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THE ACQUISITION OF CONTROL OF A UNITED STATES PUBLIC COMPANY

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For the current version of this memo, click here.
For the current version of *Checkpoints: The Consequences of Crossing Various Ownership Thresholds When Investing*, click here.
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INTRODUCTION

The acquisition of a controlling interest in any company involves numerous legal and business issues. This memorandum addresses the principal legal issues involved in acquiring control of U.S. corporations whose shares are publicly traded on a U.S. securities exchange (i.e., the NYSE or Nasdaq) or are otherwise subject to the public reporting requirements of the Securities Exchange Act of 1934, as amended (the "Exchange Act").[1]

Part I of this memo discusses the different ways in which an acquiring corporation (as used herein, the "acquiror") can acquire control of a target corporation (as used herein, the "target").[2] Part II discusses limitations that may be applicable to the acquiror's acquisition of a controlling stake in the target. Part III discusses certain restrictions on an acquiror's conduct with respect to a controlled (but not wholly-owned) target. Part IV discusses methods and considerations with respect to eliminating the minority stockholders in a controlled target.

I. MEANS OF ACQUIRING CONTROL

A. Privately Negotiated Transaction

Acquisition of a controlling stake in a public corporation may not involve transactions in the public markets. Rather, the acquiror could directly purchase a controlling stake in the target from one or more other stockholders or from the target itself.

1. Purchase of Shares from Third Parties

If the target already has a controlling stockholder or a group of stockholders who together own a controlling interest, an acquiror can acquire control by buying the controlling interest from such stockholder(s). The acquiror and stockholder(s) would negotiate a stock purchase agreement pursuant to which the acquiror will pay cash or some other form of consideration to the selling stockholder(s) in exchange for the controlling interest.

(a) Price. Acquirors seeking to buy a controlling interest in a target from a controlling stockholder will usually pay a premium over the market price of the target shares.[3] This premium is called a control premium and reflects the value of the right to

[1] The Exchange Act registration requirements are discussed below in footnote 63.

[2] This memo assumes the target is a Delaware corporation. While the laws applicable to corporations of other states are generally comparable to that of Delaware, there can be important differences. In addition, this memo does not address the particular considerations and strategies applicable to unsolicited transactions.

[3] The law of some countries requires an acquiror who purchases a controlling block of shares in a privately negotiated transaction to offer to buy the remaining shares from the minority stockholders, which effectively requires the control premium to be shared among all stockholders. Delaware law does not impose such a requirement. Rather, the acquiror may offer to buy any amount it chooses, and the selling stockholders need not share the control premium with the other stockholders.

control the target. In the case of targets without a single controlling stockholder, an acquiror may be able to acquire a controlling interest without paying a control premium by making purchases from significant stockholders sufficient to accumulate a control block. However, such purchases would need to be coordinated to ensure that they do not constitute a "tender offer" (discussed in Section I.B.1).

(b) Required Approvals.

- *Stockholders and Board of Directors*. The approval of neither the target's board of directors ("Board") nor its stockholders is required in connection with a privately negotiated purchase of a controlling interest by an acquiror from one or more stockholders of the target. However, the purchase of a controlling interest is usually the first step in a plan by the acquiror to acquire (or potentially acquire) all of the target's outstanding stock. The subsequent acquisition of the remaining shares held by the minority stockholders in a second step transaction is often called a "squeeze-out" and is discussed in Section IV. In order to preserve the ability to conduct a squeeze-out in the near term, an acquiror will need to qualify for an exemption under Delaware's business combination statute[4] (as well as any other applicable anti-takeover provisions, discussed in Section II.C). As a result, even though the target's Board approval may not be required in connection with the acquisition of a controlling interest in the target, acquirors frequently insist upon Board approval as part of an overall acquisition of the target by the acquiror.

- *HSR*. Clearance under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended ("HSR"), may be required even in the case of a purchase of shares from stockholders of the target. If the applicable requirements (discussed in Section II.D.1) are met, the acquiror will need to make a filing with the Federal Trade Commission ("FTC") and the Antitrust Division of the U.S. Department of Justice ("DOJ") so that the impact of the transaction on competition in the relevant markets can be reviewed. HSR imposes a waiting period of 30 days (or 15 days, in the case of cash tender offers) during which the regulators may submit a "second request" for additional information about the transaction or the parties. In many cases, the expiration or termination of the waiting period under HSR is what drives the timing of the transaction.

(c) Securities Law Matters. Under the Securities Act of 1933, as amended (the "Securities Act"), the sale of shares by stockholders of the target, like all sales or offers of securities, must be registered with the Securities and Exchange Commission ("SEC") or qualify for an exemption from the registration requirements of the Securities Act. These securities law issues are discussed in Section II.A. In addition, the acquiror will need to file with the SEC a beneficial ownership report on Schedule 13D relating to its interest in the target. A Schedule 13D must be filed within 10 days of the acquisition of more than 5% of any class of equity security of the target. The rules governing the filing of Schedules 13D are discussed in Section II.A.3.

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[4] Delaware General Corporation Law ("DGCL") §203.

(d) Other Factors.

- *Due Diligence*. Stockholders of the target, even controlling stockholders, have limited ability to make confidential information about the target available to the acquiror unless the target's Board separately agrees to provide access to the acquiror. Without such access, the acquiror will likely have to rely on the information contained in the target's public reports filed with the SEC, which can omit details (such as the terms of customer contracts or information about the target's technology) that are important from a business perspective.

- *Indemnification*. There is the possibility for the acquiror to obtain the right to be indemnified by the selling stockholders if the representations in the purchase agreement made by the sellers are untrue.

- *Deal Certainty*. This type of transaction gives the acquiror the greatest opportunity to structure the transaction to maximize deal certainty. In such a transaction, the sellers do not need to have a "fiduciary out," and can be bound to complete the transaction regardless of the terms of any subsequent offer. By contrast, in a deal negotiated with the target, the target's Board will insist on the right to abandon the transaction and/or change its recommendation in response to any superior proposal that may subsequently be made.

2. Purchase of Shares from Target

An alternative to acquiring shares from stockholders is for the acquiror to purchase newly issued shares directly from the target. This type of transaction is sometimes used in situations where the target needs additional capital.

(a) Price. If the issuance will effectively deliver control of the target to the acquiror, the target's Board will likely be subject to "Revlon" duties,[5] which require directors of the target to take steps designed to obtain the best price reasonably attainable under the circumstances. This, in turn, may require the target's Board to conduct a pre- or post-signing market check—to satisfy itself that it has adequate information regarding the value of the corporation's stock and the degree of interest from other parties before it completes a transaction with the acquiror—or to have a provision that permits the directors to change their recommendation to the target's stockholders or terminate the agreement if it receives a superior proposal after the acquisition agreement has been executed. In a transaction involving the sale of control, the target's Board will typically insist that the acquiror either (i) pay a control premium or (ii) agree to some type of "standstill" arrangement limiting the acquiror's ability to accumulate additional shares or exercise control over the target.

(b) Required Approvals.

[5] Named after the case that originally articulated the Board's duties in such a situation, *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986).

- *Stockholders*. The number of shares required to be issued in order to give the acquiror control over the target may be very large—and in excess of the number of authorized but unissued shares of the target. As a result, the target's certificate of incorporation ("COI") may need to be amended to increase the number of authorized shares of the target, which would require the approval of the target's stockholders. In addition, securities exchange rules require stockholders to approve certain significant issuances[6] unless the delay caused by a stockholder vote would jeopardize the financial viability of the issuer. To obtain such stockholder approval, the target needs to solicit proxies for votes at a meeting of stockholders held to approve the applicable matters, which requires the target to prepare and clear a proxy statement with the SEC. The proxy requirements are discussed in Section IV.A.2(b).

- *Board of Directors*. The target's Board must vote to approve the issuance (and, if applicable the amendment to the COI). The Board's approval in such circumstances would waive the applicability of Delaware's business combination statute under DGCL §203.

- *HSR*. If the applicable requirements are met, the purchase of newly issued shares would also require HSR approval.

(c) Securities Law Matters. The issuance of new shares by the target must be registered with the SEC or qualify for an exemption from the registration requirement. If the shares are not registered, they are usually issued in a private placement exempt from the registration requirement under Section 4(2) of the Securities Act. The requirements for a private placement are discussed in Section II.A.1(a). In addition, following the purchase, the acquiror will need to file a Schedule 13D with respect to its interest in the target.

(d) Other Factors.

- *Due Diligence*. The acquiror will expect to receive access to due diligence materials from the target.

- *Indemnification*. There is the possibility for the acquiror to obtain the right to be indemnified by the target if the representations in the stock purchase agreement regarding the target and/or its business are untrue. In a purchase of shares from

[6] Nasdaq Listing Rule 5635 requires an issuer to obtain stockholder approval of the issuance of common stock or other securities (a) in connection with the acquisition of stock or assets of another corporation in which (i) the issuance is equal to 20% or more of the number of shares or voting power outstanding before the issuance of the stock or (ii) a director, officer or holder of 5% or more of issuer's shares has a 5% or greater interest in the corporation whose shares or assets are being acquired, (b) where the issuance will result in a change of control of the issuer, (c) in connection with the establishment or material amendment of an equity compensation plan or (d) as part of a private placement of shares in which the issuance is equal to 20% or more of the number of shares or voting power outstanding before the issuance (when combined with shares sold by officers, directors or holders of 5% or more of the shares or voting power in the issuer) for less than the greater of the book or market value of the stock. NYSE Rule 312 is substantially similar.

the target, its representations regarding its business are likely to be more meaningful than the representations given by the sellers in a purchase of shares from stockholders.

