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POST-ELECTION REACTION: EARLY THOUGHTS ON A NEW ANTITRUST REGIME

On November 18, 2020, ***The M&A Lawyer*** *spoke to Ryan Thomas and Jeremy Morrison, two partners in Jones Day's Washington D.C. office, on potential changes to U.S. antitrust policies in a Biden administration. Morrison is also a former FTC attorney (including serving as Counsel to the Director of the Bureau of Competition from 2013 to 2014).*

The M&A Lawyer: *What are the major changes in 2021 going to be, on various fronts in antitrust?*

Jeremy Morrison: I think when you look at 2021, you should break it into two periods. In the short term, early- to mid-2021, we shouldn't expect to see a sea change at the DOJ or FTC. There's always a ramp-up period in a new administration, and the outcome of cases that have already been under investigation for a number of months may largely be baked.

In particular, for the FTC, there's going to be an interesting dynamic in that it could remain under Republican control until 2023 unless a Republican commissioner resigns. We're likely to have a new chair and new bureau management in 2021, but it is possible that there may not be significant change in the composition of the Commission for a while. In the ramp-up period, staff at both agencies are likely going to keep investigating deals as they always have and apply their well-worn analyses to transactions. The question becomes in the mid- to long-term, what are we going to see from Biden's appointments and where do they focus their attention.

I think there's a clear consensus that we are likely going to see increased enforcement. But there are a number of questions around that. How much and when do you start seeing that? Is that increase in enforcement going to be concentrated in certain industries, such as tech or pharma, and/or certain types of transactions, like innovation or killer acquisitions, where we've even seen some enforcement efforts under the Trump administration?

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Ryan Thomas: There's a fair amount of speculation about antitrust under Biden and what it's going to mean for companies. Observers are trying to make predictions, including based on the members of his transition team. For example, we know that Bill Baer and Gene Kimmelman are on Biden's agency transition teams. Bill Baer is on the FTC transition team. He was formerly head of the DOJ antitrust division. And Gene Kimmelman, who also formerly served at DOJ, is on the DOJ transition team. Both worked at the agency during the Obama administration. Since they're advising the Biden team, should we expect antitrust enforcement along the lines of what we saw during Obama's tenure? That's a reasonable baseline. But as Jeremy said, it's probably a matter of how much more aggressive enforcement we're going to have, not whether there's going to be more aggressive enforcement.

That said, when you talk about more or less aggressive enforcement from administration to administration, historically it has been on the margins. The agencies are confronted with hundreds of merger filings every year. At the end of the day, relatively few transactions—generally less than around 5% of reportable transactions—receive extended scrutiny in form of second request investigations, and a subset of those will end up requiring remedies, and an even smaller number of *that* subset will end up in actual litigation. So, for M&A, changes in enforcement across administration typically affect a handful of transactions.

Despite this history, there is some reason to believe this time around you might have incrementally greater enforcement. What do I mean by that? More aggressive and longer investigations. A greater willingness to investigate deals that might have been on the cusp—close calls—earlier, in terms of whether to conduct additional diligence through issuance of a second request or to push for remedies. A greater willingness to take "close" cases to court—threaten to litigate and follow through if the parties do not abandon the transaction. Coming full circle, it will be instructive to see who Biden nominates to head the DOJ antitrust division. At the FTC, he will likely elevate one of the existing

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Democrat commissioners to become chair, since this would not require Senate confirmation.

MAL: *It looks like the best-case scenario for a Biden administration would be very slender Democratic control of the Senate. Does that mean the more aggressive antitrust rhetoric we saw earlier this year, from Sen. Warren for example, is not going to translate into much, legislation-wise?*

Thomas**:** Even before this past election, there has been an evolution of increasing interest in antitrust enforcement, including among politicians. During President Obama's campaign, if memory serves, he had antitrust enforcement front and center from a policy perspective. Over the years, we've seen an increased focus on antitrust enforcement and what it means for various stakeholders—for customers, competitors, distributors, retailers, labor, and more generally from a societal perceptive. It's garnered a lot of attention in recent years in large part because of the focus on large tech companies. These online platforms have been in the antitrust crosshairs for years, and that attracts the public's and politicians' attention. So you have, for example, Senators Warren, Klobuchar, and Mike Lee all introducing various types of legislation trying to make antitrust more robust and effective.

As a practical matter, the Congress will be split during a Biden administration. Even assuming the Democrats did garner a majority in the Senate, it would be razor thin—and certainly not filibuster-proof if they wanted to push through antitrust legislation. In the near term, we should probably bet on no significant changes to antitrust law. However, there does seem to be bipartisan support to increase funding for both agencies. Remember: The DOJ and FTC are already busy right now based on their existing enforcement policies and case load. So if the Biden administration wants to substantially increase enforcement—more investigations, more litigated challenges—it will need more resources—more lawyers and economists—in order to fulfill that mission.

MAL: *Could a Biden antitrust regime have more and greater coordination with European merger regimes, as compared to the past four years?*

Morrison: At the staff level, there has still been coordination in transactions between the antitrust agencies in the U.S. and Europe. There could be more coordination between the U.S. and Europe in the next administration, but that may be less driven by personalities and more by a common outlook on antitrust and a more aggressive U.S. antitrust position going forward. That is, the U.S. agencies may more closely align with some of what we've seen in Europe in the past few years than they have in the past and that could naturally lead to the appearance of more coordination.

Thomas: Picking up on Jeremy's comments, we know that agencies in Europe, especially the EU Commission, the UK Competition Authority, have been more squarely focused on tech and online platform companies, with long investigations and fines. In the past couple of years the DOJ and FTC also have been pursuing these same companies more aggressively. So in this sense we're seeing a convergence between the U.S. and Europe.

More broadly, we're seeing increased attention by jurisdictions all around the world in a couple areas: competitive effects of large companies acquiring smaller ones (the "killer acquisitions"

Jeremy mentioned earlier) and revising merger filing thresholds to address potentially concerning transactions that, under the existing rules, fall just below the thresholds. A number of jurisdictions are asking whether they should have lower thresholds to catch these transactions so they can more easily investigate them before the parties are able to close.

That's Europe. Another interesting dynamic will be with respect to China, and how a Biden administration will approach China trade policy and any spillover effects in antitrust. This might affect certain transactions, especially tech deals, where the parties need to file and obtain clearance from SAMR, the State Administration for Market Regulation, the competition authority in China. Tech and other companies will be watching this closely.

MAL: *Are there types of mergers that may fall under greater scrutiny now—vertical mergers, for instance?*

Thomas: Vertical transactions to be sure, though again this might be more of an evolution than a revolution. In the Trump administration, the agencies focused more attention on vertical policy and transactions than in the past. This summer the DOJ and FTC released the first update to vertical merger guidelines since the 1980s. And, of course, the DOJ brought a high profile case against AT&T/Time Warner—the first vertical merger challenge in decades. The FTC, meanwhile, also investigated and reached settlements involving vertical deals. I would not be surprised if we see more investigations of vertical deals in the coming years.

Another area to watch are "potential competition" cases—transactions in which the merging parties are not current competitors but rather where one of the merging parties has plans to enter and compete in the other party's market. Or vice versa. If the deal goes forward, the agency might be concerned that customers will lose the benefit of that independent potential competition. The agencies have a longstanding practice of scrutinizing this dynamic in pharmaceutical deals. We also see it in other industries too—consumer goods, medical devices, etc. The agencies have focused increasing attention on this area in recent years and there is a good chance this will continue under Biden's nominees. It's closely related to killer acquisitions. Some of those deals might involve current competition. But many raise potential competition issues.

One additional point: A Biden DOJ and FTC might take an even harder look at consummated transactions, for example, in particular industries or by particular companies, say in the tech industry. The FTC, for example, has publicly announced investigations of past acquisitions by large technology companies, including Facebook. There is every reason to believe that a Biden administration will continue this work.

MAL: *Looking back at the Trump years, is it fair to say there was more continuity in antitrust enforcement than some had expected four years ago?*

Morrison: In part that's driven by the nature of reviews. These are very fact-intensive reviews, with a heavy reliance on staff, and there's a strong professional staff at both agencies. That's going to drive a lot of it. Perhaps that helps keep things a bit more even-keeled, so you didn't see the pendulum swing as far in antitrust as you might have in other policy areas under the Trump administration.

