Gibson Dunn’s October M&A Insights

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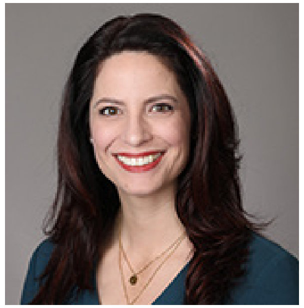
Today's Panelists

Robert B. Little

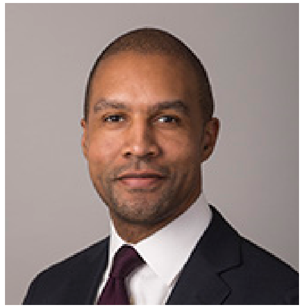
Robert B. Little is a partner in Gibson, Dunn & Crutcher's Dallas office, and he is a Global Co-Chair of the Mergers and Acquisitions Practice Group. Mr. Little has consistently been named among the nation's top M&A lawyers every year since 2013 by Chambers USA. His practice focuses on corporate transactions, including mergers and acquisitions, securities offerings, joint ventures, investments in public and private entities, and commercial transactions. Mr. Little has represented clients in a variety of industries, including energy, retail, technology, infrastructure, transportation, manufacturing and financial services.

Jessica Valenzuela



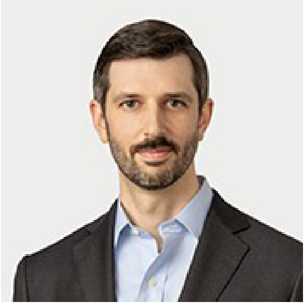
Jessica Valenzuela is a partner in the Palo Alto office of Gibson, Dunn & Crutcher and a member of the Securities Litigation Practice Group. Ms. Valenzuela's practice focuses on securities, corporate governance and other complex business litigation, including the defense of securities class actions, derivative suits and M&A-related class actions. In addition to representing clients in state and federal courts, she also represents companies, boards and special committees in government and internal investigations and counsels public and private companies and their directors and officers about a wide range of issues relating to corporate governance, insider trading, disclosure obligations, director and executive compensation matters and litigation risk and strategy.

Chris Wilson



Christopher M. Wilson is a partner in the Washington, D.C. office of Gibson Dunn & Crutcher. He is a member of the firm's Antitrust and Competition Practice Group. Mr. Wilson assists clients in navigating DOJ, FTC, and international competition authority investigations as well as private party litigation involving complex antitrust and consumer protection issues, including matters implicating the Sherman Act, the Clayton Act, the FTC Act, the Hart-Scott-Rodino (HSR) merger review process, as well as international and state competition statutes. His experience crosses multiple industries, including health insurance, transportation, telecommunications, technology, energy, agriculture, and biotechnology, and his particular areas of focus include merger enforcement, interlocking directorates, joint ventures, compliance programs, and employee "no-poach" agreements.

Alexander L. Orr



Alexander L. Orr is a partner in the Washington, D.C. office of Gibson, Dunn & Crutcher where his practice focuses primarily on mergers and acquisitions. Mr. Orr advises public and private companies, private equity firms, boards of directors and special committees in a wide variety of complex corporate matters, including mergers and acquisitions, asset sales, leveraged buyouts, spin-offs, joint ventures, equity and debt financing transactions and corporate governance matters, including securities law compliance.

Buyer Liability for Sell-Side Breaches of Fiduciary Duty

[Acquirer Aiding and Abetting Liability]

Lessons from Recent Delaware Decisions: Overview

- A trio of recent decisions (*Columbia Pipeline*, *Mindbody*, *Presidio*) in the Court of Chancery make clear that the high burden for pleading and proving an aiding and abetting claim against an M&A acquirer is not an insurmountable obstacle.
- *Columbia Pipeline* and *Mindbody* are post-trial decisions that provide M&A acquirers with fact-based examples of conduct that can give rise to liability of an otherwise arm's-length bidder for aiding and abetting breaches of fiduciary duties by the target board and executives.
- A claim for aiding and abetting a breach of fiduciary duty has four elements: (i) the existence of a fiduciary relationship, (ii) a breach of that duty by the fiduciary, (iii) knowing participation in the breach by the defendant, and (iv) damages proximately caused by the breach.
  - "Knowledge" can be actual or constructive knowledge and "turns on proof of scienter."
  - "Participation" requires that the bidder create, exacerbate, or exploit the sell-side breach.

