

# DEAL POINTS

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## The Newsletter of the Committee on Negotiated Acquisitions

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### FROM THE CHAIR

By Richard E. Climan

Our Committee will meet at the Tampa Marriott on the afternoon of Saturday, April 8, in conjunction with the Spring Meeting of the ABA's Section of Business Law. Our Committee meeting will be preceded by separate subcommittee, task force and working group meetings on Thursday afternoon, throughout the day Friday and on Saturday morning.

Immediately following our full Committee meeting on April 8, Jim Melville will chair a Committee Forum program entitled *Developments in Private Equity Acquisitions*. The report by Tom Thompson (chair of the Programs Subcommittee), which appears elsewhere in this issue of *Deal Points*, describes several other M&A-related programs that will be presented in Tampa.

Our Committee cocktail reception and dinner will take place on Saturday night at The Columbia Restaurant. Special thanks to David Gemunder for organizing this event.

We had a successful and well-attended stand-alone meeting in Las Vegas in October 2005, which included an interesting discussion of the role of the media in M&A, led by James Politi, M&A reporter for the Financial Times. In November 2005, our Committee sponsored the *Tenth Annual National Institute on Negotiating Business Acquisitions* in Washington, D.C. Participating Committee members included David Albin, Rick Alexander, Wilson Chu, Nat Doliner, Byron Egan, Joel Greenberg, Mark Morton, Leigh Walton and Alison Youngman. As it enters its second decade, this National Institute program continues to serve as

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Richard E. Climan - Chair  
Joel I. Greenberg – Vice Chair  
Byron F. Egan – Vice Chair  
Leigh Walton – Vice Chair  
Michael K. Reilly – Editor

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### CONTENTS

FROM THE CHAIR .....	1
FEATURE ARTICLE	
<i>Disney</i> for Deal Lawyers .....	2
M&A “NUGGET” .....	8
TASK FORCE REPORTS	
Task Force on Acquisitions of Public Companies .....	9
Task Force on Joint Ventures .....	9
Task Force on the Model Stock Purchase Agreement.....	10
SUBCOMMITTEE REPORTS	
International M&A Subcommittee .....	10
Membership Subcommittee .....	11
M&A Jurisprudence Subcommittee.....	11
M&A Market Trends Subcommittee .....	16
Programs Subcommittee .....	17
Technology Subcommittee .....	18
HYPOTHETICAL DISCUSSED AT MEETING WITH DELAWARE JUDGES .....	19

an excellent showcase for the work of our Committee.

As reported elsewhere in this issue of *Deal Points*, the Task Force on Acquisitions of Public Companies met in Wilmington in February and sponsored an informative discussion with judges from the Delaware Supreme Court and the Delaware Court of Chancery. Rick Alexander and Mark Morton will report on this event at the full Committee meeting in Tampa.

I'm pleased to report that the Subcommittee on M&A Market Trends has recently released two important surveys – the *First Annual Private Target M&A Deal Points Study* and the *First Annual Public Target M&A Deal Points Study*. Congratulations to the members of that subcommittee, whose work product will help enhance the profile and reputation of our entire Committee.

I am also pleased to report that Chief Justice Myron Steele of the Delaware Supreme Court will serve as Judicial Liaison to our Committee. Although Chief Justice Steele will not be able to join us in Tampa, he expects to attend our meeting in Honolulu and subsequent Committee meetings.

Later this month, on April 19, our Committee will sponsor a four-hour video/teleconference and live video/audio webcast entitled *Negotiating the Acquisition Agreement*. (This will be similar to the presentations that members of our Committee have made at Columbia and Stanford Law Schools.) Details will be circulated at our full Committee meeting in Tampa.

Please calendar the two other full Committee meetings to be held in 2006. On August 5, 2006, we will meet in Honolulu in conjunction with the ABA's Annual Meeting; and on October 21, 2006, we will hold a stand-alone meeting at the Adolphus Hotel in Dallas.

I welcome your continuing input and feedback on our Committee and its activities. Please call or e-mail me with your observations and suggestions.

## FEATURE ARTICLE

### *Disney for Deal Lawyers*

By Michael A. Pittenger and Michael K. Reilly<sup>1</sup>

Front and center on the national legal stage last year was the *Disney* litigation, which consumed thirty-seven trial days in Delaware's Court of Chancery and resulted in a 175 page opinion in which Chancellor William B. Chandler concluded that the defendants had not breached their fiduciary duties in connection with the hiring and termination of Michael Ovitz as the Walt Disney Company's President. While *Disney* dealt primarily with the hiring, termination, and compensation of a key executive and the conduct of directors in connection therewith, many of its teachings are particularly relevant to deal lawyers advising corporate boards or committees about the negotiation, evaluation, and approval of significant transactions.

The litigation involved a derivative suit against Disney's directors and officers for damages allegedly arising out of the 1995 hiring and the 1996 termination of Ovitz as Disney's President. Ovitz was employed by Disney for little more than a year before he was terminated. The termination resulted in a non-fault termination payment to Ovitz of roughly \$38 million in cash under the terms of his employment contract, as well as the immediate vesting of 3

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<sup>1</sup> Michael A. Pittenger and Michael K. Reilly practice law in the Wilmington, Delaware law firm of Potter Anderson & Corroon LLP. Portions of this article are drawn from materials previously prepared by other attorneys of Potter Anderson & Corroon with the permission of those attorneys. The views expressed are solely those of the authors and do not necessarily represent the views of the firm or its clients.

million options to buy Disney stock. The shareholders alleged that the defendant directors had breached their fiduciary duties both in approving Ovitz's employment agreement and in later allowing the payment of the non-fault termination fee.

In an earlier decision, the Court of Chancery had declined to dismiss the plaintiffs' complaint, finding that it adequately alleged facts sufficient at the pleading stage to overcome the presumptions of the business judgment rule by virtue of allegations calling into question the good faith of the directors in making the challenged decisions.<sup>2</sup> In that decision, Chancellor Chandler had held that, if true, the allegations of the complaint "imply that the defendant directors *knew* that they were making material decisions without adequate information and without adequate deliberation, and that they simply did not care if the decisions caused the corporation and its stockholders to suffer injury or loss."<sup>3</sup> If plaintiffs could make such a showing at trial, the Court held, the directors' conduct would fall outside the scope of the Section 102(b)(7) exculpatory provision in Disney's certificate of incorporation, which eliminated the personal liability of directors for monetary damages for breaches of fiduciary duty, subject to certain exceptions, including, most notably, actions not in good faith and intentional misconduct.<sup>4</sup>

The matter thus proceeded to trial. After extensive analysis of the evidence and arguments

presented during the lengthy trial, Chancellor Chandler concluded in his post-trial opinion that plaintiffs had failed to prove their claims and entered judgment in favor of defendants on all counts.<sup>5</sup> With respect to the hiring of Ovitz and the approval of his employment agreement, the Court held that the defendants had not acted in bad faith and were at most "ordinarily negligent" and, therefore, had not breached the fiduciary duty of care, which requires a showing of conduct rising to the level of gross negligence.<sup>6</sup> As to the ensuing no-fault termination of Ovitz and the resulting termination payment pursuant to his employment agreement, the Court held that the full board did not (and was not required to) approve Ovitz's termination, that Michael Eisner, Disney's CEO, had authorized the termination, and that neither Eisner, nor Sanford Litvack, Disney's General Counsel, had breached his duty of care or acted in bad faith in connection with the termination.<sup>7</sup>

### **The Fiduciary Duty of Good Faith**

One aspect of the Chancellor's decision of particular relevance to deal lawyers is the Chancellor's clarification of when directors may be deemed to have violated the so-called fiduciary duty of good faith. Deal lawyers have long been well versed in the traditional fiduciary duties of care and loyalty, but the duty of good faith – to the extent such a duty exists separately from the duties of care and loyalty – was less well understood. The Chancellor's earlier decision at the motion to dismiss stage of the *Disney* litigation gave rise to much debate over the contours of the duty of good faith. The resulting uncertainty caused concern for corporate practitioners because a breach of the duty of good faith cannot be subject to exculpation under a

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<sup>2</sup> See *In re The Walt Disney Company Deriv. Litig.*, 825 A.2d 275 (Del. Ch. 2003) (hereinafter "*Disney I*"). The *Disney I* opinion focused on an amended complaint filed by plaintiffs after their initial complaint had been dismissed for failure to adequately plead breaches of fiduciary duty. See *Brehm v. Eisner*, 746 A.2d 244 (Del. 2000). The Supreme Court's decision expressly found that a majority of the Disney board (including Michael Eisner) was disinterested in the challenged transaction, and prohibited plaintiffs from relitigating that issue.

