buyer, beginning in January 2011, before entering into a merger agreement with subsidiaries of Landry's, Inc. Morton's stockholders received $6.90 per share, a 33% premium over Morton's pre-announcement market closing price, and all stockholders received the same per share consideration.

Plaintiffs argued that Castle Harlan was a controlling stockholder acting in its own self-interest and causing the Morton's board to sell the company "quickly" and without regard for the long-term interests of the public stockholders, because Castle Harlan allegedly had a unique need for liquidity to invest in a new investment fund.

First, the Court disagreed with plaintiffs' contention that a 27.7% stockholder, who nominated only two of ten board members, was a controlling stockholder. The Court declined to
equate the facts with those in *In re Cysive, Inc. Shareholders Litigation*—the Court's "most aggressive finding" that a minority blockholder was a controlling stockholder. There, a 35% stockholder was also the company's visionary founder, CEO and chairman. In *Morton's*, the Court found nothing in the complaint suggesting that Castle Harlan could control the corporation in the same way the defendant in *Cysive* had, regardless of the fact that Castle Harlan had once owned the entire company.

Second, the Court reasoned that even if Castle Harlan were a controlling stockholder plaintiffs nonetheless failed to plead facts supporting the inference that Castle Harlan had an improper conflict of interest. Plaintiffs argued that Castle Harlan wanted to sell the company quickly as a means of gaining liquidity for its new investment fund. But the plaintiffs also conceded that, during the sales process, the board reached out to over a hundred bidders, signed over fifty confidentiality agreements, employed two different investment banks to help test the market, and treated all bidders evenhandedly. In fact, plaintiffs admitted they could not identify a single logical buyer that Morton's did not contact. The Court therefore concluded that plaintiffs failed to plead facts supporting the conclusion that the merger was a fire sale in which Castle Harlan's interest in selling quickly trumped its own natural interest in maximizing the sales price, and therefore created a conflict of interest with the other stockholders.

Moreover, the Court noted that when the largest stockholder supports an arm's-length transaction that spreads the merger consideration ratably across all stockholders, without any special treatment for itself, the stockholder's conduct presumptively falls within a safe harbor and immunizes the transaction from challenge.

The Court also rejected the argument that the board breached its fiduciary duties by allowing its financial advisor to provide financing for the Landry's bid. Morton's M&A Committee had weighed the decision and only allowed its advisor to finance the bid if it recused itself from further negotiations and reduced its fee by $600,000. The company took those funds and hired a second financial advisor. The Court concluded that these steps could not support an inference that the directors breached their duty of loyalty.

Because Morton's had an exculpatory provision in its certificate of incorporation, plaintiffs needed to plead a non-exculpated breach of duty to survive a motion to dismiss. Because the Court of Chancery concluded that the board did not breach its duty of loyalty and did not act in bad faith in agreeing to the merger agreement, it granted the motion to dismiss.

### II. AMENDMENTS TO THE GENERAL CORPORATION LAW.

#### A. 2016 Amendments (effective August 1, 2016)

House Bill 371, which contains several important amendments to the General Corporation Law of the State of Delaware (the "DGCL"), was signed by Delaware Governor Jack Markell on June 16, 2016. The 2016 legislation includes, among other things:

1. **Section 251(h)—Intermediate-Form Mergers**

   In 2013, the DGCL was amended to eliminate, subject to certain conditions, the need for a back-end merger vote in a two-step merger involving a front-end tender or exchange offer.
Since its adoption, Section 251(h) has become a preferred method of accomplishing a tender offer in public M&A transactions. The 2016 amendments to Section 251(h) are designed largely to clarify the procedures and requirements of the subsection.

Eligibility to Use Section 251(h): Offers for Different Classes or Series of Stock

As originally drafted, Section 251(h) was intended to make the “intermediate-form” merger available principally to public companies. Thus, prior to the 2016 amendments, Section 251(h) provided that, unless expressly required by the certificate of incorporation, no vote of stockholders of a target corporation whose shares are listed on a national securities exchange or held of record by more than 2,000 holders immediately prior to the execution of the merger agreement is required to authorize the merger, so long as the other requirements of the subsection are satisfied. The 2016 amendments to Section 251(h) clarify that the subsection applies to any target corporation that has any class or series of stock listed on a national securities exchange or held of record by more than 2,000 holders immediately prior to the execution of the merger agreement—and that not all classes or series of stock need be so listed or held. Thus, a target corporation whose common stock is listed on a national securities exchange may take advantage of Section 251(h), even if it has a series of preferred stock that is not listed or held of record by more than 2,000 holders. The 2016 amendments also clarify that the offer for the stock of the target corporation contemplated by the subsection (the “Offer”) may be effected through separate offers for separate classes or series of stock.

Additional Minimum Conditions

The 2016 amendments clarify that that the Offer may be conditioned on the tender of a minimum number or percentage of the shares of the stock of the constituent corporation, or of any class or series thereof.

Rollover Stock

Prior to the 2016 amendments, one of the requirements of accomplishing a merger under Section 251(h) was that, following the consummation of the Offer, the stock irrevocably accepted for purchase or exchange and received by the depositary, plus the stock otherwise owned by the offeror, equals the percentage of stock, and of each class and series thereof, that would otherwise be required to adopt the merger agreement. The 2016 amendments permit, for purposes of determining whether such requirement has been met, the inclusion of shares of stock of the target held by any person that owns, directly or indirectly, all of the outstanding stock of the offeror, or that is a direct or indirect wholly-owned subsidiary of such person or persons or of the offeror (collectively, “offeror affiliates”). The 2016 amendments also provide that shares of stock of the target corporation that are the subject of a written agreement requiring such shares to be transferred, contributed or delivered to the offeror or any offeror affiliate in exchange for stock or other equity interests in the offeror or any offeror affiliate may be counted for purposes of determining whether the minimum condition required by the statute has been met, so long as such shares are in fact so transferred, contributed or delivered before the effective time of the merger (“rollover stock”). The 2016 amendments further provide that rollover stock and shares of the target corporation held in treasury, by any direct or indirect wholly-owned subsidiary of the target, or by the offeror affiliates are excluded from the requirement that they be converted in the merger into, or into the right to receive, the same consideration paid in the Offer. In this
manner, the 2016 amendments provide a more direct and efficient means of enabling certain target stockholders to “rollover” their shares in the transaction.

**Receipt of Stock**

The 2016 amendments clarify the means by which shares of stock of the target corporation are “received” for purposes of the determining whether the minimum tender condition required by the subsection has been satisfied. The 2016 amendments clarify that shares represented by certificates will be “received” upon physical receipt of the certificate, together with an executed letter of transmittal, so long as the certificate representing such shares was not cancelled prior to consummation of the Offer. Under the 2016 amendments, uncertificated shares held of record by a clearing corporation as nominee would be “received” by transfer into the depository’s account by means of an agent’s message, and all other uncertificated shares would be “received” by physical receipt of an executed letter of transmittal by the depository. In all cases, however, under the 2016 amendments, uncertificated shares would cease to be “received” to the extent they have been reduced or eliminated due to any sale of such shares prior to the consummation of the Offer. The 2016 amendments prescribe what constitutes an “agent’s message” for these purposes, specifying that it is a message transmitted by the clearing corporation acting as nominee, received by the depository, and forming part of the book-entry confirmation, which states that the clearing corporation has received an express acknowledgment from a stockholder that such stockholder has received the Offer and agrees to be bound by the terms of the Offer, and that the offeror may enforce such agreement against such stockholder.

2. **Section 262—Appraisal Rights**

The 2016 amendments amend Section 262 of the DGCL, which governs appraisal rights, in two principal respects. First, the 2016 amendments impose de minimis limitation on appraisal claims in certain public company transactions. Second, the 2016 amendments give surviving corporations the option to pay each stockholder entitled to appraisal at an earlier stage of the appraisal proceeding as a means of cutting off the accrual of interest under the statute with respect to the amount paid.

**De Minimis Exception**

To implement the first of these changes, the 2016 amendments provide that the Court of Chancery shall dismiss an appraisal proceeding as to all stockholders otherwise entitled to appraisal rights, unless (1) the total number of shares entitled to appraisal exceeds 1% of the outstanding number of shares of the class or series entitled to appraisal; (2) the value of the consideration for such total number of shares exceeds $1 million; or (3) the merger was effected as a “short-form” merger under Section 253 or Section 267 of the DGCL. The amendment is designed to mitigate the risk that a plaintiff will use the appraisal process solely to gain leverage in a settlement negotiation. That is, the amendment is designed to prevent stockholders from demanding an appraisal in cases where the number of shares (or the value of those shares) is minimal, but the surviving corporation may be inclined to settle the claim to avoid the litigation costs attendant to the appraisal proceeding. As noted above, however, “short-form” mergers would not be subject to the de minimis carve-out, because appraisal may be the stockholders’ only remedy in such a merger. In addition, the de minimis carve-out would apply only in cases
where the shares as to which appraisal is sought were listed on a national securities exchange immediately before the merger or consolidation.

In connection with the foregoing changes, the 2016 amendments provide that, where the corporation has adopted a provision in its certificate of incorporation granting appraisal rights in circumstances where they would not otherwise exist (e.g., in connection with amendments to the certificate of incorporation or sales of all or substantially all of the corporation’s assets), an appraisal proceeding brought thereunder will be dismissed if the de minimis carve-out would apply.

**Tender of Payment**

To implement the second of the principal changes to Section 262, the 2016 amendments modify Section 262(h) to provide corporations the option of limiting the accrual of statutory interest on appraisal awards by making an early payment to the appraisal claimants. Prior to the 2016 amendments, Section 262(h) provided that, unless the Court of Chancery determines otherwise for good cause shown, interest on the amount that is determined to be the “fair value” of appraisal shares will accrue from the effective date of the merger through the date of payment of judgment, will be compounded quarterly, and will accrue at 5% over the Federal Reserve discount rate (including any surcharge) as established from time to time during that period. Since payment of “fair value” in an appraisal proceeding is not made until such amount is determined after trial, interest accrues on the full amount of the award, even if the fair value is ultimately determined to be the same as or less than the consideration paid in the merger. The 2016 amendments permit the surviving corporation to pay the appraisal claimants, at any time before the entry of judgment in the proceeding, a sum of money that it determines to be appropriate.

After making the payment, interest would only accrue upon the sum of (1) the difference, if any, between the amount so paid and the fair value of the shares as determined by the Court of Chancery, and (2) interest theretofore accrued, unless paid at that time. Any surviving corporation electing to make such a payment would be required to make the payment to all of the appraisal claimants, unless the surviving corporation has a good faith basis for contesting a particular claimant’s entitlement to an appraisal of such claimant’s shares, in which case the surviving corporation may elect to make payment only to those stockholders whose entitlement to appraisal is uncontested. The amount that the surviving corporation pays would not give rise to any inference as to the fair value of the shares as to which an appraisal is sought.

3. **Section 111—Jurisdiction**

Section 111(a) of the DGCL generally provides that any civil action to interpret, apply, enforce or determine the validity of provisions of various documents, agreements and instruments may be brought in the Court of Chancery, except to the extent that a statute confers exclusive jurisdiction on a court, agency or tribunal other than the Court of Chancery. Prior to the 2016 amendments, Section 111(a)(2) of the DGCL conferred such jurisdiction with respect to any instrument, document or agreement by which a corporation creates or sells, or offers to create or sell, any of its stock, or any rights or options respecting its stock. The 2016 amendments modify Section 111(a)(2) to permit the Court of Chancery to exercise subject matter jurisdiction over civil actions involving certain other instruments, documents, or agreements, including (i) those to which a Delaware corporation is a party and pursuant to which one or more
holders of the corporation’s stock sell or offer to sell any of such stock, and (ii) those by which a Delaware corporation agrees, subject to specified conditions, to sell, lease or exchange any of its property or assets.

4. **Section 141—Board of Directors and Committees**

*Default Quorum and Voting Requirements for Committees and Subcommittees*

The 2016 amendments modify Section 141(c) of the DGCL, which deals with the establishment of committees of the board of directors, to specify the default quorum and voting requirements for committees and subcommittees. After the 2016 amendments, a majority of the directors then serving on a committee or a subcommittee would constitute a quorum (except as otherwise provided in the certificate of incorporation, bylaws, resolutions of the board establishing the committee or resolutions of the committee establishing the subcommittee, provided that in no case may a quorum be less than one-third of the directors serving on the committee or subcommittee). The 2016 amendments also provide that the vote of a majority of the members present at a meeting of the committee or subcommittee at which a quorum is present shall be the act of the committee or subcommittee, unless the certificate of incorporation, the bylaws, the resolutions of the board establishing the committee or the resolutions of the committee establishing the subcommittee require a greater number.

*References to Subcommittees*

The 2016 amendments clarify that references in the DGCL to board committees (and committee members) will be deemed to include references to subcommittees (and subcommittee members). The 2016 amendments make other conforming changes to Section 141.

5. **Section 158—Stock Certificates**

Prior to the 2016 amendments, Section 158 of the DGCL provided that every holder of stock represented by certificates shall be entitled to have a certificate signed by, or in the name of the corporation by the chairperson or vice-chairperson of the board of directors, or the president or vice-president, and by the treasurer or an assistant treasurer, or the secretary or an assistant secretary of such corporation representing the number of shares registered in certificate form. (It should be noted that Section 142 also requires the corporation to have officers as may be necessary to enable it to sign instruments and stock certificates.) In recent years, many corporations have dispensed with the offices of “President” and “Treasurer” and have assigned the role historically assumed by the President and Treasurer to the Chief Executive Officer and Chief Financial Officer, respectively. In light of developments in practice, the 2016 amendment to Section 158 provides that any two officers of the corporation who are authorized to do so may execute stock certificates on behalf of the corporation. Thus, as a result of the 2016 amendments, any two duly empowered officers, regardless of their official title in the bylaws, would be authorized to execute stock certificates. The 2016 amendment is not intended to change the existing law that the signatures on a stock certificate may be the signatures of the same person, so long as each signature is made in a separate officer capacity of such person.
6. Section 311—Restoration

The 2016 amendments modify Section 311 of the DGCL to include a procedure to restore a corporation’s certificate of incorporation after it has expired by limitation. This change is consistent with Section 278 of the DGCL, which currently provides that Sections 279 through 282 of the DGCL, relating to corporations that have dissolved, apply to any corporation that has expired by its own limitation. Section 311 is also amended to clarify that a corporation desiring to revoke its dissolution or restore its certificate of incorporation must file all annual franchise tax reports that the corporation would have had to file if it had not dissolved or expired by limitation and pay all franchise taxes that the corporation would have had to pay if it had not dissolved or expired.

7. Section 312—Revival

The 2016 amendments to Section 312 distinguish the procedure to extend the term of a corporation’s certificate of incorporation or to restore a corporation’s certificate of incorporation if it has expired by limitation from the procedure to revive a corporation’s certificate of incorporation when it has become forfeited or void. Under the 2016 amendments, Section 312 applies only to a corporation whose certificate of incorporation has become forfeited or void. Accordingly, the 2016 amendments modify Section 312 such that it uses only the term “revival” to reflect the process for reviving such a corporation. (The 2016 amendments eliminate the terms “renewal,” “extension” and “restoration.”)

The 2016 amendments also clarify and simplify the procedures to be followed by a Delaware corporation to revive its certificate of incorporation after the certificate has become forfeited or void. (The amendments clarify that the provisions of Section 312 do not apply to a corporation whose certificate of incorporation has been forfeited or revoked by the Court of Chancery pursuant to Section 284.) Of significance, the 2016 amendments provide that a majority of the directors then in office, even if less than a quorum, or the sole director in office, may authorize the revival of the certificate of incorporation. The 2016 amendments identify such directors as those who, but for the certificate of incorporation having become forfeited or void, would be the duly elected or appointed directors of the corporation. The 2016 amendments also clarify the process for elections of directors if no directors are in office and the effect of a revival with respect to actions taken by the corporation’s directors, officers, agents and stockholders.

B. 2015 Amendments (effective August 1, 2015, unless otherwise noted)

Senate Bill 75, which contains several important amendments to the General Corporation Law of the State of Delaware (the "DGCL"), was signed by Delaware Governor Jack Markell on June 24, 2015. The 2015 legislation includes, among other things:

- **Prohibition on Fee Shifting.** The legislation amends Sections 102 and 109 to prohibit "fee shifting" provisions in certificates of incorporation and bylaws of stock corporations.

- **Authorization of Delaware Forum Selection Clauses.** The legislation adds new Section 115 to validate provisions in certificates of incorporation and bylaws that select the Delaware courts as the exclusive forum for "internal corporate claims."
• **Flexibility in Stock and Option Issuances.** The legislation amends Section 152 to provide greater flexibility in stock issuances, and makes corresponding amendments to Section 157 in respect of the authorization of rights and options to purchase stock.

• **Ratification of Defective Corporate Acts and Stock.** The legislation amends Sections 204 and 205 to clarify and streamline the procedures for ratifying defective corporate acts and stock.

• **Public Benefit Corporations.** The legislation amends Section 363 to loosen the restrictions on (x) an existing corporation becoming a "public benefit corporation" and (y) a public benefit corporation ceasing to be a public benefit corporation. It also adds a "market out" exception to the appraisal rights provided in Section 363(b) in connection with a corporation becoming a public benefit corporation.

The amendments (other than the amendments to Section 204, Section 205 and Section 363(b)) became effective on August 1, 2015. The amendments to Sections 204 and 205 apply to resolutions adopted by the board ratifying defective corporate acts or stock on or after August 1, 2015. The amendments to Section 363(b) apply to agreements of merger or consolidation entered into on or after August 1, 2015 and to amendments to the certificate of incorporation approved by the board of directors on or after August 1, 2015.

The 2015 amendments to the DGCL effect, among others, the following significant changes.

8. **Prohibition on Fee-Shifting Provisions.**

The 2015 legislation invalidates so-called fee-shifting provisions in certificates of incorporation and bylaws of stock corporations. The legislation was proposed in response to the Delaware Supreme Court's ruling in *ATP Tour, Inc. v. Deutscher Tennis Bund*, 91 A.3d 554 (Del. 2014). In *ATP*, the Court held that a bylaw that made the members of a nonstock corporation liable for the corporation's legal expenses in certain intra-corporate disputes was facially valid—which is to say that, without regard to equitable considerations surrounding its adoption or use, the bylaw was not in contravention of law. The new legislation limits the *ATP* Court's ruling to nonstock corporations.

To accomplish the foregoing, the legislation adds new Section 102(f) to the DGCL. The new subsection provides that a certificate of incorporation may not contain any provision imposing liability on a stockholder for the attorneys' fees or expenses of the corporation or any other party in connection with an "internal corporate claim," as defined in new Section 115 (discussed below). The legislation adds a similar restriction on fee-shifting provisions to Section 109(b) of the DGCL, which deals with the provisions that may be set forth in the bylaws. The legislation also amends Section 114 to provide that the restrictions on fee-shifting provisions do not apply to nonstock corporations.

Although it invalidates fee-shifting provisions in certificates of incorporation and bylaws of stock corporations, the legislation does not prevent the imposition of such provisions pursuant to any writing signed by a stockholder against whom the provision is to be enforced. Thus, corporations may continue to negotiate for fee-shifting provisions with one or more stockholders in private arrangements, including stock purchase agreements or stockholders' agreements.
9. **Forum-Selection Provisions.**

The 2015 legislation adds new Section 115 to the DGCL, authorizing the certificate of incorporation or bylaws to include forum-selection provisions. Consistent with the Delaware Court of Chancery's holding in *Boilermakers Local 154 Retirement Fund v. Chevron Corporation*, 73 A.3d 934 (Del. Ch. 2013), Section 115 confirms that the certificate of incorporation or bylaws of the corporation may specify that "internal corporate claims" (i.e., claims, including those brought 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 the DGCL confers jurisdiction upon the Court of Chancery) must be brought solely and exclusively in the Delaware courts, including the federal court.

New Section 115 does not expressly authorize or prohibit provisions of the certificate of incorporation or bylaws that select a forum other than the Delaware courts as an additional forum in which an internal corporate claim may be brought, but it does invalidate any such provision selecting courts outside of Delaware, or any arbitral forum, to the extent such provision would purport to prohibit litigation of internal corporate claims in the Delaware courts. As with the fee-shifting amendments, however, Section 115 does not prevent the application of a provision selecting a forum other than the Delaware courts pursuant to a stockholders' agreement or other writing signed by the stockholder against whom the provision is to be enforced.

Section 115 is not intended to shield the manner in which a forum-selection provision has been adopted from equitable review, nor is it intended to foreclose judicial review as to whether the terms of any such provision operate reasonably under particular factual circumstances. Moreover, it is not intended to authorize a provision that would purport to foreclose suit in a federal court based on federal jurisdiction, nor is it intended to limit or expand the jurisdiction of the Delaware Court of Chancery or the Delaware Superior Court.

10. **Stock Issuance.**

The 2015 legislation amends Section 152 of the DGCL to clarify that the board of directors may authorize stock to be issued in one or more transactions in such numbers and at such times as is determined by a person or body other than the board of directors or a committee of the board, so long as the resolution of the board or committee, as applicable, authorizing the issuance fixes the maximum number of shares that may be issued as well as the time frame during which such shares may be issued and establishes a minimum amount of consideration for which such shares may be issued. The minimum amount of consideration cannot be less than the consideration required pursuant to Section 153 of the DGCL, which, as a general matter, means that shares with par value may not be issued for consideration having a value less than the par value of the shares. The legislation clarifies that a formula by which the consideration for stock is determined may include reference to or be made dependent upon the operation of extrinsic facts, thereby confirming that the consideration may be based on, among other things, market prices on one or more dates or averages of market prices on one or more dates. Among other things, the legislation clarifies that the board (or duly empowered committee) may authorize stock to be issued pursuant to "at the market" programs without separately authorizing each individual stock issuance pursuant to the program. In addition, the legislation allows the board to delegate to officers the ability to issue restricted stock on the same basis that the board may delegate to officers the ability to issue rights or options under Section 157(c) of the DGCL.
11. Consideration for Options and Rights.

Consistent with the amendments to Section 152, the 2015 legislation amends Section 157 of the DGCL, which deals with the creation and issuance of rights and options to purchase stock, to clarify that a formula by which the consideration for stock issued upon the exercise of rights and options is determined may include reference to or be made dependent upon the operation of extrinsic facts, such as market prices on one or more dates, or averages of market prices on one or more dates.


The 2015 legislation makes several amendments to Section 204 of the DGCL, which sets forth the procedures for ratifying stock or corporate acts that, due to a "failure of authorization," would be void or voidable, to clarify and confirm various aspects of its operation and to provide additional guidance as to the specific requirements for the filing of certificates of validation. The legislation makes conforming amendments to Section 205 of the DGCL, which confers jurisdiction on the Court of Chancery to hear and determine, among other things, the validity of any ratification effected pursuant to Section 204 and the validity of any corporate act or transaction.

a. Multiple Defective Corporate Acts.

The basic premise of Section 204 is that, to ratify a defective corporate act or stock, the board must first take action to effect the ratification. The board's action must then be submitted to stockholders for adoption if the underlying act is one that requires a stockholder vote, or is one that would have required a stockholder vote, either at the time the ratification is submitted for adoption or at the time the original act was taken. Pre-amendment Section 204 requires that the board adopt a "resolution" setting forth, among other things, the defective corporate act being ratified and provides that, where a stockholder vote is or was required, the stockholders must adopt that resolution. As amended, Section 204 dispenses with the notion of the board's ratifying resolution, requiring instead that the board may initiate the ratification process by approving the ratification of one or more defective corporate acts. Under amended Section 204, it is clear that the board may ratify (or initiate the process to ratify) multiple defective corporate acts in a single set of resolutions. Section 204(c), which deals with the circumstances under which a defective corporate act must be approved by stockholders, has been revised to provide that each defective corporate act—rather than the board's resolution ratifying a defective corporate act—that requires or required a vote of stockholders must be submitted to stockholders for their approval.

b. Ratification of the Failure of the Incorporator to Elect the Initial Board.

New Section 204(b)(2) addresses the situation in which the corporation's initial directors have not been (and were not intended to be) elected in the original certificate of incorporation, and the original incorporator never elected the initial directors or evidence of such election cannot be located. Under the new subsection, the corporation's "de facto" directors may adopt a resolution that ratifies the election of those persons who, despite having not been named in the certificate of incorporation or duly elected by the incorporator as the initial directors, first took action on behalf of the corporation as the board of directors. The new subsection does not, by negative implication or otherwise, preclude the filing of a certificate of correction pursuant to
Section 103(f) of the DGCL to correct a certificate of incorporation that was intended to (but did not) name the initial directors, nor does it prevent the incorporator from executing (albeit late) an instrument signed in the manner permitted by Section 108 of the DGCL to elect such initial directors.

c. **Stockholder Approval.**

Section 204, as originally adopted, was intended to provide that only the holders of valid stock would be entitled to vote on any ratifying resolution required to be submitted to stockholders for adoption. Due to the retroactive effect that Section 204 provides to defective corporate acts, some practitioners raised the concern that the ratification of a defective corporate act arguably would cause putative stock that is "outstanding" at the time of the record date for determining stockholders entitled to vote to be retroactively cured such that holders of putative stock would be deemed to be holders of valid stock entitled to vote as of the earlier record date—and their putative shares would be counted in the ratification vote for quorum and voting purposes. As amended, Section 204(d) makes clear that the only stockholders entitled to vote on the ratification of a defective corporate act, or be counted for purposes of a quorum for such vote, are the holders of record of valid stock as of the record date for determining stockholders entitled to vote thereon. Section 204(f), which provides the retroactive effect to defective corporate acts, has also been amended to clarify the point.

d. **Certificates of Validation.**

Pre-amendment Section 204 provides that a certificate of validation must be filed with the Delaware Secretary of State whenever the underlying defective corporate act that is being ratified would have required the filing of an instrument under another section of the DGCL. Those certificates of validation must include a copy of the board's resolutions ratifying the defective corporate act as well as the information that would have been required by such other section of the DGCL. Due to the significant variation in defective corporate acts and the resolutions used to ratify them, certificates of validation, unlike most other instruments filed under the DGCL, tend to lack uniformity. As a result, Section 204(e) has been amended to clarify the requirements in respect of certificates of validation, with the ultimate goal of providing greater uniformity.

As amended, Section 204(e) no longer requires that a certificate of validation include a copy of the board's ratifying resolutions and instead provides that the certificate of validation must set forth specified information regarding the defective corporate act and the related failure of authorization. In addition, Section 204(e) requires different types of information to be set forth on or attached to the certificate of validation depending on the history of filings (or lack thereof) with the Delaware Secretary of State in respect of the applicable defective corporate act. The circumstances under which the certificates would vary are as follows:

- Where a certificate in respect of the defective corporate act had previously been filed and no changes are required to give effect to the ratification of such act, Section 204(e) requires the certificate as previously filed with the Delaware Secretary of State to be attached to the certificate of validation as an exhibit.
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- Where a certificate in respect of the defective corporate act had previously been filed and changes are required to that certificate to give effect to the ratification of such act, Section 204(e) requires that a certificate containing all of the information required under the other section of the DGCL, including the changes necessary to give effect to the ratification of the defective corporate act, be attached to the certificate of validation as an exhibit. In that case, the certificate of validation must state the date and time as of which the certificate attached to it would have become effective.

- Where no certificate had previously been filed and the filing of a certificate was required to give effect to the ratification of a defective corporate act, Section 204(e) requires that a certificate containing all of the information required under the other section of the DGCL be attached to the certificate of validation as an exhibit. In that case, the certificate of validation must also state the date and time as of which the certificate attached to it would have become effective.

e. Action by Written Consent and Notice.

Section 204, as originally drafted, included concepts relating to the submission of the board's ratifying resolution to stockholders at a duly called and held meeting. As with virtually all other sections of the DGCL, Section 204 did not specifically reference the stockholders' power to act by written consent to approve any ratifying resolution, as it was understood that, pursuant to Section 228 of the DGCL, unless otherwise restricted by the certificate of incorporation, stockholders could act by written consent in lieu of a meeting with respect to any matter required or permitted to be acted upon by stockholders at a meeting. Nevertheless, the procedures for notice in cases where stockholders are acting by written consent in lieu of a meeting were viewed as fairly difficult to parse under existing Section 204. The amendments to Section 204 clarify these procedures.

As amended, Section 204(g) expressly provides that, where the ratification of a defective corporate act is approved by consent of stockholders in lieu of a meeting, the notice required by Section 204(g) may be included in the notice required to be given pursuant to Section 228(e). Section 204(g) now clarifies that, where a notice sent pursuant to Section 204(g) is included in a notice sent pursuant to Section 228(e), the notice must be sent to the parties entitled to receive the notice under both Section 204(g) and Section 228(e). Section 204(g) further clarifies that no such notice need be provided to any holder of valid shares that acted by written consent in lieu of a meeting to approve the ratification of a defective corporate act or to any holder of putative shares who otherwise consented thereto in writing.

In addition, Section 204(g) provides that corporations that have a class of stock listed on a national securities exchange may give the notice required by Section 204(g) by means of a public filing with the Securities and Exchange Commission.

f. Validation Effective Time.

Prior to the amendment, Section 204(h)(6) defined "validation effective time" as the later of (x) the time at which the ratification of the defective corporate act is approved by stockholders (or, if no vote is required, the time at which the notice required by Section 204(g) is given) and (y) the time at which any certificate of validation has become effective. As amended, Section
204(h)(6) confirms that, in respect of the ratification of any defective corporate act for which the "validation effective time" is the time at which the stockholders approve the ratification of the defective corporate act, such validation effective time occurs at the time of stockholder approval regardless of whether the stockholders are acting at a meeting or by consent in lieu of a meeting pursuant to Section 228. Although the amendment clarifies that, in such cases, the validation effective time commences upon the stockholders' approval of the ratification of the defective corporate act, a corresponding amendment to Section 204(g) confirms that the 120-day period during which stockholders may challenge the ratification of a defective corporate act commences from the later of the validation effective time and the time at which the notice required by Section 204(g) is given. In light of the corresponding amendment to the commencement of the 120-day challenge period in Section 204(g), Section 204(h)(6), as amended, further provides that where the ratification of the defective corporate act does not require stockholder approval or the filing of a certificate of validation, the validation effective time is the time at which the board of directors adopts the resolutions to approve the ratification of the defective corporate act.

The definition of "validation effective time" has also been amended in a manner that permits the board of directors to fix a future validation effective time for any defective corporate act that does not require the filing of a certificate of validation. Where the board of directors fixes a future validation effective time, such validation effective time may not precede the time at which a defective corporate act requiring a vote of stockholders is approved by stockholders. Again, the 120-day period during which challenges to the ratification may be brought would commence from the later of the validation effective time and the time at which the notice required by Section 204(g) is given. The amendments are intended to obviate logistical issues that may arise in connection with the delivery of notices in situations where multiple defective corporate acts are being ratified at the same time. As amended, Section 204(h)(6) enables the board to set one date on which the ratification of all defective corporate acts approved by the board will be effective, regardless of when the notice under Section 204(g) is sent or when each defective corporate act would otherwise become effective under Section 204(h)(6).

g. 120-Day Challenge Period.

Consistent with the amendments to Sections 204(g) and 204(h)(6) in respect of the validation effective time and the commencement of the 120-day period during which an action may be brought to challenge the ratification of a defective corporate act, Section 205(f) has been amended to provide that no such action may be brought after the expiration of 120 days from the later of the validation effective time and the time that notice of the ratification is given under Section 204(g), if notice is required to be given under such section.

13. Restatements of Certificates of Incorporation.

In 2014, Section 242 of the DGCL was amended to eliminate the requirement to obtain a stockholder vote on an amendment to the certificate of incorporation to effect a change of the corporation's name. In furtherance of that amendment, Section 245(c) has been amended to clarify that a restated certificate of incorporation need not state that it does not further amend the provisions of the corporation's certificate of incorporation if the only amendment is to change the corporation's name without a vote of the stockholders.
14. Corporate Name.

The 2015 legislation permits the Division of Corporations of the Delaware Secretary of State (the "Division") to waive, under limited circumstances, the requirement with respect to the use of a name that has been reserved for use with the Division or is on the Division's records. Section 102(a)(1)(ii) of the DGCL provides that a Delaware corporation's name as set forth in its certificate of incorporation shall be such as to distinguish it upon the Division's records from the names that have been reserved for use with the Division and from the names on record with the Division of each other corporation, partnership, limited partnership, limited liability company or statutory trust organized or registered as a domestic or foreign corporation, partnership, limited partnership, limited liability company or statutory trust under the laws of the State of Delaware, except with the written consent of the person who has reserved the name of such corporation, partnership, limited partnership, limited liability company or statutory trust. The 2015 legislation adds a further exception such that, without prejudicing any rights of the person who has reserved the name or of such other corporation, partnership, limited partnership, limited liability company or statutory trust, the Division may waive the requirement if the corporation seeking such waiver demonstrates to the satisfaction of the Delaware Secretary of State that (a) such corporation or a predecessor entity previously has made substantial use of the name or a substantially similar name, (b) such corporation has made reasonable efforts to secure such written consent, and (c) the waiver is in the interest of the State of Delaware.

15. Public Benefit Corporations.

The 2015 legislation makes several changes with respect to the provisions of the DGCL dealing with public benefit corporations. Section 362(c) has been amended to eliminate the requirement that a public benefit corporation include in its name a specific "public benefit corporation" identifier. If the identifier is excluded, however, the corporation must, before issuing or disposing of shares, provide notice to any person acquiring the shares so issued or disposed of that the corporation is a public benefit corporation, unless the issuance is being made pursuant to an offering under the Securities Act of 1933 or the corporation has at the time of issuance a class of stock registered under the Securities Exchange Act of 1934.

The legislation also changes Section 363(a) and Section 363(c) to relax the voting standards required to approve charter amendments or transactions in which a corporation that is not a public benefit corporation becomes a public benefit corporation or its stockholders become stockholders of a public benefit corporation, as well as charter amendments or transactions in which a public benefit corporation ceases to be a public benefit corporation or its stockholders become stockholders of a corporation that is not a public benefit corporation. Prior to the amendments, Sections 363(a) and 363(c) provided that such actions required the approval of 90% of the outstanding shares of each class of stock, whether voting or nonvoting. The new legislation reduces the voting standard on these matters to 66 2/3% of the outstanding shares entitled to vote.

Prior to the 2015 amendments, Section 363(b) provided that stockholders of a corporation that is not a public benefit corporation are entitled to statutory appraisal rights in cases where the corporation amends its certificate of incorporation to become a public benefit corporation or effects a merger or consolidation that results in the shares of its stock becoming, or being converted into the right to receive, shares of a public benefit corporation. The 2015 amendments
to Section 363(b) provide a "market out" exception to these rights (similar to the exception that applies to appraisal rights generally under Section 262). Under the amendments, no such appraisal rights are available for shares of stock (or depository receipts in respect thereof) that, at the record date fixed to determine stockholders entitled to receive notice of the meeting of stockholders to act upon any such agreement of merger or consolidation, or to adopt any such amendment, were either listed on a national securities exchange or held of record by more than 2,000 holders, unless, in the case of a merger or consolidation, the holders are required by the terms of the merger to accept anything other than shares of stock (or depository receipts in respect thereof) that will be listed on a national securities exchange or held of record by more than 2,000 holders, cash in lieu of fractional shares (or fractional depository receipts), or any combination of the foregoing.

C. Delaware Rapid Arbitration Act.

On April 2, 2015, Delaware Governor Jack Markell signed a highly specialized arbitration statute into law: the Delaware Rapid Arbitration Act (the "DRAA"). The DRAA provides a quick and inexpensive process for starting an arbitration proceeding, accelerates the arbitration itself to ensure a swift resolution, eliminates confirmation proceedings, and allows for challenges directly to the Delaware Supreme Court.

Speed and efficiency are key features of the DRAA. Arbitrations brought under the new statute must be completed within 120 days of the arbitrator accepting appointment. With the unanimous consent of the parties and the arbitrator, that timeline can be extended to 180 days. Arbitrators who do not issue final awards within the prescribed timeframe face reductions in their fees corresponding to the length of the delay in the issuance of the final award.

The new legislation gives broad powers to expert arbitrators. Arbitrability is determined solely by the arbitrator, who also has the authority to grant a full array of injunctive and other remedies. The arbitrator's final award is deemed confirmed simply by the passage of time. Challenges to the final award are made directly to the Delaware Supreme Court, skipping review by the trial court. Unless altered by contract, such challenges proceed under the narrow Federal Arbitration Act standard of review.

The DRAA was designed to address resolution of disputes where sophisticated parties most need no-nonsense, swift resolution. The DRAA may not be used to resolve disputes involving consumers, and it may only be invoked against parties who sign an express agreement to arbitrate under the DRAA. One of the parties must be a Delaware business entity, although it need not be located in Delaware.

The DRAA was developed by an interdisciplinary team of arbitration practitioners led by Delaware's Chief Justice Leo E. Strine Jr., Delaware's Chancellor Andre G. Bouchard, and Delaware's Secretary of State Jeffrey Bullock. Richards, Layton & Finger lawyers also played key roles in developing the DRAA: two of our partners were deeply involved in drafting the statute, and a third played a principal role in drafting the proposed model rules.
D. **2014 Amendments (effective August 1, 2014).**

Legislation amending the DGCL was adopted by the Delaware General Assembly and was signed by the Governor of the State of Delaware on July 15, 2014. The amendments to the DGCL became effective on August 1, 2014 (except for the amendments to Section 251(h), as further described below). The amendments result in several significant changes to the DGCL. The primary components of the amendments are as follows:

1. **Section 251(h) Mergers.**

   In 2013, the DGCL was amended to eliminate, subject to certain conditions, the need for a back-end merger vote in a two-step merger involving a front-end tender or exchange offer. Early experience with Section 251(h) demonstrated the statute's utility, but also gave rise to various questions among practitioners regarding certain aspects of its use and application. The amendments to the DGCL are designed to address those questions.

   The amendments eliminate the prohibition against the statute's use in circumstances where a party to the merger agreement is an "interested stockholder" (as defined in Section 203 of the DGCL). This change, among other things, eliminates any question as to whether an offeror's entry into certain voting agreements or other arrangements with existing stockholders would render the offeror an "interested stockholder" and therefore incapable of taking advantage of Section 251(h). The amendments also clarify various timing and other requirements in respect of the back-end merger. The amendments replace the existing "ownership" requirement in respect of the target's stock with a requirement that, following the offer, the stock irrevocably accepted for purchase or exchange and received by the depository prior to the expiration, plus the stock owned by the consummating corporation, must equal at least the percentage of stock (and of each class or series) that, absent Section 251(h), would be required to adopt the merger. The amendments also replace the existing language requiring that shares of the target corporation "not to be canceled in the merger" receive the same consideration paid to holders of shares of the same class or series upon the consummation of the offer with language providing that shares that are the "subject of and not irrevocably accepted for purchase or exchange in the offer" must be converted into the same consideration paid for shares of the same class or series irrevocably accepted for purchase or exchange in the offer.

   In addition, the amendments clarify that the merger agreement in respect of a transaction under Section 251(h) may either permit or require the merger to be effected under Section 251(h). Thus, the amendments expressly enable the parties to provide in the merger agreement that the proposed merger under Section 251(h) may be abandoned in favor of a merger accomplished under a different statutory provision. As a related matter, the amendments clarify that the merger agreement must provide that the back-end merger shall be effected as soon as practicable after the offer if the merger is effected under Section 251(h). The amendments also clarify that the offeror's tender for all of the target corporation's outstanding voting stock may exclude stock that, at the commencement of the offer, is owned by the target corporation, the offeror, persons that directly or indirectly own all of the stock of the offeror, and direct or indirect wholly-owned subsidiaries of the foregoing parties.
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In furtherance of the foregoing changes, the amendments add a new paragraph to Section 251(h) setting forth the meaning of certain terms used in Section 251. Of particular note, the term "consummates" (and correlative terms) is expressly defined to mean the time at which the offeror irrevocably accepts for purchase or exchange stock tendered pursuant to a tender or exchange offer, to help eliminate questions regarding the time at which the conditions to effecting the back-end merger have been satisfied. As with the legislation originally enacting Section 251(h), the synopsis to the amendments states that the amendments to the subsection do not change the fiduciary duties of directors in connection with any merger accomplished under the subsection or the judicial scrutiny applied to any decision to enter into a merger agreement under the subsection.

The amendments to Section 251(h) are effective with respect to merger agreements entered into on or after August 1, 2014.

2. Escrowing Director Consents.

Section 141(f) of the DGCL has been amended to clarify that any person, whether or not then a director, may provide, by instruction or otherwise, that a consent to board action will be effective at a future time, including a time determined upon the occurrence of an event, no later than 60 days after the instruction is given or other provision is made, and that the consent will be deemed to have been given at that effective time as long as the person is then a director and did not, prior to the effective time, revoke the consent. The amendment to Section 141(f) was adopted in response to concerns, stemming from \textit{AGR Halifax Fund, Inc. v. Fiscina}, 743 A.2d 1188 (Del. Ch. 1999), over the validity of consents executed by persons who have not yet become directors at the time they execute board consents. The amendments, among other things, enable acquisition financing transactions to be structured such that the person or persons who are to become the directors of the surviving corporation may execute consents, to be held in escrow, authorizing the financing and security transactions and related documents, which consents will become effective upon the signing person's or persons' election to the board of the surviving corporation concurrently with the closing of the transaction.

3. Escrowing Stockholder Consents.

Consistent with the bases for the changes to Section 141(f), Section 228(c) has been amended to clarify that any person executing a stockholder consent may provide, by instruction or otherwise, that the consent will be effective at a future time, including a time determined upon the occurrence of an event, no later than 60 days after the instruction is given or other provision is made and, if evidence of the instruction or provision is given to the corporation, the later effective time will constitute the date of signature.

4. Amendments to the Certificate of Incorporation.

The amendments effect two substantive changes to Section 242 of the DGCL, which deals with amendments to the corporation's certificate of incorporation. First, the amendments eliminate the requirement that the notice of the meeting at which an amendment to the certificate of incorporation is to be voted on contain a copy of the amendment itself or a brief summary of the amendment when the notice constitutes a notice of internet availability of proxy materials
under the Securities Exchange Act of 1934. Second, the amendments authorize a corporation, by action of its board of directors, to amend its certificate of incorporation to change its name or to delete historical references to its incorporator, its initial board of directors or its initial subscribers for shares, or to provisions effecting changes to its stock (e.g., language effecting an earlier stock split), without the need to submit the amendment to a vote of stockholders.

5. Voting Trusts.

Section 218 of the DGCL previously required that a voting trust agreement, or any amendment thereto, be filed with the corporation's registered office in the State of Delaware. The amendments to Section 218 provide that a voting trust agreement, or any amendment thereto, may be delivered to the corporation's principal place of business instead of its registered office.

6. Incorporator Unavailability.

The amendments accomplish two changes to address issues that arise when a corporation's incorporator has become unavailable before completing his, her or its statutory functions. Section 103(a)(1) previously provided that if the incorporator was unavailable by reason of death, incapacity, unknown address or refusal or neglect to act, a person for whom or on whose behalf the incorporator was acting could, subject to certain conditions, execute any such certificate with the same effect as if it were executed by the incorporator. The amendments to Section 103(a)(1) eliminate any limitation arising from the reason for the incorporator's unavailability. In addition, the amendments add a new Section 108(d) that renders the concepts embodied in Section 103(a)(1) applicable to instruments in addition to certificates filed with the Delaware Secretary of State. Thus, new Section 108(d) provides that if an incorporator is not available to act, any person for whom or on whose behalf the incorporator was acting may, subject to certain conditions, take any action that the incorporator would have been entitled to take under Sections 107 or 108 of the DGCL.

E. 2013 Amendments (effective August 1, 2013 or April 1, 2014).

Legislation amending the DGCL was adopted by the Delaware General Assembly and was signed by the Governor of the State of Delaware on June 30, 2013. Most of the amendments to the DGCL became effective on August 1, 2013, while the remaining amendments will become effective on April 1, 2014. The amendments result in several significant changes to the DGCL. The primary components of the amendments are as follows:

1. Ratification of Defective Corporate Acts.

The Ratification Amendments represent an important development in corporate law, as they enable corporations to use self-help mechanisms to remedy actions that, due to a failure in the original authorization, could be challenged as void or voidable under existing case law. Where the defect is such that the self-help procedure is not available or practical, the Ratification Amendments provide that certain interested parties may petition the Court of Chancery to validate or invalidate, as the case may be, the defective act. The Ratification Amendments include two primary components: new Section 204, which sets forth the procedures and requirements for the self-help remedy, and new Section 205, which gives the Court jurisdiction
to hear and determine cases regarding defective corporate acts, whether or not ratified under the self-help procedures.

Under the Ratification Amendments, no corporate act is void or voidable solely on the basis of a "failure of authorization," so long as the act is ratified in accordance with the procedures outlined in new Section 204 or validated by the Court in a proceeding under new Section 205. The Ratification Amendments were designed to overturn the rigid holdings in cases such as STAAR Surgical Co. v. Waggoner, 588 A.2d 1130 (Del. 1991), that have held that stock issued in violation of statutory or charter-based requirements is void and cannot be cured or ratified. This precedent has led the Court, in cases such as Blades v. Wisehart, 2010 WL 4638603 (Del. Ch. Nov. 17, 2010), to invalidate certain defective corporate acts, even if such invalidation is inequitable. New Section 204 and new Section 205 give corporations (as well as the Court, upon application by specified parties) a path to avoid such inequitable outcomes. While intended principally to address defects in stock issuances, the Ratification Amendments encompass a broad array of corporate acts that, due to a failure of authorization, could be susceptible to challenge. In so doing, the Ratification Amendments provide corporations (and, upon application, the Court) the ability to give legal effect to acts that parties had intended to be valid.

Two concepts are fundamental to the application of the Ratification Amendments: "defective corporate act," which is the act that the parties seek to validate, and "failure of authorization," which is the defect in the original approval of the act the parties seek to validate. The term "defective corporate act" is intended to include all types of corporate acts and transactions, including elections or appointments of directors, that were within the power of the corporation under the DGCL. The concept of the corporation's power under the DGCL, as used in the Ratification Amendments, refers to the general powers that any Delaware corporation is authorized to exercise. The "defective" component is the "failure of authorization," which is generally defined as non-compliance with the DGCL, the corporation's certificate of incorporation or bylaws, or any plan or other agreement to which the corporation is a party, where the failure to comply with such provisions, documents or instruments would render such act void or voidable. Through this definition, new Section 204 recognizes that not all failures to comply with any "plan or other agreement" would render an act "void or voidable." New Section 204 should not be read as creating a negative implication that failure to comply with any plan or agreement, of itself, necessarily renders any particular act void or voidable.

The term "defective corporate act" includes an "overissue" of stock and other defects in stock issuances that could cause stock to be treated as void or voidable. New Section 204 thus provides a means of cure, as contemplated by Section 8-210 of the Delaware Uniform Commercial Code, for stock issued in excess of the number of shares the corporation is authorized to issue. New Section 204 also provides a means to give effect to the provisions of Section 8-202(b) of the Delaware Uniform Commercial Code, which provides that stock in the hands of a purchaser for value without notice of the defect is generally valid in the hands of such purchaser even if issued with a defect going to its validity. New Section 204 also provides a means of determining which shares constitute the "overissued" shares in various circumstances.

New Section 204 enables the board of directors to take steps, without the need to seek assistance from the Court, to validate defective corporation acts. Implicit in the board's power to take such self-help measures, though, is the existence of a valid board. In cases where, due to
defects in the corporate structure or for other reasons, a valid board is not in place, parties would need to take action under new Section 205 or existing Section 225 for relief.

While new Section 204 is intended to mitigate the harsh outcomes that might otherwise result from non-compliance with statutory or other corporate requirements, it is not a carte blanche for boards of directors to avoid those requirements. The defective corporate act would have to be approved by board resolution. That resolution would have to contain certain information regarding the defective corporate act to be ratified, including a summary of the act, the time at which the act was taken and the nature of the defect in its authorization. This would include, in the case of a defective corporate act relating to the issuance of shares, the number of shares purportedly issued, the date they were purportedly issued, the class or series of such shares and the problem with the issuance.

In cases where the defective corporate act would have required stockholder approval, the board of directors would be required to submit the ratifying resolution to a vote of stockholders. To ensure that the Ratification Amendments are not be used as a means of circumventing Section 203, the DGCL's principal anti-takeover statute, new Section 204 requires any defective corporate act resulting from a failure to comply with Section 203 to be submitted to stockholders for ratification, regardless of whether a stockholder vote would have been required at the time of the defective corporate act.

New Section 204 includes provisions that establish the quorum and voting requirements applicable to any board vote required to adopt a ratifying resolution. Those requirements are based on the quorum and vote applicable at the time of adoption for the type of defective corporate act proposed to be ratified. If the certificate of incorporation or bylaws of the corporation, any plan or agreement to which the corporation was a party or any provision of the DGCL at the time of the defective corporate act would have required a larger number or portion of directors or of specified directors for a quorum to be present or to approve the defective corporate act, the presence or approval of such larger number or portion of such directors or of such specified directors would be required. New Section 204, however, recognizes that, in cases where directors elected by specified class(es) or series of stock are no longer in office because such class(es) or series are no longer outstanding, the vote of such directors would not be required.

New Section 204 also contains detailed provisions for providing notice to, and seeking a vote of, stockholders in cases where a stockholder vote would be required. In these cases, the corporation would need to provide notice to all current holders of the corporation's valid stock and "putative stock" (generally, stock that, but for a defect in authorization, would be valid) as well as to holders of valid stock and putative stock as of the time of the defective corporate act, in each case, whether such shares are voting or nonvoting shares. In the latter case, new Section 204 provides that the notice need not be provided if the holders at such earlier date cannot be determined from the corporation's records. New Section 204 requires that the notice contain a copy of the ratifying resolution as well as a statement regarding the 120-day limitations period, imposed by new Section 204 on challenges to acts ratified under new Section 204 or validated under new Section 205. New Section 204 then provides for the quorum and stockholder vote necessary to adopt the ratifying resolutions. As a general matter, the quorum and vote required at the time the ratifying resolution is submitted to the stockholders would be sufficient to adopt the
resolution, unless the DGCL, the certificate of incorporation or bylaws or another plan or agreement in effect at the time of the defective corporate act would have required a greater vote. As with the quorum and vote required for the board's vote, the stockholder quorum and vote provisions make exceptions, in the latter case, for shares of any class(es) or series that are no longer outstanding. In the case of an election of directors, ratification requires the affirmative vote of the majority of shares present at the meeting and entitled to vote on the election of the director (or such greater vote that would have been required under the certificate of incorporation or bylaws at the time of the election). Thus, a "plurality" of the votes would not be sufficient to ratify an election. In addition, ratification of a failure to comply with Section 203 requires the vote required under Section 203(a)(3)—generally, 66 2/3% of the voting stock owned by holders other than the "interested stockholder."

New Section 204 provides that, if the defective act being ratified would have required a filing with the Delaware Secretary of State (e.g., a certificate of amendment, certificate of designation, certificate of merger, or other instrument), the corporation is required to file a new instrument called a "certificate of validation." The certificate of validation must set forth (i) a copy of the ratifying resolution, (ii) the date of its adoption by the board of directors and, if applicable, the stockholders, (iii) the information that would have been specified in the filing that would otherwise be required, and (iv) if a certificate was previously filed with respect to the defective corporate act being ratified, the title and the date of the filing of such previously filed certificate and any certificate of correction thereto.

New Section 204 gives effect to existing case law that the ratification of a prior act relates back to the time of the original act. Thus, under new Section 204, unless otherwise determined by the Court in an action pursuant to new Section 205, each defective corporate act (or each share purportedly issued) that is ratified pursuant to new Section 204 would be retroactively valid as of the time of the defective corporate act. Thus, for purposes of the DGCL, shares that were intended to be issued at a certain date, or options that were intended to be granted at a certain date, would be valid as of those dates if properly ratified in accordance with new Section 204.

To further ensure that new Section 204 does not operate to prejudice the rights of any party in interest, it requires that notice of the ratifying resolution be provided even where no stockholder approval is necessary. This notice would need to be provided to all current stockholders as well as to holders of valid and putative stock as of the time of the defective corporate act to be ratified (unless those holders cannot be identified from the corporation's records). This notice would need to contain substantially the same notice provided to stockholders in the case where a vote of stockholders is required.

Given that the Ratification Amendments were designed to give corporations an opportunity to cure defective corporate acts that, under existing law, would be "void" and not susceptible to cure under the common law of ratification, they recognize that the new provisions are not intended to preempt or restrict other means of ratifying acts that are merely voidable.

The corollary to new Section 204 is new Section 205. New Section 205 confers jurisdiction on the Court of Chancery to hear and determine the validity of any ratification effected pursuant to new Section 204 and the validity of any corporate act or transaction and any
stock or rights or options to acquire stock, and to modify or waive any of the procedures set forth in new Section 204. New Section 205 gives corporations (upon application by specified interested parties) the ability to seek a determination of the validity of acts that are not susceptible to cure under new Section 204. It also gives various parties the right to challenge the validity of ratifications under new Section 204 as well as the right to challenge defective corporate acts. Where a party is challenging a defective act ratified in accordance with new Section 204, it would be required to do so within a 120-day limitations period, subject to certain exceptions. After that date, the act would not be invalidated.

While the Ratification Amendments provide corporations with substantial authority to seek ratification of defective corporate acts, they do not affect the fiduciary duties applicable to any particular decision—either the initial decision by the board to approve the defective corporate act or the later decision by the board to seek ratification of the act. The new sections are concerned solely with statutory validity; they would not limit equitable review or restrict the courts from invalidating corporate acts or transactions on equitable grounds.

2. Formula for Stock Issuance Consideration.

The amendments add language to Section 152 of the DGCL, which addresses the authorization and issuance of capital stock, to clarify that a board of directors may determine the price or prices at which the corporation's stock is issued by approving a formula by which such price or prices is determined. This enables, among other things, stock to be issued for consideration derived by reference to, for example, the market price of the stock measured over a period of time.

3. Elimination of Required Vote in Certain Second-Step Mergers.

The amendments add a new subsection (h) to Section 251, which (absent a provision in a corporation's certificate of incorporation to the contrary) eliminates the requirement for a stockholder vote to authorize a second-step merger that follows a public tender offer, subject to certain requirements. The new subsection applies only to target corporations whose shares are listed on a national securities exchange or held of record by more than 2,000 holders immediately prior to the execution of the merger agreement. New subsection 251(h) simplifies the consummation of a second-step back-end merger of a public target corporation which follows a first-step tender offer by, subject to satisfying the requirements for its application, eliminating the need to satisfy the short-form merger 90% ownership requirement (directly in the first-step tender offer or through the use of a top-up option after the tender) in order to avoid the requirement for a stockholder vote thereon.

Under new subsection 251(h), a vote of the target corporation's stockholders is not be required to authorize the merger if: (1) the merger agreement expressly provides that the merger shall be governed by this new subsection and shall be effected as soon as practicable following the consummation of the offer described below; (2) a corporation consummates a tender or exchange offer for any and all of the outstanding stock of the target corporation on the terms provided in such merger agreement that would otherwise be entitled to vote on the adoption of the merger agreement; (3) following the consummation of the offer, the consuming corporation owns at least the percentage of the stock of the target corporation that otherwise
would be required to adopt the merger agreement; (4) at the time the target corporation's board of
directors approves the merger agreement, no other party to the merger agreement is an
"interested stockholder" (as defined in Section 203(c) of the DGCL) of the target corporation; (5)
the corporation consummating the offer merges with the target corporation pursuant to such
merger agreement; and (6) the outstanding shares of the target corporation not canceled in the
merger are converted in the merger into the same amount and kind of consideration paid for
shares in the offer.

The amendments also amend Section 252 of the DGCL to reflect the usage of subsection
251(h) in the context of a Delaware corporation merging with a non-Delaware corporation. The
amendments make additional changes to Section 262 of the DGCL to provide that appraisal
rights would be available for a merger effected pursuant to subsection 251(h), unless all of the
stock of the target corporation is owned by the offering corporation immediately prior to the
merger.

New subsection 251(h) does not change the fiduciary duties of directors in connection
with such mergers or the level of judicial scrutiny that would apply to the decision to enter into
such a merger agreement, each of which would be determined based on the common law of
fiduciary duty, including the duty of loyalty. Since subsection 251(h) applies only if provided for
in the merger agreement, the target board would retain the negotiating leverage it currently has
regarding top-up options.

4. Public Benefit Corporations.

In a development that may be of significant interest to social entrepreneurs, the
amendments add a new subchapter XV to the DGCL (Sections 361 through 368) to enable
Delaware corporations to be incorporated as or, subject to certain restrictions, to become, "public
benefit corporations." Such corporations remain subject to all other applicable provisions of the
DGCL, except as modified or supplanted by the new subchapter.

In general, a public benefit corporation is a corporation managed in a manner that
balances the stockholders' pecuniary interests, the interests of those materially affected by the
corporation's conduct, and one or more public benefits identified in its certificate of
incorporation. To this last point, each public benefit corporation is required, in its certificate of
incorporation, to identify itself as a public benefit corporation and to state the public benefits it
intends to promote. The new subchapter generally defines "public benefits" as positive effects (or
minimization of negative effects) on persons, entities, communities or interests, including those
of an artistic, charitable, cultural, economic, educational, literary, medical, religious, scientific or
 technological nature.

Central to the new subchapter's operation is the statutory mandate imposed on directors
that directors, in managing the business and affairs of the public benefit corporation, shall
balance the pecuniary interests of the stockholders, the interests of those materially affected by
the corporation's conduct, and the identified public benefits. The new subchapter also provides
that directors shall not have any duty to any person solely on account of any interest in the public
benefit and would provide that, where directors perform the balancing of interests described
above, they will be deemed to have satisfied their fiduciary duties to stockholders and the
corporation if their decision is both informed and disinterested and not such that no person of ordinary, sound judgment would approve.

The new subchapter imposes special notice requirements on public benefit corporations, mandating periodic statements to stockholders regarding the corporation's promotion and attainment of its public benefits. The new subchapter also provides a means of enforcing the promotion of the public benefits. By statute, stockholders holding at least 2% of the corporation's outstanding shares (or, in the case of listed companies, the lesser 2% of the outstanding shares or shares having at least $2 million in market value) are able to maintain a derivative lawsuit to enforce specified requirements in the subchapter.

The new subchapter contains limitations on the power of public benefit corporations to adopt amendments to their certificates of incorporation or effect mergers or consolidations if the effect would be to abandon their public benefit purpose. These limitations would be imposed through a 66 2/3% vote of each class of the public benefit corporation's outstanding stock.

The new subchapter also contains limitations on the power of corporations that are not public benefit corporations to amend their certificates of incorporation to become public benefit corporations or to effect mergers or consolidations that would result in their stockholders receiving shares in a public benefit corporation. These actions would require a 90% vote of each class of the corporation's outstanding stock. New subchapter XV also provides appraisal rights to any stockholder of a corporation that is not a public benefit corporation that, by virtue of an amendment to the corporation's certificate of incorporation or any merger or consolidation, receives equity interests in a public benefit corporation. Corresponding changes to Section 262 of the DGCL, the appraisal section, have also been made.

5. Restrictions on "Shelf" Corporations.

The amendments also make changes to Section 312(b) of the DGCL and Section 502(a) of title 8 of the Delaware Code that are intended to deter the practice of forming "shelf" corporations—that is, corporations with no stockholders or directors that are "aged" for use many years in the future. The amendments accomplish this goal by confirming the limited powers of an incorporator. The amendments clarify that only a corporation's directors or stockholders may authorize a renewal or revival of a corporation that has ceased to be in good standing. The amendments also prohibit an incorporator from signing any annual franchise tax report other than the corporation's initial report. In addition, the amendments prohibit such later reports from listing "no directors," except in the case of a report filed in connection with the corporation's dissolution.
Overview of Discussion Topics

- Amendments to the DGCL
  - Appraisal Rights
  - Section 251(h)
  - Court of Chancery Jurisdiction
  - Stock Certificates
- Stock and Stockholder Issues
  - Validation of Defective Corporate Acts
  - Stockholder Consents
  - Stock Dividends
- Directors & Officers
  - Indemnification and Advancement
  - Removal
- Anti-Reliance Provisions
- M&A Litigation
  - Standard of Review
  - Disclosure-Only Settlements
  - Appraisal Litigation
2016 Amendments to the DGCL

2016 Amendments to the DGCL: Appraisal Rights

- Section 262 was amended in two principal respects:
  - First, the statute now provides the surviving corporation of a merger with the option to pay stockholders entitled to appraisal an amount in advance in order to stop the accrual of statutory interest on such amount.
  - Additionally, a new *de minimis* exception provides that the Court of Chancery shall dismiss an appraisal proceeding with respect to certain public company transactions unless either:
    - The total number of shares entitled to appraisal exceeds 1% of the outstanding number of shares of the class or series entitled to appraisal; or
    - The value of the consideration for such total number of shares exceeds $1 million.
2016 Amendments to the DGCL: Section 251(h)

- Section 251(h) permits the consummation of a merger without a stockholder vote of a public target company if, subject to certain conditions, the acquiror consummates a tender offer for all of the target’s outstanding stock otherwise entitled to vote on the adoption of the merger agreement and, following the consummation of the offer, the acquiror owns at least the percentage of stock that would otherwise be required to adopt the agreement.

- Section 251(h) was amended to permit the inclusion of “rollover” stock in determining whether the acquirer has met its minimum condition.

- This amendment also clarifies:
  - Section 251(h) applies to target companies with any class or series of stock listed on a national exchange or held by 2,000 holders
  - A tender offer may be conditioned on the tender of a certain percentage of stock
  - The procedures by which the target’s shares may be “received”

2016 Amendments to the DGCL: Court of Chancery Jurisdiction

- The 2016 amendments to Section 111 vest the Court of Chancery with jurisdiction over disputes involving agreements to which a Delaware corporation is a party whereby either:
  - The corporation’s stockholders agree to sell or offer to sell its stock; or
  - The corporation sells, leases or exchanges its assets and the agreement requires stockholder approval by its terms.