Lessons from Recent Delaware Decisions: Background

- In *Columbia Pipeline*, *Mindbody*, and *Presidio*, the Court of Chancery identified a slew of missteps by target officers and directors in their sale processes that indicated questionable loyalties and indifference to the best interests of the target stockholders.
- What turned this problematic conduct by target fiduciaries into "aiding and abetting" violations by the third-party acquirers were (i) the acquirers' knowledge that these missteps by the personnel at the target companies constituted acts of disloyalty or deviations from practices designed to obtain the best price reasonably available, and (ii) despite this knowledge, the decision by the acquirer to exploit these missteps.
- And, despite the contractual right to review the target company's disclosures and provide comments, the failure by the acquirer to correct—or even to raise questions about—material omissions regarding the sales process missteps.

Lessons from Recent Delaware Decisions: *Columbia Pipeline*

- Vice Chancellor Laster found, after trial, that the two target company executives leading the sale process who breached their fiduciary duties:
  - conveyed to the strategic acquirer that the target was eager to sell,
  - implied to the acquirer that they were personally seeking a quick sale to trigger their change in control benefits,
  - reassured the acquirer that the process would not be competitive,
  - never mentioned to the acquirer that the acquirer's maneuvers to undermine the competitiveness of the process were in violation of the acquirer's standstill undertakings, which included a "don't ask, don't waive" provision,
  - provided the acquirer with due diligence access on an accelerated timeline not available to any other bidder,
  - were unduly receptive to proposals to decrease the proposed merger consideration,
  - extended the acquirer's exclusivity despite the existence of competitive inbound inquiries, and
  - never countered a last-minute price drop.
- Laster also found that the (i) bidder had a right under the merger agreement to review the proxy statement and an obligation to inform the target of any material omissions, and (ii) acquirer's personnel who were involved in the sales process missteps reviewed the proxy statement and failed to raise any issue with the disclosures.

Lessons from Recent Delaware Decisions: Lessons Learned

- Acquirers need to be on the lookout for acts of unwarranted favoritism by targets or actions by the target that are indicative of questionable loyalties or obvious inexperience (the “neophyte dealmaker” or “M&A newbie” as Laster put it in *Columbia Pipeline*).
- If process red flags are present, the bidder should insist on a quick, good faith confirmation that the target board is aware of and approved the developments in question and the bidder should self-assess whether a business rationale exists for such development.
- Representatives of the buyer who played a material role in the interactions with the target should carefully review the proxy statement (paying particularly close attention to the “Background” section) and, even if the material omission may be awkward to insert, send comments flagging the problems and proposing accurate language.
- Plaintiff’s lawyers will mine the bidder’s internal communications (both pre-and-post close) for evidence to support claims of knowledge and participation. Any internal communication could later become a trial exhibit.

Impact of the Proposed Hart-Scott-Rodino Rule Changes

[FTC Proposes Significant Expansion and Revision of HSR Merger Notification Form]

HSR Form Change: Overview

On June 27, FTC, with concurrence from DOJ, announced proposed changes to the Premerger Notification and Report Form.

- Implements changes required by Merger Filing Fee Modernization Act of 2022.
- Substantially increases the number of documents and amount of information to be included with HSR filing.
- First major change to HSR form since program began in 1978
- Subject to comment period ending on September 27, 2023.
  - Timing for final rule uncertain but new rules could go into effect in 1Q 2024.
  - Formal legal challenges also likely.

HSR Form Change: Selected Key Changes

- Expansion of item 4 material to include draft analyses/reports regarding transaction and to include deal team leads as item 4 custodians.
- Production of ordinary course business plans dating back one year.
- Disclosure of sales data, customer categories, and top 10 customer contact information for overlapping products/services.
- Narrative descriptions of horizontal overlaps and supply relationships.
- Identification of all prior acquisitions in past ten years in any overlapping products/services.
- Information regarding labor law violations and employee classifications.
- More difficult—but still possible—to file HSR on LOI or IOI.

HSR Form Change: Potential Ramifications

- Much longer post-signing/pre-filing timeline to prepare HSR.
  - Standard ten business day period may increase to twenty business days or more.
  - Regulatory efforts covenants may have to adjust.
- Significantly increased cost and effort to prepare HSR filings.
  - FTC estimates new rules would triple time to prepare HSR (from 37 hours to 144 hours).
- More pre-filing coordination between acquiror and target antitrust counsel.
  - Major discrepancies between parties' HSR filings may cause clearance delays.

HSR Form Change: Potential Ramifications (cont'd)

- HSR clearance timing more uncertain.
  - Increased documents, information in HSR filing may give rise to more questions from DOJ/FTC staff during HSR waiting period.
  - Possibility of more pre-filing negotiation with DOJ/FTC on whether and when HSR waiting period can start.
  - DOJ/FTC are not yet staffed to deal with increased information in HSR filings.
  - Termination dates may need to build in more cushion.
- Higher antitrust risk generally.
- Potential inquiries into antitrust issues unrelated to proposed transaction.

