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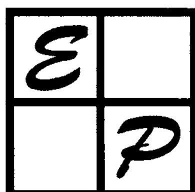

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Five Day Tender Offers: What Can Market Participants Expect?

By James Moloney, Glenn Pollner and Cem Surmeli of Gibson, Dunn & Crutcher LLP[1]

Following the issuance of a no-action letter, dated January 23, 2015 (the "No-Action Letter"), by the Division of Corporation Finance (the "Staff") of the Securities and Exchange Commission (the "SEC"), issuers, and their parent entities and wholly-owned subsidiaries, are now permitted to conduct five business day tender offers for any and all of their non-convertible debt securities so long as certain conditions are met ("Five Day Tender Offers").[2] Such conditions include requirements that the offer is: (i) announced via press release through a widely disseminated news or wire service ("Immediate Widespread Dissemination"); (i) not made in connection with a solicitation of consents to amend any of the agreements governing the subject securities; and (iii) open to all record and beneficial holders of the subject securities (except with respect to exchange offers where Qualified Debt Securities (as defined in the No-Action Letter) are offered solely to Qualified Institutional Buyers ("QIBs")[3]and non-U.S. persons (together with QIBS, "Eligible Exchange Offer Participants")).[4]

The advent of the Five Day Tender Offer is likely to have significant implications for participants in the debt markets, including issuers, dealer-managers and institutional investors, and potentially signals broader regulatory shifts that may impact tender offers on a larger scale. Although the full scope and breadth of these implications are not entirely clear, as the use of the Five Day Tender Offer potentially becomes widespread[5], the following implications and considerations may emerge and become more relevant to market participants.

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[2] SEC No-Action Letter, *Cahill Gordon & Reindel LLP* (January 23, 2015).

[3] As defined in Rule 144A under the Securities Act of 1933, as amended (the "Securities Act").

[4] *See id.; see also* James Moloney, Sean Sullivan and Todd Trattner, *Five Day Tender Offers: Conditions and Timelines*, in this March/April 2015 issue of *Deal Lawyers* (discussing each of the conditions that must be satisfied in order to conduct Five Day Tender Offers).

[5] The first issuer to conduct a Five Day Tender Offer appears to be Waste Management, Inc. *See Waste Management Announces Cash Tender Offer* (Feb 18, 2015), *http://investors.wm.com/phoenix.zhtml?c=119743&p=irol-recentnewsArticle&ID=2017702*.

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Implications for Issuers

Issuers conducting Five Day Tender Offers will need to reexamine the mechanics for their tender offers, as well as the substantive disclosures contained in their tender offer materials, in order to optimize the results of an offer conducted during the short time period. In particular, issuers may emphasize drafting shorter disclosures that are easier for holders of debt securities to read and comprehend in the short time span available. With respect to mechanics, Five Day Tender Offers will afford issuers significantly less time to communicate with and receive a response from holders, as compared to a 20-business day tender offer period. Issuers will need to work closely with their dealer-managers and legal and financial advisors to ensure that the offering documentation is finalized prior to 10 a.m. (Eastern time) on the date of commencement, and all eligible holders receive the tender offer materials with sufficient time to consider the offer and decide whether or not to tender their securities. Accordingly, issuers will want to work with their trustees to maintain a complete and accurate list of the email addresses of the holders of their debt securities.

While the initial cost and burden associated with dissemination will be lessened by the elimination of hard copy distributions and mailings, the shift to public and immediate dissemination (*e.g.*, via email, press release and 8-K filing, when the issuer is a public reporting company) will mean that the press, analysts, rating agencies and institutional investor services will have greater access to the tender documents. As a result, issuers can expect to receive increased attention and publicity with respect to their debt tender offers. Some of this attention may be beneficial, resulting in higher tender participation rates. At the same time, it could lead to increased scrutiny from other stakeholders, such as holders of debt securities that are not sought in the tender offer, equity holders, analysts, financial media and perhaps even regulators such as the SEC.

In addition to these practical considerations, issuers, working with their legal and financial advisors, will need to consider how best to structure and time their Five Day Tender Offers given the restriction on simultaneous consent solicitations. The inability to solicit consents will likely prevent many issuers from stripping out covenants present in a related indenture, a practice particularly common in connection with tender offers for high yield debt.[6] This limitation, however, should not pose a significant burden for issuers with debt securities that were initially rated investment grade when issued but have since been downgraded—so-called "fallen angels"—because the related indentures would not contain as many potentially problematic covenants. It is possible, however, that issuers with covenants in their indentures requiring attention may seek to impose relatively high minimum tender conditions in their offers to minimize the potential for defaults or cross-defaults in any bonds not tendered in the tender offer and that remain outstanding. In doing so, issuers may be able to minimize the number of bonds that remain outstanding following consummation of the offer to the point at which either the remaining stub is immaterial or the bonds can be acquired by means of a redemption pursuant to the relevant indenture terms, open market purchase or other acquisition method or satisfied and discharged and/or defeased under the relevant indenture terms. Furthermore, issuers may strategically choose the timing of their offers to minimize market risks and avoid weekends and federal holidays to maximize participation rates.

With respect to exchange offers, there will be other matters for issuers to consider. For example, while the No-Action Letter contemplates the ability to make a "private" offering of Qualified Debt Securities to investors who are QIBs or non-U.S. persons, it also requires Immediate Widespread Dissemination of the tender offer materials. As a result, an issuer may be viewed as engaging in a "general solicitation" when it sends emails and issues press releases announcing the tender offer, which would necessitate reliance on a private offering exemption that permits general solicitation. However, there may be ways in which an issuer can structure its public disclosures in order to minimize the likelihood that its communications could be deemed a general solicitation. One such approach would be for the initial offering communication to consist solely of a simple notice of transaction with directions to a secure website established by the issuer where an investor would have to "click through" and certify its QIB or non-U.S. person status in order to receive the full offer materials; any investor unable to certify to such status would be directed to a separate page with information on the cash election option afforded to such holders (as discussed more fully herein). But regardless of whether such communications rise to the level of a general solicitation, issuers contemplating exchange offers will want to carefully consider the available exemptions from registration under the U.S. securities laws. For example:

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[6] *See generally* Charles T. Haag and Zachary A. Keller, *Honored in the Breach: Issues in the Regulation of Tender Offers for Debt Securities,* 9 N.Y.U. J. L. & Bus. 199, 240-43 (2012) (discussing the use of consent solicitations in conjunction with debt tender offers).

- Rule 506(c) and/or Rule 144A under the Securities Act may provide an exemption for the offer of Qualified Debt Securities to QIBs.[7] Both of these rules were recently amended to allow for general solicitation.[8] Although Rule 144A (a resale exemption) cannot be utilized directly by issuers, a wholly-owned subsidiary of the issuer may be able to conduct a Five Day Tender Offer on the issuer's behalf while relying on Rule 144A.[9]
- Section 3(a)(9) of the Securities Act may provide another exemption where general solicitation is permitted. Section 3(a)(9) confers the added benefit that the securities distributed to holders in the exchange may not be deemed "restricted" securities, as their restriction would depend on the status of the securities surrendered in exchange. In contrast, all securities distributed while relying on Rule 144A or Rule 506(c) would be restricted. To the extent an issuer seeks to rely on Section 3(a)(9), it will be important for issuers and their counsel to carefully define the nature and scope of any dealer-manager's activities, as well as the compensation paid for such services, to ensure full compliance with the terms and conditions of Section 3(a)(9), particularly in light of the restrictions in Section 3(a)(9) against providing compensation for soliciting tenders or exchanges.
- Regulation S under the Securities Act should be available with respect to exchange offers made to non-U.S. persons.[10]

The foregoing exemptions should be evaluated fully in the context of a Five Day Tender Offer. For example, Rule 506(c) permits offers to be made to accredited investors, which includes a broader range of investors relative to QIBs.[11] However, given that the No-Action Letter limits an issuer's ability to offer Qualified Debt Securities to QIBs and non-U.S. persons under Regulation S, the added category of "accredited investor" offerees under Rule 506(c) may provide little incremental benefit, while giving rise to additional compliance burdens.

Holders of debt securities that are neither QIBs nor non-U.S. persons under Regulation S must be offered an election to receive cash (rather than the Qualified Debt Securities) in an amount that reasonably approximates the value of the subject securities. Without a cap, issuers might have to make significant outlays of cash in such exchange offers, depending on the proportion of ineligible holders that choose to receive cash. In order to limit this risk, issuers will likely condition their exchange offers on not more than a certain percentage of Eligible Exchange Offer Participants electing to receive cash. To the extent that such conditions become commonplace in exchange offers conducted on an accelerated timetable, it is likely that non-Eligible Exchange Offer Participants will seek to sell or transfer their debt securities to QIBs or non-U.S. persons that are eligible to participate in the exchange offer. This could create arbitrage opportunities for some market participants, and the guaranteed delivery procedures mandated by the No-Action Letter[12] may facilitate such transfers.

Implications for Dealer-Mangers / Financial Advisors

Based on the requirements outlined in the No-Action Letter, the role of dealer-managers is likely to evolve in the context of a Five Day Tender Offer. Whereas dealer-managers previously played a significant role in the tender offer process by ensuring full dissemination of tender offer materials to holders of debt securities at the commencement of the offer, the Immediate Widespread Dissemination requirement will render this function less prominent. Instead, the dealer-managers' role in determining the structure and economic terms of the offer, evaluating appropriate tender conditions, assisting with financing and engaging in follow-up communications with, and providing information to, holders following the initial distribution of tender offer materials will become more critical.

In addition, it may be advantageous for issuers to use dealer-managers to perform some limited "testing the waters" prior to commencing a debt tender offer. Given the relatively short time span involved,

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[7] See 17 C.F.R. § 230.144A (2013); 17 C.F.R. § 230.506(c) (2013).

[8] *See* Andrew Fabens, Peter Wardle and Stewart McDowell, *SEC Approves Final Rules to Permit Advertising in Rule 506 and rule 144A Offerings; Also Proposes Rules to Add Additional Investor Protections,* Securities Regulation and Corporate Governance Monitor *(July 11, 2013), http://www.securitiesregulationmonitor.com/Lists/Posts/Post.aspx?ID=205.*

[9] *See* SEC Division of Corporation Finance, Compliance & Disclosure Interpretations, Securities Act Rules (Interpretation #138.01) (January 26, 2009), available at *http://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm.*

[10] See 17 C.F.R. §§ 230.901 – 230.905 ([illegible]).