- The Court of Chancery has jurisdiction over any such civil suits irrespective of the nature of the relief sought.
2016 Amendments to the DGCL: Stock Certificates

- Section 158 of the DGCL was amended so that stock certificates may be executed by any two officers of a corporation who are so authorized—regardless of title.
  - Section 158 previously provided for stock certificates to be signed by “the chairperson or vice chairperson of the board of directors, or the president or vice president, and by the treasurer or an assistant treasurer, or the secretary or an assistant secretary” of a corporation.

- As a result of this amendment, corporations have additional flexibility to use titles such as “Chief Executive Officer” and “Chief Financial Officer” rather than “President” and “Treasurer” if they so desire.

- The amendment to Section 158 does not change existing law that the signatures on a stock certificate may be the signatures of the same person, so long as each signature is made in a separate officer capacity of such person.

Stock and Stockholder Issues
Validation of Defective Corporate Acts: Sections 204 and 205

- Sections 204 and 205, added in 2014, provide two alternate paths to ratify or validate defective corporate acts that previously could not be ratified.
- Section 204 provides corporations with a means to ratify defective corporate acts, including putative stock issuances.
- Section 205 permits corporations and other constituents thereof to apply to the Court of Chancery to determine the validity and effectiveness of corporate acts and ratifications undertaken pursuant to Section 204.

Validation of Defective Corporate Acts: Numoda

  - A corporate act is more than a “conversational agreement of two or three directors.”
  - “Corporate acts are driven by board meetings, at which directors make formal decisions.”
  - “The Court looks to organizational documents, official minutes, duly adopted resolutions, and a stock ledger, for example, for evidence of corporate acts.”
  - In assessing whether a defective corporate act has occurred, the Court “looks for evidence of a bona fide effort bearing resemblance to a corporate act but for some defect that made it void or voidable.”
Validation of Defective Corporate Acts: Genelux

- In *In re Genelux Corp.*, 126 A.3d 644 (Del. Ch. 2015), the Court rejected the assertion that Section 205 may be used to invalidate corporate acts.
  - In the case, a corporation claimed that 1.5 million shares of its Series A Preferred Stock had been invalidly issued because, among other things, the shares were allegedly issued in exchange for invalid consideration and the stockholder induced the issuance by fraud.
  - The Court held that Section 205 is a “remedial statute” designed to “cure otherwise incurable defective corporate acts, not a statute to be used to launch a challenge to stock issuances on grounds already available.”
  - As a result, the petition was dismissed for the failure to state a claim under Section 205.

Validation of Defective Corporate Acts: Baxter

- In *In re Baxter International Inc.*, C.A. No. 11609-CB (Del. Ch. Jan. 15, 2016) (TRANSCRIPT), the Court held that Section 205 cannot be used to ensure the validity of future corporate acts.
  - Baxter International Inc.’s board of directors adopted a resolution determining to interpret a provision of Baxter’s certificate of incorporation so that stockholder votes on an amendment to the certificate of incorporation were counted on a per share basis, rather than on a per capita basis in accordance with past practice.
  - Baxter filed a petition under Section 205 requesting that the Court validate the resolution and the voting standard set forth therein.
  - The Court liked Baxter’s petition to a request for an advisory opinion on an unripe issue since the vote had not occurred and denied the petition.
Validation of Defective Corporate Acts: Baxter

- A vote was held on the amendment and, under the board’s new interpretation of the applicable voting standard, the amendment was approved.
- After Baxter filed a certificate of amendment with the Delaware Secretary of State, it sought to have the amendment validated.
- Since the board’s new interpretation was arguably correct, the amendment was not necessarily an “invalid” corporate act.
- The Court nevertheless validated the amendment, implying that the Court is empowered under Section 205 to validate corporate acts that are not necessarily defective. *In re Baxter Int’l Inc.*, C.A. No. 11609-CB (June 22, 2016) (TRANSCRIPT).

Stockholder Consents: American Capital

  
  - Section 228 of the DGCL sets forth the default requirements for obtaining stockholder approval by written consent.
  - Plaintiffs alleged that transaction documents sent to them for adoption were “incomplete, had missing attachments, or were in draft form.”
  - The Court denied the defendants’ motion to dismiss stating that “when a consent specifically refers to exhibits and incorporates their terms, the plain language of Section 228(a) requires that a stockholder have the exhibits to execute a valid consent.”
- This decision serves as a reminder to remove “draft” stamps and verify all exhibits prior to the execution of a stockholder consent.
Stock Dividends: *Fotta*

- In *Fotta v. Morgan*, C.A. No. 8230-VCG (Del. Ch. Feb. 29, 2016), plaintiff stockholders alleged that a dividend of the company’s common stock was invalid because the defendant directors failed to designate the issued stock as statutory capital in accordance with Section 173 of the DGCL.
  - Under Section 173, when paying a dividend of unissued stock, “the board of directors shall, by resolution, direct that there be designated as capital in respect of such shares an amount which is not less than the aggregate par value of par value shares being declared as a dividend and, in the case of shares without par value being declared as a dividend, such amount as shall be determined by the board of directors.”

- A resolution adopted by the board stated that “in accordance with Section 173 of the Delaware General Corporation Law, there is designated as capital of the Company an amount which is not less than the aggregate par value of the shares being issued as a dividend by the Company.”
  - The accounting records of the company, however, did not reflect the increase in statutory capital.

- Given the discrepancy, the Court denied the plaintiffs’ motion for summary judgment, holding that issues of material fact existed as to whether the board of directors actually complied with Section 173.

- *Fotta* highlights the need to ensure that board resolutions approving and declaring a stock dividend have an affirmative resolution increasing the company’s capital by a specific amount that is at least equal to the amount required by Section 173 and that the company’s accounting records reflect this increase.
Directors and Officers

Non-Exclusivity of Indemnification and Advancement: *Sutherland*

- In *Narayanan v. Sutherland Global Holdings, Inc.*, C.A. No. 11757-VCMR (Del. Ch. July 5, 2016), the Court of Chancery clarified that “the unavailability of advancement under one source of rights does not foreclose the possibility of advancement under another.”
  - A corporation’s bylaws and indemnification agreements established independent rights to indemnification and advancement, with each specifying that such rights were non-exclusive of other instruments.
  - The Court thus held that a former director was entitled to advancement under the bylaws regardless of whether he had satisfied the conditions to receive advancement under his indemnification agreement.
- *Sutherland* highlights the importance of ensuring consistency among all documents granting indemnification and advancement when seeking to restrict such rights. Companies may also consider making such rights granted under one instrument exclusive of the rights granted under other instruments.
In *Aleynikov v. Goldman Sachs Group, Inc.*, C.A. No. 10636-VCL (Del. Ch. July 13, 2016), the Court of Chancery strongly implied that the rule of *contra proferentem* would be applied to construe any ambiguities in bylaws against the corporation and in favor of an indemnitee.

- At issue was a demand for advancement by an employee who held the title of vice president but had no managerial responsibilities. The employee sued in federal court seeking to have his expenses incurred in an ongoing criminal proceeding advanced.

- On appeal, the Third Circuit denied advancement, holding that the federal trial court in New Jersey erred by applying the doctrine of *contra proferentem* to resolve ambiguity as to the term “officer” in the bylaws.

In a subsequent suit, the Court of Chancery denied advancement based on issue preclusion but expressed its view that the doctrine of *contra proferentem* should have been applied to resolve any ambiguity as to the meaning of the term “officer” against the corporation and in favor of the employee.

*Goldman Sachs* reiterates the Delaware courts’ predisposition to construe advancement rights broadly, including by construing ambiguities in favor of indemnitees.
In *Charney v. American Apparel*, C.A. No. 11098-CB (Del. Ch. Sept. 11, 2015), the Court of Chancery clarified the circumstances in which a director or officer may or may not be entitled to advancement “by reason of the fact” of his or her service.

- The former founder and CEO of American Apparel was removed as an officer and subsequently resigned from the board. In connection with his resignation, he entered into a standstill agreement with the company agreeing, among other things, not to engage in proxy solicitations.

- American Apparel alleged that the founder breached the standstill agreement and sued to enforce its rights thereunder. The founder sought advancement for his expenses incurred in connection with this suit.

**Scope of Rights: American Apparel**

- Despite the fact that the standstill agreement and subsequent suit would not have arisen “but-for” his prior service as an officer and director, the Court held that the action did not arise by “reason of the fact” of his service as an officer or director and denied advancement.

  - The Court determined that there was no “causal nexus” between the conduct for which he was being sued and his capacity as an officer and director.

- Additionally, the Court interpreted American Apparel’s certificate of incorporation, which provided advancement rights to “directors and officers,” as only providing such rights to *current* directors and officers.
In *Hyatt v. Al Jazeera America Holdings II LLC*, C.A. No. 11465-VCG (Del. Ch. March 31, 2016), the Court of Chancery provided further clarity as to when a director or officer may be entitled to advancement “by reason of the fact” of his or her service.

- Al Gore and Joel Hyatt, former executives of Current TV, sought advancement for their expenses incurred in post-closing litigation with Al Jazeera related to Al Jazeera’s acquisition of Current TV.
- Hyatt was appointed as the escrow agent under the merger agreement and denied a request from Al Jazeera to release funds from escrow. Gore and Hyatt sought the remainder of the escrow funds, while Al Jazeera challenged Hyatt’s decision to withhold the funds.
- As the merger agreement required Al Jazeera to assume all of Current TV’s advancement and indemnification obligations post-merger, Gore and Hyatt sought to have their expenses incurred in defending Al Jazeera’s counterclaims advanced.

In so holding, the Court found persuasive a previous Master’s Report holding a former officer to be entitled to advancement where the claim against the officer in a separate capacity was “inextricably intertwined” with action he took as an officer. *Rizk v. Tractmanager, Inc.*, C.A. No. 9073-ML (Del. Ch. May 30, 2014).
Removal of Directors: *Vaalco*

- In *In re Vaalco Energy, Inc. Stockholder Litigation*, C.A. No. 11775-VCL (Dec. 21, 2015) (TRANSCRIPT), the Court of Chancery invalidated provisions of Vaalco’s certificate of incorporation and bylaws that provided that directors could only be removed for cause.
  - The Court held that Section 141(k) permits removal of directors only for cause in corporations with a classified board, which Vaalco did not have.
  - Following the *Vaalco* opinion, plaintiffs’ firms have sent demands seeking amendment of similar certificate of incorporation and bylaw provisions.

Anti-Reliance Provisions
Chapter 1—Recent Developments in Delaware Corporate Law

Anti-Reliance Provisions: *TrueBlue*

- In *TrueBlue, Inc. v. Leeds Equity Partners IV, LP*, C.A. No. N14C-12-112 WCC CCLD (Del. Super. Sept. 25, 2015), the Superior Court addressed post-closing fraud claims in the context of a buyer’s acquisition of shares of a company which had a liability that became payable following the acquisition.
  - While the buyer claimed that the seller had fraudulently promised to pay the liability post-closing, the acquisition agreement stated otherwise and contained an anti-reliance clause in which the buyer acknowledged that the representations in the agreement superseded all other representations made by the seller.
  - The Court upheld the buyer’s claim that it justifiably relied on the seller’s extra-contractual representation, because the anti-reliance provision did not clearly “disclaim reliance upon extra-contractual statements.”
  - The Court also held that a provision stating that nothing in the contract would limit a claim for “actual fraud” was sufficient to preserve the buyer’s extra-contractual fraud claim.

Anti-Reliance Provisions: *Prairie Capital*

- In *Prairie Capital III, LP v. Double E Holding Corp.*, C.A. No. 10127-VCL (Del. Ch. Nov. 24, 2015), the Court of Chancery addressed post-closing fraud claims in the context of a sale of a portfolio company by one private equity fund to another.
  - In negotiating with the buyer, the portfolio company’s CEO and CFO emphasized its growth story and sales figures and the buyer’s final offer was conditioned on the company’s sales figures.
  - The buyer alleged fraud in the inducement and fraudulent misrepresentation based upon the company’s purported falsification of its sales figures by shipping products on false pretenses and including in its accounts receivable products that were not shipped.
  - The Court held that, due to the contract’s anti-reliance provision, the buyer was limited to making fraud claims based on misrepresentations in the agreement.
The Court noted that there was no “magic language” needed to create a clear anti-reliance clause.

- The Court distinguished *Anvil Holding Corp. v. Iron Acquisition Co.* Inc., C.A. No. 7975-VCP (Del. Ch. May 17, 2013), in which an integration clause and a provision stating that neither party made representations other than those in the agreement did not preclude reliance on extra-contractual representations.

- “I do not read Anvil as requiring a specific formula, such as the two words ‘disclaim reliance.’ Language is sufficiently powerful to reach the same end by multiple means, and drafters can use any of them to identify with sufficient clarity the universe of information on which the contracting parties relied.”

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Anti-Reliance Provisions: *Prairie Capital*

- The Court noted that there was no “magic language” needed to create a clear anti-reliance clause.

- In *FdG Logistics LLC v. A&R Logistics Holdings, Inc.* C.A. No. 9706-CB (Del Ch. Feb. 23, 2016), the Court of Chancery again addressed disclaimers of extra-contractual liabilities in a merger transaction.

- The purchaser alleged that the target company had engaged in improper activities that were concealed during pre-merger due diligence and that the target had made misrepresentations in extra-contractual materials including a memorandum and a management presentation.

- The merger agreement contained an integration clause and an anti-reliance provision in which the target company disclaimed all extra-contractual representations.

- The Court held that the anti-reliance clause did not preclude extra-contractual fraud claims since it was merely a statement by the seller that it was making no representation other than those included in the agreement.
Anti-Reliance Provisions: *FdG Logistics*

- The Court held that the anti-reliance clause did not preclude extra-contractual fraud claims since it was merely a statement *by the seller that it was making no representation* other than those included in the agreement.
  - To be effective, an anti-reliance provision must instead be a disclaimer *by the buyer that it was not relying on any extra-contractual representation* by the seller.
  - This decision is consistent with the Court of Chancery’s dismissal of extra-contractual fraud claims in *Prairie Capital*, as the anti-reliance clause at issue in *Prairie Capital* was an affirmative disclaimer of reliance by the buyer.

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Anti-Reliance Provisions: Takeaways

- Sellers should be able to insulate themselves from fraud claims based on extra-contractual representations, provided the disclaimer is properly drafted.
- While *Prairie Capital* suggests that the agreement need not contain specific wording, the contract should include the following:
  - An integration clause
  - An anti-reliance provision in which the *buyer expressly disclaims* the existence of and *any reliance on any extra-contractual representations* by the seller
  - An exclusive remedy provision tailored to permit only fraud claims based on representations included in the acquisition agreement
M&A Litigation

Standard of Review: Corwin

- In Corwin v. KKR Financial Holdings LLC, No. 629, 2014 (Del. Oct. 2, 2015), the Delaware Supreme Court affirmed the Court of Chancery’s dismissal of a challenge to the acquisition of KKR Financial Holdings LLC by KKR & Co. L.P.

  - The Court ruled that, since the transaction was not subject to entire fairness, a fully informed, uncoerced vote of the disinterested stockholders invoked the business judgment rule standard of review even though the vote was required by statute.

  - While the Delaware Supreme Court’s previous ruling in Gantler v. Stephens held that a statutorily required stockholder vote would not invoke the doctrine of “ratification,” this decision has been interpreted narrowly and does not preclude a fully informed stockholder vote from shifting the applicable standard of review.
In Singh v. Attenborough, C.A. No. 645, 2015 (Del. 2016), the Delaware Supreme Court implied that, absent waste, Corwin irrebuttably invokes the business judgment rule. Subsequent Chancery Court decisions have supported this interpretation.

In In re Volcano Corp. Stockholder Litigation, C.A. No. 10485-VCMR (Del. Ch. June 30, 2016), the Court of Chancery held that the business judgment rule also irrebuttably applies when a majority of uncoerced, disinterested and fully informed stockholders tender their shares in a two-step merger consummated under Section 251(h) of the DGCL without a stockholder vote.

In Larkin v. Shah, C.A. No. 10918-VCS, (Del. Ch. Aug. 25, 2016), the Court of Chancery held that Corwin irrebuttably invokes the business judgment rule for all transactions other than those subject to entire fairness due to a conflicted controlling stockholder. As a result, a transaction otherwise subject to entire fairness because of a conflicted board may receive the benefit of the business judgment rule under Corwin where there is no conflicted controller.

In In re EZCorp Consulting Agreement Derivative Litigation, C.A. No. 9962-VCL (Jan. 25, 2016), the Court found that the entire fairness standard applied to a challenge to various advisory services agreements between a corporation and its controlling stockholder.

- The Court ruled that the entire fairness standard governs any transaction between a corporation and a controlling stockholder in which the controller receives a non-ratable benefit.

- The effect of approval by an independent committee of any such agreement may shift the burden of proof to the plaintiff.
Disclosure-Only Settlements: Trulia

- In *In re Trulia, Inc. Stockholders Litigation*, C.A. No. 10020-CB (Del. Ch. Jan. 22, 2016), the Court rejected a disclosure-only settlement of litigation challenging the stock-for-stock merger of Trulia and Zillow.
  - In rejecting the settlement, the Chancellor indicated that the Court “will be increasingly vigilant” in its review of disclosure-only settlements.
  - The Court further noted that disclosure-only settlements are unlikely to be approved in the absence of “plainly material” misrepresentations and omissions and narrowly tailored releases.

- The Court recommended that disclosure claims be litigated outside of a settlement-approval proceeding and in an adversarial context.
  - In a preliminary injunction motion, the plaintiffs bear the burden of showing that disclosure of an omitted fact would likely have been material to a reasonable investor.
  - In an application by the plaintiff’s attorneys for mootness fees after the defendants voluntarily supplement proxy materials with one or more of the disclosures sought by plaintiffs, the defendants are incentivized to oppose excessive fee requests.

- Although the Court of Chancery has approved some disclosure-based settlements post-*Trulia*, there has been a decrease in disclosure-based challenges to public M&A in Delaware courts following the decision.
Appraisal Litigation: Determination of Fair Value

- In 2014 and 2015, a number of appraisal decisions concluded that the best indication of the corporation’s fair value was the negotiated merger price:
  - Huff Fund Inv. P’ship v. CKx, Inc., C.A. No 6844-VCG (Del. Ch. May 19, 2014)

- In reaching these conclusions, the Court of Chancery relied upon robust pre-signing auction processes, uncertainty or unreliability of DCF inputs and extreme divergence of the opinions of litigation experts.

Appraisal Litigation: Dell

- In In re Appraisal of Dell Inc., 2016 WL 3186538 (Del. Ch. May 31, 2016), the Court determined that the fair value of Dell’s common stock to be approximately 28% more than the final merger consideration of $13.75.
  - The appraisal proceeding following a management buyout in which the private equity firm Silver Lake teamed with Michael Dell to take Dell Inc. private.
  - The Court rejected Dell’s contention that the merger consideration was the best evidence of fair value, despite noting that the transaction would “sail through” if reviewed under enhanced scrutiny in a fiduciary challenge.
Appraisal Litigation: Dell

- In reaching its conclusion, the Court noted, among other things:
  - The merger price was limited by the use of an LBO model, which diverges from fair value because financial sponsors “need to achieve IRRs of 20% or more to satisfy its own investors.”
  - “Widespread and compelling evidence” that the market undervalued Dell’s stock, creating an “anti-bubble” that resulted in an undervalued bid.
  - A lack of meaningful price competition in the pre-signing process, given the Court’s finding that the post-signing go-shop did not establish that the Dell stockholders received fair value.
- The Court specifically noted that go-shops in management buyouts “rarely produce topping bids” and found the fact that two higher bids emerged during Dell’s go-shop to be evidence that the original merger price was “relatively low.”

Appraisal Litigation: DFC Global

- In In re Appraisal of DFC Global, C.A. No. 9322-CB (Del. Ch. July 8, 2016), the Court of Chancery also declined to accept the deal price as the most reliable indicator of fair value, despite the fact that the transaction at issue was arm’s-length and was subject to a robust pre-signing market check.
  - DFC Global was sold to a private equity firm amidst ongoing uncertainty as to whether financial regulators in the U.S. and U.K. would impose new laws that would limit DFC Global’s business opportunities and increase its cost of doing business.
  - In the appraisal proceeding following the merger, the Court held that the transaction price was not the most reliable indicator of fair value, stating that a transaction price “is informative of fair value only when it is the product of not only a fair sale process, but also of a well-functioning market.”
Nevertheless, since DFC Global conducted a robust sales process lasting nearly two years during which dozens of financial sponsors and several strategic bidders were solicited, and the process culminated in an arm’s-length sale to a third party, the Court relied on the deal price as one component of its fair value determination.

The Court determined that the fair value of the common stock was $10.21 per share—compared to the deal price of $9.50 per share—by providing equal weight to “three imperfect techniques”:

- A discounted cash flow model incorporating certain assumptions from each party’s expert and from the Court;
- A comparable company analysis prepared by DFC Global’s expert, which the Court found to be reasonable; and
- The deal price.
Chapter 2
Drafting Contracts to Minimize Litigation Risks—Presentation Slides

Jeremy Sacks
Stoel Rives LLP
Portland, Oregon

Keith McIntire
Stoel Rives LLP
Portland, Oregon
Drafting Contracts to Minimize Litigation Risks

Presented by
Jeremy Sacks and Keith McIntire
OSB BLS Nuts and Bolts of Oregon Business Law Practice Seminar
November 18, 2016

ROADMAP

• Four goals in contract drafting
• Know your contract
• Governing principles
• Key terms to consider in minimizing litigation risk
• “Skippable” terms
• Parting thoughts
FOUR GOALS IN DRAFTING

• “Get what you want”
• Clear mutual understanding of obligations
• Protect your client in the event of breach by counterparty
• Protection your client in the event of breach by your client

KNOW YOUR CONTRACT

• UCC Article 2 contracts
• Requirements contracts
• Options contracts
• Service contracts
• Real estate contracts
• Employment contracts
GOVERNING PRINCIPLES

• Extrinsic evidence and the parol evidence rule
• Course of conduct and course of performance
• Industry practice
• Modification and changed circumstances
• Enforceability and waiver
• Termination
• Damages and other remedies

KEY TERMS TO CONSIDER IN MINIMIZING LITIGATION RISK

• Deliverables
• Term of agreement and termination
• Pricing and other market-based terms
• Parties
• Guaranties
• Confidentiality
• Non-compete and non-solicitation provisions
• Industry-specific terms
“SKIPPABLE” TERMS

- Dispute resolution mechanism
- Dispute resolution rules
- Jurisdiction and venue
- Choice of law
- Attorneys’ fees
- Indemnification

PARTING THOUGHTS

- Protect against the worst-case scenario
- Think about what you’ll wish you had
- Put it in writing
- Know your counterparty
- Don’t panic
Chapter 3

Recent Developments in Washington LLC Law
Chris Brown
Karr Tuttle Campbell
Seattle, Washington
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A. “Non-waivable provisions” in an LLC Agreement (new RCW 25.15.018)

Practice Item: New RCW 25.15.018 describes the effect of a limited liability company agreement under the Washington LLC Act. Paragraph (2) states that the LLC Act itself provides default rules that will apply in the absence of a different rule contained in an LLC Agreement. Notice that paragraph (3) lists (in one place) all of the various default terms contained in the LLC Act that cannot be changed or waived through an LLC Agreement, whether such agreement is in writing or oral.

25.15.018 Effect of limited liability company agreement — Nonwaivable provisions.

(1) Except as otherwise provided in subsection (2) and (3), the limited liability company agreement governs:

(a) Relations among the members as members and between the members and the limited liability company; and

(b) The rights and duties under this chapter of a person in the capacity of manager.

(2) To the extent the limited liability company agreement does not otherwise provide for a matter described in subsection (1), this chapter governs the matter.

(3) A limited liability company agreement may not:

(a) Vary a limited liability company’s power under RCW 25.15.031 to sue, be sued, and defend in its own name;

(b) Vary the law applicable to a limited liability company under RCW 25.15.033;

(c) Eliminate or limit the duties of a member or manager in a manner prohibited by RCW 25.15.038(6);

(d) Eliminate or limit the liability of a member or manager in a manner prohibited by RCW 25.15.038(7);

(e) Indemnify a member or manager in a manner prohibited by Section 25.15.041;

(f) Vary the requirements of RCW 25.15.086;

(g) Vary the records required under RCW 25.15.136(1) or unreasonably restrict the right to records or information under RCW 25.15.136;

(h) Vary the power of a manager to resign under RCW 25.15.176;

(i) Vary the requirements of RCW 25.15.231;

(j) Eliminate or limit the liability of a member, manager, or transferee under RCW 25.15.236;
(k) Vary the power of a court to decree dissolution in the circumstances specified in RCW 25.15.274;

(l) Vary the requirement to wind up the limited liability company’s business as specified in RCW 25.15.297(1), (2), (4) and (5);

(m) Unreasonably restrict the right to maintain an action under article X of this chapter;

(n) Restrict the right of a member that will have personal liability with respect to a surviving or converted organization to approve a merger or conversion under RCW 25.15.456; or

(o) Restrict the rights under this chapter of a person other than a member, a transferee or a manager.

B. Fiduciary Duties of LLC Managers and Members with management authority. RCW 25.15.038.

Practice Item: The new Washington LLC Act creates statutory fiduciary duties of loyalty and care for managers and managing members of LLCs. See RCW 25.15.038, below. These duties may be modified by an LLC Agreement, but may not be reduced below certain “floor duties” described in paragraph (6) below.

Prior to the adoption of 25.15.038, fiduciary duties of LLC members and managers were defined by case law. The seminal case in Washington was Bishop of Victoria Corporation Sole v. Corp. Bus. Park, LLC, 138 Wn.App. 443; 158 P.3d 1183 (May 8, 2007). Notice in the discussion of fiduciary duty law, the Court of Appeals relies on the law of general partnerships (including liberal citations to RCW 25.05) in describing the fiduciary duties owed by an LLC managing member to the other members:


Partners owe each other fiduciary duties and are obligated to deal with each other with candor and the utmost good faith. Bovy v. Graham, 17 Wn. App. 567, 570, 564 P.2d 1175 (1977). A partner owes a fiduciary duty of loyalty and care to both the partnership and to other partners. RCW 25.05.165. A partner owes a duty of loyalty to avoid secret profits, self-dealing, and conflicts of interest. RCW 25.05.165(2)(a)-(c). A partner must avoid self-dealing by refraining from dealing with the partnership on behalf of a party having an interest adverse to the
partnership. RCW 25.05.165(2)(b). And a partner must avoid conflicts of interest in refraining from competing with the partnership. RCW 25.05.165(2)(c). A partner owes a duty of care to refrain from engaging in grossly negligent conduct, intentional misconduct, and knowing violations of law. RCW 25.05.165; see also RCW 25.15.155.

**RCW 25.15.038**

**General standards—Limitation of liability.**

(1)(a) The only fiduciary duties that a member in a member-managed limited liability company or a manager has to the limited liability company and its members are the duties of loyalty and care under subsections (2) and (3) of this section.

(b) If a manager is a board, committee, or other group of persons, this section applies to each person included in such board, committee, or other group of persons as if such person were a manager.

(2) The duty of loyalty is limited to the following:

(a) To account to the limited liability company and hold as trustee for it any property, profit, or benefit derived by such manager or member in the conduct and winding up of the limited liability company's activities or derived from a use by such manager or member of limited liability company property, including the appropriation of a limited liability company opportunity;

(b) To refrain from dealing with the limited liability company as or on behalf of a party having an interest adverse to the limited liability company; and

(c) To refrain from competing with the limited liability company in the conduct or winding up of the limited liability company's activities.

(3)(a) The duty of care is limited to refraining from engaging in grossly negligent or reckless conduct, intentional misconduct, or a knowing violation of law in the conduct and winding up of the limited liability company's activities.

(b) A member or manager is not in violation of the duty of care as set forth in (a) of this subsection if, in discharging such duty, the member or manager relies in good faith upon the records of the limited liability company and upon such opinions, reports, or statements presented to the limited liability company by any person, including any manager, member, officer, or employee of the limited liability company, as to matters which the member or manager 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 limited liability company, including opinions, reports, or statements as to the value and amount of the assets, liabilities, profits, or losses of the limited liability company or any other facts pertinent to the existence and amount of assets from which distributions to members might properly be paid.
(4) A manager or member does not violate a duty under this chapter or under the limited liability company agreement merely because the manager's or member's conduct furthers the manager's or member's own interest.

(5) A manager or member is not liable to the limited liability company or its members for the manager's or member's good faith reliance on the limited liability company agreement.

(6) To the extent that, at law or in equity, a member or manager has duties (including fiduciary duties) to a limited liability company or to another member, manager, or other person bound by a limited liability company agreement, the member's or manager's duties may be modified, expanded, restricted, or eliminated by the provisions of a limited liability company agreement; provided that such provisions are not inconsistent with law and do not eliminate or limit:

(a) The duty of a member or manager to avoid intentional misconduct and knowing violations of law, or violations of RCW 25.15.231; or

(b) The implied contractual duty of good faith and fair dealing.

(7) A limited liability company agreement may contain provisions not inconsistent with law that eliminate or limit the personal liability of a member or manager to the limited liability company or its members or other persons bound by a limited liability company agreement for conduct as a member or manager, provided that such provisions do not eliminate or limit the liability of a member or manager for acts or omissions that involve intentional misconduct or a knowing violation of law by a member or manager, for conduct of the member or manager violating RCW 25.15.231, or for any act or omission that constitutes a violation of the implied contractual duty of good faith and fair dealing.

C. Default Voting Rules. RCW 25.15.121

Practice Item: In the absence of voting rules provided in an LLC Agreement, the new Washington LLC Act will impose various voting requirements, including (in paragraph (2) below) a 100% member vote, based on headcount, for a list of extraordinary actions. Notice that the voting provisions are not part of the “non-waivable” list of RCW 25.15.018, and therefore an LLC Agreement may provide (and should, in most cases, provide) for different voting rules, tailored to the details of the members’ agreement.

25.15.121
Voting and classes of membership.

(1) Except as otherwise provided by this chapter, the affirmative vote, approval, or consent of a majority of the members shall be necessary for actions requiring member approval.

(2) The affirmative vote, approval, or consent of all members shall be required to:

(a) Amend the certificate of formation, except as provided in RCW 25.15.076(2);

(b) Amend the limited liability company agreement;
(c) Authorize a manager, member, or other person to do any act on behalf of the limited liability company that contravenes the limited liability company agreement, including any provision thereof which expressly limits the purpose, business, or affairs of the limited liability company or the conduct thereof;

(d) Admit as a member of the limited liability company a person acquiring a limited liability company interest directly from the limited liability company as provided in RCW 25.15.116(2)(a);

(e) Admit as a member of the limited liability company a transferee of a limited liability company interest as provided in RCW 25.15.116(2)(b);

(f) Authorize a member’s removal as a member of the limited liability company as provided in RCW 25.15.131(1)(e);

(g) Waive a member’s dissociation as a member of the limited liability company as provided in any of RCW 25.15.131(1)(f), (g), or (h);

(h) Authorize the withdrawal of a member from the limited liability company as provided in RCW 25.15.131(2);

(i) Compromise any member’s obligation to make a contribution or return cash or other property paid or distributed to the member in violation of this chapter as provided in RCW 25.15.196(2);

(j) Amend the certificate of formation and extend the date of dissolution, if a dissolution date is specified in the certificate of formation, as provided in RCW 25.15.265(1);

(k) Dissolve the limited liability company as provided in RCW 25.15.265(3);

(l) Sell, lease, exchange, or otherwise dispose of all, or substantially all, of the limited liability company’s property, other than in the ordinary course of the limited liability company’s activities or activities of the kind carried on by the limited liability company; or

(m) Undertake any other act outside the ordinary course of the limited liability company’s activities.
Recent Developments in Washington LLC Law

CHRIS BROWN
KARR TUTTLE CAMPBELL

Presented for the Oregon State Bar Association
“Nuts and Bolts of Business Law Practice”
Portland, Oregon
Nov. 18, 2016

Main Topics

A. Washington’s New LLC Act (RCW 25.15) (effective Jan. 1, 2016)
B. Drafting Tips for WA LLC Agreements
C. Washington’s new HUB Act (RCW 23.95) (Uniform Business Organizations Code)
D. A few thoughts re Mergers, Conversions and Dissenters’ Rights (RCW 25.15.411 to 25.15.521)
Part A: Washington’s LLC Act – A brief history

- Created in 1994 (RCW 25.15)
- 2008: Committee turns to LLC Act
- What’s the model? RULLCA, ABA, Delaware?
- 2009: “Let’s just re-do what we have.”

The New LLC Act – A brief history

- Mission creep! Detours to address Chadwick Farms, entity conversions, HUB Act.
- LLCs dominate all entity filings: In 2013, 35,415 LLCs formed in Washington vs 7,284 corps.
- 2014: Done!
- 2015: Passes Olympia and Gov signs
- Jan. 1\textsuperscript{st}, 2016: Becomes law of the land.
New LLC Act: Oral Agreements

- **Old Act:** Oral LLC Agreements are OK (freedom of contract principle), but cannot override the statute’s default rules.
- **New Act:** Oral or implied LLC Agreements are OK, and do override default rules. 25.15.005.

- **Takeaway:** Make sure the LLC Agreement is in writing and can only be amended in writing.

Oral Agreements (con’t)

- **Caveat:** Beware of written LLC Agreements that are effectively modified through course of conduct, oral agreements, e-mailed agreements, meetings of members, and other “less official-looking” means

New LLC Act: Non-waivables

- **Issue:** Can an LLC Agreement veer from the terms in the LLC Act?
- **Old Act:** Easter Egg Hunt! Look for all of the sections in LLC Act that do not start with “Except as provided in LLC Agreement, . . . .” Those are the non-waivable terms!
- **New Act:** All of the non-waivable terms are now listed in RCW 25.15.017(3) (15 in total). (SEE HANDOUT)

- **Avoid drafting embarrassments:** It is prudent to confirm that your LLC Agreement does not attempt to waive or change any non-waivable items contained on the new list.

New LLC Act: Manager vs member management

- **Old Act:** Certificate of Formation (a public doc) disclosed to the world whether the entity was manager or member managed.
- **New Act:** LLC Agreement (private doc) does this. 25.15.017.

- **Good Idea Dept:** Consider changing old Certificate if it misstates the basic type of management of your LLC.
New LLC Act: Board as manager

- **Old Act**: “Person” did not include a board or committee. So a Board could not be a manager.
- **New Act**: The manager can be a board (and if so, no individual board member is a manager). 25.15.151.

- **Hygiene Check**: Review Board-as-manager LLC agreements and check who has power to act for the Board. It could be any single Board member, or the entire Board, delegating authority to a CEO or officer (*i.e.*, corporate model).

New LLC Act: No more statutory apparent authority

- **Old Act**: Any Member of a member-managed LLC had statutory apparent authority to bind the LLC on routine matters. Old 25.15.150(1).
- **New Act**: Eliminates statutory apparent authority (since LLC Certificate no longer establishes public proof of management). WA now relies instead on common law of agency to address apparent authority issues (*e.g.*, like a corporate officer).

- **More Hygiene**: Check LLC Agreement and course of dealing: Who has authority to carry out routine and non-routine acts? Who can sign checks?
New LLC Act: Fiduciary duties

- **Old Act**: No explicit fiduciary duties, but implied in the statute, and incorporated into LLC law under *Bishop of Victoria*, 138 Wash.App. 443 (2007). SEE HANDOUT.

- **New Act**: Explicit fiduciary duties added (duty of care and loyalty), subject to reduction by LLC Agreement, but limited by a “floor duty” of: Avoidance of intentional misconduct and knowing violation of law, and good faith and fair dealing. 25.15.037.

- **Sanity Check for all WA LLCs**: Who owes fiduciary duties? If these duties are limited by contract, how clear is the language used to impose the intended limits?

New LLC Act: default rules for voting

- **Old Act**: If your LLC Agreement did not address voting, then the default rule required a majority vote based on the relative value of member contributions (per LLC records).

- **New Act**: If your LLC Agreement does not address voting, then the default rule is per capita (head count) voting (“one member, one vote”). 25.15.120(1).

- **Avoid Bad Outcomes**: Make sure your LLC Agreement addresses every kind of vote.
Default voting rules (con’t)

- **Old Act:** If LLC Agreement did not cover voting, then typically 100% member approval was required. This unanimous vote default rule was interspersed (or implied) throughout the Act.

- **New Act:** All unanimous voting requirements are now stated in one place (RCW 25.15.120), if LLC Agreement does not provide a different voting threshold. SEE HANDOUT.

- **Drafting Tip:** Make sure your LLC Agreement covers voting with appropriate breadth. You don’t want to be stuck with a 100% headcount vote requirement.

New LLC Act: access to records

- **Old Act:** LLC had to retain a short list of common records. Members had limited rights to review these records, and no statutory right to see non-listed items (e.g., accounting records, tax returns).

- **New Act:** Expands required records, and adopts 2-tier member right to obtain and review records 25.15.135, (similar to 23B.16.020 in Corporate Act).

- **Observation:** Many older LLC Agreements are either silent on the topic, or probably fail the new records retention and access rules.
New LLC Act: Distribution Risks

- **Old Act**: Members who receive illegal distributions are required to disgorge, but no explicit statutory breach falls on the manager or members who approved the bad distribution.

- **New Act**: New 25.15.236 imposes personal liability on a manager or member (in a member-managed LLC) who approves a distribution that violates the LLC Agreement or solvency rules (similar to LP Act).

- **Note**: This item (25.15.236) is one of the “non-waivable provisions” under the new Act, and so cannot be changed by contract.

New LLC Act: Profit Allocations

- **Old Act**: In the absence of an LLC Agreement, profits are allocated in accordance with the contributions of each Member.

- **New Act**: Omits profit allocation rule.

- **So, how do economics work?** New LLC Act provides default rule *for distributions only*: If there is no LLC Agreement, then distributions are based on agreed value of contributions made, and agreed to be made, by members. RCW 25.15.221.
Part B: Drafting and Practical Tips

• Client says, “Could you just review my old LLC Agreement and make sure it complies with the new Washington LLC Act?”

  “Don’t charge any time. Thanks.”

Scope of Engagement Issues

• **Engagement #1:** Read “LLC Agreement” and make any absolutely necessary changes to make sure it complies with new LLC Act.

• **Engagement #2:** Do #1, but also make other improvements that you notice, or that are obviously helpful.
Engagement #1 Approach

- **Find the LLC Agreement.** Is it signed? In writing? Can it be amended only in writing?
- **Review non-waivable list** (25.15.017(3)). Does Agreement violate any item on this list?
- **Review voting terms.** Does Agreement cover every possible voting situation?
- **Review standards of conduct.** Is the Agreement silent on fiduciary duty? If yes, are the parties OK with the statutory duties provided at RCW 25.15.038?
- **Board as manager?** If so, how does the Board operate?

Engagement #2 Approach

- **Consider additional contractual terms:**
  - Waiver of dissenters’ rights.
  - Modify or eliminate fiduciary duties, subject to the “floor duties” at 25.15.038(6).
  - Same for exculpation and indemnity of members/managers.
  - Records and information. Limiting access, subject to basic requirements off 25.15.136.
  - Etc. (Especially course of dealing differences).
Other Thoughts on Engagements

• **Old LLC Treatises.** Don’t really work.

• **Downside Risk if an old LLC Agreement is not reviewed at all?** Good question. Statute provides default rules that may, or may not, be desirable.

• **Case law.** Not much yet. New statutory clarity on the effect of oral agreements and the existence of fiduciary duties.

Part C: HUB Act, RCW 23.95

• **Model:** Uniform Business Organizational Code

• **Theory:** Based on “hub and spoke” model

• **Coverage:** Centralizes standard terms for these Washington entity types: LLCs, LPs, LLPs, corporations, nonprofit corporations, and general cooperatives.

• **Topics:** Filings with Secretary of State, Name, Registered Agent, Foreign Entity Qualification, Administrative Dissolution
HUB Act – Example of Key Change

• Merger is cancelled or Articles are Erroneous?
  – Prior LLC Act:
    • No statutory withdrawal right.
    • WA Corporate Act permits filing of Articles of correction.
  – New HUB Act: LLC parties may withdraw filed articles before they take effect. May also correct defective Articles. (RCW 23.95.215 and 220.)

HUB Act – Other Items

• Certificates of Existence (23.95.235)
• Effective date and time rule (23.95.210)
• Consistent rules for Registered Agent. (Notice of change, duties, termination).
• Permits Commercial Registered Agents (23.95.420, 425)
Part D: Mergers and conversions

- **Old Act**: Only conversions (added in 2014) required a member to approve in writing if the member was going to be personally liable for a surviving LLC debt as a result of the conversion.

- **New Act**: Members now must separately approve in writing if they will be personally liable for debt of surviving entity in a conversion or merger. 25.15.456. Primarily affects merger/conversion into a general partnership.

- **Uncertainty**: Hard to say exactly how this new voting rule will apply in a post-merger indemnity, hold-back or escrow fight with members who did not “separately approve in writing” their assumption of post-closing liability.

New LLC Act: A key merger change

- **Old Act**: In a merger, LLC members have dissenter’s rights, and these rights may not be waived by contract.

- **New Act**: Dissenter’s rights of an LLC member now may be waived by contract (i.e., not part of the “nonwaivable list” in 25.10.017). But the waiver must be in writing. RCW 25.15.471(1).

- **Go-forward change**: New LLC Agreements can impose a waiver of dissenter’s rights. But make sure it is clearly stated in written agreement.
Conversions vs Mergers

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<th>CONVERSION</th>
<th>MERGER</th>
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<tr>
<td><strong>Member Approval</strong></td>
<td><strong>Conversion</strong></td>
<td><strong>Mergers</strong></td>
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<tr>
<td><strong>Default Rule</strong></td>
<td>All Members</td>
<td>Majority of Members</td>
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<td></td>
<td>RCW 25.15.441</td>
<td>RCW 25.15.421</td>
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<td><strong>Dissenters’ Rights</strong></td>
<td><strong>Default Rule</strong></td>
<td><strong>Automatic Dissenters’ Rights</strong></td>
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<td>Not provided by statute</td>
<td>Waivable, but only in writing. RCW 25.15.471</td>
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<td><strong>Conversion</strong></td>
<td><strong>Conversion</strong></td>
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<td><strong>Default Rule</strong></td>
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<td>Non-waivable. 25.15.456</td>
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The End

- **But:** If you run into interesting issues or problems with Washington LLC Act, please let me know. We are working on appropriate fixes. [cbrown@karruttle.com](mailto:cbrown@karruttle.com)

- **More resources here:** WSBA Business Law Section, Partnership and LLC Law Committee. [http://www.wabuslaw.org/PartnershipCommittee.asp](http://www.wabuslaw.org/PartnershipCommittee.asp)
Chapter 4

Earn-Outs, Escrows, and Post-Closing True-Ups in M&A—Presentation Slides

Charmin Shiely
Schwabe Williamson & Wyatt PC
Portland, Oregon
OVERVIEW

Getting the Purchase Price Right

• Earn-outs
• Indemnity Holdback Escrow
• Post-Closing Adjustments
VALUING THE BANANA STAND

EARN-OUTS

There’s always money in the banana stand
EARN-OUT CONTEXTS

• Uncertain future prospects
• Start-up company
• Synergistic transaction
• Pending event or outcome
• Deferred financing
• Motivating seller-management performance

FREQUENCY OF EARN-OUTS

2014 – 26% of deals
2012 – 25% of deals
2010 – 38% of deals

American Bar Association – the Private Target Mergers & Acquisitions Deal Point Study ("M&A Study")
(Sample size of 117 publicly available acquisition agreements in deal size range of $50M - $500M, which excluded transactions if target was in bankruptcy, reverse merger or otherwise inappropriate to include).
CAUTION: DISPUTE RISK!

• Potential divergent post-closing interests
  – May motivate Seller management for short-term goals.
  – Buyer may manipulate to reduce or eliminate contingent payout.
• Careful drafting is critical!
EARN-OUT ELEMENTS

• Benchmarks
• Earn-out Period
• Formula for calculating payment
• Post-closing operational covenants
• Seller post-closing participation rights
• Security for deferred payment obligation

EARN-OUT BENCHMARKS

• Narrowly define to address specific area of dispute or uncertainty
  – Keep simple and easy to measure
  – Ensure compatible with company’s operations
• Financial Performance Metrics
  – Revenue vs. Net income
• Use Non-financial metric if appropriate
CALCULATING PAYMENT AMOUNT

- Thresholds/ Percentages / Caps
- Accounting Principles (GAAP vs. consistency with past practice)
- Adjustments (excluding extraordinary items)

OPERATIONAL COVENANTS

- General covenant to use good faith to achieve benchmarks
- Specific covenants tailored to preclude manipulation
- Maintaining separate books / seller access
- Seller participation rights
OTHER EARN-OUT ISSUES

• Consequences of breach of covenants
• Buy-out of earn-out rights
• Security for buyer payment obligation (escrow, security interest, letter of credit)
• Lender subordination requirements

EARN-OUT TAX IMPLICATIONS

• Characterization as deferred purchase price vs. compensation income
• Actual or imputed interest on payments of deferred purchase price
• Timing of gain recognition (installment method)
INDEMNITY HOLDBACK

HOLDBACK ESCROW

• Security for post-closing adjustment and/or post-closing indemnity claims

• M&A Study – 2014, 77% of deals
  2012, 89% of deals
  2010, 86% of deals
ESCROWS: DRAFTING CONSIDERATIONS

- Escrow agreement
- Distribution terms
- Length of escrow in context of indemnity caps and survival periods
- Exclusive remedy
- Multiple escrows
- Amount of indemnity holdback
% OF PURCHASE PRICE HOLDBACK

2014 – 9.14% average
    7.5% median

2012 – 7.83% average
    7.14% median

2010 – 9.3% average
    9.19 median

M&A Study

POST-CLOSING ADJUSTMENTS
POST-CLOSING ADJUSTMENT (TRUE-UPS)

• Purchase Price adjustment based on changes from last financial statement

• M&A Study (2014):
  - 86% of deals included
  - 25% included separate escrow
  - Of 75% without separate escrow, 50% true-up payments from indemnity escrow

POST-CLOSING ADJUSTMENTS:

• Closing Prorations
• Working capital
• Inventory
• Accounts Receivable
• Taxes
POST-CLOSING ADJUSTMENTS - DRAFTING CONSIDERATIONS

- Estimated Closing Adjustments
- Accounting Specifications (GAAP vs. consistency)
- Escrow for post-closing adjustment
- Dispute Resolution

SPECIAL THANKS TO:
THANK YOU

Special thanks to **Cecilia Jeong** for assistance in preparing materials.

Contact:

**Charmin Shiely**

503-796-2768
cshiely@schwabe.com
Chapter 5
Tips for Representing Startups and Emerging Growth Companies

Jonathan Norling
Emerge Law Group PC
Portland, Oregon

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## Startup/Emerging Growth Company Client Checklist

- **Who is the Client?**
  - Principals
  - Entity
  - Investor
  - Other?

- **Is there a business plan?**
  - if no, what is the status?
  - if yes, what is the status?
  - Does it make sense?
  - Does it include financials and a pro forma?
  - Do these make sense?
  - What assets does the Company have?

- **What is the Company’s business?**
  - Services Company?
  - Technology Company?
  - Manufacturing Company?
  - Is it Project finance?
  - Other?

- **Does the company need to raise capital?**
  - If so, what is the existing funding?
  - What options is the Company exploring?
    - Reg D? 506(b)? 506(c)? Reg CF? Other?
  - Are grants available?
  - Is debt an option?
  - Has the company engaged in fundraising?
  - Do you need to clean this up?

- **What is the scope of the representation?**
  - Formation/documentation
  - Fundraising
  - Commercial contracts
  - Specified in the Engagement letter?
  - What if this changes over time?

- **Other Considerations**
  - Does it pass the straight face test
  - Does it pass the smell test?
  - What’s the client’s sophistication?
  - Any red flags?
  - Is a retainer in order?

- **Do your own due diligence!**
  - Google results?
  - Background/bad actor check
10 Tips for Representing Startups and Emerging Companies

Jonathan M. Norling
November 18, 2016

About me:

• Energy/cleantech/cannabis business lawyer
  • Project Development/finance practice
  • Venture financing
  • Business operations financing
  • Practicing for 19 years
  • L&C graduate (’97)/adjunct (since 2009)
The Consultation

• Who?
  • Individual/entity/other

• What?
  • New venture
  • Existing company

• Where?

Tip #1: request all written information
Chapter 5—Tips for Representing Startups and Emerging Growth Companies

The Engagement

- Who is the Client?
- Scope of Representation
- Fee structure
  - Retainer
  - Flat Fee
  - Hourly/DNE

Tip #2: get it all in writing

Congrats!

- You have a new client! Now what?
- Entity formation
  - Determine the right kind of entity
    - LLC
    - Corporation
      - C-Corp/S-Corp/B-Corp
      - Other (Partnership)

Tip #3: file company as soon as possible
Chapter 5—Tips for Representing Startups and Emerging Growth Companies

Approach to Multi-Member LLC

• Term sheet template
• Meeting to get on same page
• Draft OA accordingly

*Tip #4: Don’t draft the Operating Agreement first*

Dig in to the Client

• Google search
• Consider references

*Tip #5: Employ the gut and smell tests*
Dig in to the Business

- Critical analysis of the business plan
  - SWOT
  - Risk factors
  - Financial information/pro forma
  - Capital needs
- Identify external needs: Accountant, business consultant

*Tip:*#6: offer business advice as a value-add

What is the Business?

- Service Company
  - Scope: Formation and “tools”
- Technology company
  - Scope: Formation, IP, fundraising
- Manufacturing
  - Scope: SPE, debt fundraising
- Project finance
  - SPE, debt, structuring, development work

*Tip:*#7: Realize what you do; develop strong relationships
Fundraising

<table>
<thead>
<tr>
<th>Exemption</th>
<th>Pro</th>
<th>Con</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oregon</td>
<td>10 Oregon Purchasers or crowdfunded offerings up to $250k</td>
<td>Limited ability to sell to out of state; integration clause</td>
</tr>
<tr>
<td>506(b)</td>
<td>Can have up to 35 non-accredited investors</td>
<td>Need extensive documentation, audited balance sheet</td>
</tr>
<tr>
<td>506(c)</td>
<td>General solicitation</td>
<td>No non-accredited</td>
</tr>
<tr>
<td>Reg CF</td>
<td>Hip, relatively inexpensive</td>
<td>Limited to $1M</td>
</tr>
<tr>
<td>Reg A+</td>
<td>Up to 50M of crowdfunded securities</td>
<td>SEC process required; expensive</td>
</tr>
</tbody>
</table>

*Tip #8: There is no “friends and family” exemption*

Fundraising, Cont.

Do you need to “redo” the offering?
What are the risks?
Tread lightly in this area: no shortage of plaintiff attorneys
Ovrdisclose! Risk factors are key

*Tip #9: Get the securities rider on your malpractice insurance if you can*
Fundraising, Cont.

Capital Raising Options
- Convertible Debt
- SAFE: simple agreement for future equity
- Equity
  - Common, preferred, vesting
- Debt:
  - Secured, unsecured
  - Recourse/non-recourse

Tip #10: focus on an industry, build relationships
Chapter 6

The Sale Process

KENNETH HAGLUND JR.
Lane Powell PC
Portland, Oregon

M. CHRISTOPHER HALL
Perkins Coie LLP
Portland, Oregon

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- Revlon Duties
- Single-Bidder Sales
- Special Committees
- Closely-Held Company Sales
Chapter 6—The Sale Process

Auctions – Why / Why Not?

- Overview
- Advantages and disadvantages
  - Price / Market Check
  - Negotiation Leverage / Cost of Failure
  - Time and Cost
  - Fiduciary Duties

Revlon and Other Duties

- Legal Framework
- Revlon -- Sale of Control
- Blueprint for Directors
- Fiduciary Outs and Break-up Fees
- Interested Transactions
- Duty of Disclosure
Special Committees

- Role of the Special Committee
- Should one be formed?
- Rules of the Road
  - Independence
  - Retention of Advisors
  - The Power to Say “No”
- [Case Study]

Auctions Process

- Preliminary preparation
- Engage advisors
- Evaluation of potential buyers
- Internal due diligence and preparation of the data site
- Draft and distribute confidentiality agreement / teasers
- Drafting and distribution of Confidential Information Memorandum (CIM)
- Prepare bid package
- Bidder due diligence
- Bidding, negotiation and execution
Chapter 6—The Sale Process

Single-Bidder Sales

- Application of Revlon and recent Delaware decisions
  - Non-Revlon situation
  - Revlon situation:
    - viable passive market check
    - factors supporting a single-bidder process
- Process Compared to Auction
- Practice Points

Closely-Held Company Sales

- Practical Application of Fiduciary Duties
- Practical Considerations other than Economics
Questions
Auctions: From the Seller’s Perspective

by Practical Law Corporate & Securities

An auction is the sale of a company or business where the seller seeks competing bids. Although an auction has all of the same components as a single buyer transaction, there are additional steps and considerations because the seller is dealing with multiple bidders. This Note describes the auction process from the seller’s perspective, including:

- The advantages and disadvantages of an auction to the seller.
- The differences between an auction and a single buyer transaction.

For more information on single buyer transactions, see the following Practice Notes:

- Stock Acquisitions: Overview.
- Asset Acquisitions: Overview.
- Private Mergers: Overview.
- Public Mergers: Overview.
- Tender Offers: Overview.

Advantages and Disadvantages of an Auction to the Seller

There are certain advantages and disadvantages the seller should consider before deciding to auction the target company.

Advantages

The seller seeks a number of the following benefits from the auction process:

- The seller can usually reach more potential buyers through an auction.
- The competitive process maximizes the price by encouraging potential buyers to bid against each other.
- The seller can negotiate more favorable deal terms if there are competing bids.
- The seller controls the sale process and drafts the transaction documents.
- The seller controls the due diligence process, including the number and scope of the documents disclosed and amount of time bidders have to investigate the target company.
- A well run auction functions as a market check (see Box, Revlon Duties and Auctions).
- The seller can gain leverage by keeping confidential the number and identity of the bidders.

Disadvantages

- Not all businesses are suitable for sale by auction. If the market sector is limited and there are only one or two potential buyers, an auction may not be appropriate.
- If a potential buyer has already approached the seller with an offer for the target company, starting an auction process may drive that party to withdraw its offer.
- The cost to the seller is usually higher than in a single buyer sale. The seller typically engages an investment bank and may incur higher legal fees because its lawyers are responsible for drafting documents for and negotiating with multiple parties.
- A prolonged auction process with multiple bidders interrupts daily operations of the target company. Key management may become distracted from their duties because they must participate in due diligence and the drafting of the disclosure schedules for multiple bidders.
- It is often more difficult to prevent employees from learning the company is for sale if senior management is engaged in a complex auction process.

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Chapter 6—The Sale Process

• The seller may have less control over the effect of the sale on management. For example, whether or not management is retained after completion of the sale.

• Some bidders may not be serious about acquiring the target company and are interested only in finding out information about a competitor. Sellers often try to minimize this problem by withholding competitively sensitive information (such as customer contracts) until late in the auction process.

• If the auction process does not result in a sale, the market (including the target company’s competitors, investors, customers and other potential buyers) may think the target company is overvalued or in financial trouble.

Revlon Duties and Auctions

In the context of a change of ownership or the break-up of a corporation, the Delaware courts apply a higher standard when reviewing the conduct of directors (see Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986)). In this context, the Delaware courts have held that the board of directors has the burden of achieving the highest value reasonably available to stockholders (known as Revlon duties). Usually, the highest value is interpreted to mean the highest purchase price, but the board of directors can consider other factors such as certainty of completion and the likelihood of obtaining required governmental consents (such as antitrust clearance). If the directors fail to meet these Revlon duties, they must show the sale transaction was entirely fair to the corporation.

Although an auction may seem like a good way to achieve the highest value for the stockholders, the board of directors must also make sure they:

• Market the company to a wide enough pool of prospective buyers (for example, market the target company to both private equity and strategic buyers).
• Remain involved in the negotiations.
• Employ a reasonable and informed decision making process.

For more information on the fiduciary duties of the board of directors, see Practice Note, Fiduciary Duties of the Board of Directors.

Timing of an Auction

In an auction, multiple bidders submit an offer to purchase the target company. The auction can last from a couple of weeks to several months depending on factors such as:

• **The number of bidders.** If there is a large number of bidders, the process becomes more complicated because the seller conducts the due diligence process and negotiates the transaction documents individually with each bidder.

• **Whether or not the auction is competitive.** If the auction is competitive, the seller has greater control over the process and can demand a shorter time period for due diligence and negotiation.

• **If the transaction is complicated.** Sometimes there are deal-specific issues involving time intensive planning or negotiations such as complicated financing, internal reorganizations or required governmental or regulatory consents. For example, if the target company is part of an interrelated company group, the seller may need to move assets around or arrange to provide certain services to the buyer for after the transaction is completed.

• **Whether the target company is a public company.** If the target company (or the seller or buyer) has an obligation to make public disclosures, then the pre-closing process includes the preparation, filing and review (including the SEC’s review) of the necessary disclosure documents (see Practice Note, Public Mergers Disclosure: Overview).

Transaction Steps: Seller’s Role in the Auction

The number of steps in an auction differs from transaction to transaction, but almost invariably include the steps set out below. For an illustration of the auction process see Auction Timeline.

Preliminary Preparation

In an auction, the seller controls the sale process. Since it is conducting negotiations with multiple parties, the seller needs to take additional steps and use additional resources. As described below, there are certain preliminary preparations every seller should make before contacting the bidders.
Decide to Put the Company Up for Sale

Sometimes an auction is initiated when the board of directors (or the majority stockholder(s)) decides it is in the best interests of the target company to pursue a sale. Other times, a potential bidder submits an unsolicited indication of interest which causes the seller to look for other competing offers. In either case, the board of directors must make an informed decision whether or not to pursue a sale and how to achieve the highest value for its stockholders.

If the board decides to pursue an auction sale, it must also decide whether to structure the auction as either a public or closed auction. During a closed auction, the seller will approach several potential bidders confidentially. On the one hand, this structure may be disadvantageous to the seller because there will likely be less competition. On the other hand, it can be advantageous if there is no competition and the bidder submits a high purchase price believing that there are other bidders. During a public auction, the seller will make a public communication (such as a press release) that it intends to sell its company. The public auction approach often attracts more bidders.

As discussed above, the board of directors has enhanced fiduciary duties when the company is for sale (see *Box, Revlon Duties and Auctions* and *Practice Note, Fiduciary Duties of the Board of Directors*).

Engage Advisors

An auction is more complicated than a single buyer sale because the seller is simultaneously negotiating with multiple parties. The seller needs to engage additional advisors to ensure a smooth process. The seller must assemble its team and set out clearly each member’s responsibilities at an early stage. Typically the seller’s team includes:

- An investment bank as its financial advisor.
- Legal advisors.
- Accountants.
- Key managers of the seller and the target company.

Because the team can be large and includes multiple organizations, it is important to have a point person to organize and coordinate the process. The point person may be the seller, but often the seller delegates this responsibility to its investment bankers. Although deal teams may be organized in various ways, the following is a typical allocation of responsibility:

- **Investment bankers.** Usually play a key role in auctions. They:
  - solicit bidders;
  - draft marketing materials;
  - field requests for access to management;
  - arrange conference calls or visits; and
  - handle due diligence requests, questions about the process and price negotiations.

- At least at the initial stage, bidders are usually not permitted to contact the seller or its employees and must direct all questions or comments to the investment bankers. Investment bankers are also more familiar with the auction process than the seller and know how to keep it organized. Because investment bankers have access to different kinds of bidders (including financial and strategic buyers), engaging an investment bank enables the seller to reach a wider range of potential buyers and often achieve a higher price.

- **Legal counsel.** Typically the seller’s external legal advisors and internal counsel (if any) draft and negotiate the main transaction documents. Legal counsel also works with the investment bankers and the key managers to create the online data site and facilitate the due diligence process. Often counsel reviews the seller’s due diligence materials to identify any material issues, confidentiality restrictions and any competitively sensitive documents. More information about this subject is contained in the following Practice Notes:
  - *Due Diligence for Private Mergers and Acquisitions.*
  - *Due Diligence for Public Mergers and Acquisitions.*

- **Accountants and other consultants.** If the seller relies on third parties for internal reporting or expertise (for example, preparation of financial statements or insurance reports), those third parties will likely need to participate in the preparation of the data site and be available for the bidders’ due diligence investigation.

- **Key managers of the seller.** The seller’s management participates in (or sometimes leads) the creation of the data site and drafting of the disclosure schedules. Managers also need to be available to answer questions from the bidders regarding the target company’s business and operations.
Evaluation of Potential Buyers

The seller may target certain potential buyers because they indicated interest in the target company in the past or because they operate in the same industry as the target company. The investment bank also contacts a wide range of both strategic and financial buyers to see if they are interested in a potential acquisition of the target company. There are other factors besides purchase price and deal terms that the seller and its advisors should consider when evaluating potential buyers. These factors increase transaction costs and transaction risk because they involve extra time, money or impact the certainty of closing. For example:

- **Market share.** If a bidder operates in the same industry as the target company, that may cause problems with antitrust authorities. A lengthy or uncertain approval process with the Federal Trade Commission or the Department of Justice (as well as any foreign antitrust authorities) delays the transaction and increases costs. Antitrust authorities may impose onerous conditions on the sale (such as a requirement to divest certain assets) or block the sale completely.

- **Approvals.** If some bidders need stockholder approvals, investor approvals, material contractual consents or other regulatory consents, this could prevent or delay the transaction.

- **Financing.** If the bidder proposes to finance the purchase with debt or equity, the seller should ensure the full commitment of the source of financing.