Thomas: I agree in the main that, with some exceptions, the Trump administration hewed closely to mainstream antitrust policy and practice. I'll highlight just a couple high-profile exceptions or surprises. It's not merger related, but last month the DOJ brought one of its most high-profile monopolization cases in years, and the DOJ's AT&T/Time Warner vertical challenge is notable because it was the first litigated vertical merger in 40 years. The government ultimately lost that case in court.

MAL: *Anything else to keep an eye on in the months ahead?*

Thomas: We've touched on this already. There has been greater scrutiny applied to larger companies, to firms with a "dominant" market position. In the M&A context, this always has been an important consideration, say if a large firm with a strong market position seeks to acquire a smaller rival. Most transactions are investigations (and in rare cases challenged in court) under the merger statute. There have been so far limited instances, however, in which the FTC and DOJ also attack the transaction under the monopolization statute. The recent DOJ compliant challenging the acquisition by Visa of Plaid is the most recent example. We might see the agencies employing this tactic more frequently in a Biden administration.

Morrison: Whoever is appointed at either agency is going to have pressure from the outside pushing for more robust antitrust enforcement. It will be interesting to see the impact that has on decision making and how much political pressure is put on the agencies to step up enforcement.

MAL: *Could that be a factor in pushing companies today to rush their mergers now, to get ahead of this?*

Morrison: It's possible—if you are considering a deal that you could do now or wait six months, you might be more inclined to do it now. But I don't think antitrust is necessarily going to be a real driving force behind that decision in the vast majority of transactions.

Thomas: Again, it's always good to have perspective. When you look at the actual numbers, only a very small percentage of transactions historically have been subject to enforcement actions requiring remedies or litigation, or in which parties abandon the deal. That said, given the current climate in which some take the view that "big is bad," a small company looking to exit might reasonably have some incrementally greater angst about the ability of a larger, deeper-pocketed competing company to acquire it. But I wouldn't be alarmist. The level of practical risk depends on the facts. And the vast majority of transactions will be cleared with no issues or perhaps with limited remedies. A very small number of deals are blocked or abandoned in any given year.

This increased scrutiny does provide a good opportunity for companies considering M&A to revisit their antitrust compliance. For example, ensure that company documents reflect reality and to the extent possible avoid exaggerated statements about your market position and reasons for doing a deal. Party documents, especially "hot documents," represent a significant aspect of agency investigations. This was true during the Trump administration and it applies equally going forward.

DECISION HIGHLIGHTS THE LIMITS OF *CORWIN* (AND THE BENEFITS OF A GOOD PROCESS) IN THE SALE OF A COMPANY TO A PE BUYER: *MINDBODY*

By Gail Weinstein, Steven J. Steinman, Brian T. Mangino, Mark H. Lucas, and Andrea Gede-Lange

Gail Weinstein is senior counsel, and Steven Steinman and Mark Lucas are partners, in the New York office of Fried, Frank, Harris, Shriver & Jacobson LLP. Brian Mangino and Andrea Gede-Lange are partners in Fried Frank's Washington D.C. office. Contact:
gail.weinstein@friedfrank.com
or *steven.steinman@friedfrank.com*
or *brian.mangino@friedfrank.com*
or *mark.lucas@friedfrank.com*
or *andrea.gede-lange@friedfrank.com*.

In *In re MINDBODY, Inc. Stockholders Litigation*, the plaintiffs challenged the merger (the "Merger") pursuant to which private equity firm Vista Equity Partners acquired MINDBODY, Inc. (the "Company"). The key allegations were that the Company's CEO-founder-director ("RS"), due to his self-interest in obtaining liquidity and lucrative post-sale employment, "tilted" the sale process in favor of Vista rather than seeking to maximize the price on behalf of all the stockholders. The transaction was approved by a majority-independent board and the stockholders. However, the court ruled, at the pleading stage of litigation, that it was reasonably conceivable that RS may have breached his fiduciary duties to the stockholders; and, because his potential conflicts of interest were not disclosed, the alleged breaches were not "cleansed" under *Corwin*. The court also found it reasonably conceivable that the Company's CFO (who was not a director) ("BW") breached his fiduciary duties by following RS's lead in the process.

We would observe that it is relatively common, especially when a sale process involves private equity bidders, for a CEO engaged in a sale process to want to obtain liquidity and post-closing employment. *Mindbody* underscores that the particular facts and circumstances will be critical to the court's determination whether those desires constitute a disabling conflict of interest.

Key Points

The decision underscores the need for careful planning and execution in a sale process—including, specifically, with respect to officers' and/or directors' desire for liquidity or post-closing employment. The decision highlights that, at the pleading stage, the court may delve in depth into the possible personal motivations of management and/or directors in a sale process to determine if they had potential conflicts of interest.

The decision highlights the effect that a *combination* of negative factors can have on the court's result. The court found that the CEO-director's strong focus on obtaining liquidity may have constituted a conflict even though he did not have an "exigent need" for liquidity. Also, the court found that his strong focus on obtaining lucrative post-closing employment (including an equity interest in the acquiring company) may have constituted a conflict even though discussions had not taken place as to the specific terms of such employment. In our view, the court's approach does not reflect a change in the standards being applied but, rather, the effect of the *combination* of serious negative alleged facts: namely, the CEO's apparently "strained" personal finances; *plus* his apparent single-mindedness on obtaining lucrative post-closing employment; *plus* a sale process that strongly favored the bidder he expected would provide such employment; *plus* his apparent manipulation of the company's earnings guidance; *plus* his not disclosing material information to the board; *plus* a go-shop provision that was too limited to be an effective check on the sale process.

The decision also illustrates the potential limits of *Corwin* when there are serious alleged conflicts of interest. We have observed in previous memoranda that there appears to be a retrenchment to some extent by the court in applying *Corwin* in cases with a strongly negative factual context. In our view, *Mindbody* raises the further question whether, in the case of serious allegations of severe director conflicts or misconduct, there would ever be sufficient disclosure such that *Corwin* would apply. (If directors actually acted in their self-interest rather than the stockholders' interest, would the disclosure have to specifically state as much for *Corwin* to be applicable?) A good sale process, therefore, should remain the objective—to avoid the risk of personal liability, reputational damage, and an injunction against the deal before it closes.

Background

Mindbody (a cloud-based payments company for the wellness industry) was founded by RS in 2001 and went public in 2015. In early 2018, it made two major strategic acquisitions, following which its stock price was $37.50. In the week after its September 2018 earnings call, during which it emphasized the progress being made with integration, the stock price increased to $43.85 and analysts set target prices upwards of $45 per share. In early 2019, Vista acquired the Company in the Merger, for $36.25 per share in cash. At that time, the board was comprised of RS, "EL" (a designee of venture capital firm Institutional Venture Partners ("IVP")), and six independent directors. Before the Merger, RS controlled 19.8%, and IVP controlled 24.6%, of the Company's voting power.

RS had discussed a possible buyout with Vista in 2017 but Vista (a PE firm known for providing highly lucrative compensation to its portfolio company CEO-founders) had chosen not to engage because Mindbody's stock was at an all-time high. In August 2018, RS met with an investment banker at Qatalyst Partners and related that he was "frustrated with running a public company" and with having his personal wealth "tied up" in the Company. Qatalyst put RS in touch with Vista. RS did not inform the board about his discussions with Qatalyst or Vista. In October, at Vista's invitation, RS attended Vista's annual conference (the "CXO Summit") for its portfolio company CEO-founders ("CXOs"), at which Vista touted the great wealth it creates for the CXOs. Soon thereafter, Vista told RS that it would like to acquire the Company "at a substantial premium to its recent trading range." At the time, the 30-day average stock price was $38.46 and the stock had traded over $41.00 in October. RS instructed management not to discuss Vista's expression of interest with the board because he wanted to be the one to do so first. He then raised with the board the idea of taking the Company private, but did not mention Vista's expression of interest. He postponed the Company's October 2018 earnings call to November. On the November call, he lowered the Company's Q4 guidance, citing difficulties in the integration process (although management viewed the Company as on track with the process and on track to meet its forecasts). The following day, the stock price dropped to $25.00.