Identifying Asset Sales that Require Stockholder Approval

[Sales of “All or Substantially All” in Delaware]

Lessons from the *Altieri* Decision: Overview of DE Framework

- Section 271 of the Delaware General Corporation Law (DGCL) requires that a corporation's stockholders approve any asset sale constituting a sale of "all or substantially all" of the corporation's property and assets (including goodwill).*
  - No definition or bright-line tests in either the DGCL or caselaw; analysis is wholly fact-dependent.
- Under *Gimbel v. Signal Companies* (as reinforced by *Hollinger Inc. v. Hollinger Int'l.* and *Winston v. Mandor*) the court evaluates <u>both</u> "the quantitative and qualitative importance" of the transaction to determine whether it "strike[s] a blow" "at the heart of the [corporation's] corporate existence and purpose" and destroys the "means to accomplish the purpose or objects for which the corporation was [formed and actually performs]".
  - <u>Quantitative</u>: no one factor is dispositive; the sale must be evaluated in terms of the overall effect on the corporation, and there is no necessary quantifying percentage; Courts have considered revenue share, asset value, contribution to EBITDA, etc.
  - <u>Qualitative</u>: the sale must be "out of the ordinary *and* substantially affect the existence and purpose of the corporation," *i.e.*, leave stockholders with an investment qualitatively different (in economic terms) than that which they had prior to the sale.

*DGCL 272 provides exceptions for the mortgage or pledge of a corporation's assets, and for sales by a secured party (or by the corporation to offset its obligations to a secured party) of corporate assets that serve as collateral securing a mortgage or pledge, unless the corporation's governing documents provide otherwise.

Lessons from the *Altieri* Decision: Background

- In mid-2021, Mandiant, Inc. (Mandiant) sold its FireEye cybersecurity business to a private equity firm for $1.2 billion.
  - Mandiant did not seek stockholder approval in connection with the transaction.
- Months later, a Mandiant stockholder sued in the Delaware Court of Chancery seeking to void the sale, alleging that the transaction represented a sale of "all or substantially all" of Mandiant's assets and therefore required a stockholder vote.
- In May 2023, Chancellor Kathaleen McCormick granted Mandiant's motion to dismiss, determining that selling FireEye, despite it being Mandiant's "crown jewel" business, neither quantitatively nor qualitatively constituted a sale of "all or substantially all" of Mandiant's assets.
  - Note: Delaware's standard for granting a motion to dismiss: "reasonable conceivability," *i.e.*, the court must deny defendant's motion to dismiss unless *the plaintiff "could not recover under any reasonably conceivable set of [provable] circumstances*...."
- The Court's order provides a concise summary of Delaware's framework for evaluating whether a transaction is a sale of "all or substantially all" assets.