[11] See 17 C.F.R. § 230.501(a).

[12] The No-Action Letter requires that Five Day Tender Offers permit tenders from holders through the expiration of the offer using a guaranteed delivery procedure.

existing holders may be open to signing confidentiality agreements with a limited duration and may even be willing to sign lock-ups (albeit subject to specified conditions) in advance that would provide issuers with greater certainty on the acceptability of the offer terms to a sufficient number of holders. In doing so, issuers could disclose in their offer materials that holders with a specified percentage of the subject securities have agreed to tender the securities in the offer. Negotiating such lock-ups in advance should make it more likely that the offer is ultimately successful.

Moreover, given the short time frame for conducting tender and exchange offers pursuant to the No-Action Letter, any diligence on the issuer and/or guarantors would need to be conducted in advance. It is possible that some issuers will have their financial advisors perform such diligence early on, so that they are in a position to launch a tender or exchange offer on relatively short notice. This new-found flexibility should allow issuers to benefit from any windows of opportunity that may arise when low interest rates or other favorable market conditions prevail, provided they have prepared for the refinancing event in advance.

Implications for Holders of Debt Securities

The most obvious difference for holders of debt securities in a Five Day Tender Offer is that they will have significantly less time to evaluate the terms of an offer relative to a 20-business day tender offer. Combined with the shift to electronic dissemination of the offer materials, a holder may wish to take steps to see that it does not miss a tender offer entirely or learn about it too late in the process to make a fully informed investment decision. In order to reduce this risk, holders should sign up for corporate action lists that issuers will use to electronically distribute press releases related to the offer, and carefully monitor electronic communications coming from issuers where they have an investment in debt securities. Holders should also review press and analyst coverage dedicated to the offer. The Immediate Widespread Dissemination of the offer materials should encourage both the press and analyst community to pay greater attention to Five Day Tender Offers, and their coverage may provide investors with more helpful information and insight vis-à-vis traditional debt tender offers, in which only the most basic terms are summarized in a press release.

Implications for the Broader Regulatory Scheme

The issuance of the No-Action Letter also raises some important questions regarding the U.S. regulatory scheme applicable to tender offers, both with respect to the mechanics of Five Day Tender Offers in practice, as well as the extent to which the policies underlying the Five Day Tender Offer may be extended to other tender offer contexts. For example, the No-Action Letter did not address how financing or funding conditions might operate in a Five Day Tender Offer. Generally, the Staff has taken the position that any financing or funding condition placed on a tender offer must be satisfied or waived at least five business days prior to the expiration of the offer.[13] If an issuer conducting a Five Day Tender Offer must adhere strictly to this interpretive position, then issuers and lenders will likely need to change their procedures to ensure that all financing arrangements are in place on or before the time an offer is commenced, which may be impracticable. In light of the brevity of Five Day Tender Offers, a more reasonable interpretation might be to allow financing or funding conditions to be satisfied or waived on or shortly before the expiration of the offer. Indeed, given that the No-Action Letter permits a change in the consideration being offered as long as the offer remains open for five business days thereafter, it is arguable that a financing condition is significantly less material than a change in price and thus should require an offer to stay open for significantly less time, if at all. In this regard, at several American Bar Association and other securities law conferences, senior members of the Staff have indicated, albeit informally, that a shorter period, such as three business days prior to the expiration, may be acceptable, depending on the circumstances.

Similarly, there is also some uncertainty surrounding whether an "early tender" fee or a waterfall debt tender structure would be permissible in a Five Day Tender Offer context.[14] The Staff likely would not permit such practices due to the abbreviated nature of the offering period. In addition, at least one

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[13] *See* SEC Comment Letter, *Nicole Crafts LLC* (October 21, 2011).

[14] In general, the offeror in a waterfall tender offer will seek to purchase securities from across multiple series or classes of debt, but will limit the overall consideration to a fixed dollar amount and/or aggregate amount of securities (in an exchange offer context). The offeror will arrange the classes of securities sought in order of priority, with holders of debt securities with the highest priority having the best opportunity to tender and have such securities accepted for purchase. To the extent tenders from holders of debt with a higher priority do not completely exhaust the consideration offered, any remaining amounts will "flow" down from series to series in order of priority until the offer consideration is completely exhausted, thereby creating a "waterfall" structure.

senior Staff member has stated at a recent securities law conference that a waterfall structure could *not* be incorporated into a Five Day Tender Offer.[15] While certain innovative market participants may well seek to test the outer boundaries of the No-Action Letter before formal Staff guidance can be published on this and other issues, the mandatory widespread dissemination of offers is likely to attract sufficient regulatory scrutiny to deter aggressive market practices.

It is also possible that, in light of the No-Action Letter, the Staff may begin to reevaluate other aspects of the regulatory scheme applicable to traditional 20-business day tender offers and may be willing to apply some of the policy perspectives of, and rationale behind, the No-Action Letter in other tender offer contexts. For example, the No-Action Letter indicates that where offer materials are disseminated in a widespread and immediate fashion, five business days is a sufficient time to conduct an entire tender offer. Similarly, a change in the consideration offered in a Five Day Tender Offer merely requires the offer to remain open for five business days subsequent to the change.[16] Applying the logic of the No-Action Letter, the Staff may be open to accepting shorter time periods in other situations, such as those in which an early tender premium is initially offered in a traditional 20-business day tender offer and the early tender premium is later increased and/or the early tender period is extended. In such situations, assuming the change is disseminated broadly by a press release and emailed to the subscribers of corporate action lists, it may be acceptable to hold the offer open for only five business days following the early tender deadline. Likewise, the No-Action Letter takes the position that in certain contexts immediate Widespread Dissemination of tender offer materials is an acceptable alternative to physical delivery. Depending on the success or failure of this approach in Five Day Tender Offers, the Staff may choose to permit this practice in all debt tender offers, or perhaps even equity tender offers.

What remains to be seen is exactly how widespread and accepted Five Business Day Offers will become in the long run. One thing is certain, however, market participants will do their best to adapt current practices to take full advantage of all the benefits afforded by the No-Action Letter, which going forward will allow issuers to conduct their tender and exchange offers in as little as five business days. Some might even say less than five business days given that such offers can expire as early as 5:00 p.m. (Eastern time), on the date of expiration, as opposed to midnight, the expiration time traditionally imposed in order for the last day to count as a full business day.

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[15] Michele Anderson, Chief of the Office of Mergers & Acquisitions, speaking at Northwestern Law's 42nd Annual Securities Regulation Institute in Coronado, CA (Jan. 26 – 28, 2015).

[16] In contrast, Rule 14e-1(b) of the Exchange Act of 1934, as amended, requires that tender offers remain open for at least ten business days following any announced increase or decrease in the consideration offered. 17 C.F.R. § 240.14e-1(b) (2008).

Upcoming Webcasts

Here are critical webcasts coming up soon:

- **TheCorporateCounsel.net's** webcast—"Conduct of the Annual Meeting" (3/3)
- **DealLawyers.com's** webcast—"Merger Filings with the SEC: Nuts & Bolts" (3/4)
- **CompensationStandards.com's** webcast—"The Top Compensation Consultants Speak" (3/10)
- **TheCorporateCounsel.net's** webcast—"Proxy Access: The Halftime Show" (3/24)
- **TheCorporateCounsel.net's** webcast—"Form S-8: Share Counting, Fee Calculations & Other Tricks of the Trade" (5/5)
- **TheCorporateCounsel.net's** webcast—"Escheatment Soup to Nuts: Handling Unclaimed Property Audits & More" (6/2)
- **DealLawyers.com's** webcast—"Selling the Public Company: Methods, Structures, Process, Negotiating, Terms & Director Duties" (6/11)
- **CompensationStandards.com's** webcast—"Proxy Season Post-Mortem: The Latest Compensation Disclosures" (6/16)

Five Day Tender Offers: Conditions and Timelines

By James Moloney, Sean Sullivan and Todd Trattner of Gibson, Dunn & Crutcher LLP[1]

In January 2015, the Division of Corporation Finance (the "Staff") of the Securities and Exchange Commission ("SEC") issued a no-action letter (the "No-Action Letter") permitting issuers, including their parents or wholly-owned subsidiaries, to conduct five business day tender offers for any and all non-convertible debt securities when certain conditions are met ("Five Day Tender Offers").[2] This expands a nearly 30-year old interpretive position pursuant to which the Staff has generally allowed for an abbreviated offering period of seven-to-ten calendar days, but limited that position to tender offers for investment grade debt securities.[3] The abbreviated offer period is substantially less than the 20-business day minimum requirement established by Rule 14e-1 under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). The No-Action Letter also permits this shortened timeframe to be utilized in exchange offers in which non-convertible debt securities are issued for nearly identical debt securities that are the subject of the tender offer, as long as certain other conditions are met.

Five Day Tender Offer Conditions

In order to be eligible to conduct a Five Day Tender Offer consistent with the framework outlined in the No-Action Letter, a tender offer generally must satisfy the conditions described below. All times noted below are Eastern time.

The Offer

Immediate Widespread Dissemination. The announcement of the offer must be made by "Immediate Widespread Dissemination," which means that it must be announced in a press release through a widely disseminated news or wire service and disclose:

- the basic terms of the offer (identity of the offeror, class of securities sought, type and amount of consideration, expiration date of the offer); and
- the Internet address where the offer and letter of transmittal (if any) and other instructions and documents (including a form of guaranteed delivery instructions) can be found.

The announcement must be made by 10:00 a.m. in order for such day to count as the first day of the Five Day Tender Offer. In addition to Immediate Widespread Dissemination, under the Five Day Tender Offer framework, the offeror is required to (i) use commercially reasonable efforts to send the press release via electronic mail to all investors subscribing to corporate action emails or similar data, (ii) use other customary methods to expedite the dissemination of information concerning the offer to beneficial holders of the debt securities and (iii) issue a press release promptly after the closing of the offer setting forth the results.