- *Deal Certainty*. The target's Board will likely seek to obtain the right to abandon the transaction and/or change its recommendation in response to any superior proposal that may subsequently be made.[7]

- *Consequences of Issuance*. The COIs of some targets may grant existing stockholders preemptive rights on new issuances, which could have the effect of prohibiting the issuance of a controlling interest to the acquiror.[8] In addition, warrants, options and other securities exercisable for or convertible into shares of the target may contain anti-dilution provisions that are affected by an issuance.

B. Transactions Involving the Public Markets

1. Tender Offer

A tender offer is a common way for an acquiror to obtain a controlling interest in a target. Rather than purchasing shares from the target or certain of its stockholders, the acquiror offers to purchase shares of the target from any of the target's public stockholders who tender into the offer. Notably in the U.S., there is no requirement for an acquiror to tender for a minimum amount of the target's shares, nor is there any requirement for a mandatory offer to buy out remaining stockholders once an acquiror crosses a certain threshold.

(a) Advantages of a Tender Offer Structure. The primary advantage of a tender offer over other acquisition structures is the speed with which an acquiror can complete its acquisition of control of the target. Acquirors can commence and close a cash tender offer and gain control of the target in roughly 30 days, whereas completing an acquisition through a transaction structure that requires stockholder approval can take two to three months.[9] Once the acquiror gains control of the target, it can make the target a wholly-owned subsidiary by means of a second step long-form or short-form merger, as discussed below. Among the relevant features of a tender offer are:

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[7] In any transaction structure, the acquiror will generally seek to obtain protection against competition from a rival bidder. Such "deal protection" devices are heavily negotiated and outside the scope of this memo, but frequently include such things as a "no-shop" covenant by the target and a termination fee payable to the acquiror in certain circumstances. Courts recognize that the acquiror's investment of time and resources in the deal deserve to be compensated, but that a Board's fiduciary duties require it to act in the best interests of stockholders and such deal protection provisions must not preclude the emergence of a superior proposal.

[8] Most states, including Delaware, permit corporations to include a provision granting stockholders preemptive rights on new issuances, though such provisions are relatively rare. In a minority of states, including Minnesota and Texas, existing stockholders are entitled to preemptive rights unless the COI contains a provision explicitly disclaiming them.

[9] In transactions requiring extended regulatory review or the registration of securities issued as part of the consideration, the timing advantages of a tender offer structure can be diminished or eliminated.

- *Merger Without Stockholder Approval*. The acquiror may immediately complete the second step squeeze-out without the need for the approval of the target's stockholders if the acquiror and target enter into a merger agreement giving the acquiror express authorization to complete the merger after obtaining in the tender offer a majority of the target's outstanding stock (or such other amount of shares required to effect a "long-form" merger (discussed in Section IV.A.2)), the acquiror obtains such amount of stock, and certain other conditions set out in DGCL §251(h) are met.[10] To do so, the acquiror would file a certificate of merger containing a certification that the merger agreement complies with the applicable statutory conditions.[11] The acquiror must pay the minority stockholders the same amount and kind of consideration that the acquiror pays to stockholders who tender shares into the tender offer.

  Target stockholders who are cashed out in a second step merger have appraisal rights, which are discussed in Section IV.A.2(c). Consummating a second step merger under DGCL §251(h) avoids the delay of clearing a proxy statement with the SEC and waiting for 20 business days after mailing it to stockholders before holding the stockholder meeting otherwise necessary to adopt a merger agreement. If it is unable to obtain the requisite number of shares in the tender offer, the acquiror will need to accomplish the second step merger through a long-form merger, which requires preparing and clearing a proxy statement and having the stockholders adopt the merger agreement at a meeting.[12] Long-form mergers and the proxy process are discussed in Section IV.A.2.

[10] Generally speaking, the conditions to complete a second step merger under DGCL §251(h) are as follows: (a) the merger agreement expressly provides that the merger is governed by DGCL §251(h); (b) the acquiror consummates a tender offer for any and all of the outstanding shares of the target that would be entitled to vote on the adoption of the merger agreement and on terms provided in the merger agreement; (c) following consummation of the tender offer, the acquiror owns at least the percentage of shares that otherwise would be required to adopt the merger agreement; (d) the acquiror merges into the target pursuant to the merger agreement; and (e) as part of the merger, the outstanding shares of the target are converted into the same kind and amount of consideration received in exchange for shares of the target tendered into the tender offer.

[11] If the conditions to complete a second step merger under DGCL §251(h) are not met, then an acquiror can still complete a second step merger without the approval of the target's stockholders if the acquiror obtains at least 90% of the target's outstanding stock. To do so, the acquiror would file a certificate of merger containing a resolution of the acquiror's Board authorizing the merger and stating the consideration to be paid to the minority stockholders. Subject to any agreement with the target, fair price laws or provisions in the target's organizational documents, the acquiror may determine the consideration to be paid to the minority stockholders; however, in practice, because of Rule 13e-3 and the enhanced judicial scrutiny given to transactions between a target and its controlling stockholder, the consideration in a second step squeeze-out will typically be the same as that in the initial tender offer.

[12] In transactions where the acquiror must obtain 90% of the target's outstanding stock to complete a merger without target shareholder approval, the target will frequently give the acquiror an option that enables the acquiror to purchase, for the same consideration offered in the tender offer, a number of newly issued shares of the target that, when added to the target stock owned by the acquiror following the tender offer, constitutes 90% of the target's outstanding stock. Targets grant this "top-up option" because the acquiror will control the target after the closing of the tender offer and a subsequent squeeze-out will largely be a formality. As a practical matter, the shares issuable pursuant to top-up options are limited to the remaining number of authorized but unissued shares of the target.

- *Support Agreements*. The acquiror may be able to reach separate agreements with significant stockholders to tender their shares into the tender offer.

- *Immediate Commencement*. Although the acquiror must file a Schedule TO with the SEC, in a cash tender offer it does not have to wait for SEC clearance to commence the offer.

(b) Price. As a practical matter, the price offered by the acquiror in a tender offer must reflect a premium to the current market price of the target's stock in order to induce stockholders to tender a sufficient number of shares into the offer.

(c) Required Approvals.

- *Stockholders and Board of Directors*. While the approval of the target's Board and stockholders is not required to commence and close a tender offer, the approval of the target's Board is required under Delaware's business combination statute to preserve the ability to conduct a second step merger in the near term following the closing of the tender offer. Accordingly, such Board approval is usually obtained as part of a negotiated transaction.

- *HSR*. For tender offers where the acquiror offers only cash consideration, the applicable HSR waiting period is 15 days instead of 30. If the HSR filing is made promptly following the commencement of the tender offer, absent a second request, the waiting period should expire during the tender offer period.

(d) Securities Law Matters. Other than compliance with the tender offer rules (discussed in this Section I.B.1) and issues relating to the sale of restricted securities by holders thereof, there are generally no additional issues posed by a tender offer relating to registration of the shares purchased by the acquiror. Following the execution of a support agreement with stockholders of the target or (if there is no support agreement) the closing of the tender offer, if the acquiror beneficially owns more than 5% of the outstanding shares of the target, the acquiror must file with the SEC a Schedule 13D with respect to its interest in the target.

(e) Other Factors.

- *Due Diligence*. As with other negotiated transactions, the acquiror will expect to receive access to due diligence materials from the target.

- *Indemnification*. Tendering stockholders do not make any representations regarding the target and the acquiror is not entitled to post-closing indemnification from the sellers or the target.[13]

[13] In recent years, however, the use of contingent value rights has become more common. CVRs typically provide for additional payments to target stockholders post-closing upon the occurrence of certain specified events. Accordingly, they can be used to replicate some aspects of an earn-out or holdback arrangement more commonly used in deals providing for indemnification of the acquiror.

- *Deal Certainty*. The target's Board is likely to insist on the right to abandon the transaction and/or change its recommendation in response to any superior proposal that may subsequently be made.

- *Financing Issues*. Tender offers pose unique issues that complicate an acquiror's effort to finance an acquisition. The Federal Reserve Board's Regulation U prohibits a lender from extending credit that is secured by publicly traded stock in an amount that exceeds 50% of the market value of the stock. Because the assets of the target cannot be pledged as collateral for financing until the second step squeeze-out is complete, it can be difficult for an acquiror to finance a tender offer unless the acquiror obtains the number of shares required to complete a second step merger with the target without a vote of the target's stockholders.

  Further, the SEC has taken the position that the satisfaction or waiver of a financing condition[14] can constitute a material change to the terms of the tender offer, requiring that the offer remain open for at least five business days thereafter.

(f) The Tender Offer Process. The rules governing tender offers are contained in Sections 13 and 14 of the Exchange Act and the rules promulgated by the SEC thereunder. The principal features of the tender offer process are as follows:

- *Acquisition Subsidiary*. Acquirors frequently establish a special purpose subsidiary to act as the direct purchaser in the tender offer. Following a second step merger of the subsidiary and the target, the surviving entity becomes a wholly-owned subsidiary of the acquiror, maintaining a liability shield between the target and the acquiror. The merger can be structured so that the target is the surviving entity in the merger (which can be advantageous in complying with the target's contract assignment provisions). Additionally, most non-U.S. acquirors prefer, for tax and other reasons, to conduct their U.S. operations through a U.S. corporation rather than directly by the acquiror.