- **Operations.** The seller should anticipate bidders’ concerns about the ability of the target company to operate independently after the sale. In some cases, a clean break from the seller may be possible, but often a transition of ongoing supply arrangements or sharing of intellectual property rights, staff or facilities is necessary. Some bidders may be able to make a faster transition than others because they already have the necessary infrastructure.

- **Structure.** Individual bidders may prefer a different sale structure to the one proposed by the seller. For example, a bidder may prefer an asset sale to a stock sale. Sometimes bidders bid on certain assets rather than the whole company.

- **Level of interest.** The seller should beware of buyers on “fishing expeditions.” These buyers often do not have a serious interest in purchasing the target company and instead are trying to gauge its value or trying to learn confidential information from a competitor.

Internal Due Diligence

One of the potential benefits of an auction is that the seller controls the due diligence process. In a typical single buyer sale, the buyer supplies its own list of requirements. More information about this subject is contained in the following Standard Documents:

- *Due Diligence Request List: Public Mergers and Acquisitions.*
- *Due Diligence Request List: Private Mergers and Acquisitions.*

In an auction, the seller typically limits (as reasonably as possible) the amount of information disclosed and attempts to provide the information in a controlled manner. If the target company is a public company, the seller can further limit its disclosure since a significant amount of information is publicly available in its SEC filings. If some of the bidders are competitors of the target company or if some information is particularly sensitive (such as pricing information), the seller often withholds that information until there are only one or two bidders remaining (see Practice Note, Information Exchange and Integration Planning in M&A: Antitrust).

Since the seller controls the due diligence process, it must prepare a well-indexed and comprehensive set of documents (see Box, Information on the Data Site). Usually the seller (or its advisors) must investigate the target company’s business in order to identify all problems so that they can be dealt with at the outset of the transaction. The seller should avoid receiving unpleasant surprises later in the process because they can have a negative impact on the seller’s negotiating leverage. For example, the seller should seek to ensure contract or title problems, potential claims and other contingent liabilities, environmental issues, significant litigation and the need for third party consents and clearances are properly identified before inviting bidders to conduct their own due diligence.

Preparation of the Data Site

The most common method of distributing due diligence materials is via an online data site (as opposed to a physical data room or CD-ROM). An online data site permits multiple bidders password protected access to the same documents without knowledge of each others’ identities. Usually the seller can limit access of certain documents to certain parties, track a bidder’s usage of the site or restrict dissemination (such as the ability to view, but not print documents).

Once the seller identifies the material due diligence documents, they can begin setting up the data site, indexing the documents and loading them onto the site (see Box, Information on the Data Site). There are several companies that provide an online data site service (such as Intralinks). The data site companies typically assign a customer representative to help the
seller and its advisors organize the process and navigate the data site. These customer service representatives are usually available for questions and to make changes throughout the auction.

Before loading documents onto the site, the seller and its advisors must create an index. A good index is critical to keeping the process organized, responding to bidders’ requests and questions and preparing the disclosure schedules. The documents are typically indexed according to category (such as financial or environmental). The index can be viewed on the data site and can be modified as new documents are added. Once the index is completed, documents can be uploaded to the data site. Depending on choice of service, the documents are uploaded (via pdf) by employees of the seller or the service company.

**Drafting and Distribution of Documentation**

In an auction, the seller prepares the first draft of all documents. This gives the seller a substantial negotiation advantage. The seller may factor the bidder’s mark-up of the documents into its final decision, which incentivizes the bidder to make fewer changes. In a competitive auction, the bidders may accept the seller’s drafts with only minor negotiations. If the auction is less competitive and the bidders have more leverage, then the negotiation process more closely resembles a single buyer sale process. The key documents drafted by the seller are listed below in order of distribution. The investment bank typically distributes the documents electronically, but certain documents (such as the confidential information memorandum) may be mailed.

**Draft and Distribute Confidentiality Agreement**

Confidentiality is important in all sale transactions, but in an auction, confidentiality is crucial because of the greater number of parties involved. The risk of a leak of confidential information or the existence of sale discussions is greater than in a single buyer transaction. It is also important to prevent the bidders from talking to each other without the seller’s consent. Cooperation amongst the bidders can lead to less favorable sale terms if the bidders know what others are offering or the terms the seller accepted from a particular party. The seller should get an executed confidentiality agreement from each bidder before sending out any proprietary information (including the confidential information memorandum). Sometimes the seller (or the investment bank on behalf of the seller) sends the confidentiality agreement with a “teaser.” A teaser is a marketing document which gives a brief description of the target company and highlights a few facts that make it an attractive acquisition target. Bidders may negotiate the terms of the confidentiality agreement, but typically avoid lengthy negotiations that delay the distribution of materials (see Practice Note, Confidentiality Agreements: Mergers and Acquisitions and Standard Document, Confidentiality Agreement: Mergers and Acquisitions).

If the seller is publicly traded, it may also incorporate a standstill agreement into the confidentiality agreement so that the restrictions are in effect at the early stages of the transaction before the seller releases confidential information. The standstill restricts the bidder’s right to acquire the seller’s securities. For an example of a standstill provision, see Standard Document, Confidentiality Agreement: Mergers and Acquisitions: Standstill.

**Prepare Confidential Information Memorandum**

The seller and its investment bankers prepare the confidential information memorandum (the CIM). A key document in an auction, the CIM is a marketing document giving bidders a reasonable amount of information about the target company in order to elicit meaningful bids. It usually contains the following information:

- A description of the target company’s industry, business, history and principal assets.
- Up-to-date and historical financial information and projections.
- Information about management and employees, including the senior management team and board of directors.
- Depending on sensitivity, information about major customers and contracts.

The CIM also contains language stating the seller is not making any **representations or warranties** regarding the information provided in it.

**Draft and Prepare Bid Package**

The bid package typically includes a bid process letter and the purchase or merger agreement. The bid process letter explains the rules and procedure of the auction, including how to communicate with the seller, the date when bids are due, the due diligence process, if and when there will be a management presentation and site visit, how many bidding rounds are expected and what each bid submission must include (see Bidding and Negotiation). The seller may send the disclosure schedules in the bid package or wait until a later round to distribute them. In some cases, the seller offers a prearranged financing package (known as seller financing or staple financing).

Before drafting the transaction documents, the seller needs to determine the structure of the transaction and its negotiation approach (for example, aggressive or moderate). Like a single buyer transaction, if the target company is privately held, it is possible to structure the transaction in various ways (see Practice Note, Private Acquisition Structures). If the target company...
is a public company, the sale is structured as a merger, but the type of merger varies depending on business, financial and legal factors (see Practice Note, Public Mergers: Overview).

In determining its approach to drafting the sale documents, the seller should resist the temptation to make the documents too one-sided. If the documents are too seller-friendly, a bidder may feel justified in making major modifications because it assumes no other bidder will agree to those terms. For example, if the seller does not make customary representations or warranties or refuses to indemnify the buyer for any breaches, the bidders will likely build in more buyer favorable provisions. The seller is often better able to persuade bidders it will not accept wholesale amendments to the documents if the drafts are reasonable and appear to have taken into account at least some of bidders’ likely concerns. If there are problems which will affect all bidders, it may be better for the seller to address those issues in the first drafts with some suitably crafted wording, rather than leaving them to be addressed by each bidder individually and differently. The seller should take its position on issues such as the scope of and exceptions to the representations and warranties (for example, as to the seller’s knowledge and materiality) and the time and monetary limits to apply to indemnification. For more information on the various types of purchase agreements see the following Practice Notes:

- Stock Purchase Agreement Commentary.
- Asset Purchase Agreement Commentary.
- Merger Agreement Commentary: Public Mergers and Acquisitions.

For examples of purchase agreements that can be used in auctions, see Standard Documents:

- Asset Purchase Agreement (Pro-Seller Long Form).
- Stock Purchase Agreement (Auction Form).

Bidder Due Diligence

Once each bidder executes and delivers the confidentiality agreement, the seller grants the bidder and its advisors access to the data site. Sometimes (particularly if some of the bidders are competitors) access is limited until a later stage in the auction. Bidders and their teams review the documents and often send lists of requests for additional documents and questions to the seller via its investment banker. Depending on how competitive the auction is and how reasonable the requests are, the seller’s team may supplement the data site or arrange conference calls to answer questions.

Usually early in the process the seller conducts management presentations and site visits for each of the bidders. Since the seller wants to keep the bidders’ identities secret, the seller typically holds meetings with each bidder individually. Management presentations are carefully prepared and scripted, so all issues are handled consistently between the different bidders and disclosure of any sensitive issues is handled in accordance with a plan. Whenever possible, bidders should be invited to submit their questions in writing for review in advance of management meetings. Representatives of the seller or its advisors or both should attend management meetings to ensure that questions do not go outside the plan and that appropriate answers are given to questions.

The management presentation will typically include an overview of the following:

- The history, market characteristics, key trends and competitive landscape of the company.
- The products, brands, customers, research and development, pricing and marketing.
- The board of directors, senior management team and key employees.
- The current and historical financials, management’s financial projections and cashflow forecasts.

For more information on due diligence see Practice Notes:

- Due Diligence for Private Mergers and Acquisitions.
- Due Diligence for Public Mergers and Acquisitions.

Bidding and Negotiation

The number of bidding rounds in an auction, the amount of due diligence and document negotiation completed before each round and how comprehensive the bid submissions are at each stage varies from auction to auction. The seller explains the auction process in its bid process letter and instructs bidders what to include in each bid submission (see Draft and Prepare Bid Package). Often the structure of the auction depends on factors such as:

- Number of bidders.
- Level of competition.
Chapter 6—The Sale Process

- Complexity of the target company’s business.
- Seller’s proposed timing until closing.

Typically the bidding process falls into one of the following categories.

**One Round**

On or before the bid deadline, each interested bidder submits a letter detailing its bid, including proposed purchase price and type of consideration, proposed financing (if any), any conditions to the offer and either a mark-up of the purchase or merger agreement and disclosure schedules or list of issues. The seller and its advisors consider each proposal, weighing purchase price and deal terms. The board of directors selects a winner. If the winning bid is acceptable as is, the parties may execute a binding purchase agreement with only minor changes. If further negotiation and due diligence is necessary, then the seller may agree to deal exclusively with the winning bidder and execute an exclusivity agreement (see Practice Note, Exclusivity Agreements). During the exclusivity period the bidder continues to conduct due diligence and the parties continue to negotiate the purchase agreement until execution.

**Multiple Rounds: Conditional Bid and Comprehensive Bid**

Sometimes the first round of bidding is merely an indication of interest. This round is meant to eliminate bidders not serious about purchasing the target company. It can also eliminate bidders who are only interested in gaining confidential information of the seller. Typically bidders submit a non-binding purchase price and type of consideration, proposed financing (if any) and a list of conditions such as the completion of due diligence or the resolution of certain high level issues. If bidders include a mark-up of the purchase or merger agreement in the bid, it is not a final submission, but conditioned on several factors. In this round, a bidder that takes an aggressive position on documents and due diligence is likely to get through to the second round if its price is in the right range. The seller and its advisors consider each proposal, evaluating purchase price and the attached conditions. Typically purchase price is the main factor for deciding which bidders advance to the second round, although an offer with too many conditions may get rejected regardless of the price.

If the bidders raised issues or due diligence questions in their first round bid proposals, the parties work to address those concerns before the second round bid date. The second round will typically start with another bid process letter and a draft of the purchase agreement. The second round bids are significantly more comprehensive and less conditional than the first round bids. These submissions should include a firm purchase price and type of consideration, proposed financing (if any), a limited number of conditions (if any) and a comprehensive mark-up of the purchase or merger agreement and disclosure schedules. The seller and its advisors consider each proposal, weighing both purchase price and deal terms. The board of directors selects a winner. If the winning bid is acceptable as is, the parties may execute a binding purchase agreement with only minor changes. If further negotiation and due diligence is necessary, then the seller may agree to grant exclusivity to the winning bidder as discussed above. During the exclusivity period the bidder continues to conduct due diligence and the parties continue to negotiate the purchase agreement until execution.

**Multiple Rounds: Two Comprehensive Bids**

In this case, bidders submit a comprehensive bid as if there is only one round, but either the bids are too close to each other for the seller to pick a winner or the seller wants to keep a group of bidders competing to increase its negotiating leverage. In this situation, the seller may favor one particular bidder, but wants the bidder to believe it must compete against the other bidders. After additional negotiation and due diligence, bidders once again submit a comprehensive bid. Although the seller can repeat this bidding stage more than twice, the seller typically picks a winner after the second round to ensure the auction does not lose momentum.

**After Execution**

After the signing of the purchase or merger agreement, an auction proceeds exactly the same as a typical single buyer sale transaction (see Practice Note, Signing and Closing M&A Transactions). If the target company is a public company, preparation for closing involves, among other things, the filing of a proxy statement with the SEC and holding a stockholders’ meeting (see Practice Note, Public Mergers Disclosure: Overview).
Information on the Data Site

The information on the data site should contain information pertaining to any items listed on the disclosure schedules and other material information about the target company. If the target company is a public company, the site typically does not include materials publicly available via **EDGAR**. An auction data site typically contains the following information and documents:

### Financial
- Historical accounting information.
- **Capital expenditures.**
- Information about capital stock and debt, distinguishing between intergroup loans and bank or other third party loans.
- Copies of loan and security documents and **guaranties**.
- Business plan or projections for the current year.

### Taxation
- Copies or summaries of income tax returns for the last three years.
- Summaries of any ongoing audits.
- Copies or summaries of revenue agent reports for the last three years.

### Organizational Documents
- The certificate of incorporation and by-laws (or the equivalent documents) of the target company and any subsidiaries.
- Details of any arrangements with directors and officers.
- Any stockholder arrangements.

### Assets
- Details of principal assets.

### Contracts
- Details of major suppliers and customers, and copies of relevant contracts (although because of commercial sensitivity, some of these may be held back until the preferred bidder has been selected).
- Contracts with principal agents and distributors.
- Joint venture agreements, licenses and other material contracts.

### Licenses
- Details of licenses and permits required for the target company’s business.

### Employment
- Employment contracts with directors and key employees.
- Standard terms and conditions of employment for other categories of staff.
- Details of pension plans and other employee benefits such as profit-sharing plans.
- Analysis of workforce and length of service.

### Property
- Details of major factories and offices.
- Copies of title deeds to properties owned by the target company.
- Copies of any material leases for real property.

### Intellectual property
- Details of patents, trademarks, copyright and other intellectual property used by the target company.
- Licenses of intellectual property rights.
- Details of computer systems and software used.

### Insurance
- Copies of insurance policies and claims information.

### Litigation
- Details of liabilities, including litigation or **arbitration** proceedings, and other disputes or investigations (including environmental disputes and investigations) affecting the target company.
Chapter 6—The Sale Process

Auctions: From the Bidder’s Perspective

by Walter J. Mostek, Jr., Scott B. Connolly, Justin J. Watkins and Craig L. Bazarsky, Drinker Biddle & Reath LLP

An auction is the sale of a company or business where the seller solicits bids from potential buyers. The auction process creates a competitive environment in which all potential buyers must submit bids that the seller can more easily compare. Accordingly, from the bidder’s perspective, an auction has some fundamental differences from a negotiated transaction between a single buyer and a single seller.

Unlike in a negotiated transaction, the seller controls the auction process. It will try to maximize its bargaining leverage by:

• Developing a timeline that requires potential buyers to submit bids on an expedited schedule (which allows the seller greater time to renegotiate more favorable terms from the bidder after it accepts a bid).
• Controlling the timing and scope of access to due diligence materials.
• Providing an initial draft of the acquisition agreement to each bidder for its review.
• Factoring the bidder’s markup of the acquisition agreement into its final decision (which incentivizes the bidder to make fewer changes).
• Keeping confidential the number and identity of bidders in the auction.

Another difference from a negotiated transaction is the timing for the involvement of counsel. The bidder should engage its counsel in the auction process from the beginning. Counsel can assist the bidder with several aspects, such as:

• Establishing a strategy for conducting legal due diligence.
• Formulating a negotiating strategy.
• Preparing a markup of the target form of acquisition agreement or a memorandum summarizing comments and open items.

The seller may structure the auction as a closed auction or a public auction. During a closed auction, the seller will approach several potential bidders confidentially. On the one hand, this structure may be advantageous to the bidder because there will likely be less competition. On the other hand, it can be disadvantageous if there is no competition and the bidder submits a high purchase price believing that there are other bidders.

During a public auction, the seller will make a public communication (such as a press release) that it intends to sell its company. The public auction approach often attracts more bidders. In both types of auction, the bidder is usually unable to determine the existence or identity of other bidders and must appropriately balance its desire to win the bid with its need for favorable terms. If the bidder emphasizes terms favorable to the bidder, it could lose the bid, which results in lost time and unreimbursed costs. Conversely, if the bidder focuses on winning the bid by proposing seller-friendly terms, such as a high purchase price or limited representations, warranties and indemnities, the bidder may not get the benefit of its bargain in the long run.

In addition to these differences from a negotiated transaction, there are other considerations and concerns for a bidder in an auction. This Note describes the auction process from the bidder’s perspective, including the:

• Preliminary steps that the bidder undertakes.
• Principal concerns that the bidder has when reviewing and marking up the acquisition agreement.
• Strategies involved with preparing the bid package that the bidder submits to the seller.
• Changing dynamics that occur during later bidding rounds and negotiations.

For information on the auction process from the seller’s perspective, see Practice Note, Auctions: From the Seller’s Perspective.

Preliminary Steps

The auction process commences with the seller conducting a search to identify potential bidders. Each bidder often receives a two to five page summary, known as a “teaser,” that describes the target company, its business and its strategic objectives.

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The teaser is usually accompanied by a confidentiality agreement that each bidder must enter into before it can continue with the bidding process.

**Negotiate Confidentiality Agreement**

The confidentiality agreement will be subject to negotiation between the seller and each bidder. When reviewing the confidentiality agreement, the bidder should consider limiting comments to essential substantive matters, avoiding unnecessary or stylistic changes. Otherwise, the bidder may be perceived as an undesirable negotiating partner by the seller.

The confidentiality agreement may contain certain provisions particular to an auction, such as provisions prohibiting a bidder from talking to other bidders or to certain financing sources, or engaging in discussions regarding the target company with other companies. A strategic bidder in the same industry as the seller may have existing relationships with the other bidders as customers, suppliers or as strategic partners. If so, then that bidder may be unwilling or unable to agree to any restrictions.

The confidentiality agreement may also prohibit a bidder from talking to the seller’s customers and suppliers. Many of the seller’s customers and suppliers may also be customers and suppliers of the bidder. As a result, the bidder should require the confidentiality agreement to permit continued interaction with these customers and suppliers in the ordinary course of business, provided that the bidder does not discuss the target company or its proposed transaction with the target company. If not, then the bidder may be restricted in how it operates its business.

For publicly traded sellers, the bidder may also be required to sign a standstill agreement. Sellers often incorporate the standstill into the confidentiality agreement so that the restrictions are in effect at the early stages of a transaction, before the sellers’ release of confidential information. A standstill restricts the bidder’s right to acquire the seller’s securities. Sellers typically want this agreement because it helps them stay in control of the deal process and prevents a bidder from using confidential information to facilitate a hostile takeover. Bidders typically resist signing because they want to remain flexible with how to structure the sale. For example, if the bidder cannot negotiate with the board, it may want to go directly to the stockholders and acquire shares of the company. For this reason, standstills are often highly negotiated.

For more information on confidentiality agreements in mergers and acquisitions, see *Practice Note, Confidentiality Agreements: Mergers and Acquisitions*.

For more information on standstill agreements, see *Practice Note, Standstill Agreements in Public M&A Deals* and *Standard Document, Confidentiality Agreement: Mergers and Acquisitions: Standstill*.

**Review Confidential Information Memorandum and Bid Process Letter**

After the bidder has entered into a confidentiality agreement, the bidder will likely receive a confidential information memorandum (the CIM) and bid process letter from the seller. The CIM provides more detailed information about the target company than the teaser to elicit meaningful bids. It usually contains the following information about the target company:

- A description of the industry, business, history and principal assets.
- Current and historical financial information and projections.
- Information about management and employees, including the senior management team and board of directors.
- Information about major customers and contracts to the extent the seller is comfortable disclosing this information at this stage of the process.

The bidder should carefully review the contents of the CIM. While the CIM often states that the seller is not making any representations or warranties about the information provided, the seller’s description of its business, assets and financial condition often alerts the bidder to potential due diligence issues that it must address later in the auction process.

The bid process letter sets the stage for the auction. It explains the rules and procedures of the auction, including:

- How the bidder may communicate with the seller and the seller’s investment bank.
- The date when bids are due.
- The due diligence process.
- If and when there will be a management presentation and site visit.
- How many bidding rounds are expected and what each bid package must include.

The information contained in the bid process letter often gives the bidder a sense of how long the auction process will last, the degree of competitiveness that the seller anticipates and the level of communication that bidders may have with the seller’s management during the process.
Assemble Team

The bidder should engage legal counsel, financial advisors, accountants and any other specialists whose expertise the bidder may require before submitting its initial bid, if possible. If the bidder successfully proceeds to later rounds of bidding, it will be very difficult for the bidder to re-trade any material terms of its bid based on further input from its outside advisors. The bidder must, however, balance the need for input from its advisors against a desire to limit costs associated with a transaction the bidder may not ultimately be able to close. The bidder should therefore identify the nature of the engagement as being in connection with an auction and set clear guidelines on the nature and scope of the services the bidder requires. The bidder should also ensure each advisor is aware of its area of responsibility to avoid costly duplication of effort.

Attend Management Presentation and Site Visit

The seller’s management team may prepare a presentation for the bidder’s key decision makers. The seller will likely seek to keep the bidders’ identities secret by interacting with each bidder individually. The bidder and its counsel should prepare in advance for the presentation or call by identifying questions to ask the target company’s management. Sellers often request that these question be submitted in writing in advance of the presentation or call. The bidder should ensure its questions are both insightful and noncombative. In addition to considering the bidder’s questions, the seller and its investment banker will gauge the bidder’s commitment by making note of the number of bidder representatives that attend and their rank within the bidder’s organization. The management presentation will typically include an overview of the following:

- The history, market characteristics, key trends and competitive landscape of the company.
- The products, brands, customers, research and development (R&D), pricing and marketing.
- The board of directors, senior management team and key employees.
- The current and historical financials, management’s financial projections and cashflow forecasts.

The seller’s management team may also give a tour of its major facilities and afford the bidder an opportunity to ask questions.

Conduct Due Diligence Review

Before requesting due diligence materials from the seller, the bidder may be able to conduct an initial due diligence review from public information. This could include SEC filings for a public company, company websites, litigation docket searches, Patent and Trademark Office searches, UCC lien searches and good standing certificates from the secretary of state. After conducting this initial due diligence, the seller typically posts disclosure documents in an online data room for the bidder to review. Most due diligence is conducted through online data rooms, so bidders no longer need to travel to the seller’s location. This saves both time and expenses for the bidder. Online data rooms, however, also allow the seller to easily limit access or restrict certain functions, such as printing documents, and to track access by each bidder and its representatives.

The level of access that a bidder has to due diligence materials varies, depending on the transaction. In some auctions, a bidder will have access to a limited number of documents in the initial bidding round. In other auctions, a bidder may not be permitted to make a due diligence request until after the seller has chosen that bidder’s bid. The seller often allows the bidder only a short time to conduct due diligence before bids must be submitted. A bidder wishing to conduct a complete diligence review in a short timeframe may incur substantial costs resulting from the time and effort required of counsel, financial analysts and other specialists. These cost constraints may limit the amount of due diligence that some bidders conduct, especially early in the auction process.

The bidder may have access to the following documents:

- Financial and accounting information including audited financials, tax information, and accounting policies and procedures.
- Management and employee information including organization charts, employee policies and benefits, pensions and employment contracts.
- Operating and facilities information including environmental reports, R&D activity and management information systems.
- Supplier and customer information including lists of the most important suppliers and customers, supply contracts and license agreements.
- Legal information including litigation matters, board minutes, resolutions, stock certificates and organizational documents.
- Other information including press releases, product brochures and marketing information.
Due diligence may also occur in several phases. If the auction consist of multiple rounds of bidding, the due diligence review may become more extensive or delve into more substantive issues. Other auctions may only allow expansive due diligence to be conducted by the winning bidder after its bid is chosen. The documents that the bidder should insist on reviewing in the preliminary stage are determined by the structure of the sale. For example:

- With a stock purchase, the bidder should request the target company’s governing documents, stock certificates, material contracts, financial statements and any documents related to litigation and liabilities.

- With an asset purchase, the bidder should request recorded titles to property, lien searches, financing agreements and any documents regarding potential encumbrances or security interests on the assets to be acquired. The bidder should also review financial statements and information regarding litigation and liabilities, but these items are less relevant in the asset purchase context, particularly if the bidder is a strategic buyer hoping to integrate selected assets in its current operations.

- In general, the bidder should request the disclosure of any documents that could impact the purchase price or the bidder’s general desire to complete the transaction and any material third-party consents that may be required.

The bidder should be sensitive to the amount and nature of the due diligence requests that it makes. Burdensome or excessive requests by a bidder may indicate that it will be difficult to work with and may dissuade the seller from selecting that bidder’s bid. The bidder should refrain from using standard due diligence checklists and instead should supplement the data room index prepared by the seller with its requests.

The due diligence process is also an opportunity for the bidder to demonstrate its interest by performing as thorough a review of the documents as time allows. With virtual data rooms increasingly being the standard method by which the seller makes disclosure, the seller can easily monitor each bidder’s access to the disclosed documents and may use this data as an indicator of a bidder’s interest in the transaction.

Although the bidder may not have direct access to the seller during the early stages of the auction, it can sometimes solicit information from the seller’s investment banker that is not formally disclosed to all bidders. In addition, conversations with the investment banker may indicate what level of preliminary interest the bidder should demonstrate to advance to further rounds of bidding. Conversations with seller’s management, if feasible, may allow the bidder to identify other bidders against which it is competing and management’s perceptions of those other bidders.

For more information on due diligence in mergers and acquisitions, see Practice Notes:

- *Due Diligence for Private Mergers and Acquisitions.*
- *Due Diligence for Public Mergers and Acquisitions.*

**Review and Mark-up of Acquisition Agreement**

The acquisition agreement that the seller distributes to each bidder is similar to acquisition agreements in negotiated transactions. However, the initial draft of the acquisition agreement in an auction is drafted by the seller. Therefore, it generally reflects the seller’s positions on key transaction terms, such as the form of consideration, conditions to closing, the scope of representations and warranties and limitations on indemnification. The terms of the acquisition agreement can vary widely and may be very favorable to the seller or more neutral.

Each bidder typically submits either a mark-up of the acquisition agreement or an issues list regarding the acquisition agreement as part of its bid package, depending on the bid procedures. If the bidder submits a mark-up of the acquisition agreement, it should consider limiting its comments to substantive issues and refrain from making stylistic changes to the document. A heavy mark-up can signal that there will be a long and difficult negotiation, while a mark-up with fewer changes can signal a quick negotiation. Typically, the two most important issues from the bidder’s perspective are the purchase price and any risk allocation provisions, such as representations, warranties and indemnities. The successful bidder should focus on these aspects when making its mark-up and avoid adding burdensome or open-ended conditions to closing. Instead of sending a full mark-up of the acquisition agreement, the bidder may be required to or may choose to submit an issues list indicating specific points that the bidder wants to negotiate. The issues list can be helpful to focus the bidder and seller on those aspects of the acquisition agreement that are of the greatest importance to each party.

Generally, the bidder must make a tactical decision on how aggressive it should be during negotiations. This decision can be difficult, especially if there is limited due diligence made available by the seller before the bidder must submit its mark-up of the acquisition agreement or its issues list. The bidder should balance its desire to close the deal against its need to include certain terms and risk allocation provisions in the acquisition agreement. The bidder should attempt to achieve its goals in a way that simultaneously furthers the seller’s interests. Substantially changing the scope of the seller’s representations and warranties, for example, may necessitate extensive and time-consuming changes to disclosure schedules that the seller will...
want to avoid. The prudent bidder may accomplish the same objective by making limited but purposeful comments to indemnification provisions. An important caveat is that the bidder’s behavior in an auction process may change significantly if it suspects that it is the only serious bidder in the auction. In that case, a bidder may have greater leverage, particularly if the seller has limited options beyond the sale of its business.

For more information on the various types of purchase agreements, see Practice Notes:

- *Asset Purchase Agreement Commentary.*
- *Stock Purchase Agreement Commentary.*

### Bid Package

When making its bid, the bidder submits a bid package that typically consists of a bid letter and either a mark-up of the acquisition agreement or an issues list, depending on the bid procedures. The bid letter is similar to a letter of intent in a negotiated transaction and usually describes:

- The proposed purchase price and type of consideration (including any proposed adjustments, such as a post-closing working capital adjustment).
- Any proposed financing, with evidence that the bidder will be able to receive the financing at closing.
- A list of closing conditions such as the completion of due diligence or the resolution of certain high-level issues.

An important tactical decision for the bidder is whether or not to fully comply with the bidding procedures, particularly when the seller requests a full and final mark-up of an acquisition agreement based on limited due diligence. Because submitting a full mark-up is virtually impossible without the acceptance of significant risk and the incurrence of substantial costs by a bidder, many bidders opt to submit detailed mark-ups or issues lists that focus on conceptual issues rather than specific language. The decision of how to comply with bidding procedures is often determined by the bidder’s perceived leverage and desire to close the transaction. The bidder’s legal and financial advisors should discuss the form the bid will take early in the process to avoid unnecessary time and expense.

The most important part of the bid letter is the proposed purchase price. The bidder should include a purchase price that is both attractive and credible from the seller’s perspective. The seller may dismiss a low purchase price as economically unattractive, and it may question the seriousness of a bidder that submits an exceptionally high purchase price, suspecting that the high offer will be substantially reduced in later negotiating. The bidding procedures often require the bidder to include the methodology that it used to arrive at its purchase price, such as a multiple of EBITDA. The bidding procedures may also request a detailed calculation for the valuation. Bidders should resist including this type of information without extensive due diligence as sellers often use it to negotiate an increased purchase price later in the process.

The form of consideration is also an important factor in a seller’s analysis of potential bids. A bidder that offers forms of consideration that are contingent, potentially illiquid or with an uncertain valuation, such as equity, contingent payments, earn-outs or promissory notes, may be less attractive than a bidder that makes an all-cash offer, even if the cash offer constitutes a lower purchase price overall.

The seller will often focus on certainty of closing when evaluating competing bids. Sellers also factor in other conditions to closing, including any regulatory, board or shareholder approvals. Bidders have, therefore, historically sought to limit their reliance on financing contingencies and similar walk away rights, although these provisions are more common in times when there is general illiquidity in the credit market.

Finally, the bidder should include in its bid package that the bid is non-binding and confidential. The bidder may also want to limit the time period that the offer remains open and require exclusivity if accepted.

### Later Bidding and Negotiation Rounds

The auction process may include multiple rounds of bidding. The number of bidding rounds in an auction and how comprehensive the bid submissions are at each stage vary from auction to auction. Sometimes the first round of bidding is merely an indication of interest. This round is meant to eliminate bidders not serious about purchasing the target company. It can also eliminate bidders who are only interested in gaining confidential information of the seller. In this round, the bidder will typically submit a non-binding purchase price, the type of consideration, any proposed financings and conditions to closing. A bidder that takes an aggressive position on documents and due diligence is likely to get through to the second round if its price is in the right range. The seller and its advisors consider each proposal, evaluating purchase price and any conditions. Typically, the purchase price is the main factor for deciding which bidders advance to the second round, although an offer with too many conditions may get rejected, regardless of the price. If the bidders raised issues or due diligence
questions in their first-round bid proposals, the parties usually work to address those concerns before the second-round bid date.

In later rounds, the seller will simultaneously negotiate with the other bidders in an effort to elicit bids with a higher purchase price or more favorable terms by playing one bidder against another. The second-round will typically start with another bid process letter and a draft of the purchase agreement. The second round bids are significantly more comprehensive and less conditional than the first round bids. The bid should include a firm purchase price and type of consideration, proposed financing (if any), a limited number of conditions (if any) and a comprehensive mark-up of the purchase or merger agreement and disclosure schedules. If the winning bid is acceptable as is, the parties may execute a binding acquisition agreement with only minor changes. If further negotiation and due diligence are necessary, then the seller may agree to deal exclusively with the winning bidder and execute an exclusivity agreement (see Practice Note, Exclusivity Agreements). During the exclusivity period, the bidder continues to conduct due diligence and the parties continue to negotiate the acquisition agreement until execution.

After the signing of the acquisition agreement, an auction proceeds similar to the typical single buyer sale transaction (see Practice Note, Signing and Closing M&A Transactions). If the target company is a public company, preparation for closing may involve, among other things, the filing of a proxy statement with the SEC and holding a stockholders’ meeting (see Practice Note, Public Mergers Disclosure: Overview).

For more information regarding stages of bidding, see Practice Note, Auctions: From the Seller’s Perspective.

Teaming up With Other Bidders

In some instances, a bidder may choose to team up with other bidders and submit a joint bid to the seller, called a consortium bid. Bidders may choose to combine their resources to submit an attractive bid with a higher purchase price than each bidder would individually be capable of making. However, some sellers explicitly require that potential bidders agree, as a condition to entering the auction process, not to team up with other bidders without the seller’s permission. Sellers often include this condition in the confidentiality agreement. The seller may expressly prohibit each bidder from making any agreement to refrain from bidding against other bidders in an effort to lower the purchase price. In some circumstances, antitrust laws may also restrict bidders from teaming up in this manner.
**Chapter 6—The Sale Process**

This timeline highlights the typical stages in a single round private company auction. Like any acquisition, the timing in an auction varies from deal to deal. However, almost all auctions have the same structure. Auctions can run from a few weeks to many months. This timeline assumes a period of 12 weeks from inception to closing.

### AUCTION TIMELINE

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<tr>
<th><strong>Bidder</strong></th>
<th><strong>Seller</strong></th>
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<tr>
<td>Sometimes an auction is initiated when potential bidders submit unsolicited indications of interest. Other times the auction is initiated by the seller.</td>
<td>Week 0-2 Seller's board of directors (or its equivalent) of the seller approves pursuit of a sale transaction.</td>
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<td>Week 0-2 Seller engages legal and business advisors to facilitate sale process.</td>
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<td>Week 2 Seller distributes confidentiality agreement and “teaser” highlighting information about the target company to potential bidders.</td>
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<td>Week 2 Parties execute the confidentiality agreement.</td>
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<td>Interested bidders may begin market research and initial business due diligence with available information.</td>
<td>Week 2</td>
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<td>Week 3 Seller prepares and distributes the confidential information memorandum and bid process letter.</td>
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<td>Week 3 In larger auctions, the seller may hold a preliminary round and ask bidders to submit an indication of interest before distributing further information.</td>
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<td>Week 3-4 Seller distributes transaction agreement to potential bidders.</td>
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<tr>
<td>Interested bidders conduct due diligence (legal and other) and review the transaction agreement.</td>
<td>Week 4 Seller provides access to due diligence materials (often via an online data site).</td>
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<tr>
<td>Bidders secure any necessary debt and/or equity financing commitments.</td>
<td>Week 4-7 Seller holds management presentations for interested bidders.</td>
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| Bid deadline (bidders submit bid letter; marked-up transaction agreement and financing commitment letter(s)). | Week 7-8 Seller board reviews bid submissions and:  
- Accepts a bid and signs the transaction agreement;  
- Grants exclusivity to a bidder and continues negotiations;  
- Continues to negotiate with several parties; or  
- Rejects all bids and terminates the auction process. |
| Bidder obtains any necessary approvals before executing transaction agreement. | Week 7-9 Seller obtains any necessary board and/or stockholder approval. |
| Parties negotiate and sign transaction documents. | Week 7-9 |
| Bidder negotiates debt and/or equity financing. | Week 9-12 |
| Transaction closes. | Week 9-12 Parties prepare for closing. |

**Key**
- Action by one party
- Action by both

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Stock Purchase Agreement (Auction Form)\(^1\)

by Practical Law Corporate & Securities

Environmental provisions by Andrew N. Davis, Ph.D. and Aaron D. Levy, Shipman & Goodwin LLP. Employment and labor provisions by Michael A. Hausknecht, Nixon Peabody LLP. These provisions are periodically updated by the contributors. With respect to their respective contributed portions, the contributors' views expressed herein do not necessarily reflect the views of their firms or clients.

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<th>STOCK PURCHASE AGREEMENT</th>
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Recitals

(A) WHEREAS, Seller owns all of the issued and outstanding shares of common stock, par value [DOLLAR AMOUNT] (the "Shares"), of [TARGET COMPANY NAME], a [STATE OF ORGANIZATION] corporation (the "Company"); and

(B) WHEREAS, Seller wishes to sell to Buyer, and Buyer wishes to purchase from Seller, the Shares, subject to the terms and conditions set forth herein;

(C) NOW, THEREFORE, in consideration of the mutual covenants and agreements hereinafter set forth and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto agree as follows:

ARTICLE I

Definitions

The following terms have the meanings specified or referred to in this Article I:

"Affiliate" of a Person means any other Person that directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with, such Person. The term "control" (including the terms "controlled by" and "under common control with") means the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of a Person, whether through the ownership of voting securities, by contract or otherwise.

\(^1\) Practical Law™, a Thomson Reuters Legal Solution, http://us.practicallaw.com/3-502-5305. Reprinted with permission. ©2016 Thomson Reuters. All rights reserved.
"Agreement" has the meaning set forth in the preamble.

"Audited Financial Statements" has the meaning set forth in Section 3.06.

"Balance Sheet" has the meaning set forth in Section 3.06.

"Balance Sheet Date" has the meaning set forth in Section 3.06.

"Benefit Plan" has the meaning set forth in Section 3.16(a).

"Business Day" means any day except Saturday, Sunday or any other day on which commercial banks located in [LOCATION] are authorized or required by Law to be closed for business.

"Buyer" has the meaning set forth in the preamble.

"Buyer Benefit Plans" has the meaning set forth in Section 5.05(b).


"Closing" has the meaning set forth in Section 2.04.

"Closing Date" has the meaning set forth in Section 2.04.


"Common Stock" has the meaning set forth in Section 3.03(a).

"Company" has the meaning set forth in the recitals.

"Company Continuing Employee" has the meaning set forth in Section 5.05(a).

"Company Intellectual Property" has the meaning set forth in Section 3.11(b).

"Confidentiality Agreement" means the Confidentiality Agreement, dated as of [DATE], between Buyer and Seller.

"Data Room" means the electronic documentation site established by [NAME OF VIRTUAL DATA ROOM PROVIDER] on behalf of Seller containing the documents set forth in the index included in Section [1.01(a)] of the Disclosure Schedules.

"Direct Claim" has the meaning set forth in Section 7.05(c).

"Disclosure Schedules" means the Disclosure Schedules delivered by Seller and Buyer concurrently with the execution and delivery of this Agreement.

"Dollars or $" means the lawful currency of the United States.

"Drop Dead Date" has the meaning set forth in Section 8.01(b)(i).

"Employees" means those Persons employed by the Company immediately prior to the Closing.

"Encumbrance" means any lien, pledge, mortgage, deed of trust, security interest, charge, claim, easement, encroachment or other similar encumbrance.

"Environmental Claim" means any action, suit, claim, investigation or other legal proceeding by any Person alleging liability of whatever kind or nature (including liability or responsibility for the costs of enforcement proceedings, investigations, cleanup, governmental response, removal or remediation, natural resources damages, property damages, personal injuries, medical monitoring, penalties, contribution, indemnification and injunctive relief) arising out of, based on or resulting from: (a) the presence, Release of, or exposure to, any Hazardous Materials; or (b) any actual or alleged non-compliance with any Environmental Law or term or condition of any Environmental Permit.

"Environmental Law" means any applicable Law, and any Governmental Order or binding agreement with any Governmental Authority: (a) relating to pollution (or the cleanup thereof) or the protection of natural resources, endangered or threatened species, human health or safety, or the environment (including ambient air, soil, surface water or groundwater, or subsurface strata); or (b) concerning the presence of, exposure to, or the management, manufacture, use, containment, storage, recycling, reclamation, reuse, treatment, generation, discharge, transportation, processing, production, disposal or remediation of any Hazardous Materials. The term “Environmental Law” includes, without limitation, the following (including their implementing regulations and any state analogs): the Comprehensive Environmental Response, Compensation, and Liability Act of 1980, as amended by the Superfund Amendments and Reauthorization Act of 1986, 42 U.S.C. §§ 9601 et seq.; the Solid Waste Disposal Act, as amended by the Resource Conservation and Recovery Act of 1976, as amended by the Hazardous and Solid Waste Amendments of 1984, 42 U.S.C. §§ 6901 et seq.; the Federal Water Pollution Control Act of 1972, as amended by the Clean Water Act of 1977, 33 U.S.C. §§ 1251 et seq.; the Toxic Substances Control

"Environmental Notice" means any written directive, notice of violation or infraction, or notice respecting any Environmental Claim relating to actual or alleged non-compliance with any Environmental Law or any term or condition of any Environmental Permit.

"Environmental Permit" means any Permit, letter, clearance, consent, waiver, closure, exemption, decision or other action required under or issued, granted, given, authorized by or made pursuant to Environmental Law.


"Financial Statements" has the meaning set forth in Section 3.06.

"GAAP" means United States generally accepted accounting principles in effect from time to time.

"Governmental Authority" means any federal, state, local or foreign government or political subdivision thereof, or any agency or instrumentality of such government or political subdivision, or any self-regulated organization or other non-governmental regulatory authority or quasi-governmental authority (to the extent that the rules, regulations or orders of such organization or authority have the force of Law), or any arbitrator, court or tribunal of competent jurisdiction.

"Governmental Order" means any order, writ, judgment, injunction, decree, stipulation, determination or award entered by or with any Governmental Authority.

"Hazardous Materials" means: (a) any material, substance, chemical, waste, product, derivative, compound, mixture, solid, liquid, mineral or gas, in each case, whether naturally occurring or man-made, that is hazardous, acutely hazardous, toxic, or words of similar import or regulatory effect under Environmental Laws; and (b) any petroleum or petroleum-derived products, radon, radioactive materials or wastes, asbestos in any form, lead or lead-containing materials, urea formaldehyde foam insulation and polychlorinated biphenyls.

"HSR Act" means the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended.

"Indemnified Party" has the meaning set forth in Section 7.04.

"Indemnifying Party" has the meaning set forth in Section 7.04.

"Indemnified Person" has the meaning set forth in Section 5.07(a).

"Insurance Policies" has the meaning set forth in Section 3.12.

"Intellectual Property" has the meaning set forth in Section 3.11(a).

"Interim Balance Sheet" has the meaning set forth in Section 3.06.

"Interim Balance Sheet Date" has the meaning set forth in Section 3.06.

"Interim Financial Statements" has the meaning set forth in Section 3.06.

"Knowledge of Seller or Seller's Knowledge" or any other similar knowledge qualification, means the actual knowledge of those persons listed on Section [1.01(b)] of the Disclosure Schedules.

"Law" means any statute, law, ordinance, regulation, rule, code, order, constitution, treaty, common law, judgment, decree, other requirement or rule of law of any Governmental Authority.

"Losses" means actual out-of-pocket losses, damages, liabilities, costs or expenses, including reasonable attorneys’ fees.

"Material Adverse Effect" means any event, occurrence, fact, condition or change that is materially adverse to (a) the business, results of operations, financial condition or assets of the Company, or (b) the ability of Seller to consummate the transactions contemplated hereby; provided, however, that “Material Adverse Effect” shall not include any event, occurrence, fact, condition or change, directly or indirectly, arising out of or attributable to: (i) general economic or political conditions; (ii) conditions generally affecting the industries in which the Company operates; (iii) any changes in financial, banking or securities markets in general, including any disruption thereof and any decline in the price of any security or any market index or any change in prevailing interest rates; (iv) acts of war (whether or not declared), armed hostilities or terrorism, or the escalation or worsening thereof; (v) any action required or permitted by this Agreement or any action taken (or omitted to be taken) with the written consent of or at the written request of Buyer; (vi) any matter of which Buyer is aware on the date hereof; (vii) any changes in applicable Laws or accounting rules (including GAAP) [or the enforcement, implementation or interpretation thereof]; (viii) the announcement, pendency or completion of the transactions contemplated by this Agreement,
including losses or threatened losses of employees, customers, suppliers, distributors or others having relationships with the Company; (ix) any natural or man-made disaster or acts of God; or (x) any failure by the Company to meet any internal or published projections, forecasts or revenue or earnings predictions (provided that the underlying causes of such failures (subject to the other provisions of this definition) shall not be excluded).

"Material Contracts" has the meaning set forth in Section 3.09(a).

"Permits" means all permits, licenses, franchises, approvals, authorizations, and consents required to be obtained from Governmental Authorities.

"Permitted Encumbrances" has the meaning set forth in Section 3.10(a).

"Person" means an individual, corporation, partnership, joint venture, limited liability company, Governmental Authority, unincorporated organization, trust, association or other entity.

"Purchase Price" has the meaning set forth in Section 2.02.

"Qualified Benefit Plan" has the meaning set forth in Section 3.16(b).

"Real Property" means the real property owned, leased or subleased by the Company, together with all buildings, structures and facilities located thereon.

"Release" means any actual or threatened release, spilling, leaking, pumping, pouring, emitting, emptying, discharging, injecting, escaping, leaching, dumping, abandonment, disposing or allowing to escape or migrate into or through the environment (including, without limitation, ambient air (indoor or outdoor), surface water, groundwater, land surface or subsurface strata or within any building, structure, facility or fixture).

"Representative" means, with respect to any Person, any and all directors, officers, employees, consultants, financial advisors, counsel, accountants and other agents of such Person.

"Seller" has the meaning set forth in the preamble.

"Shares" has the meaning set forth in the recitals.

"Taxes" means all federal, state, local, foreign and other income, gross receipts, sales, use, production, ad valorem, transfer, franchise, registration, profits, license, lease, service, service use, withholding, payroll, employment, unemployment, estimated, excise, severance, environmental, stamp, occupation, premium, property (real or personal), real property gains, windfall profits, customs, duties or other taxes, fees, assessments or charges of any kind whatsoever, together with any interest, additions or penalties with respect thereto and any interest in respect of such additions or penalties.

"Tax Return" means any return, declaration, report, claim for refund, information return or statement or other document required to be filed with respect to Taxes, including any schedule or attachment thereto, and including any amendment thereof.

"Third-Party Claim" has the meaning set forth in Section 7.05(a).

"WARN Act" means the federal Worker Adjustment and Retraining Notification Act of 1988, and similar state, local and foreign laws related to plant closings, relocations, mass layoffs and employment losses.

ARTICLE II

Purchase and sale

2.01 Purchase and Sale. Subject to the terms and conditions set forth herein, at the Closing, Seller shall sell to Buyer, and Buyer shall purchase from Seller, the Shares for the consideration specified in Section 2.02.

2.02 Purchase Price. The aggregate purchase price for the Shares shall be $[AMOUNT] (the "Purchase Price").

2.03 Transactions to be Effected at the Closing.

(a) At the Closing, Buyer shall deliver to Seller:

(i) the Purchase Price by wire transfer of immediately available funds to an account of Seller designated in writing by Seller to Buyer no later than [two/[NUMBER]] Business Days prior to the Closing Date; and

(ii) all other agreements, documents, instruments or certificates required to be delivered by Buyer at or prior to the Closing pursuant to Section 6.03 of this Agreement.
(b) At the Closing, Seller shall deliver to Buyer:

(i) stock certificates evidencing the Shares, free and clear of all Encumbrances, duly endorsed in blank or accompanied by stock powers or other instruments of transfer duly executed in blank, with all required stock transfer tax stamps affixed thereto; and

(ii) all other agreements, documents, instruments or certificates required to be delivered by Seller at or prior to the Closing pursuant to Section 6.02 of this Agreement.

2.04 Closing. Subject to the terms and conditions of this Agreement, the purchase and sale of the Shares contemplated hereby shall take place at a closing (the “Closing”) to be held at [TIME] a.m., [LOCATION] time, no later than [two/[NUMBER]] Business Days after the last of the conditions to Closing set forth in Article VI have been satisfied or waived (other than conditions which, by their nature, are to be satisfied on the Closing Date), at the offices of [SELLER’S LAW FIRM NAME], [ADDRESS], or at such other time or on such other date or at such other place as Seller and Buyer may mutually agree upon in writing (the day on which the Closing takes place being the "Closing Date").

ARTICLE III

Representations and warranties of seller

Except as set forth in the Disclosure Schedules, Seller represents and warrants to Buyer that the statements contained in this Article III are true and correct as of the date hereof.

3.01 Organization and Authority of Seller. Seller is a corporation duly organized, validly existing and in good standing under the Laws of the state of [STATE OF ORGANIZATION]. Seller has all necessary corporate power and authority to enter into this Agreement, to carry out its obligations hereunder and to consummate the transactions contemplated hereby. The execution and delivery by Seller of this Agreement, the performance by Seller of its obligations hereunder and the consummation by Seller of the transactions contemplated hereby have been duly authorized by all requisite corporate action on the part of Seller. This Agreement has been duly executed and delivered by Seller, and (assuming due authorization, execution and delivery by Buyer) this Agreement constitutes a legal, valid and binding obligation of Seller, enforceable against Seller in accordance with its terms, except as such enforceability may be limited by bankruptcy, insolvency, reorganization, moratorium or similar Laws affecting creditors’ rights generally and by general principles of equity (regardless of whether enforcement is sought in a proceeding at law or in equity).

3.02 Organization, Authority and Qualification of the Company. The Company is a corporation duly organized, validly existing and in good standing under the Laws of the state of [STATE OF ORGANIZATION] and has all necessary corporate power and authority to own, operate or lease the properties and assets now owned, operated or leased by it and to carry on its business as it is currently conducted. The Company is duly licensed or qualified to do business and is in good standing in each jurisdiction in which the properties owned or leased by it or the operation of its business as currently conducted makes such licensing or qualification necessary, except where the failure to be so licensed, qualified or in good standing would not have a Material Adverse Effect. [All corporate actions taken by the Company in connection with this Agreement will be duly authorized on or prior to the Closing.]

3.03 Capitalization.

(a) The authorized capital stock of the Company consists of [NUMBER] shares of common stock, par value [DOLLAR AMOUNT] ("Common Stock"), of which [NUMBER] shares are issued and outstanding and constitute the Shares. All of the Shares have been duly authorized, are validly issued, fully paid and non-assessable, and are owned of record and beneficially by Seller, free and clear of all Encumbrances, other than those Encumbrances set forth in Section 3.03(a) of the Disclosure Schedules.

(b) There are no outstanding or authorized options, warrants, convertible securities or other rights, agreements, arrangements or commitments of any character relating to the capital stock of the Company or obligating Seller or the Company to issue or sell any shares of capital stock of, or any other interest in, the Company. The Company does not have outstanding or authorized any stock appreciation, phantom stock, profit participation or similar rights. There are no voting trusts, stockholder agreements, proxies or other agreements or understandings in effect with respect to the voting or transfer of any of the Shares.

3.04 No Subsidiaries. The Company does not own, or have any interest in any shares or have an ownership interest in any other Person.

3.05 No Conflicts; Consents. The execution, delivery and performance by Seller of this Agreement, and the consummation of the transactions contemplated hereby, do not and will not: (a) result in a violation or breach of any
provision of the certificate of incorporation or by-laws of Seller or the Company; (b) result in a violation or breach of any provision of any Law or Governmental Order applicable to Seller or the Company; or (c) except as set forth in Section 3.05 of the Disclosure Schedules, require the consent, notice or other action by any Person under, conflict with, result in a violation or breach of, constitute a default under or result in the acceleration of any Material Contract, except in the cases of clauses (b) and (c), where the violation, breach, conflict, default, acceleration or failure to give notice would not have a Material Adverse Effect. No consent, approval, Permit, Governmental Order, declaration or filing with, or notice to, any Governmental Authority is required by or with respect to Seller or the Company in connection with the execution and delivery of this Agreement and the consummation of the transactions contemplated hereby, except for such filings as may be required under the HSR Act [and as set forth in Section 3.05 of the Disclosure Schedules] and such consents, approvals, Permits, Governmental Orders, declarations, filings or notices which, in the aggregate, would not have a Material Adverse Effect.

3.06 Financial Statements. Copies of the Company’s audited financial statements consisting of the balance sheet of the Company as at [DATE OF FISCAL YEAR END] in each of the years [YEAR 1], [YEAR 2] and [YEAR 3] and the related statements of income and retained earnings, stockholders’ equity and cash flow for the years then ended (the "Audited Financial Statements"), and unaudited financial statements consisting of the balance sheet of the Company as at [DATE OF MOST RECENT QUARTER END] and the related statements of income and retained earnings, stockholders’ equity and cash flow for the [three-/six-/nine-month] period then ended (the "Interim Financial Statements" and together with the Audited Financial Statements, the "Financial Statements") [are included in the Disclosure Schedules/have been delivered or made available to Buyer in the Data Room]. The Financial Statements have been prepared in accordance with GAAP applied on a consistent basis throughout the period involved, subject, in the case of the Interim Financial Statements, to normal and recurring year-end adjustments and the absence of notes. The Financial Statements fairly present in all material respects the financial condition of the Company as of the respective dates they were prepared and the results of the operations of the Company for the periods indicated. The balance sheet of the Company as of [DATE OF MOST RECENT FISCAL YEAR END] is referred to herein as the "Balance Sheet" and the date thereof as the "Balance Sheet Date" and the balance sheet of the Company as of [DATE OF MOST RECENT FISCAL QUARTER END] is referred to herein as the "Interim Balance Sheet" and the date thereof as the "Interim Balance Sheet Date".

3.07 Undisclosed Liabilities. The Company has no liabilities, obligations or commitments of a type required to be reflected on a balance sheet prepared in accordance with GAAP, except (i) those which are adequately reflected or reserved against in the Balance Sheet as of the Balance Sheet Date; and (ii) those which have been incurred in the ordinary course of business since the Balance Sheet Date and which are not material in amount.

3.08 Absence of Certain Changes, Events and Conditions. Except as expressly contemplated by the Agreement [or as set forth on Section 3.08 of the Disclosure Schedules], from the [Interim] Balance Sheet Date until the date of this Agreement, the Company has operated in the ordinary course of business in all material respects and there has not been, with respect to the Company, any:

(a) event, occurrence or development that has had a Material Adverse Effect;
(b) material amendment of the charter, by-laws or other organizational documents of the Company;
(c) split, combination or reclassification of any shares of its capital stock;
(d) issuance, sale or other disposition of any of its capital stock, or grant of any options, warrants or other rights to purchase or obtain (including upon conversion, exchange or exercise) any of its capital stock;
(e) declaration or payment of any dividends or distributions on or in respect of any of its capital stock or redemption, purchase or acquisition of its capital stock;
(f) material change in any method of accounting or accounting practice of the Company, except as required by GAAP or applicable Law or as disclosed in the notes to the Financial Statements;
(g) incurrence, assumption or guarantee of any indebtedness for borrowed money in an aggregate amount exceeding $[AMOUNT], except unsecured current obligations and liabilities incurred in the ordinary course of business;
(h) sale or other disposition of any of the assets shown or reflected on the Balance Sheet, except in the ordinary course of business and except for any assets having an aggregate value of less than $[AMOUNT];
(i) increase in the compensation of its Employees, other than as provided for in any written agreements or in the ordinary course of business;
(j) adoption, amendment or modification of any Benefit Plan, the effect of which in the aggregate would increase the obligations of the Company by more than [PERCENTAGE] percent of its existing annual obligations to such plans;

(k) acquisition by merger or consolidation with, or by purchase of a substantial portion of the assets or stock of, or by any other manner, any business or any Person or any division thereof for consideration in excess of $[AMOUNT];

(l) adoption of any plan of merger, consolidation, reorganization, liquidation or dissolution or filing of a petition in bankruptcy under any provisions of federal or state bankruptcy Law or consent to the filing of any bankruptcy petition against it under any similar Law; or

(m) any agreement to do any of the foregoing, or any action or omission that would result in any of the foregoing.

3.09 Material Contracts.

(a) Section 3.09(a) of the Disclosure Schedules lists each of the following contracts and other agreements of the Company (together with all Leases listed in Section 3.10(b) of the Disclosure Schedules, collectively, the "Material Contracts"):

(i) each agreement of the Company involving aggregate consideration in excess of $[AMOUNT] or requiring performance by any party more than one year from the date hereof, which, in each case, cannot be cancelled by the Company without penalty or without more than [180]/[NUMBER] days' notice;

(ii) all agreements that relate to the sale of any of the Company's assets, other than in the ordinary course of business, for consideration in excess of $[AMOUNT];

(iii) all agreements that relate to the acquisition of any business, a material amount of stock or assets of any other Person or any real property (whether by merger, sale of stock, sale of assets or otherwise), in each case involving amounts in excess of $[AMOUNT];

(iv) except for agreements relating to trade receivables, all agreements relating to indebtedness (including, without limitation, guarantees) of the Company, in each case having an outstanding principal amount in excess of $[AMOUNT];

(v) all agreements between or among the Company on the one hand and Seller or any Affiliate of Seller (other than the Company) on the other hand; and

(vi) all collective bargaining agreements or agreements with any labor organization, union or association to which the Company is a party.

(b) [Except as set forth on Section 3.09(b) of the Disclosure Schedules,] the Company is not in breach of, or default under, any Material Contract, except for such breaches or defaults that would not have a Material Adverse Effect.

3.10 Title to Assets; Real Property.

(a) The Company has good and valid (and, in the case of owned Real Property, good and marketable fee simple) title to, or a valid leasehold interest in, all Real Property and tangible personal property and other assets reflected in the Audited Financial Statements or acquired after the Balance Sheet Date, other than properties and assets sold or otherwise disposed of in the ordinary course of business since the Balance Sheet Date. All such properties and assets (including leasehold interests) are free and clear of Encumbrances except for the following (collectively referred to as "Permitted Encumbrances"):

[(i) those items set forth in Section 3.10(a) of the Disclosure Schedules;]

(ii) liens for Taxes not yet due and payable or being contested in good faith by appropriate procedures;

(iii) mechanics, carriers', workmen's, repairmen's or other like liens arising or incurred in the ordinary course of business;

(iv) easements, rights of way, zoning ordinances and other similar encumbrances affecting Real Property;

(v) other than with respect to owned Real Property, liens arising under original purchase price conditional sales contracts and equipment leases with third parties entered into in the ordinary course of business; or

(vi) other imperfections of title or Encumbrances, if any, that have not had, and would not have, a Material Adverse Effect.
(b) Section 3.10(b) of the Disclosure Schedules lists: (i) the street address of each parcel of owned Real Property; and (ii) the street address of each parcel of leased Real Property, and a list, as of the date of this Agreement, of all leases for each parcel of leased Real Property involving total annual payments of at least $[AMOUNT] (collectively, "Leases"), including the identification of the lessee and lessor thereunder.

3.11 Intellectual Property.

(a) "Intellectual Property" means any and all of the following in any jurisdiction throughout the world: (i) trademarks and service marks, including all applications and registrations and the goodwill connected with the use of and symbolized by the foregoing; (ii) copyrights, including all applications and registrations related to the foregoing; (iii) trade secrets and confidential know-how; (iv) patents and patent applications; (v) internet domain name registrations; and (vi) other intellectual property and related proprietary rights, interests and protections.

(b) Section 3.11(b) of the Disclosure Schedules lists all patents, patent applications, trademark registrations and pending applications for registration, copyright registrations and pending applications for registration and internet domain name registrations owned by the Company. Except [as set forth in Section 3.11(b) of the Disclosure Schedules, or] as would not have a Material Adverse Effect, the Company owns or has the right to use all Intellectual Property necessary to conduct the business as currently conducted (the "Company Intellectual Property").

(c) Except [as set forth in Section 3.11(c) of the Disclosure Schedules, or] as would not have a Material Adverse Effect, to Seller’s Knowledge: (i) the Company Intellectual Property as currently licensed or used by the Company, and the Company’s conduct of its business as currently conducted, do not infringe, misappropriate or otherwise violate the Intellectual Property of any Person; and (ii) no Person is infringing, misappropriating or otherwise violating any Company Intellectual Property. This Section 3.11(c) constitutes the sole representation and warranty of Seller under this Agreement with respect to any actual or alleged infringement, misappropriation or other violation by Seller and the Company of the Intellectual Property of any other Person.

3.12 Insurance. Section 3.12 of the Disclosure Schedules sets forth a list, as of the date hereof, of all material insurance policies maintained by the Company or with respect to which the Company is a named insured or otherwise the beneficiary of coverage (collectively, the "Insurance Policies"). Such Insurance Policies are in full force and effect on the date of this Agreement and all premiums due on such Insurance Policies have been paid, except as would not have a Material Adverse Effect.

3.13 Legal Proceedings; Governmental Orders.

(a) [Except as set forth in Section 3.13(a) of the Disclosure Schedules,] there are no actions, suits, claims, investigations or other legal proceedings pending or, to Seller’s Knowledge, threatened against or by the Company affecting any of its properties or assets (or by or against Seller or any Affiliate thereof and relating to the Company), which if determined adversely to the Company (or to Seller or any Affiliate thereof) would result in a Material Adverse Effect.

(b) [Except as set forth in Section 3.13(b) of the Disclosure Schedules,] there are no outstanding Governmental Orders and no unsatisfied judgments, penalties or awards against or affecting the Company or any of its properties or assets which would have a Material Adverse Effect.

3.14 Compliance With Laws; Permits.

(a) [Except as set forth in Section 3.14(a) of the Disclosure Schedules,] the Company is in compliance with all Laws applicable to it or its business, properties or assets, except where the failure to be in compliance would not have a Material Adverse Effect.

(b) All Permits required for the Company to conduct its business have been obtained by it and are valid and in full force and effect, except where the failure to obtain such Permits would not have a Material Adverse Effect.