Current Report on Form 8-K Filing. If an issuer is a reporting company under the Exchange Act (including a voluntary filer), it must provide the press release as an exhibit to a Current Report on Form 8-K filed with the SEC prior to 12:00 noon, in order for such day to count as the first day of the five business day offer period.

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[1] © 2015 Gibson, Dunn & Crutcher LLP. James J. Moloney is Co-Chair of the Securities Regulation and Corporate Governance Practice Group and is a Partner in the Corporate Transactions Group in Gibson Dunn's Orange County office. Sean Sullivan and Todd Trattner are Associates in the Corporate Transactions Group in Gibson Dunn's San Francisco office.

[2] SEC No-Action Letter, *Cahill Gordon & Reindel LLP* (January 23, 2015).

[3] See SEC No-Action Letter, *Goldman, Sachs & Co.* (March 26, 1986); SEC No-Action Letter, *Salomon Brothers Inc.* (March 12, 1986). "The no-action position encompasses the letters issued to Goldman, Sachs & Co. (March 26, 1986), Salomon Brothers Inc. (March 12, 1986), Salomon Brothers Inc. (October 1, 1990) and any similar letters relating to abbreviated offering periods for nonconvertible debt tender offers. None of the foregoing letters should be taken to express the Division's position with respect to tender offers commencing after January 23, 2015." SEC No-Action Letter, *Cahill Gordon & Reindel LLP* (January 23, 2015).

Changes to the Offer. Any changes to the offer must be communicated by Immediate Widespread Dissemination by 10:00 a.m.:

- at least five business days prior to expiration of the offer for any change in the consideration offered; and
- at least three business days prior to expiration of the offer for any other material change to the offer.

If the issuer is a reporting company under the Exchange Act (including a voluntary filer), the issuer must describe any change in the consideration being offered in a Current Report on Form 8-K filed with the SEC prior to 12:00 noon, at least five business days prior to expiration of the offer. The ability to announce a price change with only five business days remaining in the offer is a substantial reduction in time from the ten business days that would otherwise be required under Rule 14e-1(b) of the Exchange Act.

Guaranteed Delivery Procedure. The offer must permit tenders from holders through the expiration of the offer using a guaranteed delivery procedure, in which a certification by or on behalf of a holder guarantees that the holder is tendering securities beneficially owned by it and that the delivery of the securities will be made no later than the close of business on the second business day after expiration.

Withdrawal Rights. The offer must provide for withdrawal rights that are exercisable at least until the earlier of (i) the expiration date of the offer and (ii) the tenth business day after commencement of the offer in the event that the offer is extended. In addition, the offer must provide for withdrawal rights at any time after the 60th business day following commencement if, for any reason, the offer has not been consummated by that time.

Parties and Consideration

Issuer. The offer must be made by the issuer, a direct or indirect wholly-owned subsidiary of the issuer or a parent company that directly or indirectly owns 100% of the capital stock (other than directors' qualifying shares) of the issuer.

Non-Convertible Debt Securities. The offer must be made for a class or series of non-convertible debt securities, and can be made for such securities regardless of the rating of the debt securities. This differs from prior SEC guidance, which limited the shortened tender offer framework to offers associated with investment grade debt securities. The offer must be for any and all securities of the class. The No-Action Letter also allows for separate offers to be made for more than one class or series of debt securities as part of the same offer to purchase document.

Consideration. Consideration for the Five Day Tender Offer must consist of (i) cash, (ii) Qualified Debt Securities, as defined in the No-Action Letter, or (iii) a combination of cash and Qualified Debt Securities.

Benchmark Pricing. The consideration offered may be (i) a fixed amount of cash (and/or Qualified Debt Securities) or (ii) an amount of cash (and/or Qualified Debt Securities) that is determined based on a fixed spread to a particular benchmark, as discussed in the No-Action Letter. In the case of Qualified Debt Securities, the coupon may be based on a spread to a specified benchmark.

No Early Settlement. The offer must provide that the offeror will not pay the consideration offered until promptly after the expiration date, pursuant to Rule 14e-1(c). This condition effectively precludes payment of the consideration offered on a rolling basis as securities are tendered in the offer.

Open to All Holders. The offer must be open to all record and beneficial holders of the debt securities subject to the offer. In the case of an exchange offer in which Qualified Debt Securities are offered, the offer of new debt securities must be restricted to Qualified Institutional Buyers (as defined in Rule 144A

under the Securities Act of 1933, as amended (the Securities Act), QIBs) and/or non-U.S. persons (within the meaning of Regulation S under the Securities Act) (collectively, Eligible Exchange Offer Participants) in a transaction that is exempt from the registration requirements of the Securities Act. Holders that are not Eligible Exchange Offer Participants (or an affiliate thereof) must be given an option concurrent with the offer to receive cash, from either the offeror or a dealer-manager, for such holders' debt securities in a fixed amount (set forth at the commencement of the offer) that approximates the value of the Qualified Debt Securities being offered, as determined by the offeror in its reasonable judgment. The shortened tender offer framework is not available for partial offers.

Exclusions

Senior Debt. The offer may not be financed with debt that (i) has obligors, guarantors or collateral (or a higher priority with respect to collateral) that differs from the subject debt securities, (ii) has a weighted average life to maturity less than that of the subject debt securities or (iii) is otherwise senior in right of payment to the subject debt securities. However, an issuer may use funds from indebtedness or borrowings under any credit or debt facility that exists prior to the commencement of the offer. Accordingly, the parent of an issuer of debt securities would be precluded from offering its own debt securities in exchange for the subject debt securities.

Consent Solicitation. The offer may not be made in connection with a solicitation of consents to amend the indenture, form of security or note or other agreement governing the subject debt securities.

Default. The offer may not be made if a default or event of default exists under the Indenture or any other indenture or material credit agreement to which the issuer is a party.

Bankruptcy or Insolvency. The offer may not be made if the issuer is the subject of bankruptcy or insolvency proceedings, has commenced a solicitation of consents for a "pre-packaged" bankruptcy proceeding or if the board of directors of the issuer has authorized discussions with creditors of the issuer to effect a consensual restructuring of the issuer's outstanding debt.

Change of Control or Other Extraordinary Transactions. In addition, the offer may not be:

- made in anticipation of or in response to, or concurrently with, a change of control or other type of extraordinary transaction involving the issuer (such as a merger or similar business combination, reorganization or liquidation or a sale of all or substantially all of its consolidated assets);

- made in anticipation of or in response to other tender offers for the issuer's securities;

- made concurrently with a tender offer by the issuer (or any subsidiary or parent company of the issuer) for any other series of the issuer's securities if the consummation of such offer would add obligors, guarantors or collateral, increase the priority of liens securing such other series or shorten the weighted average life to maturity of such other series; or

- commenced within ten business days after the first public announcement or the consummation of the purchase, sale or transfer by the issuer or any of its subsidiaries of a material business or amount of assets that would require the furnishing of pro forma financial information with respect to such transaction pursuant to Article 11 of Regulation S-X (whether or not the issuer is subject to reporting requirements under the Exchange Act).

Illustrative Timeline: Five Day Tender Offer Framework

The following timeline sets forth an illustrative schedule for conducting an offer consistent with the Five Day Tender Offer framework set forth in the No-Action Letter. Only business days are included in the timeline.

Five Day Tender Offer Framework

Monday	Thursday	Friday	Tuesday (Week 2)	Monday (Week 13)
Commencement of the Offer	**Day Prior to Expiration of the Offer**	**Expiration of the Offer**	**Delivery of Securities**	**If Offer has not been Consummated**
10:00 a.m.—Deadline for Immediate Widespread Dissemination of the offer. • Announce the basic terms of the offer and the Internet address in a press release. • Announce the spread used, if any, for determining the amount of consideration offered. • Announce the fixed amount of the interest rate or the spread used for determining the interest rate for an offer of Qualified Debt Securities. • In the case of an offer of Qualified Debt Securities, announce the minimum acceptance amount, if any. • Offer holders who are not Eligible Exchange Offer Participants the option to receive cash in a fixed amount that approximates the value of the Qualified Debt Securities being offered. **12:00 noon**—Deadline for reporting companies to file a Current Report on Form 8-K.	**9:00 a.m.**-Deadline to announce the final interest rate if a range was used to determine the interest rate or spread at commencement.	**2:00 p.m.**—Disclose by press release the exact amount of consideration and the interest rate (in the case of amounts or interest rates based on fixed spreads to a benchmark) of any Qualified Debt Securities. ——— **Prior to Expiration**—Tender withdrawals allowed before expiration of the offer. ——— **Closing**—Issue a press release promptly after the closing of the offer setting forth the results.	**Close of Business**—Deadline for holders to deliver securities that were tendered via guaranteed delivery procedures.	**At Any Time**—[illegible] withdrawals at any time on or after [illegible] securities were not accepted for purchase and paid for.

Other Key Dates When Changing Consideration or Other Material Terms

Monday (Week X)*	Wednesday (Week X)	Friday (Week X) Expiration of the Changed Offer	*Week X refers to the week of the new expiration date of the amended offer*
10:00 a.m.—Deadline for Immediate Widespread Dissemination of changes in consideration offered. ——— **12:00 noon**—Deadline for reporting companies to file Form 8-K disclosing changes in consideration offered.	**10:00 a.m.**—Deadline for Immediate Widespread Dissemination of material changes other than changes in the consideration offered.	**Prior to Expiration**—Tender withdrawals allowed before expiration of the offer.	