- *Commencement*. The acquiror commences a tender offer by publishing a summary advertisement in a daily newspaper with national circulation (such as *The Wall Street Journal* or *The New York Times*).[15] The tender offer commences at 12:01 a.m. on the day the acquiror publishes the advertisement.[16]

[14] A financing condition provides that the acquiror is not obligated to close the tender offer unless it has received the contemplated financing to fund the acquisition.

[15] Rule 14d-4. Upon commencement of a tender offer, an acquiror must publish either a summary advertisement or a long-form advertisement detailing the terms of the offer. The acquiror must also promptly furnish the tender offer materials to any stockholder that requests them.

[16] Commencement also involves the payment by the acquiror of a filing fee to the SEC (equal to $0.00011460 per dollar of transaction value, subject to periodic adjustment), hand delivery of the tender offer documents to the target and notice of commencement of the offer to the applicable stock exchange. The acquiror will also retain a number of agents to facilitate various aspects of the offer, including managing the tender process, printing and distributing materials to stockholders, receiving tenders and processing payment.

- *Terms of the Offer*. The acquiror can set the terms and conditions of its offer to purchase shares, including the price it will pay and the number of shares it is seeking to buy (usually, but not necessarily, all outstanding shares of the target). It can also condition its obligation to purchase shares in the offer on, among other things,[17] the tender of a minimum number of shares by the target's stockholders.[18] The acquiror must extend the offer to all of the target's stockholders[19] and must pay to each stockholder for shares tendered in the offer the highest consideration that it pays to any other stockholder for shares tendered in the offer.[20] The acquiror must hold the tender offer open for at least 20 business days.[21] If the acquiror tenders for less than all of the target's outstanding shares and the offer is oversubscribed, the acquiror must accept and pay for a pro rata portion of the shares tendered by each stockholder.[22] In addition, each stockholder must have the right to withdraw any shares that the stockholder has tendered at any time during the period that the tender offer remains open and, if tendered shares have not been accepted for payment by the acquiror within 60 days of commencement of the offer, thereafter until accepted for payment.[23]

- *Disclosure by the Acquiror*. The documents required of an acquiror in conducting a tender offer include the following:

  - *Schedule TO*. The acquiror must prepare and file a Tender Offer Statement on Schedule TO with the SEC. Usually, the Schedule TO incorporates the required disclosure by reference to the Offer to Purchase, which is an exhibit to the Schedule TO. Other required exhibits to the Schedule TO include any agreements relating to the target's securities (such as a merger agreement and any support agreements with stockholders) and any loan agreement relating to funds borrowed to

[17] Other customary conditions include the continued accuracy of the target's representations, the absence of material adverse effect with respect to the target, no breach by the target of the merger agreement, receipt of required governmental approvals and the absence of any law, order or proceeding prohibiting or challenging the transaction.

[18] Typically, this "minimum condition" is set at a majority of the target's shares on a fully-diluted basis, to ensure the acquiror's ability to consummate a second step merger under DGCL §251(h) without a vote of the target's shareholders or, in transactions where the conditions for a merger under DGCL §251(h) have not been met, to ensure the acquiror's ability to consummate a long-form merger in the event the acquiror is unable to obtain 90% and consummate a merger without a vote of the target's shareholders.

[19] Rule 14d-10(a)(1).

[20] Rule 14d-10 explicitly permits an acquiror to offer different forms of consideration, such as cash or shares of the acquiror's stock, to the target's stockholders, as long as the stockholders can choose which form of consideration they will receive and the highest consideration of each type paid to any stockholder is paid to any other stockholder receiving that type of consideration. Rule 14d-10(d) also permits certain compensation arrangements, such as severance packages offered to employee-stockholders that are approved by the compensation committee of the target's or acquiror's Board. Such arrangements are often used by acquirors to ensure that key employees of the target continue to work for the target after the acquisition.

[21] Rule 14e-1(a).

[22] Section 14(d)(6); Rule 14d-8.

[23] Section 14(d)(5); Rule 14d-7.

finance the transaction. The Schedule TO must be signed by an officer of each "bidder"—which includes the parent of any special acquisition subsidiary used to conduct the tender offer—and must be amended promptly if there is a material change to the information it contains. In addition, the acquiror must file all pre-commencement communications with target stockholders regarding the tender offer under cover of Schedule TO no later than the date of such communication.[24]

- *Offer to Purchase*. The Offer to Purchase is the primary disclosure document the acquiror prepares in connection with a tender offer. Its required disclosure includes: (i) the terms and conditions of the offer; (ii) procedures for tendering and withdrawing shares; (iii) information about the target, the acquiror and related entities involved in the transaction (including financial statements of the acquiror unless the tender consideration is all cash, the offer is not subject to a financing condition and either the offer is for all outstanding shares of the target or is being made by a U.S. public reporting corporation); (iv) the history of the negotiation or contacts between the parties to the transaction; (v) a summary of the material transaction agreements, (vi) the source of funds used in the transaction; (vii) information about the executive officers and directors of the acquiror and related entities involved in the transaction; (viii) information about any transactions by the acquiror or its officers and directors in the target's shares during the 60 days prior to filing the Schedule TO and (ix) any other material information related to the transaction.

- *Ancillary Documents*. In addition, the acquiror typically distributes *certain* ancillary documents facilitating the dissemination of the tender offer to the target's stockholders by financial institutions and the tender by target stockholders of their shares into the offer.

- *Disclosure by the Target*. Within 10 business days of commencement of a tender offer, the target must file a Solicitation/Recommendation Statement on Schedule 14D-9 with the SEC and deliver it to its stockholders.[25] Schedule 14D-9 contains the target Board's position on the tender offer. In the Schedule 14D-9, the target's Board must disclose its views on the tender offer by recommending the acceptance or rejection of the offer, expressing no opinion, or explaining that it cannot take a position at that time. The target must also disclose whether its financial advisor believes the acquiror's offer is fair and whether the executive officers and directors intend to tender their shares.

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[24] Rule 14d-2(b).

[25] In negotiated transactions, the target's Schedule 14D-9 is typically filed contemporaneously with the Acquiror's Schedule TO.

- *Amendments to Offer; Extension*. If the acquiror amends the terms of the offer to increase or decrease (i) the percentage of securities it seeks to acquire, (ii) the consideration it has offered or (iii) the dealer manager's soliciting fee, it must keep the tender offer open for at least 10 business days from the date that notice of such increase or decrease is published, sent or given to stockholders.[26] If the acquiror makes other material amendments to the terms of the offer, including a waiver of a condition, it will need to extend the offer for five business days. The acquiror may also voluntarily extend the offer if it publicly announces such extension by the business day following the scheduled expiration date and discloses the approximate number of shares tendered as of the date of such extension.[27]

- *Subsequent Offering Period*. In order to facilitate the acquiror obtaining the requisite amount of the target's stock, SEC rules and merger agreements typically permit the acquiror to use one or more "subsequent offering periods" during which the acquiror keeps the offer open following its acceptance of securities tendered in the initial offering period.[28] A subsequent offering period is only available in offers to purchase all outstanding shares. During a subsequent offering period, the acquiror must accept and pay for shares as they are tendered and must offer to pay the same form and amount of consideration as during the initial offering period and stockholders who tender shares of the target may not withdraw those shares.

- *No Purchases Outside of Offer*. The acquiror and certain other related persons may not purchase, or make an arrangement to purchase, shares of the target or any related securities, except pursuant to the tender offer.[29] The prohibition extends from the announcement of the tender offer through the expiration of the initial offering period.

(g) Avoiding Designation as a Tender Offer. No statute or regulation sets forth a bright-line rule for what constitutes a "tender offer."[30] As a result, acquirors must

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[26] Rule 14e-1(b).

[27] Rule 14e-1(d).

[28] Rule 14d-11.

[29] Rule 14e-5. This rule exempts the following transactions: (1) purchases or arrangements to purchase during a subsequent offering period; (2) purchases pursuant to contractual obligations, provided that (i) the contract was entered into before public announcement of the tender offer, (ii) the contract is unconditional and binding on both parties and (iii) the existence of the contract and all material terms, including quantity, price and parties, are disclosed in the offering materials and (3) purchases or arrangements to purchase by an affiliate of the dealer manager, subject to specified conditions.

[30] The seminal court case addressing this question was *Wellman v. Dickinson*, 475 F. Supp. 783 (S.D.N.Y. 1979), which discussed eight factors that may be considered in determining whether an offer to purchase securities constitutes a tender offer. The eight factors are whether: (1) the acquiror makes an active and widespread solicitation of stockholders for shares of the target; (2) the acquiror offers to purchase a substantial percentage of the target's stock; (3) the offer to purchase is at a premium over the prevailing market price for the target's share; (4) the terms of the offer are firm rather than negotiable; (5) the offer is contingent on the tender of a fixed minimum number of shares; (6) the offer is open for a limited period of time; (7) the target's

take care to ensure that conduct intended not to constitute a tender offer is not subject to the tender offer rules. Acquirors can reduce the risk of being deemed to be engaged in a tender offer by limiting their discussions to a small number of stockholders and by avoiding a general solicitation or publicity. Acquirors may also limit their communications to discussions with knowledgeable investors, such as institutional or corporate stockholders, because such investors are less likely to require the protection of the federal tender offer rules.