<sup>3</sup> *Id.* at 289.

<sup>4</sup> *Id.* at 289-90 (citing 8 *Del. C.* § 102(b)(7)).

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<sup>5</sup> See *In re The Walt Disney Company Deriv. Litig.*, C. A. No. 15452, 2005 Del. Ch. LEXIS 113 (Del. Ch. Aug. 9, 2005) (hereinafter "*Disney II*").

<sup>6</sup> See *id.* at \*190.

<sup>7</sup> See *id.* at \*235, \*241, \*244-45.

Section 102(b)(7) charter provision, would deprive a director of the right to be indemnified by the corporation,<sup>8</sup> and might result in the unavailability of D&O insurance coverage.

In his post-trial decision, the Chancellor acknowledged that existing Delaware case law had not clearly defined the scope of the duty of good faith or even provided clear guidance about whether such a duty exists separately from the duties of care and loyalty. In that regard, the Court suggested that good faith is a fundamental, overarching concept that encompasses “not simply the duties of care and loyalty . . . but all actions required by a true faithfulness and devotion to the interests of the corporation and its shareholders.”<sup>9</sup> The Court explained that “[t]o act in good faith, a director must act at all times with an honesty of purpose and in the best interests and welfare of the corporation.”<sup>10</sup> Although the Court declined to “create a definitive and categorical definition of the universe of acts that would constitute bad faith,” it observed that a lack of good faith may be shown, for example, when: (1) a fiduciary “intentionally acts with a purpose other than that of advancing the best interests of the corporation;” (2) a fiduciary “acts with the intent to violate applicable positive law;” or (3) the fiduciary “intentionally fails to act in the face of a known duty to act, demonstrating a conscious disregard for his duties.”<sup>11</sup> Notably, each example involves an element of subjective intent. The Court further explained:

Upon long and careful consideration, I am of the opinion that the concept of *intentional dereliction of duty, a conscious disregard for one’s responsibilities*, is an appropriate (although not the only)

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<sup>8</sup> See 8 Del. C. §145(a), (b) (requiring a person to have acted in good faith as a condition to indemnification).

<sup>9</sup> *Disney II*, 2005 Del. Ch. LEXIS 113, at \*176.

<sup>10</sup> *Id.*

<sup>11</sup> *Id.* at \*176-77.

standard for determining whether fiduciaries have acted in good faith. Deliberate indifference and inaction *in the face of a duty to act* is, in my mind, conduct that is clearly disloyal to the corporation. It is the epitome of faithless conduct.<sup>12</sup>

In applying the facts of the case, the Court concluded that the Disney directors had not acted in bad faith in connection with the hiring of Ovitz and the approval of his compensation arrangement. Although the Chancellor’s opinion chastises Eisner and other directors for not acting in accordance with best practices, the Chancellor nevertheless found that Eisner and the other directors had acted in good faith and with the subjective belief that their actions were in the best interests of the Company.

#### **The Business Judgment Rule and Best Practices**

In concluding that the defendants had not breached their fiduciary duties, the Chancellor leaned heavily and, to many, reassuringly, on the business judgment rule, as it has been understood traditionally. The Chancellor noted that “the greatest strength of Delaware’s corporation law” – and the business judgment rule in particular – is the fact that corporate fiduciaries, although held to “a high standard in fulfilling their stewardship over the assets of others,” are granted “wide latitude in their efforts to maximize shareholders’ investments” when they act “faithfully and honestly on behalf of those whose interests they represent.”<sup>13</sup>

Differentiating between the role of the Court to provide a remedy for breaches of fiduciary duty and the role of the market to provide a remedy for bad business decisions, the Court reasoned as follows:

Even where decision-makers act as faithful servants, however, their ability and the

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<sup>12</sup> *Id.* at \*175 (emphasis in original).

<sup>13</sup> *Id.* at \*5.

wisdom of their judgments will vary. The redress for failures that arise from faithful management must come from the markets, through the action of shareholders and the free flow of capital, and not from this Court. Should the Court apportion liability based on the ultimate outcome of decisions taken in good faith by faithful directors or officers, those decision-makers would necessarily take decisions that minimize risk, not maximize value. The entire advantage of the risk-taking, innovative, wealth-creating engine that is the Delaware corporation would cease to exist, with disastrous results for shareholders and society alike. That is why, under our corporate law, corporate decision-makers are held strictly to their fiduciary duties, but within the boundaries of those duties are free to act as their judgment and duties dictate, free of *post hoc* penalties from a reviewing court using perfect hindsight. Corporate decisions are made, risks are taken, the results become apparent, capital flows accordingly, and shareholder value is increased.<sup>14</sup>

While the Court made clear that Delaware law does not hold fiduciaries liable for a failure to comply with corporate governance “best practices” prevailing at the time a corporate decision is taken,<sup>15</sup> it also indicated throughout the opinion many instances in which, in the Court’s view, the defendants did not appear to have complied with “best practices.” The Court expressed hope that its observations “may serve as guidance for future officers and directors — not only of The Walt Disney Company, but of other Delaware corporations.”<sup>16</sup> The Chancellor stressed that while “best practices” always include compliance with

fiduciary duties, the converse is not true.<sup>17</sup> As the Court noted, “[a]spirational ideals of good corporate governance practices for boards of directors that go beyond the minimal legal requirements of the corporation law are highly desirable, often tend to benefit stockholders, sometimes reduce litigation and can usually help directors avoid liability. But they are not required by the corporation law and do not define standards of liability.”<sup>18</sup>

The Court’s decision in *Disney II* thus resoundingly reaffirms the importance of the business judgment rule, while offering guidance (and some fairly stern warnings) to corporate directors and officers not only with respect to compliance with the fiduciary duties of care and good faith, but also with respect to the importance of corporate governance “best practices.”

### **Lessons for Deal Lawyers**

The Court’s findings with respect to the fiduciary duties of care and good faith, as well as its observations about “best practices,” contain many practical teachings for deal lawyers advising directors in connection with M&A and other significant transactions. Those teachings include the following:

- **Informal Communications With and Among Board Members:** Consultation between an executive and board members, or among board members, that occurs on an individual basis and outside of a formal board or committee meeting is less helpful than consultation in the context of a formal meeting. Although some informal discussions cannot be avoided and may even be somewhat helpful in keeping directors informed in between committee or board meetings,<sup>19</sup> informal consultation on an

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<sup>14</sup> *Id.* at \*7-8.

<sup>15</sup> *Id.* at \*4-5.

<sup>16</sup> *Id.* at \*8.

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<sup>17</sup> *Id.* at \*147.

<sup>18</sup> *Id.* at \*147 n. 399 (quoting *Brehm v. Eisner*, 746 A.2d 244, 256 (Del. 2000)).

<sup>19</sup> *See id.* at 202 n. 504 (“Although it would have been ideal if the other members of the compensation committee were more substantively involved in those negotiations, it would

individual basis should not be a substitute for full deliberation at a formal meeting. Consultation outside of a formal board or committee meeting may result in members of the board or a committee being unequally or unevenly informed and may have the effect of diminishing the board's or committee's ability as an institutional body to function together collectively, collegially, and deliberatively.<sup>20</sup> Also, informal consultations outside of a formal meeting are often undocumented, leaving the board or committee with an insufficient record to establish that proper deliberation and care with respect to a matter occurred.