Potential Changes in Practice

The following table sets forth some of the key differences between shortened offers conducted prior to the release of the No-Action Letter and offers that can be conducted consistent with the Five Day Tender Offer framework set forth in the No-Action Letter:

	Practice prior to the release of the No-Action Letter	***Practice consistent with the Five Day Tender Offer framework set forth in the No-Action Letter***
Credit Rating	Shortened tender offers were limited to investment grade non-convertible debt securities.	Shortened tender offers are allowed for both investment grade and non-investment grade non-convertible debt securities.
Time Offer Held Open	Shortened offers were held open for as few as seven to ten calendar days.	Shortened offers may be held open for as few as five business days.
Dissemination	Shortened offers were disseminated on an expedited basis.	Shortened offers must be delivered via Immediate Widespread Dissemination (as described above).
Commencement	Shortened offers were often delivered to the DTC a few minutes before midnight on the commencement date.	Shortened offers are required to be announced by 10:00 a.m. (Eastern) on the commencement date.
Current Report on Form 8-K	No Current Report on Form 8-K filing was required for shortened offers and few companies voluntarily filed such 8-Ks.	Reporting companies must provide the press release in a Current Report on Form 8-K filed with the SEC prior to 12:00 noon (Eastern) on the commencement date.
Exchange Offer	Shortened offers were limited to cash-only tender offers. Exchange Offers were not eligible for abbreviated offering period.	The consideration offered in shortened offers may be (i) cash, (ii) Qualified Debt Securities or (iii) a combination thereof.
Guaranteed Delivery	Shortened offers were not required to provide a guaranteed delivery procedure.	Shortened offers are required to provide a guaranteed delivery procedure by means of a certification.
Withdrawal & Settlement	Shortened offers were not required to provide for withdrawal rights and could provide for early settlement with payment made on a rolling basis as securities were tendered.	Shortened offers must provide for withdrawal rights and the offeror may not pay the consideration offered until promptly after expiration of the offer.
No Exit Consents	Shortened offers could be made in connection with an exit consent that would typically allow for the stripping of covenants in the indenture.	Shortened offers may not be made in connection with an exit consent. The stripping of covenants in the related indenture is not allowed.
Disqualifying Circumstances	Shortened offers were not allowed in connection with other change of control circumstances or tender offers.	Shortened offers may not be made in connection with, among other circumstances, other tender offers, issuances of senior debt, defaults, insolvency proceedings, a change of control transaction, structural changes and material acquisitions and/or dispositions.

Wake-Up Call for Private M&A Deal Structuring

By Ethan Klingsberg, Partner, Cleary Gottlieb Steen & Hamilton LLP[1]

The widespread practice in private acquisitions of combining a "subsidiary merger" acquisition structure with release, indemnification, and escrow arrangements, which purport to bind the target stockholders, received a jolt from the Delaware Court of Chancery's recent decision in Cigna v. Audax. The merger structure, ubiquitious in acquisitions of publicly traded targets, has emerged as the structure of choice in acquisitions of private targets that have a number of non-insider stockholders from whom it is not practicable to obtain an agreement to sell their stock during the period prior to signing a definitive acquisition agreement.

When preparing merger agreements in this private M&A context, the parties regularly layer in provisions that have their origin in stock purchase agreements, as opposed to public-company merger agreements, including the release, indemnification, and escrow provisions addressed by the Court. This new decision is a wake up call for acquirors to the risks that come with this approach and the care that is required to address these risks.

How Did We Get Here?

Many private companies, especially start-ups, incentivize their employees with equity and raise capital from a spectrum of sources. These companies often end up with a stockholder profile that includes numerous low level employees, some former employees, some strategic investors and a bunch of individual, fund and institutional investors that are not actively involved with governance or oversight of the company. For an acquiror that wants to enter into a definitive acquisition agreement quickly and confidentially, the idea of collecting signatures to a stock purchase agreement from each of these non-insider holders is both unappealing and impractical.

Fortunately, the stockholder profile will regularly include not only this unwieldy group, but also a small number of insider holders—usually founders and venture capital funds with board seats—that hold the requisite voting power to approve and force a sale of all of the shares of the company by merger. The merger structure permits the acquiror to acquire 100% of the target company by obtaining quick approvals from the target's board and the insider stockholders (the latter approval being available at almost all private companies by written consent in lieu of a meeting). Whether or not a target stockholder is one of those that consented to the merger, the holder's stock is canceled at the closing by virtue of the merger and, subject to the right to pursue appraisal rights by the non-consenting holders, converted into merger consideration.

Meanwhile, the acquiror wants to have the customary protections of a stock purchase agreement: broad releases from the target stockholders, an indemnity from the target stockholders for breaches of the representations and warranties about the target's operations, and an escrow to secure at least part of these indemnity obligations. Is this asking for too much?

Tension between the Merger Structure and Private M&A Obligations of Target Stockholders

The efficiency of the merger agreement structure, in being able to squeeze out the non-insiders without their consent or involvement, has a tension with extending the customary post-closing protections afforded an acquiror of a privately held target. While state merger statutes provide that, with the approval of the target board and requisite stockholder vote or consent, all of the shares may be automatically converted into the merger consideration even though many holders may not have consented to the merger, no statutory mechanic exists to automatically bind all target stockholders to post-closing obligations, such as those found in the release and indemnity provisions of a stock purchase agreement, without individual consent from each such holder.

[1] My partners Benet O'Reilly, Glenn McGrory and Matt Salerno contributed ideas and insights to this article.

Quick Fix?

Undaunted by this chasm between the merger statute and the undertakings of a stock purchase agreement, practitioners regularly relied upon a solution that leveraged the customary letter of transmittal used in mergers for the exchange of a target holder's canceled shares for the merger consideration. The letter of transmittal had traditionally been a relatively simple document whereby the target holder would confirm ownership of its shares as part of the process of transmitting the shares in exchange for the merger consideration. The clever idea these practitioners had was to bulk up the letter of transmittal, sometimes to the extent that it would go on for several pages, and turn it into an opportunity to obtain a panolopy of agreements and obligations to benefit the acquiror, the most valuable of which were releases and indemnities.

Finally, a target stockholder said, "No thanks, I'm passing on signing this burdensome letter of transmittal that would impose upon me obligations not provided for in the merger statute, but I do want my merger consideration as required by the merger statute." Or, in other words, "Hold the obligations, but I'll take the cash." The Court of Chancery agreed and set forth an explanation that arguably deals a death blow to the use of the letter of transmittal as a way to resolve the tension between a merger statute and the desire to bind target stockholders with stock purchase agreement style obligations.

The obligation of the acquiror to pay the merger consideration, according to the Court, is a pre-existing duty that arises when the merger becomes effective. Nothing in the merger statute supports the idea that a target stockholder must sign up for further obligations as a condition to receipt of its merger consideration. The idea that the merger consideration is being provided in exchange for the target stockholder's election to sign up for these new obligations cannot fly because the closing of the merger already entitles the target stockholder to the consideration. Accordingly, the requirement to execute a supercharged letter of transmittal constitutes an attempt to create a binding contract without any consideration and therefore is wholly unenforceable.

Revisiting What Constitutes Merger Consideration

Requiring target stockholders to execute an obligation-laden letter of transmittal as a condition to receipt of their merger consideration is not the only technique for addressing the disconnect between the merger structure and the imposition on target stockholders of post-closing obligations to the acquiror. An alternative is to attempt to bake these obligations into the merger agreement itself and thereby into the merger consideration itself. In other words, the right to the merger consideration comes with the limitations imposed by the obligations. The Court discusses this concept at length and concludes that there is, in certain instances, merit to this approach. Although the Court does not provide entirely precise guidance, the following principles emerge:

- *Releases and Indemnities for Amounts Beyond the Merger Consideration.* Obligations that are not defining limits on the actual merger consideration cannot be deemed to be part of the merger consideration and therefore will not be enforceable against target stockholders simply by virtue of the closing of the merger. Examples would include releases and undertakings to pay amounts in excess of the merger consideration. Even if these obligations are written into the merger agreement as obligations of the target stockholders, the effectiveness of the merger, by itself, is not going to be sufficient to cause these obligations to become binding on target stockholders.

- *Escrows, Holdbacks and Earn-Outs.* Provisions in the merger agreement for setting aside funds that would otherwise have been merger consideration—*e.g.*, in an escrow account or as a holdback—to secure post-closing indemnity and purchase price adjustment obligations, or to function as an earn-out, should be enforceable if drafted appropriately, as these structures may be viewed as creating contingent rights of target stockholders to receive additional consideration, as opposed to new obligations. The Court does not directly rule on the enforceability of these provisions, but the dicta and precedents are supportive.

- *Merger Consideration Clawbacks for Indemnity Claims and Purchase Price Adjustments.* The most interesting area is subjecting the merger consideration delivered at closing to a clawback right of the acquiror—*e.g.*, a post-closing right of the acquiror to have merger consideration returned by,

the target stockholder based on purchase price adjustments or indemnification claims. According to the Court, whether these clawback rights will be enforceable against target stockholders by virtue of the merger should depend on the level of visibility that the stockholders have into the likelihood and extent of the clawback right being exercised.

The rationale for applying this standard is that target holders need to be in a position, in connection with the adoption of the merger agreement, where they can evaluate whether to exercise appraisal rights – the process whereby target holders may elect to forgo the receipt of merger consideration and commence legal proceedings to receive a dollar amount that the court ultimately determines to be "fair value" (which may be more or less than the merger consideration specified in the merger agreement). Thus, in the Court's view, when determining whether a clawback right is enforceable simply by being referenced as a component of the merger consideration, the key issue is whether the clawback right is, at the time of the adoption of the merger agreement, subject to sufficient parameters to permit a reasonable assessment of the right's impact on the value of the merger consideration.

- *A misguided standard.* The Court's decision to use this standard for determining the enforceabilty of indemnity clawbacks is distressing. Indemnity clawbacks, just like contingent rights to escrows, hold-backs and earn-outs, regularly do not meet the Court's test of having to be *"ascertainable, either precisely or within a reasonable range of values."*

  If they were, the parties would have just adjusted the purchase price up front. The ultimate impact of indemnities, escrows, hold backs and earn-outs is arguably always unascertainable at the time of adoption and that is why these mechanics are used. Moreover, since the consequences of these provisions will be based entirely on representations, warranties, or financial or other metrics for the very company with which the plaintiff is already familiar as an equity investor, the Court's efforts to protect the target stockholder from these provisions seem like an overreach.

- When applying this standard, at one end of the spectrum are post-closing clawbacks for all of the merger consideration, without limitations as to time and scope of damages, and based on potential breaches of a broad set of representations and warranties made by the target company. The consequence of imposing such a broad limitation on the merger consideration, according to the Court, is that *"the value of the merger consideration itself is not, in fact, ascertainable, either precisely or within a reasonable range of values."* As a result, such a broad clawback right conflicts with the merger statute and is not enforceable as a component of the merger consideration.