2. Other Public Market Transactions

(a) Open Market Purchases and Block Trades. An acquiror can accumulate shares of the target through purchases in the open market. An acquiror can also engage in block trades, which are typically facilitated by an investment bank and involve purchases of publicly traded shares from significant stockholders. These approaches allow the acquiror to establish a position from which to commence a tender offer or to decrease the cost of any subsequent transaction but, for the reasons discussed below, are unlikely to be used to acquire a controlling interest in the target.

(b) Issues Associated with Open Market Purchases and Block Trades.

- *Price*. Purchases by an acquiror on a large scale are likely to drive up the price of the target's stock, potentially significantly.

- *Required Approvals*. While the approval of the target's Board and stockholders is not required in connection with open market purchases or block trades, the approval of the target's Board is required under Delaware's business combination statute to preserve the ability to conduct a squeeze-out in the near term following the closing of any tender offer. The acquisition of shares in open market purchases or block trades also requires HSR approval if the applicable requirements are met.

- *Securities Law Matters*. Once the acquiror acquires beneficial ownership of 5% of the target's stock, it will be required to file a Schedule 13D with the SEC. The acquiror will also want to ensure that any program of open market purchases or block trades is not deemed to constitute a tender offer.

- *Due Diligence and Indemnification*. An acquiror will not have the opportunity to conduct due diligence and will not obtain indemnification rights with respect to shares purchased on the open market or in block trades.

II. ISSUES RELATING TO ACQUISITION

This section discusses limitations and other requirements that can be applicable to acquisitions of a controlling interest in a target. These include statutory and regulatory

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stockholders are subject to pressure to sell their stock and (8) a public announcement of the offer to purchase precedes or is accompanied by a rapid accumulation of shares by the acquiror.

hurdles to acquisitions that the acquiror may need to overcome as well as devices that targets employ to prevent unsolicited takeover attempts.

A. Securities Laws

The two primary sources of U.S. federal securities law are the Exchange Act and the Securities Act, together with the regulations promulgated under each by the SEC. In general terms, the Securities Act governs the offer and sale of securities in the U.S. and the Exchange Act regulates the trading of securities on securities exchanges (including the NYSE and Nasdaq), ongoing periodic reporting and tender offers.

1. General Rule—Registration Requirement

Section 5 of the Securities Act forbids the offer or sale of any security unless there is a registration statement in effect for the transaction, the transaction is exempt from the registration requirement, or the security is of a type exempt from the registration requirement.

(a) Exempt Purchases from Issuer.

- *Section 4(2) Private Placements*. Section 4(2) of the Securities Act exempts from the registration requirement any sale by an issuer of securities "not involving any public offering." As a general matter, issuers may make such sales to sophisticated investors who have not been solicited as part of a general solicitation or advertising effort (except as specifically permitted pursuant to Regulation D promulgated under the Securities Act ("Regulation D")) and who have been provided with information relevant to their investment decision. Section 4(2) of the Securities Act itself does not set forth clear rules that an issuer may follow to ensure the sale is exempt from registration. As a result, many sales under this provision are conducted pursuant to Regulation D, which sets forth certain safe-harbor criteria by which a sale of securities is deemed to qualify as a private placement.

- *Regulation D Safe Harbor*. To be eligible for the Regulation D safe harbor, an issuance of securities must comply with a number of restrictions. First, the issuer must furnish the acquiror with its most recent annual report and proxy statement, Form 10-K and any other Exchange Act filings filed since the its most recent Form 10-K. Second, the issuer must exercise reasonable care to ensure that the purchasers are not underwriters under the Securities Act (i.e., not acquiring the securities with a view to the distribution thereof).[31] Third, the issuer must ensure that the securities are issued only to specified categories of purchasers. If the issuer offers or sells securities through general solicitation or general

[31] This is typically accomplished by (a) asking the purchaser to make representations regarding its investment intent, (b) disclosing that the securities have not been registered and cannot be resold absent registration or another exemption from the registration requirement and (c) placing a legend on any instrument evincing the security regarding such transfer restrictions.

advertising,[32] Regulation D permits private placements only to purchasers who are "accredited investors."[33,34] If the issuer offers or sells securities without undertaking any general solicitation or general advertising, the issuer may sell securities to accredited investors and to up to 35 non-accredited investors who have such knowledge and experience in financial and business matters that they are capable of evaluating the merits and risks of the prospective investment.

- *Regulation S Offerings*. An issuer may also issue shares to a non-U.S. acquiror in a Regulation S offering, which exempts transactions that involve an offer and sale of securities occurring outside of the U.S. Under the safe harbor of Rule 903 under the Securities Act, an offer and sale of securities is deemed to occur outside of the U.S. if it is made in an "offshore transaction"[35] in which no "directed selling efforts" are made in the U.S. by the issuer, a distributor, any of their respective affiliates, or any person acting on their behalf, and certain other restrictions are imposed on the offering to prevent "flowback" of the securities into the U.S.

(b) Purchases from Other Stockholders.

- *Overview*. If a stockholder is not an affiliate[36] of the issuer, it may freely resell shares of the issuer that were issued in a registered transaction. Generally, shares acquired by a stockholder in a transaction exempt from registration constitute "restricted securities" and may not be resold without being registered, unless they are resold pursuant to another transaction exempt from the registration

[32] General solicitations and general advertising include (a) advertisements, articles, notices or other communications published in any newspaper, magazine or similar media or broadcast over television or radio; and (b) any seminar or meeting whose attendees have been invited by general solicitation or general advertising.

[33] Accredited investors include (a) institutional investors such as banks, brokers, dealers, insurance companies, investment companies and employee benefit plans, (b) tax-exempt organizations with more than $5 million in assets, (c) directors, executive officers or general partners of the issuers, (d) certain individuals of net worth that exceeds $1 million (exclusive of the value of the individual's primary residence) or income that exceeds $200,000, (e) certain trusts with more than $5 million in assets, and (f) entities in which all of the equity owners are accredited investors.

[34] The issuer must take reasonable steps to verify that all of the investors who purchase securities in connection with the offering are accredited investors. Reasonable steps can include: (a) a review of specified documentation (e.g., Internal Revenue Service forms, bank statements, credit reports) showing that the investor meets either the income test or net worth test set out under in the Securities Act rules; (b) reliance on written confirmation from a third party showing that the third party has verified the investor's accredited investor status; or (c) reliance on a certification from an existing investor who previously invested in a private placement by the issuer under Regulation D.

[35] An off-shore transaction is a transaction in which (x) the offer and sale is not made to a person in the U.S. and (y) either the acquiror is outside the U.S. when the buy order is originated or the transaction takes place through the facilities of a non-U.S. securities market.

[36] U.S. securities laws generally define an "affiliate" of a person to be another person that, directly or indirectly, controls, is controlled by or is under common control with such person. A "control" relationship can exist in circumstances where a person holds less than a majority of the voting securities of another person. Among the factors that are relevant to such analysis are the applicable stockholder composition, governance structure, contractual rights and the relative size and management influence of the person.

requirement. A stockholder that is not an affiliate of the issuer may resell shares of the issuer that constitute restricted securities without limitation if the applicable conditions under Rule 144 under the Securities Act have been satisfied. However, any shares—whether or not previously registered—that are sold by an affiliate of the issuer (including a controlling stockholder) are required to be registered if the sale is deemed part of a "distribution,"[37] and sales by affiliates are subject to additional limitations under Rule 144. If the transaction does not meet the requirements of Rule 144, the parties typically seek to qualify the sale of shares by an affiliate for the "private resale" or "Section 4(1½)" exemption.

- *Rule 144*. Section 4(1) of the Securities Act exempts "transactions by any person other than an issuer, underwriter, or dealer." Rule 144 is a non-exclusive safe harbor that sets forth conditions[38] under which an affiliate of an issuer or a holder of restricted securities may resell its securities without being deemed to be engaged in a distribution and, therefore, not an "underwriter."

- *"Section 4(1½)" Exemption*. While Section 4(1) of the Securities Act exempts "transactions by any person other than an issuer, underwriter, or dealer," underwriters are defined[39] to include any "person who has purchased from an issuer with a view to . . . the distribution of any security." Section 4(2) only exempts transactions "by an issuer" not involving any public offering. Taking these two provisions together, practitioners have generally recognized a "Section 4(1½)" exemption for resales of unregistered shares by a stockholder that fit the criteria for a private placement.[40]

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[37] For purposes of Regulation M under the Exchange Act, a distribution is defined to be "an offering of securities, whether or not subject to registration under the Securities Act, that is distinguished from ordinary trading transactions by the magnitude of the offering and the presence of special selling efforts and selling methods."

[38] Resales are permitted differently by Rule 144, depending on whether the seller is an affiliate of the issuer:

- <u>Non-Affiliate Resales</u>. Resales of restricted securities by a person who in the three months prior to determination was not an affiliate of an issuer that is a reporting corporation current in its SEC filings are freely permitted after a six-month holding period. Resales of restricted securities by such a non-affiliate of a reporting corporate issuer, even if it is not current in its SEC filings, are freely permitted after a one-year holding period. Resales of restricted securities by a non-affiliate of a non-reporting corporate issuer are also freely permitted after a one-year holding period.
- <u>Affiliate Resales</u>. Resales of securities by an affiliate (including a person who was an affiliate in the three months prior to determination) of a reporting issuer are permitted after a six-month holding period, subject to compliance with the volume limitation, current public information, manner of sale and filing requirements of Rule 144. Resales by an affiliate of a non-reporting issuer are permitted after a one-year holding period, subject to compliance with the same requirements.