(c) None of the representations and warranties contained in Section 3.14 shall be deemed to relate to environmental matters (which are governed by Section 3.15), employee benefits matters (which are governed by Section 3.16), employment matters (which are governed by Section 3.17) or tax matters (which are governed by Section 3.18).

3.15 Environmental Matters.

(a) [Except as set forth in Section 3.15(a) of the Disclosure Schedules, or] as would not have a Material Adverse Effect, to Seller’s Knowledge, the Company is in compliance with all Environmental Laws and has not, and the Seller has not, received from any Person any (i) Environmental Notice or Environmental Claim, or (ii) written request for information pursuant to Environmental Law, which, in each case, either remains pending or unresolved, or is the source of ongoing obligations or requirements as of the Closing Date.
(b) The Company has obtained and is in material compliance with all Environmental Permits (each of which is disclosed in Section 3.15(b) of the Disclosure Schedules) necessary for the ownership, lease, operation or use of the business or assets of the Company.

(c) No real property currently owned, operated or leased by the Company is listed on, or has been proposed for listing on, the National Priorities List (or CERCLIS) under CERCLA, or any similar state list.

(d) Except as set forth in Section 3.15(d) of the Disclosure Schedules, or as would not have a Material Adverse Effect, to Seller’s Knowledge, there has been no Release of Hazardous Materials in contravention of Environmental Laws with respect to the business or assets of the Company or any Real Property currently owned, operated or leased by the Company, and neither the Company nor Seller has received an Environmental Notice that any Real Property currently owned, operated or leased in connection with the business of the Company (including soils, groundwater, surface water, buildings and other structure located on any such real property) has been contaminated with any Hazardous Material which would reasonably be expected to result in an Environmental Claim against, or a violation of Environmental Laws or term of any Environmental Permit by, Seller or the Company.

(e) Seller has previously made available to Buyer in the Data Room or otherwise any and all environmental reports, studies, audits, records, sampling data, site assessments and other similar documents with respect to the business or assets of the Company or any currently owned, operated or leased Real Property which are in the possession or control of the Seller or Company.

(f) The representations and warranties set forth in this Section 3.15 are the Seller’s sole and exclusive representations and warranties regarding environmental matters.

3.16 Employee Benefit Matters.

(a) Section 3.16(a) of the Disclosure Schedules contains a list of each material benefit, retirement, employment, consulting, compensation, incentive, bonus, stock option, restricted stock, stock appreciation right, phantom equity, change in control, severance, vacation, paid time off, welfare and fringe-benefit agreement, plan, policy and program, whether or not reduced to writing, in effect and covering one or more Employees, former employees of the Company, current or former directors of the Company or the beneficiaries or dependents of any such Persons, and is maintained, sponsored, contributed to, or required to be contributed to by the Company, or under which the Company has any material liability for premiums or benefits (as listed on Section 3.16(a) of the Disclosure Schedules, each, a “Benefit Plan”).

(b) Except as set forth in Section 3.16(b) of the Disclosure Schedules, or as would not have a Material Adverse Effect, to Seller’s Knowledge, each Benefit Plan and related trust complies with all applicable Laws (including ERISA [and/] the Code [and applicable local Laws]). Each Benefit Plan that is intended to be qualified under Section 401(a) of the Code (a "Qualified Benefit Plan") has received a favorable determination letter from the Internal Revenue Service, or with respect to a prototype plan, can rely on an opinion letter from the Internal Revenue Service to the prototype plan sponsor, to the effect that such Qualified Benefit Plan is so qualified and that the plan and the trust related thereto are exempt from federal income Taxes under Sections 401(a) and 501(a), respectively, of the Code, and, to Seller’s Knowledge, nothing has occurred that could reasonably be expected to cause the revocation of such determination letter from the Internal Revenue Service or the unavailability of reliance on such opinion letter from the Internal Revenue Service. Except as set forth in Section 3.16(b) of the Disclosure Schedules, or as would not have a Material Adverse Effect, all benefits, contributions and premiums required by and due under the terms of each Benefit Plan or applicable Law have been timely paid in accordance with the terms of such Benefit Plan, the terms of all applicable Laws and GAAP. With respect to an "annuity contract", each such Benefit Plan is so qualified and that the plan and trust related thereto are exempt from federal income Taxes under Sections 401(a) and 501(a), respectively, of the Code, and, to Seller’s Knowledge, nothing has occurred that could reasonably be expected to cause the revocation of such determination letter from the Internal Revenue Service or the unavailability of reliance on such opinion letter from the Internal Revenue Service. Except as set forth in Section 3.16(b) of the Disclosure Schedules, or as would not have a Material Adverse Effect, all benefits, contributions and premiums required by and due under the terms of each Benefit Plan or applicable Law have been timely paid in accordance with the terms of such Benefit Plan, the terms of all applicable Laws and GAAP. With respect to any Benefit Plan, to Seller’s Knowledge, no event has occurred or is reasonably expected to occur that has resulted in or would subject the Company to a Tax under Section 4971 of the Code or the assets of the Company to a lien under Section 430(k) of the Code.

(c) Except as set forth in Section 3.16(c) of the Disclosure Schedules, no Benefit Plan: (i) is subject to the minimum funding standards of Section 302 of ERISA or Section 412 of the Code; or (ii) is a “multi-employer plan” (as defined in Section 3(37) of ERISA). Except as would not have a Material Adverse Effect, neither Seller nor the Company: (i) has withdrawn from any pension plan under circumstances resulting (or expected to result) in a liability to the Pension Benefit Guaranty Corporation; or (ii) has engaged in any transaction which would give rise to a liability of the Company or Buyer under Section 4069 or Section 4212(c) of ERISA.

(d) Except as set forth in Section 3.16(d) of the Disclosure Schedules and as would not have a Material Adverse Effect, to Seller’s Knowledge, each Benefit Plan and related trust complies with all applicable Laws (including ERISA [and/] the Code [and applicable local Laws]). Each Benefit Plan that is intended to be qualified under Section 401(a) of the Code (a "Qualified Benefit Plan") has received a favorable determination letter from the Internal Revenue Service, or with respect to a prototype plan, can rely on an opinion letter from the Internal Revenue Service to the prototype plan sponsor, to the effect that such Qualified Benefit Plan is so qualified and that the plan and the trust related thereto are exempt from federal income Taxes under Sections 401(a) and 501(a), respectively, of the Code, and, to Seller’s Knowledge, nothing has occurred that could reasonably be expected to cause the revocation of such determination letter from the Internal Revenue Service or the unavailability of reliance on such opinion letter from the Internal Revenue Service. Except as set forth in Section 3.16(b) of the Disclosure Schedules, or as would not have a Material Adverse Effect, all benefits, contributions and premiums required by and due under the terms of each Benefit Plan or applicable Law have been timely paid in accordance with the terms of such Benefit Plan, the terms of all applicable Laws and GAAP. With respect to any Benefit Plan, to Seller’s Knowledge, no event has occurred or is reasonably expected to occur that has resulted in or would subject the Company to a Tax under Section 4971 of the Code or the assets of the Company to a lien under Section 430(k) of the Code.
life or disability insurance following retirement or other termination of employment (other than death benefits when termination occurs upon death).

(e) Except [as set forth in Section 3.16(e) of the Disclosure Schedules, or] as would not have a Material Adverse Effect: (i) there is no pending or, to Seller’s Knowledge, threatened action relating to a Benefit Plan; and (ii) no Benefit Plan has within the [three/[NUMBER]] years prior to the date hereof been the subject of an examination or audit by a Governmental Authority.

(f) Except [as set forth in Section 3.16(f) of the Disclosure Schedules, or] as would not have a Material Adverse Effect, no Benefit Plan exists that could: (i) result in the payment to any Employee, director or consultant of any money or other property; (ii) accelerate the vesting of or provide any additional rights or benefits (including funding of compensation or benefits through a trust or otherwise) to any Employee, director or consultant, except as a result of any partial plan termination resulting from this Agreement; or (iii) limit or restrict the ability of Buyer or its Affiliates to merge, amend or terminate any Benefit Plan, in each case, as a result of the execution of this Agreement. Neither the execution of this Agreement nor the consummation of the transactions contemplated hereby will result in “excess parachute payments” within the meaning of Section 280G(b) of the Code.

(g) The representations and warranties set forth in this Section 3.16 are the Seller’s sole and exclusive representations and warranties regarding employee benefit matters.

3.17 Employment Matters.

(a) [Except as set forth in Section 3.17(a) of the Disclosure Schedules,] the Company is not a party to, or bound by, any collective bargaining or other agreement with a labor organization representing any of its Employees. [Except as set forth in Section 3.17(a) of the Disclosure Schedules,] since [DATE], there has not been, nor, to Seller’s Knowledge, has there been any threat of, any strike, slowdown, work stoppage, lockout, concerted refusal to work overtime or other similar labor activity or dispute affecting the Company.

(b) The Company is in compliance with all applicable Laws pertaining to employment and employment practices to the extent they relate to employees of the Company, except to the extent non-compliance would not result in a Material Adverse Effect. Except [as set forth in Section 3.17(b) of the Disclosure Schedules, or] as would not have a Material Adverse Effect, there are no actions, suits, claims, investigations or other legal proceedings against the Company pending, or to the Seller’s Knowledge, threatened to be brought or filed, by or with any Governmental Authority or arbitrator in connection with the employment of any current or former employee of the Company, including, without limitation, any claim relating to unfair labor practices, employment discrimination, harassment, retaliation, equal pay or any other employment related matter arising under applicable Laws.

(c) The representations and warranties set forth in this Section 3.17 are the Seller’s sole and exclusive representations and warranties regarding employment matters.

3.18 Taxes.

(a) [Except as set forth in Section 3.18 of the Disclosure Schedules:] 

(i) The Company has filed (taking into account any valid extensions) all material Tax Returns required to be filed by the Company. Such Tax Returns are true, complete and correct in all material respects. The Company is not currently the beneficiary of any extension of time within which to file any material Tax Return other than extensions of time to file Tax Returns obtained in the ordinary course of business. All material Taxes due and owing by the Company have been paid or accrued.

(ii) No extensions or waivers of statutes of limitations have been given or requested with respect to any material Taxes of the Company.

(iii) There are no ongoing actions, suits, claims, investigations or other legal proceedings by any taxing authority against the Company.

(iv) The Company is not a party to any Tax-sharing agreement.

(v) All material Taxes which the Company is obligated to withhold from amounts owing to any employee, creditor or third party have been paid or accrued.

(b) Except for certain representations related to Taxes in Section 3.16, the representations and warranties set forth in this Section 3.18 are the Seller’s sole and exclusive representations and warranties regarding Tax matters.

3.19 Brokers. [Except for [NAME OF BROKER, FINDER OR INVESTMENT BANKER],] no broker, finder or investment banker is entitled to any brokerage, finder’s or other fee or commission in connection with the transactions contemplated by this Agreement based upon arrangements made by or on behalf of Seller.
3.20 No Other Representations and Warranties. Except for the representations and warranties contained in this Article III (including the related portions of the Disclosure Schedules), none of Seller, the Company or any other Person has made or makes any other express or implied representation or warranty, either written or oral, on behalf of Seller or the Company, including any representation or warranty as to the accuracy or completeness of any information regarding the Company furnished or made available to Buyer and its Representatives (including [the Confidential Information Memorandum prepared by [NAME OF FINANCIAL ADVISOR] dated [DATE] and] any information, documents or material made available to Buyer in the Data Room, management presentations or in any other form in expectation of the transactions contemplated hereby) or as to the future revenue, profitability or success of the Company, or any representation or warranty arising from statute or otherwise in law.

ARTICLE IV

Representations and warranties of buyer

[Except as set forth in the Disclosure Schedules.] Buyer represents and warrants to Seller that the statements contained in this Article IV are true and correct as of the date hereof.

4.01 Organization and Authority of Buyer. Buyer is a [TYPE OF ENTITY] duly organized, validly existing and in good standing under the Laws of the state of [STATE OF ORGANIZATION]. Buyer has all necessary [corporate/company/partnership] power and authority to enter into this Agreement, to carry out its obligations hereunder and to consummate the transactions contemplated hereby. The execution and delivery by Buyer of this Agreement, the performance by Buyer of its obligations hereunder and the consummation by Buyer of the transactions contemplated hereby have been duly authorized by all requisite [corporate/company/partnership] action on the part of Buyer. This Agreement has been duly executed and delivered by Buyer, and (assuming due authorization, execution and delivery by Seller) this Agreement constitutes a legal, valid and binding obligation of Buyer, enforceable against Buyer in accordance with its terms, except as such enforceability may be limited by bankruptcy, insolvency, reorganization, moratorium or similar Laws affecting creditors’ rights generally and by general principles of equity (regardless of whether enforcement is sought in a proceeding at law or in equity).

4.02 No Conflicts; Consents. The execution, delivery and performance by Buyer of this Agreement, and the consummation of the transactions contemplated hereby, do not and will not: (a) result in a violation or breach of any provision of the [LIST ORGANIZATIONAL DOCUMENTS] of Buyer; (b) result in a violation or breach of any provision of any Law or Governmental Order applicable to Buyer; or (c) except as set forth in Section 4.02 of the Disclosure Schedules, require the consent, notice or other action by any Person under, conflict with, result in a violation or breach of, constitute a default under or result in the acceleration of any agreement to which Buyer is a party, except in the cases of clauses (b) and (c), where the violation, breach, conflict, default, acceleration or failure to give notice would not have a material adverse effect on Buyer’s ability to consummate the transactions contemplated hereby. No consent, approval, Permit, Governmental Order, declaration or filing with, or notice to, any Governmental Authority is required by or with respect to Buyer in connection with the execution and delivery of this Agreement and the consummation of the transactions contemplated hereby, except for such filings as may be required under the HSR Act [and as set forth in Section 4.02 of the Disclosure Schedules] and such consents, approvals, Permits, Governmental Orders, declarations, filings or notices which would not have a material adverse effect on Buyer’s ability to consummate the transactions contemplated hereby.

4.03 Investment Purpose. Buyer is acquiring the Shares solely for its own account for investment purposes and not with a view to, or for offer or sale in connection with, any distribution thereof. Buyer acknowledges that the Shares are not registered under the Securities Act of 1933, as amended, or any state securities laws, and that the Shares may not be transferred or sold except pursuant to the registration provisions of the Securities Act of 1933, as amended or pursuant to an applicable exemption therefrom and subject to state securities laws and regulations, as applicable. Buyer is able to bear the economic risk of holding the Shares for an indefinite period (including total loss of its investment), and has sufficient knowledge and experience in financial and business matters so as to be capable of evaluating the merits and risk of its investment.

4.04 Brokers. [Except for [NAME OF BROKER, FINDER OR INVESTMENT BANKER],] no broker, finder or investment banker is entitled to any brokerage, finder’s or other fee or commission in connection with the transactions contemplated by this Agreement based upon arrangements made by or on behalf of Buyer.

4.05 Sufficiency of Funds. Buyer has sufficient cash on hand or other sources of immediately available funds to enable it to make payment of the Purchase Price and consummate the transactions contemplated by this Agreement.

4.06 Legal Proceedings. [Except as set forth in Section 4.06 of the Disclosure Schedules,] there are no actions, suits, claims, investigations or other legal proceedings pending or, to Buyer’s knowledge, threatened against or by Buyer or
any Affiliate of Buyer that challenge or seek to prevent, enjoin or otherwise delay the transactions contemplated by this Agreement.

**4.07 Independent Investigation.** Buyer has conducted its own independent investigation, review and analysis of the business, results of operations, prospects, condition (financial or otherwise) or assets of the Company, and acknowledges that it has been provided adequate access to the personnel, properties, assets, premises, books and records, and other documents and data of Seller and the Company for such purpose. Buyer acknowledges and agrees that: (a) in making its decision to enter into this Agreement and to consummate the transactions contemplated hereby, Buyer has relied solely upon its own investigation and the express representations and warranties of Seller set forth in Article III of this Agreement (including the related portions of the Disclosure Schedules); and (b) none of Seller, the Company or any other Person has made any representation or warranty as to Seller, the Company or this Agreement, except as expressly set forth in Article III of this Agreement (including the related portions of the Disclosure Schedules).

**ARTICLE V**

**Covenants**

**5.01 Conduct of Business Prior to the Closing.** From the date hereof until the Closing, except as otherwise provided in this Agreement or consented to in writing by Buyer (which consent shall not be unreasonably withheld or delayed), Seller shall, and shall cause the Company to: (a) conduct the business of the Company in the ordinary course of business; and (b) use commercially reasonable efforts to maintain and preserve intact the current organization, business and franchise of the Company and to preserve the rights, franchises, goodwill and relationships of its Employees, customers, lenders, suppliers, regulators and others having business relationships with the Company. From the date hereof until the Closing Date, except as consented to in writing by Buyer (which consent shall not be unreasonably withheld or delayed), Seller shall not cause or permit the Company to take any action that would cause any of the changes, events or conditions described in Section 3.08 to occur.

**5.02 Access to Information.** From the date hereof until the Closing, Seller shall, and shall cause the Company to: (a) afford Buyer and its Representatives reasonable access to and the right to inspect all of the Real Property, properties, assets, premises, books and records, contracts, agreements and other documents and data related to the Company; (b) furnish Buyer and its Representatives with such financial, operating and other data and information related to the Company as Buyer or any of its Representatives may reasonably request; and (c) instruct the Representatives of Seller and the Company to cooperate with Buyer in its investigation of the Company; provided, however, that any such investigation shall be conducted during normal business hours upon reasonable advance notice to Seller, under the supervision of Seller’s personnel and in such a manner as not to interfere with the normal operations of the Company. All requests by Buyer for access pursuant to this Section 5.02 shall be submitted or directed exclusively to [NAME OF SELLER DESIGNEE] or such other individuals as Seller may designate in writing from time to time. Notwithstanding anything to the contrary in this Agreement, neither Seller nor the Company shall be required to disclose any information to Buyer if such disclosure would, in Seller’s sole discretion: (x) cause significant competitive harm to Seller, the Company and their respective businesses if the transactions contemplated by this Agreement are not consummated; (y) jeopardize any attorney-client or other privilege; or (z) contravene any applicable Law, fiduciary duty or binding agreement entered into prior to the date of this Agreement. Prior to the Closing, without the prior written consent of Seller, which may be withheld for any reason, Buyer shall not contact any suppliers to, or customers of, the Company and Buyer shall have no right to perform invasive or subsurface investigations of the Real Property. Buyer shall, and shall cause its Representatives to, abide by the terms of the Confidentiality Agreement with respect to any access or information provided pursuant to this Section 5.02.

**5.03 Supplement to Disclosure Schedules.** From time to time prior to the Closing, Seller shall have the right (but not the obligation) to supplement or amend the Disclosure Schedules hereto with respect to any matter hereafter arising or of which it becomes aware after the date hereof (each a "Schedule Supplement"). Any disclosure in any such Schedule Supplement shall not be deemed to have cured any inaccuracy in or breach of any representation or warranty contained in this Agreement, including for purposes of the indemnification or termination rights contained in this Agreement or of determining whether or not the conditions set forth in Section 6.02 have been satisfied; provided, however, that if Buyer has the right to, but does not elect to, terminate this Agreement within [NUMBER] Business Days of its receipt of such Schedule Supplement, then Buyer shall be deemed to have irrevocably waived any right to terminate this Agreement with respect to such matter and, further, shall have irrevocably waived its right to indemnification under Section 7.02 with respect to such matter.

**5.04 Resignations.** Seller shall deliver to Buyer written resignations, effective as of the Closing Date, of the officers and directors of the Company [set forth on Section 5.04 of the Disclosure Schedules/requested by Buyer at least [five/[NUMBER]] Business Days prior to the Closing].
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5.05 Employees; Benefit Plans.

(a) During the period commencing at the Closing and ending on the date which is [12/[NUMBER]] months from the Closing (or if earlier, the date of the employee’s termination of employment with the Company), Buyer shall and shall cause the Company to provide each Employee who remains employed immediately after the Closing ("Company Continuing Employee") with: (i) base salary or hourly wages which are no less than the base salary or hourly wages provided by the Company immediately prior to the Closing; (ii) target bonus opportunities (excluding equity-based compensation), if any, which are no less than the target bonus opportunities (excluding equity-based compensation) provided by the Company immediately prior to the Closing; (iii) retirement and welfare benefits that are no less favorable in the aggregate than those provided by the Company immediately prior to the Closing; and (iv) severance benefits that are no less favorable than the practice, plan or policy in effect for such Company Continuing Employee immediately prior to the Closing.

(b) With respect to any employee benefit plan maintained by Buyer or its Subsidiaries (collectively, "Buyer Benefit Plans") in which any Company Continuing Employees will participate effective as of the Closing, Buyer shall, or shall cause the Company to, recognize all service of the Company Continuing Employees with the Company or any of its Subsidiaries, as the case may be as if such service were with Buyer, for vesting and eligibility purposes in any Parent Benefit Plan in which such Company Continuing Employees may be eligible to participate after the Closing Date; provided, however, such service shall not be recognized to the extent that (x) such recognition would result in a duplication of benefits or (y) such service was not recognized under the corresponding Benefit Plan.

(c) This Section 5.05 shall be binding upon and inure solely to the benefit of each of the parties to this Agreement, and nothing in this Section 5.05, express or implied, shall confer upon any other Person any rights or remedies of any nature whatsoever under or by reason of this Section 5.05. Nothing contained herein, express or implied, shall be construed to establish, amend or modify any benefit plan, program, agreement or arrangement.

5.06 [Plant Closings and Mass Layoffs. Buyer shall not, and shall cause the Company not to, take any action following the Closing that could result in WARN Act liability.]

5.07 Director and Officer Indemnification and Insurance.

(a) Buyer agrees that all rights to indemnification, advancement of expenses and exculpation by the Company now existing in favor of each Person who is now, or has been at any time prior to the date hereof or who becomes prior to the Closing Date, an officer or director of the Company, as provided in the certificate of incorporation or by-laws of the Company, in each case as in effect on the date hereof and disclosed in Section 5.07(a) of the Disclosure Schedules, shall survive the Closing Date and shall continue in full force and effect in accordance with their respective terms.

(b) The Company shall, and Buyer shall cause the Company to (i) maintain in effect for a period of six (6) years after the Closing Date, if available, the current policies of directors’ and officers’ liability insurance maintained by the Company immediately prior to the Closing Date (provided that the Company may substitute therefor policies, of at least the same coverage and amounts and containing terms and conditions that are not less advantageous to the directors and officers of the Company when compared to the insurance maintained by the Company as of the date hereof), or (ii) obtain as of the Closing Date “tail” insurance policies with a claims period of six (6) years from the Closing Date with at least the same coverage and amounts, and containing terms and conditions that are not less advantageous to the directors and officers of the Company, in each case with respect to claims arising out of or relating to events which occurred on or prior to the Closing Date (including in connection with the transactions contemplated by this Agreement).

(c) The obligations of Buyer and the Company under this Section 5.07 shall not be terminated or modified in such a manner as to adversely affect any director or officer to whom this Section 5.07 applies without the consent of such affected director or officer (it being expressly agreed that the directors and officers to whom this Section 5.07 applies shall be third-party beneficiaries of this Section 5.07, each of whom may enforce the provisions of this Section 5.07).

(d) In the event Buyer, the Company or any of their respective successors or assigns (i) consolidates with or merges into any other Person and shall not be the continuing or surviving corporation or entity in such consolidation or merger or (ii) transfers all or substantially all of its properties and assets to any Person, then, and in either such
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case, proper provision shall be made so that the successors and assigns of Buyer or the Company, as the case may be, shall assume all of the obligations set forth in this Section 5.07.

5.08 Confidentiality. Buyer acknowledges and agrees that the Confidentiality Agreement remains in full force and effect and, in addition, covenants and agrees to keep confidential, in accordance with the provisions of the Confidentiality Agreement, information provided to Buyer pursuant to this Agreement. If this Agreement is, for any reason, terminated prior to the Closing, the Confidentiality Agreement and the provisions of this Section 5.08 shall nonetheless continue in full force and effect.

5.09 Governmental Approvals and Other Third-party Consents

(a) Each party hereto shall, as promptly as possible, use its reasonable best efforts to obtain, or cause to be obtained, all consents, authorizations, orders and approvals from all Governmental Authorities that may be or become necessary for its execution and delivery of this Agreement and the performance of its obligations pursuant to this Agreement. Each party shall cooperate fully with the other party and its Affiliates in promptly seeking to obtain all such consents, authorizations, orders and approvals. The parties hereto shall not willfully take any action that will have the effect of delaying, impairing or impeding the receipt of any required consents, authorizations, orders and approvals. If required by the HSR Act and if the appropriate filing pursuant to the HSR Act has not been filed prior to the date hereof, each party hereto agrees to make an appropriate filing pursuant to the HSR Act with respect to the transactions contemplated by this Agreement within [NUMBER] Business Days after the date hereof and to supply as promptly as practicable to the appropriate Governmental Authority any additional information and documentary material that may be requested pursuant to the HSR Act.

(b) [Without limiting the generality of Buyer’s undertaking pursuant to this Section 5.09, Buyer agrees to use its reasonable best efforts and to take any and all steps necessary to avoid or eliminate each and every impediment under any antitrust, competition or trade regulation Law that may be asserted by any Governmental Authority or any other party so as to enable the parties hereto to close the transactions contemplated by this Agreement as promptly as possible, including proposing, negotiating, committing to and effecting, by consent decree, hold separate orders, or otherwise, the sale, divestiture or disposition of any of its assets, properties or businesses or of the assets, properties or businesses to be acquired by it pursuant to this Agreement as are required to be divested in order to avoid the entry of, or to effect the dissolution of, any injunction, temporary restraining order or other order in any suit or proceeding, which would otherwise have the effect of materially delaying or preventing the consummation of the transactions contemplated by this Agreement. In addition, Buyer shall use its reasonable best efforts to defend through litigation on the merits any claim asserted in court by any party in order to avoid entry of, or to have vacated or terminated, any Governmental Order (whether temporary, preliminary or permanent) that would prevent the consummation of the Closing.]

(c) All analyses, appearances, meetings, discussions, presentations, memoranda, briefs, filings, arguments, and proposals made by or on behalf of either party before any Governmental Authority or the staff or regulators of any Governmental Authority, in connection with the transactions contemplated hereunder (but, for the avoidance of doubt, not including any interactions between Seller or the Company with Governmental Authorities in the ordinary course of business, any disclosure which is not permitted by Law or any disclosure containing confidential information) shall be disclosed to the other party hereunder in advance of any filing, submission or attendance, it being the intent that the parties will consult and cooperate with one another, and consider in good faith the views of one another, in connection with any such analyses, appearances, meetings, discussions, presentations, memoranda, briefs, filings, arguments, and proposals. Each party shall give notice to the other party with respect to any meeting, discussion, appearance or contact with any Governmental Authority or the staff or regulators of any Governmental Authority, with such notice being sufficient to provide the other party with the opportunity to attend and participate in such meeting, discussion, appearance or contact.

(d) Seller and Buyer shall use commercially reasonable efforts to give all notices to, and obtain all consents from, all third parties that are described in Section 3.05 [and Section 4.02] of the Disclosure Schedules; provided, however, that Seller shall not be obligated to pay any consideration therefor to any third party from whom consent or approval is requested.

5.10 Books and Records.

(a) In order to facilitate the resolution of any claims made against or incurred by Seller prior to the Closing, or for any other reasonable purpose, for a period of [NUMBER] years after the Closing, Buyer shall:

(i) retain the books and records (including personnel files) of the Company relating to periods prior to the Closing in a manner reasonably consistent with the prior practices of the Company; and
(ii) upon reasonable notice, afford the Representatives of Seller reasonable access (including the right to make, at Seller’s expense, photocopies), during normal business hours, to such books and records.

(b) In order to facilitate the resolution of any claims made by or against or incurred by Buyer or the Company after the Closing, or for any other reasonable purpose, for a period of [NUMBER] years following the Closing, Seller shall:

(i) retain the books and records (including personnel files) of Seller which relate to the Company and its operations for periods prior to the Closing; and

(ii) upon reasonable notice, afford the Representatives of Buyer or the Company reasonable access (including the right to make, at Buyer’s expense, photocopies), during normal business hours, to such books and records.

(c) Neither Buyer nor Seller shall be obligated to provide the other party with access to any books or records (including personnel files) pursuant to this Section 5.10 where such access would violate any Law.

5.11 Closing Conditions. From the date hereof until the Closing, each party hereto shall, and Seller shall cause the Company to, use commercially reasonable efforts to take such actions as are necessary to expeditiously satisfy the closing conditions set forth in Article VI hereof.

5.12 Public Announcements. Unless otherwise required by applicable Law [or stock exchange requirements] (based upon the reasonable advice of counsel), no party to this Agreement shall make any public announcements in respect of this Agreement or the transactions contemplated hereby or otherwise communicate with any news media without the prior written consent of the other party (which consent shall not be unreasonably withheld or delayed), and the parties shall cooperate as to the timing and contents of any such announcement.

5.13 Further Assurances. Following the Closing, each of the parties hereto shall, and shall cause their respective Affiliates to, execute and deliver such additional documents, instruments, conveyances and assurances, and take such further actions as may be reasonably required to carry out the provisions hereof and give effect to the transactions contemplated by this Agreement.

5.14 Transfer Taxes. All transfer, documentary, sales, use, stamp, registration, value added and other such Taxes and fees (including any penalties and interest) incurred in connection with this Agreement (including any real property transfer Tax and any other similar Tax) shall be borne and paid by Buyer when due. Buyer shall, at its own expense, timely file any Tax Return or other document with respect to such Taxes or fees (and Seller shall cooperate with respect thereto as necessary).

ARTICLE VI
Conditions to closing

6.01 Conditions to Obligations of All Parties. The obligations of each party to consummate the transactions contemplated by this Agreement shall be subject to the fulfillment, at or prior to the Closing, of each of the following conditions:

(a) The filings of Buyer and Seller pursuant to the HSR Act, if any, shall have been made and the applicable waiting period and any extensions thereof shall have expired or been terminated.

(b) No Governmental Authority shall have enacted, issued, promulgated, enforced or entered any Governmental Order which is in effect and has the effect of making the transactions contemplated by this Agreement illegal, otherwise restraining or prohibiting consummation of such transactions or causing any of the transactions contemplated hereunder to be rescinded following completion thereof.

(c) [Seller shall have received all consents, authorizations, orders and approvals from the Governmental Authorities referred to in Section 3.05 and Buyer shall have received all consents, authorizations, orders and approvals from the Governmental Authorities referred to in Section 4.02, in each case, in form and substance reasonably satisfactory to Buyer and Seller, and no such consent, authorization, order and approval shall have been revoked.]]

6.02 Conditions to Obligations of Buyer. The obligations of Buyer to consummate the transactions contemplated by this Agreement shall be subject to the fulfillment or Buyer’s waiver, at or prior to the Closing, of each of the following conditions:

(a) The representations and warranties of Seller contained in Article III shall be true and correct in all respects as of the Closing Date with the same effect as though made at and as of such date (except those representations and warranties that address matters only as of a specified date, which shall be true and correct in all respects as of that specified date), except where the failure of such representations and warranties to be true and correct would not have a Material Adverse Effect.
(b) Seller shall have duly performed and complied in all material respects with all agreements, covenants and conditions required by this Agreement to be performed or complied with by it prior to or on the Closing Date.

(c) Buyer shall have received a certificate, dated the Closing Date and signed by a duly authorized officer of Seller, that each of the conditions set forth in Section 6.02(a) and Section 6.02(b) have been satisfied.

(d) Buyer shall have received a certificate of the Secretary or an Assistant Secretary (or equivalent officer) of Seller certifying that attached thereto are true and complete copies of all resolutions adopted by the board of directors of Seller authorizing the execution, delivery and performance of this Agreement and the consummation of the transactions contemplated hereby, and that all such resolutions are in full force and effect and are all the resolutions adopted in connection with the transactions contemplated hereby.

(e) Buyer shall have received a certificate of the Secretary or an Assistant Secretary (or equivalent officer) of Seller certifying the names and signatures of the officers of Seller authorized to sign this Agreement and the other documents to be delivered hereunder.

(f) Buyer shall have delivered, or caused to be delivered, to Buyer stock certificates evidencing the Shares, free and clear of Encumbrances, duly endorsed in blank or accompanied by stock powers or other instruments of transfer duly executed in blank and with all required stock transfer tax stamps affixed.

6.03 Conditions to Obligations of Seller. The obligations of Seller to consummate the transactions contemplated by this Agreement shall be subject to the fulfillment or Seller’s waiver, at or prior to the Closing, of each of the following conditions:

(a) The representations and warranties of Buyer contained in Article IV shall be true and correct in all respects as of the Closing Date with the same effect as though made at and as of such date (except those representations and warranties that address matters only as of a specified date, which shall be true and correct in all respects as of that specified date), except where the failure of such representations and warranties to be true and correct would not have a material adverse effect on Buyer’s ability to consummate the transactions contemplated hereby.

(b) Buyer shall have duly performed and complied in all material respects with all agreements, covenants and conditions required by this Agreement to be performed or complied with by it prior to or on the Closing Date.

(c) Seller shall have received a certificate, dated the Closing Date and signed by a duly authorized officer of Buyer, that each of the conditions set forth in Section 6.03(a) and Section 6.03(b) have been satisfied.

(d) Seller shall have received a certificate of the Secretary or an Assistant Secretary (or equivalent officer) of Buyer certifying that attached thereto are true and complete copies of all resolutions adopted by the board of directors of Buyer authorizing the execution, delivery and performance of this Agreement and the consummation of the transactions contemplated hereby, and that all such resolutions are in full force and effect and are all the resolutions adopted in connection with the transactions contemplated hereby.

(e) Seller shall have received a certificate of the Secretary or an Assistant Secretary (or equivalent officer) of Buyer certifying the names and signatures of the officers of Buyer authorized to sign this Agreement and the other documents to be delivered hereunder.

(f) Buyer shall have delivered to Seller cash in an amount equal to the Purchase Price by wire transfer in immediately available funds, to an account or accounts designated at least [two/[NUMBER]] Business Days prior to the Closing Date by Seller in a written notice to Buyer.

ARTICLE VII
Indemnification

7.01 Survival. Subject to the limitations and other provisions of this Agreement, the representations and warranties contained herein shall survive the Closing and shall remain in full force and effect until the date that is [NUMBER] years from the Closing Date. None of the covenants or other agreements contained in this Agreement shall survive the Closing Date other than those which by their terms contemplate performance after the Closing Date, and each such surviving covenant and agreement shall survive the Closing for the period contemplated by its terms. Notwithstanding the foregoing, any claims asserted in good faith with reasonable specificity (to the extent known at such time) and in writing by notice from the non-breaching party to the breaching party prior to the expiration date of the applicable survival period shall not thereafter be barred by the expiration of such survival period and such claims shall survive until finally resolved.
7.02 Indemnification By Seller. Subject to the other terms and conditions of this Article VII, Seller shall indemnify Buyer against, and shall hold Buyer harmless from and against, any and all Losses incurred or sustained by, or imposed upon, Buyer based upon, arising out of, with respect to or by reason of:

(a) any inaccuracy in or breach of any of the representations or warranties of Seller contained in this Agreement; or
(b) any breach or non-fulfillment of any covenant, agreement or obligation to be performed by Seller pursuant to this Agreement.

7.03 Indemnification By Buyer. Subject to the other terms and conditions of this Article VII, Buyer shall indemnify Seller against, and shall hold Seller harmless from and against, any and all Losses incurred or sustained by, or imposed upon, Seller based upon, arising out of, with respect to or by reason of:

(a) any inaccuracy in or breach of any of the representations or warranties of Buyer contained in this Agreement; or
(b) any breach or non-fulfillment of any covenant, agreement or obligation to be performed by Buyer pursuant to this Agreement.

7.04 Certain Limitations. The party making a claim under this Article VII is referred to as the "Indemnified Party", and the party against whom such claims are asserted under this Article VII is referred to as the "Indemnifying Party". The indemnification provided for in Section 7.02 and Section 7.03 shall be subject to the following limitations:

(a) The Indemnifying Party shall not be liable to the Indemnified Party for indemnification under Section 7.02(a) or Section 7.03(a), as the case may be, until the aggregate amount of all Losses in respect of indemnification under Section 7.02(a) or Section 7.03(a) exceeds $[AMOUNT]/[PERCENTAGE]% of the Purchase Price (the "Deductible"), in which event the Indemnifying Party shall only be required to pay or be liable for Losses in excess of the Deductible. With respect to any claim as to which the Indemnified Party may be entitled to indemnification under Section 7.02(a) or Section 7.03(a), as the case may be, the Indemnifying Party shall not be liable for any individual or series of related Losses which do not exceed $[AMOUNT] (which Losses shall not be counted toward the Deductible).

(b) The aggregate amount of all Losses for which an Indemnifying Party shall be liable pursuant to Section 7.02(a) or Section 7.03(a) as the case may be, shall not exceed $[AMOUNT]/[PERCENTAGE]% of the Purchase Price.

(c) Payments by an Indemnifying Party pursuant to Section 7.02 or Section 7.03 in respect of any Loss shall be limited to the amount of any liability or damage that remains after deducting therefrom any insurance proceeds and any indemnity, contribution or other similar payment received or reasonably expected to be received by the Indemnified Party (or the Company) in respect of any such claim. The Indemnified Party shall use its commercially reasonable efforts to recover under insurance policies or indemnity, contribution or other similar agreements for any Losses prior to seeking indemnification under this Agreement.

(d) Payments by an Indemnifying Party pursuant to Section 7.02 or Section 7.03 in respect of any Loss shall be reduced by an amount equal to any Tax benefit realized or reasonably expected to be realized as a result of such Loss by the Indemnified Party.

(e) In no event shall any Indemnifying Party be liable to any Indemnified Party for any punitive, incidental, consequential, special or indirect damages, including loss of future revenue or income, loss of business reputation or opportunity relating to the breach or alleged breach of this Agreement, or diminution of value or any damages based on any type of multiple.

(f) Each Indemnified Party shall take, and cause its Affiliates to take, all reasonable steps to mitigate any Loss upon becoming aware of any event or circumstance that would be reasonably expected to, or does, give rise thereto, including incurring costs only to the minimum extent necessary to remedy the breach that gives rise to such Loss.

(g) Seller shall not be liable under this Article VII for any Losses based upon or arising out of any inaccuracy in or breach of any of the representations or warranties of Seller contained in this Agreement if Buyer had knowledge of such inaccuracy or breach prior to the Closing.

7.05 Indemnification Procedures.

(a) Third-Party Claims. If any Indemnified Party receives notice of the assertion or commencement of any action, suit, claim or other legal proceeding made or brought by any Person who is not a party to this Agreement or an Affiliate of a party to this Agreement or a Representative of the foregoing (a "Third-Party Claim") against such Indemnified Party with respect to which the Indemnifying Party is obligated to provide indemnification under this Agreement, the Indemnified Party shall give the Indemnifying Party prompt written notice thereof. The failure to give such prompt written notice shall not, however, relieve the Indemnifying Party of its indemnification
obligations, except and only to the extent that the Indemnifying Party forfeits rights or defenses by reason of such failure. Such notice by the Indemnified Party shall describe the Third-Party Claim in reasonable detail, shall include copies of all material written evidence thereof and shall indicate the estimated amount, if reasonably practicable, of the Loss that has been or may be sustained by the Indemnified Party. The Indemnifying Party shall have the right to participate in, or by giving written notice to the Indemnified Party, to assume the defense of any Third-Party Claim at the Indemnifying Party’s expense and by the Indemnifying Party’s own counsel, and the Indemnified Party shall cooperate in good faith in such defense. In the event that the Indemnifying Party assumes the defense of any Third-Party Claim, subject to Section 7.05(b), it shall have the right to take such action as it deems necessary to avoid, dispute, defend, appeal or make counterclaims pertaining to any such Third-Party Claim in the name and on behalf of the Indemnified Party. The Indemnified Party shall have the right, at its own cost and expense, to participate in the defense of any Third-Party Claim with counsel selected by it subject to the Indemnifying Party’s right to control the defense thereof. If the Indemnifying Party elects not to compromise or defend such Third-Party Claim or fails to promptly notify the Indemnified Party in writing of its election to defend as provided in this Agreement, the Indemnified Party may, subject to Section 7.05(b), pay, compromise, defend such Third-Party Claim and seek indemnification for any and all Losses based upon, arising from or relating to such Third-Party Claim. Seller and Buyer shall cooperate with each other in all reasonable respects in connection with the defense of any Third-Party Claim, including making available (subject to the provisions of Section 5.08) records relating to such Third-Party Claim and furnishing, without expense (other than reimbursement of actual out-of-pocket expenses) to the defending party, management employees of the non-defending party as may be reasonably necessary for the preparation of the defense of such Third-Party Claim.

(b) Settlement of Third-Party Claims. Notwithstanding any other provision of this Agreement, the Indemnifying Party shall not enter into settlement of any Third-Party Claim without the prior written consent of the Indemnified Party (which consent shall not be unreasonably withheld or delayed), except as provided in this Section 7.05(b). If a firm offer is made to settle a Third-Party Claim without leading to liability or the creation of a financial or other obligation on the part of the Indemnified Party and provides, in customary form, for the unconditional release of each Indemnified Party from all liabilities and obligations in connection with such Third-Party Claim and the Indemnifying Party desires to accept and agree to such offer, the Indemnifying Party shall give written notice to that effect to the Indemnified Party. If the Indemnified Party fails to consent to such firm offer within [ten/[NUMBER]] days after its receipt of such notice, the Indemnified Party may continue to contest or defend such Third-Party Claim and in such event, the maximum liability of the Indemnifying Party as to such Third-Party Claim shall not exceed the amount of such settlement offer. If the Indemnified Party fails to consent to such firm offer and also fails to assume defense of such Third-Party Claim, the Indemnifying Party may settle the Third-Party Claim upon the terms set forth in such firm offer to settle such Third-Party Claim. If the Indemnifying Party has assumed the defense pursuant to Section 7.05(a), it shall not agree to any settlement without the written consent of the Indemnifying Party (which consent shall not be unreasonably withheld or delayed).

(c) Direct Claims. Any claim by an Indemnified Party on account of a Loss which does not result from a Third-Party Claim (a “Direct Claim”) shall be asserted by the Indemnified Party giving the Indemnifying Party prompt written notice thereof. The failure to give such prompt written notice shall not, however, relieve the Indemnifying Party of its indemnification obligations, except and only to the extent that the Indemnifying Party forfeits rights or defenses by reason of such failure. Such notice by the Indemnified Party shall describe the Direct Claim in reasonable detail, shall include copies of all material written evidence thereof and shall indicate the estimated amount, if reasonably practicable, of the Loss that has been or may be sustained by the Indemnified Party. The Indemnifying Party shall have [30/[NUMBER]] days after its receipt of such notice to respond in writing to such Direct Claim. During such [30/[NUMBER]]-day period, the Indemnified Party shall allow the Indemnifying Party and its professional advisors to investigate the matter or circumstance alleged to give rise to the Direct Claim, and whether and to what extent any amount is payable in respect of the Direct Claim and the Indemnified Party shall assist the Indemnifying Party’s investigation by giving such information and assistance (including access to the Company’s premises and personnel and the right to examine and copy any accounts, documents or records) as the Indemnifying Party or any of its professional advisors may reasonably request. If the Indemnifying Party does not so respond within such [30/[NUMBER]]-day period, the Indemnifying Party shall be deemed to have rejected such claim, in which case the Indemnified Party shall be free to pursue such remedies as may be available to the Indemnified Party on the terms and subject to the provisions of this Agreement.

7.06 Tax Treatment of Indemnification Payments. All indemnification payments made under this Agreement shall be treated by the parties as an adjustment to the Purchase Price for Tax purposes, unless otherwise required by Law.

7.07 Exclusive Remedies. Subject to Section 9.11, the parties acknowledge and agree that their sole and exclusive remedy with respect to any and all claims [(other than claims arising from [intentional] fraud on the part of a party hereto in connection with the transactions contemplated by this Agreement)] for any breach of any representation,
warranty, covenant, agreement or obligation set forth herein or otherwise relating to the subject matter of this Agreement, shall be pursuant to the indemnification provisions set forth in this Article VII. In furtherance of the foregoing, each party hereby waives, to the fullest extent permitted under Law, any and all rights, claims and causes of action for any breach of any representation, warranty, covenant, agreement or obligation set forth herein or otherwise relating to the subject matter of this Agreement it may have against the other parties hereto and their Affiliates and each of their respective Representatives arising under or based upon any Law, except pursuant to the indemnification provisions set forth in this Article VII. Nothing in this Section 7.07 shall limit any Person’s right to seek and obtain any equitable relief to which any Person shall be entitled pursuant to Section 9.11 [or to seek any remedy on account of [intentional] fraud by any party hereto].

ARTICLE VIII
Termination

8.01 Termination. This Agreement may be terminated at any time prior to the Closing:

(a) by the mutual written consent of Seller and Buyer;

(b) by Buyer by written notice to Seller if:

(i) Buyer is not then in material breach of any provision of this Agreement and there has been a material breach, inaccuracy in or failure to perform any representation, warranty, covenant or agreement made by Seller pursuant to this Agreement that would give rise to the failure of any of the conditions specified in Article VI and such breach, inaccuracy or failure cannot be cured by Seller by [DATE] (the "Drop Dead Date"); or

(ii) any of the conditions set forth in Section 6.01 or Section 6.02 shall not have been fulfilled by the Drop Dead Date, unless such failure shall be due to the failure of Buyer to perform or comply with any of the covenants, agreements or conditions hereof to be performed or complied with by it prior to the Closing;

(c) by Seller by written notice to Buyer if:

(i) Seller is not then in material breach of any provision of this Agreement and there has been a material breach, inaccuracy in or failure to perform any representation, warranty, covenant or agreement made by Buyer pursuant to this Agreement that would give rise to the failure of any of the conditions specified in Article VI and such breach, inaccuracy or failure cannot be cured by Buyer by the Drop Dead Date; or

(ii) any of the conditions set forth in Section 6.01 or Section 6.03 shall not have been fulfilled by the Drop Dead Date, unless such failure shall be due to the failure of Seller to perform or comply with any of the covenants, agreements or conditions hereof to be performed or complied with by it prior to the Closing; or

(d) by Buyer or Seller in the event that:

(i) there shall be any Law that makes consummation of the transactions contemplated by this Agreement illegal or otherwise prohibited; or

(ii) any Governmental Authority shall have issued a Governmental Order restraining or enjoining the transactions contemplated by this Agreement, and such Governmental Order shall have become final and non-appealable.

8.02 Effect of Termination. In the event of the termination of this Agreement in accordance with this Article, this Agreement shall forthwith become void and there shall be no liability on the part of any party hereto except:

(a) as set forth in this Article VIII and Section 5.08 and Article IX hereof; and

(b) that nothing herein shall relieve any party hereto from liability for any intentional breach of any provision hereof.

ARTICLE IX
Miscellaneous

9.01 Expenses. Except as otherwise expressly provided herein (including Section 5.14 hereof), all costs and expenses, including, without limitation, fees and disbursements of counsel, financial advisors and accountants, incurred in connection with this Agreement and the transactions contemplated hereby shall be paid by the party incurring such costs and expenses, whether or not the Closing shall have occurred; provided, however, that Buyer shall be responsible for all filing and other similar fees payable in connection with any filings or submissions under the HSR Act [and [Buyer/Seller] shall pay all amounts payable to [BROKER/FINDER/INVESTMENT BANKER]].
9.02 Notices. All notices, requests, consents, claims, demands, waivers and other communications hereunder shall be in writing and shall be deemed to have been given: (a) when delivered by hand (with written confirmation of receipt); (b) when received by the addressee if sent by a nationally recognized overnight courier (receipt requested); (c) on the date sent by facsimile or e-mail of a PDF document (with confirmation of transmission) if sent during normal business hours of the recipient, and on the next Business Day if sent after normal business hours of the recipient; or (d) on the [third/[NUMBER]] day after the date mailed, by certified or registered mail, return receipt requested, postage prepaid. Such communications must be sent to the respective parties at the following addresses (or at such other address for a party as shall be specified in a notice given in accordance with this Section 9.02):

If to Seller:  
[SELLER ADDRESS]  
Facsimile: [FAX NUMBER]  
E-mail: [E-MAIL ADDRESS]  
Attention: [TITLE OF OFFICER TO RECEIVE NOTICES]

with a copy to:  
[SELLER LAW FIRM]  
Facsimile: [FAX NUMBER]  
E-mail: [E-MAIL ADDRESS]  
Attention: [ATTORNEY NAME]

If to Buyer:  
[BUYER ADDRESS]  
Facsimile: [FAX NUMBER]  
E-mail: [E-MAIL ADDRESS]  
Attention: [TITLE OF OFFICER TO RECEIVE NOTICES]

with a copy to:  
[BUYER LAW FIRM]  
Facsimile: [FAX NUMBER]  
E-mail: [E-MAIL ADDRESS]  
Attention: [ATTORNEY NAME]

9.03 Interpretation. For purposes of this Agreement: (a) the words “include,” “includes” and “including” shall be deemed to be followed by the words “without limitation”; (b) the word “or” is not exclusive; and (c) the words “herein,” “hereof,” “hereby,” “hereto” and “hereunder” refer to this Agreement as a whole. Unless the context otherwise requires, references herein: (x) to Articles, Sections, Disclosure Schedules and Exhibits mean the Articles and Sections of, and Disclosure Schedules and Exhibits attached to, this Agreement; (y) to an agreement, instrument or other document means such agreement, instrument or other document as amended, supplemented and modified from time to time to the extent permitted by the provisions thereof; and (z) to a statute means such statute as amended from time to time and includes any successor legislation thereto and any regulations promulgated thereunder. This Agreement shall be construed without regard to any presumption or rule requiring construction or interpretation against the party drafting an instrument or causing any instrument to be drafted. The Disclosure Schedules and Exhibits referred to herein shall be construed with, and as an integral part of, this Agreement to the same extent as if they were set forth verbatim herein.

9.04 Headings. The headings in this Agreement are for reference only and shall not affect the interpretation of this Agreement.

9.05 Severability. If any term or provision of this Agreement is invalid, illegal or unenforceable in any jurisdiction, such invalidity, illegality or unenforceability shall not affect any other term or provision of this Agreement or invalidate or render unenforceable such term or provision in any other jurisdiction. Upon such determination that any term or other provision is invalid, illegal or unenforceable, the parties hereto shall negotiate in good faith to modify this Agreement so as to effect the original intent of the parties as closely as possible in a mutually acceptable manner in order that the transactions contemplated hereby be consummated as originally contemplated to the greatest extent possible.

9.06 Entire Agreement. This Agreement constitutes the sole and entire agreement of the parties to this Agreement with respect to the subject matter contained herein [and therein], and supersedes all prior and contemporaneous representations, warranties, understandings and agreements, both written and oral, with respect to such subject matter. In the event of any inconsistency between the statements in the body of this Agreement, the Exhibits and Disclosure Schedules (other than an exception expressly set forth as such in the Disclosure Schedules), the statements in the body of this Agreement will control.
9.07 Successors and Assigns. This Agreement shall be binding upon and shall inure to the benefit of the parties hereto and their respective successors and permitted assigns. Neither party may assign its rights or obligations hereunder without the prior written consent of the other party, which consent shall not be unreasonably withheld or delayed. No assignment shall relieve the assigning party of any of its obligations hereunder.

9.08 No Third-party Beneficiaries. Except as provided in Section 5.07 and Article VII, this Agreement is for the sole benefit of the parties hereto and their respective successors and permitted assigns and nothing herein, express or implied, is intended to or shall confer upon any other Person or entity any legal or equitable right, benefit or remedy of any nature whatsoever under or by reason of this Agreement.

9.09 Amendment and Modification; Waiver. This Agreement may only be amended, modified or supplemented by an agreement in writing signed by each party hereto. No waiver by any party of any of the provisions hereof shall be effective unless explicitly set forth in writing and signed by the party so waiving. No waiver by any party shall operate or be construed as a waiver in respect of any failure, breach or default not expressly identified by such written waiver, whether of a similar or different character, and whether occurring before or after that waiver. No failure to exercise, or delay in exercising, any right, remedy, power or privilege arising from this Agreement shall operate or be construed as a waiver thereof; nor shall any single or partial exercise of any right, remedy, power or privilege hereunder preclude any other or further exercise thereof or the exercise of any other right, remedy, power or privilege.

9.10 Governing Law; Submission to Jurisdiction; Waiver of Jury Trial.

(a) This Agreement shall be governed by and construed in accordance with the internal laws of the State of [RELEVANT STATE] without giving effect to any choice or conflict of law provision or rule (whether of the State of [RELEVANT STATE] or any other jurisdiction).

(b) ANY LEGAL SUIT, ACTION OR PROCEEDING ARISING OUT OF OR BASED UPON THIS AGREEMENT[, THE OTHER TRANSACTION DOCUMENTS] OR THE TRANSACTIONS CONTEMPLATED HEREBY [OR THEREBY] MAY BE INSTITUTED IN THE FEDERAL COURTS OF THE UNITED STATES OF AMERICA OR THE COURTS OF THE STATE OF [RELEVANT STATE] IN EACH CASE LOCATED IN THE CITY OF [RELEVANT CITY] AND COUNTY OF [RELEVANT COUNTY], AND EACH PARTY IRREVOCABLY SUBMITS TO THE EXCLUSIVE JURISDICTION OF SUCH COURTS IN ANY SUCH SUIT, ACTION OR PROCEEDING. SERVICE OF PROCESS, SUMMONS, NOTICE OR OTHER DOCUMENT BY MAIL TO SUCH PARTY’S ADDRESS SET FORTH HEREIN SHALL BE EFFECTIVE SERVICE OF PROCESS FOR ANY SUIT, ACTION OR OTHER PROCEEDING BROUGHT IN ANY SUCH COURT. THE PARTIES IRREVOCABLY AND UNCONDITIONALLY WAIVE ANY OBJECTION TO THE LAYING OF VENUE OF ANY SUIT, ACTION OR ANY PROCEEDING IN SUCH COURTS AND IRREVOCABLY WAIVE AND AGREE NOT TO PLEAD OR CLAIM IN ANY SUCH COURT THAT ANY SUCH SUIT, ACTION OR PROCEEDING BROUGHT IN ANY SUCH COURT HAS BEEN BROUGHT IN AN INCONVENIENT FORUM.

(c) EACH PARTY ACKNOWLEDGES AND AGREES THAT ANY CONTROVERSY WHICH MAY ARISE UNDER THIS AGREEMENT [OR THE OTHER TRANSACTION DOCUMENTS] IS LIKELY TO INVOLVE COMPLICATED AND DIFFICULT ISSUES AND, THEREFORE, EACH SUCH PARTY IRREVOCABLY AND UNCONDITIONALLY WAIVES ANY RIGHT IT MAY HAVE TO A TRIAL BY JURY IN RESPECT OF ANY LEGAL ACTION ARISING OUT OF OR RELATING TO THIS AGREEMENT[, THE OTHER TRANSACTION DOCUMENTS] OR THE TRANSACTIONS CONTEMPLATED HEREBY [OR THEREBY], EACH PARTY TO THIS AGREEMENT CERTIFIES AND ACKNOWLEDGES THAT (A) NO REPRESENTATIVE OF ANY OTHER PARTY HAS REPRESENTED, EXPRESSLY OR OTHERWISE, THAT SUCH OTHER PARTY WOULD NOT SEEK TO ENFORCE THE FOREGOING WAIVER IN THE EVENT OF A LEGAL ACTION, (B) SUCH PARTY HAS CONSIDERED THE IMPLICATIONS OF THIS WAIVER, (C) SUCH PARTY MAKES THIS WAIVER VOLUNTARILY, AND (D) SUCH PARTY HAS BEEN INDUCED TO ENTER INTO THIS AGREEMENT BY, AMONG OTHER THINGS, THE MUTUAL WAIVERS AND CERTIFICATIONS IN THIS SECTION 9.10(c).

9.11 Specific Performance. The parties agree that irreparable damage would occur if any provision of this Agreement were not performed in accordance with the terms hereof and that the parties shall be entitled to specific performance of the terms hereof, in addition to any other remedy to which they are entitled at law or in equity.

9.12 Counterparts. This Agreement may be executed in counterparts, each of which shall be deemed an original, but all of which together shall be deemed to be one and the same agreement. A signed copy of this Agreement delivered by facsimile, e-mail or other means of electronic transmission shall be deemed to have the same legal effect as delivery of an original signed copy of this Agreement.
9.13 [Non-recourse. This Agreement may only be enforced against, and any claim, action, suit or other legal proceeding based upon, arising out of, or related to this Agreement, or the negotiation, execution or performance of this Agreement, may only be brought against the entities that are expressly named as parties hereto and then only with respect to the specific obligations set forth herein with respect to such party. No past, present or future director, officer, employee, incorporator, manager, member, partner, stockholder, Affiliate, agent, attorney or other Representative of any party hereto or of any Affiliate of any party hereto, or any of their successors or permitted assigns, shall have any liability for any obligations or liabilities of any party hereto under this Agreement or for any claim or Action based on, in respect of or by reason of the transactions contemplated hereby.]

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be executed as of the date first written above by their respective officers thereunto duly authorized.

[SELLER NAME]

By ______________________
Name: ______________________
Title: ______________________

[BUYER NAME]

By ______________________
Name: ______________________
Title: ______________________
A discussion of how seller's counsel can prepare for an auction, drawn on resources that describe the auction process.

*Practical Law Corporate & Securities*

When a decision is made to put a business up for sale, the seller's foremost concern is maximizing its return. An auction sale process is a common approach to achieving this goal because:

- A robust and properly conducted auction can provide the seller with significant negotiating leverage, especially where multiple bidders are attracted.
- A well-run process can aid the seller and the auction organizers in establishing that their sale, if challenged by unsuccessful bidders, was conducted fairly.
- In the public company setting, an auction process can function as a pre-signing market check in furtherance of the target board of directors' satisfaction of their *Revlon* duties (see *Practice Note, Fiduciary Duties of the Board of Directors: Sale of Control*).

Practical Law offers several resources that guide the auction process for the seller and provide templates for seller-friendly transaction documents.

**Initial Preparation Steps**

The number of steps in an auction differs from transaction to transaction, but almost invariably include these initial steps:

- **Engagement of advisors.** An auction is more complicated than a single buyer sale because the seller will simultaneously negotiate with multiple parties. The seller therefore needs to engage additional advisors to ensure a smooth process. The seller must also assemble its internal team and its legal advisors and clearly define each member's responsibilities at an early stage. For more on these early-stage organizational steps, see *Preparing a Company for Sale Checklist*.

- **Internal due diligence.** One of the potential benefits of an auction is that the seller controls the due diligence process. In a typical single-buyer sale, the buyer supplies its own list of requirements. For more information on due diligence tailored for a private or public deal, see *Standard Documents, Due Diligence Request List: Public Mergers and Acquisitions* and *Due Diligence Request List: Private Mergers and Acquisitions*.

- **Preparation of the data site.** The most common method of distributing due diligence materials is via an online data site (as opposed to a physical data room or CD-ROM). An online data site permits multiple
bidders password protected access to the same documents without knowledge of each others’ identities. Usually the seller can limit access of certain documents to certain parties, track a bidder’s usage of the site or restrict dissemination (such as the ability to view documents without printing them).

Each of these and other initial steps is further described in Practice Note, Auctions: From the Seller’s Perspective: Transaction Steps: Sellers Role in the Auction. In addition, for a graphic outline of the auction process, see Auction Timeline.

Initial Deal Documents
In an auction, the seller prepares the first draft of all documents. This gives the seller a substantial negotiation advantage. In a competitive auction, the bidders may accept the seller’s drafts with only minor negotiations. If the auction is less competitive and the bidders have more leverage, then the negotiation process more closely resembles a single buyer sale process. The key documents drafted by the seller are listed below in order of distribution.

Confidentiality Agreement
While confidentiality is important in all sale transactions, in an auction, confidentiality becomes crucial because of the greater number of parties involved. The risk of a leak of confidential information or the existence of sale discussions is greater than in a single-buyer transaction. The bidders should also be prevented from talking to each other without the seller’s consent. Bidders may negotiate the terms of the confidentiality agreement, but typically avoid lengthy negotiations that delay the distribution of materials. For more information about confidentiality agreements in M&A transactions, see Practice Note, Confidentiality Agreements: Mergers and Acquisitions. For a form confidentiality agreement for M&A deals, see Standard Document, Confidentiality Agreement: Mergers and Acquisitions.

Confidential Information Memorandum
The seller and its investment bankers prepare the confidential information memorandum (CIM). A key document in an auction, the CIM serves as a marketing document, giving bidders a reasonable amount of information about the target company to elicit meaningful bids.

Bid Package
The bid package typically includes a bid process letter and the purchase or merger agreement (see Auction-form Stock Purchase Agreement). The bid process letter explains the rules and procedure of the auction, including:

- How to communicate with the seller.
- The date when bids are due.
- How many bidding rounds are expected.
- What each bid submission must include.
The seller may send the disclosure schedules in the bid package or wait until a later round to distribute them. In some cases, the seller offers a prearranged financing package (known as seller financing or staple financing), although the Del Monte and Rural/Metro decisions have thrown this practice into disrepute.

It is crucial that sellers and their advisors include clear and precise language in bid process letters to minimize the risk of lawsuits instigated by unsuccessful bidders. Counsel must therefore ensure that:

- Auction procedures are clear.
- Appropriate disclaimers are made regarding the seller's control of the process.
- Amendment and interpretation of the auction rules and procedures are reserved to the seller.
- Written procedures govern.
- Restrictions on collusion are included.
- Decision-making process is documented.

Each of these action items is described in full in Practice Note, Bid Process Letters. For a checklist highlighting best practices and important issues for consideration when designing bid procedures in an auction, see Best Practices in Bid Procedures Checklist.