- At the other end of the spectrum are post-closing clawbacks of merger consideration based on well-defined purchase price adjustment provisions that include specific financial statement-based formulas and time limitations for resolution (*e.g.*, a typical, post-closing true-up of an adjustment to the purchase price derived from the closing balance sheet). Here, the Court's dicta implies that this type of well-defined clawback should be enforceable, but ultimately the Court leaves the issue wide open as does the one precedent that addresses the subject and that the Court cites approvingly.

- An even more grey area is inhabited by post-closing clawbacks for indemnification and purchase price adjustment that are limited in time (e.g., a one to three year survival period) and limited in scope as to damages and the nature of the subject matter covered by the indemnification. In the case at hand, the Court rejected the acquiror's right to clawback indemnity payments from the merger consideration payable by the non-consenting, plaintiff-stockholder to the extent those indemnity payments arise from claims for breaches of representations and warranties subject to a three year survival period and a monetary cap. But the Court provides little guidance as to why the three year limit or cap may be insufficient and notes that its decision is without prejudice to future challenges by the plaintiff.

- In sum, the Court provides insufficient clarity on the enforceability of indemnities fashioned as clawbacks of the merger consideration. For acquirors, this lack of a clear path to

enforceability in the context of indemnity claims can be costly, especially in the context of settlement discussions, given the other impediments, such as factual disputes, that often make it difficult for acquirors to recover on such claims.

- Stockholder Representative Appointments. Another unsettled area noted by the Court, but not addressed, is the authorization of stockholder representatives to act post-closing on behalf of non-consenting target stockholders—*e.g.*, in connection with defending and settling indemnification claims. Even if, by virtue of the merger alone, the right to clawback merger consideration to cover indemnity claims were enforceable, should the effectiveness of the merger automatically bind a target stockholder to the agency of the stockholder representative?

  Despite the efficiencies and practicality of this regularly used mechanic of a stockholder representative, the merger statute itself does not, at least on its face, appear to have a clear hook for binding a stockholder to the appointment of such a representative without the holder's consent. This may be an area where action by the legislature would be of value. One idea for legislation would be a scheme where the target stockholders are deemed to have accepted the representative's appointment unless they affirmatively opt out following a notice period.

Advice for Acquirors

Practitioners will be mistaken and misguiding their acquiror clients if they read this new Chancery Court decision as sending a message that use by acquirors of a merger structure when seeking private M&A style protections is inadvisable or somehow contrary to public policy. The quick fix of the letter of transmittal is off the table. But all is not lost.

- Support Agreements and Joinders. Nothing in the decision should be read to imply that broad indemnity obligations, even if implemented in the context of a merger structure, would be unenforceable *as a contractual matter* due to vagueness, public policy or any other reason. The Court makes clear that, even in the context of a merger structure, *"individual stockholders may contract—such as in the form of a Support Agreement—to accept the risk of having to reimburse the buyer over an indefinite period of time for breaches of the Merger Agreement's representations and warranties."* Accordingly acquirors should keep in mind the following considerations:

  - Undertakings and joinders, not just resolutions. Assure that at least all the insider stockholders, simultaneously with their execution of consents to the adoption of the merger agreement, execute express undertakings and joinders relating to releases, confidentiality, cooperation, indemnification, stockholder representative appointment and all other matters that arguably go beyond the express terms of the merger consideration. These undertakings and joinders should be in addition to their written consents to the stockholder resolutions that adopt the terms of the merger agreement, even if the terms of the merger agreement and the resolutions reflect these matters. *"The merger agreement, even though approved by the consenting stockholders, remains a contract solely between the acquiror and the target company,"* in the words of the Chancery Court. Accordingly, express contractual undertakings and joinders, and not the resolutions approving the merger, are the advisable means to bind the signatory stockholders.

  - Leverage Drag-Along Rights, Closing Conditionality and Pro Rata Formulas. Many private companies already have investor and stockholder agreements in place that bind their stockholders with broad drag-along obligations that require that the holders not only vote in favor of change in control transactions supported by the majority stockholders, but also sign up for all obligations ancillary to the change in control transaction. Acquirors should not overlook these valuable rights buried within investor and stockholder agreements, which agreements are typically otherwise irrelevant to the acquisition transaction.

    A well advised acquiror should obligate targets and their insider stockholders to use the period between signing and closing to enforce these drag-along rights and otherwise exert efforts to cause the non-insiders to execute undertakings to comply with the indemnity and other provisions of the merger agreement that purport to bind target stockholders. In addition, acquirors should consider beefing up their merger agreements to include closing

of these executed undertakings from all or at least a minimum percentage of the non-insider stockholders as one of the conditions to closing.

A further mechanic to protect the acquiror and cause the insider stockholders to obtain these undertakings is to provide for the following adjustment to the pro rata formula that specifies how the indemnity obligations are allocated among the target stockholders. Rather than allocating the indemnity obligations pro rata based on the respective portions of the merger consideration received by each stockholder relative to the aggreate consideration received by all stockholders as would be customary, acquirors should consider insisting upon allocation of these obligations pro rata relative only to the pool of stockholders that have signed undertakings or joinders to be bound contractually by the indemnity.

Thus, for example, if stockholders representing only 85% of the shares have agreed to be bound by the indemnity, that group should be fully responsible for 100% of the indemnification obligations not covered by escrow. This approach is particularly important in the case of indemnities for breaches of "fundamental" representations and warranties, which are often uncapped and of indefinite duration.

- *Draft the Merger Agreement to Enhance Enforceability.* In the absence of separate undertakings and joinders, acquirors can increase the chances of enforceability of target stockholder obligations by drafting merger agreements in a manner that makes clear that these obligations are part of the merger consideration and that they are subject to parameters.
  - *Contingent Rights to Merger Consideration, Not Post-Closing Set-Asides.* Amounts that are set aside for future release to the target stockholders pursuant to escrow, holdback and earn-out provisions should be described as amounts to which the target stockholders have contingent rights that are part of their merger consideration, as opposed to amounts that are set aside or taken back a moment in time after the merger consideration is determined and payable.
  - *Converting Clawback Rights into Contingent Rights to Merger Consideration.* If, as the Court implies, contingent rights to escrow, hold-backs and earn-outs are not problematic, while indemnities fashioned as clawbacks need to meet the troublesome "reasonably ascertainable value" standard, it may be worthwhile for acquirors to structure the merger consideration in a manner that effectively converts the indemnity clawback into a contingent right.
    - For example, a merger agreement could provide for a contingent right to escrowed funds, with all or part of the escrowed funds being released if and when the target stockholder executes a joinder to the indemnity.
    - Another idea would be for the acquiror to enter into an arrangement to purchase insurance with coverage equivalent to what would otherwise be covered by an indemnity from the target stockholders. The cost of the insurance would be deducted from the cash portion of the merger consideration, but the merger consideration would include a right to additional merger consideration (equal to each target stockholder's pro rata portion of the cost of the insurance) contingent upon a stockholder's execution of a pro rata indemnity undertaking. The insurance arrangement would similarly provide for reduction of the insurance cost and coverage on a pro rata basis as the direct indemnity undertakings are executed and delivered.
  - *Clawback Rights Baked into the Merger Consideration.* In any event, obligations to pay indemnification and purchase price adjustment amounts should be referenced in the section that provides for the delivery of the merger consideration. In addition, they should be described as obligations that give rise to clawback rights of the acquiror against the merger consideration and as integral components of and limitations on the merger consideration.
  - *Time Limitations.* Acquirors should consider inclusion of time limitations on all obligations of the target stockholders that give rise to clawback rights against the merger consideration, even if they are simply restatements of the applicable statute of limitations. The greater the challenges the acquiror will face in obtaining contractual undertakings from target

stockholders, the more advisable to include meaningful time limitations to enhance the likelihood of enforceability without these separate undertakings.

The merger structure should continue to provide an effective means for acquirors to proceed quickly and confidentially to a definitive acquisition agreement with privately held targets that locks in the target to a sale of 100% of the equity, especially when these targets have numerous non-insider stockholders. A well-advised acquiror should be able to craft an approach to the merger agreement and ancillary support agreements in ways that do not leave the acquiror with a bleak choice between a merger agreement structure that provides inadequate post-closing protections, and a stock purchase agreement structure that is characterized by unacceptable risks of failing to acquire 100% of the equity as well as impediments from the perspectives of speed and confidentiality.

Courts Increasingly Skeptical of the Value of Disclosure-Only Settlements

By Tim Mast, Tom Bosch, and Nicholas Howell of Troutman Sanders LLP

In 2013 and early 2014, courts in Delaware and other jurisdictions increasingly began to scrutinize attorneys' fee awards in disclosure-only settlements resolving shareholder challenges to merger transactions.[1] In several decisions, courts reduced or denied plaintiffs' attorneys' fees because the settlements involved only nonmaterial additional disclosures. Delaware courts have been relatively quiet on this issue since the Court of Chancery's February 2014 decision in *In re Medicis Pharm. Corp., S'holders Litig.*;[2] however, several recent decisions from the New York Supreme Court's Commercial Division and one decision from the Northern District of California indicate that courts will continue to eschew the practice of "automatic" fee awards in favor of awarding fees based on the benefit that the additional disclosures provide to shareholders and, in appropriate circumstances, rejecting settlements and fee requests.

Reduction of Fees. In June 2014, after certifying a class for settlement purposes, Judge Charles E. Ramos of the New York Supreme Court's Commercial Division rejected a request by plaintiff's counsel for $465,000 in fees in *Schumacher v. NeoStem, Inc*.[3] Although Judge Ramos believed that plaintiff's counsel had "undoubtedly achieved value" for the class by securing additional disclosures and several corporate governance reforms, he opined that the benefit to shareholders was "limited" because the settlement did not provide the shareholders any monetary relief.[4] Consequently, Judge Ramos reduced the fee award to $125,000.[5]

Several months later, in *West Palm Beach Police Pension Fund v. Gottdiener*, Judge Marcy Friedman of the Commercial Division approved a disclosure-only settlement, but applied the lodestar method to reduce an unopposed fee request from the $500,000 requested to $379,566.50 plus $36,637.65 in unreimbursed expenses.[6] Judge Friedman declined to apply a multiplier to increase the amount of the fees awarded because "the contingency risk that the plaintiff faced was insubstantial, given the ubiquity of settlements in shareholder derivative actions challenging mergers based on insufficient disclosures."[7]

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[1] *See* Tim Mast, Tom Bosch, and Mary Weeks, *Attys' Fees Under Increasing Scrutiny In M&A Settlements*, Law360 (Apr. 3, 2014), http://www.law360.com/articles/524910/attys-fees-under-increasing-scrutiny-in-m-a-settlements.