[39] Securities Act Section 2(a)(11).

[40] The Fixing America's Surface Transportation Act ("<u>FAST Act</u>") contains what many practitioners understand as Congress's codification of "Section 4(1½)" into the text of the Securities Act, as Section 4(a)(7), a new non-exclusive safe harbor. For a resale transaction to qualify under Section 4(a)(7), it must satisfy several requirements including the following: (a) each purchaser must be an accredited investor; (b) the seller or any of its agents cannot use general solicitation or general advertising; (c) for securities of certain non-reporting corporate issuers, the seller and purchaser must obtain from the issuer certain information; (d) if the seller is an affiliate of the issuer, the seller must disclose certain information; (e) the seller and any person that will be

2. Blue Sky Laws

In addition to registration under the Securities Act, nearly every state has securities laws (known as "blue sky" laws) that require an issuer of securities to register certain offers and sales within that state. Under the National Securities Markets Improvement Act of 1996, as amended, offers and sales of "covered securities" need not be registered under state blue sky laws. Covered securities include securities listed or authorized for listing on a national securities exchange.

3. Disclosure Requirements Related to Acquisition

(a) Section 13(d). Section 13(d) of the Exchange Act requires any person who becomes the beneficial owner[41] of 5%[42] or more of a class of equity securities of an issuer to file a Schedule 13D with the SEC within 10 days of the acquisition.[43] The filing of a Schedule 13D by an acquiror serves as an "early warning system" to the target and the public that the acquiror may seek to gain control of the target. Targets often respond by deploying takeover defenses, which are discussed in Section II.C.

Required disclosure under Schedule 13D includes information about the identity of each person deemed to be a beneficial owner, the nature and size of such person's interest in the securities, the source of funds used, such person's purpose in acquiring the securities (including future plans with respect to any transactions involving the issuer) and any contracts or other arrangements with respect to any securities of the issuer. If there is a material change of any of the facts set forth in the Schedule 13D, the acquiror must file an amendment thereto disclosing such changes.

(b) Section 16(a). Section 16(a) of the Exchange Act requires that each officer, director, and beneficial owner[44] of 10% or more of any class of equity security of

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compensated for its participation in the transaction cannot be subject to a disqualification event under Rule 506(d)(1) of Regulation D or a statutory disqualification under Section 3(a)(39) of the Exchange Act; (f) the issuer must be engaged in business and cannot be a shell company; (g) the exemption cannot be used by an issuer or its subsidiary; (h) the exemption cannot be used for an unsold allotment held by a broker or dealer as underwriter; and (i) the class of securities to be resold in the transaction must have been authorized and outstanding for at least ninety days prior to the transaction.

[41] Under Rule 13d-3(a), beneficial ownership is imputed to "any person who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise has or shares" the power to vote or dispose of (or direct the voting or disposition of) shares in a class of equity securities of an issuer. Beneficial ownership of shares is also imputed to a person who has the right to acquire such shares within 60 days (e.g., by conversion or the exercise of a derivative security such as a convertible note or an option).

[42] A person's beneficial ownership is calculated by dividing (a) the total number of shares beneficially owned by such person by (b) the total number of shares outstanding at that time (giving effect to any rights held by the filing person to acquire shares within 60 days but not to rights held by anyone else). The total number of shares outstanding may be determined by reference to the issuer's latest Exchange Act filing unless the filing person has reason to know that such information is inaccurate.

[43] Certain investors holding less than 20% of the issuer's stock who would otherwise be required to file a Schedule 13D, but acquired the securities "not with the purpose nor with the effect of changing or influencing the control of the issuer, nor in connection with or as a participant in any transaction having such purpose or effect," may file a shorter Schedule 13G instead. Rule 13d-1(b).

[44] Determined in the same manner as the determination of beneficial ownership under Section 13(d).

an issuer (an "insider") must file reports with respect to its transactions in the equity securities of the issuer. The insider must file a Form 3 with the SEC reporting its beneficial ownership within 10 days of becoming an insider. Subsequently, the insider must then file a Form 4 with the SEC by the second business day following a transaction pursuant to which the insider's beneficial ownership changes, unless the transaction is an exempt transaction.[45] Lastly, the insider must file a Form 5 within 45 days after the end of the issuer's fiscal year and report all exempt transactions and transactions that should have been reported on a Form 4 but were not. Insiders are also subject to liability for certain trades in the issuer's stock discussed in Section III.D.2(b).

B. State Anti-Takeover Laws

Even in "friendly" transactions, state anti-takeover provisions applicable to the target can present issues that must be addressed. The corporate law applicable to a target is determined by the state in which it is incorporated. State corporate law restrictions on takeovers vary and in some cases reflect a policy of seeking to protect the interests of the state or other constituencies, in addition to the interests of the target's stockholders.[46]

1. Business Combination Statutes

Business combination statutes prohibit a target from consummating a business combination with an interested stockholder for a period of time (three years, for Delaware companies) after the person becomes an interested stockholder. The effect of such statutes is to reduce the attractiveness of pursuing a takeover attempt in the face of opposition from the target's Board by limiting the acquiror's ability to quickly consolidate the acquisition through a second step squeeze-out transaction.[47]

Under DGCL §203, business combinations are exempt from the prohibition of DGCL §203 if (i) prior to the time that the interested stockholder became an interested stockholder, the target's Board approved either the business combination or the transaction that resulting in the person becoming an interested stockholder, (ii) upon consummation of the transaction which resulted in the person becoming an interested stockholder, the person owned at least 85% of the voting stock of the target (excluding certain shares owned by management) or (iii) the business combination is approved by the target's Board and by at least 66 ⅔% of the target's voting stock not owned by the interested stockholder. "Business combination" is defined broadly to include mergers

[45] For example, Rule 16a-6 under the Exchange Act allows insiders to abstain from reporting acquisitions of equity securities or the right to acquire equity securities not exceeding $10,000 in market value. More generally, Rule 16a-9 under the Exchange Act exempts from reporting under Section 16(a) of the Exchange Act increases and decreases in holdings due to a stock split, stock dividend or pre-emptive right granted to all holders of the class of equity securities.

[46] State corporate law also frequently imposes other technical requirements that must be navigated in acquiring a controlling interest in a corporation. These can affect the timing, structure and mechanics of a transaction.

[47] Arizona, Connecticut, Delaware, Georgia, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Maine, Maryland, Massachusetts, Michigan, Minnesota, Missouri, Nebraska, Nevada, New Jersey, New York, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, Virginia, Washington, Wisconsin and Wyoming all have business combination statutes.

and transfers of assets or stock by the target with an interested stockholder, and "interested stockholder" is defined to include beneficial owners of 15% or more of the corporation's voting stock.

2. Control Share Statutes

Control share statutes restrict the ability of acquirors to vote shares they acquire that expand their ownership stake beyond certain thresholds corresponding with varying degrees of control over the corporation. These statutes allow a target to deny voting rights to any shares acquired by an acquiror in a transaction that, together with certain shares acquired by such person prior to such transaction, takes the acquiror's voting interest in the target over, for example, any of one-fifth, one-third or one-half, unless the stockholders or target's Board vote to confer voting rights on such shares. The effect of a control share statute is to limit the influence that an unsolicited acquiror can exercise over the target by preventing it from voting shares obtained in a transaction without the approval of the target's Board. Delaware does not have a control share statute.[48]

3. Fair Price Statutes

Fair price statutes generally prohibit a target from consummating a business combination with an interested stockholder without the approval of the target's Board and unaffiliated stockholders, unless the consideration paid to the unaffiliated stockholders in the transaction is a fair price. "Fair price" is usually defined to be a price at least equal to the greater of the current fair market value per share of the target's stock and the highest price paid by the interested stockholder for shares it previously acquired. Delaware does not have a fair price statute.[49]

4. Director Discretion Statutes

Director discretion statutes allow directors to consider the impact of a director's decisions on constituencies other than the stockholders of the target. In states with such statutes, a director need not focus only on maximizing stockholder value when considering a potential business combination, but can also consider the impact of the transaction on employees, customers, the community in which the business is located and even the national economy. In effect, such statutes give the target additional discretion to

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[48] Hawaii, Idaho, Indiana, Kansas, Louisiana, Minnesota, Mississippi, Missouri, Nebraska, Nevada, North Carolina, Ohio, Oklahoma, Oregon, Pennsylvania, South Carolina, South Dakota, Tennessee, Utah, Virginia, Washington and Wisconsin all have control share statutes that apply to domestic corporations. In addition, Arizona, Florida and Massachusetts have statutes that apply to all corporations (both domestic and foreign) that have significant contacts with the state; however, the enforceability of these statutes with respect to foreign corporations is uncertain.