The board formed a "Transaction Committee" comprised of RS, EL, and two other directors. At RS's urging, the Committee retained Qatalyst to act as the Company's financial advisor in connection with the possible sale of the Company. RS and Qatalyst then selected the potential bidders to be contacted. On December 18, while other parties were beginning or midway through their due diligence processes, Vista submitted an offer to buy the Company at $35 per share. The offer emphasized Vista's admiration for the Company's management and its desire to partner with them going forward. Qatalyst informed RS that management could expect to receive a 10% equity stake in the post-merger entity (which would double their pre-deal stake). Qatalyst then instructed two of the three remaining potential bidders to submit offers within the next 24-48 hours. Both indicated they could not submit a bid on that timeline and withdrew.

On December 20, 2018, the board met and instructed Qatalyst to seek a $40 per share price from Vista. The next day, Vista made a "final and best" offer of $36.50. The board met again on December 23. On that date, Qatalyst advised the directors that the other potential bidders needed more time to complete due diligence before they could submit bids; Qatalyst delivered a fairness opinion for Vista's bid; the board unanimously approved Vista's offer; and the Company entered into the Merger Agreement with Vista. RS and IVP executed irrevocable proxies to vote their shares for the Merger. On February 14, 2019, the stockholders approved the Merger and it closed the next day. The plaintiffs brought suit against RS, EL, and BW, alleging fiduciary breaches. Vice Chancellor Kathaleen McCormick granted the defendants' motion to dismiss with respect to EL, but denied it for RS and BW.

Discussion

RS's desire to obtain liquidity constituted a potential conflict of interest. Under Delaware precedent, it has been well established that a director who holds stock has an *identity* (and *not* a conflict) of interest with the other stockholders in maximizing the sale price when the company is sold. The Vice Chancellor noted that, in *Synthes* (2012), the court established that "liquidity needs can give rise to a conflict only where there is a 'crisis,' 'fire sale,' or 'exigent need' for 'immediate cash.' " The Vice Chancellor stated, however, that the *Synthes* standard should be interpreted in the context of the factual situation in that case-which, she wrote, unlike *Mindbody*, involved a complaint "strikingly devoid of pled facts to support the alleged liquidity-driven conflict." The Vice Chancellor noted that, based on the *Mindbody* plaintiffs' allegations, RS's personal finances were "seemingly stretched"—given his numerous financial commitments (*e.g.*, millions of dollars invested in relatives' businesses, a sizable home mortgage, a million-dollar home renovation, and a multi-million dollar commitment to a local college); his having begun to start trying to obtain liquidity (by setting up a "10b5-1 plan" to sell his stock on a monthly basis); his having complained about his personal wealth being "tied up" in the Company; and his having told his personal financial advisor that he would be "digging into" his line of credit to fund his high expenses.

Of course, many CEOs selling their companies have been in similar situations—with "stretched" finances, their personal wealth "locked in" the company, and a general desire for liquidity—and they have not been found to have a conflict unless they had an "exigent need for immediate cash." In this case, it appears that the Vice Chancellor was responding to the combination of numerous, serious negative factors that, taken together, led almost inescapably to a conclusion that it was reasonably conceivable at the pleading stage that RS may have been acting based on his own rather than the stockholders' interests. These factors included not only his often-repeated focus on obtaining liquidity *but also* a blatant focus on post-closing employment, manipulation of the Company's guidance, failure to disclose material information to the board, and sale process decisions that definitively advantaged the bidder that he believed would most benefit him personally. *In combination, these factors strongly supported an inference that RS was acting based on his personal interests.*

IVP's desire to obtain liquidity due to the impending expiration of its fund did *not* constitute a conflict of interest for its representative on the board. The plaintiffs argued that EL was conflicted by virtue of IVP's fixed-life investment fund that was facing an expiring investment horizon. The court reaffirmed that a fund's desire for liquidity based on its investment horizon does not itself create a conflict for the fund's designated directors. Moreover, in this case, the court stated, even assuming that EL was conflicted based on IVP's investment horizon, no facts were alleged that supported a reasonable inference that EL (who was not involved in the lowered guidance, the due diligence process, or the go-shop process) actually took any action to tilt the process toward Vista.

RS's desire for lucrative post-closing employment constituted a potential conflict of interest. Under Delaware precedent, an officer's or director's desire to obtain post-closing employment with the acquiring company does not, in and of itself, constitute a conflict of interest—although it becomes a conflict if, absent instruction and oversight by the board, the officer or director engages in discussions about the specific terms of such employment before the material sale terms have been agreed. The court noted that, in this case: Vista was known for being a buyer that always retained the management teams of its acquired companies and offered them lucrative compensation; Vista had expressed in its offer letter that it wanted the management team to continue post-closing; and RS had learned from Qatalyst that management would be granted a 10% equity stake in the post-merger entity (doubling their pre-deal stake). Of course, none of these factors is necessarily uncommon in the course of a sale process involving private equity firm bidders. Again, however, it was the combination of factors that indicated that RS may have differentiated his personal interests from those of the other stockholders. Notably, the sale process began with RS's reaching out to Qatalyst about his desire to sell the Company to a private equity fund that would agree to employ the management team post-closing; he rejected contacting certain "logical" buyers on the basis that he did not want to work for them or they were known generally to not retain management; and he gushed that the CXO Summit was "mind-blowing" and that Vista "loved" him and he loved Vista. Moreover, he and Vista had numerous "private conversations" throughout the sale process. Finally, and critically, he did not disclose most of the foregoing to the board.

Vista was strongly favored in the sale process. The court observed that:

- RS lowered guidance, apparently (according to the court) to depress the stock and make the Company a less expensive target for Vista (which had previously rejected acquiring the Company because of its high stock price);
- RS was in contact with Vista (but not the other bidders) before and throughout the sale process;
- Vista received access to about 1,000 documents for due diligence. while the other bidders received about 35 documents and the provision of information to them was delayed;
- RS provided "real-time input" to Vista on its valuation model (but not to the other bidders);
- After Vista submitted its offer, the board accelerated the process, as a result of which the remaining bidders withdrew because they needed more time to complete their due diligence;
- The board sought only once to have Vista increase its price (to $40) and then readily accepted Vista's "final and best offer" of $36.50; and
- The post-signing go-shop was ineffective—because it required that any superior offer be both made *and accepted* during a 30-day period (which spanned the Christmas holidays and during which RS took vacation), and the board did not include in the go-shop due diligence data room all of the materials to which Vista had been provided access.

***Corwin* did not apply because the stockholder vote was not "fully informed."** Under *Corwin*, stockholder approval of a transaction "cleanses" potential fiduciary breaches if the vote was fully informed and uncoerced. The court wrote: "Generally, where facts alleged make the paradigmatic *Revlon* claim reasonably conceivable, it will be difficult to show on a motion to dismiss that the stockholder vote was fully informed." While the court noted the following specific deficiencies in the disclosure, we question (as noted above) whether, in light of the combination of seriously negative factors, any disclosure short of, in effect, a declaration that fiduciary duties were breached would have been deemed adequate—and, even if such disclosure were made, whether the court would find *Corwin* cleansing available.

- ***RS's post-sale employment.*** The Company stated that the terms of post-closing employment for management had not been discussed with Vista. The court found this disclosure "true in the literal sense," but "materially misleading" given the absence of disclosure as to (i) RS's many private interactions with Vista (and Vista CXOs) before and throughout the sale process and (ii) the advantages provided to Vista in the sale process. The court (citing its 2018 *Morrison v. Berry* and *Xura* decisions) stated that a reasonable stockholder would want to know about the level of a director's commitment to a potential purchaser, as well as the extent to which a CEO influenced the negotiations and ultimate terms of a transaction, and any possible self-interested motivation for "pushing" for an allegedly undervalued transaction.

- ***Vista's willingness to pay a premium.*** The court found that the proxy statement should have disclosed that Vista stated in its initial expression of interest that it was willing to pay "a substantial premium to [the] recent trading range." This statement "signaled Vista's willingness to pay a price per share much higher than the ultimate Merger price," a fact that would be material to a reasonable stockholder. The court acknowledged that "preliminary discussions" need not be disclosed, but observed that here the statement was made by the ultimate acquiror after weeks of discussions with the CEO, in a direct expression of interest, and at a time when the target's stock was trading at a price higher than the ultimate merger price.

- ***Sale process.*** The proxy statement did not disclose the sale process deficiencies discussed above. The court stated that a reasonable stockholder would want to know whether a serious bidder was treated in a materially different way from others because it would help with assessing "the probative value of the sale process."