[2] *See In re Medicis Pharm. Corp. S'holders Litig.*, No. 7857-CS (Del. Ch. Feb. 26, 2014).

[3] *Schumacher v. NeoStem, Inc.*, 993 N.Y.S.2d 646, 646 (2014).

[4] *Id.*

[5] *Id.*

[6] *W. Palm Beach Police Pension Fund v. Gottdiener*, 2014 N.Y. Misc. LEXIS 4686, at *10 (N.Y. Sup. Ct. Oct. 22, 2014).

[7] *Id.* at *8-9.

Similarly, in *St. Louis Police Retirement System v. Severson*, Judge Yvonne Rogers of the Northern District of California also approved a disclosure-only settlement and used the lodestar method to reduce a fee request of $1,650,000 to $543,018.75.[8] Although Judge Rogers found that the defendants failed to make "full disclosures of material facts bearing on the shareholders' proxy vote," she applied only a 1.5 multiplier—rather than the requested 2.8—because the case did not involve extraordinary risk, complexity, or effort on behalf of plaintiff's counsel.[9] Judge Rogers also scrutinized the plaintiff counsel's request for $51,231.89 in expenses and awarded only $36,410.78.[10]

Denial of Settlements. In December 2014, in *Gordon v. Verizon Communications, Inc.*, Judge Melvin L. Schweitzer of the New York Supreme Court's Commercial Division rejected a proposed disclosure-only settlement and request for attorneys' fees because the additional disclosures were immaterial.[11] Judge Schweitzer described the supplemental disclosures as "unnecessary surplusage" that "individually and collectively fail[ed] to materially enhance the shareholders' knowledge" of the merger. Thus, he held that any award of legal fees would constitute a misuse of corporate assets.[12] Noting the "tsunami of litigation" and the "suspect disclosure-only settlements associated with public acquisitions today," Judge Schweitzer denied the proposed settlement because approving it would have made him "an enabler of an unwarranted divestiture of shareholder rights by virtue of plaintiff's release, as well as a misuse of corporate assets were plaintiff's legal fees to be awarded."[13] The plaintiff's appeal of the court's denial of the settlement is pending.

Most recently, in *City Trading Fund v. Nye*, Judge Shirley W. Kornreich of the Commercial Division also denied approval of a disclosure-only settlement. Judge Kornreich criticized the plaintiffs' claims for their "downright frivolity" because the plaintiffs neither alleged material omissions nor settled for material supplemental disclosures.[14] She also denied the plaintiffs' request for attorneys' fees totaling $500,000.[15] Despite acknowledging that the company wished to settle, Judge Kornreich determined that she could not certify the class for settlement purposes because doing so would undermine the public interest, incentivize plaintiffs to file frivolous disclosure suits, and levy unnecessary costs on shareholders.[16] The plaintiffs responded by voluntarily dismissing their claims.

When considered alongside the prior decisions from Delaware, these rulings signal courts' (1) growing frustration with the deluge of frivolous or questionable shareholder merger challenges, and (2) increasing willingness to override defendants' decisions to settle merger challenges on a disclosure-only basis. If this trend continues, it remains to be seen whether it will stem the tide of merger challenge lawsuits, which appears to be one of the courts' goals in rendering these decisions, or simply make merger litigation more difficult to settle, which could put companies in a precarious position when trying to consummate mergers.

[8] *St. Louis Police Ret. Sys. v. Severson*, No. 12-CV-5086 YGR, 2014 U.S. Dist. LEXIS 110984, at *21 (N.D. Cal. Aug. 11, 2014).

[9] *Id.* at *20-21.

[10] *Id.* at *23.

[11] *Gordon v. Verizon Commc'ns, Inc.*, 2014 N.Y. Misc. LEXIS 5642, at *11 (N.Y. Sup. Ct. Dec. 19, 2014).

[12] *Id.* at *16, *21.

[13] *Id.* at *19, *21.

[14] *City Trading Fund v. Nye*, 2015 N.Y. Misc. LEXIS 11, at *32, *41 (N.Y. Sup. Ct. Jan. 7, 2015).

[15] *Id.* at *37.

[16] *Id.* at *33.

Transaction Costs: Negotiating Their Tax Benefit

By Saba Ashraf & Wayne Strasbaugh, Partners of Ballard Spahr LLP

In any merger or acquisition, parties incur costs beyond payment of the purchase price. Transaction costs can include compensatory payments (option cancellation payments, bonuses, etc.) and professional fees (legal, accounting, and investment banking fees). Often, there are extensive negotiations over the tax benefits associated with these costs.

Negotiations involving tax benefits can arise in a number of circumstances, including the following: (i) A purchaser assuming responsibility for the payment of a significant target transaction cost may be advised that the cost is not as high after the associated tax benefit is taken into account—leading to negotiations with the seller for the purchaser to claim the tax deduction. (ii) A target corporation may not have taxable income in a pre-closing period against which to offset a tax deduction—leading to an offer to allow the purchaser to claim the deduction, if it pays the selling shareholders for the tax benefit.

A basic premise of M&A tax structuring is that in evaluating an acquisition of a business, a purchaser should take into account the tax benefit resulting from the structure. For example, if a purchase of assets, or stock with an election under Code[1] Section 338(h)(10) or Code Section 336(e) yields a stepped-up tax basis, and therefore tax depreciation/amortization deductions, that should certainly be taken into account by the parties. *However*, negotiating which party may claim tax deductions for transaction costs and how much should effectively be "paid" for the associated tax benefits can be a bit tricky, and parties should proceed cautiously, for the reasons discussed below:

- Capitalized, amortized or deducted. For many transaction costs, there simply will be no current tax deduction. While costs may often be deducted as ordinary and necessary business expenses under Code Section 162, a cost that is a "capital expenditure" may not be currently deducted. In particular, a taxpayer must capitalize an amount paid to facilitate an acquisition of an ownership interest in a trade or business. Treas. Reg. § 1.263(a)-5. An amount is paid to facilitate an acquisition if the amount is paid in the process of investigating or otherwise pursuing the transaction—but only if it relates to activities performed on or after the "bright line date." The bright line date is the earlier of the letter of intent date or the date of the agreement on material terms (the date of execution of a binding written agreement or the date the board of directors or other appropriate governing body authorizes or approves the material terms, if such authorization or approval is required). Even if the bright line date rule is satisfied, if a cost is considered "inherently facilitative," it must be capitalized. Inherently facilitative costs include costs of securing an appraisal or fairness opinion; structuring the transaction, including negotiation of the structure and obtaining tax advice on the structure; preparing the transaction documents; obtaining regulatory approval of the transaction; and obtaining shareholder approval of the transaction. Treas. Reg. § 1.263(a)-5(e)(2). *Thus, to have the possibility of an immediate deduction, the cost must be incurred before the bright line date, and not fall in any of the categories of expenses deemed inherently facilitative. This limits quite significantly the universe of costs that are deductible.*[2]
    - There is some good news. One important transaction cost that is generally deductible under Section 162 is the cost of compensation triggered by the acquisition, including payments related to cancellation of nonqualified stock options and bonuses paid to target management.
- Timing of deduction. Even though compensatory payments are generally deductible, whether they may be deducted on the pre-closing tax return (*generally, though not always,* benefitting the seller), or the post-closing tax return (*generally, though not always,* benefitting the purchaser) is an issue that is governed by a multitude of tax rules. The application of some of these rules is not very clear. [3] A discussion of each of these tax rules is outside the scope of this advisory,

[1] References to Code Sections are to Sections of the Internal Revenue Code of 1986, as amended.

[2] That said, the IRS did in 2011 issue a Revenue Procedure permitting taxpayers a deduction of 70 percent of success-based fees for covered transactions. Rev. Proc. 2011-29. These are costs contingent upon the closing of a transaction—a common fee structure for investment banking services.

[3] Generally, these rules include Section 83(h) of the Code, the consolidated return regulations (where the target corporation is entering or leaving a consolidated group), the method of accounting of the payor, and the time for economic performance under Sections 404(a)(5) and 461(h) of the Code.

and—most discouraging—there is not absolute certainty as to how most of them should apply. In the absence of clear guidance (and sometimes in spite of relatively clear guidance), many parties agree contractually on the timing of the deduction, and therefore which party may claim the tax benefit on its return (or the return of target at a time when the target is owned by such party). It is important to understand that while contractual agreement on the taking and timing of a deduction may be helpful, it is not binding on the Internal Revenue Service ("IRS"). The IRS may not agree with the position the parties have taken. Unfortunately, the IRS disagreement will likely not "turn up" until audit of one of the parties to the deal—which likely will be years later when the opportunity for the audited taxpayer to obtain a purchase price adjustment from the other party may have passed.

- <u>Quantification of tax benefit.</u> Quantification of the tax benefit (and thus the amount a party pays or is paid for such benefit) is quite difficult. There are generally two approaches that may be taken in determining the value of the tax benefit. First, the parties may attempt to quantify the value of the tax benefit as of the time of the signing of the acquisition agreement, and incorporate the agreed-upon value in the purchase price. This, in our experience, does not frequently happen. Second, the parties may provide in the contract the methodology for determining the value of the tax deduction and provide for some sort of "true up" when the tax deduction is taken. Issues that arise in determining the methodology for valuing the tax deduction include: (i) whether the tax deduction will be considered to be taken as one of the first deductions the company takes or one of the last ones (in which case it is quite possible that it would yield no tax benefit as the earlier deductions will have offset all the income), (ii) when a tax benefit from the deduction will be available in the future, (iii) what discount rate should be used to determine the present value, and (iv) the value of any corresponding "lost" tax benefit to the other party.