[49] Georgia, Illinois, Indiana, Kentucky, Louisiana, Michigan, New Jersey, New York, North Carolina, Virginia and Wisconsin have all enacted fair price statutes governing domestic corporations.

resist unsolicited takeover attempts. Delaware does not have a director discretion statute.[50]

C. Target-Specific Takeover Provisions

The acquisition of control of a target can also implicate provisions of its organizational documents or other contracts. Examples include the following:

1. Poison Pills

Stockholder rights plans (also known as "poison pills") provide for the issuance to the current target stockholders of "rights" to purchase preferred stock of the target. The rights become exercisable upon the acquisition by a person of a specified percentage (frequently, 20%) of the target's stock or the commencement of a tender or exchange offer the consummation of which would result in such an acquisition. The acquiror is not able to exercise such rights and, as a result, the exercise of such rights by the other stockholders of the target is highly dilutive to the acquiror, making an acquisition significantly more expensive.

2. Staggered Board

The COI or bylaws of a target can provide for the directors of a corporation to be classified, with members of only one particular class up for election in any particular year.[51] The establishment of a "staggered board" means that, without the target Board's cooperation, stockholders (including the acquiror) can only replace one-third of the directors in any year.

3. Fair Price Charter Provisions

Fair price charter provisions are provisions in a target's COI providing that the approval of a super majority of the target's unaffiliated stockholders is required for the target to consummate a business combination transaction with an interested stockholder, unless the target Board approves the transaction and/or the consideration paid by the acquiror in the business combination is at least equal to the greater of the current fair market value per share of the target's stock and the highest price paid by the interested stockholder for shares it previously acquired.

4. Other Provisions

Other anti-takeover provisions that can be included in a target's organizational documents are provisions: (i) giving the directors the authority to expand the Board and

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[50] Arizona, Connecticut, Florida, Georgia, Hawaii, Idaho, Illinois, Indiana, Iowa, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Minnesota, Missouri, Nebraska, Nevada, New Jersey, New Mexico, New York, North Dakota, Ohio, Oregon, Pennsylvania, Rhode Island, South Dakota, Tennessee, Vermont, Virginia, Wisconsin, and Wyoming have all enacted statutes that enable directors to consider the interests of non-shareholder corporate constituencies.

[51] DGCL §141(d) permits the creation of no more than 3 classes.

fill any vacancies created by such expansion; (ii) giving the directors the ability to adopt a poison pill, by granting them authority to create and issue preferred stock with such rights as the directors may determine; (iii) prohibiting the removal of directors without cause; (iv) restricting stockholders' right to call special meetings; (v) requiring a super-majority vote of the stockholders to approve amendments to the COI or bylaws; (vi) prohibiting the stockholders from taking action by written consent rather than at a meeting; (vii) requiring any stockholder desiring to make a proposal at a stockholders' meeting to provide a detailed notice of its proposal well in advance of the meeting date; (viii) giving the Board the right to postpone or adjourn stockholder meetings and (ix) creating two classes of voting stock where one class has superior voting rights to the other.[52]

5. Change-of-Control Provisions in Contracts

Contracts to which the target is a party may contain "change of control" provisions. These can provide that the acquisition by a third party of a majority of the target's stock constitutes a default or triggers some other adverse consequence under the contract—for example, accelerating the target's required performance under the contract (particularly repayment of indebtedness), giving a counterparty the right to terminate the contract or requiring, either alone or in combination with management restructuring the acquiror may conduct, significant payments (or the acceleration of unvested awards) under the target's compensation arrangements.

D. Antitrust Laws

Because one effect of an acquisition may be the lessening of competition in markets related to the business of the target or the acquiror, acquisitions can raise antitrust concerns. Acquisitions meeting certain size and other characteristics require pre-closing antitrust approval. In cases where the transaction raises serious antitrust concerns, securing such approval can involve significant expense and delay.

1. HSR

HSR requires preacquisition notification of significant acquisitions to the FTC and the DOJ. This notification is designed to enable the U.S. government to analyze the effects of the acquisition on competition before the acquisition is consummated. The notification requires information concerning the proposed transaction, data on the filing person's operations and revenues, financial information, lists of subsidiaries, the identities of holders of 5% or more of its stock, holdings of other issuers' securities, and revenue from U.S. operations. The regulations also require the submission, together with the notification form, of any documents (including emails) prepared in connection with the transaction "for the purpose of evaluating or analyzing the acquisition with respect to

[52] If the target is already listed on an exchange, it may not create a super-voting class of stock because the listing rules prohibit issuers from creating new securities with more voting power than an existing class of security or from taking any other action that "has the effect of restricting or reducing the voting rights on an existing class of security." See Nasdaq Listing Rule 5640 and Rule 313.00 of NYSE's Listed Company Manual.

market shares, competition, competitors, markets, potential for sales growth or expansion into product or geographic markets."

The HSR notification requirement applies to acquisitions of assets or voting securities that meet specified *size of transaction* and *size of person* tests.[53] The HSR size of transaction threshold is set at $80.8 million.[54] If a transaction has a value of $80.8 million or more, but not more than $323 million, an HSR notification is required to be filed if the parties to the transaction meet the size of person test. If the HSR value of the transaction is greater than $323 million, there is no size of person test, and the parties must file an HSR notification regardless of their size. The HSR size of person test is satisfied if one party to the transaction (or its ultimate parent entity) has worldwide assets or worldwide net annual sales of $161.5 million or more and the other party (or its ultimate parent entity) has worldwide assets or worldwide net annual sales of $16.2 million or more.

After filing the HSR form, the parties cannot close the acquisition unless a 30-day waiting period has expired so that the reviewing agency (either the FTC or the DOJ) has an opportunity to determine whether the proposed transaction raises substantive antitrust issues.[55] The reviewing agency may seek additional information about the transaction during the waiting period by making an informal request or by issuing a second request, which can include a lengthy set of document requests and interrogatories. A second request extends the waiting period for 30 days from the date that the required additional information is submitted. Compliance with a second request can take several months. At the conclusion of the HSR notification process, the reviewing agency can approve the transaction as proposed, seek to block it in court, or reach a settlement with the parties to the transaction.[56] If the initial waiting period expires with neither the FTC nor DOJ making a second request, the parties can proceed with the transaction.

2. Foreign Regulation

Foreign governments similarly require regulatory approval of transactions that may harm competition within their jurisdiction. Even if both the acquiror and the target are U.S. entities, foreign regulators may still seek to review the transaction if the

[53] The HSR size of transaction and size of person tests, along with certain other jurisdictional and HSR exemption thresholds, are adjusted annually to track growth in the U.S. gross national product. The new thresholds are usually announced in January of each year and become effective 30 days after publication.

[54] The amount of the filing fee that the acquiror must pay in connection with the filing of an HSR notification is also based on the size of the transaction. The fee for transactions with a value of more than $80.8 million but less than $161.5 million is $45,000. The fee for transactions with a value greater than or equal to $161.5 million but less than $807.5 million is $125,000. The fee for transactions with a value greater than or equal to $807.5 million is $280,000. These fees and thresholds are from 2017.

[55] This waiting period is reduced to 15 days in the case of an all-cash tender offer.

[56] Settlements can involve restructuring the proposed transaction so that fewer assets are acquired or may involve an agreement by the acquiror to restrict the manner in which it conducts business following the closing (for example by limiting the geographic territory or lines of business in which it operates), divest some of its own assets or sell some of the assets it has agreed to acquire.

combined entity transacts a certain amount of business in their territory.[57, 58] In addition, certain foreign laws applicable to a U.S. target or its subsidiaries may require filings or other approvals in connection with a change of control of the target.

E. Regulation of Acquisitions by Foreign Persons (Exon-Florio)

The Exon-Florio Amendment to the Defense Production Act of 1950 ("Exon-Florio") permits the President of the United States to prevent acquisitions of U.S. corporations by foreign investors when, in the President's view, such acquisitions threaten national security. This power applies not only to mergers and other acquisitions of 100% of the shares in a U.S. corporation, but also to the acquisition of "control" and transfers of technology,[59] and permits the President to unwind already completed acquisitions.

The statute does not define national security and the scope of businesses viewed by regulators as related to national security can be very broad. In practice, the Committee on Foreign Investment in the United States ("CFIUS"), the interagency committee charged with reviewing transactions, has tended to look at whether: (1) the transaction threatens to impair national security; (2) the transaction would involve control by a foreign government or (3) the transaction would result in foreign control of "critical infrastructure," which includes "critical technology."

Notice of an acquisition under Exon-Florio involves filing with CFIUS a detailed description of the transaction, the parties to the transaction, the sensitive technology or information possessed by the target corporation and/or the government contracts implicated by the transaction. Exon-Florio does not impose a mandatory filing requirement on an acquiror. However, acquirors are well advised to give notice of a potential acquisition if there is any reasonable possibility that the target could be seen as a player in a strategic industry or connected to national security. Without a filing, the President may order the acquiror to divest an acquired asset, corporation or technology.

CFIUS will review transactions covered by Exon-Florio for a 30-day period. If it does not initiate a formal investigation during this period, the transaction is cleared and

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[57] For example, the European Commission (the executive arm of the European Union) generally requires that parties proposing a merger obtain pre-closing approval if either (a) the combined turnover of all of the parties to the transaction exceeds €5 billion worldwide and the EU-wide turnover of each of at least two parties exceeds €250 million or (b) the combined worldwide turnover of all of parties exceeds €2.5 billion worldwide and €100 million in each at least 3 EU member states and the EU-wide turnover of each of at least two of the parties exceeds €100 million.