- ***Q4 guidance and results.*** The proxy statement disclosed that the merger price represented a premium of 68% to the then-current trading price. The court reasoned that gauging value against the then-current trading price was materially misleading "because Defendants drove down that price" by lowering Q4 guidance and then not disclosing that Q4 actual results substantially beat both the original and the lowered guidance. Stockholders were left with the impression that the merger price offered a substantial premium, "when it is reasonably conceivable that the premium resulted from the Q4 'guide down' that depressed the Company's stock."

A director's failure to disclose material information to the board (a "fraud-on-the-board") can have serious consequences. First, generally, when there has been a "fraud-on-the-board" (*i.e.*, one or more directors did not disclose material information to the board, such as relating to a conflict of interest or the sale process), the applicable standard of review is the stringent "entire fairness" standard (which requires that both the price and the process are fair to the stockholders). In this case, the parties had agreed that, if *Corwin* were not applicable, *Revlon* (which requires that directors seek to maximize the sale price) would apply. The court stated that it remained an open issue whether, given RS's non-disclosures to the board, entire fairness, rather than *Revlon*, would be the standard of review applied at trial. Second, while "as a general rule, a plaintiff can only sustain a claim for breach of the duty of loyalty by pleading facts showing that it is reasonably conceivable that each of *a majority of the board* is conflicted," the *Mindbody* plaintiffs argued that there should be an exception to this rule where there has been a fraud-on-the-board. The court found that the plaintiffs alleged sufficient facts to support this "theory." The court reasoned that the existence of the Committee "evidences some level of board involvement and oversight that cuts against the notion that the Board was the passive victim of a rogue fiduciary," but that its "mere existence" did not suggest sufficient involvement and oversight, particularly in light of the following allegations:

the timing of the Committee's formation was unclear; its mandate initially was limited (and, by the time it was expanded, the Company had already retained Qatalyst and RS and Qatalyst had already selected the potential bidders to be contacted); it relied entirely on Qatalyst and never hired its own counsel or financial advisor; and it "took a back seat" while RS vetoed outreach to certain potential bidders, controlled the level of diligence provided to potential bidders, and continued to meet privately with Vista. The Vice Chancellor wrote: "For these reasons, it is reasonably conceivable that the Board lacked material information and failed to adequately oversee [RS]. Therefore, at the pleading stage, the presence of a disinterested and independent majority of the Board does not defeat a claim for liability."

BW may have breached his fiduciary duties by following RS's sale process directions. The court found it reasonably conceivable that BW acted with "gross negligence" throughout the sale process by being "at least recklessly indifferent to the steps RS took to tilt the sale process in Vista's favor." The court noted that BW followed RS's instructions not to disclose immediately to the board Vista's expression of interest; followed RS's lead in trying to "be creative" to guide expectations for 2019 downward; delivered the lowered Q4 guidance on the earnings call (even though RS's communications with him suggested RS's manipulative purpose and other management members stated that the lower guidance was inaccurate); and worked with RS to delay and limit other bidders' access to due diligence materials. The court noted that BW, as an officer (and not a director), would not be exculpated under the Company's charter for a breach of the duty of care. The court therefore found it unnecessary to address at the pleading stage whether BW also may have breached the duty of loyalty based on his personal motivations for post-closing employment.

Practice Points

Officers and directors must be careful about what they say or write (including in emails or other informal communications) during a sale process. They should be highly sensitive to the possibility that their statements (for example, relating to a desire for liquidity and/or post-closing employment) could be interpreted as reflecting that they may view themselves as having interests different from the other stockholders and possibly are motivated by their self-interest.

In a sale process: a board must carefully seek to identify actual and potential conflicts of interest of officers and directors (and, particularly, of the lead negotiator), and then must appropriately deal with them; a director generally should not meet privately with a bidder unless instructed and supervised by the board—and, if private discussions do take place, they should be promptly disclosed to the board; an officer's or director's discussions with a potential buyer about post-closing employment should not constitute a disabling conflict if the discussions occur after the material terms for the sale of the company have been agreed and/or if the discussions are appropriately overseen by the board (or other appropriate body or person); expressions of interest should be promptly reported to the board; and, if an advantage is to be accorded to a particular bidder over others, the board (or committee) should be informed and should approve the course of action only if it believes that it will be beneficial to the stockholders.

A board should be *proactive* in identifying conflicts. The Mindbody board allowed RS to run the sale process notwithstanding strong clues that made it reasonably conceivable that he may have been strongly motivated by his own personal interests. The board could have become aware of RS's potential conflicts (and questionable sale process decisions) if it had, for example, spoken with the financial advisor about how the list of potential bidders to be contacted was developed; asked the financial advisor if it had previously had discussions with Vista or other potential bidders about the Company; spoken with RS to become informed about his personal objectives; spoken with other management members about how the process was unfolding; and/or in general provided more oversight of the sale process. Importantly, whenever just before or during a sale process there is a change in the company's projections or guidance, or a significant drop in the stock price, the board should carefully investigate the reasons therefor.

An officer should not simply follow the sale process directions of a potentially conflicted CEO that appear to undermine the sale process. For example, an officer should not limit or delay the provision of due diligence materials or change the company's guidance or projections without a legitimate basis for doing so.

2020 HALF-YEAR ACTIVISM UPDATE

By Barbara L. Becker, Richard J. Birns, Eduardo Gallardo, Saee Muzumdar and Daniel S. Alterbaum

Barbara L. Becker, Richard J. Birns, Eduardo Gallardo and Saee Muzumdar are partners, and Daniel S. Alterbaum is a senior associate, in the New York office of Gibson, Dunn & Crutcher LLP. Contact: bbecker@gibsondunn.com or rbirns@gibsondunn.com or egallardo@gibsondunn.com or smuzumdar@gibsondunn.com or dalterbaum@gibsondunn.com. The following has been prepared for general informational purposes only and is not intended as legal advice.

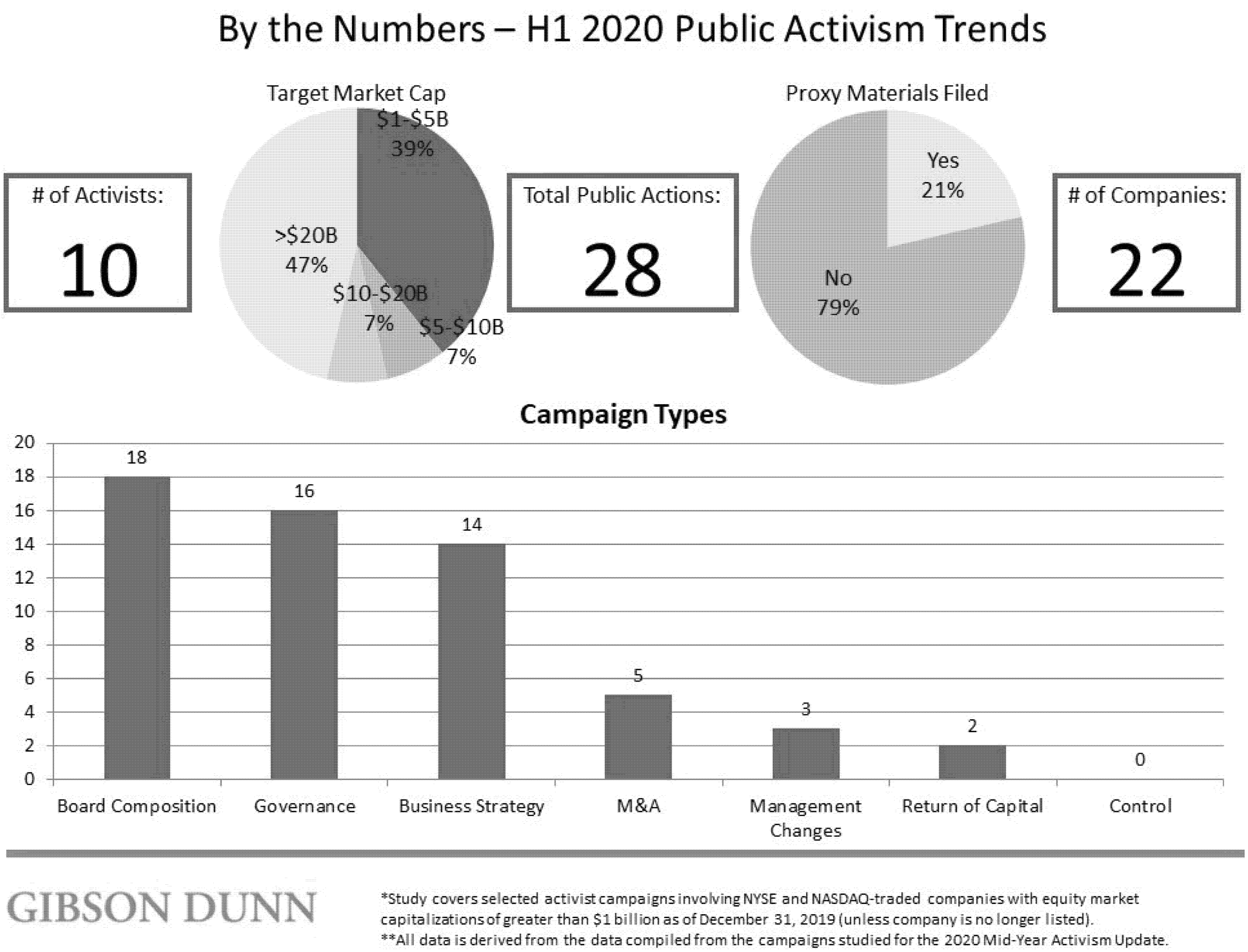
This article provides an update on shareholder activism activity involving NYSE- and Nasdaq-listed companies with equity market capitalizations in excess of $1 billion and below $100 billion (as of the close of trading on June 30, 2020) during the first half of 2020. (See our previous article on 2019 year-end activism in the June 2020 issue of *The M&A Lawyer*.) As the markets weathered the dislocation caused by the novel coronavirus (COVID-19) pandemic, shareholder activist activity decreased dramatically. Relative to the first half of 2019, the number of public activist actions declined from 51 to 28, the number of activist investors taking actions declined from 33 to 10 and the number of companies targeted by such actions declined from 46 to 22.