  The parties should also consider what will happen if there is an audit and the deductibility of costs that the parties have already valued, and negotiated "ownership" of, is at issue. Will the party that claimed the tax benefit be indemnified? How will the indemnification be determined? If the party claiming the tax benefit is not the party dealing with the IRS on audit, how will it protect itself and ensure that the tax benefit is in fact worth the value placed on it by the parties?

All parties to business transactions want to maximize their return. It is tempting to use tax benefits of transaction costs either to provide extra return to a party or to make the transaction costs the party is incurring a bit easier to accept. However, parties should tread carefully in this area. While ultimately dependent on the underlying facts, there may be uncertainty as to the existence of the tax benefit. Further, any "trading" of the tax deduction and an agreement that it be allocated to a certain party—and therefore claimed by it—may be inconsistent with the governing tax rules.

Food for Thought: Conflicting Views on the "Knowing Participation" Element of Aiding & Abetting Claims

By Kevin Miller, a Partner of Alston & Bird LLP[1]

Despite the Delaware Court of Chancery's decision in *Pontiac General Employees Retirement System v Healthways,* C.A. No. 9789-VCL (Del. Ch. Oct. 14, 2014) (transcript ruling) denying motions to dismiss claims against a borrower and the administrative agent of a credit facility, many banks continue to believe that including a provision in credit agreements that allows the banks to require the prompt repayment of their loans if a dissident stockholder's nominees are elected as a majority of the board of a borrower is an appropriate and effective way to protect the financial interests of the banks and their stockholders.

From the banks' perspective, the election of a dissident stockholder's nominees as a majority of the board of the borrower is likely to result in a material change in the business strategy and objectives of the board, the persons legally responsible for managing the business and affairs of the borrower. Given that

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risk and that they are agreeing to lend hundreds of millions if not billions of dollars based on diligence relating to the current and proposed future business, operations, financial condition and prospects of the borrowers, the banks justifiably want protection in the event of a material change in the directors comprising a majority of the borrower's board.

For lenders, credit evaluation and repayment protection are not solely a matter of financial covenants but also include knowing your borrower and understanding its business strategy and objectives. As a consequence, the banks continue to believe that absent well pled allegations of complicity or collusion with the board of the borrower to provide entrenchment benefits (*e.g.*, as an inducement to permit the banks to obtain improper benefits), aiding and abetting breach of fiduciary duty claims based solely on the existence of a so-called "dead hand" change of control default provision in a proffered form of credit agreement should be dismissed.

The banks' view is supported by the narrower definitions of "knowing participation," an essential element of an aiding and abetting claim, more recently applied by other members of the Court of Chancery in *Lee v Pincus*, C.A. No. 8458-CB (Del. Ch. Dec. 11, 2014) and *In re Comverge* C.A. No. 7368-VCP (Del. Ch. Dec. 25, 2014) adjudicating aiding and abetting breach of fiduciary duty claims against an underwriter and an acquiror, respectively. Arguably, the definitions of "knowing participation" applied in those decisions would have resulted in the dismissal of the aiding and abetting breach of fiduciary duty claims against the administrative agent of the credit facility at issue in *Healthways*.

Healthways

In *Healthways*, a bench ruling by Vice Chancellor Laster, the Court refused to dismiss an aiding and abetting breach of fiduciary duty claim against the administrative agent of Healthways' credit facility for including a so-called "dead hand" change of control default provision in an amended credit agreement. The Court of Chancery also refused to dismiss breach of fiduciary duty claims against the board of directors of Healthways for agreeing to the amended credit agreement containing that provision.

Credit agreements and bond indentures often contain a provision that a "change of control" of the borrower will constitute an event of default. Typically a "change of control" will be deemed to occur if, among other things, within a certain period of time (*e.g.*, 12 or 24 months), a majority of the borrower's directors are not "continuing directors"—*i.e.*, directors who were on the board at the time the credit agreement was signed or who were later appointed or approved by such persons or their appointed or approved successors.

In *Kallick v SandRidge Energy*, C.A. No. 8182-CS (Del. Ch. March 8, 2013), an earlier decision by the Court of Chancery, the Court interpreted such "change of control" provisions to permit a board to "approve" persons nominated for election to the board by a dissident stockholder even if the board continued to recommend that stockholders vote in favor of the board's nominees and not vote in favor of the dissident stockholder's nominees. Such board approval of persons nominated by a dissident stockholder would, under the definition of "continuing director," preclude the election of such persons from being deemed a "change of control" under the terms of the debt instrument, significantly undermining the protective benefits to the lenders of such provision. *See also San Antonio Fire & Police Pension Fund v Amylin Pharmaceuticals*, C.A. No. 4446-VCL (Del. Ch. May 12, 2009).

As a consequence of the Court's decision in *SandRidge*, lenders began to more frequently include so-called "dead hand" change of control default provisions in credit agreements. The inclusion of a dead hand change of control default provision preserves the ability of lenders to declare a default in the event of the election of a dissident stockholder's nominees as a majority of the board of the borrower, regardless of whether the current board ultimately approves the dissident stockholder's nominees as they did in *Amylin* and were required to do in *SandRidge*. Specifically, "dead hand" provisions prevent persons initially nominated by a dissident stockholder from ever being deemed "continuing directors" regardless of whether such nominees are later approved (for purposes of the definition of a change of control in the credit agreement) by the current members of the board. The following sample provision contains a "dead hand" provision in bold italics at the end:

> [A Change of Control shall occur if] during any period of 24 consecutive months, a majority of the members of the board of directors or other direct or indirect equivalent governing body of the

Company cease to be composed of individuals (i) who were members of that board or equivalent governing body on the first day of such period, (ii) whose election or nomination to that board or equivalent governing body was approved by individuals referred to in clause (i) above constituting at the time of such election or nomination at least a majority of that board or equivalent governing body or (iii) whose election or nomination to that board or other equivalent governing body was approved by individuals referred to in clauses (i) and (ii) above constituting at the time of such election or nomination at least a majority of that board or equivalent governing body ***(excluding, in the case of both clause (ii) and clause (iii), any individual whose initial nomination for, or assumption of office as, a member of that board or equivalent governing body occurs as a result of an actual or threatened solicitation of proxies or consents for the election or removal of one or more directors by any Person or group other than a solicitation for the election of one or more directors by or on behalf of the board of directors)***.

In *Healthways*, the Court of Chancery found that there was ample precedent from prior decisions of the Court of Chancery (*e.g.*, *SandRidge* and *Amylin*) to put lenders on notice that similar "change of control" default provisions in debt instruments were highly suspect and could potentially lead to a breach of duty on the part of the fiduciaries of the borrower negotiating the debt instrument.

The *Healthways* Court went on to say that:

> It is certainly true, and I agree, that evidence of arm's-length negotiation negates claims of aiding and abetting. In other words, when you are an arm's-length contractual counterparty, you are permitted, and the law allows you, to negotiate for the best deal that you can get. What it doesn't allow you to do is to propose terms, insist on terms, demand terms, contemplate terms, incorporate terms that take advantage of a conflict of interest that the fiduciary counterparts on the other side of the negotiating table face.
>
> This is the premise that is true in third-party deal cases. The acquirer is perfectly able to negotiate for the best deal it can get, but as soon as it starts offering side benefits, entrenchment benefits, other types of concepts that create a conflict of interest for the fiduciaries with whom it's negotiating, that acquirer is now at risk. Is the acquirer necessarily liable? No. But does that take the acquirer out of the privilege that we afford arm's-length negotiation? It does.

In the wake of the *Healthways* ruling, numerous copycat lawsuits have been filed against the boards of directors of other companies whose credit agreements contain "dead hand" change of control default provisions and the administrative agents under those credit facilities, and more copycat lawsuits will certainly follow. In effect, it has become a cottage industry. Typically, the plaintiffs' firms identify Delaware incorporated companies whose publicly filed credit agreements contain a "dead hand" change of control default provision; they then serve a Section 220 demand on behalf of an institutional stockholder seeking to inspect board minutes and other records of the borrower in an effort to ascertain whether the board discussed, negotiated or otherwise gave consideration to whether the inclusion of the dead hand provision was in the best interests of stockholders and then, in the absence of evidence of such discussion, negotiation or other consideration, file suit in the Delaware Court of Chancery alleging that the board of the borrower breached its fiduciary duties and that the administrative agent aided and abetted that breach. If the borrower and the administrative agent/lenders agree to amend the credit agreement to remove the "dead hand" change of control default provision, plaintiffs notify the court that the issue has been mooted and seek attorneys' fees for the corporate benefit achieved on behalf of the borrower's stockholders. In the case of *Healthways*, the plaintiffs' attorneys are seeking attorneys' fees of $1.2 million, an amount to which Healthways has apparently agreed not to object. In another recent case mooted after the *Healthways* decision, but prior to the plaintiffs having to brief or argue a motion to dismiss or otherwise expend significant effort, the plaintiffs' attorneys sought attorneys' fees of $750,000 but were only awarded $125,000. *See The Fire and Police Pension Fund, San Antonio v. Axis Group*, C.A. No. 10078-VCP (Del. Ch. Feb. 25, 2015) (Stipulation and Order of Dismissal and Resolution of Plaintiff's Fee Application).

Significantly, both *SandRidge* and *Amylin* related to decisions by the boards of those companies with respect to the approval of director nominees for purposes of the change of control provisions in their bond indentures in the midst of contested director elections. While not adopted in connection with a contested director election, the amended credit agreement containing the dead hand provision at issue

in *Healthways* was arguably adopted on a "cloudy day"—it was dated as of eight days following the approval by Healthway's stockholders of a precatory resolution calling for the elimination of Healthway's classified board. However, the issue of a "clear" versus a "cloudy" day is more relevant to the question of whether the Healthway's board breached its fiduciary duty, and is significantly less relevant to the question of whether the administrative agent aided and abetted a breach of fiduciary duty by including a provision in the credit agreement that furthers the lenders' own legitimate interests. In any event, it appears that the copycat complaints relate to credit agreements entered into on a clear day as the only evidence proferred in support of the allegation that the administrative agents aided and abetted a breach of fiduciary duty appears to be that the administrative agent permitted a dead hand change of control default provision to be included in the relevant credit agreement. There are no references in any of the copycat complaints to a contested director election or similar event. As a consequence, the aiding and abetting allegations leveled at the administrative agents are conclusory and not supported by well-pled allegations of fact. In effect, plaintiffs appear to be arguing that such provisions are per se invalid.[2]

While the *Healthways* Court was careful to say that it was not making a determination that "dead hand" change of control default provisions were per se invalid, in light of the increased risk of litigation as a result of the *Healthways* ruling, many banks are evaluating whether the protective benefits of such provisions outweigh the risks and costs of litigation. While some banks have at least for now determined not to include "dead hand" change of control default provisions in their credit agreements pending further legal developments, other banks continue to believe that such provisions remain legitimate and appropriate, and that absent well pled allegations of complicity or collusion with the board of the borrower to provide entrenchment benefits in exchange for selling out the borrower's stockholders, aiding and abetting breach of fiduciary duty claims based solely on the existence of a so-called "dead hand" change of control default provision in a proffered form of credit agreement should be dismissed.