- *Time for Deliberations:* Adequate time should be allotted at scheduled board or committee meetings for consideration of material matters. Chancellor Chandler emphasized that the Disney compensation committee met for only one hour to consider the Ovitz employment agreement,<sup>21</sup> and in his prior decision on the motion to dismiss stressed the complaint's allegations about the failure of the board to spend any significant time deliberating over the employment agreement.<sup>22</sup>
- *Minutes:* If board or committee action is challenged, minutes often become some of the most significant evidence. In both the post-trial decision and the earlier decision on the motion to dismiss, the Court relied on board and committee minutes as evidence of what was and was not discussed at meetings,

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certainly be unwieldy as a practical matter to require the entire committee, together as a whole, to negotiate on the Company's behalf"); *id.* at \*216 (noting that compensation committee members had understanding of the *bona fides* of Ovitz's employment agreement, in part, due to "more than minimal informal discussions" among committee members before the committee meeting).

<sup>20</sup> See *id.* at \*135 n. 373 (quoting expert testimony).

<sup>21</sup> See *id.* at \*215.

<sup>22</sup> *Disney I*, 825 A.2d at 287.

how long discussions lasted, whether questions were asked, and what advice was given. In the motion to dismiss opinion, Chancellor Chandler expressly noted that the discussion of Mr. Ovitz's hiring took up one and a half pages in the fifteen pages of minutes of the meeting at which it was approved, and that much of that discussion centered on a "finder's fee" to be paid to another director.<sup>23</sup> In the post-trial opinion, the Chancellor expressed some frustration at the difficulty in ascertaining the length of a committee meeting and the amount of time at that meeting devoted to discussion of Ovitz's employment agreement.<sup>24</sup> Thus, meeting minutes should be detailed enough that it is later possible for the directors to establish, or a neutral fact finder to determine, not only the substance of matters discussed, but the approximate length of time spent considering matters of importance. In addition, to the extent directors have engaged in informal consultations outside of a formal meeting to inform themselves of the terms and circumstances surrounding significant matters later considered at a board or committee meeting, the meeting minutes should reference those consultations.

- *Unilateral Action of Officers:* The taking of action by an executive with respect to a matter prior to formal board action may give rise to an inference that the board's later approval is a mere "rubber stamp" of the executive's action. While execution of an employment letter agreement by Mr. Ovitz and Mr. Eisner on behalf of the company prior to board approval was not legally binding upon the company, the Chancellor observed that such action, coupled with the public announcement of Mr. Ovitz' hiring,

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<sup>23</sup> *Id.*

<sup>24</sup> *Disney II*, 2005 Del. Ch. LEXIS 113, at \*215.

appeared to have placed inappropriate pressure on the board to approve the action.<sup>25</sup> If an executive has not first consulted with and received appropriate authority from the board, caution should be exercised before the executive executes a letter of intent or other agreement relating to a proposed significant transaction, even if the agreement is not technically binding without board approval.

- Reviewing Documents and Proposed Agreements: All board or committee members should have the opportunity to review written materials regarding an important action prior to their decision. Where the action involves execution of an agreement on behalf of the corporation, although not strictly required, the directors should ideally have an opportunity to review the agreement itself. At a minimum, they should review a detailed written summary of the agreement's material terms.<sup>26</sup> Moreover, where further negotiation of an agreement results in a material change in the terms most recently reviewed by the board, those changes should be clearly communicated to the board prior to taking action on behalf of the corporation.
- Reliance on Experts: If experts and advisors have been selected with care and directors rely on their advice in good faith, the fault for any errors or flaws in the expert's advice will be laid at the feet of the expert and directors will not be held responsible unless they are shown to have had actual knowledge of such errors.<sup>27</sup> To ensure maximum protection for directors, reliance on the advice of experts or outside counsel, including care in the selection process,

should be properly documented. An expert's advice should ideally be memorialized in writing.<sup>28</sup> Also, although it is not necessary for any expert or advisor upon which directors will rely to make a formal presentation at the board or committee meeting at which the action is considered that is generally the better practice.<sup>29</sup>

### Conclusion

In addition to reaffirming the importance and continued efficacy of the business judgment rule and providing much needed guidance about the scope and contours of the fiduciary duty of good faith, the Court of Chancery's post-trial decision in *Disney* offers many lessons for deal lawyers about what officers and directors should and should not be doing when negotiating, evaluating, and approving significant corporate transactions. An appeal of the Court of Chancery's decision is currently pending before the Delaware Supreme Court. Briefing and oral argument on that appeal have been completed and the litigants currently are awaiting a decision. One may reasonably expect that the Delaware Supreme Court will offer in its ruling a further explication of the fiduciary duties of care and good faith and perhaps additional guidance on corporate governance "best practices" in the context of evaluating and approving significant corporate transactions.

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<sup>25</sup> *Id.* at \*195, \*198-99.

<sup>26</sup> *See id.* at \*218 (review and discussion of full text of then-existing draft employment agreement not required).

<sup>27</sup> *Id.* at \*220-21.

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<sup>28</sup> *Id.* at \*100-02.

<sup>29</sup> *Id.* at \*218.

## **M&A “Nugget” – A Potentially Dangerous Carve-Out From the “MAC” Definition**

*Recently, Wilson Chu, Rick Climan and Joel Greenberg participated in a webcast for DealLawyers.com in which they presented a series of M&A “nuggets.” An edited transcript of one of the “nuggets” presented by Joel Greenberg is set forth below:*

The first topic we’re going to talk about today is a closing condition found in virtually every merger or other acquisition agreement and that’s the material adverse change, or MAC, condition. This condition provides that the buyer is excused from proceeding with the transaction if it discovers by the closing time that the target has suffered a material adverse change.

This is a very substantial condition for both parties because it’s essentially unbounded. It doesn’t operate with reference to any particular representation or warranty, and anything that falls within the definition excuses the buyer from its obligation to close. Due to its significance, the MAC definition is typically the subject of negotiation, and one effort that target companies often make is to seek to add carve-outs to the definition (*i.e.*, specific types of events that are not taken into account in determining whether a MAC has occurred).

The carve-out I want to talk about today is for matters that are either required or permitted by the merger agreement. The target may introduce this subject by saying, “Well of course if the merger agreement requires us to do something, such as a spin-off of a particular asset to stockholders before the closing, that event and its consequences shouldn’t be a MAC. After all, you [the buyer] required us to do it and we had no choice.”

It’s hard to argue with the conclusion the target is advocating in that situation, but if you dig into the language of the proposed carve-out and

think about its implications, it has enormous breadth and can largely vitiate the MAC condition.

Focus on the words – one part of the proposed carve-out is for matters “required” by the merger agreement. In most cases, the merger agreement requires the target company to operate in the ordinary course. That may encompass virtually everything that the target does between the signing and the closing and it’s hard to argue that all of those actions and their consequences – no matter how catastrophic – should be excluded from the MAC definition.

The other half of the proposed carve-out, which is for matters “permitted” by the merger agreement, is in some sense even broader, because the target can argue that anything that isn’t prohibited by the covenants that apply between signing and closing is permitted. Therefore, any target action that isn’t a breach of those covenants and the consequences of any such action would arguably be carved out of the material adverse change definition.

The lesson here for buyers is first, not to immediately nod yes when the target argues that anything that’s required or permitted by the agreement should be carved out of the MAC definition, and second, if you’re going to accept this concept in the agreement at all, to draft it very tightly so that it refers to specific events that the parties have negotiated to occur, which shouldn’t excuse the buyer from its obligation to close.

## TASK FORCE REPORTS

### Task Force on Acquisitions of Public Companies

The Task Force on Acquisitions of Public Companies met on Saturday, February 25, 2006 in Wilmington, Delaware, with Chief Justice Steele, Justices Jacobs and Ridgely and Vice Chancellors Lamb, Noble and Parsons. We devoted the morning to a discussion of a hypothetical prepared by Rick Alexander that provoked lively discourse. (A copy of the hypothetical is printed in this issue of *Deal Points* for your information.) Thanks both to the judiciary and to the participants: Jim Melville, Joel Greenberg, Jim Walther, Lorna Telfer, Mark Morton and Bruce Cheatham – the interchange among those task force members led to lots of interesting discussion. (We also had a wonderful dinner Friday evening, joined by those members of the bench noted above as well as Chancellor Chandler and Vice Chancellor Strine.)