**Auction-form Stock Purchase Agreement**

In an auction, seller's counsel prepares the first draft of the stock purchase agreement, favoring the seller. While the seller may be tempted to make the agreement one-sided, it may be better off presenting a more reasonable draft to bidders, especially if the auction is less competitive and the bidders have more leverage. If the stock purchase agreement is too seller-friendly, a bidder may feel justified in making major modifications because it assumes the other bidders will do the same. Bidders may be less likely to propose wholesale amendments to the stock purchase agreement if the initial draft is reasonable and appears to have taken into account at least some of the bidders' likely concerns.


**Related content**

**Topics**
- Private Equity
- Private M&A
- Public M&A

**Practice Notes**
- Auctions: From the Seller's Perspective
- Bid Process Letters
Chapter 6—The Sale Process

Confidentiality Agreements: Mergers and Acquisitions

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Bid Process Letters

by Robert S. Reder and Dean W. Sattler, Milbank, Tweed, Hadley & McCloy LLP

When the decision is made to put a business up for sale, the seller’s foremost concern is maximizing its return. An auction sale process is a common approach to achieving this goal because:

- A robust and properly conducted auction can provide the seller with significant negotiating leverage, especially where multiple bidders are attracted.
- A well-run process can aid the seller and the auction organizers in establishing that their auction, if challenged by unsuccessful bidders, was conducted fairly.
- In the public company setting, an auction process can function as a pre-signing market check in furtherance of the target board of directors’ satisfaction of their Revlon duties (see Practice Note, Fiduciary Duties of the Board of Directors: Sale of Control).

However, an auction process also has its fair share of dangers and pitfalls. Auctions can potentially expose sellers (and sometimes their auction organizers) to lawsuits, bad publicity and liability if an auction participant believes the sale process was biased or unfair. By focusing on the bid process letter, counsel can guide their clients through an auction process that both maximizes value and limits risk. This Note explains how and when sellers and their advisors use bid process letters, examines common features and provides key drafting and practice tips.

Purpose of Bid Process Letters

In the typical seller-run auction, the seller’s auction organizers (often the seller’s financial advisors) begin the process by contacting potential bidders who may be interested in acquiring the target business. At the same time, the seller’s management and financial and legal advisors work together to prepare a Confidential Information Memorandum (CIM) containing a brief summary of the target business and general information that potential bidders will need to prepare their initial bids. Potential bidders will be required to sign a confidentiality agreement with the seller before receiving a CIM (see Standard Document, Confidentiality Agreement: Mergers and Acquisitions).

Under the confidentiality agreement, potential bidders are:

- Required to keep all information regarding the target business contained in the CIM or otherwise distributed during the auction process (and even the very existence of the auction process) strictly confidential.
- Restricted from using that information for any purpose other than preparing their bids. If the target is a public company, this confidentiality agreement also often contains a standstill provision limiting the bidders’ ability, for a period of time (usually one to three years), to take hostile actions or otherwise acquire shares.
- Prohibited from teaming up with other bidders, at least in the initial phase of the auction.

After these initial contacts, the seller and its auction organizers focus on structuring a controlled and efficient auction process. This allows the seller and its advisors to evaluate competing bids both quantitatively and qualitatively. It also enables them to narrow the pool of interested parties to those financially and operationally capable of completing a deal.

Once a framework has been designed, it is time to communicate the auction’s processes, rules and standards to potential bidders, including the timing and nature of bids. This is accomplished through the bid process letters. Bid process letters communicate a clear and definitive framework for the auction process and apprise all potential bidders of the procedures and requirements for successful navigation of the bid process. Presenting potential bidders with a bid process letter up front, which makes it clear that the organizers and the seller are in full control of the process, helps to insulate the seller and auction organizers from spurned bidders who might seek to litigate their complaints.

For more information on auctions generally, see Practice Notes, Auctions: From the Seller’s Perspective and Auctions: From the Bidder’s Perspective and Auction Timeline.

Bid Process Letters at Different Auction Phases

Sellers and their advisors often break the auction into two distinct phases, commonly known as Phase I and Phase II (also known as bidding rounds). This is due in part to the complexity of an auction sale and the seller’s interest in beginning the process with as large a pool of bidders as possible.
Phase I Bid Process Letters

In Phase I, the bidders are asked to submit an initial non-binding bid. This bidding round gives sellers and their advisors a means to survey the bidder pool and to gain a sense of potential purchasers’ interest in the target and the valuation they will be prepared to assign to it. It also helps the seller and its advisors eliminate bidders whom they suspect are incapable of successfully consummating a deal or who might be competitors (or potential competitors) merely trying to obtain the seller’s confidential information.

A Phase I bid process letter sets forth the timing and content requirements of the initial non-binding bids. Typically, potential bidders are prohibited from contacting the seller or the target directly. They are also barred from contacting or teaming up with other potential bidders without the prior written approval of the seller. All communications regarding the non-binding bid are typically conducted through the auction organizers and (sometimes) the seller’s other advisors.

Phase I bid process letters also typically contain a clear deadline for submission, together with specific instructions regarding the required contents of the non-binding bid, such as:

- **Identity of the bidder.** The identity of the bidder is particularly important for predicting potential financing issues and antitrust or other regulatory considerations that could affect the transaction. This includes guarantors if the bidder is a special purpose entity.

- **Valuation.** Sellers vary in what types and methods of valuations they require (for example, pure equity valuation, EBITDA or other multiples), but the bid process letter often includes a request for an estimated range of the total enterprise value of the target, together with all applicable deductions and offsets.

- **Consideration.** It is important for the seller and the auction organizers to know the form of consideration up front (cash or securities or some combination of the two). Sellers typically expect bidders to provide 100% cash consideration payable at closing.

- **Financing.** It is also important for the seller to understand if a bidder needs third-party financing and will only bid subject to a financing contingency. Sellers ask for the particulars for each bidder’s sources of financing, including a:
  - description of the steps the bidder has taken to secure third-party financing; and
  - detailed description of the expected sources and uses of the funds.

- **Valuation assumptions.** Sellers often want to see that the bidder has thought through its proposed valuation and adequately taken into account the relevant financial, legal and structural considerations. For example, the seller often asks whether the bidder expects to take the target on a debt-free and cash-free basis.

- **Due diligence.** Bidders requiring extensive, protracted or specialized due diligence are viewed less favorably than bidders who are willing and can expeditiously complete due diligence. A Phase I bid often must include the timing and scope of the bidder’s expected due diligence review.

- **Third-party approvals and other conditions.** Knowing each bidder’s anticipated governmental and regulatory approvals, as well as any other significant conditions the bidder expects to incorporate into the definitive acquisition agreement helps the seller and its advisors evaluate and distinguish bidders.

- **Strategic plans for the target and other information.** It is helpful to the seller and its advisors to understand each bidder’s plans for the target. Bidders often choose to include their relevant industry experience and any other information that might make its bid more attractive. Sellers are sometimes interested in the bidders’ plans for employees or relocating plants or offices.

In addition, Phase I letters also include language indicating that, based on the evaluation of Phase I bids, the seller and its advisors will invite a select group of Phase I bidders to participate in Phase II.

Phase II Bid Process Letters

After the non-binding Phase I bids have been received, the seller and its financial advisors determine which (if any) of the bidders move on to Phase II of the auction process. Typically, only a small group of serious bidders advance. Once the determination has been made, the seller’s financial advisors send a Phase II bid process letter to the select group that sets out the timing and content requirements for the bidders to submit a binding bid for the acquisition of the target.

A Phase II bid process letter is usually accompanied by a draft of the definitive acquisition agreement prepared by the seller’s legal counsel (for example, see Standard Document, Stock Purchase Agreement (Auction Form)). The bidder will be required to mark up and return the draft to the seller and its advisors in a form the bidder is willing to execute. At this stage in the process, rather than submitting a full mark-up of the agreement, some bidders find it more efficient (and less costly in terms of legal fees) to submit a significant issues list to serve as a starting point for negotiations and to address those aspects of the
acquisition agreement the bidder finds most important. However, submitting a significant issues list when a full mark-up was requested could be prejudicial to the bidder’s chance of success. This depends on the strength of the bidder’s valuation and whether other strong bidders submit a full mark-up.

Additionally, at this stage in the process the bidders are granted access to a physical or (more commonly) an electronic data room and given the opportunity to conduct due diligence. The seller’s expectation is that due diligence will be completed by the time the bidder submits its binding bid.

A typical Phase II letter contains terms very similar to the Phase I letter, with the exception that all terms left flexible in the non-binding bid must be finalized with specificity. In addition to those terms contained in the Phase I letter, a Phase II letter typically:

- Includes the requirement that the binding bid be kept open through a specified date.
- Conveys an expectation that the bid is not conditioned on any further due diligence.

Sometimes sellers and their advisors may be open to allowing parties to contact each other to form a bidding consortium during Phase II. This may be because of weak interest during Phase I or the realization that none of the bidders, acting alone, can raise enough cash or equity commitments to close the deal. In this case, it is important for sellers and their advisors to clearly set up rules and expectations about when and how fellow bidders may contact each other in the context of the auction. Usually, this is only permitted after obtaining the express written consent of the auction organizers.

In an effort to maximize value, sellers often move forward with more than one bidder simultaneously. Sometimes bidders may seek a period of exclusivity to negotiate the terms of the definitive acquisition agreement, but it is not unusual for a seller to be engaged in negotiations with multiple bidders simultaneously if the bids are comparable or if bids with stronger financial terms are more conditional. For an example of an exclusivity agreement that may be used in an auction, see Standard Document, Exclusivity Agreement.

**Important Disclaimers and Reservations**

Both Phase I and Phase II letters typically contain numerous disclaimers by the seller, particularly that:

- Until the consummation of a definitive acquisition agreement between the parties:
  - the letter does not constitute an offer to sell the target;
  - the seller is not obligated to negotiate with any bidder; and
  - no bid will be deemed accepted.
- Each potential bidder is solely responsible for its own costs incurred during the investigation of the target and the seller and its advisors have no liability for information supplied to potential bidders during the auction process.
- The seller and its financial advisors make no representations or warranties regarding the accuracy or completeness of any information furnished during the course of the auction process.

Additionally, Phase I and Phase II letters contain typical reservations of rights by the seller, including the following language:

“The right, in seller’s sole discretion, to (i) consider all factors in determination of a successful bid; (ii) modify, suspend or terminate the sale process at any time; (iii) remove any bidder from the sale process at any time and without notice; (iv) negotiate with one or more parties simultaneously; (v) enter into a definitive acquisition agreement with any party; and (vi) not do a deal at all.”

Ultimately, the disclaimers and reservations aim to:

- Make clear to potential bidders that the seller, together with its advisors, is in full control of the auction process at all times.
- Help shield the seller and its advisors from liability in case a rejected bidder litigates against the organizers.

Finally, Phase I and Phase II letters also often indicate that the terms of the letters (and disclosure of their existence) are governed by the terms of pre-existing confidentiality agreements between the parties (see Purpose of Bid Process Letters). In addition, the bid process letters state that the terms of the CIM and bid process letters themselves, all information presented in connection with due diligence, any and all communications between the parties and their respective advisors and (often) the mere fact that the auction is taking place are to be maintained in strict confidence. In some situations, particularly when the potential bidder will have access to proprietary commercial information (for example, customer lists or pricing information), the Phase II letter may require any potential bidder who is also a competitor to sign an additional confidentiality agreement.
with more restrictive terms before that potential bidder is granted access to the due diligence materials or more sensitive areas of the electronic data room.

**Best Practices in Bid Procedures**

**General Considerations**

It is crucial that sellers and their advisors include clear and precise language in bid process letters to minimize the risk of lawsuits instigated by unsuccessful bidders. However, as highlighted by the *Solow* decision, precise language might not be enough (see *Box, Solow v. Conseco*). Therefore, counsel must ensure:

- **Auction procedures are clear.** Carefully review bid process letters to make sure they are complete and internally consistent and that the seller and its advisors are comfortable with the established procedures.

- **Appropriate disclaimers regarding seller’s control of the process are made.** Include sufficient express disclaimers in the auction procedures to make it clear that the seller retains complete discretion for all decisions regarding the auction procedures, including:
  - which parties the seller decides to negotiate with;
  - the selection of the winning bidder;
  - the right to reject any and all proposals;
  - the right to change or abandon the process altogether; and
  - the right to consummate the transaction on any terms, whether or not they differ from the procedures established for the auction.

- **Amendment and interpretation of the auction rules and procedures are permitted.** Reserve the right to amend the auction procedures at any time and state explicitly that the seller’s interpretation of the procedures and any questions arising thereunder will be final and binding on all auction participants.

- **Written procedures govern.** Make it clear that the distributed written procedures govern the process in all respects, and that no oral representations or modifications are binding on the seller or can be relied on by any auction participants.

- **Auction process and its participants are carefully monitored and limited.** Limit the number of representatives of the seller and its advisors who are entitled to communicate with the auction participants. Advisors must also closely monitor management presentations and all interactions between the target’s personnel and the representatives of and advisors to the various participants.

- **Restrictions on collusion are included.** Make it clear at each phase of the auction process whether collusion among bidders is permitted and, if so, what type of collusion. Be mindful that allowing collusion may have important implications for the various confidentiality obligations of the parties.

- **A level playing field.** Take care to create as much of a level playing field among auction participants as practicable to minimize the opportunity for any participant to claim unfair treatment in relation to any other participant.

- **Decision-making process is documented.** To the extent possible, have a rational basis for all decisions made in the course of the auction, and document those decisions and the way in which they were reached.

- **Auction organizers also follow procedures.** Follow the written procedures that have been communicated to the bidders and communicate any changes in the procedures more or less simultaneously to all auction participants in writing.

**Special Considerations when Target’s Management is Different from Seller’s Management**

A further complication that sellers may face in an auction sale process arises when the seller (or management of the seller) is not involved in the management of the target’s business. In this situation, the interests of the target’s management and those of the seller are not always aligned. This could result in the target’s management favoring one bidder or refusing to cooperate fully to undermine the auction. These challenges can be dealt with by auction organizers establishing clear rules for the target management’s involvement in the process.

Some common techniques include:

- **Limiting the involvement of the target’s management during Phase I.** This helps prevent management from tainting the pool of potential bidders or attempting to work out a sweetheart deal favoring one of the bidders. Further, if
management is against the sale altogether, it allows the auction organizers to keep management from trying to stop the deal.

- **Setting management’s expectations.** Maintain a consistent message to potential bidders about a particular sale process by informing the target’s management of the organizers’ and seller’s expectations up front.

- **Restricting contact with bidders.** Limit communications between the target’s management and bidders, and require that seller’s representatives accompany the target’s management to management presentations and due diligence sessions.

- **Prohibiting discussions regarding employee contracts and benefits.** Restrict bidders from offering or discussing post-closing employment terms with the target’s management until later in the process.

- **Providing stay bonuses.** Provide incentives to the target’s management to stay with the target and cooperate with the process by offering stay bonuses or other forms of compensation tied to a successful transaction.

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**Solow v. Conseco**

In 2008, the US District Court for the Southern District of New York was asked to rule on a dispute arising from an auction process where an unsuccessful bidder sought to hold the seller liable as a result of the seller’s dealings with another bidder in alleged violation of the established bid procedures (see *Solow v. Conseco, Inc., No. 06-CV-5988, 2008 WL 190340, (S.D.N.Y. Jan. 18, 2008)*). This case highlights why bid process letters must be drafted carefully and bid procedures must be enforced.

**Facts**

At the center of the dispute in *Solow* was the auction of the General Motors Building in midtown Manhattan by Conseco, Inc. through its agent, Eastdil Realty Company. The invitations to bid circulated on behalf of Conseco included a confidentiality agreement that prospective bidders were required to sign before being allowed to conduct due diligence. This confidentiality agreement expressly reserved the right for Conseco, “in its sole and absolute discretion,” to:

- Accept or reject any offer for any reason.
- Terminate discussions with any bidder.
- Exercise discretion in evaluating any valid bid.

The invitation required submission of initial bids to Eastdil and, thereafter, a smaller group of bidders would be selected to participate in a final round of bidding. Conseco then instructed bidders of the final bid submission date through a letter that contained the same reservations of seller’s rights regarding the auction as included in the confidentiality agreement.

Among other bidders, Sheldon H. Solow was invited to participate in the final round. In compliance with the terms of the bid process, Solow submitted a timely final bid with a purchase price of $1.4 billion, with 20% as equity and a $50 million deposit, both to be provided by Solow. Although Solow claimed that his was the best and highest credible bid received by Conseco, Conseco sold the building to another bidder, Harry Macklowe, for the same price. Solow alleged that Conseco’s deal with Macklowe was consummated in violation of the auction rules.

Solow brought suit against Conseco, asserting (among other things) fraud and breach of the duty to hold a fair auction. Solow further alleged that the Macklowe bid contained misrepresentations about financing.

**Key Litigated Issues**

Specifically, Solow claimed that Conseco, through Eastdil, assured Solow that:

- The auction would be conducted fairly.
- Bids would have to be submitted as specified by Conseco.
- Bidders would not be shown or told about the amounts offered by other bidders.
- The building would be sold to the best bidder.

However, according to Solow’s complaint, Conseco contacted Macklowe the next day to tell him that he would be sold the building if he agreed to match Solow’s final bid of $1.4 billion. In essence, Solow claimed that Conseco used him as a *[stalking horse]* to set up the price paid by Macklowe.
Conseco moved to dismiss the claims, arguing that Solow could not, as a matter of law, set up a cause of action for fraud or breach of the duty to conduct a fair auction. In its argument, Conseco cited both the confidentiality agreement and the final bid process letter that expressly reserved certain rights (see Facts).

**Outcome and Practical Implications**

The court denied Conseco’s motion to dismiss and stated that Conseco’s “reservation of rights…would not extend to fraud or an unfair departure from the auction rules.”

Notably, the court’s opinion contained a footnote citing an earlier New York decision for the proposition that, under New York law, “a private auction to selected potential purchasers who submitted written bids” must be “conducted fairly pursuant to its terms.” Conseco argued that because the written documents directed to the potential bidders for the GM Building did not expressly use the term “auction,” Solow was not entitled to rely on this decision. However, according to the court, Conseco failed to cite any case law for the proposition that the GM Building auction must have been specifically labeled as an auction for Solow to pursue his claim. Accordingly, the court found that the absence of the term “auction” in the written documents was insufficient at this stage of the litigation to defeat Solow’s claim.

Although the Solow case was not decided on its merits, the fact that Solow’s complaint survived Conseco’s motion to dismiss should raise a red flag for auction organizers who set up procedures for bidders to follow but then fail to abide by those procedures. As the court noted, even when a seller reserves certain rights in setting up an auction, these reservations do not completely shield against liability for fraud or an unfair departure from the auction rules.
Fiduciary Duties of the Board of Directors

This Note covers the fiduciary duties of the board of directors, including a discussion of the core duties of care and loyalty and certain circumstances when the board holds heightened duties.

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Every director owes fiduciary duties to the corporation and its stockholders. Since directors can be subject to personal liability for breaches of these duties, it is important that directors and the attorneys advising them understand what is required.
This Note covers the fiduciary duties of the board of directors under Delaware law. It focuses on Delaware law because:

- The majority of companies are incorporated in Delaware.
- Delaware's law on fiduciary duties is well established and widely followed by other states.

For information on how fiduciary duties are applied in other states, see Corporation Law: State Q&A Tool: Question 4.

This Note does not address the public company corporate governance requirements of the SEC or the various stock exchanges. For more information on the obligations of directors under those regimes, see Practice Notes, Corporate Governance Standards: Board of Directors and Periodic Reporting and Disclosure Obligations: Overview.

**Legal Framework**

Directors' fiduciary duties are regulated by:

- Statutory law of the state in which the corporation is incorporated. Many corporations incorporate in the state of Delaware. The majority of other states base their legislation on Delaware law or on the Model Business Corporations Act (MBCA).
- Common law rules (for example, case law relating to directors’ fiduciary duties).
- The corporation's articles or certificate of incorporation and by-laws.
- The stockholder activist climate. Reform of corporate governance regulations and directors' duties is often influenced by, if not a direct result of, stockholder activism and litigation.

**Role of Directors in Management of the Corporation**

A corporation's board of directors is ultimately responsible for its management. This power is codified in Section 141 of the Delaware General Corporation Law (DGCL) (8 Del. C. § 141) and by similar statutes in other states. Although the power to manage the corporation is often broadly stated and not clearly defined, responsibility for making decisions on behalf of the corporation is clearly vested with the directors and not the stockholders. The board discharges this responsibility by:

- Appointing officers who run the day-to-day operations of the corporation, propose strategies and objectives, and implement corporate plans.
- Supervising those officers.
- Making major decisions for the corporation (for example, entering into a significant joint venture or licensing its key intellectual property platform).

Often selected for their expertise in a particular area or industry connections, directors typically hold an advisory or supervisory role. State statutory law and a corporation's charter normally permit the board to
delegate any of its powers to a committee of directors. However, many state statutes restrict the scope of the activities that can be conducted by a committee of less than an entire board.

Under Delaware law, a duly appointed committee (such as a compensation or nominating committee) holds all powers delegated to it by the full board (or as otherwise provided for in the certificate of incorporation or by-laws) other than the power to:

- Approve, adopt or recommend to the stockholders any action or matter (other than the election or removal of directors) expressly required by Delaware law to be approved by the stockholders.
- Adopt, amend or repeal any of the corporation’s by-laws.

(See 8 Del. C. § 141(c)(2).)

Directors can reasonably rely on reports from committees, officers and other experts when making decisions for the corporation (see 8 Del. C. § 141(e)).

Core Fiduciary Duties

There are two core fiduciary duties:

- The duty of care (see Duty of Care).
- The duty of loyalty (see Duty of Loyalty).

Directors owe these duties to the corporation and its stockholders (Arnold v. Soc'y for Sav. Bancorp, Inc., 678 A.2d 533, 539 (Del. 1996)). The corporation itself does not owe fiduciary duties to the stockholders and similarly cannot be held to have aided or abetted any breaches by the directors of their duties (see Buttonwood True Value P’rs, L.P. v. R.L. Polk & Co., Inc., C.A. No. 9250-VCG (Del. Ch. Aug. 7, 2014))

In addition to fiduciary duties owed under the law of the jurisdiction of incorporation, directors may have many other duties stemming from the corporation’s charter documents, ethics policies, stock exchange (if a public company) or the SEC (see Practice Note, Corporate Governance Standards: Board of Directors).

Duty of Care

A director must employ the duty of care when making decisions or acting on behalf of the corporation. Most states have codified the duty of care, generally following the standards of the MBCA. The MBCA requires a director to act with the care that a person in a like position would reasonably believe appropriate under similar circumstances. For example, both California and New York have codified the duty of care and closely follow the MBCA with minor modifications:

- The California statute requires a director to act in good faith, in a manner the director believes to be in the best interests of the corporation and its stockholders, and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances (see California Corporation Code § 309(a) and Corporation Law: California: State Q&A: Question 4).
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- The New York statute requires a director to perform his duties in good faith and with the degree of care which an ordinarily prudent person in a like position would use under similar circumstances (see N.Y. Bus. Corp. § 717(a) and Corporation Law: New York: State Q&A: Question 4).

While not codified in Delaware, the duty of care has been developed in case law. Similar to the MBCA, New York and California, Delaware courts generally describe the duty of care as the obligation to use the amount of care which an ordinarily careful and prudent person would use in similar circumstances. A director also breaches his duty of care if he takes no action in a situation where a careful person would have taken action. For example, if a corporation commits securities fraud, a director can become liable for failing to stop the fraud if he failed to attend any meetings, monitor management in any way or otherwise take action (see Duty of Oversight).

Delaware courts recognize that directors sometimes must take business risks to promote the best interests of the corporation and its stockholders, and that judges and stockholders are not in the best position to second guess business decisions made by the board of directors. Judges have been particularly careful not to impose liability for a decision that seems wrong only with the benefit of hindsight. To allow boards to take necessary business risks and to attract qualified people to serve as directors, Delaware has adopted the following:

- The business judgment rule. The business judgment rule presumes that directors comply with the duty of care (see Business Judgment Rule).

- Analysis of process not substance. Courts focus on the process used in making the decision rather than the substance of the decision.

- Statutory limitation of liability. Most states allow the corporation's certificate of incorporation to eliminate or limit directors' personal liability for money damages to the corporation or its stockholders for breach of their duty of care. However, restrictions are often placed on these limitations. For example, Section 102(b)(7) of the DGCL provides that directors' liability cannot be eliminated or limited under any of the following circumstances:
  - breaches of the director's duty of loyalty;
  - intentional misconduct, bad faith or a knowing violation of law;
  - unlawful payments of dividends or unlawful stock purchases;
  - actions involving any improper personal benefit; or
  - any acts occurring prior to the effective date of the provision limiting the director's liability in the certificate of incorporation.

Of note, while the 102(b)(7) exculpation provision eliminates personal monetary liability for the directors, it does not erase the underlying breach of that duty. Consequently, a third party (such as a financial advisor) can be held liable for aiding and abetting a director's breach, even if the director who committed the breach is personally exculpated (In re Rural Metro Corp. S'holders Litig., 88 A.3d 54, 86 (Del. Ch. 2014)). In addition, the provision only eliminates monetary liability, but does not preclude the court from issuing an injunction to provide relief for the breach (Malpiede v. Townsend, 780 A.2d 1075, 1095 (Del. 2001)).

- Indemnification. Indemnification statutes protect directors from stockholder litigation. For example, in Delaware, corporations are authorized to indemnify and advance expenses to directors if the director acts in good faith and in the best interests of the corporation and has no reasonable cause to believe that his behavior was unlawful (see 8 Del. C. § 145).
• **Insurance.** Delaware law permits corporations to insure directors to cover losses (such as settlement costs, fines and legal fees) resulting from a breach of the duty of care. Companies can purchase this insurance, known as Director and Officer Insurance (or D&O Insurance). Insurance to protect directors from fraud, dishonesty or for violations of criminal law cannot be purchased (see 8 Del. C. § 145 and Practice Note, Directors and Officers Liability Insurance Policies).

**Business Judgment Rule**

Courts are loath to substitute their business judgment for the directors’ or to question business decisions with the benefit of hindsight. For this reason, directors' actions are protected by the presumptions of the business judgment rule. The rule presumes that the board of directors acted on an informed basis and in the honest belief that the action was taken in the best interest of the corporation. In a lawsuit alleging a breach of the duty of care, the court makes this presumption unless the plaintiff can show that a majority of the directors did not meet the following three elements:

• **Informed.** The director must keep informed about the corporation and its decisions. Directors should be made aware that they are required to participate in board actions. This means attending meetings (in person or by phone), carefully reading reports or other materials and asking questions. Directors can rely on information and opinions from consultants, management and employees, but need to make a good faith determination that those persons can competently produce the reports and make the analysis on which the board relies (see 8 Del. C. § 141(e)). Directors sometimes serve on multiple corporate boards, but must be careful not to spread themselves too thin or risk breaching the duty of care.

• **Good faith.** The directors must act in good faith. The decision-making process must be substantive and cannot just rubber-stamp management’s actions (see Duty of Good Faith).

• **Best interest of the corporation.** The directors must reasonably believe the action or transaction was made in the best interest of the corporation. A director who has a conflict of interest in the underlying action is not entitled to the presumptions of the business judgment rule (see Duty of Loyalty).

Delaware courts apply the standard of gross negligence to determine if a board of directors breached its duty of care (see In re Citigroup Inc. S’holder Deriv. Litig., 964 A.2d 106, 124 (Del. Ch. 2009), citing Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984)). Even if a plaintiff chooses to file a claim for breach of fiduciary duties against only one director, it still must rebut the presumptions of the business judgment rule as to a majority of the directors to succeed on its claim against the individual (Hamilton Prs, L.P. v. Highland Capital Mgmt., L.P., C.A. No. 6547–VCN, 2014 WL 1478511 (Del. Ch. May 7, 2014)). If the plaintiff can prove the directors did not meet any of the above elements, then the burden of proof shifts to the directors to prove the action or transaction was entirely fair to the corporation. In this context, entirely fair means a fair price and fair dealing. Once directors lose the protection of the business judgment rule, it is difficult to show that a transaction is entirely fair. It is unlikely that directors acting with gross negligence can prove they engaged in fair dealing.

**Duty of Loyalty**

The duty of loyalty requires directors to act in good faith for the benefit of the corporation and its stockholders (and not for their own interest). Decisions or transactions involving a conflict of interest are not protected by the business judgment rule and the statutory limitation of liability under Section 102(b)(7) of the DGCL is not available. If the directors hold a personal interest in an action, the court will not presume they acted in the best interest of the corporation. (Conversely, disinterested and independent directors are not presumed to have
acted disloyally, even when they facilitated a transaction with a controlling stockholder that will be reviewed for its entire fairness.)

To meet the higher standard of scrutiny under entire fairness, many states codified a procedure for transactions involving a conflict of interest. In Delaware, a transaction involving a director with a conflict of interest is not voidable if one of the following three conditions applies:

- The material facts of the conflict of interest are disclosed and the board of directors authorizes the transaction in good faith by a majority of the disinterested directors. Often a special committee of disinterested directors is convened for this purpose.
- The material facts of the conflict of interest are disclosed and the stockholders approve the transaction.
- The transaction is fair to the corporation at the time it is approved or ratified by the board of directors or the stockholders.

To avoid the need to prove a transaction is fair, a director should always disclose any conflict of interest and get the approval of the disinterested directors. If possible, but not required, a director can get ratification by or approval from the stockholders. However, if a stockholder vote is legally required to approve an action and the board does not submit that particular action to a vote, the board cannot use ratification by the stockholders to get a presumption of fairness (see Practice Note, In Dispute: Gantler/Stephens).

Conflicts of interest are not deemed apparent simply because the directors have an interest in maintaining their office, even if they are compensated for their service (Moran v. Household Int'l, Inc., 490 A.2d 1059, 1074 (Del. Ch. 1985), aff'd, 500 A.2d 1346 (Del. 1985)). Rather, the court will review the materiality of the alleged interest of each individual director and only conclude that the board was conflicted if the impartiality of a majority of the directors is impugned.

On the other hand, a conflict of interest can arise even when the director does not hold a personal interest in the transaction. For example, a director may represent an interested class of stockholders whose interests diverge from the corporation’s. In venture capital and private equity transactions, investors commonly hold the right to elect a certain number of directors to represent their interests. Directors must remember that they owe a duty to the stockholders as a whole, not just a certain group.

**Corporate Waste**

In a claim of breach of fiduciary duties, if the plaintiff fails to rebut the presumption of the business judgment rule and cannot demonstrate a breach of a duty, he will not be entitled to any remedy unless the challenged transaction constitutes waste (In re Walt Disney Co. Deriv. Litig., 906 A.2d 27, 74 (Del. 2006)). To recover on a claim of waste, a plaintiff must prove that the relevant exchange was "so one-sided that no business person of ordinary, sound judgment could conclude that the corporation has received adequate consideration." This is considered a stringent standard that, under Disney, is only met in the "rare, unconscionable case where directors irrationally squander or give away corporate assets." For example, the Delaware courts have ruled consistently that structuring a compensation plan in such a way that does not minimize corporate taxes is a "classic exercise of business judgment" that does not support a claim of waste (see Freedman v. Adams, 58 A.3d 414, 417 (Del. 2013)). Similarly, spending on items such as employee vehicles, outings, social-club dues and holiday gifts is also usually attributable to a rational business purpose and typically does not support a finding of waste (see Zutrau v. Jansing, 2014 WL 3772859, at *20 (Del. Ch. July 31, 2014)).
Heightened Duties

Certain situations require a heightened duty of care and courts use greater scrutiny in determining whether a board carried out its fiduciary duties. This means the business judgment rule does not become available until certain hurdles are met because the directors’ action or inaction could potentially have a more damaging effect on the stockholders.

Defensive Measures

A successful contested takeover usually leads to the replacement of management and the board of directors. In friendly transactions, the board and management may remain with the corporation or get attractive severance packages. Because of this inherent conflict of interest, the Delaware courts apply a heightened test when examining anti-takeover defensive measures (see Unocal v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985)). The directors must first show:

- Reasonable grounds for believing a danger existed to the operation or policies of the corporation. Because the Unocal analysis is very fact intensive, the board of directors should ensure that there is a reasonable and good faith investigation by non-management (if possible) directors before any defensive measures are put in place.

- The defensive measure was reasonable in relation to the threat. Defenses that preclude all other offers or coerce stockholders to approve a management sponsored bid are generally considered unreasonable in relation to a threat. For example, in the Omnicare case, the Delaware court found that the board breached its fiduciary duty by approving a merger agreement that contained a force the vote provision in conjunction with an agreement by two of its largest stockholders to vote in favor of the merger (see Omnicare v. NCS Healthcare, Inc., 818 A.2d 914 (Del. 2003)). The combination of these two factors in the Omnicare case precluded any competing offers and were considered unreasonable.

If the directors fail to prove the two elements above, they must show that the action was entirely fair to the corporation.

For more information on defensive measures, see Practice Notes, Defending Against Hostile Takeovers and Poison Pills: Defending Against Takeovers and Protecting NOLs.

Interference with Stockholder Vote

Stockholders can influence the management of the corporation by:

- Electing (or by not voting for) directors.
- Selling their shares of stock (and ceasing to be owners of the corporation).

The right to elect directors is especially important because it allows stockholders to influence the management of the corporation without selling their shares. If the board acts with the primary purpose of interfering with the fundamental right to elect directors, the board must show it had compelling justification for doing so (see Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651 (Del. Ch. 1988)). If the board can show it had a compelling
justification, then the business judgment rule applies. Meeting this standard is difficult, so courts typically only apply it when the board truly acts with the primary purpose of disenfranchising the stockholders.

In 2007, the Delaware Court of Chancery found that a board had a compelling justification when it postponed a stockholder vote in order to get more votes for a merger that was going to be voted down (see Mercier v. Inter-Tel, Inc., 929 A.2d 786 (Del. Ch. 2007)). In Inter-Tel, the court applied a modified Unocal standard (see Defensive Measures). According to this revised standard, the directors must show that:

- They pursued a legitimate corporate objective motivated by a good faith concern for the stockholders' best interests and did not preclude the stockholders from their right to vote or coerce them to vote in a particular way.
- Their actions were reasonable in relation to the threat.

Although the court applied this revised standard, it also found that the directors had a compelling justification for their actions. Significantly, several important facts in this case helped to justify the board's actions including:

- The stockholders were about to reject a merger proposal.
- A special committee of independent directors believed the merger to be in the best interest of the stockholders.
- New information relevant to the merger had not yet been disclosed (such as the second quarter financial results).
- The directors reasonably feared losing the offer if stockholders voted against the merger.
- The directors rescheduled the meeting within a reasonable time period.

Sale of Control

In the context of a change of control or the break-up of a corporation, the Delaware courts also apply the heightened reasonableness standard introduced in Unocal when reviewing the conduct of directors (see Revlon, Inc. v. MacAndrews & Forbes Hldgs., Inc., 506 A.2d 173 (Del. 1986)). In this context, the Delaware courts place the burden on the board of directors to obtain the highest value reasonably available to the stockholders (a standard of review known as "Revlon duties"). Revlon duties attach only once the directors have decided to sell the company, or before that, if a sale has become inevitable. The board is not subject to Revlon duties merely because the corporation is "in play" or a candidate for takeover (see Lyondell Chem. Co. v. Ryan, 970 A.2d 235, 242 (Del. 2009) and Legal Update, Delaware Supreme Court Reverses Chancery Court on Lyondell). If the directors fail to meet their Revlon duties, they must show that the sale transaction was entirely fair to the corporation. Usually, the highest value is interpreted to mean the highest purchase price, but the board of directors can consider other factors such as certainty of completion in light of required financing and governmental consents (such as Hart-Scott-Rodino (HSR)).

In Lyondell, the Delaware Supreme Court emphasized on appeal that there is only one duty in Revlon deals, to obtain the best price for the stockholders. Although the court has declined to specify what actions directors must take when Revlon duties are implicated, directors should consider the following:

- The board should obtain a fairness opinion, carefully review any valuations of the corporation and consider alternative valuation methodologies. The board must also carefully consider the role and
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independence of any financial advisors. For detailed discussion of all these factors, see Practice Note, Fairness Opinions.

- The board (or special committee assigned to the transaction) should monitor negotiations between the CEO (or other management) and the buyer.

- Any potential conflicts of interest should be fully disclosed to the board and stockholders (see Duty of Disclosure). If any directors have a personal interest in the transaction, a special committee of disinterested directors should be convened (Practice Note, Making Good Use of Special Committees.)

- Parties with a personal interest in the transaction should not negotiate the terms of the transaction.

- The board should conduct a meaningful market check to confirm the existence (or nonexistence) of a better deal.

- The board should consider negotiating with different types of buyers. For example, the Delaware Court of Chancery found a board of directors did not employ a reasonable process when they conducted a limited auction with private equity buyers and relied on a window-shop provision in the merger agreement to attract any potential strategic buyers after signing the merger agreement (see In re Netsmart Techs., Inc. S'holders Litig., 924 A.2d 171 (Del. Ch. 2007)).

- The board should consider the totality of the deal protections in place (see Practice Note, Defending Against Hostile Takeovers).

- The board should consider the particular circumstances affecting the corporation. For example, the Netsmart court held that an auction of a smaller corporation can require significantly more marketing than a widely held public corporation in order to be considered reasonable.

Although directors should give each of these suggestions its due weight, the Delaware courts have repeatedly emphasized that there is no single blueprint for directors to follow to fulfill their Revlon duties (see Barken v. Amsted Indus., Inc. 567 A.2d 1279, 1286 (Del. 1989)). For example, in Plains, the Court of Chancery held that the directors satisfied their Revlon duties even though the board did not conduct a pre-signing market check or demand a post-signing go-shop right because of the directors' industry expertise and justifiable reliance on their financial advisor's advice (In re Plains Exploration & Prod. Co. S'holder Litig., 2013 WL 1909124 (Del. Ch. May 9, 2013)). For more information, see Legal Update, In re Plains: Revlon Duties Met Despite no Special Committee or Pre-agreement Market Check. At the same time, the court will not consider the listed suggestions in isolation. For example, in Koehler v. NetSpend, the Court of Chancery said that the board's decision to conduct a single-bidder process, though not unreasonable per se, put the board's other decisions under even greater scrutiny (2013 WL 2181518 (Del. Ch. May 21, 2013) and see Legal Update, Koehler v. NetSpend: Chancery Court Finds Board Acted Unreasonably in Sale Process).

Although the Court of Chancery has at times applied this scrutiny strictly, the Delaware Supreme Court has emphasized that the board of the target company has no obligation to perform an auction or post-signing market check, and does not have to have "impeccable knowledge" of the company's value (the phrase used in Plains) to enter into single-bidder negotiations. In the Supreme Court's view, as long as a majority of the board is disinterested and independent and the stockholders will hold an informed vote, the board can rely on a passive market check enabled by a fiduciary out and modest break-up fee to fulfill its Revlon duties (C&J Energy Serv., Inc. v. City of Miami Gen. Emps' and Sanitation Emps' Ret. Trust, 2014 WL 7243153 (Del. Dec. 19, 2014); see Legal Update, C&J Energy Services v. City of Miami GESERT: Delaware Supreme Court Reverses Chancery Court, Rules that Passive Market Check Satisfied Revlon).
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Fiduciary Outs and Break-up Fees

Because of their heightened fiduciary obligation in a sale transaction, directors need the ability to consider superior offers without being fully locked up by the terms of the acquisition agreement. In other words, directors need to be able to withdraw their approval of the deal and cause the corporation to terminate the agreement if a better deal comes along (known as a fiduciary out). Both parties understand this obligation, so sellers often successfully negotiate a fiduciary out exception to a no-shop provision in public company merger agreements. To compensate the buyer, most acquisition agreements with a fiduciary out also provide for the payment of a break-up fee to the buyer if a seller terminates the agreement for a better offer. For more information on fiduciary outs and break-up fees, see Practice Notes, Break-up or Termination Fees and No-shops and Their Exceptions.

A fiduciary out must be meaningful in order for the board to satisfy its fiduciary obligations. In Omnicare, the Delaware court found that the board breached their fiduciary duties even though the merger agreement contained standard fiduciary out language. The fiduciary out was essentially irrelevant since the merger agreement also contained a force the vote provision and the largest stockholders agreed to vote in favor of the transaction. This meant the board could not effectively pursue another buyer. Courts will also review the size of the break-up fee to determine if it will effectively prevent a third party bid. Directors can look to market practice to see what size of break-up fee or level of deal protections companies of a certain size commonly use, but no bright line rule exists.

Exculpation for Failure to Satisfy Revlon Duties

Even if the board is found to have breached its duty of care under Revlon, a claim against the directors will still fail if the corporation's charter contains an exculpation provision under Section 102(b)(7) of the DGCL. In these situations, the plaintiff must also prove that the directors breached their duty of loyalty or that they acted in bad faith (see Duty of Good Faith). Because a finding of gross negligence is necessary to establish a breach of the duty of care (which is excused by a Section 102(b)(7) provision), a bad faith act (which is not excused) must be "qualitatively more culpable than gross negligence" (In re Walt Disney Co. Deriv. Litig., 906 A.2d 27, 66 (Del. 2006)). The primary finding necessary to establish bad faith is that the "fiduciary intentionally fails to act in the face of a known duty to act, demonstrating a conscious disregard for his duties" (Lyondell, 970 A.2d at 243). The Lyondell court emphasized the "vast difference" between an imperfect effort at satisfying the board's duties and a conscious disregard for those duties, which ensuing cases have gone on to describe. For example, in Houseman v. Sagerman, the Court of Chancery dismissed a fiduciary duty claim against a board that had failed to obtain a formal fairness opinion and failed to audit the company's financial statements. Even though the board "did not conduct a perfect sales process," it defeated the claim because it did not "utterly fail to undertake any action to obtain the best price for stockholders" (C.A. No. 8897–VCG, 2014 WL 1478511, at *7 (Del. Ch. Apr. 16, 2014)).

For further examples of misconduct that have been found insufficiently egregious to breach the standard in Lyondell, see In re Answers Corp. S'holders Litig., Consol. C.A. No. 6170–VCN, 2014 WL 463163 (Del. Ch. Feb. 3, 2014) and Legal Update, In re Answers Corp.: Delaware Court of Chancery Finds No Breach of Revlon Duties Under Lyondell Standard.

Revol Dutes in Mixed-consideration Deals

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Revlon duties attach in change-of-control transactions because it is there that the "omnipresent specter" exists that the board of the target company will act in its own interests to the detriment of the stockholders (Unocal, 493 A.2d at 954). Conversely, Revlon duties do not attach, and the board retains the presumptions of the business judgment rule, in stock-for-stock deals, if control of the post-merger entity remains in a "large, fluid, changeable and changing public market" (Paramount Commc'n Inc. v. QVC Network Inc., 637 A.2d 34, 47 (Del. 1994)).

The analysis in mixed-consideration transactions turns on the percentage of cash versus stock being paid. The Delaware Court of Chancery in Smurfit-Stone applied Revlon duties where the mix of consideration at signing was 50/50 stock and cash consideration, even though the cash portion fell to less than 50% following the signing date (In re Smurfit-Stone Container Corp. S'holder Litig., 2011 WL 2028076, at *12-16 (Del. Ch. May 20, 2011, rev'd May 24, 2011)). In an earlier transcript ruling, Vice Chancellor Laster had stressed that the important factor in determining when enhanced Revlon scrutiny applies is the percentage of the surviving entity that the current target-company stockholders will own, rather than the percentage of cash versus stock consideration (see Legal Update, Delaware Chancery Court's Occam Ruling Applies Revlon to Mixed Consideration Transaction). However, Vice Chancellor Laster himself adopted the Smurfit-Stone formulation in Chen v. Howard-Anderson, 87 A.3d 648, 667 (Del. Ch. Apr. 8, 2014).

Transactions Involving Controlling Stockholders

When a controlling stockholder is involved in a transaction where the minority will be cashed out, the threat of a conflict of interest creates additional requirements beyond satisfaction of traditional Revlon duties. In these situations, the Delaware courts either demand additional protections of the minority stockholders or apply a heightened standard to their review of the controlling stockholder's and board's conduct. A stockholder may be found to be a "controlling stockholder" even if it does not own a majority interest if that stockholder exercises control over the company's business decisions (see Kahn v. Lynch Commc'n Sys., Inc., 638 A.2d 1110 (Del. 1994)). However, the question of which standard of review to apply under various circumstances has been the subject of some debate in the Delaware courts. As with any fiduciary duty analysis, the facts and circumstances surrounding the transaction and the procedural protections employed by the board are a crucial part of the court's analysis.

Avoiding Entire Fairness Review by Employing Procedural Protections

Dictum in several post-Lynch Delaware opinions suggested that a one-step merger with a controlling-stockholder buyer should be reviewed under the entire fairness standard of review regardless of any procedural protections benefitting the minority. Rather, the defendants could only shift the burden of proof to the plaintiffs as described below, but could not obtain the presumptions of the business judgment rule. However, in Kahn v. M & F Worldwide Corp., the Delaware Supreme Court upheld the Court of Chancery's decision in In re MFW Shareholders Litigation, 67 A.3d 496 (Del. Ch. 2013), affirming that the business judgment rule applies where the controlling stockholder conditioned its offer upfront on both of the following:

- Approval by an independent special committee empowered to negotiate and choose to reject the deal.
- Approval by a majority of the unaffiliated minority stockholders.
If this test is met, and assuming the target company is not otherwise up for sale, the standard for review will be the business judgment rule, not Revlon. This is because Revlon duties are triggered only when a sale to a third party becomes inevitable. Because a controlling stockholder has no duty to sell its stock, it has the power to reject on behalf of the company any transaction it does not like. (*Frank v. Elgamal, 2014 WL 957550, at *21 (Del. Ch. Mar. 10, 2014).*

In the buyout at issue in *M & F Worldwide*, the controlling stockholder promised not to proceed with a going private proposal if it was not supported by the special committee, and also made it clear that it was not interested in selling its shares in an alternative transaction. These promises enabled the special committee to negotiate the deal as if the target company were an unaffiliated third party. The majority-of-the-minority condition was also included upfront as part of the offer and not traded for at a later stage of the negotiations instead of obtaining a price increase. Ultimately, the Delaware Supreme Court held that the business judgment rule can apply if and only if:

- The controlling stockholder conditions the procession of the transaction on the approval of both a special committee and a majority of the minority stockholders.
- The special committee is independent.
- The special committee is empowered to freely select its own advisors and to say no definitively.
- The special committee meets its duty of care in negotiating a fair price.
- The vote of the minority is informed and is not coerced. This means the parties must consider what information and materials should be included in the proxy statement (for example, financial projections and underlying assumptions) to ensure that appropriate and sufficient information is made available to the voting stockholders and to try to avoid or, at least, limit future plaintiffs’ claims of inadequate disclosure.
- The vote of the minority is not coerced.

While the Court of Chancery only required that the special committee act with care, the Supreme Court added particular focus on the duty of care in negotiating the price. In a bench ruling, the Court of Chancery interpreted the price element to mean that it must review the special committee’s efforts on the price negotiations under a standard of gross negligence, because that is the standard by which compliance with the fiduciary duty of care is measured (*Swomley v. Schlecht ("Synqor"), No. 9355-VCL, 2014 WL 4470947 (Del. Ch. Aug. 27, 2014) (TRANSCRIPT)*).

For more information on the *M & F Worldwide* opinion and the earlier *MFW* opinion, see *Legal Updates, Kahn v. M & F Worldwide: Delaware Supreme Court Upholds Chancery Decision in MFW, but Opens Door to Challenges Against Controller Mergers* and *In re MFW: Delaware Court of Chancery Applies Business Judgment Rule to Controlling Stockholder Transaction*.

A similar standard has previously been applied by the Court of Chancery in transactions with unrelated third-party buyers and controlling stockholders who do not stand on both sides of the transaction but receive different consideration than the minority stockholders. See *In re John Q. Hammons Hotels Inc. S'holder Litig., 2009 WL 3165613 (Del. Ch. Oct. 2, 2009)* and *Legal Update, In re John Q. Hammons Hotels: Chancery Court Examines When Entire Fairness Applies*. See also *Legal Updates:*

- *Frank v. Elgamal: Chancery Court Applies "Hammons" Standard to Review Merger*, in which the court reviewed a transaction under entire fairness because of the failure to meet the conditions set out in
Hammons (Frank v. Elgamal, 2012 WL 1096090 (Del. Ch. Mar. 30, 2012)).

- Delaware Court of Chancery Applies Business Judgment Rule Using "Hammons" Test, Addresses Special Committee Compensation, in which a transaction that satisfied the Hammons test entitled the board to the presumptions of the business judgment rule (Se. Pa. Transp. Auth. v. Volgenau, 2013 WL 4009193 (Del. Ch. Aug. 5, 2013)).

The Delaware Supreme Court has affirmed the Volgenau decision on the basis of the Court of Chancery's reasons, implying its approval of the Hammons standard (Se. Pa. Transp. Auth. v. Volgenau, 91 A.3d 562 (Del. 2014)).

On the other hand, a transaction does not trigger entire fairness review just because a company has a controlling stockholder. If the company enters into a third-party transaction and the controlling stockholder shares its control premium equally with the minority stockholders, the appearance of conflict is avoided at the outset (see In re Synthes, Inc. S'holder Litig., 50 A.3d 1022, 1039 (Del. Ch. 2012) and In re Morton's Rest. Gp. Inc. S'holders Litig., 74 A.3d 656, 662 (Del. Ch. 2013)).

Burden Shifting when Entire Fairness Review Applies

If the controlling stockholder stands on both sides of the transaction in a one-step merger and the transaction did not employ both of the procedural protections as outlined above, the defendants must show that the transaction is entirely fair to the stockholders in both price and process (see Lynch). However, in Lynch, the court indicated that the controlling stockholder can shift the burden of proving entire fairness to the plaintiff with either:

- Approval by an independent special committee.
- Approval by a majority of the unaffiliated minority stockholders.

As with the analysis described above, the special committee must be truly independent and fully empowered, and the majority of the minority vote must not be tainted with coercion or disclosure violations.

Controlling Stockholder Transactions Structured as a Tender Offer Followed by a Short-form Merger

There are currently competing lines of Delaware Court of Chancery decisions over the question of which standard of review to apply if a controlling stockholder transaction is structured as a tender offer followed by a short-form merger.

Historically, a controlling stockholder could avoid entire fairness review by structuring a going private transaction as a non-coercive tender offer (followed by a short-form merger). The test for non-coerciveness requires a showing of each of the following:

- The tender offer was subject to a non-waivable majority-of-the-minority tender condition.
- The controlling stockholder promised to complete a prompt short-form merger at the same price as was offered in the tender offer if it obtained more than 90% of the shares in the tender offer.
- The controlling stockholder made no threats of retribution to the minority stockholders if they were to fail to tender into the offer.
• The independent directors had both "free rein and adequate time" to consider the tender offer and provide the minority stockholders with a recommendation and adequate information with which to make their decision.

(See In re Pure Resources S'holders Litig., 808 A.2d 421, 446 (Del. Ch. 2002) and Legal Update, In re Cox Radio: DE Chancery Court Confirms "Pure Resources" Standard for Tender Offers by Controlling Stockholders.)

However, another Delaware Court of Chancery decision applied a "unified standard" of review to this type of transaction that is similar to the standard employed in M & F Worldwide. (The M & F Worldwide decision did not directly address controlling stockholder transactions structured as tender offers.) Under the unified standard of review, the business judgment rule only applies when the non-coercive tender offer is conditioned on both the:

• Approval by an independent special committee.
• Approval of a majority of the unaffiliated stockholders.

(See In re CNX Gas Corp. S'holders Litig., 4 A.3d 397 (Del. Ch. 2010) and Legal Update, In re CNX Gas: DE Chancery Court Revisits Proper Standard of Review for Tender Offers by Controlling Stockholders.)

Non-Transformative Decisions by the Board

The procedural protections of M & F Worldwide that allow the directors to obtain the presumptions of the business judgment rule are necessary in the context of a buyout by the controlling stockholder. However, the Delaware Court of Chancery has held that decisions that are not "transformative," such as decisions over annual compensation, are entitled to more deference than entire fairness, even without the full set of protections (In re Tyson Foods, Inc. Consol. S'holder Litig., 919 A.2d 563, 589 (Del. Ch. 2007); Friedman v. Dolan, 2015 WL 4040806, at *6 (Del. Ch. Jun. 30, 2015)).

The Dolan court explained that the protections described in M & F Worldwide are necessary when there are concerns of informational advantage on the part of the stockholder and that the controller will exercise leverage over the other stockholders. When these concerns are absent, the court applies the business judgment rule, even to a decision involving the controlling stockholder, as long as the decision was taken by a body comprised of a majority of independent directors. If the full board approved the transaction, then a majority of the board must have been independent. If less than a majority of all the directors, the business judgment rule can still be salvaged if a committee made up of a majority of independent directors made the decision in question.

Insolvency

Directors have a duty to the corporation and its stockholders. Under Delaware law, this duty does not typically extend to other constituencies such as bond holders and other creditors because they are protected by contract or other statutory schemes (such as state commercial laws). However, as a corporation approaches insolvency, the creditors start to resemble equity holders and as the corporation's equity shrinks, creditors might be the only constituents remaining on the balance sheet. At this point, creditors arguably hold an interest in maximizing the value of the corporation. Some courts have indicated that a director's fiduciary duties might shift at this point to the creditors.
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The Delaware Supreme Court addressed this question in the Gheewalla case (see *N. Am. Catholic Educ. Programming Found. Inc. v. Gheewalla, 930 A.2d 92 (Del. 2007)*). The court decided that creditors of a corporation have no right to assert **direct claims** against directors for breach of fiduciary duty. This prohibition applies whether the corporation is merely approaching insolvency (referred to as the zone of insolvency) or already insolvent. When a corporation reaches the zone of insolvency, directors need the protection of the business judgment rule so they can work to improve the corporation's financial situation. The court rationalized that creditors should continue to be protected by contracts, commercial laws (such as the covenant of good faith and fair dealing) and bankruptcy laws. When a corporation falls into the zone of insolvency, directors should not be hindered by the threat of fiduciary duty lawsuits when negotiating with creditors. However, creditors hold standing to bring a **derivative claim** for any breaches of fiduciary duty on behalf of the corporation once a corporation becomes insolvent (see also *Quadrant Structured Prod. Co., Ltd. v. Vertin, C.A. No. 6990-VCL, 2014 WL 5099428, at *10 (Del. Ch. Oct. 1, 2014)*).

For more information on the fiduciary duties of directors of distressed or insolvent companies, see **Practice Note, Fiduciary Duties of Directors of Financially Troubled Corporations**.

**Other Duties?**

The duty of care and the duty of loyalty represent the two main fiduciary duties of the board of directors, but certain components of those duties are sometimes singled out and discussed as stand-alone duties.

**Duty of Good Faith**

Good faith is not a separate fiduciary duty, but is a component of the duty of care and the duty of loyalty, as follows:

- **Duty of care.** A director must use good faith when exercising the duty of care. If a plaintiff can prove that the director acted in bad faith, then the presumptions of the business judgment rule will not protect the director from liability. Similarly, directors cannot seek limitation of liability under **Section 102(b)(7) of the DGCL** for bad-faith actions (see **Duty of Care**). Consequently, if a corporation's charter exculpates the directors under Section 102(b)(7) for breaches of the duty of care, a plaintiff must demonstrate bad faith on the directors’ part to succeed on a fiduciary duty claim.

- **Duty of loyalty.** A director acting in bad faith does not act in the best interest of the corporation. In the *Stone v. Ritter* litigation, the Delaware court said the failure to act in good faith does not automatically result in a breach of duty, but becomes a factor when determining a breach of the duty of loyalty (see *Stone ex rel. AmSouth Bancorporation v. Ritter, 911 A.2d 362 (Del. 2006)*).

To act in good faith, a director must act with honesty of purpose and in the best interest of the corporation. No single definition or set of factors exists that defines good faith or bad faith, but the courts have identified several situations that usually involve bad faith. These include:

- An intentional failure to act in the face of a known duty to act, demonstrating a conscious disregard for one’s duties. For example, a director knows management is violating corporate policy, but makes no attempt to change the situation.
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A knowing violation of law. For example, if a director approves a waste removal plan knowing it violates environmental laws (but saves the corporation money).

If a director acts for any purpose other than advancing the best interests of the corporation or its stockholders. For example, if a director approves a sale transaction because the director wants to sell its stock.

(In re Walt Disney Co. Deriv. Litig., 906 A.2d 27, 67 (Del. 2006).)

An allegation of an intentional failure to act is the most common allegation made against a board in the context of a sale of the corporation. In light of the board's Revlon duties in a change-of-control situation, the Lyondell decision and its progeny in the Delaware Court of Chancery have described the standard for this allegation as a showing that the board "utterly failed to attempt to obtain the best price" (Lyondell Chem. Co. v. Ryan, 970 A.2d 235, 244 (Del. 2009)). To establish such an utter failure that rises to the level of conscious disregard for its duties, the board's failure to act must have been "so far beyond the bounds of reasonable judgment that it seems essentially inexplicable on any ground other than bad faith" (In re Alloy, Inc. S'holders Litig., 2011 WL 4863716, at *10 (Del. Ch. Oct. 13, 2011)).

Alternatively, a plaintiff can establish bad faith without alleging a conscious disregard for the board's duties or utter failure to attempt to obtain the best price, by instead proving that the directors succumbed to a situational conflict of interest inherent in a change of control (Chen v. Howard-Anderson, 87 A.3d 648, 680 (Del. Ch. Apr. 8, 2014)). This approach relies on establishing that the board intentionally acted with a purpose other than that of advancing the best interests of the corporation, which is an example of bad faith cited in Disney. For example, for reasons of "greed... hatred, lust, envy, revenge... shame or pride," the board may have made decisions that are "outside the range of reasonableness for reasons other than pursuit of the best value reasonably available" (Chen v. Howard-Anderson, 87 A.3d at 684).

Duty to Obey the Law

Directors have a duty to comply with the law. If a director knowingly breaks the law, the director is denied the protection of the business judgment rule and cannot benefit from limited liability under Section 102(b)(7) of the DGCL (8 Del. C. § 102(b)(7)) (see Duty of Care). A knowing violation of law is evidence of bad faith (see Duty of Good Faith). Breaking the law for the interest of the corporation is not an excuse. For example, directors breach their fiduciary duties when they pay bribes to foreign officials even if it results in a large profit for the corporation.

Duty of Oversight

A corporation can be held responsible for the actions of its management and employees. Since the board of directors is charged with overseeing those managers and employees on behalf of the corporation, the board needs a functioning oversight and compliance system in place. The Federal Sentencing Guidelines impose large penalties on corporations for violation of federal criminal laws, but these penalties can be significantly reduced if corporations put appropriate oversight and compliance programs in place. For a public corporation, the board must consider the additional compliance requirements of the SEC and the exchange on which its stock is listed.
Under Delaware law, the board of directors similarly has an obligation to attempt to assure that the corporation has an adequate information and reporting system. However, only an utter failure to make that attempt will establish the lack of good faith that is a necessary condition for liability (In re Caremark Int'l Inc. Deriv. Litig., 698 A.2d 959, 970 (Del. Ch. 1996)). A claim that a director has failed to this degree is known as a "Caremark" claim and can result in personal liability for the director.

The Delaware courts addressed the duty of oversight in the Caremark and Stone v. Ritter cases. In Caremark, the plaintiffs alleged the directors breached their duty of oversight when certain employees violated the federal law prohibiting payment to induce Medicare or Medicaid referrals. In Stone v. Ritter, the plaintiffs alleged the directors breached their duty of oversight because the corporation failed to comply with the Bank Secrecy Act. In both of these cases, the court said directors need to assure themselves in good faith that the corporation has reporting systems in place which are reasonably designed to provide timely and accurate information to the board. Directors subject themselves to liability for breaching the duty of oversight if they fail to:

- Implement any reporting system or controls.
- Monitor the reporting system thereby preventing themselves from learning of any risks.

In both of the above situations, the court held the boards breached their fiduciary duties because they knowingly failed to discharge their duties and acted in bad faith.

The Delaware Court of Chancery affirmed these requirements in Puda Coal for outside directors of foreign-based corporations, advising that to meet the bare minimum for avoiding personal liability under Caremark, a director must also:

- Be frequently present in the country the corporation is based.
- Possess "the language skills to navigate the environment in which the company is operating."

(In re Puda Coal, Inc. S'holders Litig., C.A. No. 6476-CS, 2013 WL 769400 (Del. Ch. Feb. 6, 2013) (TRANSCRIPT) and see Legal Update, In re Puda Coal: Delaware Court of Chancery Describes Efforts Required of Directors of Foreign-based Delaware Corporations.)

The court also stated that a director cannot avoid liability by resigning, finding it "troubling" that independent directors would abandon a troubled company to the sole control of those who have harmed the company. For more on the line of cases regarding directors of foreign-based corporations, see also Legal Updates, Rich v. Chong: Delaware Court of Chancery Finds Basis for "Caremark" Claims against Directors of China-based Delaware Corporation and In re China Agritech: Delaware Court of Chancery Upholds Caremark Claims at Pleading Stage.

**Duty of Disclosure**

Directors also hold a fiduciary duty to communicate honestly with the stockholders and to make full and fair disclosures. This duty, also referred to as a "duty of candor," does not obligate the board to provide all of the corporation's financial or business information to the stockholders. Rather, the information must meet a materiality standard of a "substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable stockholder as having significantly altered the total mix of information made available" (Rosenblatt v. Getty Oil Co., 493 A.2d 929, 944 (Del. 1985)). Delaware law does not require the board of
directors to disclose information simply because that information "might be helpful" (Skeen v. Jo-Ann Stores, Inc., 750 A.2d 1170, 1174 (Del. 2000)). The courts have similarly admonished against "the fallacy that increasingly detailed disclosure is always material and beneficial disclosure" (Zirn v. VLI Corp., 1995 WL 362616, at *4 (Del. Ch. June 12, 1995)). The board is also entitled to keep certain information confidential in order for the corporation to succeed (Stroud v. Grace, 606 A.2d 75, 89 (Del. 1992)).