[58] Similarly, China's Ministry of Commerce ("MOFCOM") generally requires parties to a transaction to notify it if (a) either the combined worldwide turnover of all of the parties exceeds RMB 10 billion or (b) the combined turnover in China of all of the parties exceeds RMB 2 billion and, in each case, at least two of the parties to the transaction have turnover in China that exceeds RMB 400 million. The parties must notify MOFCOM prior to closing and may not close the transaction until MOFCOM has cleared the transaction or the relevant waiting period has expired without adverse decision.

[59] In addition, the acquisition of control of a U.S. corporation by a non-U.S. person may trigger restrictions under licenses applicable to the export of certain sensitive technology administered by the U.S. Department of Commerce under the Export Administration Act.

may proceed. If CFIUS initiates an investigation, it will take up to 45 days to investigate and make a recommendation to the President. U.S. Presidents have only blocked or unwound a handful of transactions using their powers under Exon-Florio, but it is not uncommon for parties to withdraw their transactions from consideration by CFIUS or restructure[60] the transaction to meet CFIUS's concerns.

F. Industry-Specific Regulations

State and federal laws subject corporations in certain industries to extensive licensing and other requirements, as well as on-going regulation of their activities. Corporations operating in the banking, insurance, broadcasting, aviation and utility industries are all examples of such businesses. Regulators in these fields can scrutinize acquisitions to determine whether an acquisition is consistent with the public interest and with industry-specific policy goals.

G. Tax Issues

Acquisition of control of the target could result in limitations on its ability to use net operating losses ("NOLs") and certain other favorable tax attributes arising prior to the acquisition. As a general rule, corporations can carry back NOLs two years and carry forward NOLs 20 years to offset taxable income for such years. Section 382 of the Internal Revenue Code limits the use of NOLs and built-in losses after an "ownership change"[61] of the target. It imposes an annual limit on a target's ability to use its NOLs to offset future income based on the value of the target's stock immediately before the ownership change multiplied by a statutorily-prescribed interest rate. As a result, the target may report higher taxable income than it would absent the acquisition.

III. ISSUES RELATING TO POST-ACQUISITION CONDUCT

Apart from the rules governing an acquiror's acquisition of a controlling stake in a U.S. public corporation, there are restrictions on its conduct with respect to the target until the acquiror obtains ownership of 100% of the shares in the target.

A. Fiduciary Duties of Controlling Stockholder

Controlling stockholders owe a fiduciary duty to the corporation to refrain from improper self-dealing that benefits the controlling stockholder at the expense of the corporation and the minority stockholders. As a result, transactions between a controlling stockholder and the controlled corporation are often subject to enhanced judicial scrutiny.

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[60] In some instances, parties have agreed to take measures to address potential security concerns as a condition to approval, such as establishing a corporate security committee, guidelines for handling sensitive customer information, or procedures for notifying the U.S. government in the case of a security breach. In other cases, foreign acquirors have agreed to make efforts to sell a subsidiary of the target that owned sensitive technology to a U.S. national.

[61] Under Section 382, an "ownership change" occurs when the percentage of a corporation's stock owned by one or more stockholders who directly or indirectly owns more than 5% of the corporation's common stock increases by more than 50% within a 3-year period.

Further, directors nominated by controlling stockholders owe fiduciary duties of care and loyalty to all stockholders, including those in the minority.

This can pose significant issues for acquirors, because synergies are often a key driver of acquisition transactions. Corporate parents that have multiple businesses also frequently arrange for separate subsidiaries to share certain group-wide overhead and support functions, such as human resources, IT, legal, tax, treasury and finance. To minimize the risk of litigation, a controlling stockholder would need to ensure the fairness of any intercompany dealings to the minority stockholders of the target.[62] This can significantly impair the acquiror's flexibility in making strategic and operational decisions that affect the target until a squeeze-out of the minority stockholders is accomplished.

B. Target's Exchange Act Reporting Obligations

Until the acquiror acquires 100% of the target, the target will remain subject to the Exchange Act reporting requirements for public corporations.[63] In that case, the target will continue to be subject to the burden, expense and liability associated with preparing and filing reports and other statements with the SEC.[64] Pursuant to Item 404 of SEC Regulation S-K ("Item 404"), the target will have to disclose the material terms of any related party transactions—including transactions with the acquiror or an affiliate of the acquiror—with a value of greater than $120,000.[65] The target will have to disclose its policies and procedures "for the review, approval or ratification" of such transactions.[66]

[62] Frequently, this involves the use of a related party transaction committee, composed of independent directors of the target, to negotiate and approve the terms of related party transactions.

[63] An issuer becomes subject to the registration and reporting requirements of the Exchange Act pursuant to one of three sections. First, an issuer is subject to the Exchange Act under Section 15(d) in a fiscal year during which it has filed a registration statement under the Securities Act that has become effective if the securities of such class are held of record by 300 or more holders. Second, an issuer is generally subject to the Exchange Act under Section 12(g) if a class of its equity securities is held by either (a) 2000 holders of record or (b) 500 holders of record who are not "accredited investors" (discussed above in footnote 33) and the total value of its assets on the last day of the fiscal year exceeds $10 million. Third, an issuer is subject to the Exchange Act under Section 12(b) of the Exchange Act if a class of its securities are listed on a national securities exchange.

[64] The required filings include Annual Reports on Form 10-K containing audited financial statements and extensive non-financial disclosure relating to the target and its business, Quarterly Reports on Form 10-Q containing unaudited financial statements, Current Reports on Form 8-K describing certain material events and Proxy Statements on Schedule 14A relating to each meeting of stockholders.

[65] In particular, Item 404 requires disclosure of (i) the related person's interest in the transaction and its relationship with the issuer, (ii) the value of the transaction, (iii) the approximate value of the related party's interest in the transaction (without regard to the amount of profit or loss), (iv) in the case of indebtedness, the interest rate, the largest amount outstanding during the period being disclosed, the amount outstanding at the latest practicable date, and the amount of principal and interest paid during the applicable period and (v) "any other information regarding the transaction or the related person in the context of the transaction that is material to investors in light of the circumstances of the particular transaction."

[66] This includes descriptions of (w) the types of transactions covered by such policies, (x) the standards to be applied pursuant to such policies and procedures, (y) the persons responsible for applying such policies and procedures and (z) whether such policies and procedures are in writing and, if not, how such policies and procedures are evidenced. Further, the target must identify any related party transactions that were not subject to such review, approval or ratification.

Additional disclosure may also be required by Statement of Financial Accounting Standards No. 57, which sets forth the standards under U.S. generally accepted accounting principles for financial statement disclosure of related party transactions. These disclosures can provide the basis for lawsuits by plaintiffs on behalf of minority stockholders alleging that such transactions disadvantage the target for the benefit of the controlling stockholder.

C. Proxy Access by Minority Stockholders

Until the acquiror acquires 100% of the target, SEC regulations could require the target to include in its proxy statements certain proposals made by minority stockholders. Under Rule 14a-8, corporations must include in their proxy materials certain non-binding proposals made by stockholders and submit the proposals to a vote at the annual meetings of stockholders.[67]

D. Restrictions on Sales by Acquiror

Upon acquiring a controlling interest in the target, the acquiror would become subject to a number of limitations on its ability to resell the shares it has acquired.

1. Securities Act Restrictions

As described in Section II.A.1, resales of shares by an affiliate of the issuer—even if the initial issuance of such shares was registered—would need to be registered or qualify for an exemption from the registration requirement of the Securities Act if such resale is part of a "distribution". Under the Rule 144 safe harbor from being deemed a distribution, resales by an affiliate of the issuer are subject to compliance with the volume limitation, current public information, manner of sale and filing requirements of the rule.

2. Exchange Act Restrictions

(a) Material Nonpublic Information. Rule 10b-5 promulgated under the Exchange Act sets forth a broad anti-fraud rule prohibiting manipulative or deceptive statements in connection with the purchase or sale of any security—including to "make any untrue statement of a material[68] fact or omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were

[67] The SEC has also attempted to adopt rules requiring corporations to include in their proxy materials nominations made by minority stockholders. In 2010, the SEC adopted Rule 14a-11, which required corporations to include in their proxy materials, alongside the management's Board nominees, qualifying individuals nominated to the Board by stockholders meeting specified criteria for up to the greater of one Board seat or 25% of the total number of directors (rounding down). Under the rule, eligible stockholders would need to have owned at least 3% of the corporation's stock for at least three years. The United States Court of Appeals for the District of Columbia Circuit vacated Rule 14a-11 in 2011, however, and the SEC has not proposed an alternative rule.

[68] The term "material" is generally understood to mean information that a reasonable investor would consider important in deciding whether to buy or sell the securities in question.

made, not misleading."[69] Courts and the SEC have interpreted this rule to require insiders of an issuer, including controlling stockholders, to either abstain from buying or selling securities of the issuer while knowingly in possession of material non-public information ("MNPI") or publicly disclose such MNPI.[70]

A person who violates Rule 10(b)-5 can face criminal and/or civil penalties. In addition, under Sections 20(a) and 21A of the Exchange Act, anyone who controls a person liable for such a violation can be jointly and severally liable to the same extent as the controlled person. Out of concern for the foregoing issues and to decrease the risk that insiders trade while in possession of MNPI, corporations frequently adopt trading policies prohibiting directors and employees from trading in the corporation's stock during "blackout periods" that extend from a specified period of time prior to end of a fiscal quarter until the corporation's financial results for such fiscal quarter have been publicly released and digested by the market (in addition to any other time they are in possession of MNPI). While such policies do not apply to a person in its capacity as a stockholder of the corporation, the acquiror and its personnel are well advised to observe the same restrictions.