On Saturday afternoon we addressed task force business. We heard from Rick Alexander that a proposal had been submitted to the Delaware legislature to amend the Delaware code to clarify the enforceability of resignations of directors if tendered in advance of annual meetings – an amendment intended to address the majority vote issue. We also heard from Jim Melville regarding the SEC’s recent proposed rulemaking regarding the best price rule.

We then turned to the conditions section of the Model Merger Agreement and reviewed the draft through Section 5.1. If you have comments please contact Lori Anne Czepiel directly. We will finish our discussion of the conditions in Tampa, and will review the latest drafts of the exclusivity letter and voting agreement. We are still due drafts of Section 1, commentary to Section 4.7, revisions to the termination section, commentary to the representations and warranties

and some revisions to the miscellaneous provisions.

We will have a Task Force dinner Friday, April 7, commencing at 7:00 p.m. in the Lafayette room at Mise en Place. The restaurant is located at 442 W. Kennedy Blvd., Suite 110, Tampa, FL 33606. The telephone number is (813) 254-5373. We look forward to seeing you there. Please RSVP to me and Nat Doliner so we can plan properly for the dinner.

For your reference, there will be two sessions for our Task Force. Session 1 will be on Friday, April 7, from 1:00 p.m. to 3:30 p.m. at the Tampa Marriott, Salon A, Level 2. Session 2 takes place on Saturday, April 8, from 9:00 a.m. to 11:00 a.m. at the Tampa Marriott, Meeting Room 8, Level 3.

Diane Holt Frankle  
Stephen H. Knee  
Co-Chairs

### Task Force on Joint Ventures

The Task Force on Joint Ventures has two projects: (i) publishing the Model Joint Venture Agreement, and (ii) “internationalizing” that agreement. With respect to the latter project, the text of the questionnaire has been completed and the list of participants will be finalized in Tampa. Several members of the Task Force will then take charge of following up with the different country contributions. Our plan is to have all responses in hand by our Fall stand-alone meeting. There will be a short meeting of the Task Force to discuss this in Tampa (from 1:00 p.m. to 2:00 p.m. on Friday, April 7).

With respect to the former project, the “final” Model Joint Venture Agreement and all of its attachments have been sent to the ABA, which expects to publish it in the next four to six months. The efforts of literally scores of people have been involved. Those involved included most notably The Editorial Committee (consisting of Rich Hoyt, George Patrick, Peter Prokop, Paul

Steinkraus, Tom Van Dyke and the two of us) and also the LLC Working Group (consisting of Alan Donn, Henry Hope, Rich Hoyt, Mike Long, David Rex, Andrew Saul, Tom Van Dyke and Tom Hyman). In addition, we'd be remiss in not noting the special efforts of Rich Hoyt during the final stretch. The Model Joint Venture Agreement will be published in an LLC format, and we're considering whether a partnership supplement would be helpful. There will be a short meeting of the Task Force – to discuss that question and also the status of the publication process – from 2:00 p.m. to 3:00 p.m. on Friday, April 7.

Thomas B. Hyman, Jr.  
Alison J. Youngman  
Co-Chairs

### **Task Force on the Model Stock Purchase Agreement**

The Editorial Working Group of the Task Force on the Model Stock Purchase Agreement has been meeting monthly via conference call over the last five months in an effort to bring together the basic text of the Revised Model Stock Purchase Agreement. It is anticipated that editorial work on the text will continue through the summer, after which the Editorial Working Group will turn its attention to Commentary and the Sellers' Response. If any members of the Task Force have completed additional work on the Commentary, you are encouraged to submit your work to Hendrik Jordaan. We also want to encourage Task Force members to work with Scott Whittaker and Jim Melville on the judicial interpretations project.

Robert T. Harper  
Chair

## **SUBCOMMITTEE REPORTS**

### **International M&A Subcommittee**

The International M&A Subcommittee (formerly the International Acquisition Transactions Subcommittee) met from 8:00 a.m. to 11:00 a.m. on Friday, October 21, 2005 in connection with the Fall stand-alone meeting of the Committee on Negotiated Acquisitions. The discussion included reports on the status of the Subcommittee's current projects, the principal goals of the Subcommittee and our future plans. We decided that future meetings would continue to include presentations by Subcommittee members on recent developments in cross-border M&A transactions and other legal developments of interest to members. Our meetings will also include a general discussion segment in which members will have an opportunity to discuss legal issues or developments they are encountering in their practices and to compare experiences with other Subcommittee members. The Subcommittee will also undertake shorter term projects of interest to international M&A practitioners, as well as continuing our traditional work on preparation of model transaction agreements and guides intended for formal publication by the ABA. The results of the shorter term projects will not necessarily be intended for ABA publication and will be made available through the Subcommittee's website.

We then turned to the international version of the Model Asset Purchase Agreement which is the Subcommittee's current major project. While substantial progress has been made on this project to date, we discussed organizational approaches to increasing the efficiency of the drafting process. It was decided that a small group of persons should prepare a complete initial draft of the entire agreement to establish a consistent basic structure. Separate drafting subgroups will then consider individual segments of the draft

agreement in greater detail for the dual purposes of (i) considering whether changes should be made to facilitate use of the agreement in many jurisdictions without the necessity of separate subagreements, and (ii) preparing commentary regarding the individual segments, including their purposes and issues that buyers and sellers typically raise with respect to each segment. Frank Picciola and Stan Friedman agreed to prepare the initial draft of the agreement for discussion at the Spring Meeting in Tampa.

The Subcommittee then discussed drafts of the representations and warranties sections on: financial statements, prepared by Franziska Ruf; sufficiency of assets, prepared by Jay Lefton; and owned real property and leased real property, prepared by Ed Kerwin.

The Subcommittee's website has been redesigned and a revised mission statement for the Subcommittee has been included on the website. The revised mission statement highlights the Subcommittee's role as a forum for U.S. and non-U.S. lawyers to discuss issues of common interest regarding cross-border M&A transactions, the collection and dissemination of information useful for international transactions and preparation of model agreements for such transactions. We plan to expand the website to include a reference section collecting the results of our projects for easy reference and use by practitioners. We are also updating the website listing of our members. Over time we intend to develop an expanded listing of members and their firms that will facilitate communications among members, including in connection with locating lawyers in other jurisdictions as client needs arise.

The next meeting of the Subcommittee will be in connection with the Spring Meeting of the Business Law Section in Tampa, Florida from 2:00 p.m. to 4:00 p.m. (note the time change from earlier notices) on Friday, April 7.

Daniel Rosenberg  
James R. Walther  
Co-Chairs

## Membership Subcommittee

Current Committee membership exceeds 1400, and is up about 7% since last October. We've tied the availability of the Private Target and Public Target Deal Points Studies to Committee membership (*i.e.*, they're only available to Committee members). Thus, the Studies' anticipated popularity will likely lead to a nice spike in Committee membership.

The Subcommittee's vice chairs, Deb Telman and Hendrik Jordaan, are leading an effort to produce a "Corporate Counsel Survey on Selection and Use of Outside M&A Counsel." That Survey will be co-sponsored by the Corporate Counsel Committee. In addition, Michael Hollingsworth is leading the effort to produce a Survey of Committee Members.

We expect to release the Corporate Counsel and Members' Surveys by August, in time for our meeting in Honolulu.

Wilson Chu  
Chair

## M&A Jurisprudence Subcommittee

The M&A Jurisprudence Subcommittee has two working groups. The Annual Survey Working Group identifies and reports to the Committee on recent decisions of importance in the M&A area, and prepares the Annual Survey of Judicial Developments Pertaining to Mergers and Acquisitions, which is published annually in *The Business Lawyer*. The Judicial Interpretations Working Group examines judicial interpretations of specific provisions of acquisition agreements and ancillary documents, looking not only for recent M&A cases of special interest, but also examining the entire body of case law on the specified type of provision. The Annual Survey Working Group will meet in Tampa on Thursday, April 6, from 4:30 p.m. until 5:30 p.m. in Meeting Room 4, Level 2, of the Tampa Marriott. The

Judicial Interpretations Working Group will meet on Friday, April 7, from 11:30 a.m. until 1:00 p.m. in Salon A, Level 2, of the Tampa Marriott.