The Delaware Court of Chancery has identified four recurring scenarios where the duty of disclosure may arise:

- When the board of directors seeks a statutorily required stockholder approval for an action, directors hold a fiduciary duty to disclose fully and fairly all material information that the board controls. For example, a proxy statement for the approval of a merger would be misleading if it failed to disclose a CEO's personal financial interest in the merger (see In re Lear Corp. S'holder Litig., 926 A.2d 94 (Del. Ch. 2007)).

- When the board of directors seeks a stockholder ratification that is not required by the DGCL of a transaction in which a director or officer has a personal interest that conflicts with the corporation's interest, directors must disclose all material facts that the board controls.

- When a director communicates publicly or directly with stockholders, with or without a request for stockholder action, the director must not speak falsely so as to misinform the stockholders. In other words, if a director discloses information, it must be truthful.

- When a director either directly buys or sells shares from or to an outside stockholder in a private stock sale, the director must disclose any material information that qualifies as special facts or circumstances, including knowledge of important transactions, prospective mergers and probable sales of entire assets or business. The duty to disclose in this scenario only arises if the director also deliberately misleads the stockholder about those facts.

(In re Wayport, Inc. Litig., 76 A.3d 296 (Del. Ch. May 1, 2013).)

In sales of public corporations, the SEC's rules promulgated under the Securities Exchange Act of 1934 govern much of the disclosure that the target company is required to make. For information about these rules, see Practice Note, Proxy Statements: Public Mergers. Beyond these required disclosures, stockholder plaintiffs frequently bring Revlon claims alleging that the board of directors of the target company failed to disclose other material information to the stockholders in the proxy statement, such as:

- Management's projections for the company on a stand-alone basis.
- The compensation and potential conflicts of the financial advisor.
- Details of the background to the transaction and how the board reached a decision to approve a sale.

The courts measure each of these claims against the reasonable-investor standard, with the analysis turning on the specific facts of the case.

Under Delaware law, there is no duty per se to disclose to stockholders the financial projections given to and relied on by the financial advisor for the formulation of its fairness opinion (McMillan v. Intercargo Corp., 1999 WL 288128, at *6 (Del. Ch. May 3, 1999)). Particularly in a merger with a controlling stockholder where the outcome of the vote itself is not in question, there is less of a need to provide these disclosures (Dent v. Ramtron Int'l Corp., 2014 WL 2931180, at *11 (Del. Ch. June 30, 2014)). However, in a cash-out merger where
there is no controlling stockholder, reliable management projections are typically considered material (In re PNB Hldg. Co. S'holders Litig., 2006 WL 2403999, at *15 (Del. Ch. Aug. 18, 2006)). The disclosure of inherently unreliable or speculative information is not required, but management projections made in the course of business are generally deemed reliable (Cede & Co. v. Technicolor, Inc., 2003 WL 23700218, at *7 (Del. Ch. July 9, 2004), aff'd in part, rev'd in part, 884 A.2d 26 (Del. 2005)).

If the financial advisor has in fact relied on management's projections to render its fairness opinion, the failure to disclose the projections will be considered a material omission that warrants injunctive relief if not corrected (In re Netsmart Techs., Inc. S'holders Litig., 924 A.2d 171, 203 (Del. Ch. 2007), In re BioClinica, Inc., S'holder Litig., 2013 WL 673736, at *5 (Del. Ch. Feb. 25, 2013)). Projections and other inputs provided by the board but not relied on by the financial advisor, however, do not need to be disclosed (In re Micromet, Inc. S'holders Litig., 2012 WL 681785, at *12-13 (Del. Ch. Feb. 29, 2012)).

Delaware courts generally require full disclosure of investment banker compensation and potential conflicts (In re Del Monte Foods Co. S'holders Litig., 25 A.3d 813, 832 (Del. Ch. 2011)). Particularly where the financial advisor for the target company is also providing staple financing for the buyer, the courts require disclosure of that arrangement and the banker's fee and pay particular attention to the management of the inherent conflicts in that arrangement (see Del Monte, In re Toys "R" Us, Inc. S'holder Litig., 877 A.2d 975, 1005–06 (Del. Ch. 2005) and In re Rural Metro Corp. S'holders Litig., 88 A.3d 54, 106 (Del. Ch. 2014)).

As for detailed narratives of the background to the transaction, the Court of Chancery has stated that the standard "does not require a blow-by-blow description of events leading up to the proposed transaction" (Matador Capital Mgmt. Corp. v. BRC Hldgs., Inc., 729 A.2d 280, 295 (Del. Ch. 1998)). However, once the board voluntarily makes a partial disclosure, it has "an obligation to provide the stockholders with an accurate, full, and fair characterization" of the facts relating to that partial disclosure (Arnold v. Soc'y for Sav. Bancorp, Inc., 650 A.2d 1270, 1280 (Del. 1994)).

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Recent Delaware decisions have emphatically confirmed a trend of increased judicial deference to sale process decisions made by directors without a conflict of interest. While deference to board decisions made by independent, disinterested, engaged directors has always been the animating principle of Delaware jurisprudence, the opinions issued by the courts over the past year have exhibited more emphasis on that deference and less of a focus on judicial inquiry into the reasonableness of the decisions made by independent boards.

Under the “heightened scrutiny” demands of the Revlon doctrine, directors, in a sale context, are obliged to seek the best price for their company that is reasonably available. Delaware law previously made clear that the courts are not to substitute their judgment for the board’s judgment as to what steps to take, but rather are to evaluate with some restraint whether the board process was reasonable. The courts’ recent shift—in language, tone, and substantive decisions—subtly, but clearly, reflects increased judicial deference to directors’ judgments when making that evaluation. Consistent with this trend, the Delaware Supreme Court, in a recent decision, confirmed that, even in a Revlon situation, an independent board can engage with a single bidder in a sale process, and not actively shop the company either before or after signing the merger agreement—so long as there is a “viable passive market check” after signing (through a fiduciary out, accompanied by only modest deal protection provisions, so that other parties can make unsolicited competing bids and the board can accept a superior bid if it is received).

In the past, the courts’ view was that a single bidder sale process was permissible in a Revlon situation only under limited circumstances. The court tended to evaluate a non-auction sale strategy with skepticism and to require that its reasonableness be supported by a board judgment informed through consideration of the particular facts and circumstances, with an emphasis on knowledge of the likelihood of competing bids, the benefits and risks of the single bidder strategy, and the nature of the deal protection devices. By contrast, Chief Justice Strine recently wrote:

*Revlon* does not require a board to set aside its own view of what is best for the corporation’s stockholders and run an auction whenever the board approves a change of control transaction…. [A board may] pursue the transaction it reasonably views as most valuable to stockholders, so long as the transaction is subject to an effective market check under circumstances in which any bidder interested in paying more has a reasonable opportunity to do so. Such a market check does not have to involve an active solicitation, so long as 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.
While some have interpreted the Supreme Court as now having provided a blanket endorsement of the concept of a single-bidder passive-shopping-only strategy without regard to the particular contextual facts, in our view, the facts and circumstances supporting the reasonableness of the board’s decision are still critical to the courts’ analysis. While the burden of establishing reasonableness under Revlon may now be less demanding than in the past, in our view, a board deciding to engage in a single-bidder passive-shopping-only sale process will still have to establish that it had a reasonable basis for structuring the process as it did. Notably, in the single-bidder passive-shopping-only sale process recently upheld by the Delaware Supreme Court, the Court found that, among other supporting factors, there was “no hint” of an entrenchment or defensive motive by the board and noted that, while there was a fiduciary out and only a modest termination fee, no competing bid was received during the five-month period between signing and closing.

Factors Supporting a Single-Bidder Passive-Shopping-Only Process

The following factors would support the reasonableness of a decision to engage in a single bidder strategy with only post-signing passive shopping:

- attractive price and terms of the bidder’s proposed transaction;
- a low likelihood of other parties being interested in bidding, based on the board’s and management’s experience and the advice of the investment bankers;
- credible risks of active shopping of the company that the board reasonably determines outweigh the potential benefits of active shopping (taking into account such factors as the effect of the process becoming public; the impact on customers, employees, and others; and the possibility of a “failed” auction);
- credible insistence by the bidder that the company not be shopped;
- only “modest” deal protections;
- the bidder being, in the board’s judgment, a “strong” buyer;
- a reasonable period of time between signing and shareholder approval;
- no defensive or entrenchment motive by the board and the absence of conflicts of interest on the part of management;
- alignment of the board’s interests with the stockholders, which could include significant stock ownership by the directors (or by stockholders affiliated with and specifically represented by directors);
- significant advantages of the proposed transaction; and
- target stockholders having a right to accept or reject the transaction.

Of course, all of these factors are not prerequisites and no single one or more may prove dispositive.

At one end of the continuum, a decision to engage in a single-bidder passive-shopping-only process would clearly be reasonable if: there is an attractive bid, with certainty of closing; a strong bidder, who credibly insists on exclusivity; meaningful concern about maintaining confidentiality of the process; a low
likelihood of other interested bidders; deal protection terms that clearly facilitate post-signing unsolicited bids being made and the company’s ability to accept them; and a stockholder vote on the transaction. At the other end of the continuum, the foundation for the decision would be lacking if: there is a low bid, with meaningful closing uncertainty; a weak bidder, who does not insist on exclusivity; limited concern about confidentiality of the process; a high likelihood that there are other parties interested in bidding, including stronger potential acquirors; and deal terms that materially inhibit third parties from making post-signing unsolicited bids or the company from being able to accept them. The Supreme Court may have moved the guidepost for where along this continuum a single-bidder passive-shopping-only strategy is supportable; however, the facts supporting the board’s judgment continue to be critical.

Practice Points

- **More pressure for exclusivity and no active shopping.** We expect that bidders will now be more inclined to seek to pressure target company boards to agree to a single-bidder passive-shopping-only process. In determining its response, the target board must consider and weigh all of the advantages and disadvantages of the process under the circumstances. In any given case, establishing a floor price for the target—without the burden, uncertainty and risks of active pre-signing shopping—while maintaining the ability to receive and accept competing bids post-signing, may, in the board’s reasonable judgment, be the best course for maximizing value.

- **Advantages of single-bidder passive-shopping-only process.** The advantages to the target of the first public announcement of the sale of the company being the signed deal, and to there being no active post-signing solicitation, include the following:
  - a floor price for the target being established, with limited deal protections (that would not preclude other possible bidders);
  - avoiding the possible adverse impact on employees, suppliers, customers, and other constituencies that could accompany a more public process;
  - limiting the delay in getting to a signed agreement (and the associated deal risk);
  - limiting the time and burden on management of a more aggressive solicitation campaign;
  - restricting access to confidential company information; and
  - eliminating the possibility of (and stigma from) a failed auction.

- **Disadvantages of single-bidder passive-shopping-only process.** The disadvantages of not actively seeking out potential bidders include:
  - most critically, competition, if it can be developed, can be the most certain course to maximize value;
  - the judgments by management, the directors and the investment bankers as to the potential for interested bidders cannot be guaranteed, even if soundly based;
  - it may be possible to satisfy confidentiality concerns with a process that targets solicitation of just the limited number of key potential bidders (in which case there would be less reason for a single-bidder process); and
certain potential bidders might not want to “jump” a signed deal and so may not submit a
bid post-signing although they would have been interested otherwise.

**General process.** In this new paradigm, if a target determines—whether on its own or after
being approached by a third party bidder—to offer itself for sale, then, as is always the case, the
target company must seek to ensure that the board process in general is as thorough and
effective as possible—including through retention of independent advisors; disclosure of any
conflicts of interests (of directors, investment bankers, management, or others) and appropriately
dealing with them; and a consistent focus on directors being informed, engaged, and motivated
to achieve the best result for shareholders.

**Evaluating alternative shopping strategies.** The target initially should evaluate whether to
approach a number of possible buyers, approach a targeted list of more likely buyers, or engage
with the “most likely” or “strongest” potential buyer. The potential benefits and risks of each
strategy should be considered. Relevant factors would include:

- What is the likelihood of there being interested bidders?
  - How many parties might be interested? Who would they likely be? Has the company
    been approached recently or in the past?
  - Is there a clear dominant buyer? Is there a small number of “strong” potential
    bidders—in terms of value of the company to them, ability to pay, lack of
    issues (such as antitrust or regulatory) that would affect certainty of closing, or other factors?
  - Would potentially interested bidders be less likely to engage during a post-signing
    passive shopping period?

- What would be the consequences of a public process, and would the process become
  public?
  - Would a public process have an adverse impact on employees, suppliers, customers,
    or other constituencies?
  - What would be the likelihood, and the consequences, of a “failed” auction?
  - Would a public process itself result in a material turnover of shareholders and, if no
    deal is done, a more “unstable” shareholder body?
  - Is it feasible to make a few discrete calls at the beginning of the process to determine
    possible interest without clearly opening up the process to public exposure?
  - How realistic is it that confidentiality could be maintained in a pre-signing shopping
    process (no matter how limited)?

- What do management and the investment bankers advise is the best way to approach
  the process? Note that in a Revlon sale to a private equity firm, in a transaction in which
  management would expect to be participating and so would have a conflict of interest, the
  board would have to assume a more dominant role.
Responding to a bidder’s exclusivity request. If a bidder requests exclusivity, the target board should:

- Deliberate to consider the reasonableness of agreeing to the requested process.
- Try to determine the level of seriousness of the bidder’s insistence on the process.
  - Is it likely that the bidder would engage only if that process is adopted?
  - In responding to the request for exclusivity, should the target specify that exclusivity would have to be accompanied by merger agreement provisions that facilitate a viable passive market check (such as limited deal protections, a suitable period between signing and closing, no force-the-vote provision, limited matching rights if any, and a committed merger agreement)?
- Evaluate the bid.
  - Is the price offered at the high end of the valuation range? How much can this bidder pay? How accretive would the acquisition be for this bidder?
  - What is the certainty of closing? Can a “tight” agreement (from the seller’s point of view) be negotiated? Are there any regulatory concerns? Does the bidder understand that the seller will want a “hell or high water” commitment to resolve any regulatory issues?
  - Does this bidder offer any unique advantages as compared to other potential bidders?
- Consider the extent to which other potentially interested bidders would or would not be likely to submit a post-signing competing bid.
- Try to negotiate a go-shop so that the company can be actively shopped post-signing.
- Determine what value the board can extract from the bidder in exchange for agreeing to a single-bidder process.

Ensuring the viability of a post-signing “passive market check”. If the board decides to agree to a single-bidder process without active shopping post-signing, the board should seek to ensure that the post-signing passive shopping will be a “viable passive market check”—by limiting impediments to unsolicited competing bids emerging and by being in a position to accept a superior bid if one is received. Thus, the board should:

- Agree to only modest deal protections.
- Obviously, obtain a fiduciary out so that a competing bid can be accepted. Also, do not agree to a force-the-vote provision.
- Agree only to limited restrictions on providing unsolicited competing bidders with information.
- Agree to matching rights, if any, that are as limited as possible.
Chapter 6—The Sale Process

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- Ensure that there will be a sufficient period of time between signing and the shareholder vote. (Thus, the bidder should understand that a 20-business day cash tender offer will not be acceptable.)

Special issues in controller transactions. If the bidder is a controlling stockholder of the target company, additional issues arise. Under Delaware law, unless the bidder complies with the MFW guidelines, the court will apply entire fairness review under which, instead of deferring to the directors' decisions, the court will determine whether the price and the process were "entirely fair". Thus, the board should:

- Determine whether the bidder agrees to follow the MFW guidelines; and, if so, ensure that it is clear at the "outset" of the process that the bid is being conditioned on approval by an independent and disinterested special committee and a majority-of-the-minority stockholder vote.

- If the MFW procedures are followed by the bidder, the business judgment rule will govern a court’s review of the sale process. However, in light of the controller’s stock position, considering whether or not to shop the company could be an academic exercise if, as is typical, the controller has advised that it is a buyer only and is not willing to be a seller of its shares. The special committee could probe the controller’s intentions; and, even if the controller maintains the position that it will not be a seller, the investment banker to the committee should advise the committee of the range of third party sale value.

- Seek to maximize the price and obtain better terms from the controller. Given the controller's stock position and, if applicable, its position that it will not be a seller, the committee's only leverage may come from its ability to "just say no". The committee should communicate to the bidder the committee's right and, when appropriate, its intention to "just say no".

Authors:
Abigail Pickering Bomba
Steven Epstein
Arthur Fleischer, Jr.
Peter S. Golden
David B. Hennes
Philip Richter
Robert C. Schwenkel
David N. Shine
John E. Sorkin
Gail Weinstein
This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its contents. If you have any questions about the contents of this memorandum, please call your regular Fried Frank contact or an attorney listed below: **Contacts:**

**New York**

<table>
<thead>
<tr>
<th>Name</th>
<th>Phone</th>
<th>Email</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jeffrey Bagner</td>
<td>+1.212.859.8136</td>
<td><a href="mailto:jeffrey.bagner@friedfrank.com">jeffrey.bagner@friedfrank.com</a></td>
</tr>
<tr>
<td>Abigail Pickering Bomba</td>
<td>+1.212.859.8622</td>
<td><a href="mailto:abigail.bomba@friedfrank.com">abigail.bomba@friedfrank.com</a></td>
</tr>
<tr>
<td>Andrew J. Colosimo</td>
<td>+1.212.859.8868</td>
<td><a href="mailto:andrew.colosimo@friedfrank.com">andrew.colosimo@friedfrank.com</a></td>
</tr>
<tr>
<td>Aviva F. Diamant</td>
<td>+1.212.859.8185</td>
<td><a href="mailto:aviva.diamant@friedfrank.com">aviva.diamant@friedfrank.com</a></td>
</tr>
<tr>
<td>Steven Epstein</td>
<td>+1.212.859.8964</td>
<td><a href="mailto:steven.epstein@friedfrank.com">steven.epstein@friedfrank.com</a></td>
</tr>
<tr>
<td>Christopher Ewan</td>
<td>+1.212.859.8875</td>
<td><a href="mailto:christopher.ewan@friedfrank.com">christopher.ewan@friedfrank.com</a></td>
</tr>
<tr>
<td>Arthur Fleischer, Jr. *</td>
<td>+1.212.859.8120</td>
<td><a href="mailto:arthur.fleischer@friedfrank.com">arthur.fleischer@friedfrank.com</a></td>
</tr>
<tr>
<td>Peter S. Golden</td>
<td>+1.212.859.8112</td>
<td><a href="mailto:peter.golden@friedfrank.com">peter.golden@friedfrank.com</a></td>
</tr>
<tr>
<td>David J. Greenwald</td>
<td>+1.212.859.8209</td>
<td><a href="mailto:david.greenwald@friedfrank.com">david.greenwald@friedfrank.com</a></td>
</tr>
<tr>
<td>Tiffany Pollard</td>
<td>+1.212.859.8231</td>
<td><a href="mailto:tiffany.pollard@friedfrank.com">tiffany.pollard@friedfrank.com</a></td>
</tr>
<tr>
<td>Philip Richter</td>
<td>+1.212.859.8763</td>
<td><a href="mailto:philip.richter@friedfrank.com">philip.richter@friedfrank.com</a></td>
</tr>
<tr>
<td>Steven G. Scheinfeld</td>
<td>+1.212.859.8475</td>
<td><a href="mailto:steven.scheinfeld@friedfrank.com">steven.scheinfeld@friedfrank.com</a></td>
</tr>
<tr>
<td>Robert C. Schwenkel</td>
<td>+1.212.859.8167</td>
<td><a href="mailto:robert.schwenkel@friedfrank.com">robert.schwenkel@friedfrank.com</a></td>
</tr>
<tr>
<td>David L. Shaw</td>
<td>+1.212.859.8803</td>
<td><a href="mailto:david.shaw@friedfrank.com">david.shaw@friedfrank.com</a></td>
</tr>
<tr>
<td>David N. Shine</td>
<td>+1.212.859.8284</td>
<td><a href="mailto:david.shine@friedfrank.com">david.shine@friedfrank.com</a></td>
</tr>
<tr>
<td>John E. Sorkin</td>
<td>+1.212.859.8980</td>
<td><a href="mailto:john.sorkin@friedfrank.com">john.sorkin@friedfrank.com</a></td>
</tr>
<tr>
<td>Steven J. Steinman</td>
<td>+1.212.859.8092</td>
<td><a href="mailto:steven.steinman@friedfrank.com">steven.steinman@friedfrank.com</a></td>
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**Washington, D.C.**

<table>
<thead>
<tr>
<th>Name</th>
<th>Phone</th>
<th>Email</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jerald S. Howe, Jr.</td>
<td>+1.202.639.7080</td>
<td><a href="mailto:jerry.howe@friedfrank.com">jerry.howe@friedfrank.com</a></td>
</tr>
<tr>
<td>Mario Mancuso</td>
<td>+1.202.639.7055</td>
<td><a href="mailto:mario.mancuso@friedfrank.com">mario.mancuso@friedfrank.com</a></td>
</tr>
<tr>
<td>Brian T. Mangino</td>
<td>+1.202.639.7258</td>
<td><a href="mailto:brian.mangino@friedfrank.com">brian.mangino@friedfrank.com</a></td>
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* Senior Counsel
Making Good Use of Special Committees

This Practice Note discusses why and how to establish a special committee, including when a special committee is needed or useful in connection with a transaction, a proper mandate for the special committee, and how a special committee conducts a proper process.

Frank Aquila and Danyang Zhao, Sullivan & Cromwell LLP, with Practical Law Corporate & Securities

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Avoiding Entire Fairness Review by Employing Additional Procedural Protections

In transactions that involve a real or potential conflict interest for the board of directors, the full board frequently appoints a special committee of independent and disinterested directors to provide assurance that the board's decision has not been coerced or unduly influenced by the conflicted directors. Special committees can also be useful in transactions involving a controlling stockholder, even if the directors themselves are independent and disinterested in the transaction.

This Note explains when a Delaware corporation should use a special committee, how to establish the committee, and the important issues for the committee to consider throughout the process. The Note focuses on special committees used in a transactional rather than a litigation context.

When Is a Special Committee Needed?

A special committee is never needed as a matter of legal obligation, but should be appointed whenever at least half the members of a board of directors has a conflict of interest in the transaction or matter at hand. An interested director is one who has a potential interest on both sides of the transaction or expects to derive a personal financial benefit from the transaction, as opposed to a benefit that exists for the company or all stockholders generally (see Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984), overruled on other grounds by Brehm v. Eisner, 746 A.2d 244, 253-54 (Del. 2000)). A special committee is appointed to provide assurance that the corporate decision has not been coerced or unduly influenced by the interested directors.

A special committee can also be useful if investors and others may perceive that the board of directors, though consisting of a majority of nominally independent and disinterested directors, is dominated or unduly influenced by a "controlling stockholder" (In re Orchard Enter., Inc. S'holder Litig., 88 A.3d 1, 36 (Del. Ch. 2014), citing Kahn v. Lynch Commc'n Sys., Inc., 638 A.2d 1110, 1116-1117 (Del.1994)).

Delaware courts will generally find that a stockholder is a controlling stockholder if the stockholder either:

- Owns more than 50% of the voting power of the corporation.
- Exercises control over the business and affairs of the corporation.


Based on these considerations, special committees are generally appointed in four categories of corporate situations:

- **Going private** or "freeze out" transactions where a controlling or significant stockholder wishes to eliminate the public minority (see Practice Notes, Going Private Transactions: Overview and Fiduciary Duties in M&A Transactions: Controlling-Stockholder Transaction Structured as a Front-End Tender Offer).
- **Leveraged buyouts** in which management is participating and will have an equity interest in the surviving company or will remain in their management positions post-closing (see Practice Notes, Buyouts:
Overview and Management Equity Incentives in Buyouts).

- Controlling-stockholder transactions where the controlling stockholder is not the buyer but will receive different consideration from the other stockholders (see In re John Q. Hammons Hotels Inc. S’holder Litig., 2009 WL 3165613 (Del. Ch. Oct. 2, 2009); Practice Note, Fiduciary Duties in M&A Transactions: Transaction Structures that Trigger Entire Fairness.)

- Hostile takeover attempts in which the chief executive officer and other members of senior management are likely to be replaced by the bidder and are therefore opposed to the transaction (a particular concern if the CEO or other members of senior management sit on the board of directors). For a general discussion of hostile takeovers, see Practice Note, Defending Against Hostile Takeovers.

Even if some of the directors have an interest in the transaction, forming a special committee is not necessary if a majority of the board of directors is independent and disinterested in the transaction and does not otherwise have, and may not otherwise be perceived as having, any other conflict of interest. In that case, the interested directors can simply recuse themselves from the deliberations and decisions regarding the proposed transaction. However, if half or more of the directors on the board are, or may be perceived to be, interested, or if a controlling stockholder is on both sides of the transaction or will receive different consideration, the board should delegate the power to review and negotiate the transaction to a special committee.

The need to establish a special committee is context-specific and may change as the transaction evolves. Potential acquirors that start out as third-party bidders may become affiliated with management, or management may respond to an unsolicited offer for the company by arranging a management buyout. Throughout the entire process, the board of directors must be alert to any potential conflicts and be prepared to establish a special committee if the facts and circumstances require one.

The Advantages of Using a Special Committee

Stockholder litigation and public scrutiny are likely in a transaction where either:

- A public minority is being squeezed out by a controlling stockholder or a controlling stockholder is receiving different consideration from the public minority (controlling-stockholder transaction).

- Members of the board of directors are interested in the transaction (an interested-board transaction).

The formation of an independent and disinterested special committee tends to reduce the criticism and litigation that naturally results from controlling-stockholder or interested-board transactions. By removing directors with an actual or perceived conflict of interest from the decision-making process, special committees provide comfort that the transaction that has been negotiated is fair.

Another advantage of appointing a special committee of independent and disinterested directors to negotiate the transaction is that it can qualify the transaction for a more deferential standard of review. Without the appointment of a special committee, the Delaware courts will review controlling-stockholder and interested-board transactions (other than possibly interested-board transaction claims following a fully informed, uncoerced, and disinterested stockholder vote or acceptance of a tender offer, see Larkin v. Shah 2016 WL 4485447 (Del. Ch. Aug. 25, 2016), In re Volcano Corp. S’holder Litig., 2016 WL 3626521 (Del. Ch. Jun. 30, 2016), and Box, Cleansing Effect of Fully Informed, Uncoerced, and Disinterested Stockholder Vote or Acceptance of Tender Offer in Interested-Board Transactions) under the exacting "entire fairness" standard.
The entire fairness standard is Delaware law's most onerous standard of review and subjects the transaction to scrutiny of both its price and process. Therefore, when confronting a transaction that would likely be subject to entire fairness review, a board of directors would be well advised to create a special committee of disinterested and independent directors as early in the process as is feasible. In virtually all cases where entire fairness preliminarily applies, the parties can structure the transaction, at least partly by using a disinterested and independent special committee, to either shift the burden of proof of the transaction's fairness back to the stockholder plaintiff or even qualify for the presumptions of the business judgment rule (see Box, Standard of Review).

Disadvantages of Using a Special Committee

While special committees are extremely useful in interested-board and controlling-stockholder transactions, the creation of a special committee should still be approached with caution. The board of directors must weigh the time and cost involved in using a special committee. If the board otherwise employs a proper process, a special committee will add a layer of complexity and could slow down the transaction. The board not only needs to consider the compensation of the committee itself, but also the cost of engaging independent financial and legal advisors in addition to the company's own advisors (see Independent Advisors). The involvement of multiple advisors may also increase the opportunity for a leak of transaction information before the parties are ready for a public announcement. If the majority of a company's board is disinterested and independent, and a controlling stockholder transaction is not involved, it is may be better to allow the disinterested and independent members of the board to act for the entire board rather than undertake the time, risks, and expense of creating a special committee.

Issues to Consider When Forming a Special Committee

A properly formed and fully functioning special committee must be disinterested in the transaction and independent from the interested directors or controlling stockholder (or the party that otherwise creates the potential conflict), and have a meaningful mandate. Not only must the special committee members be disinterested and independent, but its legal and financial advisors must also be independent of the full board's advisors and the interested parties. The special committee should be formed so that it has a clear understanding of its role as an independent, arms'-length negotiator.

Independence of Special Committee Members

The independence of the members of the special committee is of paramount importance because it is often the first thing that the courts will scrutinize. To the extent possible, the special committee should be chosen by directors who are not personally interested in the transaction under consideration, and each member of the committee should have no direct or indirect interest in, and be independent from any of the proponents of, the transaction.

An independent director is one whose decision "is based on the corporate merits of the subject before the board rather than extraneous considerations or influence" (see Odyssey Partners, L.P. v. Fleming Companies, Inc., 735 A.2d 386, 407 (Del. Ch. 1999), citing Aronson v. Lewis, 473 A.2d at 816). A director who is dominated or controlled by an interested individual or entity will not be considered independent (see In re MAXXAM, Inc., 659 A.2d 760, 773 (Del.Ch. 1995)). However, directors are presumed to be independent, even when appointed by a controlling stockholder or other allegedly interested party (Aronson v. Lewis, 473 A.2d at 816). To rebut
this independence presumption, courts applying Delaware law require the stockholder plaintiff to show that the
director is so "beholden" to the controlling stockholder or other interested party or so under its influence that
"the director's discretion would be sterilized" (*Rales v. Blasband*, 634 A.2d 927, 936 (Del. 1993)).

An independence determination is highly dependent on the facts, considered in their totality, and courts
applying Delaware law will analyze the facts using a subjective standard. "Bare allegations that directors are
friendly with, travel in the same social circles as, or have past business relationships with the proponent of a
transaction ... are not enough to rebut the presumption of independence." Instead, a stockholder plaintiff must
show that "sufficiently substantial" or "material" ties existed between the director and controlling stockholder or
other interested party that could affect the director's impartiality and ability to fulfill his or her fiduciary duties.
(*Kahn v. M & F Worldwide Corp.*, 88 A.3d 635, 648-49 (Del. 2014).)

The Delaware courts have provided broad guidelines for the qualifications for independence, but the question
of whether a particular director's relationship with an interested party will be found to rise to the level of a
conflict cannot be predicted with certainty. Beyond clear-cut cases of obviously interested or disinterested
directors lies a gray area that evades clear rule-making. The *New York Stock Exchange* (NYSE) and
*NASDAQ Stock Market* (NASDAQ) standards of director independence may provide additional guidance, and
they are frequently cited by Delaware courts as useful guides for determining whether a director was
independent, but they are not definitive as a matter of Delaware law. Therefore, it is important to recognize that
a director who is otherwise independent under the NYSE and NASDAQ standards may still not be considered
independent for purposes of serving on a special committee. The reverse is also true. See, for example,
*Teamsters Union 25 Health Services & Insurance Plan v. Baiera*, in which the Delaware Chancery Court ruled
that the directors in question were independent for purposes of Delaware law even though they would not have
qualified as independent for purposes of the relevant stock exchange rule (119 A.3d 44, 61 (Del. Ch. 2015)).

**Disinterest of Special Committee Members**

Under Delaware law, the test for a finding of a disabling interest on the part of a director is met if either:

- The director has a material financial interest in a transaction with a third party that is not shared equally by
  the stockholders (*Rales v. Blasband*, 634 A.2d at 936).

- The transaction involves any self-dealing on the part of the director, in which case no materiality standard

The materiality of a financial benefit to a director is determined in the context of the director's personal financial
circumstances. The benefit has to have made it improbable that the director could perform their fiduciary duties
without being influenced by their overriding personal interest (*New Jersey Carpenters Pension Fund v.
infoGROUP, Inc.*, 2011 WL 4825888, at *9 (Del. Ch. Sept. 30, 2011)). The benefit must cause the director's
personal interest to diverge from the stockholders' interests at large. The fact that a director owns shares in the
company and stands to gain from a sale does not itself represent a disabling interest, absent a "compelling" or
"idiosyncratic" need for liquidity (*In re Crimson Exploration Inc. S'holder Litig.*, 2014 WL 5449419, at *19-20
(Del. Ch. Oct. 24, 2014)). In addition, a director will also not be disqualified on the basis of a disabling financial
interest solely because the individual will continue as a director in the surviving corporation. However, a long-
term board seat guarantee for a specific director might raise concerns as to that director's independence or
Trust*, 107 A.3d 1049, 1062 n.57 (Del. 2014)).
Independent Advisors

A special committee needs independent financial and legal advisors to assist in the evaluation of the transaction at issue. If the advisors chosen by the special committee have a relationship with the controlling stockholder in a controlling-stockholder transaction or with another interested party, or otherwise have a financial connection to the transaction, that relationship or connection:

- Will undermine the purpose of the special committee, to provide assurance that the board considered the transaction without a disabling conflict of interest.
- Will make it harder for the special committee to demonstrate that it satisfied the procedural requirements necessary to revert the standard of review back to the business judgment rule or to shift the burden of proving entire fairness (see Standard of Review).
- May be a factor toward a finding that the directors breached their fiduciary duties.

The special committee should take an active role in choosing its advisors. In addition to evaluating whether the advisors are qualified and experienced in the type of transaction under consideration, the special committee should also implement a process to identify any potential conflicts early in the process. The special committee may receive suggestions from management on which advisors could have sufficient expertise, but the special committee must make the final decision.

In choosing its advisors, the special committee should independently interview the advisors and determine whether or not the advisors have any interest that would cast doubt on their advice. Advisors who have previously acted for the company do not necessarily need to be excluded. However, if there has been a previous relationship with the company, the special committee should carefully consider that issue and document the decision to negate any future claim that the advisor was not independent and disinterested. In general, the special committee should retain advisors who have not had any significant previous relationship with the company.

The special committee should also confirm that the advisors have no financial connection to the transaction, a controlling stockholder, or other interested party in the transaction. For example, an advisor’s stock ownership in a bidder, whether by the advisor’s firm or individually by a member of the team handling the transaction, could indicate that the sale process was tainted by breaches of fiduciary duties (see In re El Paso Corp. S’holder Litig., 41 A.3d 432, 434, 444 (Del. Ch. 2012)). Additionally, if the advisor is pursuing a role in the financing of the transaction or using its role to gain more lucrative financing work, that motivation may impair the advisor’s independence and call into question the special committee’s oversight of the transaction (see RBC Capital Markets, LLC v. Jervis, 129 A.3d 816, 855 (Del. 2015), and In re Del Monte Foods Co. S’holders Litig., 25 A.3d 813 (Del.Ch.2011)).

Special committee advisors should also not receive compensation that is contingent on the outcome of a particular transaction. A contingency fee, while potentially aligning a financial advisor’s interests with the target stockholders by providing an incentive for the advisor to negotiate a higher sale price, may also undermine an advisor’s independence by presenting a conflict of interest as to whether the advisor should recommend proceeding with a transaction in the first place (see RBC Capital Markets, LLC v. Jervis, 129 A.3d at 864-65).

For additional information concerning avoiding conflict of interests when selecting financial advisors in particular, see Practice Note, Fairness Opinions: Avoiding Conflict Issues: Compensation and Motivation.
The Special Committee's Mandate

When creating a special committee, the committee should be empowered to act on behalf of the corporation independently of the interested directors or any controlling stockholder. The special committee should have a clear understanding of its role and should not be constrained by a narrow mandate. The critical attributes of a special committee, in addition to independent legal and financial advice, are:

- Access to all the information required to make an informed decision.
- The ability to forcefully and diligently negotiate on behalf of the company's stockholders.
- The power to enforce a decision to reject the proposed transaction.

Without a broad mandate encompassing these concepts, or if a controlling stockholder interferes with the special committee's mandate, a transaction utilizing an independent and disinterested special committee may still fail to meet the heightened, entire fairness standard of review (see In re Dole Food Co., Inc. S'holder Litig., 2015 WL 5052214 (Del. Ch. Aug. 27, 2015), and In re S. Peru Copper Corp. S'holder Deriv. Litig., 52 A.3d 761 (Del. Ch. 2011)).

The action of the directors in forming the special committee should be reflected in the minutes, with a formal resolution describing the specific powers and purpose of the committee. While not necessary to empower the special committee, some boards adopt a special committee charter describing the powers, duties, and procedures of the special committee. The record should also demonstrate that the special committee is aware of its responsibilities and can meet them without being limited or constrained by the board of directors or management.

Size of the Special Committee

Under Delaware law, a committee of the board of directors may be composed of one or more directors (8 Del. C. § 141(c)(1)), but as a practical matter a special committee should have at least three members. Courts have expressed significant skepticism about the ability of a special committee with fewer than three members (and especially a one-member special committee) to remain objective and properly exercise its responsibilities. In general, the fewer the members of a special committee there are, the greater the scrutiny. As the Delaware Supreme Court stated in Kahn v. Tremont Corp., "[i]f a single member committee is to be used, the member should, like Caesar's wife, be above reproach" (see Kahn v. Tremont Corp., 694 A.2d 422, 430 (Del. 1997), citing Lewis v. Fuqua, 502 A.2d 962, 967 (Del. Ch. 1985)). Under certain circumstances, companies have added directors solely for the purpose of populating a special committee. When a director is added for the purpose of serving as a special committee member, the new director should not be brought on for a limited term. The expectation should be that the new director will remain on the board beyond the term of the special committee.

How to Conduct a Proper Process

The special committee essentially has the same role as that of the board as a whole: to act with due care and loyalty to protect the interests of the company’s stockholders. In essence, the special committee functions as a proxy for a disinterested board in negotiations with a third party. In this regard, the special committee has the
obligation not to merely pass judgment on the price and terms proposed by the other party to the transaction, but also to actively negotiate to achieve the highest price and the best possible terms for the company's stockholders. In other words, the special committee must have real bargaining power sufficient to simulate an arms'-length transaction (see, *In re Orchard Enter., Inc. S'holder Litig.*, 88 A.3d 1, 26 (Del. Ch. 2014) quoting *Kahn v. Tremont Corp.*, 694 A.2d at 430). Important criteria for conducting a proper process are discussed below.

**Access to Information**

To properly fulfill its responsibilities, the special committee must have access to all material information about the company and the transaction (*In re Tele–Comm'ns, Inc. S'holders Litig.*, 2005 WL 3642727, at *10 (Del. Ch. 2005)). In a controlling-stockholder transaction, it is also crucial that the controlling stockholder disclose to the special committee all material information known to the controlling stockholder (other than information that relates solely to its bottom line negotiating position), including:

- The material proposed transaction terms.
- Material asset value or use facts (for example, alternate uses or hidden value).
- Material market value facts (for example, known future regulations or technological changes).

(*In re Dole Food Co., Inc. S'holder Litig.*, 2015 WL 5052214, at *29.)

The board resolutions creating the special committee and establishing its mandate should specifically state that the committee will have full access to all reasonably available information (see *The Special Committee's Mandate*).

**Active Role in Negotiation**

The special committee must also have the ability to negotiate the transaction when necessary. If management is actively involved in the transaction, such as a leveraged buyout in which management is participating, management's role should be limited to providing information and general assistance to the special committee and the committee's advisors. However, if management does not have a meaningful interest in the transaction, such as in a merger with a non-controlling third party, management may actually take the lead in the negotiations. In any case, management's involvement in the negotiations should be in close cooperation with, and under the supervision of, the special committee.

**Ability to Do a Market Check**

A post-signing market check, or a *go-shop* provision, is useful in transactions that are likely to attract conflict of interest allegations. A go-shop allows the target company to actively seek other buyers for a period of time after the transaction has been announced. By contrast, a *fiduciary out* without the benefit of a go-shop provision authorizes the board of the target company to accept a superior competing offer that is brought to it, but does not allow the target board to actively seek competing offers.

Frequently, in M&A transactions, a third party will propose entering into the acquisition agreement before the board of directors of the target company has had the opportunity to ascertain the company's value and whether other bidders would be interested in doing a deal. When the target board does not have good
information for the company’s value, the agreement should provide the target company with a right to do a meaningful, active post-signing market check. This allows the target to ensure that the price received is the best price available for the stockholders.

The Delaware Supreme Court ruled in *C & J Energy Services* that in transactions reviewable for the reasonableness of the board’s decisions (enhanced scrutiny review under *Revlon, Inc. v. MacAndrews & Forbes Holdings., Inc.*, 506 A.2d 173, 182 (Del. 1986); see also *Practice Note, Fiduciary Duties in M&A Transactions: Sale of Control: Enhanced Scrutiny*), a passive market check enabled by a fiduciary out frequently suffices for the board to satisfy its fiduciary duties (see 107 A.3d 1049 at 1070-71). However, the analysis may be different in controlling-stockholder transactions, which are reviewed for their entire fairness (in the absence of procedural protections that shift the standard of review back to the business judgment rule, as discussed in *Box, Standard of Review*). Entire fairness is a stricter standard of review than the standard of enhanced scrutiny that attaches to sales of control in third-party acquisitions. For that reason, although a passive market check generally suffices for the target board to show it acted reasonably in a sale of control to a third-party, it may not muster on its own in deals where the board must demonstrate a fair price and process. Therefore, in controlling-stockholder transactions (where the entire fairness review standard may apply), the special committee should demand a go-shop right if it had not had a chance to canvass the market before receiving the controlling stockholder’s offer. For more information on go-shops, see *Practice Notes, No-Shops and Their Exceptions: Go-Shops and What’s Market: No-Shop*.

**Power to “Just Say No”**

The special committee should also have a real ability to “just say no” to a transaction if the committee determines that it is not in the best interest of the company's stockholders.

Where a special committee has been formed to consider a takeover bid, the resolution that establishes the special committee should give the committee the power to say no to the transaction and adopt takeover defenses to protect the company from an unsolicited bid (see *The Special Committee’s Mandate*). Otherwise, the special committee cannot properly meet its obligation to achieve the best possible result for the stockholders of the company. If the special committee, after careful consideration and with advice from advisors, determines that the company should reject a hostile takeover bid, the special committee should have the power to adopt a **stockholder rights plan** ("poison pill"), refuse to redeem a poison pill, or take other measures within the limits of its fiduciary duties (see *Practice Notes, Fiduciary Duties of the Board of Directors: Defensive Measures, Defending Against Hostile Takeovers, and Poison Pills: Defending Against Takeovers/Stockholder Activism and Protecting NOLs*).

To support its power to just say no to the controlling stockholder, the special committee should also have the authority to consider alternative transactions. Even in situations involving a controlling stockholder that could, or threatens to, veto an alternative transaction, the resolution that establishes the special committee should at the very least provide the committee with an opportunity to evaluate other alternatives. Such a mandate serves the purpose of providing the special committee with meaningful information for determining whether the proposed transaction is fair to the corporation's minority stockholders or should be abandoned. (See *Kahn v. M & F Worldwide Corp.*, 88 A.3d at 652-53.)

**Independent Fairness Opinion**
Chapter 6—The Sale Process

As part of the process of evaluating the proposed transaction, the special committee should obtain a fairness opinion from its independent financial advisor if it is approving a transaction. The committee should be satisfied by the scope of the financial advisor’s investigation and the procedures followed by the financial advisor in reaching the fairness opinion. For additional information on fairness opinions, see Practice Note, Fairness Opinions.

Majority-of-the-Minority Approval

In the absence of procedural protections, a controlling-stockholder transaction is subject to review for its entire fairness. However, special committee approval can potentially qualify the transaction for review under the deferential business judgment rule if the controlling stockholder conditions its offer upfront on both:

- Approval by an independent "adequately empowered" special committee "that fulfills its duty of care."
- Approval by a majority of the unaffiliated, informed, and uncoerced minority stockholders.

(Kahn v. M & F Worldwide Corp., 88 A.3d at 644; see also Box, Avoiding Entire Fairness Review by Employing Additional Procedural Protections.)

While less beneficial from a target board’s perspective than the application of the deferential business judgment standard of review, a majority-of-the-minority condition alone (without a special committee that meets all of the Kahn v. M & F Worldwide related conditions) can still be helpful to the target board by shifting the burden of proving entire fairness to the plaintiffs under Delaware law (see Practice Note, Fiduciary Duties in M&A Transactions: Shifting the Burden when Entire Fairness Applies). However, even in these cases, it is still advantageous for the board to use a special committee throughout the negotiation process because, if there is no special committee, the court may be more skeptical of whether full disclosure has been made to the minority stockholders for purposes of obtaining their approval of the transaction. Beyond the possibility of a skeptical court, it is useful as a practical matter to have a special committee with an independent financial advisor involved in the transaction to assure that the disclosure obligation has been satisfied. In addition, if the board agrees to only one procedural protection, a special committee is sometimes chosen over a majority-of-the-minority vote because many buyers will argue against including a majority-of-the-minority condition in the purchase agreement because of the risk that activist hedge funds will then have the ability to block approval of the transaction and thereby have the power to negotiate a higher price.

Preserve a Proper Record

In reviewing the involvement and negotiating power of the special committee, a court will thoroughly examine the record of the special committee’s proceedings. For that reason, it is critical to keep careful minutes of committee meetings and to preserve the documents submitted by advisors. As with any action by a board of directors, the special committee should be meticulous in creating a record that demonstrates active participation by all the members in the special committee’s activities and informed, deliberate, and careful review of the issues. It is particularly helpful if the record created by the special committee reflects price increases and improvements in other material terms of the transaction. Of course, Delaware courts are cognizant of the fact that no process, no matter how well thought-out, is perfect. If the overall process is carried out in good faith by disinterested and independent directors with an understanding of their duties and who are properly advised by independent advisors, individual flaws in the process should not impact the outcome.
Compensation of the Special Committee

Deciding how to compensate the members of the special committee can be complicated. The members of a special committee can be compensated under a flat-fee arrangement, a per-meeting fee arrangement, or a combination of both. It is important that the fee be fixed in advance and not be dependent on the outcome of the proposed transaction. Compensation of special committee members that is contingent, ambiguous, or otherwise uncertain may throw the committee members' independence into question. Excessive compensation may also cast doubt on the special committee's independence and should be avoided. (See, In re Tele-Comm'ns, Inc. S'holders Litig., 2005 WL 3642727, at *5 & n.52 (Del. Ch. Dec. 21, 2005).) Because self-interest questions must be analyzed using a subjective standard, even the granting of, or a special committee member's request for, a success fee after the approval of the transaction may call into question that director's state of mind when approving the transaction and therefore potentially the director's independence and disinterestedness (see, Se. Pa. Transp. Auth. v. Volgenau, 2013 WL 4009193, at *15 (Del. Ch. Aug. 5, 2013), aff'd, 91 A.3d 562 (Del. 2014)).

Standard of Review

As a matter of state corporate law, boards of directors are tasked with the responsibility for managing the business and affairs of a corporation (see 8 Del. C. § 141(a)). Recognizing this statutory authority, courts applying Delaware law will generally review a board of directors’ actions under the business judgment rule. The business judgment rule establishes a presumption that defers to a board's business judgment unless the challenging stockholder can plead evidence that supports rebutting that presumption. For additional information concerning the application of the business judgment rule standard of review, see Practice Note, Fiduciary Duties in M&A Transactions: The Business Judgment Rule.

Controlling-stockholder transactions and interested-board transactions are two types of transactions where a court applying Delaware law may find that the plaintiff has rebutted the presumptions of the business judgment rule and may instead apply the most rigorous standard of review, the entire fairness standard.

However, in virtually all cases where entire fairness preliminarily applies, the parties can structure the transaction to either:

- Shift the burden of proof of the transaction's fairness back to the stockholder plaintiff (see Special Committees: Burden Shifting Effect When Entire Fairness Review Applies).
- Qualify for the presumptions of the business judgment rule (see Cleansing Effect of Fully Informed, Uncoerced, and Disinterested Stockholder Vote or Acceptance of Tender Offer in Interested-Board Transactions and Avoiding Entire Fairness Review by Employing Additional Procedural Protections).

Entire Fairness

Based on the Delaware case law defining the conflicts of interest that trigger entire fairness review, the entire fairness standard of review generally applies to the following interested-director and controlling-stockholder transactions:
• Interested-director transactions where at least half the directors are either interested or not independent, even if the transaction is not with a controlling stockholder of the company (see GPC XL I L.L.C. v. Lorall Space & Communications Inc., 2008 WL 4293781 at *21 n.109 (Del. Ch. Sept. 19, 2008), citing Rales v. Blasband, 634 A.2d 927, 936 (Del.1993)).

• Controlling-stockholder transactions where the counterparty to the company is a controlling stockholder of the company, even if a majority of the directors are disinterested and independent (see Calessa Associates, L.P. v. Am. Capital, Ltd., 2016 WL 770251, at *9 (Del. Ch. Feb. 29, 2016), quoting In re KKR Fin. Hldgs. LLC S'holder Litig., 101 A.3d 980, 990 (Del. Ch. Oct. 14, 2014)).

• Controlling-stockholder transactions where the counterparty is an unrelated third-party buyer, but the company has a controlling stockholder that receives different consideration in the transaction than the other stockholders (In re John Q. Hammons Hotels Inc. S'holder Litig., 2009 WL 3165613, at *12 (Del. Ch. Oct. 2, 2009)). Entire fairness should apply in this scenario even if a majority of the directors are disinterested and independent. Even though the controlling stockholder is not the counterparty in the transaction, the controlling stockholder can be said to be competing with the other stockholders for the merger consideration, which is sufficient to trigger entire fairness review.

Entire fairness review requires a judicial determination of whether the transaction was entirely fair to stockholders (see Weinberger v. UOP, Inc., 457 A.2d 701, 710 (Del. 1983)). In analyzing the entire fairness of a transaction, Delaware courts consider two basic aspects of the transaction:

• **Fair dealing.** In this prong of the analysis, the court focuses on process: how 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."

• **Fair price.** The second prong of the analysis requires the court to consider all relevant factors that pertain to value: "assets, market value, earnings, future prospects, and any other elements that affect the intrinsic or inherent value of a company's stock."

(Weinberger v. UOP, 457 A.2d at 711.)

The inquiry is not bifurcated; rather, a court conducting an entire fairness review will examine the process aspect and the price aspect as a whole (see Hamilton Partners, L.P. v. Highland Capital Mgmt., L.P., 2016 WL 612233, at *5 (Del. Ch. Feb. 2, 2016), citing Weinberger v. UOP, 457 A.2d at 711). For additional information concerning the application of the entire fairness review standard, see Practice Note, Fiduciary Duties in M&A Transactions: Conflict Transactions: Entire Fairness Review.

**Special Committees: Burden Shifting Effect When Entire Fairness Review Applies**

For purposes of any eventual litigation, the use of a properly formed and functioning special committee of independent and disinterested directors (see Issues to Consider When Forming a Special Committee), on its own, shifts the burden of proving that a transaction was entirely fair to the plaintiff in the following types of transactions:

• Controlling-stockholder transactions where the controlling stockholder is the counterparty (see Kahn v. M & F Worldwide Corp., 88 A.3d at 646).
• Controlling-stockholder transactions where the controlling stockholder is not the counterparty, but receives different consideration (see In re John Q. Hammons Hotels Inc. S'holder Litig., 2009 WL 3165613, at *12).

• Interested-director transactions where there is no controlling stockholder (see In re Tele-Commic'ns, Inc. S'holders Litig., 2005 WL 3642727, at *8).

Shifting the entire fairness standard of review burden to the plaintiff means that instead of the controlling stockholder or the board of directors having to demonstrate the entire fairness of the interested-director or controlling-stockholder transaction, the stockholder plaintiffs who are attacking the transaction must show that the transaction was not entirely fair. While not necessarily outcome-determinative, shifting the burden back to the plaintiff is a useful maneuver for defeating a judicial challenge.

Cleansing Effect of Fully Informed, Uncoerced, and Disinterested Stockholder Vote or Acceptance of Tender Offer in Interested-Board Transactions

Even if an interested-board transaction might otherwise be subject to entire fairness review, the Delaware Court of Chancery recently held in Larkin v. Shah and Volcano that a fully informed, uncoerced, and disinterested stockholder vote or acceptance of a tender offer cleanses the board’s decision. In these interested-board transaction cases involving claims for post-closing damages, the irrebuttable business judgment rule standard of review will apply if:

- No conflicted and controlling stockholder is involved.
- The transaction was approved by a fully informed, uncoerced vote, or acceptance of a tender offer by the disinterested stockholders.


Notably, this approach was not followed by the Chancery Court in Miami General Employees v. Comstock, a decision also involving a conflicted board of directors and issued the day before Larkin. In Comstock the Chancery Court ruled like Larkin to restore the business judgment rule standard of review, but did so based on a finding that the plaintiff had not established that the directors suffered disabling conflicts of interest, rather than on the Larkin court’s view that a fully informed and uncoerced vote of the disinterested stockholders cleanses the conduct of a conflicted board (see City of Miami Gen. Employees’ and Sanitation Employees’ Ret. Trust v. Comstock, 2016 WL 4464156 (Del. Ch. Aug. 24, 2016)). This seems to suggest that the Chancery Court in Comstock would have applied the entire fairness standard of review instead of the business judgment rule if the plaintiff had established that the board was interested, even though the transaction had been approved by a fully informed vote of the disinterested stockholders. The Chancery Court’s disparate approach in these two decisions potentially leaves this issue open until the Delaware Supreme Court addresses it definitively. For more information, see Practice Note, Fiduciary Duties of the Board of Directors: Restoring the Business Judgment Rule with a Stockholder Vote.

Avoiding Entire Fairness Review by Employing Additional Procedural Protections
The use of a properly formed and functioning special committee of independent and disinterested directors (see Issues to Consider When Forming a Special Committee), when combined with a fully informed "majority-of-the-minority" stockholder vote (see Majority-of-the-Minority Approval), has the additional benefit of potentially shifting the standard of review back to the deferential business judgment rule.

The Delaware Supreme Court fleshed out the conditions for restoring the presumptions of the business judgment rule in Kahn v. M & F Worldwide Corp. In that decision, the court held that the business judgment rule can apply if and only if:

- The controlling stockholder conditions the entry into a transaction on both the approval by a special committee and a majority-of-the-minority stockholder vote.
- The special committee is independent (see Independence of Special Committee Members).
- The special committee has the power to freely select its own advisors and to "just say no" (see Independent Advisors and Power to "Just Say No").
- When negotiating the fair price, the special committee meets its duty of care. The Delaware Chancery Court has interpreted this to mean that the court must review the special committee's efforts on the price negotiations under a standard of gross negligence (Swomley v. Schlecht, 2014 WL 4470947 (Del. Ch. Aug. 27, 2014) (TRANSCRIPT)).

The vote of the minority is informed. This means the parties must consider what information and materials should be included in the proxy statement (for example, financial projections and underlying assumptions) to ensure that appropriate and sufficient information is made available to the voting stockholders and to try to avoid or, at least, limit future plaintiffs' claims of inadequate disclosure. For additional information on matters that the special committee should disclose, see Practice Note: Fiduciary Duties of the Board of Directors: Duty of Disclosure.

- The vote of the minority is not coerced.

(Kahn v. M & F Worldwide Corp., 88 A.3d at 645.)

The Kahn v. M & F Worldwide Corp. conditions for restoring the presumption of the business judgment rule—at least in the context of a going-private merger—have also been expressly adopted by New York’s highest court, the New York Court of Appeals (see In re Kenneth Cole Prods., Inc., S’holder Litig., 2016 WL 2350133 (N.Y. May 5, 2016)).

For additional information on how to avoid the entire fairness review by employing procedural protections, see Practice Notes, Fiduciary Duties of the Board of Directors: Avoiding Entire Fairness Review by Employing Procedural Protections, and Fiduciary Duties of the Board of Directors: Business Judgment Rule Using Procedural Protections.

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Chapter 7

Intellectual Property for the General Business Lawyer—Presentation Slides

LEIGH FRANCIS GILL
Immix Law Group PC
Portland, Oregon
A Top 10 for 2016

1. **Confidentiality**—including the new Defend Trade Secrets act
2. Avoiding mistakes and selecting an appropriate **trademark**
3. **Whose idea is it?** Securing rights from employees and contractors
4. Copyright **registration**
5. **DMCA** and available protection for technology companies
6. Advising clients about **patents**, from the non-patent bar perspective
7. Software **licensing**
8. **Open source**
9. Using **internet images** for company materials
10. **Sharing credit**: cross licensing, joint development and market development
1) **Confidentiality**—preserving and maximizing the value in ideas

- Identify the audience
- Determine what to protect
- Practical identification of protection (e.g., stamping documents “confidential”)
- Remedies

At issue with confidential information is the intended use of the information. For the same two parties, confidentiality may change both over time and with different projects, contexts or negotiations.

1) **Confidentiality (cont.)**

- In Oregon, ORS §§646.461 to 646.475 provides some protection of trade secrets. Application of trade secrets law relies on misappropriation and has its roots in tort.
- Trade Secret Act is a blunt tool and additive to customizing confidentiality.

There is no trade secret without “effort . . . reasonable under the circumstances to maintain its secrecy.” ORS §646.461(4)(b). A contract describing confidentiality is good evidence of efforts to maintain secrecy.
1 } Confidentiality (cont.)

♦ In May 2016, President Obama passed the Defend Trade Secrets Act, creating a new federal cause of action for trade secrets misappropriation. Trade Secrets have long been protected under state law, but the new law provides a choice of courts.

♦ As a transactional matter, the Defend Trade Secrets Act requires changes to drafting for employee and independent contractor agreements. Agreements with “employees” (broadly defined) must provide notice of individual protections, including for disclosure to government (whistleblower protection)

♦ The Defend Trade Secrets Act also provides a new remedy of civil seizure of trade secret material.

2 } Avoiding mistakes and selecting an appropriate trademark

♦ For internet-age businesses, the process of selecting a trademark is dominated by whether the domain name is available.

♦ Descriptive and suggestive trademarks have little or limited protection, but may have practical value in lowering advertising costs.

♦ There is newfound attention to the interstate commerce requirement for federal trademark registration.

Just like baby names in the census, popular words or marks change over time. Entering a crowded space may seem like a good idea, but the investment costs of green field are rewarded by long-tail if successful.
Avoiding mistakes and selecting an appropriate trademark (cont.)

♦ How many puns on the word “hops” can you think of?
  ♦ “Hop to it?” – Kereru Brewing Company, New Zealand.
  ♦ He’s got a “Rye Wit?” – Freetail Brewing Company, San Antonio TX.
  ♦ “Hopportunity Knocks?” – Caldera Brewing Company, Ashland, OR.
  ♦ “Sock Hop?” – Sock Hop Monkey Brewery, Silver Springs, MD.
  ♦ “Don’t Worry, Bee Hoppy?” – Riverside Brewery, West Bend, WI
  ♦ “The Ties that Bine?” – Available! But RHIZING BINES is a registered TM of Dogfish Head, Milton, DE.

Innovation Brewing is a craft brewery in North Carolina that did a search for trademarks, got the domain name, and then applied for trademark registration.

Bell’s is a large craft brewery in Michigan that sells beer in North Carolina. They contacted Innovation and requested they withdraw their application. The trademark has now moved to an extended opposition before the TTAB.
Avoiding mistakes and selecting an appropriate trademark (cont.)

♦ Lagunitas is the fifth largest craft brewery by volume and Sierra Nevada is the second. In 2015, Lagunitas sued Sierra Nevada alleging infringement of its “large, bold, black, centralized ‘IPA’ lettering.”

♦ Two days after the case was filed in the Northern District of California, Lagunitas announced it would voluntarily dismiss the case due to negative publicity.

Rights to a trademark are not created by registration of a trademark. In the U.S., rights accrue through use, although they may be recognized (and may prevent accrual by others of competing rights) through registration.

♦ Some recent TTAB decisions have affirmed the importance of material, interstate use in establishing registration. (e.g., Adidas AG v. Christian Faith Fellowship Church, Cancellation No. 92053314 (TTAB 2015), Doctor’s Associates v Janco, LLC, Opposition No. 91217243 (TTAB 2016) )

♦ Unknown as of the date of this presentation is the fate of “scandalous” trademarks like “Redskins,” “Slants” and “Chief Wahoo” (logo for the Cleveland Indians), as SCOTUS has granted cert for Lee v. Tam.
3 } Whose idea is it? Securing rights from employees and contractors
- The copyright default is rights to the author. The “Author” is an individual, with few exceptions. (Work made for hire).
- Patent rights arise in the inventor, although “shop rights” may give an employer some rights.
- It is imperative that contractors sign an agreement with clear IP ownership.

It is invariably more expensive and difficult to secure rights after discovering that certain IP is valuable than it is to secure rights prior to the activities creating that IP.

4 } Copyright registration
- Copyrights are developed at fixation; trademarks accrue through use.
- There are important benefits to the owner with registration, including presumptions of validity, statutory rights, etc.
- Copyright registration is nearly a do-it-yourself exercise.
- Changes to the registration system are likely to come soon.

Copyright registration fees increased in 2014. There is a new librarian of Congress, and the Register of Copyrights has been removed. There is an increased focus on digital records and software tools, so we expect procedural changes to come soon.
5) Using DMCA notice and takedown procedures

- DMCA is not new but remains an effective tool for establishing safe harbor.
- Recent decisions have emphasized the obligations of technology companies to exercise judgement and not blanket policies.
- Active discussion in industry and at the copyright office about the “balance” between technology companies and content companies.

A proposed change to DMCA registration of agents would retire the “interim” designation of agent form with online process, frequent renewals.


6) Advising clients about patents, from the non-patent bar perspective

- The 2011 America Invents Act is now fully implemented for new applications. First to file means an inventor must decide to patent or not.
- Software and business method patents are less readily given and may have decreased scope in light of cases like Bilski and Alice. But see contra Enfish v. Microsoft.
- Cost-benefit analysis is still essential. Pay attention to the nature of the invention.
- Design patents appear to be on the rise, but SCOTUS to hear Samsung v. Apple

As ever with patents, and particularly in light of first-to-file in the U.S., acting quickly is critical if there is to be effective protection of the invention.
6) Advising clients about patents (cont.)