The decline in shareholder activism activity brought concentration among those investors engaged in activist activity during the first half of 2020. For example, during the first half of 2020, NorthStar Asset Management launched six campaigns and Starboard Value LP launched four campaigns. Three activists represented half of the total public activist actions that began during the first half of 2020.

In addition, as compared to the first half of 2019, activists turned their focus away from agitating for particular transactions as the animating rationale for the campaigns they launched. While changes in board composition remained the leading rationale for campaigns initiated in the first half of 2019 and the first half of 2020, M&A (which includes advocacy for or against spin-offs, acquisitions and sales) and acquisitions of control, which served as the rationale for 24% and 8%, respectively, of activist campaigns in the first half of 2019, declined to 9% and 0%, respectively, in the first half of 2020. By contrast, advocacy for changes in governance, which emerged in 6% of campaigns in the first half of 2019, became the principal rationale for 28% of campaigns in the first half of 2020. Business strategy also remained a high-priority area of focus for shareholder activists, representing the rationale for 22% of campaigns begun in the first half of 2019 and 24% of campaigns begun in the first half of 2020. The rate at which activists engaged in proxy solicitation remained consistent at 24% in the first half of 2019 and 21% in the first half of 2020. (Note that the percentages for campaign rationales described in this paragraph sum to over 100%, as certain activist campaigns had multiple rationales.)

Publicly-filed settlement agreements declined alongside the decrease in shareholder activism activity. Nine settlement agreements were filed during the first half of 2020, as compared to 17 such agreements during the first half of 2019. Nonetheless, the settlement agreements into which activists and companies entered contained many of the same features noted in prior reviews, including voting agreements and standstill periods as well as non-disparagement covenants and minimum and/or maximum share ownership covenants. Expense reimbursement provisions appeared in two thirds of the settlement agreements reviewed, which represented an increase relative to historical trends.

2020 Mid-Year Activism Update



2020 Mid-Year Activism Update

By the Numbers – Trends in Settlement Agreements (2014 – H1 2020)

H1 2020 Board Representation Analysis

Category	Average
Board Seats Granted	2.4
Total Board Size*	11.5
Percent of Board*	24.2%

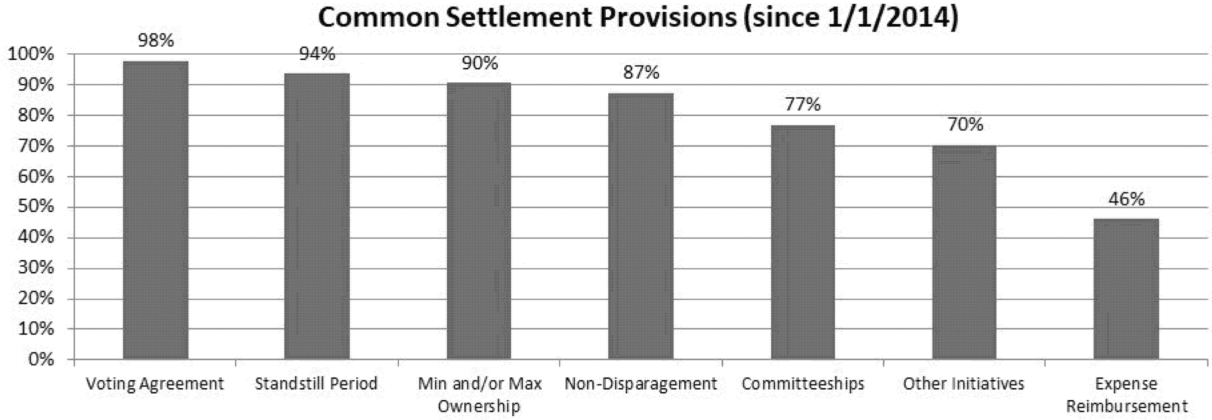
*Following settlement agreement

2014-H1 2020 Board Representation Analysis

Category	Average
Board Seats Granted	2.2
Total Board Size*	11.0
Percent of Board*	20.2%

*Following settlement agreement

Common Settlement Provisions (since 1/1/2014)



GIBSON DUNN

*All data represented here is derived from the data compiled from the campaigns studied for Activism Update and includes 12 agreements filed in 2014, 22 agreements filed in 2015, 30 agreements filed in 2016, 16 agreements filed in 2017, 30 agreements filed in 2018, 22 agreements filed through H2 2019 and 9 agreements filed through H1 2020.

EU ANTI-SUBSIDY INITIATIVE MEANS MORE NOTIFICATIONS, INVESTIGATIONS ON THE WAY

By Jay Modrall

Jay Modrall is a partner in the Brussels office of Norton Rose Fulbright LLP. Contact: jay.modrall@nortonrosefulbright.com.

The European Commission ("EC") believes that non-European State-owned enterprises ("SOEs") and other companies receive subsidies that can distort competition in the European single market. According to the EC, existing trade and antitrust tools leave a gap in the protection of European Union ("EU") markets. Trade defense rules relate only to exports of goods and do not address other potential distortions from non-EU subsidies, which may facilitate the acquisition of EU companies, distort investment decisions, market operations or pricing policies in beneficiaries' European operations, or distort bidding in European public procurement.

Adopting new tools to combat the effects of non-EU subsidies is a top European Union priority for 2021. The EC recently published comments[1] on a June 2020 white paper[2] on levelling the playing field as regards foreign subsidies ("the White Paper"), shedding new light on the forthcoming proposals. The EC is now working on draft legislation creating an unprecedented legal framework empowering the EC and national authorities to take action against multinationals benefiting from foreign subsidies. The new legislation could apply not only to multinationals receiving direct foreign subsidies for their EU operations, but also to companies benefiting from special tax or other regimes that arguably increase their profitability and thereby affect their competitive behavior in the EU. Examples could include the energy, food, and agriculture and transport sectors, which benefit from special incentives and legal regimes in many jurisdictions.

The new EU legislation will reflect three so-called "Modules" outlined in the White Paper to address the distortive effects of foreign subsidies in the EU Single Market generally (Module 1), acquisitions of EU companies (Module 2) and EU public procurement procedures (Module 3). The EC received hundreds of submissions from Member States, non-EU stakeholders and governments, business and industry associations, and individual companies and law firms, academic institutions, trade unions, NGOs, other public authorities and individual citizens. While non-EU respondents questioned the need for new legislation, almost all EU Member States—who will need to approve the new law along with the European Parliament—favored creating new anti-subsidy tools. On the other hand, significant differences of opinion between Member States commenting on the White Paper may prove difficult to reconcile.