### **Annual Survey Working Group**

The fourth Annual Survey of Judicial Developments Pertaining to Mergers and Acquisitions will appear in the February 2006 issue of *The Business Lawyer*, which we expect will be published sometime this summer. Our working group is now collecting 2006 cases for consideration for inclusion in our next annual survey. We are asking all members of our Committee to send us significant judicial decisions for possible inclusion in the survey. Submissions can be sent by e-mail either to Scott Whittaker ([swhittaker@stonepigman.com](mailto:swhittaker@stonepigman.com)) or Jon Hirschhoff ([jhirschhoff@fdh.com](mailto:jhirschhoff@fdh.com)). You may fax cases to Scott at (504) 596-0836 or to Jon at (203) 348-5777. Please state in your e-mail or on the fax cover sheet why you believe the case merits inclusion in the survey.

The first criterion for inclusion is that the decision must involve a merger, an equity sale of a controlling interest, a sale of all or substantially all assets, a sale of a subsidiary or division, or a recapitalization resulting in a change of control. The second criterion is that the decision must (a) interpret or apply the provisions of an acquisition agreement or an agreement preliminary to an acquisition agreement (*e.g.*, a letter of intent, confidentiality agreement or standstill agreement), (b) interpret or apply a state statute that governs one of the constituent entities (*e.g.*, the Delaware General Corporation Law or the Louisiana Limited Liability Company Law), (c) pertain to a successor liability issue, or (d) decide a breach of fiduciary duty claim. We are currently excluding cases dealing with federal law, securities law, tax law and antitrust law. But if you feel a case dealing with an M&A transaction is particularly significant please send it, even if it does not meet the foregoing criteria.

### **Decisions to be Discussed at the Tampa Committee Meeting**

*Berg Chilling Systems, Inc. v. Hull Corporation*, 435 F.3d 455 (3d Cir. 2006).

A recent opinion by Judge Alito (now U.S. Supreme Court Justice Alito) in *Berg Chilling Systems, Inc. v. Hull Corporation*, and Judge Ambro's dissenting opinion in that case, offer useful perspectives on choice of law in successor liability cases in the sale of assets context.

Berg Chilling Systems ("Berg"), a Canadian corporation, contracted with a Chinese company, Hua Du Meat Products Company ("Huadu") to provide an industrial freeze drying system. Berg entered into a contract with Hull Corporation ("Hull") under which Hull would design and manufacture two freeze dryers. After problems had arisen with the freeze dryers, Hull negotiated and entered into an asset purchase agreement to sell to SP Industries, Inc. ("SPI") the division that had manufactured the freeze dryers.

While the asset purchase agreement was being negotiated, Berg inquired about the transfer of liabilities under the asset purchase agreement, and who would have the "full financial responsibility for this project." Hull responded that if the division should be transferred to another entity, Hull's responsibility "will of course be assumed by the successor." The asset purchase agreement, however, together with a side letter, provided only that SPI would do warranty repair work on the freeze dryers, and specifically excluded any assumption by SPI of liability to "any third party claimant" (the "APA Liability Exclusion"). The asset purchase agreement provided that the "interpretation, construction, [and] effect" of the asset purchase transaction would be governed by New Jersey law (the "APA Choice of Law Provision").

In an international arbitration action filed by Huadu against Berg, Huadu won an award of approximately \$2,500,000, and the parties then

settled, with Berg making a payment of \$1,000,000 and Huadu keeping the freeze dryers.

Berg meanwhile sued Hull and SPI, asserting claims for breach of contract, breach of express and implied warranties, and indemnity and contribution. Hull and SPI cross-claimed against each other for indemnity and contribution. The District Court apportioned liability for the \$1,000,000 payment to Huadu equally among Berg, Hull and SPI, but on appeal the Court of Appeals found that the APA Liability Exclusion precluded SPI's liability to Berg on the basis of the Asset Purchase Agreement. The Court of Appeals directed the District Court on remand to determine whether the APA Liability Exclusion was void as against public policy, and whether SPI was liable to Berg under the doctrine of successor liability.

The District Court decided that there was no material difference between New Jersey and Pennsylvania successor liability law, and ultimately found no successor liability. It further determined that the APA Liability Exclusion did not violate public policy.

On a second appeal, Berg contended that SPI had successor liability to it because there had been a *de facto* merger between SPI and Hull, or because SPI was a "mere continuation" of Hull, and that these issues should be resolved under New Jersey's law of successor liability because of the APA Choice of Law Provision.

The Court of Appeals viewed New Jersey successor liability law as more favorable to plaintiffs than the successor liability law of Pennsylvania, and therefore found it necessary to decide which law applied. In his majority opinion, after pointing out that exceptions to the ordinary rule regarding successor liability cannot be uniformly characterized as wholly based in tort, contract or corporate law, Judge Alito engaged in a choice of law analysis which rejected Berg's claim that the asset purchase agreement's specification of New Jersey law should control. Among other things, he noted that

Berg was not a party to that agreement. The same analysis, as applied to products liability cases, has often resulted in a choice of law based on conflicts of laws principles applicable to actions in tort. *See, e.g., Savage Arms, Inc. v. Western Auto Supply Co.*, 18 P.3d 49, 53 (Alaska 2001). Judge Alito concluded that under Pennsylvania law, successor liability did not apply in these circumstances.

Judge Ambro dissented on the basis that since the successor liability claim related, in the words of the APA Choice of Law Provision, to the interpretation, construction and effect of the asset purchase transaction, that provision should therefore control, resulting in the application of New Jersey successor liability law. He wrote: "SPI purchased an entire division of Hull and operated that division as an ongoing business, holding the division out to the world as a continuation of Hull, and presumably reaping substantial rewards by doing so. That division was almost entirely responsible for serious deficiencies in freeze dryers sold to Berg, but SPI disclaimed any resulting liabilities in an asset purchase agreement that was negotiated without Berg's participation, all while Berg was being assured by Hull that 'of course' SPI would assume full liability. . . . [H]ull went out of business. The result, therefore, is that SPI gets the benefit of the continuation of Hull's business without any attendant liabilities . . . and Berg is left to bear all the liabilities for a problem it did not create."

*ABRY Partners V, L.P. v. F&W Acquisition LLC*, 891 A.2d 1032 (Del. Ch. 2006).

In *ABRY Partners V, L.P. v. F&W Acquisition LLC*, Vice Chancellor Strine refused to grant a seller's motion to dismiss a buyer's post-closing claim for rescission of a Stock Purchase Agreement, even though the Agreement contained a clear and unequivocal waiver of rescission rights, limited buyer's remedies to a claim for damages, subject to a cap, and required

such a damages claim to be pursued through arbitration.

In this transaction, ABRY Partners (the “Buyer”), a sophisticated private equity firm, purchased the shares of F&W Publications, Inc. (the “Company”) from another private equity firm, Providence Equity Partners (the “Seller”). The Company, which was in the business of magazine publication and book sales, was sold pursuant to an auction conducted by Credit Suisse First Boston. The Buyer paid \$500 million, which was negotiated based on expected company EBITDA for the year ending June 30, 2005. During negotiations, the parties projected EBITDA calculations ranged between \$480 million (Buyer’s calculation) and \$510 million (Seller’s calculation). The Stock Purchase Agreement was signed on June 11, 2005, and the closing occurred on August 5, 2005.