Lee v Pincus

In *Lee v Pincus*, a subsequent decision by Chancellor Bouchard, the Court of Chancery appears to have applied a narrower definition of "knowing participation" than the Court in *Healthways* and granted a motion to dismiss aiding and abetting breach of fiduciary duty claims against underwriter defendants for consenting to the waiver of certain contractual restrictions that had prevented most pre-IPO investors from selling their stock for a designated period of time in a discriminatory manner that benefitted half of the issuer's board of directors. The Court explained that:

> "To demonstrate the "knowing participation" element of an aiding and abetting claim, it must be reasonably conceivable from the well-pled allegations that "the third party act[ed] with the knowledge that the conduct advocated or assisted constitute[d] . . . a breach [of fiduciary duty]." Knowing participation has been described as a "stringent" standard that "turn[s] on proof of scienter." The alleged aider and abettor, not the fiduciary, must act with scienter. In *In re Telecommunications, Inc. Shareholders Litigation*, the Court provided an instructive summary of some of the ways in which a plaintiff successfully may plead knowing participation:
>
>> [K]nowing participation may be inferred where the terms of the transaction are so egregious or the magnitude of side deals is so excessive as to be inherently wrongful. In addition, the Court may infer knowing participation if it appears that the defendant may have used knowledge of the breach to gain a bargaining advantage in the negotiations. The plaintiff's burden of pleading knowing participation may also be met through direct factual allegations supporting a theory that the defendant sought to induce the breach of fiduciary duty, such as through the offer of side payments intended as incentives for the fiduciaries to ignore their duties.

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[2] *See Fire and Police Pension Fund, San Antonio v Ann Cronin*, C.A. No. 10073 (Del. Ch. Sept. 3, 2014) (Verified Class Action and Derivative Complaint); *George v WCM* [illegible], C.A. No. 10262 (Del. Ch. Oct. [illegible], 2014) (Verified Complaint); [illegible] *Pension Fund v Jay Gobel*, C.A. No. [illegible] (Del. Ch. Nov. 12, 2014) (Verified Class Action and Derivative Complaint); [illegible] *Local No. 25 Pension Fund v B/E Aerospace*, C.A. No. 10342 (Del. Ch. Nov. 11, 2014) (Verified Class Action and Derivative Complaint); [illegible] *Local No. 25 Pension Fund v Patterson UTI*, C.A. No. 10143 (Del. Ch. Nov. 12, 2014) (Verified Class Action and Derivative Complaint) and [illegible] *Local No. 25 Pension Fund v* [illegible], C.A. No. [illegible] (Del. Ch. Feb. 23, 2015) (Verified Class Action and Derivative Complaint).

In my opinion, the allegations of the Amended Complaint do not support a reasonable inference of knowing participation by the Underwriter Defendants. Critically, plaintiff has failed to plead any facts from which it is reasonably inferable that the Underwriter Defendants knew when they provided their consent to modify the lockup restrictions that such action would facilitate a breach of fiduciary duty by the Director Defendants. The fact that the Underwriter Defendants' consent was necessary for the Director Defendants to waive a lockup restriction, without more, is insufficient to demonstrate that the Underwriter Defendants gave their consent with the knowledge that the Director Defendants were treating Lee and the putative class unfairly.

The Amended Complaint, moreover, does not allege that the amount of fees the Underwriter Defendants received in connection with the secondary offering were unreasonable for the services performed. Thus, there is no well-pled basis to infer that the Underwriter Defendants extracted unreasonable compensation or any form of improper "side deal" for consenting to the selective lockup waivers. In sum, it is not reasonable to infer here that, simply by receiving fees (that are not alleged to be unreasonable) for acting as underwriters in the secondary offering, the Underwriter Defendants "participated in the [Zynga] board's decisions, conspired with [the] board, or otherwise caused the board to make the decisions at issue. . . ."

In sum, the allegations of knowing participation in the Amended Complaint are conclusory and fall short of those that Delaware courts routinely conclude do not substantiate a claim for aiding and abetting. I therefore dismiss Count II for failure to state a claim for relief under Rule 12(b)(6)."

Comverge

Similarly, in Vice Chancellor Parsons' subsequent *Comverge* opinion relating to claims arising from Comverge's acquisition by H.I.G. Capital, the Court of Chancery applied a narrower view of the scienter required to establish knowing participation for purposes of an aiding and abetting breach of fiduciary duty claim—appearing to require complicity or misleading behavior by an advisor or the actual inducement of a board to sell out its stockholders by an arms'-length counterparty. According to the Court, hard negotiating for provisions advantageous to an arms'-length counterparty—like a better price, are not actionable unless the arms'-length counterparty induces the board to sell out its stockholders:

Proving liability under an aiding and abetting theory—largely come[s] down to what constitutes "knowing participation." In at least one case, this Court has suggested that this element of the aiding and abetting test—requires an understanding between the parties—with respect to their complicity in any scheme to defraud or in any breach of fiduciary duties.

This Court also has suggested, however, that aiding and abetting liability may exist in situations not rising to the level of a subjective understanding of—complicity—between the fiduciary and the aider-and-abettor in a scheme involving the breach of a duty. Specifically, Delaware courts have found aiding and abetting liability—when a third party, for improper motives of its own, misleads the directors into breaching their duty of care. . . . These cases [[illegible], *Del Monte* and [illegible]] are similar in the critical sense that the third party aider and abettor possessed the requisite degree of scienter—or knowing participation, because the factual record—point[ed] to evidence of a conflict of interest diverting the advisor's loyalties from its client, such that the advisor, like the bankers in *Del Monte* and *El Paso*, is [illegible] paid in some fashion something he would not otherwise get in order to assist in the breach of duty.

These cases stand in contrast to many others that have rejected aiding and abetting claims as a matter of law, primarily because in the latter category of cases there was no comparable evidence of an abuse of trust by the third-party aiders-and-abettors vis-à-vis the corporate fiduciaries. The most typical example of such failed aiding and abetting claims is when a third-party acquirer is accused of aiding and abetting fiduciary breaches by the target board. In those situations, this Court has adhered to the rule that—a bidder's attempts to reduce the sale price through arm's-length negotiations cannot give rise to liability

for aiding and abetting, so long as the bidder does not induce the target's fiduciaries to sell out the target's stockholders by creating or exploiting self-interest on the part of the fiduciaries. This prevailing rule, that arm's-length bargaining cannot give rise to aiding and abetting liability on the part of the acquirer, is well supported by both logic and our law, as it—helps to safeguard the market for corporate control by facilitating the bargaining that is central to the American model of capitalism.

The administrative agent and lenders under a credit facility are arms-length counterparties, not members of management or advisors alleged to have committed an abuse of trust as was the case in [illegible], *Del Monte* and *Rural/Metro*, whose conflicts with the interests of the borrower—seeking better and more protective terms for their loan—are readily apparent. Under [illegible], absent well pled allegations of additional facts suggesting the administrative agent induced the borrower's fiduciaries to sell out the borrower's stockholders, it does not appear that merely including a dead hand change of control default provision in a proffered form of credit agreement implies an understanding between the parties or complicity in a scheme to defraud or breach fiduciary duties.

Food for Thought

A number of commentators have analogized the dead hand change of control default provisions in credit agreements to the dead hand poison pill invalidated by the Delaware Supreme Court in *Quickturn Design Systems v Shapiro*, No. 511 (Del 1998). But, in *Quickturn*, the dead hand poison pill was unilaterally adopted by the Quickturn board despite its potential self-serving entrenchment benefits. In contrast, the dead hand change of control default provision at issue in *Healthways* was proffered by the lenders in order to protect their ability to be repaid in full in the event an insurgent stockholder took control of the Healthways board. Like the underwriters in *Lee v. Pincus*, the administrative agent in *Healthways* was an arm's-length counterparty and could not know the extent to which the Healthways board had considered or approached other sources of financing or the potential ramifications of the dead hand change of control default provision or otherwise fulfilled its fiduciary duties.

Absent collusion or complicity, should an arm's-length counterparty's pursuit of its best interests through hard bargaining over contractual terms subject it to nondismissable aiding and abetting breach of fiduciary duty claims? Consider a greeting card company heavily dependent on a license to use certain cartoon and animated characters in its birthday, holiday and other cards. Should the owner of the rights to use the cartoon and animated characters be potentially liable for aiding and abetting a breach of fiduciary duty if, in an effort to protect its intellectual property, it insists on a dead hand change of control termination right in its intellectual property license agreement with the greeting card company?

The complaints in *Healthways* and in the copycat cases have not alleged that the dead hand change of control default provisions at issue were proffered by the administrative agents as an inducement to obtain an above market interest rate or other improper benefit to the detriment of the borrowers' stockholders nor do the complaints allege contemporaneous facts supporting allegations of collusion or complicity. At best, the complaints merely allege that the administrative agents aided and abetted the borrowers' boards' breaches of fiduciary duty by proffering a form of credit agreement that contained a dead hand change of control default provision. Nothing prohibited the borrowers from negotiating to delete the provision or obtain other more favorable terms, and to the extent the borrowers failed to adequately consider the potential ramifications of the provision or to negotiate for more favorable terms, the fault lies with the borrowers (as advised by their counsel) and should not be laid at the door of an arm's-length counterparty seeking to protect its financial interests and the financial interests of its stockholders.

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