Scope: Foreign Subsidies and Companies Covered

The White Paper defined "foreign subsidies" broadly as financial contributions by a government or public body of a non-EU State conferring a benefit limited to an individual company, industry, or group of companies or industries, insofar as they directly or indirectly cause distortions within the EU Single Market.

To determine whether a financial contribution confers a benefit, authorities would take into account private investors' usual investment practices, market rates for financing, and the adequate remuneration for a given good or service. If there are no directly comparable benchmarks, existing benchmarks can be adjusted or market conditions can be established based on generally accepted assessment methods. Foreign subsidies below €200,000 would be presumed not to confer a benefit for these purposes.

Member States generally agreed with the proposed scope, though some Member States considered that the concept of foreign subsidy definition should be broadened to cover more types of fiscal support or lower labor law or environmental protection standards.

Module 1: General Instrument to Capture Distortive Effects of Foreign Subsidies

Module 1 would create a general "market scrutiny instrument" potentially covering any market situation in which foreign subsidies may cause distortions in the EU Single Market. This instrument could be used by national authorities or the EC under a shared system of review, perhaps modelled on the European Competition Network ("ECN") for enforcement of EU competition law.

A case would start with a preliminary review to examine whether there is a foreign subsidy that may distort the internal market. If there is evidence tending to show that a foreign subsidy may distort the proper functioning of the internal market, an in-depth investigation would follow.

Once the existence of a foreign subsidy is established, the EC or a national authority would assess whether such subsidy causes a distortion in the internal market. Certain categories of foreign subsidies could be presumed to cause distortions, while others would require a more detailed assessment. In any event, the concerned companies could also show that the foreign subsidy in question is not capable of distorting the internal market in the specific circumstances of the case.

The White Paper proposed a non-exhaustive list of indicators to determine the impact of foreign subsidies: the relative size of the subsidy; the size and capacity utilization of the beneficiary; market structure (*e.g.*, markets with structural excess capacity, concentrated markets and fast-growing markets are more likely to be subject to distortions); the market conduct in question (*e.g.*, outbidding in acquisitions or distortive bidding in procurement procedures); and the beneficiaries' level of activity in the EU. Authorities would also consider whether the beneficiary has privileged access to its domestic market (through measures equivalent to special or exclusive rights) leading to an artificial competitive advantage that could be leveraged in the EU.

If the existence and distortive impact of a foreign subsidy are established, the EC or national authority would then impose measures to remedy the likely distortive impact, such as structural or behavioral remedies (assuming that repayment to the non-EU country are not suitable or feasible). Such measures could include prohibition of a subsidized acquisition; mandated third party access, for example to mobility apps for providers of transportation services; mandatory licensing on fair, reasonable and non-discriminatory (FRAND) terms (*e.g.*, if an undertaking receives subsidies and obtains telecom frequencies or provides access to networks using such frequencies); prohibition of specific market conduct linked to the foreign subsidy; or publication of R&D results so other companies can reproduce them.

A finding of distortive effects could be weighed against evidence of possible positive impacts that the supported economic activity or investment might have within the EU or on public policy interests recognized by the EU, such as creating jobs, achieving climate neutrality and protecting the environment, digital transformation, security, public order and public safety and resilience. If, on balance, the positive impact of the supported economic activity or investment sufficiently mitigates any distortion on the internal market, no redressive measures would be required (the "EU Interest Test").

Member States generally agreed on the proposed approach to Module 1, though some raised practical concerns such as the difficulty of obtaining information on non-EU subsidies, the time required for investigations and the ability to enforce redressive measures. Some Member States considered that Module 1 would be broad enough to eliminate the need for Modules 2 and 3. In relation to enforcement responsibilities, some Member States argued for shared responsibilities between Member States and the EC, while others supported giving the EC exclusive authority. Most non-governmental contributors considered that the EC should be exclusively responsible for enforcing Module 1.

Several Member States agreed with the €200,000 *de minimis* threshold, while others argued for a higher threshold to avoid discouraging foreign direct investment and to focus enforcement on the most distortive subsidies. Views of non-governmental commentators on the necessity of a *de minimis* threshold were mixed, with some respondents arguing there here should be no threshold at all and others arguing that the threshold should be lower or sector-based.

Module 2: New Notification Requirement for Acquisitions Facilitated by Foreign Subsidies

Module 2 would specifically address distortions caused by foreign subsidies facilitating the acquisition of EU companies by creating a mandatory *ex ante* notification system analogous to that created by the EU Merger Regulation. For this purpose, an "acquisition" would be defined as the acquisition—directly or indirectly—of control of an undertaking, a specific percentage of the shares or voting rights or a "material influence" in an undertaking. Module 2 would thus be broader than the EU Merger Regulation, which is triggered only where there is a change in control of the target.

Companies benefitting from non-EU subsidies would need to notify their acquisitions of EU companies, above a given threshold, to the competent supervisory authority. The actual thresholds would depend in particular on the options chosen regarding the EU target, the trigger for notification and the appropriate competent supervisory authorities. Thresholds could be based on turnover (*e.g.*, €100 million), assets likely to generate a significant EU turnover and/or transaction value.

The notification requirement could also be limited to acquisitions facilitated by a certain volume of financial contribution from non-EU authorities. Potentially subsidized acquisitions would be defined as acquisitions of EU targets, where a party has received a financial subsidy in the last three calendar years prior to the notification or up to one year following the closing of the acquisition. This approach would require a degree of self-assessment by the companies involved, creating a risk of error or circumvention, but the EC notes that the identification of a financial contribution should be more objective than the identification of a financial subsidy, which requires an assessment of the competitive benefit of the financial contribution in the EU.

In a first step, acquirers would be obliged to file a short information notice containing basic information needed for the competent supervisory authority to identify possibly problematic operations involving foreign subsidies. This could include legal information such as ownership and governance; information on financing; turnover information; description of the business; financing of the transaction; main sources of overall financing of the acquirer; financial contributions from non-EU authorities for purposes of the transaction or otherwise for the past three years; and information on alternative prospective acquirers of the target, including any bid that has been received as part of the sale process.

Transactions could not be closed while the review is pending. Should the supervisory authority find that the acquisition is facilitated by the foreign subsidy and distorts the Single Market, it could either accept commitments by the notifying party that effectively remedy the distortion or prohibit the acquisition. As in Module 1, the reviewing authority could allow a transaction that would otherwise be prohibited based on the EU Interest Test.

While the White Paper leaves open the possibility that reviewing authority under Module 2 could be exercised at the Member State level, there was a strong preference for the EC being the competent supervisory authority. This approach would provide a one-stop-shop control across the EU for acquisitions above the thresholds and avoid the need for several Member State authorities to review a single transaction in parallel. Member States would be involved through an information mechanism at the start and during the EC procedure and would be consulted on final decisions, following in-depth investigations. If Module 2 is combined with Module 1, moreover, Member States could in any case examine acquisitions *ex officio*, even below the thresholds set up in Module 2.

Most Member States commenting on the White Paper supported Module 2, but some raised practical concerns, for instance regarding the administrative burden and risk of delay, while others opposed the introduction of a new notification requirement for fear of creating overlaps with merger control and foreign direct investment screening. Similarly, some Member States proposed using the EU Merger Regulation definition of acquisition for acquisitions caught by Module 2. Several Member States favored sharing enforcement powers for Module 2, instead of giving sole jurisdiction to the EC.

As concerns the notification requirement, Member States proposed a variety of criteria. Several Member States proposed that only subsidized acquisitions should be notified, and some argued for limiting notifiable transactions based on quantitative criteria, to certain sectors or only when a trade defense instrument notification is compulsory. On the other hand, some Member States questioned the need for turnover thresholds or recommended using lower thresholds. Otherwise, very few transactions involving innovative start-ups and scale-ups would be covered. Another option would be for the EC to have the power to launch investigations into specific investments and acquisitions on its own initiative rather than requiring ex ante notification. This approach could reduce administrative burdens on companies and supervisory authorities but result in less legal certainty.