After the closing, the Buyer uncovered a variety of alleged financial statement manipulations, which the Buyer alleged had the effect of inflating revenues and EBITDA, resulting in overvaluation of the Company by approximately \$100 million. The Buyer alleged that the financial statement manipulations resulted in a breach of the financial statement representations set forth in the Agreement.<sup>30</sup> Furthermore, the Buyer discovered that a book

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<sup>30</sup> The financial statement representation provided as follows:

The Company Financial Statements: (i) are derived from and reflect, in all material respects, the books and records of the Company and the Company Subsidiaries; (ii) fairly present in all material respects the financial condition of the Company and the Company Subsidiaries at the dates therein indicated and the results of operations for the periods therein specified; and (iii) have been prepared in accordance with GAAP applied on a basis consistent with prior periods except, with respect to the unaudited Company Financial Statements, for any absence of required footnotes and subject to the Company’s customary year-end adjustments.

order fulfillment system, which the Company agreed to use “commercially reasonable efforts to implement prior to July 15, 2005,” was not functional, which allegedly caused several customers, including Amazon.com, to cease ordering products from the Company. According to the Buyer, the problem with the book order fulfillment system constituted a material adverse effect (“MAE”) prior to closing, and therefore Seller breached the provision of the Agreement that required the Company to notify Buyer of an MAE, and Seller also provided a false bring-down certificate. Most importantly, the Buyer alleged that the Seller participated in the financial statement manipulations, and knew the financial statement representations and the bring-down certificate were false when given.

The Agreement contained extensive “non-reliance” provisions<sup>31</sup> and provided that the

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<sup>31</sup> The non-reliance provisions were contained in Sections 7.8 and 3.23 of the Agreement, both of which are quoted in the opinion. Section 7.8 provided as follows:

Acquiror acknowledges and agrees that neither the Company nor the Selling Stockholder has made any representation or warranty, expressed or implied, as to the Company or any Company Subsidiary or as to the accuracy or completeness of any information regarding the Company or any Company Subsidiary furnished or made available to Acquiror and its representatives, except as expressly set forth in this Agreement . . . and neither the Company nor the Selling Stockholder shall have or be subject to any liability to Acquiror or any other Person resulting from the distribution to Acquiror, or Acquiror’s use of or reliance on, any such information or any information, documents or material made available to Acquiror in any “data rooms,” “virtual data rooms,” management presentations or in any other form in expectation of, or in connection with, the transactions contemplated hereby.

Section 3.23 of the Agreement provided as follows:

EXCEPT AS EXPRESSLY SET FORTH IN THIS ARTICLE III, THE COMPANY MAKES NO REPRESENTATION OR WARRANTY, EXPRESSED OR IMPLIED, AT LAW OR IN EQUITY IN RESPECT OF THE COMPANY OR

exclusive remedy of the Buyer under the Agreement was a claim for indemnification pursuant to the indemnification section of the Agreement.<sup>32</sup> The indemnification provisions of the Agreement required all indemnification claims to be resolved pursuant to arbitration conducted in Massachusetts, and imposed a \$20 million maximum on the aggregate amount the Buyer could recover under all indemnification claims brought, which amount was deposited into escrow to serve as the exclusive indemnity fund.

In response to the Buyer's suit for rescission, the Seller brought a motion to dismiss on the grounds that the Agreement unambiguously barred Buyer from seeking rescission and limited Buyer to recovery of

damages, through arbitration and subject to the \$20 million cap. The Buyer argued that Delaware public policy prohibited a seller from insulating itself in this way from intentional misrepresentations amounting to fraud. Vice Chancellor Strine agreed with the Seller's position that the Agreement was clear and unequivocal in that it purported to limit the Buyer's remedies to \$20 million in damages, regardless of whether Seller's breach of a representation, warranty or covenant was intentional or accidental.

With respect to the public policy issue, however, Vice Chancellor Strine agreed with the Buyer and held that, in circumstances where a party has intentionally lied, Delaware public policy will prevent that party from contractually barring a rescission claim. The opinion states:

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THE COMPANY SUBSIDIARIES, OR ANY OF THEIR RESPECTIVE ASSETS, LIABILITIES OR OPERATIONS, INCLUDING WITH RESPECT TO MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE, AND ANY SUCH OTHER REPRESENTATIONS OR WARRANTIES ARE HEREBY EXPRESSLY DISCLAIMED. ACQUIROR HEREBY ACKNOWLEDGES AND AGREES THAT, EXCEPT TO THE EXTENT SPECIFICALLY SET FORTH IN THIS ARTICLE III, THE ACQUIROR IS ACQUIRING THE COMPANY ON AN "AS IS, WHERE IS" BASIS. THE DISCLOSURE OF ANY MATTER OR ITEM IN ANY SCHEDULE HERETO SHALL NOT BE DEEMED TO CONSTITUTE AN ACKNOWLEDGEMENT THAT ANY SUCH MATTER IS REQUIRED TO BE DISCLOSED.

<sup>32</sup> The opinion quotes the following provisions from the indemnification section:

Except as may be required to enforce post-closing covenants hereunder . . . after the Closing Date the indemnification rights in this Article IX are and shall be the sole and exclusive remedies of the Acquiror, the Acquiror Indemnified Persons, the Selling Stockholder, and the Company with respect to this Agreement and the Sale contemplated hereby; provided that this sentence shall not be deemed a waiver by any party of its right to seek specific performance or injunctive relief in the case of another party's failure to comply with the covenants made by such other party.

I resolve this case in the following manner. To the extent that the Stock Purchase Agreement purports to limit the Seller's exposure for its own conscious participation in the communication of lies to the Buyer, it is invalid under the public policy of this State. That is, I find that the public policy of this State will not permit the Seller to insulate itself from the possibility that the sale would be rescinded if the Buyer can show either: 1) that the Seller knew that the Company's contractual representations and warranties were false; or 2) that the Seller itself lied to the Buyer about a contractual representation and warranty. This will require the Buyer to prove that the Seller acted with an illicit state of mind, in the sense that the Seller knew that the representation was false and either communicated it to the Buyer directly itself or knew that the Company had.

Vice Chancellor Strine emphasized in his opinion that a party's ability to override a clear waiver of remedies provisions is a limited one, especially in the context of a transaction between two sophisticated parties:

The Buyer knowingly accepted the risk that the Seller would act with inadequate deliberation. It is an experienced private equity firm that could have walked away without buying. It has no moral justification for escaping its own voluntarily-accepted limits on its remedies against the Seller absent proof that the Seller itself acted in a consciously improper manner.

Although honest sellers can take comfort in this limiting language, the result in this case will also provide cause for concern on the part of sellers, because one goal of careful acquisition agreement drafting is to enable the seller to escape claims that are contrary to the agreement at the motion to dismiss stage, before the seller becomes pressured to settle an improper claim based on high cost of defense and risk of loss at trial. Under the reasoning in this decision, a well-pleaded complaint alleging that the Seller knew a representation in the acquisition agreement was false can allow the Buyer to survive a motion to dismiss (and presumably a motion for summary judgment, since the Seller's knowledge or state of mind is often a disputed material fact that can only be resolved at trial).

#### **Judicial Interpretations Working Group**

The third meeting of the Judicial Interpretations Working Group, one of the Committee on Negotiated Acquisitions' newest working groups, was held during the Committee's October 2005 stand-alone meeting in Las Vegas. Teams have been formed to research and prepare memoranda pertaining to the jurisprudence interpreting more than 20 different provisions of M&A agreements and ancillary documents. At the Las Vegas meeting, the working group reviewed initial drafts of work product from two teams and discussed research techniques as well as the scope and format of work product and potential new projects.

The next meeting of the Judicial Interpretations Working Group will be on Friday, April 7, from 11:30 a.m. to 1:00 p.m. in Salon A, Level 2 of the Tampa Marriot in connection with the Spring Meeting of the ABA's Section of Business Law. We have a number of new projects that we would like to start and invite new members to join us. To join, please e-mail Jim Melville at [jcm@kskpa.com](mailto:jcm@kskpa.com) with a copy to Scott Whittaker at [swhittaker@stonepigman.com](mailto:swhittaker@stonepigman.com) or simply come to our working group meeting in Tampa.

Scott T. Whittaker  
Subcommittee Chair

Jon T. Hirschhoff  
Chair - Annual Survey Working Group

James C. Melville  
Chair - Judicial Interpretations Working Group

### **M&A Market Trends Subcommittee**

The Subcommittee's long-awaited *First Annual Private Target M&A Deal Points Study* was released on March 27, 2006 and is available, free of charge, to Committee members at [www.abanet.org/dch/committee.cfm?com=CL560003](http://www.abanet.org/dch/committee.cfm?com=CL560003). This Study benchmarks a broad range of key negotiated deal points from publicly available acquisition agreements involving public buyers of private target companies, thus providing key data for the oft-debated issue in M&A transactions: "what's market?" The companion Public Target M&A Deal Points Study is scheduled to be released in early April. Both of those studies are expected to become indispensable resources for M&A lawyers. Plans are underway to produce iPod versions of both studies (just kidding).