- NPE (or PAE) activities remain an important issue for small businesses.
- Costs of filing suit has gone up with AIA (joinder rules).
- Settlement remains a good business decision if a small business wins the NPE lottery. Litigation costs are high and issued patents, including business method and software patents, have a presumption of validity.

The proposed FRCP revisions to rule 26 may offer some reduction in the cost to small business defendants who find themselves subject to a patent infringement claim.

7) Software licensing

- Services such as Office365 and Salesforce make software audits less of an issue, but any business which has multiple workstations may have licensing requirements to comply with.
- Businesses contracting for app development, custom software development, or even configuration services needs to carefully consider compliance.
- A business without an IT department should ensure that its contract with outsourced IT resource includes responsibilities in the event of a software audit.
8. Open source, creative commons, and standards

- For small companies, use of common licensed works (e.g., open source) can be a wonderful accelerator to growth.
- License scope is better understood. Pay attention to license terms.
- “Non-commercial” term is the most difficult to apply to the facts.

When relying on a contractor (graphic designer, developer, systems architect, etc.), companies should investigate the use of common licensed elements. With server-side install this is less frequently at issue. However, standards become increasingly important.

8. Open source, creative commons, and standards (cont.)

- Small companies are increasingly encountering standards and common IP elements. These are often either unregulated or self-regulated spaces.
- Use case: small company builds a health app which medical service providers would like to use. Service providers request an integration between health app and billing software. CPT codes are registered copyright of the American Medical Association and defacto standard.

As disruptive technologies and innovative services are developed by small businesses, they tend to affect established licensing models.
9 } Using internet images for the business website

- “Stock footage” can be a deceptive term, more so when a non-internet business hires a graphic designer or web developer.
- It can be very difficult to determine the provenance of digital images.
- Algorithmic image searches can easily identify likely infringing images.

Google search by image, for example, allows a user to upload an image and search for online images that contain matching elements.

9 } Using internet images for the business website (cont.)

As part of a movie campaign, photos including actor Vince Vaughn were offered as the “free photo of the week.” The license was for an “editorial use,” which on close review excludes commercial use.
9 } Using internet images for the business website (cont.)

♦ In a recent case, a DC patent attorney settled copyright infringement claims with Masterfile Corporation for $8,000. Masterfile claimed rights to two photographs that it alleged appeared on the attorney’s website.

♦ Getty Images, with a library of more than 80 million images, acquired a software company PicScout to identify matching images.

Companies using online images need to pay close attention to their source. A warranty from the web developer may be good, but inadequate. Infringement occurs by copying, not by intention.

10 } Sharing credit: cross licensing, joint development and market dev

♦ Small companies often have trouble penetrating markets, or have limited resources. Joining forces makes sense, but understand who owns the IP.

♦ Portfolio rights (to display the work in a portfolio) can be very valuable. Companies desiring this need the confidentiality provision to support this.

♦ If one company is responsible for developing a market or potential client, they need adequate trademark rights to do so.

Understanding the competencies of the businesses involved is required to adequately provide for shared IP use. In most cases a “sub-contractor” type relationship is easier to manage than any joint project.
Thank you

Supplemental materials available at: http://ImmixLaw.com/Education
Chapter 8

Mandatory Elder Abuse Reporting for Oregon Lawyers

MARK JOHNSON ROBERTS
Deputy General Counsel
Oregon State Bar
Tigard, Oregon

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Chapter 8—Mandatory Elder Abuse Reporting for Oregon Lawyers

QUESTION 1: What is Mandatory Elder Abuse Reporting?

The Oregon elder abuse reporting law is found at ORS 124.050 to ORS 124.095. It imposes a legal obligation on certain “public and private officials” to report elder abuse. Lawyers are included in the definition of “public or private officials” having a duty to report. ORS 124.050(9). Physicians; dentists; optometrists; chiropractors; nurses; police officers; firefighters; Department of Human Services (DHS) and Oregon Health Authority workers; owners and employees of adult foster care facilities; clergy; social workers; psychologists, counselors, and psychotherapists; physical, speech and occupational therapists; audiologists; speech pathologists; senior center workers; information and referral or outreach workers and members of the Legislative Assembly are among the other mandatory reporters.

Oregon is in the midst of a demographic shift: As baby boomers age, our population as a whole is aging. Each year, over 50,000 Oregonians turn 65 years old. The median age of Oregon’s population was 30.3 in 1980, but is forecast to rise to 39.7 by 2020. With advancing age come declining health and greater reliance on family members and caregivers. And elder abuse is a significant problem. In 2014, DHS investigated and substantiated over 2,500 instances of elder abuse in Oregon. Nationally, one in ten elders living at home is subject to abuse, neglect, or exploitation.

QUESTION 2: What Are Lawyers Required To Do?

Elder abuse reporting is a 24-hour-a-day, 7-day-a-week responsibility. Reporting is required whenever a lawyer has “reasonable cause to believe that any person 65 years of age or older with whom the [lawyer] comes in contact has suffered abuse, or that any person with
Chapter 8—Mandatory Elder Abuse Reporting for Oregon Lawyers

ORS 124.060. The administrative rules encourage voluntary reporting in situations where reporting is not mandated. OAR 411-020-0020(2). Failure to report as required by the statute is a Class A violation. ORS 124.990. The penalty for a Class A violation is a maximum fine of $2,000. ORS 153.018(2)(a).

Oregon Rule of Professional Conduct (RPC) 1.6(a) prohibits a lawyer from revealing information relating to the representation of a client. RPC 1.6(b)(5) permits, but does not require, a lawyer to disclose information relating to the representation of a client when required by law. A lawyer may report elder abuse as required by law without violating the lawyer’s ethical duty of confidentiality to a client.

Note that when one of the exceptions to reporting applies (Question 6, below), the law does not require reporting, and therefore would not permit a lawyer to disclose information protected by RPC 1.6. In addition, RPC 1.6(b)(5) permits disclosure only to the extent required by law; it does not give a lawyer permission to reveal information about elder abuse that the law does not require be reported. A lawyer cannot use the permission in the disciplinary rule to justify disclosing information about elder abuse that is not required to be reported by the exceptions in ORS 419B.010.

Question 3: What Is “Reasonable Cause?”

There are no reported cases applying or interpreting this term specifically in connection with the abuse reporting statutes. The Department of Human Services interprets “reasonable cause” in related statutes as being equivalent to “reasonable suspicion.” A.F. v. Dep’t of Human Res. ex rel. Child Protective Servs. Div., 251 Or App 576, 590, 98 P3d 1127 (2012); Berger v. State Office for Services to Children and Families, 195 Or App 587, 590, 98 P3d 1127 (2004). In that context, “[r]easonable suspicion’ means a reasonable belief given all of the circumstances, based upon specific and describable facts, that the suspicious physical injury may be the result of abuse.” The rule further explains:

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1 Lawyers similarly are required by ORS 9.460 to “maintain the confidences and secrets of ... clients consistent with the rules of professional conduct ... .” ORS 9.460 uses the terminology of former DR 4-101, which has been replaced by RPC 1.6.
“The belief must be subjectively and objectively reasonable. In other words, the person subjectively believes that the injury may be the result of abuse, and the belief is objectively reasonable considering all of the circumstances. The circumstances that may give rise to a reasonable belief may include, but not be limited to, observations, interviews, experience, and training. The fact that there are possible non-abuse explanations for the injury does not negate reasonable suspicion.”

OAR 413-015-0115(37). Similarly, “reasonable suspicion” for an officer to stop an individual in the criminal law context is defined as “a belief that is reasonable under the totality of the circumstances existing at the time and place the peace officer acts.” ORS 131.605(5). The standard is an “objective test of observable facts” and requires the officer “to point to specific articulable facts that give rise to a reasonable inference that a person has committed a crime.” State v. Ehly, 317 Or 66, 80, 854 P2d 421 (1993).

By contrast, the standard of “probable cause” for arrest in the criminal law context is generally thought of as a higher standard than that of “reasonable suspicion.” “Probable cause” is defined by ORS 131.005(11) as a “substantial objective basis for believing that more likely than not an offense has been committed and a person to be arrested has committed it.” In State v. Childers, 13 Or App 622, 511 P2d 447 (1973), the court held that a police officer did not have probable cause to make a warrantless search for marijuana since he was uncertain whether he had smelled it. The court cited the probable cause standard as the existence of circumstances that would lead a reasonably prudent person to believe that an event had occurred, and distinguished it from “mere suspicion or belief... .” Id. at 629.

Interpreting “reasonable cause” in the context of obtaining a subpoena for bank records under ORS 192.565(6), the court in State v. McKee, 89 Or App 94, 99, 747 P3d 395 (1987), held that a showing of reasonable cause required a recital of known facts, not mere conclusory statements. In another case, a merchant was found to have reasonable cause to detain a suspected shoplifter when the merchant saw the person leaving the store with unpaid-for

A potential “floor” for “reasonable cause” is found in ORS 124.075, which provides immunity to reporters for criminal and civil liability. In order to qualify for immunity, the reporter must “participat[e] in good faith” in the reporting process, and have “reasonable grounds” for the making of the report. Outside the client representation context, attorneys are well advised to use this standard for determining when to make a report of potential elder abuse.

**Question 4: What Is “Comes In Contact?”**

“Comes in contact” is a more unfamiliar phrase that is also not defined in the statute or case law. A dictionary definition of “contact” includes “a touching or meeting” and “association or relationship (as in physical or mental or business or social meeting or communication).” *Webster’s Third New International Dictionary* 490 (unabridged ed 1993). That definition, and common usage, suggest that a lawyer is required to report elder abuse only when the lawyer has had some kind of physical or associational contact with a person who has abused an elder or with an elder who has been abused. This does not necessarily mean “in person” contact; telephone or even email or written contact would likely suffice.

The “comes in contact” requirement does not appear to modify the “reasonable cause” requirement. In other words, the statute does not appear to require reporting only when the lawyer learns of the abuse directly from the victim or the abuser. Reliable second- or third-hand information may provide reasonable cause to believe that abuse has occurred; reporting would then be required if the lawyer had come in contact with either the abuser or the victim. For example, if a neighbor tells a lawyer that she heard from another neighbor that an elder living down the street (with whom the lawyer has occasional contact) appears to have been abused,

² The statute applied in *Delp*, which allows merchants to detain suspected shoplifters, has since been amended to require “probable cause” as opposed to “reasonable cause.” See ORS 131.655(1).
the lawyer may have reasonable cause to believe that abuse occurred if the lawyer believes the neighbors are reliable sources of information.

It is sometimes suggested, under a broad reading of the statute and its purpose, that “contact” includes knowledge of abuse even without any physical or associational contact with the victim or the abuser. The Attorney General does not interpret the statute so broadly, opining in another context that “physicians, psychologists and social workers who serve as members of the board of directors of a self-help child abuse prevention organization, but who do not provide direct services, are not required to report suspected child abuse when they acquire that information indirectly in their official capacities as board members.” Attorney General Letter of Advice to Sen Margie Hendriksen (OP-5543) (June 12, 1984). The basis for the opinion lies primarily in the fact that the list of mandatory reporters in Oregon consists of professionals and service providers who are most likely to come into direct contact with victims or perpetrators of child abuse. “We believe that if the drafter of [the statute] had intended to impose a mandatory reporting duty, violation of which is punishable by a substantial fine ... , upon persons who merely have knowledge about child abuse, from whatever source, they would have said so clearly.” Id.

**Question 5: What Is Elder Abuse?**

The elder abuse reporting statute identifies the types of conduct that constitute elder abuse:

- **Infliction of Pain or Physical Injury:** Pain or injury caused by other than accidental means or apparently inconsistent with the explanation given for it. According to regulation, this includes force-feeding and all physical punishments. OAR 411-020-0002(a)(B)(ii). Physical abuse is presumed to injure and inflict pain upon someone who is non-responsive. See OAR 411-020-0002(a)(C).

- **Abandonment or Neglect:** This includes desertion as well as withholding caretaking responsibilities.
• **Financial Exploitation:** Defined in ORS 124.050(4). Wrongful taking of an elder’s property; a threat of taking that causes alarm to an elder; stealing or transferring account funds without authorization (even if jointly held); failing to use the elder’s resources effectively for their support.

• **Sex Abuse:** Commission of a crime enumerated in the statute, including both public and private indecency.

• **Involuntary Seclusion:** For convenience or discipline.

• **Wrongful Use of Physical or Chemical Restraints:** Authorized medical or legal uses are excluded.

ORS 124.050(1).

Lawyers, like many mandatory reporters, may not be experts in identifying abuse and are not expected to be. The law does not require lawyers to conduct investigations into suspected abuse, but lawyers should make reasonable inquiries where possible to follow up on initial observations or information that appears to involve elder abuse, to ensure that they have “reasonable cause” to believe that abuse has occurred. The intent of the statute is to get at-risk seniors into a regulatory system where the circumstances will be evaluated and, as necessary, addressed by qualified professionals. Hence, the standard for reporting is only “reasonable cause,” not “certainty.”

**Question 6: Are There Any Exceptions To The Reporting Requirement?**

There are three exceptions to the statutory reporting requirement:

• Lawyers, together with clergy, psychiatrists, and psychologists, are not required to report information “communicated by a person if the communication is privileged under ORS 40.225 to 40.295 [OEC 503 – OEC 295].” ORS 124.060.

• A lawyer is also not required to report elder abuse based on information communicated to the lawyer “in the course of representing a client if disclosure of the information would be detrimental to the client.” *Id.*
• “An elderly person who in good faith is voluntarily under treatment solely by spiritual means through prayer in accordance with the tenets and practices of a recognized church or religious denomination by a duly accredited practitioner thereof shall, for this reason alone, not be considered subjected to abuse by reason of neglect ... .” ORS 124.095.

The effect of these statutory exceptions to the duty to report is that most of the information a lawyer will be required to report will be that learned outside the lawyer’s “official capacity.” For instance, witnessing an act of abuse in a public place will trigger the reporting obligation, despite the fact that the lawyer may not have a lot of information to report. Similarly, information that a non-client friend or neighbor is abusing an elder, or is a victim of abuse, must be reported.

A. Privileged Communications.

The first exception relates to statutory privileges. Lawyers are not required to report information that is “privileged under ORS 40.225 to 40.295.” ORS 40.225 is OEC 503, the lawyer-client privilege. The reference, however, encompasses thirteen other privileges: psychotherapist-patient (OEC 504), physician-patient (OEC 504-1), nurse-patient (OEC 504-2), school employee-student (OEC 504-3), clinical social worker-client (OEC 504-4), husband-wife (OEC 505), clergy-penitent (OEC 506), counselor-client (OEC 507), stenographer-employer

3 A client has a privilege to refuse to disclose and to prevent any other person from disclosing confidential communications made for the purpose of facilitating the rendition of professional legal services to the client. A “confidential communication” is one that is “not intended to be disclosed to third persons other than those to whom disclosure is in furtherance of the rendition of professional legal services to the client or those reasonably necessary for the transmission of the communication.” Confidential communications include those (1) between the client or the client’s representative and the client’s lawyer or a representative of the lawyer, (2) between the client’s lawyer and the lawyer’s representative, (3) by the client or the client’s lawyer to a lawyer representing another in a matter of common interest, (4) between representatives of the client or between the client and a representative of a client, or (5) between lawyers representing the client. OEC 503.
(508A), public officer (OEC 509), disabled person-sign language interpreter (OEC 509-1), non-
English speaking person-interpreter (OEC 509-2), and informer (OEC 510).  

Clearly, if a lawyer learns in a privileged communication with a client that the client has
abused an elder, the lawyer is not required to report. What, however, of information protected
by one of the other privileges contained in ORS 40.225 to 40.295? Can ORS 419B.010(1) be read
to also exempt a lawyer from reporting information that is protected by any one of the other
thirteen privileges even if it was not, for some reason, covered by the attorney-client privilege?
For instance, what if the lawyer receives a report containing the client’s disclosure to a
psychotherapist that the client committed abuse, but the client has never made the disclosure
directly to the lawyer. Is the lawyer exempted from reporting the information because it is
protected by the psychotherapist-patient privilege? Or is the psychotherapist-patient privilege
lost when the report is delivered to the lawyer? The first question to ask in a situation such as
the foregoing is whether the information continues to be privileged; if so, there remains the
unanswered question of whether a lawyer is excepted from reporting information protected by
the other privileges.

Although the plain language of the statute suggests that lawyers, psychiatrists,
psychologists and clergy are excused from reporting information protected by all the statutory
privileges, there is no authority interpreting the scope of the privilege exception. Given that
absence of authority and the broad protective purpose behind the statute, prudence may
dictate a less expansive reading.

B. Information Detrimental to Client if Disclosed.

The second exception to mandatory reporting applies only to lawyers, and tracks to
some extent a lawyer’s ethical obligation to protect confidential client information. Lawyers are
prohibited by RPC 1.6(a) from revealing “information relating to the representation of a client.”
“Information relating to the representation of a client” is defined in RPC 1.0(f) as both

\[ \text{Also included is OEC 512, “privileged matter disclosed under compulsion or without}
\text{opportunity to claim privilege.”} \]
“information protected by the lawyer-client privilege under applicable law” and “other information gained in a current or former professional relationship that the client has requested be held inviolate or the disclosure of which would be embarrassing or would be likely to be detrimental to the client.”

Clearly then, “information relating to the representation” is not limited to information that is privileged because communicated by the client. Information protected under Oregon RPC 1.6 includes information learned from witnesses and other third parties as well as information imparted by the client that is, for some reason, not covered by the privilege. All that is required is that it be gained during the course of the professional relationship between the lawyer and the client, and either that the client has requested it be “held inviolate” or that it would be embarrassing or detrimental to the client if revealed.

In creating a statutory exception for only some of the information that would be protected by RPC 1.6, the legislature limited the reporting exception to information that would be detrimental (not merely embarrassing) to the client if disclosed. This appears to be the legislature’s way of reconciling the sanctity of the lawyer-client relationship with the interest of protecting elders from abuse. The legislature appears to have concluded that mere embarrassment to a client is not sufficient justification for the lawyer to ignore elder abuse.

C. Treatment by Spiritual Means Through Prayer.

This exception is not elaborated in case law or in regulation. Practitioners should note that it is very narrow. The treatment must be “voluntary”; beliefs of the caregiver are irrelevant to the determination of whether reporting is required. The treatment must be “through prayer.” It must be “in accordance with the tenets and practices of a recognized church or religious denomination” and conducted “by a duly accredited practitioner” of the church. Here as elsewhere, attorneys should err on the side of reporting and letting DHS evaluate the situation.

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5 These are the definitions, respectively, of “confidences” and “secrets” from former DR 4-101.
Question 7: What If Someone Expresses The Intent To Commit An Act Of Elder Abuse?

ORS 124.060 mandates reporting only when there is reasonable cause to believe that an elder “has suffered abuse” or that a person “has abused a person 65 years of age or older.” It does not require advance reporting of possible future abuse, except where the future abuse constitutes “verbal abuse” under ORS 124.050(1)(f). “Verbal abuse” is defined in regulation to include “threatening significant physical harm or threatening or causing significant emotional harm to an adult ... .” OAR 411-020-0002(1)(d)(A).

If the situation does not involve “verbal abuse” within the meaning of ORS 124.050(1)(f), reporting may still be possible. RPC 1.6(b)(1) permits a lawyer to reveal confidential information to the extent the lawyer reasonably believes necessary “to disclose the intention of the lawyer’s client to commit a crime and the information necessary to prevent the crime.” There is also no lawyer-client privilege under OEC 503(4)(a) “if the services of the lawyer were sought or obtained to enable or aid anyone to commit or plan to commit what the client knew or reasonably should have known to be a crime or fraud.” RPC 1.6(b)(2) permits a lawyer to reveal information otherwise protected to the extent the lawyer reasonably believes necessary “to prevent reasonably certain death or substantial bodily harm,” whether or not a crime is involved. When used in reference to degree or extent, “substantial” denotes “a material matter of clear and weighty importance.” RPC 1.0(o).

It is not clear that all incidents of elder abuse identified in the statute constitute crimes. A lawyer whose client has expressed a clear intention to commit elder abuse in the future should ascertain first whether the intended conduct is a crime or if it puts a person at risk of reasonably certain death or substantial bodily harm. If so, the lawyer may disclose information necessary to prevent the intended conduct.

A voluntary report of suspected future abuse that is not required under ORS 124.060 is subject to the same statutory confidentiality and immunity as a mandatory report. See ORS 124.075; ORS 124.085; ORS 124.090.
Question 8: Are Lawyers Obligated to Report Elder Abuse Occurring Outside Of Oregon?

While all states have adopted some form of elder abuse prevention laws, the laws are not uniform and lawyers are not mandatory reporters in all jurisdictions. Lawyers who are licensed in multiple jurisdictions should be attentive to the statutory requirements of each jurisdiction as well as to the interplay between those statutory requirements and the disciplinary rules to which the lawyer is subject.

The scope of Oregon’s mandatory elder abuse reporting law is not clear with respect to incidents occurring outside of Oregon or involving abusers and victims who are not residents of Oregon. Nothing in the statute can be read to limit reporting only to incidents occurring within the state. The language of the statute sweeps broadly to include “any person 65 years of age or older” who has been abused and “any person” who has abused an elder.

A lawyer who wishes to act most cautiously should make a report to DHS of the out-of-state incident and allow DHS to determine whether and how to deal with the information. Reporting in that circumstance does not violate any ethical responsibility of the lawyer or violate any right of the persons involved; moreover, it is consistent with the policy behind the DHS regulation that encourages encourage voluntary reporting. See OAR 411-020-0020(2).

Question 9: What Type Of Report Is Required And To Whom Must It Be Made?

The statute requires that “an oral report be made immediately by telephone or otherwise ....”6 ORS 124.065(1). Reports must be made to the local office of the Department of Human Services or a law enforcement agency within the county where the person making the report is located at the time of the contact. ORS 124.050(6) defines “law enforcement agency” to mean:

- a city or municipal police department,
- a county sheriff’s office,
- the Oregon State Police,
- a police department established by a university, or

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6 The statewide telephone number for reporting suspected abuse is 1-855-503-SAFE (7233).
• any district attorney.

The report must contain, if known:

• the names and addresses of the elderly person and any persons responsible for care of the elderly person,
• the nature and extent of the abuse, including any evidence of previous abuse,
• the explanation given for the abuse, and
• any other information that might be helpful in establishing the cause of the abuse and the identity of the perpetrator.

ORS 124.065(1).

When a report of a potential crime is received by DHS, it is required to notify law enforcement. ORS 124.065(2); see also ORS 124.065(3). When law enforcement receives a report of elder abuse, it is required to notify both DHS and the law enforcement agency having jurisdiction. ORS 124.065(4).

**Question 10: Are Elder Abuse Reports Confidential?**

Notwithstanding Oregon’s public records law, “the names of the public or private official or any other person who made the complaint, the witnesses and the elderly persons, and the reports and records compiled under the [elder abuse reporting law], are confidential and are not accessible for public inspection. ORS 124.090(1). DHS is required to make the reports available in some circumstances and permitted to do so in other circumstances. ORS 124.090(2). Recipients of records under DHS’s mandatory or permissive disclosure authority are also required to maintain the confidentiality of the records. ORS 124.090(3).

The confidentiality is not absolute, as a reporter may be required to testify in juvenile or criminal court proceedings relating to the report. In criminal proceedings, the alleged abuser’s constitutional right to confront witnesses would override the statutory confidentiality.

Confidentiality may be enhanced by reporting anonymously. While there is no requirement in the statute that the reporter identify him- or herself, it is also clear that the statute does not contemplate anonymous reporting, and it is likely not preferred by DHS. Law enforcement and DHS will accept anonymous reports. Because of the liability that can result
from not reporting, lawyers should weigh the desire for confidentiality with the possible need for proof that a report was in fact made as required.

**Question 11: What If I Am Wrong, And There Really Was No Abuse?**

A person who acts in good faith in making a report of elder abuse, and who has reasonable grounds for doing so, is immune from civil or criminal liability for making the report and for the content of the report. Reporters have the same immunity with respect to their participation in any judicial proceeding resulting from the report. ORS 124.075(1); see *also* *McDonald v. State of Oregon*, 71 Or App 751, 694 P2d 569 (1984) (negligence claim against teacher dismissed because plaintiffs failed to assert any facts to negate teacher’s good faith and reasonable grounds to report child abuse, notwithstanding the fact that the report was later determined to be unfounded).

The efficacy of the foregoing immunity provision may be open to question, based on the Oregon Supreme Court’s decision in *Smothers v. Gresham Transfer, Inc.*, 332 Or 83, 23 P3d 333 (2001). That case held that the exclusive remedy of the workers’ compensation statutes violated Article I, Section 10, of the Oregon Constitution, to the extent that it left the plaintiff without a remedy for an injury not compensable under the workers’ compensation system. Similarly, the immunity granted by ORS 124.075(1) may conflict with the arguable common-law right of an alleged abuser to sue the abuse reporter for defamation.

**Question 12: Are Lawyers Liable For Not Reporting Elder Abuse?**

As mentioned above, failure to report elder abuse when required under the statute is a Class A violation, punishable by a fine. The bar is aware of at least two cases in which a mandatory reporter (not a lawyer) was prosecuted for failing to report child abuse. In one case, the official informed the parents of the victim, who took immediate and apparently successful steps to protect her. The official also informed her supervisor. She was prosecuted for not reporting to DHS exactly as the statute required; she was eventually acquitted. In another case, a mother who was also a mandatory reporter was found to have violated her duty when she failed to immediately report the abuse of her own daughter. *See Dep’t of Human Servs. v. F.L.B.*, 255 Or App 709, 711–12, ___ P3d ___ (2013).
Civil liability is also a possibility. There are no reported cases in Oregon imposing liability on mandatory reporters for failure to report elder abuse, but at least one jury has rendered a verdict in favor of a plaintiff based in part on the defendant’s failure to report child abuse. See Shin v. Sunriver Prep. School, 199 Or App 352, 111 P3d 352 (2005). A statutory tort theory may provide the basis for liability because the mandatory reporting statute “imposes a duty to protect a specified group of persons.” Scovill v. City of Astoria, 324 Or 159, 172, 921 P2d 1312 (1996) (setting forth the statutory tort analysis in the context of the protective custody statute, ORS 430.399). In addition, the Court of Appeals has held that a child who had been sexually abused could state a claim for negligence against the Children’s Services Division (CSD) by alleging that CSD breached its statutory duty to investigate abuse allegations. Blachly v. Portland Police Dept., 135 Or App 109, 898 P2d 784 (1995).

**Question 13:** What Does the Law Require the Oregon State Bar to Do in Connection with Elder Abuse Reporting?

The bar is required to ensure that attorneys complete one hour of training every three years regarding their obligations under the mandatory elder abuse reporting law. ORS 9.114.

**Question 14:** Are Lawyers also Mandatory Reporters of Child Abuse?

Yes. The parameters are similar to the elder abuse reporting requirement. A lawyer must report child abuse when he or she has reasonable cause to believe child abuse has occurred, and the lawyer has had contact with the potential victim or the alleged abuser. ORS 419B.010(1). The threshold for reporting is low, and the scope of abuse encompassed within the law is broad. Additional information may be found in a separate Q&A sheet on child abuse reporting. An exception is provided for information acquired in a privileged context. See id.

**Question 15:** Are Lawyers Mandatory Reporters of Abuse in Other Contexts?

Yes. First, in certain contexts, lawyers must report suspected abuse of people with developmental disabilities or mental illness. ORS 430.765(1) provides, “Any public or private official who has reasonable cause to believe that any adult with whom the official comes in contact while acting in an official capacity, has suffered abuse, or that any person with whom
or cause a report to be made in the manner required in ORS 430.743.” The legislature has defined “public or private official” to include attorneys. ORS 430.735(12)(i). Under the statute, “Adult” means any person 18 years of age or older with “(a) A developmental disability who is currently receiving services from a community program or facility or was previously determined eligible for services as an adult by a community program or facility; or (b) A mental illness who is receiving services from a community program or facility.” ORS 430.735(2).

In addition, ORS 441.640 requires any public or private official to report abuse of a resident of a long-term care facility. The definition of “public or private official” in this section includes legal counsel for the resident, guardian or family member of the resident. ORS 441.630(6)(h). Long-term care facility means “a facility with permanent facilities that include inpatient beds, providing medical services, including nursing services but excluding surgical procedures except as may be permitted by the rules of the director, to provide treatment for two or more unrelated patients.” ORS 442.015(2).
Chapter 8—Mandatory Elder Abuse Reporting for Oregon Lawyers

APPENDIX A
OREGON REVISED STATUTES 2015
REPORTING OF ELDER ABUSE

124.050 Definitions for ORS 124.050 to 124.095. As used in ORS 124.050 to 124.095:
(1) “Abuse” means one or more of the following:
(a) Any physical injury to an elderly person caused by other than accidental means, or which appears to be at variance with the explanation given of the injury.
(b) Neglect.
(c) Abandonment, including desertion or willful forsaking of an elderly person or the withdrawal or neglect of duties and obligations owed an elderly person by a caretaker or other person.
(d) Willful infliction of physical pain or injury upon an elderly person.
(e) An act that constitutes a crime under ORS 163.375, 163.405, 163.411, 163.415, 163.425, 163.427, 163.465, 163.467 or 163.525.
(f) Verbal abuse.
(g) Financial exploitation.
(h) Sexual abuse.
(i) Involuntary seclusion of an elderly person for the convenience of a caregiver or to discipline the person.
(j) A wrongful use of a physical or chemical restraint of an elderly person, excluding an act of restraint prescribed by a physician licensed under ORS chapter 677 and any treatment activities that are consistent with an approved treatment plan or in connection with a court order.
(2) “Elderly person” means any person 65 years of age or older who is not subject to the provisions of ORS 441.640 to 441.665.
(3) “Facility” means:
(a) A long term care facility as that term is defined in ORS 442.015.
(b) A residential facility as that term is defined in ORS 443.400, including but not limited to an assisted living facility.
(c) An adult foster home as that term is defined in ORS 443.705.
(4) “Financial exploitation” means:
(a) Wrongfully taking the assets, funds or property belonging to or intended for the use of an elderly person or a person with a disability.
(b) Alarming an elderly person or a person with a disability by conveying a threat to wrongfully take or appropriate money or property of the person if the person would reasonably believe that the threat conveyed would be carried out.
(c) Misappropriating, misusing or transferring without authorization any money from any account held jointly or singly by an elderly person or a person with a disability.
(d) Failing to use the income or assets of an elderly person or a person with a disability effectively for the support and maintenance of the person.
(5) “Intimidation” means compelling or deterring conduct by threat.
(6) “Law enforcement agency” means:
(a) Any city or municipal police department.
(b) Any county sheriff’s office.
(c) The Oregon State Police.
(d) Any district attorney.
(e) A police department established by a university under ORS 352.121 or 353.125.
(7) “Neglect” means failure to provide basic care or services that are necessary to maintain the health or safety of an elderly person.
(8) “Person with a disability” means a person described in:
(a) ORS 410.040 (7); or
(b) ORS 410.715.
(9) “Public or private official” means:
(a) Physician or physician assistant
licensed under ORS chapter 677,
naturopathic physician or chiropractor,
including any intern or resident.
(b) Licensed practical nurse, registered
nurse, nurse practitioner, nurse’s aide,
home health aide or employee of an in-
home health service.
(c) Employee of the Department of
Human Services or community
developmental disabilities program.
(d) Employee of the Oregon Health
Authority, local health department or
community mental health program.
(e) Peace officer.
(f) Member of the clergy.
(g) Regulated social worker.
(h) Physical, speech or occupational
therapist.
(i) Senior center employee.
(j) Information and referral or outreach
worker.
(k) Licensed professional counselor or
licensed marriage and family therapist.
(L) Member of the Legislative Assembly.
(m) Firefighter or emergency medical
services provider.
(n) Psychologist.
(o) Provider of adult foster care or an
employee of the provider.
(p) Audiologist.
(q) Speech-language pathologist.
(r) Attorney.
(s) Dentist.
(t) Optometrist.
(u) Chiropractor.
(v) Personal support worker, as defined
by rule adopted by the Home Care
Commission.
(w) Home care worker, as defined in ORS
410.600.
(10) “Services” includes but is not
limited to the provision of food, clothing,
medicine, housing, medical services,
assistance with bathing or personal hygiene
or any other service essential to the well-
being of an elderly person.
(11)(a) “Sexual abuse” means:
(A) Sexual contact with an elderly person
who does not consent or is considered
incapable of consenting to a sexual act
under ORS 163.315;
(B) Verbal or physical harassment of a
sexual nature, including but not limited
to severe or pervasive exposure to sexually
explicit material or language;
(C) Sexual exploitation;
(D) Any sexual contact between an
employee of a facility or paid caregiver and
an elderly person served by the facility or
caregiver; or
(E) Any sexual contact that is achieved
through force, trickery, threat or coercion.
(b) “Sexual abuse” does not mean
consensual sexual contact between an
elderly person and:
(A) An employee of a facility who is also
the spouse of the elderly person; or
(B) A paid caregiver.
(12) “Sexual contact” has the meaning
given that term in ORS 163.305.
(13) “Verbal abuse” means to threaten
significant physical or emotional harm to an
elderly person or a person with a disability
through the use of:
(a) Derogatory or inappropriate names,
insults, verbal assaults, profanity or ridicule;
or
(b) Harassment, coercion, threats,
inimidation, humiliation, mental cruelty or
inappropriate sexual comments.

124.055 Policy. The Legislative Assembly
finds that for the purpose of preventing
abuse, safeguarding and enhancing the
welfare of elderly persons, it is necessary
and in the public interest to require
mandatory reports and investigations of allegedly abused elderly persons.

124.060 Duty of officials to report; exception. Any public or private official having reasonable cause to believe that any person 65 years of age or older with whom the official comes in contact has suffered abuse, or that any person with whom the official comes in contact has abused a person 65 years of age or older, shall report or cause a report to be made in the manner required in ORS 124.065. Nothing contained in ORS 40.225 to 40.295 affects the duty to report imposed by this section, except that a psychiatrist, psychologist, member of the clergy or attorney is not required to report such information communicated by a person if the communication is privileged under ORS 40.225 to 40.295. An attorney is not required to make a report under this section by reason of information communicated to the attorney in the course of representing a client if disclosure of the information would be detrimental to the client.

124.065 Method of reporting; content; notice to law enforcement agency and to department. (1) When a report is required under ORS 124.060, an oral report shall be made immediately by telephone or otherwise to the local office of the Department of Human Services or to a law enforcement agency within the county where the person making the report is at the time of contact. If known, such reports shall contain the names and addresses of the elderly person and any persons responsible for the care of the elderly person, the nature and the extent of the abuse (including any evidence of previous abuse), the explanation given for the abuse and any other information which the person making the report believes might be helpful in establishing the cause of the abuse and the identity of the perpetrator.

(2) When a report of a possible crime is received by the department under ORS 124.060, the department or the designee of the department shall notify the law enforcement agency having jurisdiction within the county where the report was made. If the department or the designee of the department is unable to gain access to the allegedly abused elderly person, the department or the designee of the department may contact the law enforcement agency for assistance and the agency shall provide assistance.

(3) If the department or the designee of the department determines that there is reason to believe a crime has been committed, the department or the designee of the department shall immediately notify the law enforcement agency having jurisdiction within the county where the report was made. The law enforcement agency shall confirm to the department or the designee of the department its receipt of the notification.

(4) When a report is received by a law enforcement agency, the agency shall immediately notify the law enforcement agency having jurisdiction if the receiving agency does not. The receiving agency shall also immediately notify the local office of the department in the county where the report was made.

124.070 Duty to investigate; notice to law enforcement agency and department; written findings; review by district attorney. (1) Upon receipt of the report required under ORS 124.060, the Department of Human Services or the law enforcement agency shall cause an investigation to be commenced promptly to determine the nature and cause of the abuse. The investigation shall include a visit
to the named elderly person and communication with those individuals having knowledge of the facts of the particular case. If the alleged abuse occurs in a residential facility, the department shall conduct an investigation regardless of whether the suspected abuser continues to be employed by the facility.

(2) If the department finds reasonable cause to believe that a crime has occurred, the department shall notify in writing the appropriate law enforcement agency. If the law enforcement agency conducting the investigation finds reasonable cause to believe that abuse has occurred, the agency shall notify the department in writing. Upon completion of the evaluation of each case, the department shall prepare written findings that include recommended action and a determination of whether protective services are needed.

(3) After receiving notification from the department that there is reasonable cause to believe that a crime has occurred, a law enforcement agency shall notify the department:

(a) That there will be no criminal investigation, including an explanation of why there will be no criminal investigation;

(b) That the investigative findings have been given to the district attorney for review; or

(c) That a criminal investigation will take place.

(4) If a law enforcement agency gives the findings of the department to the district attorney for review, the district attorney shall notify the department that the district attorney has received the findings and shall inform the department whether the findings have been received for review or for filing charges. A district attorney shall make the determination of whether to file charges within six months of receiving the findings of the department.

(5) If a district attorney files charges stemming from the findings of the department and the district attorney makes a determination not to proceed to trial, the district attorney shall notify the department of the determination and shall include information explaining the basis for the determination.

124.071 Deadline to complete abuse investigation; exception; written report required. (1) Investigations commenced by the Department of Human Services pursuant to ORS 124.070 must be completed by the department on or before 120 days after receipt of the report of abuse made under ORS 124.060, unless there is an ongoing concurrent criminal investigation, in which case the department may take a reasonable amount of additional time in which to complete the investigation.

(2) Upon completion of an investigation in accordance with subsection (1) of this section, a written report shall be prepared that includes information as required by rule adopted by the department, including but not limited to the following:

(a) The date and location of the report of abuse and of the incident of abuse that was reported;

(b) The dates that the investigation was commenced and completed and by what entity;

(c) A description of documents and records reviewed during the investigation;

(d) An identification of any witness statements that were obtained during the investigation; and

(e) A statement of the factual basis for any findings and a summary of the findings made as a result of the investigation.
124.072 Required disclosure of protected health information to law enforcement agency; liability for disclosure. (1) Upon notice by a law enforcement agency that an investigation into abuse is being conducted under ORS 124.070, and without the consent of the named elderly person or of the named elderly person’s caretaker, fiduciary or other legal representative, a health care provider must:

(a) Permit the law enforcement agency to inspect and copy, or otherwise obtain, protected health information of the named elderly person; and

(b) Upon request of the law enforcement agency, consult with the agency about the protected health information.

(2) A health care provider who in good faith discloses protected health information under this section is not civilly or criminally liable under state law for the disclosure.

(3) For purposes of this section:

(a) “Health care provider” has the meaning given that term in ORS 192.556.

(b) “Protected health information” has the meaning given that term in ORS 192.556.

124.073 Training for abuse investigators. (1) The Department of Human Services shall:

(a) Using new or existing materials, develop and implement a training and continuing education curriculum for persons other than law enforcement officers required by law to investigate allegations of abuse under ORS 124.070 or 441.650. The curriculum shall address the areas of training and education necessary to facilitate the skills required to investigate reports of abuse, including, but not limited to, risk assessment, investigatory technique, evidence gathering and report writing.

(b) Using new or existing materials, develop and implement training for persons that provide care to vulnerable persons to facilitate awareness of the dynamics of abuse, abuse prevention strategies and early detection of abuse.

(2) For purposes of this section, “vulnerable person” means a person 65 years of age or older.

124.075 Immunity of person making report in good faith; identity confidential.

(1) Anyone participating in good faith in the making of a report of elder abuse and who has reasonable grounds for making the report shall have immunity from any criminal or civil liability that might otherwise be incurred or imposed with respect to the making or content of such report. Any such participant shall have the same immunity with respect to participating in any judicial proceeding resulting from such report.

(2) The identity of the person making the report shall be treated as confidential information and shall be disclosed only with the consent of that person or by judicial process, or as required to perform the functions under ORS 124.070.

124.077 Immunity for disclosure to prospective employer. A person who has personal knowledge that an employee or former employee of the person was found by the Department of Human Services, a law enforcement agency or a court to have committed abuse under ORS 124.005 to 124.040, 124.050 to 124.095 or 124.100 to 124.140, is immune from civil liability for the disclosure to a prospective employer of the employee or former employee of known facts concerning the abuse.
124.080 Photographing of victim; photograph as record. (1) In carrying out its duties under ORS 124.070 a law enforcement agency or the Department of Human Services may photograph or cause to have photographed any victim who is the subject of the investigation for purposes of preserving evidence of the condition of the victim at the time of the investigation.  
(2) For purposes of ORS 124.090, photographs taken under authority of subsection (1) of this section shall be considered records.

124.085 Catalog of abuse records; confidentiality. A proper record of complaints made under ORS 124.060 and 124.065 shall be maintained by the Department of Human Services. The department shall prepare reports in writing when investigation has shown that the condition of the elderly person was the result of abuse even if the cause remains unknown. The complaints and investigative reports shall be cataloged under the name of the victim but shall be treated as confidential information subject to ORS 124.090, and shall be disclosed only with the consent of that person or by judicial process.

124.087 Policies and guidelines to plan for development and standardization of certain resources and technologies. The Department of Human Services shall adopt policies and guidelines to plan for the development and standardization of resources and technologies to:
(1) Create a database, registry or other electronic record of reports of abuse made under ORS 124.060 and 441.640 and investigations of abuse conducted pursuant to ORS 124.070 and 441.650 with information including, but not limited to:

(a) The date and location of the report of abuse and the incident of abuse that was reported;
(b) If applicable, the date that the initial status report required under ORS 441.650 was completed and a summary of the information required to be contained in the initial status report as set forth in ORS 441.650;
(c) The date that the investigation was commenced and by what entity;
(d) Any actions taken during the course of the investigation, including but not limited to the actions required under ORS 441.650 (6);
(e) The date that a written report, including but not limited to the written report required under ORS 124.071 and 441.650 (6), was completed and a summary of the information contained in the written report; and
(f) The disposition of the report of abuse or the investigation of the report, including but not limited to the date and time that the investigation, if applicable, was completed and the date that a letter of determination under ORS 441.677 was prepared;
(2) Standardize procedures and protocols for making and responding to reports of abuse made under ORS 124.060 and 441.640;
(3) Standardize procedures and protocols for investigations of reports of abuse conducted pursuant to ORS 124.070 and 441.650; and
(4) Promote and coordinate communication and information sharing with law enforcement agencies regarding reports and investigations of abuse under ORS 124.060, 124.070, 441.640 and 441.650.
124.090 Confidentiality of records; exceptions. (1) Notwithstanding the provisions of ORS 192.410 to 192.505, the names of the public or private official or any other person who made the complaint, the witnesses and the elderly persons, and the reports and records compiled under the provisions of ORS 124.050 to 124.095, are confidential and are not accessible for public inspection.

(2) Notwithstanding subsection (1) of this section, the Department of Human Services or the department’s designee may, if appropriate, make the names of the witnesses and the elderly persons, and the reports and records compiled under ORS 124.050 to 124.095, available to:

(a) A law enforcement agency;

(b) A public agency that licenses or certifies residential facilities or licenses or certifies the persons practicing in the facilities;

(c) A public agency or private nonprofit agency or organization providing protective services for the elderly person;

(d) The Long Term Care Ombudsman;

(e) A public agency that licenses or certifies a person that has abused or is alleged to have abused an elderly person;

(f) A court pursuant to a court order or as provided in ORS 125.012; and

(g) An administrative law judge in an administrative proceeding when necessary to provide protective services as defined in ORS 410.040 to an elderly person, when in the best interests of the elderly person or when necessary to investigate, prevent or treat abuse of an elderly person.

(3) Information made available under subsection (2) of this section, and the recipient of the information, are otherwise subject to the confidentiality provisions of ORS 124.050 to 124.095.

124.095 Spiritual treatment not abuse. An elderly person who in good faith is voluntarily under treatment solely by spiritual means through prayer in accordance with the tenets and practices of a recognized church or religious denomination by a duly accredited practitioner thereof shall, for this reason alone, not be considered subjected to abuse by reason of neglect under ORS 124.050 to 124.095.
APPENDIX B
OREGON REVISED STATUTES 2015
PRIVILEGES

40.225 Rule 503. Lawyer-client privilege. (1) As used in this section, unless the context requires otherwise:
(a) “Client” means a person, public officer, corporation, association or other organization or entity, either public or private, who is rendered professional legal services by a lawyer, or who consults a lawyer with a view to obtaining professional legal services from the lawyer.
(b) “Confidential communication” means a communication not intended to be disclosed to third persons other than those to whom disclosure is in furtherance of the rendition of professional legal services to the client or those reasonably necessary for the transmission of the communication.
(c) “Lawyer” means a person authorized, or reasonably believed by the client to be authorized, to practice law in any state or nation.
(d) “Representative of the client” means:
(A) A principal, an officer or a director of the client; or
(B) A person who has authority to obtain professional legal services, or to act on legal advice rendered, on behalf of the client, or a person who, for the purpose of effectuating legal representation for the client, makes or receives a confidential communication while acting in the person’s scope of employment for the client.
(e) “Representative of the lawyer” means one employed to assist the lawyer in the rendition of professional legal services, but does not include a physician making a physical or mental examination under ORCP 44.
(2) A client has a privilege to refuse to disclose and to prevent any other person from disclosing confidential communications made for the purpose of facilitating the rendition of professional legal services to the client:
(a) Between the client or the client’s representative and the client’s lawyer or a representative of the lawyer;
(b) Between the client’s lawyer and the lawyer’s representative;
(c) By the client or the client’s lawyer to a lawyer representing another in a matter of common interest;
(d) Between representatives of the client or between the client and a representative of the client; or
(e) Between lawyers representing the client.
(3) The privilege created by this section may be claimed by the client, a guardian or conservator of the client, the personal representative of a deceased client, or the successor, trustee, or similar representative of a corporation, association, or other organization, whether or not in existence. The person who was the lawyer or the lawyer’s representative at the time of the communication is presumed to have authority to claim the privilege but only on behalf of the client.
(4) There is no privilege under this section:
(a) If the services of the lawyer were sought or obtained to enable or aid anyone to commit or plan to commit what the client knew or reasonably should have known to be a crime or fraud;
(b) As to a communication relevant to an issue between parties who claim through the same deceased client, regardless of whether the claims are by testate or intestate succession or by inter vivos transaction;
(c) As to a communication relevant to an issue of breach of duty by the lawyer to the client or by the client to the lawyer;

(d) As to a communication relevant to an issue concerning an attested document to which the lawyer is an attesting witness; or

(e) As to a communication relevant to a matter of common interest between two or more clients if the communication was made by any of them to a lawyer retained or consulted in common, when offered in an action between any of the clients.

(5) Notwithstanding ORS 40.280, a privilege is maintained under this section for a communication made to the office of public defense services established under ORS 151.216 for the purpose of seeking preauthorization for or payment of nonroutine fees or expenses under ORS 135.055.

(6) Notwithstanding subsection (4)(c) of this section and ORS 40.280, a privilege is maintained under this section for a communication that is made to the office of public defense services established under ORS 151.216 for the purpose of making, or providing information regarding, a complaint against a lawyer providing public defense services.

(7) Notwithstanding ORS 40.280, a privilege is maintained under this section for a communication ordered to be disclosed under ORS 192.410 to 192.505.

40.252 Rule 504-5. Communications revealing intent to commit certain crimes.

(1) In addition to any other limitations on privilege that may be imposed by law, there is no privilege under ORS 40.225, 40.230, 40.250 or 40.264 for communications if:

(a) In the professional judgment of the person receiving the communications, the communications reveal that the declarant has a clear and serious intent at the time the communications are made to subsequently commit a crime involving physical injury, a threat to the physical safety of any person, sexual abuse or death or involving an act described in ORS 167.322;

(b) In the professional judgment of the person receiving the communications, the declarant poses a danger of committing the crime; and

(c) The person receiving the communications makes a report to another person based on the communications.

(2) The provisions of this section do not create a duty to report any communication to any person.

(3) A person who discloses a communication described in subsection (1) of this section, or fails to disclose a communication described in subsection (1) of this section, is not liable to any other person in a civil action for any damage or injury arising out of the disclosure or failure to disclose.
Chapter 8—Mandatory Elder Abuse Reporting for Oregon Lawyers

APPENDIX C
Selected Oregon Rules of Professional Conduct
(As amended, effective February 19, 2015)

Rule 1.0 Terminology

(f) “Information relating to the representation of a client” denotes both information protected by the attorney-client privilege under applicable law, and other information gained in a current or former professional relationship that the client has requested be held inviolate or the disclosure of which would be embarrassing or would be likely to be detrimental to the client.

Rule 1.6 Confidentiality of Information

(a) A lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation or the disclosure is permitted by paragraph (b).

(b) A lawyer may reveal information relating to the representation of a client to the extent the lawyer reasonably believes necessary:

(1) to disclose the intention of the lawyer’s client to commit a crime and the information necessary to prevent the crime;
(2) to prevent reasonably certain death or substantial bodily harm;
(3) to secure legal advice about the lawyer’s compliance with these Rules;
(4) to establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client, to establish a defense to a criminal charge or civil claim against the lawyer based upon conduct in which the client was involved, or to respond to allegations in any proceeding concerning the lawyer’s representation of the client;
(5) to comply with other law, court order, or as permitted by these Rules; or
(6) in connection with the sale of a law practice under Rule 1.17 or to detect and resolve conflicts of interest arising from the lawyer’s change of employment or from changes in the composition or ownership of a firm. In those circumstances, a lawyer may disclose with respect to each affected client the client’s identity, the identities of any adverse parties, the nature and extent of the legal services involved, and fee and payment information, but only if the information revealed would not compromise the attorney-client privilege or otherwise prejudice any of the clients. The lawyer or lawyers receiving the information shall have the same responsibilities as the disclosing lawyer to preserve the information regardless of the outcome of the contemplated transaction.

(7) to comply with the terms of a diversion agreement, probation, conditional reinstatement or conditional admission pursuant to BR 2.10, BR 6.2, BR 8.7or Rule for Admission Rule 6.15. A lawyer serving as a monitor of another lawyer on diversion, probation, conditional reinstatement or conditional admission shall have the same responsibilities as the monitored lawyer to preserve information relating to the representation of the monitored lawyer’s clients, except to the extent reasonably necessary to carry out the monitoring lawyer’s responsibilities under the terms of the diversion, probation, conditional
reinstatement or conditional admission and in any proceeding relating thereto.

(c) A lawyer shall make reasonable efforts to prevent the inadvertent or unauthorized disclosure of, or unauthorized access to, information relating to the representation of a client.
### Changes Due to Normal Aging and Potential for Abuse/Neglect

<table>
<thead>
<tr>
<th>Aging Process Changes</th>
<th>Normal Aging Outcomes</th>
<th>Implications For Potential Abuse</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Skin:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loss of skin thickness</td>
<td>Skin becomes paper thin</td>
<td>Immobilization and neglect may cause bedsores, skin infection, bruises, skin laceration (potential for physical abuse)</td>
</tr>
<tr>
<td>Atrophy of sweat glands and decreased blood flow</td>
<td>Decreased sweating, loss of skin water, dry skin</td>
<td></td>
</tr>
<tr>
<td>Increased wrinkles and laxity of skin</td>
<td></td>
<td></td>
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<tr>
<td><strong>Lung:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Decreased lung tissue elasticity</td>
<td>Reduced overall efficiency of gases exchanged</td>
<td>Immobilization and neglect may cause lung infection</td>
</tr>
<tr>
<td>Decreased respiratory muscle strength</td>
<td>Reduced ability to handle secretions and foreign particles</td>
<td>Decreased stamina may result in dependence and isolation</td>
</tr>
<tr>
<td><strong>Heart changes:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Heart valves thicken</td>
<td>Decreased blood flow</td>
<td>Potential for falls/injuries, physical and psychological abuse</td>
</tr>
<tr>
<td>Increased fatty deposits in artery wall</td>
<td>Decreased responsiveness to stress, confusion, and disorientation</td>
<td></td>
</tr>
<tr>
<td>Increased hardening, stiffening of blood vessels</td>
<td>Prone to loss of balance</td>
<td></td>
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<tr>
<td>Decreased sensitivity to change in blood pressure</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Gastric and intestinal:</strong></td>
<td>Altered ability to taste sweet, sour, salt and bitter</td>
<td>Mal/under nutrition</td>
</tr>
<tr>
<td>Atrophy and decreased number of taste buds</td>
<td>Possible delay in vitamin and drug absorption</td>
<td>Fecal impaction (potential physical abuse)</td>
</tr>
<tr>
<td>Decreased gastric secretion</td>
<td>Altered motility</td>
<td>Change in how medications are absorbed, resulting in possible over-medicating, resulting in falls, confusion, etc.</td>
</tr>
<tr>
<td>Decreased gastric muscle tone</td>
<td>Decreased peristalsis</td>
<td></td>
</tr>
</tbody>
</table>
### Aging Process Changes

<table>
<thead>
<tr>
<th>Bladder:</th>
<th>Normal Aging Outcomes</th>
<th>Implications For Potential Abuse</th>
</tr>
</thead>
<tbody>
<tr>
<td>Decreased bladder muscle tone and bladder capacity</td>
<td>Increased residual urine&lt;br&gt;Sensation of urge to urinate may not occur until bladder is full&lt;br&gt;Increased risk of infection, stress incontinence&lt;br&gt;Urination at night may increase&lt;br&gt;Enlarged prostate gland in male</td>
<td>Incontinence along with immobilization and neglect may cause skin breakdown and/or bedsores&lt;br&gt;Potential for falls and injuries when having to get up more at night&lt;br&gt;Incontinence is the single most predictive factor for abuse</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Muscles, joint, and bone:</th>
<th></th>
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</thead>
<tbody>
<tr>
<td>Decreased muscle mass&lt;br&gt;Deterioration of joint cartilage&lt;br&gt;Decreased bone mass&lt;br&gt;Decreased processing speed and vibration sense&lt;br&gt;Decreased nerve fibers</td>
<td>Increased residual urine&lt;br&gt;Sensation of urge to urinate may not occur until bladder is full&lt;br&gt;Increased risk of infection, stress incontinence&lt;br&gt;Urination at night may increase&lt;br&gt;Enlarged prostate gland in male</td>
<td><strong>Immobilization and neglect may cause contracture deformities (potential for physical and psychological abuse)</strong>&lt;br&gt;Increased potential for falls&lt;br&gt;More likely to fracture under less impact than a bone of a younger person&lt;br&gt;Less strength resulting in increased isolation and dependence on caregiver</td>
</tr>
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<tr>
<th>Sensory:</th>
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<tbody>
<tr>
<td>Changes in sleep-wake cycle&lt;br&gt;Slower stimulus identification and registration&lt;br&gt;Decreased visual acuity&lt;br&gt;Slower light and dark adaptation&lt;br&gt;Difficulty in adapting to lighting changes&lt;br&gt;Distorted depth perception&lt;br&gt;Impaired color vision&lt;br&gt;Changes in lens&lt;br&gt;Diminished tear secretion&lt;br&gt;Decreased tone discrimination&lt;br&gt;Decreased sensitivity to odors&lt;br&gt;Reduced tactile sensation</td>
<td>Increased or decreased time spent sleeping&lt;br&gt;Increased nighttime awakenings&lt;br&gt;Delayed reaction time&lt;br&gt;Prone to falls&lt;br&gt;Increased possibility of disorientation&lt;br&gt;Glare may pose an environmental hazard&lt;br&gt;Incorrect assessment of height of curbs and steps&lt;br&gt;Presbyopia (diminished ability to focus on near objects)&lt;br&gt;Presbycusis (high frequency sounds lost)&lt;br&gt;Less able to differentiate lower color tones e.g. blues, greens&lt;br&gt;Dullness and dryness of the eyes&lt;br&gt;Decreased ability to sense pressure, pain, temperature</td>
<td><strong>Neglect and social isolation (potential for financial abuse)</strong>&lt;br&gt;Falls, fractures, and injuries (potential for physical and psychological abuse)</td>
</tr>
</tbody>
</table>

<table>
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<tr>
<th>Immune system:</th>
<th></th>
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<tbody>
<tr>
<td>Decline in secretion of hormones&lt;br&gt;Impaired temperature regulation&lt;br&gt;Impaired immune reactivity&lt;br&gt;Decreased basal metabolic rate</td>
<td>Decreased resistance to certain stresses (burns, surgery, etc.)&lt;br&gt;Increased susceptibility and incidence of infection&lt;br&gt;Increased incidence of obesity</td>
<td><strong>Bedsores&lt;br&gt;Infections&lt;br&gt;Fractures&lt;br&gt;Isolation&lt;br&gt;Dependence</strong></td>
</tr>
<tr>
<td>Aging Process Changes</td>
<td>Normal Aging Outcomes</td>
<td>Implications For Potential Abuse</td>
</tr>
<tr>
<td>-----------------------</td>
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<td>----------------------------------</td>
</tr>
<tr>
<td><strong>Mental and cognitive:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Some cognitive and mental functions decline</td>
<td>Short-term memory declines but long-term recall is usually maintained</td>
<td>Potential for financial abuse and exploitation</td>
</tr>
<tr>
<td>Some cognitive skills including judgment, creativity, common sense, and breadth of knowledge and experience, are maintained or improved.</td>
<td>Difficulty understanding abstract content. Learning abilities change—older adults are more cautious in their responses; are capable of learning new things but their speed of processing information is slower.</td>
<td>Increased risk for self-neglect</td>
</tr>
<tr>
<td>Some cognitive skills, including abstraction, calculation, word frequency, verbal comprehension, and inductive reasoning, show slight or gradual decline.</td>
<td></td>
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</tr>
</tbody>
</table>

**Source:** California State University, Los Angeles, School of Social (2003). Adult Protective Services Worker Training for the California State University Department of Social Services
Mandatory Elder Abuse Reporting for Oregon Lawyers

Mark Johnson Roberts
Deputy General Counsel
Oregon State Bar

Amber A. Hollister, General Counsel

Oregon’s Changing Demographics

- Over 50,000 Oregonians turn 65 each year.
- Oregonians have 15 expected “healthy” years beyond age 65.
- About 600,000 people last year; about 900,000 in 2020.
- In 2030, an estimated 20 percent of Oregonians will be 65 or older.
Attorneys’ Abuse Reporting Duties

- ELDERS
- CHILDREN
- MENTAL ILLNESS/DEVELOPMENTAL DISABILITY
- LONG-TERM CARE RESIDENT

Elder Abuse Reporters

- Physicians, Dentists, Optometrists, Chiropractors, and Nurses
- Audiologists and Speech Pathologists
- Police Officers and Firefighters
- Department of Human Services and Oregon Health Authority Workers
- Owners and Employees of Adult Foster Care Facilities
- Clergy, Social Workers, Psychologists, Counselors, and Psychotherapists
- Physical, Speech and Occupational Therapists
- Senior Center Workers and Information and Referral or Outreach Workers
- Members of the Legislative Assembly
- Attorneys
Legislative Purpose

“The Legislative Assembly finds that for the purpose of preventing abuse, safeguarding and enhancing the welfare of elderly persons, it is necessary and in the public interest to require mandatory reports and investigations of allegedly abused elderly persons.”
ORS 124.055

Reported Abuse in Oregon

- 2014
  - Reports: Over 38,000
  - Almost 33,000 adults
  - Investigations: 18,185
  - More than half living in the community
  - Over 4,000 in licensed settings
  - Findings of abuse: 4,544 (4,208 victims)
Where does abuse occur?

- 66% at home
- 34% care facility

Your Elder Abuse Reporting Duty

You **must** report elder abuse if you have
- **Contact** with an Elder or an Abuser and
- **Reasonable Cause** to Believe that
- A person **65 or Older**
- Has Been **Abused**,

UNLESS an exception applies.

This duty exists 24 hours a day, 7 days a week.
Chapter 8—Mandatory Elder Abuse Reporting for Oregon Lawyers

What is Abuse?

- **Wrongfully taking** the property of an elderly person
- **Alarming** an elderly person by a threat to take property
- **Misappropriating** money from any account (EVEN JOINT)
- **Failing to use income or assets effectively** for support and maintenance of person

*“including, but not limited to, deceit, trickery, subterfuge, coercion, harassment, duress, fraud, or undue influence” (OAR 411-020-0002(1)(e))*
Abandonment or Neglect

- Desertion for any period of time
- Failure to provide basic care or services
- May be active or passive (OAR 411-020-0002(1)(b)(A)(i))
- Religious exception, ORS 124.095

Verbal Abuse

- Threat of significant harm
- Derogatory or inappropriate names, insults, verbal assaults, profanity, ridicule
- Harassment, coercion, threats, intimidation, humiliation, mental cruelty, inappropriate sexual comments
- Victim’s comprehension immaterial (OAR 411-020-0002(1)(d)(B)(i))
Physical Abuse

- Physical injury caused by other than accidental means, or apparently inconsistent with the explanation given for it.
- Willful infliction of physical pain or injury
- Includes force-feeding and all physical punishments (OAR 411-020-0002(1)(a)(B)(ii))
- Presumed to injure the non-responsive (OAR 411-020-0002(1)(a)(C))

Sexual Abuse

- Enumerated sex crimes
- Sexual contact without consent
- Sexual harassment
- Sexual exploitation
- Sexual contact with (non-spouse) employee of a paid facility or caregiver
- BUT NOT with the paid caregiver themselves
Chapter 8—Mandatory Elder Abuse Reporting for Oregon Lawyers

Seclusion & Restraint

- Involuntary seclusion for convenience or discipline
- Wrongful use of a physical or chemical restraint

Warning Signs

- Unexplained injury or one that doesn’t fit the explanation given for it
- Elder not permitted to speak for themselves or without the presence of others.
- Being extremely withdrawn and non-communicative or non-responsive.
- Unpaid bills, overdue rent, utility shut-off notices
Chapter 8—Mandatory Elder Abuse Reporting for Oregon Lawyers

2014 Substantiated Abuse

Reasonable Cause
What is Reasonable Cause?