Non-governmental respondents from the EU were supportive of Module 2, though some cautioned against applying it too broadly, *e.g.* in relation to the concept of de facto facilitation or certain types of investments (*e.g.*, portfolio or passive financial investments). Some respondents noted ambiguities in terms of procedure, assessment criteria and definitions and called for alignment of Module 2 with the EU Merger Regulation. Most respondents agreed with the use of quantitative thresholds, but without consensus on the right threshold, in some cases with parallel qualitative standards for smaller transactions of a strategic nature. As mentioned, most non-EU contributions argued that no new regulation is needed, or that any new notification obligation should be limited to SOEs or previously distortive companies.

Module 3: Foreign Subsidies in EU Public Procurement Procedures

Module 3 is intended to address potential harmful effects of foreign subsidies in EU public procurement procedures. Foreign subsidies may enable bidders to gain an unfair advantage, for example by submitting bids below market price or even below cost, allowing them to obtain public procurement contracts that they would otherwise not have obtained. The White Paper proposes a mechanism whereby bidders would have to notify the contracting authority of financial contributions received from non-EU countries. The competent contracting and supervisory authorities would then assess whether there is a foreign subsidy and whether it made the procurement procedure unfair. In this case, the bidder would be excluded from the procurement procedure.

The majority of Member States who commented on Module 3 agreed with the need for action on public procurement but not necessarily with the proposed framework. Several Member States challenged the need for a dedicated legal instrument to tackle the distortive effects of foreign subsidies in public procurement. Some disagreed with the premise that foreign subsidies have a negative effect on public procurement, while others suggested address the issue under existing rules on abnormally low tenders.

A majority of Member States expressed concern about the proposal to share responsibilities between contracting authorities and supervisory authorities. Member States broadly agreed that contracting authorities should not be responsible for assessing whether a foreign subsidy distorts the public procurement procedure, and that this task should instead be incumbent on the national supervisory authority or the EC. Some Member States argued that the EC should have exclusive jurisdiction in the interest of consistency and legal certainty.

Key Takeaways

The anti-subsidy tools proposed in the White Paper are an important part of the Von der Leyen Commission's industrial strategy, and the EC will likely move quickly to translate the White Paper proposals into draft legislation in the first half of 2021. Member State comments on the White

Paper revealed substantial support for the introduction of new powers to combat the distortive effect of non-EU subsidies, but also significant differences of opinion that may stand in the way of rapid adoption.

Some of the differences in Member States' views are quite fundamental—for example, whether a notification obligation for subsidized acquisitions (Module 2) is needed if the general investigation power (Module 1) will cover potentially distortive acquisitions. A number of Member States challenge the need for new legislation on public procurement (Module 3). A number of Member States also resist conferring exclusive jurisdiction on the EC, even to investigate potentially subsidized acquisitions under Module 2.

Can the EC reconcile these differences of opinion, and if so how? A possible compromise on Module 2 could involve a narrowly defined obligation to notify potentially subsidized acquisitions of control to the EC. Acquisitions of control and other investments not subject to mandatory notification could remain subject to investigation by the EC and national authorities under Module 1. Module 3, on public procurement procedures, may be dropped in view of the lukewarm Member State support and existence of a well-developed EU legal framework to address these issues.

Regardless of the proposed approach on Modules 1, 2, and 3, clearer guidance on the foreign subsidies that will trigger application of the new framework will be critical, especially for multinationals that must determine whether transactions trigger a notification requirement. The definition of non-EU financial contributions will likely be based on the broad EU concept of State aid. But there is currently no precedent for determining when such non-EU contributions are likely to distort markets, or proposed acquisitions, in the EU.

EC officials stress that the new framework would target only clear distortions and should not create excessive burdens for multinationals or supervisory authorities. In the case of Module 1, the burden of identifying and proving distortive non-EU subsidies will fall on the EC and national authorities. This burden of proof and limited resources may ensure that relatively few companies are impacted. On the other hand, the burden of identifying acquisitions that may trigger mandatory notification under Module 2 will fall on the private sector. Clear guidelines, and potentially safe harbors, will be essential to avoid imposition of significant burdens that may deter needed investment into the EU.

ENDNOTES:

[1] https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12452-White-Paper-on-Foreign-Subsidies/public-consultation.

[2] https://ec.europa.eu/competition/international/overview/foreign_subsidies_white_paper.pdf.

LOOMING PROXY CONTEST BY AN ACTIVIST, STANDING ALONE, DID NOT RENDER DIRECTORS CONFLICTED: *RUDD v. BROWN*

By Gail Weinstein, Philip Richter, Warren S. de Wied, Brian T. Mangino, and Andrew J. Colosimo

Gail Weinstein is senior counsel, and Philip Richter, Warren de Wied, and Andrew Colosimo are partners, in the New York office of Fried, Frank, Harris, Shriver & Jacobson LLP. Brian Mangino is a partner in Fried Frank's Washington D.C. office. Contact: gail.weinstein@friedfrank.com or philip.richter@friedfrank.com or warren.dewied@friedfrank.com or andrew.colosimo@friedfrank.com or brian.mangino@friedfrank.com.

In *Rudd v. Brown*[1], the plaintiff alleged that the defendant directors of Outerwall, Inc. had decided to sell the company because they feared and wanted to avoid "a costly and embarrassing ouster" in a proxy contest that was threatened by activist stockholder Engaged Capital. The Delaware Court of Chancery found, at the pleading stage of litigation, that selling the company in the face of a looming proxy contest to replace directors did not, standing alone, render the directors conflicted with respect to the sale. Vice Chancellor Zurn granted the defendant directors' motion to dismiss the case.

Key Points

- **The court confirmed that the fact that a company is sold in the shadow of a threatened proxy contest will not, without more, indicate that the directors acted disloyally or in bad faith.** The court distinguished this case from three recent cases in which the court refused to dismiss fiduciary claims against directors based on their having sold a company in the face of a looming proxy contest. In those cases, the court explained, there were "other indicia of gross negligence or disloyalty" by the defendant directors.

- **The court reaffirmed that stockholder-appointed directors and directors hoping for post-closing employment are not inherently conflicted.** The court explained that the fact that a director is a designee of a stockholder will not indicate self-interest of the director without alleged facts supporting a reasonable inference that the director actually made decisions based on a preference for the designator's interests over the interests of the other stockholders. Also, the fact that a director is interested in securing post-closing employment with an acquiror will not indicate self-interest if no discussions relating to the employment took place.

- **The court reaffirmed that an alleged disclosure violation does not, without more, indicate that directors or officers acted disloyally or in bad faith.** The court's discussion reflects that not every alleged disclosure violation indicates possible disloyalty or bad faith by the directors and officers who prepared and reviewed the disclosure.

Background

In 2015, Outerwall was experiencing financial difficulties, but management and analysts remained optimistic about the company's future. In early 2016, Engaged Capital amassed a 14.6% interest in Outerwall and became its second-largest stockholder. Engaged publicly released materials criticizing Outerwall, urging that it explore strategic alternatives, and threatening a proxy contest to replace multiple directors. Outerwall engaged Morgan Stanley as a financial advisor and shortly thereafter announced that it had initiated a process to explore strategic and financial alternatives to maximize shareholder value. Over several months, Morgan Stanley contacted 53 potential bidders, 42 of which expressed an interest in further evaluating a potential transaction.

As due diligence progressed, Outerwall announced that it had entered into a Cooperation Agreement with Engaged. Under this agreement, Engaged agreed not to launch a proxy contest; it appointed one director to Outerwall's board ("JB"); and it had the right to appoint two directors to two newly-created vacancies on the board (which was expanded from nine members to 12) by August 1, 2016 (which date, according to the plaintiff, "provided a deadline for the Board to negotiate a sale or be swamped by Engaged appointees"). Outerwall received "numerous" indications of interest, ranging from $27 to $53 per share, and focused on Apollo's bid of $50 per share (which ultimately was raised to $52) and Company A's bid of $48 per share (which ultimately was raised to $50.82). In July, the board resolved to sell Outerwall to Apollo. Outerwall entered into an agreement with Apollo pursuant to which Apollo would acquire all of Outerwall's outstanding common stock at $52 per share through a tender offer and subsequent short-form merger (the "Acquisition"). After Engaged extended the tender offer by several weeks, 69.3% of the outstanding shares were ultimately tendered and the tender offer closed.