Wilson Chu  
Lawrence Glasgow  
Co-Chairs

## Programs Subcommittee

The programs being sponsored by our Committee in Tampa are George Taylor's panel on closings and Jim Melville's Committee Forum on private equity deals. In addition, there are three strong and entertaining programs that our Committee is co-sponsoring with other committees. These additional programs are aimed primarily at M&A lawyers.

### PROGRAMS SPONSORED BY THE COMMITTEE ON NEGOTIATED ACQUISITIONS

***Program: Closing the Deal: A Guide to the Not-So-Scientific Process of Bringing a Transaction to a Successful Conclusion***

Thursday, April 6  
2:30 p.m. - 4:30 p.m.

This program will address closings, including practical tips, pitfalls and issues arising out of remote and electronic closings. The program will be chaired and moderated by George Taylor, III, with a panel including Robert Ouellette, Leigh Walton, Steve Bolden and Tom Thompson. This program will draw on the chapter on closings and related materials in *The M&A Process: A Practical Guide for the Business Lawyer*, and will explore many of the difficult closing practice issues discussed during the editorial process by the Task Force that prepared the *Guide*.

***Committee Forum: Developments in Private Equity Acquisitions***

Saturday, April 8  
4:00 p.m. - 5:00 p.m.

The Committee Forum will be chaired by James Melville and will include Rick Alexander and other panelists experienced in acquisitions and divestitures by private equity funds. The panel will address structures used in private equity deals as well as the deal terms often offered up and negotiated in these transactions.

### PROGRAMS CO-SPONSORED BY THE COMMITTEE ON NEGOTIATED ACQUISITIONS

The three programs that our Committee is co-sponsoring in Tampa are aimed directly at M&A practitioners and our Committee members in particular, and should be on your Tampa CLE "dance card."

***Program: The Model Entity Transactions Act: New Ways to Do Deals and Restructure Businesses***

Thursday, April 6  
8:30 a.m. - 10:30 a.m.

This panel will discuss the "junction box" concept under proposed state legislation that would address interspecies deals between different types of entities. The panel includes William Clark and Jon Hirschhoff.

***Program: Memo to Transactional Lawyers - Take a Shot at Resolving Disputes***

Friday, April 7  
8:00 a.m. - 10:00 a.m.

This program has been developed by Jim Freund, our Committee's Advisor and acclaimed author of *Anatomy of a Merger* (among other deal-related publications). The program is aimed at deal lawyers faced with post-closing disputes. Jim believes that transactional lawyers should play a more active role in dispute resolution and not simply abandon the fight to the litigators. The panel will cover different dispute resolution techniques, and will include a presentation by Bill Payne of our Committee (and a prime contributor to the chapter on transactional disputes in *The M&A Process: A Practical Guide for the Business Lawyer*) and a presentation by Chancellor William B. Chandler, III of the Delaware Court of Chancery on mediation services provided by that court. The panel includes Gail Reese as moderator, Jim Freund, William Payne, Chancellor Chandler and Karol Denniston.

***Program: Teaching, Growing and Training  
M&A Lawyers***

Friday, April 7  
2:30 p.m. - 4:30 p.m.

This program will present a number of innovative approaches to teaching and training M&A lawyers. The panel will explore various tools available to law professors teaching courses in M&A and to those training and nurturing the development of M&A lawyers. The panel will describe some of the different approaches used by those who teach M&A courses in law schools, including Samuel Thompson, Jr. of UCLA School of Law and Therese Maynard of Loyola Law School, who are the authors of two of the seminal books for M&A courses. The panel will include Alison Youngman, Jane Ross (who will describe the “Cooley College” program) and Jon Hirshoff, and will be moderated by Jonathan Lipson of Temple Law School and Tom Thompson of the Committee on Negotiated Acquisitions. The panel will address how ABA resources such as the ABA Model Asset Purchase Agreement, *The M&A Process: A Practical Guide for the Business Lawyer* and *Deal Points* can play a key role in both law school courses and law firm and law department training programs, as well as other training tools and approaches used to develop starting associates into experienced, functioning deal lawyers.

Thomas M. Thompson  
Chair

## **Technology Subcommittee**

The Technology Subcommittee has continued its work at improving our Committee’s website with the objective of having it play a more central role in communications among Committee members. The website now includes an accurate description of the various Subcommittees, Task Forces and Working Groups and serves as a guide for prospective members in

getting involved in the work of the various groups. Important archival information (past issues of *Deal Points* and lists of Committee programs) is now posted. We now have the ability to post documents on the website for all members to review, and those leaders of Subcommittees and Task Forces who have been through training can make changes to their pages directly without the intervention of the ABA staff. A short-term goal is to include on the site a listing of all pending Committee projects and the status of each. A longer-term goal is to develop tools whereby Committee members can collaborate on various projects directly online (the establishment of “virtual rooms”) but further progress in that area will depend on programming changes by the ABA. The Technology Subcommittee welcomes your comments on ways that we can make the website better serve the needs of our Committee. We hope soon to present a Committee Forum dealing with various issues of technology for business lawyers. Please send us your ideas.

George M. Taylor, III  
Chair

## **HYPOTHETICAL DISCUSSED AT MEETING WITH DELAWARE JUDGES**

*On February 25, 2006, the Task Force on Acquisitions of Public Companies met in Wilmington, Delaware with Chief Justice Steele, Justices Jacobs and Ridgely and Vice Chancellors Lamb, Noble and Parsons. At center stage was a hypothetical prepared by Rick Alexander, which provoked lively discussion. Set forth below is the full text of the hypothetical.*

### **HYPOTHETICAL FOR 2006 PUBLIC COMPANY MERGER TASK FORCE STAND-ALONE MEETING**

#### **Participants:**

**Senior Partner (SP)**  
**Young Associate (YA)**  
**Committee Counsel (CC)**  
**Regular Banker Counsel (RBC)**  
**Committee Banker Counsel (CBC)**  
**MBA Counsel (MBAC)**  
**Freezer Food Counsel (FFC)**

Soylent is a global food processing corporation with significant sales and operations in the Americas and Europe. Chuck Heston, its founder and very active CEO, owns 20% of the outstanding shares. Other than that, the Company is largely held by institutions, and there are no other stockholders over 5%. The board consists of the CEO and six outside directors, five of whom are active or retired executives and none of whom are dependent on their board fees for financial security. One of the board members is a former investment banker who focused on the food processing industry and who, over the years, earned significant income from transactions on behalf of Soylent. In response to mounting stockholder activism, Soylent recently

destaggered its board, although it retains a poison pill (from whose operation Mr. Heston is excluded).

Over drinks at an industry conference, a principal of Morton, Bigler and Alexander, a large private equity firm (“MBA”), raises the possibility of a leveraged buy out with Mr. Heston. Together, they sketch out a proposed transaction in which stockholders of Soylent will receive a premium of close to 25% of the Company’s current stock price (taking the deal to 11 figures), and in which the CEO will roll over all of his shares and the top twenty members of management will roll over their restricted stock and options into equity in the surviving entity. MBA tells Heston that they understand that the Board will have to give some consideration to other potential transactions but hopes that Heston will support this transaction. “Don’t worry,” Heston says. “I am not going to go out and shop your deal.” Mr. Heston calls his law firm to tell them what’s happening. The senior partner calls in a young associate, who recently finished a Chancery Court clerkship, to discuss next steps. The young associate raises the possible need for a committee. The two lawyers engage in a discussion as to whether this is a good idea.