- Any reasonable suspicion of abuse should be reported.
- Reasonable suspicion is more than a hunch.
- It requires an ability to point to articulable facts based on the totality of the circumstances.
- Your obligation to report does not depend upon whether abuse actually occurred.

Contact
What is Contact?

- A touching or meeting; association or relationship
- Need not be linked to abuse BUT there must be physical or associational contact
- Receiving information in a public meeting about someone is not sufficient (AG opinion)
- Telephone or email contact?
- Can be before or after the abuse or the disclosure

Exceptions to Reporting
Chapter 8—Mandatory Elder Abuse Reporting for Oregon Lawyers

Exceptions: Certain Client Confidences

- **Attorney-Client Privileged** under ORS 40.225 (OEC 503)
- Information communicated during representation that is detrimental to client if disclosed (reconciles RPC 1.6 duty)

Reporting Required or Allowed?

<table>
<thead>
<tr>
<th>RPC 1.6(A) REQUIRES LAWYERS TO PRESERVE CONFIDENCES</th>
<th>RPC 1.6(A),(B) ALLOW LAWYERS TO REVEAL CONFIDENCES IF</th>
</tr>
</thead>
<tbody>
<tr>
<td>✓ Attorney-client privileged information AND</td>
<td>✓ Client consents;</td>
</tr>
<tr>
<td>✓ Other information gained during course of</td>
<td>✓ Impliedly authorized to carry out the representation;</td>
</tr>
<tr>
<td>representation IF</td>
<td>✓ Client intends to commit future crime; or</td>
</tr>
<tr>
<td>✓ Client requests to keep secret;</td>
<td>✓ To prevent reasonably certain death or substantial</td>
</tr>
<tr>
<td>✓ Embarrassing if disclosed; or</td>
<td>body harm.</td>
</tr>
<tr>
<td>✓ Likely detrimental to client if disclosed.</td>
<td></td>
</tr>
</tbody>
</table>
## To Report or Not to Report?

<table>
<thead>
<tr>
<th>MUST REPORT</th>
<th>MUST NOT REPORT</th>
<th>MAY REPORT</th>
</tr>
</thead>
</table>
| If you have reasonable cause to believe that elder abuse has occurred and you have had contact with elder or abuser  
AND the information on which you would base your report is (1) not attorney-client privileged and (2) if otherwise confidential under RPC 1.6, would not be detrimental to client if disclosed. | If you have reasonable cause to believe that elder abuse has occurred and you have had contact with elder or abuser  
BUT the information on which you would base your report is either (1) attorney-client privileged (ORS 40.225), or (2) is confidential under RPC 1.6 and would be detrimental to your client if disclosed. | If you have reasonable grounds to believe that elder abuse has occurred, you report in good faith,  
AND the information is confidential under RPC 1.6  
BUT your client consents, or reporting is necessary to prevent reasonably certain death or substantial bodily harm or to prevent client’s future crime. RPC 1.6. |

### Exception: Spiritual Treatment

- Voluntary
- Through prayer
- Recognized church
- Duly accredited practitioner
How to Report

- Immediately = without delay
- To DHS or law enforcement
- Oral report required
- Give as much as information as possible
- Explain allegation of abuse

**Reporting Hotline:**

1-855-503-SAFE

or call DHS Branch Offices
Chapter 8—Mandatory Elder Abuse Reporting for Oregon Lawyers

Report Should Include ...

- Names and addresses
- Nature and extent of abuse
- Explanation given for the abuse
- Cause of abuse and identity of perpetrator.

Behind the Scenes

- Screening
- Investigation and Evaluation (Substantiated, Unsubstantiated, Inconclusive)
- Follow up with Reporter
- Possible Law Enforcement Involvement
Community-Based Complaint Outcomes (2013) (~8000 complaints)

<table>
<thead>
<tr>
<th>2013 Outcomes</th>
<th>Incidence</th>
</tr>
</thead>
<tbody>
<tr>
<td>Risk reduced</td>
<td>673</td>
</tr>
<tr>
<td>Victim declined intervention</td>
<td>442</td>
</tr>
<tr>
<td>Issue resolved</td>
<td>429</td>
</tr>
<tr>
<td>Referred to District Attorney</td>
<td>369</td>
</tr>
<tr>
<td>Accepted services</td>
<td>235</td>
</tr>
<tr>
<td>Entered care setting</td>
<td>223</td>
</tr>
<tr>
<td>Guardian / Conservator appointed</td>
<td>112</td>
</tr>
<tr>
<td>Victim deceased</td>
<td>56</td>
</tr>
<tr>
<td>Moved out of the area</td>
<td>42</td>
</tr>
<tr>
<td>Services not available</td>
<td>35</td>
</tr>
</tbody>
</table>

Immunity & Anonymity

**Immunity**
- Report made in good faith
- Reasonable grounds

**Anonymity**
- Anonymous reports accepted but not preferred
Consequences

- Class A violation (fine)
- Failure to perform duties of office
- Tort liability
- Not generally an ethics violation

Hypothetical No. 1

You are representing Pat, a 69 year old woman, in a dissolution. You notice that there are large withdrawals from Pat’s savings account. Pat explains that her niece Jane has been taking care of her for the past year, and that she writes Jane regular checks to help pay for groceries. The checks total $30,000. You share this information with Pat and she is shocked that the number is so high. You know that Pat has been experiencing some mild dementia and is under the care of a doctor. Pat is adamant that she loves Jane and doesn’t want to do anything about it. Do you have a duty to report elder abuse?
Hypothetical No. 2

At a hot yoga class, your yoga buddy Sam mentions that she is worried about her 71-year-old mother, Sally. Sam explains that Sally is at home recovering from a knee replacement. Sam visited Sally yesterday and she had not bathed for two weeks and complained she had missed several doctor’s appointments. Sam’s sister, Amanda, is being paid about $750 a month by the state to take care of Sally, but Sam thinks Amanda may be using the money to improve her shoe collection. You remember meeting Sally at a yin yoga class a few months ago, prior to her surgery. Do you have a duty to report?

Hypothetical No. 3

Your neighbor Jack approaches you while you are raking leaves on a beautiful fall day. Jack is concerned that his brothers are bilking his father John for free vacations and new cars. Jack explains that his father has been despondent after the death of his wife of 50 years, and seems to have lost all of his zest for life. Jack says he is upset because he feels like his family is taking advantage of his father when he is mired in grief. Do you have a duty to report elder abuse?
Chapter 8—Mandatory Elder Abuse Reporting for Oregon Lawyers

Mark Johnson Roberts  
Deputy General Counsel  
Oregon State Bar  
503.431.6363  
1.800.452.8260 x 363  
mjroberts@osbar.org
Chapter 9

Legal Ethics for Business Lawyers

Nellie Barnard
Holland & Knight LLP
Portland, Oregon

Dayna Underhill
Holland & Knight LLP
Portland, Oregon

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Legal Ethics for Business Lawyers

Know Your Client -- Keep Your License
November 18, 2016
Portland, OR

Dayna E. Underhill
Nellie Q. Barnard

Today's Agenda

» Who is the Client?
» Conflicts (always worth talking about!)
» Entity Representation
» Joint Representation
Who is the Client?

Why is Client Identification Critical?

» Conflicts of Interest
» Confidentiality
Chapter 9—Legal Ethics for Business Lawyers

Who is the Client?

» Attorney-client relationship defined as:
  – A subjective belief that you are his/her lawyer
  – And that belief must be objectively reasonable

» Be vigilant to avoid unintended clients:
  – Non-engagement letters/emails
  – Updated notices when circumstances change
  – Avoid giving even benign advice to non-client.

So...Who is the Client?

» Closely held corporations

» Parent, sub and sibling
  – Look for control and legal decision making

» Successor entities – still your client/former client?
  – Were the liabilities transferred?
  – Was the property an identified asset?
  – Transaction exclusions
What is the Scope of Representation?

» Find out – ask the client!

» Detail the matter that you were retained for to avoid being trapped into doing more.

» Explain the scope of representation clearly: advice, negotiation, litigation, or appeal.

» Limit the scope, with the clients’ written consent, to mitigate future conflicts of interest.

Business Versus Legal Advice

» Lawyers often give business as well as legal advice, and clients often come to them for it

» No defense that a license to practice law doesn’t include a license to give business advice

» If business advice is given, it can’t be negligent

» Like any other kind of advice, business advice must be qualified or limited

» If the client needs other advisers, say so

» If the client has other advisors, document their involvement

» (This ties back to question of client sophistication)
Conflicts

Why Should We Care About Conflicts?

» Discipline
» Disqualification
» Tort Liability
» Fee Disgorgement
» Replacement Counsel
» Very Unhappy Management
Conflicts (RPC 1.7)

- RPC 1.7
- Except as provided in paragraph (b), a lawyer shall not represent a client if the representation involves a current conflict of interest. A current conflict of interest exists if:
  1. the representation of one client will be directly adverse to another client;
  2. there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer.

Former Client Conflicts (RPC 1.9)

A lawyer who has formerly represented a client in a matter must not afterwards:

A. represent another person in the same or a substantially related matter in which that person's interests are materially adverse to the interests of the former client unless the former client gives informed consent;

B. use information relating to the representation to the disadvantage of the former client except as these rules would permit or require with respect to a client or when the information has become generally known; or

C. reveal information relating to the representation except as these rules would permit or require with respect to a client.
Conflicts – The High Points

» Representation of one client in any matter adverse to another client of the firm
  – Relationship between the matters is irrelevant
» The Three Musketeers rule
» Former clients always, waivable
» Business and ethical considerations

Waivers

» What is a valid waiver?
» Consent after full disclosure confirmed in writing…and some other details
» Materiality: “If I put it in, they may not sign”
» Consider not only how you see things now but how someone else may see things later.
Joint Representation

» What are the risks?
   - Conflicts
   - Breaches of confidentiality
   - Loss of ACP protection
   - Breaches of fiduciary duties
Essential Elements of Joint Representation

» No advocacy as between them
» No confidentiality
» Confirm that the clients’ interests are presently aligned and unlikely to diverge
» Explain how you will handle disputes between clients
» Warn that the clients’ communications with you are not confidential or privileged with respect to each other
» Consider an advance waiver for the inevitable disagreement later

Entity Representation
Entity Representation – RPC 1.13

a) A lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents.

f) In dealing with an organization’s directors, officers, employees, members, shareholders or other constituents, a lawyer shall explain the identity of the client when the lawyer knows or reasonably should know that the organization’s interests are adverse to those of the constituents with whom the lawyer is dealing.

Who’s in Charge Around Here?

» When an attorney represents the entity, the attorney takes orders from the organization.
» Such direction will usually come from the Board of Directors, who manage the business affairs of the organization.
» The organization may choose to have an individual or group separate from the full board make such decisions. Such designation should be set out pursuant to the company governance and should be made clear to the lawyer.
» Managing internal strife:
  – Do not take sides.
  – Take direction from authorized actor only and seek confirmation of authority if needed.
  – If there is an impasse, that is the company’s problem to resolve. Do not act without authority.
  – Occasionally, the impasse creates a conflict, and the lawyer must withdraw. This is better than being named in a later shareholder dispute.
RPC 1.13(b) – Organization as Client

» Up the ladder reporting obligation:
  – If a lawyer for an organization knows that an officer, employee or other person associated with the organization is engaged in action, intends to act or refuses to act in a matter related to the representation that is a violation of a legal obligation to the organization, or a violation of law which reasonably might be imputed to the organization, and that is likely to result in substantial injury to the organization, then the lawyer shall proceed as is reasonably necessary in the best interest of the organization.
  – Unless the lawyer reasonably believes that it is not necessary in the best interest of the organization to do so, the lawyer shall refer the matter to higher authority in the organization, including, if warranted by the circumstances, referral to the highest authority that can act on behalf of the organization as determined by applicable law.

HYPO: Scope Limitations and Conflicts Avoidance

» You represent ABC Corp. A, B, and C are shareholders of ABC Corp. A and B are passive owners, and C is President/CEO. You take orders from C.
» Bigco offers to purchase ABC Corp. C wants an employment contract or a buyout of his non-compete. Bigco offers $X, so anything paid to C for salary or non-compete comes out of per share price.
» In a meeting with A, B, and C, C asks for your advice on this.
» Is this within the scope of your ABC Corp. representation?
» If not, can you advise C and under what circumstances?
  – Potential use of “conflicts counsel” or equivalent
  – Waivers? Waivable?
Document, Document, Document!!

» Engagement letters and conflict waivers
  – Identify the client
  – Define the scope of representation
  – Explain how conflicts will be handled
  – Obtain waivers if necessary

» Non-engagement letters – avoiding the accidental client
  – Disclaim attorney-client relationship
  – Do not give legal advice
  – Maintain confidentiality

Questions?

Holland & Knight
Thank you!

Dayna E. Underhill  
Holland & Knight  
2300 U.S. Bancorp Tower  
111 S.W. Fifth Avenue  
Portland, OR 97204  
503.243.5891  
Dayna.Underhill@hklaw.com

Nellie Q. Barnard  
Holland & Knight  
2300 U.S. Bancorp Tower  
111 S.W. Fifth Avenue  
Portland, OR 97204  
503.243.5892  
Nellie.Barnard@hklaw.com
Oregon Rules of Professional Conduct

RULE 1.7 CONFLICT OF INTEREST: CURRENT CLIENTS

(a) Except as provided in paragraph (b), a lawyer shall not represent a client if the representation involves a current conflict of interest. A current conflict of interest exists if:

(1) the representation of one client will be directly adverse to another client;

(2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer; or

(3) the lawyer is related to another lawyer, as parent, child, sibling, spouse or domestic partner, in a matter adverse to a person whom the lawyer knows is represented by the other lawyer in the same matter.

(b) Notwithstanding the existence of a current conflict of interest under paragraph (a), a lawyer may represent a client if:

(1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;

(2) the representation is not prohibited by law;

(3) the representation does not obligate the lawyer to contend for something on behalf of one client that the lawyer has a duty to oppose on behalf of another client; and

(4) each affected client gives informed consent, confirmed in writing.

Adopted 01/01/05

Defined Terms (see Rule 1.0):
“Believes”
“Confirmed in writing”
“Informed consent”
“Knows”
“Matter”
“Reasonably believes”

Comparison to Oregon Code
The current conflicts of interest prohibited in paragraph (a) are the self-interest conflicts currently prohibited by DR 5-101(A) and current client conflicts prohibited by DR 5-105(E). Paragraph (a)(2) refers only to a “personal interest” of a lawyer, rather than the specific “financial, business, property or personal interests” enumerated in DR 5-101(A)(1). Paragraph (a)(3) incorporates the “family conflicts” from DR 5-101(A)(2).
Paragraph (b) parallels DR 5-101(A) and DR 5-105(F) in permitting a representation otherwise prohibited if the affected clients give informed consent, which must be confirmed in writing. Paragraph (b)(3) incorporates the “actual conflict” definition of DR 5-105(A)(1) to make it clear that a lawyer cannot provide competent and diligent representation to clients in that situation. Paragraph (b) also allows consent to simultaneous representation “not prohibited by law,” which has no counterpart in the Oregon Code. According to the official Comment to MR 1.7 this would
apply, for instance, in jurisdictions that prohibit a lawyer from representing more than one defendant in a capital case, to certain representations by former government lawyers, or when local law prohibits a government client from consenting to a conflict of interest.

Comparison to ABA Model Rule
This is essentially identical to the ABA Model Rule, except for the addition of paragraphs (a)(3) and (b)(3) discussed above; also, the Model Rule uses the term “concurrent” rather than “current.” The Model Rule allows the clients to consent to a concurrent conflict if “the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal.”
RULE 1.8 CONFLICT OF INTEREST: CURRENT CLIENTS: SPECIFIC RULES

(a) A lawyer shall not enter into a business transaction with a client or knowingly acquire an ownership, possessory, security or other pecuniary interest adverse to a client unless:

(1) the transaction and terms on which the lawyer acquires the interest are fair and reasonable to the client and are fully disclosed and transmitted in writing in a manner that can be reasonably understood by the client;

(2) the client is advised in writing of the desirability of seeking and is given a reasonable opportunity to seek the advice of independent legal counsel on the transaction; and

(3) the client gives informed consent, in a writing signed by the client, to the essential terms of the transaction and the lawyer's role in the transaction, including whether the lawyer is representing the client in the transaction.

(b) A lawyer shall not use information relating to representation of a client to the disadvantage of the client unless the client gives informed consent, confirmed in writing, except as permitted or required under these Rules.

(c) A lawyer shall not solicit any substantial gift from a client, including a testamentary gift, or prepare on behalf of a client an instrument giving the lawyer or a person related to the lawyer any substantial gift, unless the lawyer or other recipient of the gift is related to the client. For purposes of this paragraph, related persons include a spouse, domestic partner, child, grandchild, parent, grandparent, or other relative or individual with whom the lawyer or the client maintains a close familial relationship.

(d) Prior to the conclusion of representation of a client, a lawyer shall not make or negotiate an agreement giving the lawyer literary or media rights to a portrayal or account based in substantial part on information relating to the representation.

(e) A lawyer shall not provide financial assistance to a client in connection with pending or contemplated litigation, except that:

(1) a lawyer may advance court costs and expenses of litigation, the repayment of which may be contingent on the outcome of the matter; and

(2) a lawyer representing an indigent client may pay court costs and expenses of litigation on behalf of the client.

(f) A lawyer shall not accept compensation for representing a client from one other than the client unless:

(1) the client gives informed consent;

(2) there is no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship; and

(3) information related to the representation of a client is protected as required by Rule 1.6.

(g) A lawyer who represents two or more clients shall not participate in making an aggregate settlement of the claims of or against the clients, or in a criminal case an aggregate agreement as to guilty or nolo contendere pleas, unless each client gives informed consent, in a writing signed
by the client. The lawyer's disclosure shall include the existence and nature of all the claims or pleas involved and of the participation of each person in the settlement.

(h) A lawyer shall not:

(1) make an agreement prospectively limiting the lawyer's liability to a client for malpractice unless the client is independently represented in making the agreement;

(2) settle a claim or potential claim for such liability with an unrepresented client or former client unless that person is advised in writing of the desirability of seeking and is given a reasonable opportunity to seek the advice of independent legal counsel in connection therewith;

(3) enter into any agreement with a client regarding arbitration of malpractice claims without informed consent, in a writing signed by the client; or

(4) enter into an agreement with a client or former client limiting or purporting to limit the right of the client or former client to file or to pursue any complaint before the Oregon State Bar.

(i) A lawyer shall not acquire a proprietary interest in the cause of action or subject matter of litigation the lawyer is conducting for a client, except that the lawyer may:

(1) acquire a lien authorized by law to secure the lawyer's fee or expenses; and

(2) contract with a client for a reasonable contingent fee in a civil case.

(j) A lawyer shall not have sexual relations with a current client of the lawyer unless a consensual sexual relationship existed between them before the client-lawyer relationship commenced; or have sexual relations with a representative of a current client of the lawyer if the sexual relations would, or would likely, damage or prejudice the client in the representation. For purposes of this rule:

(1) "sexual relations" means sexual intercourse or any touching of the sexual or other intimate parts of a person or causing such person to touch the sexual or other intimate parts of the lawyer for the purpose of arousing or gratifying the sexual desire of either party; and

(2) "lawyer" means any lawyer who assists in the representation of the client, but does not include other firm members who provide no such assistance.

(k) While lawyers are associated in a firm, a prohibition in the foregoing paragraphs (a) through (i) that applies to any one of them shall apply to all of them.

Adopted 01/01/05
Amended 01/01/13: Paragraph (e) amended to mirror ABA Model Rule 1.8(e).

Defined Terms (see Rule 1.0):
“Confirmed in writing”
“Information relating to the representation of a client”
“Informed consent”
“Firm”
“Knowingly”
“Matter”
“Reasonable”
“Reasonably”
“Substantial”
“Writing”

**Comparison to Oregon Code**

This rule has no exact counterpart in the Oregon Code, although it incorporates prohibitions found in several separate disciplinary rules.

Paragraph (a) replaces DR 5-104(A) and incorporates the Model Rule prohibition against business transactions with clients even with consent except where the transaction is “fair and reasonable” to the client. It also includes an express requirement to disclose the lawyer’s role and whether the lawyer is representing the client in the transaction.

Paragraph (b) is virtually identical to DR 4-101(B).

Paragraph (c) isminated to DR 5-101(B), but broader because it prohibits soliciting a gift as well as preparing the instrument. It also has a more inclusive list of “related persons.”

Paragraph (d) is identical to DR 5-104(B).

Paragraph (e) incorporates ABA Model Rule 1.8(e).

Paragraph (f) replaces DR 5-108(A) and (B) and is essentially the same as it relates to accepting payment from someone other than the client. This rule is somewhat narrower than DR 5-108(B), which prohibits allowing influence from someone who “recommends, employs or pays” the lawyer.

Paragraph (g) is virtually identical to DR 5-107(A).

Paragraph (h)(1) and (2) are similar to DR 6-102(A), but do not include the “unless permitted by law” language. Paragraph (h)(3) retains DR 6-102(B), but substitutes “informed consent, in a writing signed by the client” for “full disclosure.” Paragraph (h)(4) is new and was taken from Illinois Rule of Professional Conduct 1.8(h).

Paragraph (i) is essentially the same as DR 5-103(A).

Paragraph (j) retains DR 5-110, reformatted to conform to the structure of the rule.

Paragraph (k) applies the same vicarious disqualification to these personal conflicts as provided in DR 5-105(G).

**Comparison to ABA Model Rule**

This rule is identical to ABA Model Rule 1.8 with the following exceptions. MR 1.8 (b) does not require that the client’s informed consent be confirmed in writing as required in DR 4-101(B). MR 1.8 (h) does not prohibit agreements to arbitrate malpractice claims. MR 1.8 (j) does not address sexual relations with representatives of corporate clients and does not contain definitions of terms.
RULE 1.9 DUTIES TO FORMER CLIENTS

(a) A lawyer who has formerly represented a client in a matter shall not thereafter represent another person in the same or a substantially related matter in which that person's interests are materially adverse to the interests of the former client unless each affected client gives informed consent, confirmed in writing.

(b) A lawyer shall not knowingly represent a person in the same or a substantially related matter in which a firm with which the lawyer formerly was associated had previously represented a client:

   (1) whose interests are materially adverse to that person; and
   (2) about whom the lawyer had acquired information protected by Rules 1.6 and 1.9(c) that is material to the matter, unless each affected client gives informed consent, confirmed in writing.

(c) A lawyer who has formerly represented a client in a matter or whose present or former firm has formerly represented a client in a matter shall not thereafter:

   (1) use information relating to the representation to the disadvantage of the former client except as these Rules would permit or require with respect to a client, or when the information has become generally known; or
   (2) reveal information relating to the representation except as these Rules would permit or require with respect to a client.

(d) For purposes of this rule, matters are “substantially related” if (1) the lawyer’s representation of the current client will injure or damage the former client in connection with the same transaction or legal dispute in which the lawyer previously represented the former client; or (2) there is a substantial risk that confidential factual information as would normally have been obtained in the prior representation of the former client would materially advance the current client’s position in the subsequent matter.

Adopted 01/01/05
Amended 12/01/06: Paragraph (d) added.

Defined Terms (see Rule 1.0):
“Confirmed in writing”
“Informed consent”
“Firm”
“Knowingly”
“Known”
“Matter”
“Reasonable”
“Substantial”

Comparison to Oregon Code
This rule replaces DR 5-105(C), (D) and (H). Like Rule 1.7, this rule is a significant departure from the language and structure of the Oregon Code provisions on conflicts. Paragraph (a) replaces the sometimes confusing reference to “actual or likely conflict” between current and former client with the simpler “interests [that are] materially adverse.” The prohibition applies...
Paragraph (b) replaces the limitation of DR 5-105(H), but is an arguably clearer expression of the prohibition. The new language makes it clear that a lawyer who moves to a new firm is prohibited from being adverse to a client of the lawyer’s former firm only if the lawyer has acquired confidential information material to the matter while at the former firm.
Paragraph (c) makes clear that the duty not to use confidential information to the client’s disadvantage continues after the conclusion of the representation, except where the information “has become generally known.”
Paragraph (d) defines “substantially related.” The definition is taken in part from former DR 5-105(D) and in part from Comment [3] to ABA Model Rule 1.9.

**Comparison to ABA Model Rule**
ABA Model Rule 1.9(a) and (b) require consent only of the former client. The Model Rule also has no definition of “substantially related;” this definition was derived in part from the Comment to MR 1.9.
RULE 1.13 ORGANIZATION AS CLIENT

(a) A lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents.

(b) If a lawyer for an organization knows that an officer, employee or other person associated with the organization is engaged in action, intends to act or refuses to act in a matter related to the representation that is a violation of a legal obligation to the organization, or a violation of law which reasonably might be imputed to the organization, and that is likely to result in substantial injury to the organization, then the lawyer shall proceed as is reasonably necessary in the best interest of the organization. Unless the lawyer reasonably believes that it is not necessary in the best interest of the organization to do so, the lawyer shall refer the matter to higher authority in the organization, including, if warranted by the circumstances, referral to the highest authority that can act on behalf of the organization as determined by applicable law.

(c) Except as provided in paragraph (d), if

(1) despite the lawyer's efforts in accordance with paragraph (b) the highest authority that can act on behalf of the organization insists upon or fails to address in a timely and appropriate manner an action or a refusal to act, that is clearly a violation of law, and

(2) the lawyer reasonably believes that the violation is reasonably certain to result in substantial injury to the organization, then the lawyer may reveal information relating to the representation whether or not Rule 1.6 permits such disclosure, but only if and to the extent the lawyer reasonably believes necessary to prevent substantial injury to the organization.

(d) Paragraph (c) shall not apply with respect to information relating to a lawyer’s representation of an organization to investigate an alleged violation of law, or to defend the organization or an officer, employee or other constituent associated with the organization against a claim arising out of an alleged violation of law.

(e) A lawyer who reasonably believes that he or she has been discharged because of the lawyer’s actions taken pursuant to paragraphs (b) or (c), or who withdraws under circumstances that require or permit the lawyer to take action under either of those paragraphs, shall proceed as the lawyer reasonably believes necessary to assure that the organization’s highest authority is informed of the lawyer’s discharge or withdrawal.

(f) In dealing with an organization's directors, officers, employees, members, shareholders or other constituents, a lawyer shall explain the identity of the client when the lawyer knows or reasonably should know that the organization's interests are adverse to those of the constituents with whom the lawyer is dealing.

(g) A lawyer representing an organization may also represent any of its directors, officers, employees, members, shareholders or other constituents, subject to the provisions of Rule 1.7. If the organization's consent to the dual representation is required by Rule 1.7, the consent may only be given by an appropriate official of the organization other than the individual who is to be represented, or by the shareholders.

Adopted 01/01/05
Amended 12/01/06: Paragraph (b) amended to conform to ABA Model Rule 1.13(b).
Defined Terms (see Rule 1.0):
“Believes”
“Information relating to the representation”
“Knows”
“Matter”
“Reasonable”
“Reasonably”
“Reasonably believes”
“Reasonably should know”
“Substantial”

**Comparison to Oregon Code**
This rule has no counterpart in the Oregon Code.

**Comparison to ABA Model Rule**
This is the ABA Model Rule, as amended in August 2003, except that in paragraph (g), the words “may only” replace “shall” to make it clear that the rule does not require the organization to consent.

*Oregon Rules of Professional Conduct (02/19/15) Page 14*
Chapter 9—Legal Ethics for Business Lawyers

Nuts and Bolts of Oregon Business Law Practice
FORMAL OPINION NO 2005-85

Identifying the Client:
Corporations and Partnerships

Facts:

Corporation has two shareholders, $A$ and $B$, who are not members of the same family. Partnership has two owners, $C$ and $D$, who are not members of the same family.

Questions:

1. Does representation of Corporation automatically constitute representation of $A$ and $B$?
2. Does representation of Partnership automatically constitute representation of $C$ and $D$?
3. Does representation of $A$ or $B$ automatically constitute representation of Corporation?
4. Does representation of $C$ or $D$ automatically constitute representation of Partnership?

Conclusions:

1. No.
2. No.
3. No.
4. No.

Discussion:

Identifying the client is essential to a proper determination of matters such as to whom the lawyer owes a duty of confidentiality under ORS 9.460(3) and Oregon RPC 1.6 and whether a current- or former-client conflict exists under Oregon RPC 1.7, Oregon RPC 1.8, and Oregon RPC 1.9. Cf. OSB Formal Ethics Op No 2005-62; OSB Formal...

A lawyer who represents an entity, such as a corporation or partnership, generally represents that entity only and not its employees, shareholders, or owners. See Oregon RPC 1.13(a), which provides that “[a] lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents.” See also *In re Weidner*, 310 Or 757, 801 P2d 828 (1990), and OSB Formal Ethics Op No 2005-46, in which we noted that the modern test for the presence or absence of a lawyer-client relationship is, in essence, the reasonable-expectations test.

In *In re Banks*, 283 Or 459, 584 P2d 284 (1978), the court observed that, in general, representation of an entity, such as a corporation, does not automatically constitute representation of its shareholders. Nevertheless, the court held that representation of a corporation whose stock was owned by a single person or by a single person and member of the person’s family constituted representation of the person when, at the time of the legal work in question, the person “was the corporation” and had “no real reason . . . to differentiate in his mind between his own and corporate interests.” *In re Banks*, 283 Or at 472, 474 (emphasis in original). On the other hand, the court in *In re Kinsey*, 294 Or 544, 562 n 10, 660 P2d 660 (1983), noted that the normal entity theory applied when a corporation was owned by shareholders who were not members of the same family. The opinions in both *Banks* and *Kinsey* represent applications of the reasonable-expectations test.1

1 The *Banks* rule should not apply, for example, when the sole shareholder is a major corporation and its subsidiary is itself a major corporation that is independently run and is in an altogether different line of business. *Hartford Acc. & Indem. Co. v. RJR Nabisco, Inc.*, 721 F Supp 534, 540 (SDNY 1989); *Am. Special Risk Ins. Co. v. Delta Am. Re Ins. Co.*, 634 F Supp 112, 120 n 14 (SDNY 1986); *Pennwalt Corp. v. Plough, Inc.*, 85 FRD 264, 268–69 (D Del 1980). The *Banks* rule also may not apply if the “family” of shareholders is an extended and fractious family rather than a family whose interests are aligned, as was the case in *Banks*. 

*2016 Revision*
On the facts presented, and based on the foregoing discussion, representation of a corporation or partnership with two shareholders or owners who are not family members does not automatically constitute representation of the shareholders or owners. A contrary rule could well require the lawyer to withdraw whenever the two shareholders disagreed on a matter. Cf. OSB Formal Ethics Op No 2005-40; DC Bar Ethics Op No 216 (1991). If, however, a lawyer tells the shareholders or owners that they are individual clients or otherwise leads the shareholders or owners reasonably to believe that they are also the lawyer’s clients, they will be held to be clients.2

Similarly, there is no reason for a reverse imputation. In other words, representation of one of two unrelated shareholders or owners should not be deemed as a matter of law to constitute representation of Corporation or Partnership. Once again, however, a lawyer who reasonably leads Corporation or Partnership (or the other shareholder or owner) to believe that they are clients will be held to have additional clients.

Approved by Board of Governors, August 2005.

2 A lawyer who wishes to negate any possible application of the Banks outcome would be well advised to send the shareholders or owners a letter to the effect that they are not the lawyer’s clients.

COMMENT: For additional information on this general topic and other related subjects, see The Ethical Oregon Lawyer § 5.1 to § 5.3-2 (client identification) (OSB Legal Pubs 2015); Restatement (Third) of the Law Governing Lawyers § 14 (2000) (supplemented periodically); and ABA Model RPC 1.7–1.8.
FORMAL OPINION NO 2005-123
Conflicts of Interest, Current Clients:
Formation of Corporation or Partnership

Facts:

A, B, and C wish to form a corporation or partnership. They ask Lawyer to represent all three of them.

Question:

May Lawyer represent the three individuals to form a corporation or partnership?

Conclusion:

See discussion.

Discussion:

This question presents a situation involving the potential for current-client conflicts under Oregon RPC 1.7:

(a) Except as provided in paragraph (b), a lawyer shall not represent a client if the representation involves a current conflict of interest. A current conflict of interest exists if:

(1) the representation of one client will be directly adverse to another client;

(2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer’s responsibilities to another client, a former client or a third person or by a personal interest of the lawyer; or

(3) the lawyer is related to another lawyer, as parent, child, sibling, spouse or domestic partner, in a matter adverse to a person whom the lawyer knows is represented by the other lawyer in the same matter.

(b) Notwithstanding the existence of a current conflict of interest under paragraph (a), a lawyer may represent a client if:

2016 Revision
(1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;

(2) the representation is not prohibited by law;

(3) the representation does not obligate the lawyer to contend for something on behalf of one client that the lawyer has a duty to oppose on behalf of another client; and

(4) each affected client gives informed consent, confirmed in writing.

For previous opinions discussing multiple-client conflicts, see, for example, OSB Formal Ethics Op No 2005-86, OSB Formal Ethics Op No 2005-77 (rev 2016), and OSB Formal Ethics Op No 2005-72. As those opinions and the authorities cited therein indicate, a lawyer may represent multiple current clients in a matter, without “informed consent”\(^1\) that is “confirmed in writing,”\(^2\) if no conflict under Oregon RPC 1.7 is present. If, on the other hand, such a conflict is present, it is necessary to determine whether the conflict is waivable or nonwaivable.

Pursuant to Oregon RPC 1.0(h), a lawyer is charged with knowledge of facts that the lawyer knew, or by the exercise of reasonable care should have known, that pertain to the existence of a conflict. \textit{Cf. In re }

\begin{footnotesize}
\textsuperscript{1} Oregon RPC 1.0(f) provides:

“Information relating to the representation of a client” denotes both information protected by the attorney-client privilege under applicable law, and other information gained in a current or former professional relationship that the client has requested be held inviolate or the disclosure of which would be embarrassing or would be likely to be detrimental to the client.

\textsuperscript{2} Oregon RPC 1.0(b) provides:

“Confirmed in writing,” when used in reference to the informed consent of a person, denotes informed consent that is given in writing by the person or a writing that a lawyer promptly transmits to the person confirming an oral informed consent. . . . If it is not feasible to obtain or transmit the writing at the time the person gives informed consent, then the lawyer must obtain or transmit it within a reasonable time thereafter.
\end{footnotesize}
Chapter 9—Legal Ethics for Business Lawyers

Harrington, 301 Or 18, 718 P2d 725 (1986); In re Johnson, 300 Or 52, 707 P2d 573 (1985). In addition, the nature of a conflict situation—and the lawyer’s resulting duties—can change over time. If, for example, a situation in which a waivable conflict is present turns into one in which a nonwaivable conflict is present, the lawyer must withdraw. If a situation in which no conflict was present turns into one in which a waivable conflict is present, a lawyer may continue only with consent based on full disclosure. See, e.g., In re Johnson, 300 Or at 60.

Absent further facts, it is not possible to state whether, or what type of, a conflict is present here. If, after the required inquiry, it reasonably appears to Lawyer that the interests of A, B, and C are consistent and there is no material divergence of opinion or interests between them, no current-client conflict would be present. Cf. In re Griffith, 304 Or 575, 748 P2d 86 (1987), reinstatement granted sub nom Application of Griffith, 323 Or 99, 913 P2d 695 (1996); In re Samuels & Weiner, 296 Or 224, 674 P2d 1166 (1983). If the interests of A, B, and C are fundamentally antagonistic, it could well be that a nonwaivable conflict would be present. Cf. ABA Model RPC 1.7 cmt [28]; In re Phelps, 306 Or 508, 760 P2d 1331 (1988). In circumstances falling in between these two extremes, a waivable conflict could be present.

**Approved by Board of Governors, August 2005.**

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3 The opinion in In re Phelps, which involved a partnership dissolution, does not stand for the proposition that any level of disagreement between would-be partners or incorporators necessarily gives rise to a nonwaivable conflict. There is a difference between persons who wish to come together to do business together and who, therefore, have a substantial common interest (in addition to potential differences) and persons who are seeking to go their separate ways and who thus lack such a continuing common interest.

COMMENT: For additional information on this general topic and other related subjects, see The Ethical Oregon Lawyer § 10.2-2(e)(3) (multiple partners or incorporators) (OSB Legal Pubs 2015); Restatement (Third) of the Law Governing Lawyers §§ 121, 130 (2000) (supplemented periodically); and ABA Model RPC 1.7.
FORMAL OPINION NO 2006-176
[REVISED 2015]

Conflicts of Interest:
Lawyer Functioning in Multiple Roles in
Client’s Real Estate Transaction

Facts:

Client informs Lawyer that Client would like to buy or sell real
estate. Lawyer is willing to represent Client in the transaction and does
not represent any other party in the transaction. Lawyer would, however,
like to act not only as Lawyer, but also as a real estate agent or broker
and as a mortgage broker or loan officer in the transaction.

Question:

May Lawyer serve in all three capacities?

Conclusion:

Yes, qualified.

Discussion:

1. Potential Limitations of Substantive Law.

This Committee is authorized to construe statutes and regulations
pertaining directly to lawyers, but not to construe substantive law gener-
ally. We therefore begin with the observation that if this joint
combination of roles is prohibited by substantive law pertaining to real
estate agents or brokers, mortgage brokers, or loan officers, Lawyer
could not play multiple roles. Similarly, Lawyer would be obligated to
meet in full any licensing, insurance, disclosure, or other obligations
imposed by the substantive law pertaining to these lines of business. In
the discussion that follows, therefore, we assume that there are no such
requirements or, alternatively, that Lawyer will meet all such require-
ments.
2. **Lawyer-Client Conflicts of Interest.**

These facts present the potential for conflicts of interest between Client and Lawyer. Oregon RPC 1.7 states, in part:

(a) Except as provided in paragraph (b), a lawyer shall not represent a client if the representation involves a current conflict of interest. A current conflict of interest exists if:

(1) the representation of one client will be directly adverse to another client;

(2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer’s responsibilities to another client, a former client or a third person or by a personal interest of the lawyer; or

(3) . . .

(b) Notwithstanding the existence of a current conflict of interest under paragraph (a), a lawyer may represent a client if:

(1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;

(2) the representation is not prohibited by law;

(4) the representation does not obligate the lawyer to contend for something on behalf of one client that the lawyer has a duty to oppose on behalf of another client; and

(5) each affected client gives informed consent, confirmed in writing.

Lawyer’s other business interests in the real estate transaction could give rise to a conflict under Oregon RPC 1.7(a)(2) because there is a significant risk that these other roles might interfere with Lawyer’s representation of Client. This would be true whether Lawyer plays the nonlawyer roles as the owner or co-owner of a nonlaw business or as an employee or independent contractor for such a business. Considering an Oregon lawyer’s efforts to fulfill his function as both a lawyer and a realtor, the Oregon Supreme Court said:
... contrary to the accused’s argument, the [lawyer’s] interest in acquiring a share of the sales commission is not identical to a lawyer’s interest in recovering a contingency fee. A lawyer will recover a contingency fee only if the client succeeds in the matter on which the lawyer provides legal representation. In contrast, the [lawyer’s] ability to recover a sales commission did not turn on whether he advanced [his client’s] legal interests in the transaction. Indeed, an insistence on protecting [his client’s] legal interests could have prevented a sale from closing that, from a broker’s perspective, may have made business sense. Therein, we think, lies the problem in the accused’s serving as both [his client’s] broker and lawyer. In advancing his client’s business interests as a broker, the accused may have discounted risks that, as a lawyer, he should counsel his client to avoid or at least be aware of.¹

_In re Spencer_, 355 Or 679, 691, 330 P3d 538 (2014).

It follows that if Lawyer undertakes multiple roles resulting in a conflict, Lawyer must comply with each of the requirements of Oregon RPC 1.7(b).² Before we turn to the requirements of Oregon RPC 1.7(b), however, we note that since Lawyer will be doing business with Client in

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¹ This Ethics Opinion has been revised following the court’s opinion, _Spencer_, 355 Or at 697, in which the court rejected the suggestion that simultaneously acting as attorney, real estate broker, and mortgage broker would, _per se_, constitute a current conflict of interest. The court said:

If, as other jurisdictions have held, additional aspects of a real estate transaction (on which the Bar does not rely here) can result in a current conflict under RPC 1.7(a)(2), careful lawyers who seek to serve as both a client’s legal advisor and broker in the same real estate transaction would be advised to satisfy the advice and consent requirements of both RPC 1.8(a) and RPC 1.7(b). See ABA Model Rules, Rule 1.8, comment [3] (recognizing that the same transaction can implicate both rules and require that both consent requirements be satisfied).

² As noted above, we have assumed that multiple roles are legally permissible under applicable substantive law and thus need not consider Oregon RPC 1.7(b)(2). And since it is assumed that Lawyer represents Client and only Client, we need not consider Oregon RPC 1.7(b)(3).
Lawyer’s additional roles, it is also necessary to consider the conflict-of-interest limitations in Oregon RPC 1.8(a):

(a) A lawyer shall not enter into a business transaction with a client or knowingly acquire an ownership, possessory, security or other pecuniary interest adverse to a client unless:

(1) the transaction and terms on which the lawyer acquires the interest are fair and reasonable to the client and are fully disclosed and transmitted in writing in a manner that can be reasonably understood by the client;

(2) the client is advised in writing of the desirability of seeking and is given a reasonable opportunity to seek the advice of independent legal counsel on the transaction; and

(3) the client gives informed consent, in a writing signed by the client, to the essential terms of the transaction and the lawyer’s role in the transaction, including whether the lawyer is representing the client in the transaction.

There is significant overlap between Oregon RPC 1.7(b) and Oregon RPC 1.8(a). For example, both rules would apply whether Lawyer plays the nonlawyer role (or roles) as the owner or co-owner of a nonlaw business or as an employee or independent contractor for such a business. In addition, both rules require Lawyer to obtain Client’s informed consent and to confirm that consent in a contemporaneous

3 Oregon RPC 1.0(g) provides:

“Informed consent” denotes the agreement by a person to a proposed course of conduct after the lawyer has communicated adequate information and explanation about the material risks of and reasonably available alternatives to the proposed course of conduct. When informed consent is required by these Rules to be confirmed in writing or to be given in a writing signed by the client, the lawyer shall give and the writing shall reflect a recommendation that the client seek independent legal advice to determine if consent should be given.
writing. See Oregon RPC 1.7(b)(4); Oregon RPC 1.8(a)(3). The informed consent requirements under Oregon RPC 1.8(a)(3) are more stringent, however:

- It is not enough that Lawyer confirm Client’s waiver by a writing sent by Lawyer, as would be the case under Oregon RPC 1.7. Lawyer must also receive Client’s informed consent “in a writing signed by the client.”
- Lawyer’s writing must clearly and conspicuously set forth each of the essential terms of each aspect of Lawyer’s business relations with Client and the role that Lawyer will play in each such regard, as well as the role that Lawyer will play as Client’s Lawyer. This would include, for example, the fees that Lawyer or others would earn in each capacity and the circumstances under which each such fee would be payable (e.g., only upon closing or without regard to closing). It would also include a clear explanation of any limitation of liability provisions that might exist regarding Lawyer’s other roles.

4 Oregon RPC 1.0(b) provides:

“Confirmed in writing,” when used in reference to the informed consent of a person, denotes informed consent that is given in writing by the person or a writing that a lawyer promptly transmits to the person confirming an oral informed consent. See paragraph (g) for the definition of “informed consent.” If it is not feasible to obtain or transmit the writing at the time the person gives informed consent, then the lawyer must obtain or transmit it within a reasonable time thereafter.

5 For prior formal opinions citing to both Oregon RPC 1.7(a) and Oregon RPC 1.8(a), see OSB Formal Ethics Op No 2005-10 (in addition to lawyer’s private practice, lawyer also owns a real estate firm and a title insurance company that occasionally do business with lawyer’s clients); and OSB Formal Ethics Op No 2005-28 (discussing conflict of interest in representing both sides in adoption).

6 For cases and ethics opinions discussing the general level of disclosure requirements when lawyers do business with clients, see, for example, OSB Formal Ethics Op No 2005-32.
• In addition to recommending that Client consult independent
counsel, Lawyer must expressly inform Client in writing that such
consultation is desirable and must make sure that Client has a
reasonable opportunity to secure the advice of such counsel.

• Communications between Lawyer and Client as part of their
lawyer-client relationship are subject to Lawyer’s duties of con-
fidentiality under Oregon RPC 1.6. Communications between
Lawyer and Client in other capacities would not be subject to
Oregon RPC 1.67, and Lawyer must explain to Client why this

7 Oregon RPC 1.6 provides:

(a) A lawyer shall not reveal information relating to the
representation of a client unless the client gives informed consent, the
disclosure is impliedly authorized in order to carry out the representa-
tion or the disclosure is permitted by paragraph (b).

(b) A lawyer may reveal information relating to the represen-
tation of a client to the extent the lawyer reasonably believes neces-
sary:

(1) to disclose the intention of the lawyer’s client to
commit a crime and the information necessary to prevent the crime;

(2) to prevent reasonably certain death or substantial bodily
harm;

(3) to secure legal advice about the lawyer’s compliance
with these Rules;

(4) to establish a claim or defense on behalf of the lawyer
in a controversy between the lawyer and the client, to establish a
defense to a criminal charge or civil claim against the lawyer based
upon conduct in which the client was involved, or to respond to
allegations in any proceeding concerning the lawyer’s representation
of the client;

(5) to comply with other law, court order, or as permitted
by these Rules; or

(6) in connection with the sale of a law practice under Rule
1.17 or to detect and resolve conflicts of interest arising from the
lawyer’s change of employment or from changes in the composition or
ownership of a firm. . . .
distinction is potentially significant. This explanation must be given whether Lawyer’s multiple roles are carried out from a single office or from physically distinct offices.

Two requirements remain to be discussed. One requirement is that the terms of the business aspects of the transactions between Lawyer and Client be “fair and reasonable” pursuant to Oregon RPC 1.8(a)(1). We assume that this requirement will be met if Client would be unable to obtain the same services from another under more favorable terms. Whether, or to what extent, the “fair and reasonable” requirement could be met if there were other available suppliers at materially lower cost is a subject on which this Committee cannot define any bright-line rule. Other jurisdictions have been more inclined to approve Lawyers’ business relations with Clients when the Client is relatively sophisticated. See, e.g., Atl. Richfield Co. v. Sybert, 51 Md App 74, 441 A2d 1079 (1982), aff’d, 295 Md 347, 456 A2d 20 (1983) (lawyers who acted as realty brokers for sophisticated corporate seller were not barred from recovering real estate commission); McCray v. Weinberg, 4 Mass App Ct 13, 340 NE2d 518 (1976) (declining to set aside foreclosure of lawyer’s mortgage loan, one of a series, to knowledgeable and experienced client).

8 See, e.g., United States v. Huberts, 637 F2d 630, 639–40 (9th Cir 1980), cert den, 451 US 975 (1981) (lawyer as business agent; no privilege); United States v. Davis, 636 F2d 1028, 1043–44, 81-1 US Tax Cas P 9193 (5th Cir 1981) (lawyer as tax preparer; no privilege); Diamond v. City of Mobile, 86 FRD 324, 327–28 (SD Ala 1978) (lawyer as investigator; no privilege); Neuder v. Battelle Pac. Nw. Nat. Lab., 194 FRD 289, 292–97 (DDC 2000) (when corporate lawyer acts in nonlegal capacity in connection with employment decisions, communications between lawyer and corporate representatives not privileged). A variant could arise if Lawyer’s role were ambiguous, resulting in Client’s inability to carry the burden of proof on lawyer-client privilege. See Groff v. State Indus. Acc. Comm’n, 246 Or 557, 565–66, 426 P2d 738 (1967) (person asserting privilege has burden of showing that one asserting privilege and nature of testimony offered are both within ambit of privilege); OEC 104(1).

9 The explanation about privilege and confidentiality issues might, for example, include a discussion about the effect that a lack of confidentiality could have on an opposing party’s ability to call Lawyer as a witness in any subsequent litigation and thus on Lawyer’s ability to represent Client in that litigation in light of the lawyer-witness rule, Oregon RPC 3.7.
The other requirement is that Lawyer must “reasonably believe that [Lawyer] will be able to provide competent and diligent representation to” Client under Oregon RPC 1.7(b)(1). This means not only that Lawyer must have the subjective belief that Lawyer can do so, but also that Lawyer’s belief must be objectively reasonable under the circumstances. See, e.g., Restatement (Third) of the Law Governing Lawyers § 126, cmt e (2000) (supplemented periodically). Other state bar ethics committees have split on whether such an objectively reasonable belief can exist if, for example, a Lawyer wishes to act both as legal counsel to and insurance agent for a Client, or as legal counsel to and securities broker for a Client. We cannot say that it will always be unreasonable for a Lawyer to conclude that the Lawyer can provide competent and diligent legal advice to a Client while also fulfilling other roles. We note, however, that there will be times when the Lawyer’s conflicting obligations and interests will preclude such roles. Cf. In re Phelps, 306 Or 508, 510 n 1, 760 P2d 1331 (1988) (lawyer cannot be both counsel to a party in a transaction and escrow for that transaction); OSB Formal Ethics Op No 2005-55 (rev 2014) (same).

3. Additional Caveats and Concluding Remarks.

Given these numerous and delicate potential issues, one might fairly conclude that multidisciplinary practice means having multiple opportunities to be disciplined. See generally In re Phillips, 338 Or 125, 107 P3d 615 (2005) (36-month suspension for violation of multiple provisions in former Code of Professional Responsibility in connection with program to help insurance agents sell insurance products to lawyer’s estate planning clients and share in resulting commissions). Nevertheless, it will sometimes, but not always, be permissible for Lawyer to play these multiple roles. The answer will depend on factors including the fairness and reasonableness of the multiple roles, whether it is objectively reason-

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10 See, e.g., California Formal Ethics Op No 1995-140 (lawyer as insurance broker); New York State Bar Association Ethics Op No 2002-752 (lawyer may not provide real estate brokerage services in the same transaction as legal services); New York State Bar Association Ethics Op No 2005-784 (lawyer also acting in entertainment management role).
able to believe that Lawyer can provide competent and diligent representation while playing multiple roles, and whether Lawyer can and does obtain Client’s informed consent in a writing signed by the Client. Before concluding this opinion, however, we note three caveats:

- If someone other than Client were to pay Lawyer for the provision of legal services to Client, Lawyer would also have to comply with Oregon RPC 1.8(f).11
- If Lawyer were to endeavor to use Lawyer’s role as real estate broker or agent, or mortgage broker or loan officer, to obtain clients for Lawyer’s practice of law, Lawyer would have to comply with applicable advertising and solicitation requirements in Oregon RPC 7.1 et seq.12

11 Oregon RPC 1.8(f) provides:

A lawyer shall not accept compensation for representing a client from one other than the client unless:

1. the client gives informed consent;
2. there is no interference with the lawyer’s independence of professional judgment or with the client-lawyer relationship; and
3. information related to the representation of a client is protected as required by Rule 1.6.

For an ethics opinion discussing this rule, see OSB Formal Ethics Op No 2005-30 (rev 2016) (legal fees paid by insurer).

12 For the present text and prior formal ethics opinions addressing these requirements, see OSB Formal Ethics Op No 2005-106 (rev 2016) (lawyer who purchases tax advice business may not use that business to engage directly or indirectly in improper solicitation of legal clients); OSB Formal Ethics Op No 2005-101 (rev 2015) (lawyer and psychologist may market a joint “Family Mediation Center”); and OSB Formal Ethics Op No 2005-108 (rev 2015) (lawyer may advertise family mediation service in marriage and family therapy section of Yellow Pages).
Lawyers covered by the Oregon State Bar Professional Liability Fund (PLF) who do not wish to risk losing potentially available legal malpractice coverage should contact the PLF about exclusions that may apply.

Approved by the Board of Governors, September 2015.

COMMENT: For additional information on this general topic and other related subjects, see *The Ethical Oregon Lawyer* § 7.2 to § 7.2-8 (competence), § 7.3 (diligence), § 9.2-1 to § 9.2-1(c) (personal-interest conflicts), § 9.5-1 to 9.5-1(c) (business transactions between lawyer and client), § 9.6 (informed consent) (OSB Legal Pubs 2015); and *Restatement (Third) of the Law Governing Lawyers* §§ 121–122, 125–126 (2000) (supplemented periodically).

2016 Revision
FORMAL OPINION NO 2011-183

Scope of Representation; Limiting the Scope

Facts:

Lawyer A is asked by Client X for assistance in preparing certain pleadings to be filed in court. Client X does not otherwise want Lawyer A’s assistance in the matter, plans to appear pro se, and does not plan to inform anyone of Lawyer A’s assistance.

Lawyer B has been asked to represent Client Y on a unique issue that has arisen in connection with complex litigation in which Client Y is represented by another law firm.

Lawyer C has consulted with Client Z about an environmental issue that is complicating Client Z’s sale of real property. Client Z asks for Lawyer C’s help with the language of the contract, but intends to conduct all of the negotiations with the other party and the other party’s counsel by herself.

Question:

1. May Lawyers A, B, and C limit the scope of their representations as requested by the respective clients?

Conclusion:

1. Yes, qualified.

Discussion:

In each example, the prospective client seeks to have the lawyer handle only a specific aspect of the client’s legal matter. Such limited-scope representation1 is expressly allowed by Oregon RPC 1.2(b):

A lawyer may limit the scope of the representation if the limitation is reasonable under the circumstances and the client gives informed consent.

1 This is sometimes described as the “unbundling” of legal services, or as discrete task representation.

2016 Revision
As the examples herein reflect, a lawyer may limit the scope of his or her representation to taking only certain actions in a matter (e.g., Lawyer A’s drafting or reviewing pleadings), or to only certain aspects of, or issues in, a matter (e.g., Lawyer B’s representation on a unique issue in litigation, or Lawyer C’s advising in a single issue in a transactional matter). In order to limit the scope of the representation, Oregon RPC 1.2 requires that (1) the limitation must be reasonable under the circumstances, and (2) the client must give informed consent.²

With respect to the requirement that the limitations of the representation be reasonable, comment [7] to ABA Model RPC 1.2 offers the following guidance:

If, for example, a client’s objective is limited to securing general information about the law the client needs in order to handle a common and typically uncomplicated legal problem, the lawyer and client may agree that the lawyer’s services will be limited to a brief telephone consultation. Such a limitation, however, would not be reasonable if the time allotted was not sufficient to yield advice upon which the client could rely. Although an agreement for a limited representation does not exempt a lawyer from the duty to provide competent representation, the limitation is a factor to be considered when determining the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation.

The second requirement of Oregon RPC 1.2 is the client’s informed consent to the limited scope representation. Oregon RPC 1.0(g) defines informed consent as:

>[T]he agreement by a person to a proposed course of conduct after the lawyer has communicated adequate information and explanation about the material risks of and reasonably available alternatives to the proposed course of conduct.

² A lawyer providing a limited scope of services must be aware of and comply with any applicable law or procedural requirements. For example, if Lawyer A drafts pleadings for Client X, the pleadings would need to comply with Uniform Trial Court Rule (UTCR) 2.010(7), which requires a Certificate of Document Preparation by which a pro se litigant indicates whether he or she had paid assistance in selecting and completing the pleading.
Obtaining the client’s informed consent requires the lawyer to explain the risks of a limited-scope representation. Depending on the circumstances, those risks may include that the matter is complex and that the client may have difficulty identifying, appreciating, or addressing critical issues when proceeding without legal counsel.³ One “reasonably available alternative” is to have a lawyer involved in each material aspect of the legal matter. The explanation should also state as fully as reasonably possible what the lawyer will not do, so as to prevent the lawyer and client from developing different expectations regarding the nature and extent of the limited-scope representation.

By way of example, Oregon RPC 4.2 generally prohibits a lawyer from communicating with a person if the lawyer has actual knowledge that the person is represented by a lawyer on the subject of the communication.⁴ Mere knowledge of the limited-scope representation may not be

³ A limited-scope representation does not absolve the lawyer from any of the duties imposed by the Oregon Rules of Professional Conduct (RPCs) as to the services undertaken. For example, the lawyer must provide competent representation in the limited area, may not neglect the work undertaken, and must communicate adequately with the client about the work. See, e.g., Oregon RPC 1.1; Oregon RPC 1.3; Oregon RPC 1.4. Likewise, a lawyer providing limited assistance to a client must take steps to ensure there are no conflicts of interest created by the representation. See, e.g., Oregon RPC 1.7; Oregon RPC 1.9.

⁴ Oregon RPC 4.2 provides that:

In representing a client or the lawyer’s own interests, a lawyer shall not communicate or cause another to communicate on the subject of the representation with a person the lawyer knows to be represented by a lawyer on that subject unless:

(a) the lawyer has the prior consent of a lawyer representing such other person;

(b) the lawyer is authorized by law or by court order to do so; or

(c) a written agreement requires a written notice or demand to be sent to such other person, in which case a copy of such notice or demand shall also be sent to such other person’s lawyer.

See, e.g., OSB Formal Ethics Op No 2005-6 (discussing communicating with a represented party in general); OSB Formal Ethics Op No 2005-80 (rev 2016); In
sufficient to invoke an obligation under Oregon RPC 4.2. Accordingly, the lawyer providing the limited-scope representation should communicate the limits of Oregon RPC 4.2 with the client. If the client wants the protection of communication only through the lawyer on some or all issues, then the lawyer should be sure to communicate clearly to opposing counsel the scope of the limited representation and the extent to which communications are to be directed through the lawyer.

5 *See*, e.g., Colorado RPC 4.2 cmt [9A] (“[a] pro se party to whom limited representation has been provided . . . is considered to be unrepresented for purposes of this Rule unless the lawyer has knowledge to the contrary”); Los Angeles County Bar Association Formal Ethics Op No 502 (1999) (“[s]ince Attorney is not counsel of record for Client in the litigation . . . the opposing attorney is entitled to address Client directly concerning all matters relating to the litigation, including settlement of the matter”); Missouri Supreme Court Rule 4-1.2(e) (“[a]n otherwise unrepresented party to whom limited representation is being provided or has been provided is considered to be unrepresented for purposes of communication under Rule 4-4.2 and Rule 4-4.3 except to the extent the lawyer acting within the scope of limited representation provides other counsel with a written notice of a time period within which other counsel shall communicate only with the lawyer of the party who is otherwise self-represented”); DC Bar Ethics Op No 330 (2005) (“Even if the lawyer has reason to know that the pro se litigant is receiving some behind-the-scenes legal help, it would be unduly onerous to place the burden on that lawyer to ascertain the scope and nature of that involvement. We therefore believe that the most reasonable course for an attorney dealing with a party who is proceeding pro se is to treat the party as not having legal representation, unless and until the party or a lawyer for the party provides reasonable notice that the party has obtained legal representation.”).

6 While not required, it may be advisable to clarify the scope of the limited-scope representation in writing to opposing counsel. Cf. Washington RPC 4.2 cmt [11] (providing “[a] person not otherwise represented to whom limited representation is being provided or has been provided in accordance with Rule 1.2(c) is considered to be unrepresented for purposes of this Rule unless the opposing lawyer knows of, or has been provided with, a written notice of appearance under which, or a written notice of time period during which, he or she is to
In the case of Lawyer A, even if the lawyer’s participation was announced in compliance with court rules (such as by compliance with UTCR 2.010(7)), Oregon RPC 4.2 would not be implicated because Lawyer A is not counsel of record and the limited assistance in preparing pleadings is not evidence that Lawyer A represents Client X in the matter.\(^7\) In the case of Lawyer C, the lawyer should make clear to Client Z that that the limited-scope representation does not include communication with the opposing counsel.

Finally, while the client’s informed consent to the limited-scope representation is not generally required to be in writing,\(^8\) an effective written engagement letter minimizes any such risks if it “specifically describe[s] the scope of the representation, how the fee is to be communicate only with the limited representation lawyer as to the subject matter within the limited scope of the representation”).

\(^7\) See, e.g., Kansas Bar Association Ethics Op No 09-01 (2009): “Attorneys who provided limited representation must include on any pleadings a legend stating ‘Prepared with Assistance of Counsel.’” But “[a]n attorney who receives pleadings or documents marked with the legend ‘Prepared with Assistance of Counsel’ has no duty to refrain from communicating directly with the pro se party, unless and until the attorney has reasonable notice that the pro se party is actually represented by another lawyer in the matter beyond the limited scope of the preparation of pleadings or documents, or the opposing counsel actually enters an appearance in the matter.”

See also State Bar of Nevada Formal Advisory Op No 34 (rev 2009) (an ostensibly pro se litigant assisted by a “ghost-lawyer” is to consider the pro se litigant “unrepresented” for purposes of the RPCs, which means that the communicating attorney must comply with RPC 4.3 governing communications with unrepresented persons).

\(^8\) Since Oregon RPC 1.2 does not require a writing, Oregon RPC 1.0 does not require a recommendation to consult independent counsel. It is worth noting, however, that if the lawyer is providing a limited-scope representation with respect to a contingency matter, such an arrangement would need to be in writing. See ORS 20.340. See also Fee Agreement Compendium ch 8 (contingent-fee agreement) (Oregon CLE 2007).
computed, how the tasks are to be limited, and what the client is to do.”

The Ethical Oregon Lawyer § 16.4-3(c) (OSB Legal Pubs 2015).

Approved by Board of Governors, February 2011.

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9 In addition, “when a lawyer associates counsel to handle certain aspects of the client’s representation, the division of responsibility between the lawyers should also be documented in a written agreement.” See Fee Agreement Compendium ch 9 (hourly fee agreement). See also Oregon RPC 1.5(d) (discussing when fees may be split between lawyers who are not in the same firm).

COMMENT: For additional information on this general topic and other related subjects, see The Ethical Oregon Lawyer § 3.4-2 (describing scope of representation in the fee agreement), § 7.5-1 (scope of representation), § 8.5-1 (communicating with a represented person); and Restatement (Third) of the Law Governing Lawyers § 90 (2000) (supplemented periodically).