Lessons from the *Altieri* Decision: Analysis and Key Facts

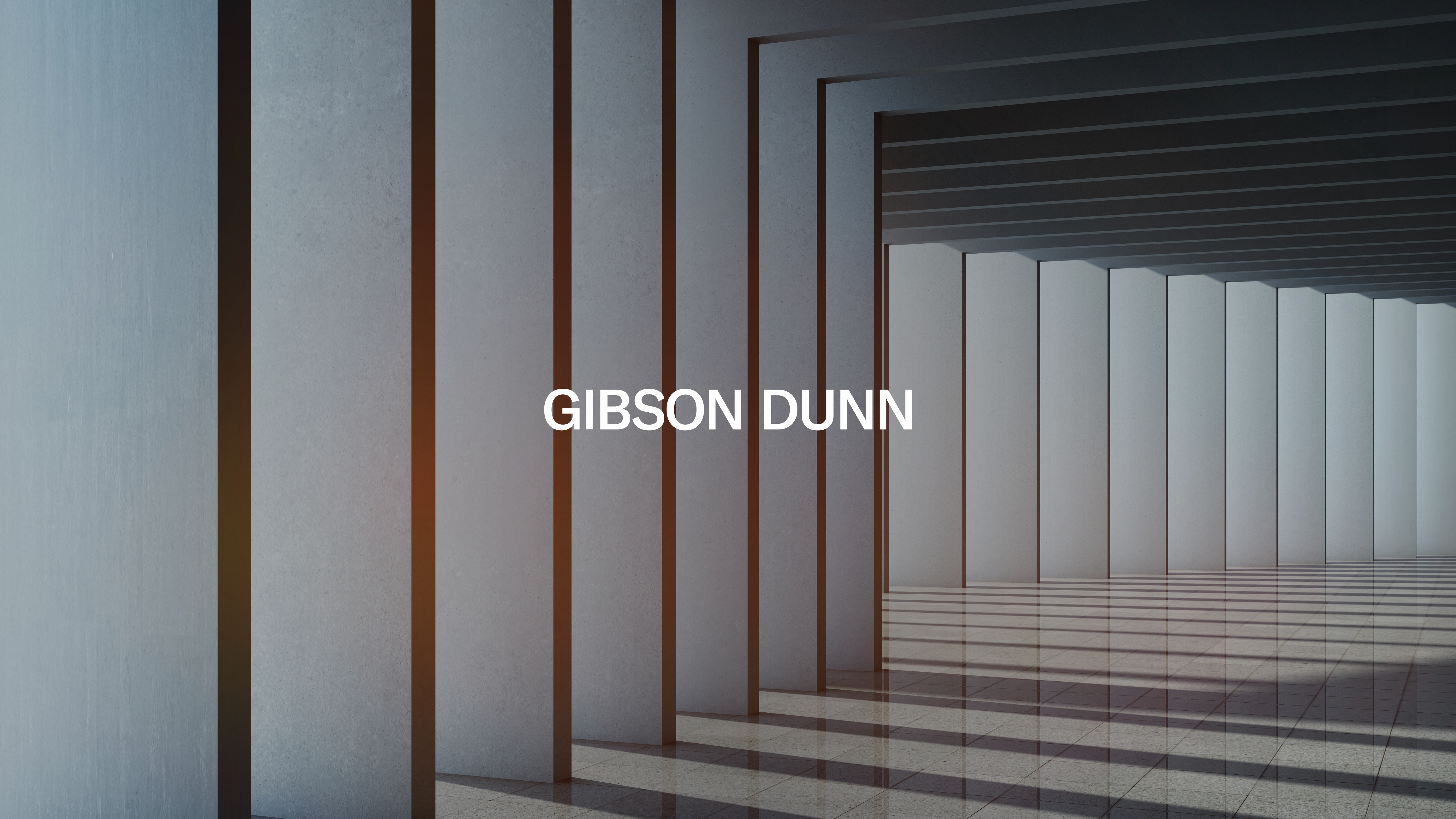
- Quantitative Analysis: 38% of assets "falls short of the substantially-all threshold"; no argument that Mandiant could not generate other revenue such that the sale could be seen to remove Mandiant's only revenue-producing asset.
  - FireEye generated roughly 60% of Mandiant's revenues and accounted for 50% of its $1 billion goodwill balance, but only 38% of its assets based on the sale price ($1.2 billion out of ~$3.2 billion)
  - Mandiant generated nearly $122 million in revenue from its remaining businesses in the fiscal quarter immediately after the sale.
- Qualitative Analysis: While FireEye was Mandiant's most valuable business and the sale was not ordinary course, "*Mandiant was a cybersecurity company before the sale[, and] is a cybersecurity company after the sale*." "Although the sale may alter the course of how Mandiant operates, the change is not qualitatively so significant as to 'strike a blow' to the 'heart'" of Mandiant's core business identity.
  - From its formation in 2004, Mandiant provided cyber incident response and consulting services in connection with data security breaches.
  - FireEye developed products designed to detect & prevent cyber attacks; adding FireEye allowed Mandiant to both detect and respond to data security issues.

Lessons from the *Altieri* Decision: Distinguishable Examples

- The Court distinguished a number of similar cases cited by plaintiff:
  - ***Shift from historically successful business***: sale of a business with a similar revenue share to FireEye that shifted the seller from an established producer of steel drums to a fledgling producer of plastic drums (a "radical departure").
  - ***Large asset shares coupled with sale of sole / only significant revenue-producing assets***: two cases in which the businesses sold comprised 68% and 75% of the companies' respective assets; in the first, the seller's remaining business constituted only a single, minimally profitable entity; in the second, the company was left with zero income-producing assets.
  - ***Shift in core business; reasonably large asset share***: sale of 60% of a company's assets that shifted the seller's business from holding real property (*i.e.*, hard assets) to holding linked securities.
    - This example comes from a motion to dismiss. It was "reasonably conceivable" that the proposed sale could be a sale of "all or substantially all."

Lessons from the *Altieri* Decision: Key Takeaways

- Even with a relatively clear framework, the application of the framework to any reasonably "close" case remains somewhat unpredictable.
- When evaluating a proposed asset sale in this context, consider these factors, among others:
  - Quantitative:
    - What does the business contribute to the corporation's overall revenue, asset value, EBITDA, goodwill, etc.? Courts may also look to potential future contributions, if relevant.
    - Do the remaining assets leave the company with viable options for continuing to generate revenue, profits, etc. or is the selling entity more akin to a "shell"?
  - Qualitative:
    - Does the potential sale constitute a radical departure or complete shift from the corporation's historical business description (as opposed to a mere alteration)?
    - Will stockholders hold the same type of investment in economic terms that they held before?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