#### **SP/YA**

- *Is this a Weinberger situation because of the CEO’s 20% ownership, hands-on management style and the fact that he is rolling over his shares, or is this a transaction involving a noncontrolling stockholder in which only the business judgment rule or an enhanced version thereof will apply?*
  - *Kahn and Cysive suggest 50% not magic and that “hands on CEO” is important factor.*
- *Even if this is not a fairness case does it make sense to establish an independent committee?*

- *Need structure for negotiating with CEO and may create better dynamic, by adding “third side” to table.*
- *The associate also raises Section 203 and the pill issues -- Senior Partner explains why there is no problem.*
  - *“agreement, arrangement or understanding”*
  - *inadvertent person exception requires board action under pill*
  - *what is “inadvertent”*
  - *Should the former banker be included on any committee?*
  - *Expertise v. conflict shadow?*
- **Questions for Bench:**
  - *Any comments on foregoing?*
  - *Who should decide whether to establish the committee?*
  - *What calls should go to board? What would be reaction of reviewing court if the issues revolving around establishing committee and Section 203 were never raised with full board?*

The board has met and determined that it will be more efficient to run the negotiation through a special committee even if the 20% ownership of the CEO does not lead to an entire fairness analysis. The Chairman of the committee meets with the two lawyers who discuss what the committee should do next.

### **SP/YA**

- *Can the Company’s counsel represent the committee or should they interview other counsel?*
- *If the Committee hires independent counsel, does that mean that the*

*Company’s counsel must no longer participate in the process?*

- **Question for Bench:**

- *Can a committee ever effectively rely on company counsel?*

After this initial conversation, the Chairman determines that he and the other members of the Committee should select their own counsel before moving forward. They have several questions for their new counsel.

### **CC**

- *How should the committee members be paid for their services? When should that decision be made? Should the chairman receive more than the other committee members? How much work should the committee anticipate doing?*
- *Surely we will need help from top management even though they are “on the other side” of the transaction. We need to understand the company’s business plan and we will of course need their cooperation in the due diligence phase in any sale of the Company. How can we handle this?*
- **Question for Bench:**
  - *To what extent will reviewing court examine this process: Will supervision of management in due diligence ever be litigable?*

The Committee decides that the next order of business is to choose a banker. They have a number of candidates: The Company’s regular banker who has a long relationship with the CEO and the Company. The second candidate is familiar with the Company based on its participation in a financing as a co-arranger for which it received a million dollar fee the year before. The third candidate is a top-tier bank that has a significant presence in the industry but that has done no work for the Company over the last three years. This bank makes it very clear that it

wants to do a “stapled financing” in shopping the company. The last candidate is the nephew of the Committee chair and has an oil and gas boutique bank headquartered in Oklahoma City, which neither wants to do stapled financing nor has any prior contact with the Company.

#### CC/RBC

- *What are the problems with using the Company’s regular banker on this project? Is it absolutely forbidden?*

#### CC/CBC

- *Are there any problems with using a banker that plans to do buy-side work?*
- **Questions for Bench:**
  - *Is it “safest” to go with the most independent candidate regardless of experience?*
  - *Will court apply only procedural test to permission granted to bankers to do buy-side work, etc.*

The Company chooses the top-tier bank with no prior contacts but vetoes the stapled financing concept.

#### CC/CBC

- *How should fee be structured in light of fact that there is already a deal on the table?*
- *Should banker give a fairness opinion?*
- **Question for Bench:**
  - *Comments on banker fees/structure opinions*

Based on MBA’s urging and timetable, the committee realizes it cannot go through a three-month shopping process without losing the “bird in hand” but is advised by Banker that given the relative simplicity of the business and the short list of capable buyers it can do a relatively quick pre-signing market check while MBA moves into its due diligence phase. MBA does not insist on

exclusivity, but it does insist on having all of its expenses reimbursed if they do not sign up a deal. It also refuses to sign a confidentiality agreement that prohibits it from talking to other private equity groups.

#### CC/MBAC

- *Are either of these concessions problematic?*
- **Question for Bench:**
  - *Does the fact that an insider is participating in the bid put more pressure on the club deal issue?*

A week after the banker begins its market check, MBA, for reasons known only to itself, exits the transaction. The market check, however, flushes out two very serious strategic buyers (Freezer Foods and Salt-n-Sugar), each of whom, in connection with the process, sign standstill agreements that prevent them from making an unsolicited bid for twelve months, whether or not Soylent enters into a merger agreement with another party. Soylent agrees to be purchased by Freezer Foods, another global food processor with significant overlapping businesses in Europe. The companies realize there will be significant negotiations with the EU and some divestment required and that as a result, the transaction may take nine to twelve months to close, but both sides are confident that the issues are containable. The deal will be at a 35% premium to Soylent’s market price and will be paid 50% in cash and 50% in stock, at a ratio fixed at the time the Agreement is signed. After the transaction is signed up, the Banker again approaches the Committee and asks whether it may participate in the financing, noting that the financing will be even more lucrative than the deal fee, and that it would be unfair for the banker to be disabled from taking such an engagement on after it did such a good job for the public stockholders.

### CC/CBC

- *Should the committee accede to this request?*
- **Comments from Bench**

Forty-five days after the merger agreement has been signed, while the S-4 is still being reviewed by the SEC, the Salt-n-Sugar CEO sees Heston at a political fundraising dinner and mentions that, hypothetically, it could make a bid for the same amount of cash and for stock with a greater current value than the stock of Freezer Foods (which had traded down over the last several weeks.) Salt-n-Sugar's CEO notes that such a hypothetical transaction could close several months sooner because there will be no antitrust issues and that there is no reason to think that Freezer Food stock will outpace that of Salt-n-Sugar. He also notes that his company is cash rich from a recent divestiture and can essentially pay for entire deal out of its cash reserves and current credit facilities, thus eliminating any financing risk.

### CC/SP

- *Is there any reason to continue using a special committee given that the CEO will exit the Company in either deal and will receive the same compensation as the other stockholders?*

### RBC/CBC

- *Can the Company use Banker in deciding how to react to the hypothetical, given banker's interest in buy-side work in the Freezer Foods deal?*
- **Comments from Bench**

In order to comply with the deal protection provisions of the merger agreement, SoyLent reports this contact to Freezer Foods. Freezer Foods insists that SoyLent (1) not violate its no shop by responding to Salt-n-Sugar and (2) "enforce" the standstill agreement, since it has agreed, in the merger agreement, not to waive any material contact. The board of directors meets and consults

with the Company's regular banker who it has re-engaged. The board discusses the fact that the stock of Salt-n-Sugar is trading well above its current value for several reasons unique to its business, which are unlikely to change over the next year or two, but that the combination of SoyLent and Freezer Foods will create a market leader with significant pricing power that will result in greater value for long term stockholder. The board also believes that a significant part of Salt-n-Sugar's willingness to pay a large premium is due to "synergies" that will devastate SoyLent's US employee base, whereas Freezer Foods was likely to retain a much greater number of the Company's employees.

### FFC/CC

- *Given the amount of cash in this transaction, can the board consider future stock price in its analysis?*
- **Comments from Bench** – *what does QVC teach on this?*
- *What relevance to their decision is the future of SoyLent's employee base?*
- *Can the Board ignore Salt-n-Sugar's renewed interest based on the contracts it has signed?*
- *What about its disclosure duties?*
- **Comments from Bench on Board's dilemma.**

The board decides it is in the best interest of stockholders to stay the course with the Freezer Foods deal. Salt-n-Sugar launches a hostile offer, recognizing that most of the stock is held by sophisticated institutions who are very likely to tender into the higher price transaction. The Company has not held an election in the last thirteen months (having delayed its annual meeting until the proxy statement for the merger was cleared in order to avoid having two meetings.) Salt-n-Sugar files a Section 211 action asking the Company to set an annual meeting date as quickly

as possible with the plan of running a slate that will redeem the Company's poison pill, waive any violation of the standstill agreement, and take any action necessary under Section 203 so that it can close on its tender/exchange offer. At the same time, it files a lawsuit seeking to invalidate the covenants in the merger agreement pursuant to which the Company agreed not to amend or take any other action with respect to its rights plan or the standstill without consent of Freezer Food.

### CC/SSC

- *What protection will Section 203 provide?*
- *Are the covenants relating to the pill and the standstill enforceable?*
- **Comments from Bench**
- *How would the situation differ if the CEO only owned 5% of the Company?*

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