Discussion

The court found that the fact of the threatened proxy contest, without more, did not give rise to a reasonable inference of disloyalty by the directors. The plaintiff challenged the Acquisition on "narrow grounds." He did not assert that the sale process was defective, but "that the defendants decided to sell the Company out of self-interest" to avoid the cost and embarrassment of being ousted through a proxy contest. He also claimed that the offer price was unfair and that the disclosure in the proxy statement was materially unfair. The defendants argued, first, that the claims should be dismissed under *Corwin* given the stockholders' approval of the Acquisition through their tender of shares; and, second, that, even if *Corwin* were not applicable, the claims should be dismissed under *Cornerstone* because the plaintiff failed to plead any *non*-exculpated fiduciary claim (*i.e.,* any claim of breach of the duty of loyalty, because the directors were exculpated for breaches of the duty of care under the company's charter, as authorized under DGCL Section 102(b)(7)). The court concluded that, even if the disclosure were inadequate and *Corwin* thus were not applicable, the plaintiff failed to plead exculpable claims. While "enhanced judicial scrutiny" of directors' conduct was applicable under *Revlon*, the court explained, "plaintiffs challenging a transaction under *Revlon* and seeking monetary damages. . .[still] must plead facts sufficient to state a non-exculpated fiduciary duty claim."

The court stated a "great reluctance" to infer disloyalty by directors in selling a company in the face of a looming proxy contest. The Vice Chancellor acknowledged that in three recent cases, in which directors faced fiduciary claims based on their having sold a company allegedly due to self-interest to avoid their ouster in a proxy contest that had been threatened, the court did *not* grant dismissal of the claims at the pleading stage. In each of those cases, however, the Vice Chancellor stated, the court had found "other indicia of gross negligence or disloyalty" by the defendant directors. In *In re Tangoe*, the directors revised their own compensation structures so that they would benefit in the short term from a change in control transaction. In *Kosseff v. Ciocia*, the directors approved an agreement that "neutralized the threat of a proxy context, but also sold the company's assets to an insider board member and his confreres." In *In re PLX Technology*, the directors "double flip-flopped after successive activist campaigns and ultimately decided to sell the company at a price less than its standalone value." In *Rudd*, however, the Vice Chancellor found, the "Plaintiff's allegations offer no such meat on the bone." She wrote: "Given this court's reluctance to find that the mere threat of a proxy contest renders directors conflicted, the Plaintiff's allegations that the Director Defendants were conflicted solely because they initiated the sale process after Engaged threated a proxy contest is insufficient as a matter of law to plead a non-exculpated breach of fiduciary duty." Therefore, dismissal was "compelled" under Cornerstone (which provides for dismissal at the pleading stage of litigation of claims that would be exculpated under a company's charter provisions authorized under DGCL Section 102(b)(7)).

The court reaffirmed that the fact that a director was appointed by a stockholder does not, without more, give rise to a reasonable inference of disloyalty by the director in favor of that stockholder. The plaintiff contended that one of the directors, who was Engaged's designee on the Outerwall board, had prioritized Engaged's desire to exit its Outerwall investment over the interests of the other stockholders. The court stated that, under Delaware law, "a director's independence is not compromised by virtue of his status as a stockholder appointee." The court characterized as "conclusory" the plaintiff's allegations that this director had prioritized Engaged's interest. In a footnote, the court contrasted the situation in *Coty*, where the court found that the complaint had sufficiently alleged that a director acted to advance the self-interest of his appointing stockholder in connection with a challenged tender offer. (In *Coty*, the director "allegedly made sure that the projections the Special Committee and its financial advisor used in connection with the tender offer were understated and kept the market in the dark about the company's strategic plan, which helped create uncertainty to benefit the appointing stockholder's plan to acquire majority ownership at the expense of the public stockholders.") The court also rejected the plaintiff's contention that this director's "long history of being appointed [including by Engaged] to companies' boards to push a merger or acquisition for short-term profit" gave rise to a conflict. A director is not "conflicted purely by virtue of his track record," the Vice Chancellor wrote.

The court reaffirmed that the fact of a director's interest in securing post-closing employment with an acquiror, without any allegation that discussions with respect to employment took place, does not give rise to a reasonable inference of disloyalty by the director. The court emphasized that the proxy statement clearly stated that no negotiations with respect to post-closing employment had taken place (a disclosure that the plaintiff did not challenge). Without alleged facts supporting a reasonable inference that discussions had taken place, the allegations only that the director was involved in the sale process and wanted to be employed post-closing did not give rise to an inference of self-interest. (We note that post-employment discussions generally will not create a conflict if they occur after material terms of the transaction have been agreed or the discussions are appropriately supervised by the board.)

The court held that the fact that there was a disclosure violation, without more, does not support a rational inference that the directors and officers provided the disclosure in bad faith (*i.e.*, that they knew the disclosure was inadequate and intended to provide inadequate disclosure). Outerwall's proxy statement disclosed three sets of projections: the "Core Case," "Unrisked Strategy Case," and "Downside Case." The proxy disclosed that the Core Case reflected management's best estimate and had been approved by the board for use by its financial advisor in evaluating the Acquisition. The plaintiff asserted that the proxy was misleading in portraying the Core Case as most accurately portraying management's view of the company's future, primarily because the Core Case allegedly contained incorrect assumptions. The court found that the alleged facts did not support a reasonable inference of bad faith or disloyalty by the directors or the company's CEO. The court noted, in a footnote, that in *Kahn v. Stern*,[2] the Delaware Supreme Court "recognized that a plaintiff can state a claim under *Revlon* by pleading that a conflicted fiduciary failed to disclose 'critical information' to the board or that the board failed to oversee a conflicted fiduciary sufficiently throughout the sale process." However, "Plaintiff does not pursue either of these theories," the court wrote. (Note that, in the recent *USG* decision, Vice Chancellor Glasscock appears to have clarified that his *Morrison v. Berry* decision, issued after remand of that case from the Delaware Supreme Court, did not stand for the contrary proposition that *any* disclosure violation may, at the pleading stage, indicate the possibility of bad faith.)

ENDNOTES:

[1] *Rudd v. Brown*, C.A. No. 2019-0775 MTZ (Del. Ch. Sept. 11, 2020).

[2] *Kahn v. Stern*, 183 A.3d 715 (Del. 2018).

FROM THE EDITOR

The Last Days of a Tumultuous Year

This year-end issue of *The M&A Lawyer* for 2020 goes to press a month after the presidential election. Joe Biden has been elected the 46th president of the United States, while President Trump, as of press time, is contesting this and filing multiple lawsuits.

It's perhaps how we should have expected this most unusual of years to end: in a cloud of confusion. Still, this issue offers some attempts at predicting the near future under a presumptive Biden administration in 2021. For example, Jones Day's Ryan Thomas and Jeremy Morrison, in an interview with *MAL*, discuss how antitrust enforcement from the Department of Justice and the Federal Trade Commission could change. While you should expect a more aggressive antitrust regime, one that may be under greater political pressure than usual, keep in mind that change in antitrust enforcement usually occurs on the margins.

As Thomas says, "the agencies are confronted with hundreds of merger filings every year. At the end of the day, relatively few transactions—generally less than around 5% of reportable transactions—receive extended scrutiny in form of second request investigations, and a subset of those will end up requiring remedies, and an even smaller number of *that* subset will end up in actual litigation. So, for M&A, changes in enforcement across administration typically affect a handful of transactions."

Could the Biden years even be fertile ground for M&A? Gibson Dunn's James Langston and Kyle Harris, as part of a post-election summary that the firm issued, predicted that divided government should reduce any potential headwinds. As long as private equity dry powder continues to amass and a low interest rate environment persists, M&A should continue to be strong, they said. Further, cross-border M&A could be invigorated under Biden. "If the U.S. political environment is perceived as being more predictable and less politicized, levels of cross-border M&A into the U.S. could normalize," Langston and Harris wrote. "Once the COVID-19 virus is tamed, expect to see more foreign acquirors look to the U.S. for M&A."

In terms of CFIUS, Gibson Dunn's Paul Marquardt and Chase Kaniecki added that they "generally expect continuity in the staff-led CFIUS process, as there has been from Bush to Obama to Trump. While the TikTok matter was a politicized aberration, the concerns of the professional national security community will remain the same and drive most reviews."

This is the last issue of *The M&A Lawyer* for 2020. We'll be back early in January, with our annual comprehensive year-in-review article, among other pieces. Until then, we'd like to wish all of our readers a happy and safe holiday season. This year has shown, more than usual, how important our family and friends are. All best to everyone, and we'll see you soon.

Chris O'Leary

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