(b) Section 16 Rules. Section 16(b) of the Exchange Act permits an issuer—and, importantly, any stockholder on behalf of the issuer—to sue an insider for disgorgement of profits realized from either (a) the purchase and subsequent sale or (b) the sale and subsequent purchase of any equity security of the issuer (or an equity-based swap agreement) within any period of less than six months.[71] In addition, Section 16(c) prohibits any insider from selling any equity security in the issuer that such person does not own.

E. Tax Issues

For U.S. federal income tax purposes, two U.S. corporations can file a consolidated return for federal tax purposes if one corporation owns at least 80% of the voting power and value of the other corporation. Thus, if the acquiror acquires 80% or more of the voting stock of the target, it should be eligible to include the target in its consolidated federal tax return. Filing a consolidated return provides the benefit of allowing losses from one member of the consolidated group to offset income of other group members. In addition, dividend distributions received by the acquiror from the

[69] In addition, Rule 14e-3 under the Exchange Act expressly prohibits trading in securities of an issuer by a person who is in possession of MNPI relating to a tender offer for such securities that another person has commenced or taken substantial steps to commence, which MNPI was obtained from the offering person, the issuer or any persons (including officers and directors) acting on their behalf.

[70] A narrow exception to this rule is trades conducted pursuant to a "Rule 10b5-1 Plan", named after the corresponding SEC rule permitting trades pursuant to a plan established by the person before acquiring MNPI and specifying in advance the dates and amounts of securities to be purchased or sold.

[71] To be subject to this rule, stockholders who are not officers or directors must beneficially own 10% of the shares of the issuer before both the sale and purchase (or purchase and sale). The purchase that causes a stockholder to become the beneficial owner of 10% or more of the issuer's shares does not count when determining liability pursuant to Section 16(b). In addition, certain other transactions are exempt from potential disgorgement.

target are excluded from the acquiror's income for purposes of computing the consolidated group's taxable income.

In general, the target's tax attributes (including tax basis in its assets) do not change following its acquisition. When a target enters a consolidated group, however, its existing NOLs incurred in taxable years prior to entrance are subject to limitations. Usually such NOLs can only be used against the income of the target itself or, if that target was part of another consolidated group that entered the acquiror's group together, against the income of such target subgroup.

In addition, if the acquiror owns at least 80% of the stock of the target after the acquisition, the acquiror may exclude 100% of the dividends received from the target from its income, irrespective of whether it elects to file consolidated tax returns. If the acquiror owns less than 80% but at least 20% of the target's stock, it will be entitled to deduct 80% of the dividends distributed by the target.

If the acquiror is foreign, dividends paid by the target will be subject to a 30% U.S. withholding tax. This withholding tax may be reduced or eliminated by an applicable tax treaty between the U.S. and the acquiror's country of residence. Sales of the target's stock by the acquiror generally are not subject to U.S. withholding tax.

IV. ACQUISITION OF REMAINING INTEREST

For a variety of reasons, including those described above, the acquisition by an acquiror of a controlling interest in the target short of 100% is often the first step down a path that ultimately leads to the acquisition of 100% of the target. This section describes the structures and issues associated with eliminating the remaining minority stockholders.

A. Structures for Acquisition of Remaining Interest

1. Tender Offer/Short-Form Merger

If the acquiror obtained its initial stake in the target without already conducting a tender offer, it may commence a tender offer for the remaining shares of the target in an effort to obtain the number of shares required to consummate a merger without stockholder approval. The tender offer process and the consummation of a merger following a tender offer without stockholder approval are discussed in Section I.B.1.

As with the negotiation of a merger agreement, any tender offer conducted after the acquiror has already become a controlling stockholder will potentially be subject to "entire fairness" review. This review examines both the fairness of the process used to reach agreement about price (and other terms) and the fairness of the price itself. Entire fairness review is discussed in Section IV.B.2(b).

2. Long-Form Merger

(a) Overview. A long-form merger is a common way to acquire the remaining interests in the target. In a merger, one of the two constituent corporations merges into the other and the surviving corporation succeeds to all of the rights and obligations of the two constituent corporations. As a consequence of the merger, the shares of the target are converted into the right to receive certain consideration specified in the merger agreement (which can include stock of the acquiror). Unlike a short-form merger, a long-form merger requires both the approval of the merger by the target's Board and the adoption of the merger agreement by the target's stockholders.[72] Following the merger, the target's shares are delisted from the applicable stock exchange and its registration under the Exchange Act is terminated.[73]

(b) The Proxy Statement Process. In order to solicit[74] proxies from stockholders to vote their shares in support of a merger, the target must comply with the rules under Section 14 of the Exchange Act. The principal features of the process of soliciting proxies are as follows:

- *Filing and Review of Proxy Statement*. While the target may solicit proxies prior to sending a definitive proxy statement to stockholders,[75] it must send them a definitive proxy statement before or at the same time it furnishes them with a proxy card. Before the target can send a definitive proxy statement to stockholders, it must file a preliminary proxy statement with the SEC 10 days in advance. During the initial 10 days, the SEC may comment on the preliminary proxy statement and the target may ultimately be required to revise the proxy statement multiple times before satisfactorily addressing the SEC's comments and receiving clearance to mail the definitive proxy statement.

- *Timing.* It can often take 60 to 90 days following the signing of a merger agreement to obtain the required stockholder vote.[76] It frequently takes over a

[72] Typically, states require that a merger agreement be adopted by the holders of a majority of the target's outstanding stock entitled to vote. However, some states impose approval requirements higher than a simple majority. Alabama, Alaska, the District of Columbia, Illinois, Louisiana, Maryland, Massachusetts, Missouri, Montana, Nebraska, New Jersey (corporations incorporated before January 1, 1969), New York (corporations incorporated before February 22, 1998) Ohio, South Carolina, Texas, Virginia and Washington all require the assent of holders of two-thirds the shares of a domestic corporation to approve a merger agreement. Hawaii requires stockholders representing three-quarters of the shares of a domestic corporation incorporated before July 1, 1987 to vote to approve a merger agreement. Illinois, Hawaii, Louisiana, Montana, New Jersey, New York, South Carolina, Virginia and Washington each allow domestic corporations to specify lower thresholds in their articles of incorporation or otherwise adopt lower thresholds for approval.

[73] After delisting from a national securities exchange, an issuer may terminate registration and suspend reporting by filing Form 15 with the SEC and certifying that their securities are held of record by fewer than 300 persons or are held of record by fewer than 500 persons and the issuer's total assets have not exceeded $10 million on the last day of each of the most recent three fiscal years.

[74] The term "solicitation" is, under Rule 14a-1(l), defined broadly to include any request for a proxy or any "other communication to security holders under circumstances reasonably calculated to result in the procurement, withholding or revocation of a proxy."

[75] In order to do so, (a) the target must file the communication with the SEC on the date that the communication is first published or sent to stockholders, (b) the communication must identify the participants in the solicitation, and (c) the communication must contain a legend advising stockholders to read the applicable proxy statement when it becomes available and explaining how they may obtain a copy thereof. Rule 14a-12.

[76] As a result of this, some participants in two-step tender offer transactions where the acquiror must obtain 90% of the shares of the target have chosen to incur the extra burden of preparing and clearing the proxy statement during the 20-business-day tender offer period. This "dual-track" approach can significantly reduce the time

month for a target to produce a draft of the preliminary proxy statement and clear SEC comments. After mailing the definitive proxy statement, targets then wait another 20 business days prior to holding the stockholder meeting.[77]

- *Contents of the Proxy Statement*. Proxy statements are required to contain the information called for by the applicable items of Schedule 14, which includes certain information about the target, the stockholders' meeting for which proxies are solicited, the participants in the solicitation, and the officers, directors and beneficial owners of 5% or more of the corporation's shares. Proxy statements relating to approval of an acquisition must also contain a summary term sheet outlining the transaction and descriptions of the material terms of the transaction, required regulatory approvals and reports or opinions relating to the transaction received from a third party, as well as a summary of past contacts and negotiations between the parties to the transaction. Further, if the acquisition consideration includes securities of the acquiror and/or a vote of the acquiror's stockholders is required in connection with the transaction, then additional financial information relating to the acquiror and the combined corporation will be required.

(c) Appraisal Rights. In certain situations[78], stockholders who vote against a merger and take other steps necessary to perfect their appraisal rights[79] will be entitled to receive a court-determined fair value for their shares, which may be more or less than the agreed merger consideration.

3. Reverse Share Split

An acquiror can also complete its acquisition of 100% of the target through a reverse share split, which involves converting each outstanding target share into a

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required to obtain stockholder approval in the event the acquiror is unable to obtain 90% of the target's stock in the tender offer.

[77] While as a technical matter there is no affirmative requirement to wait 20 business after mailing the definitive proxy statement before holding a meeting (the only restriction, under instruction D3 of Schedule 14A, is that a corporation must wait 20 business days if it incorporates required information into the proxy statement by reference to other public filings of the target or the acquiror), it is rare for targets not to incorporate by reference and wait 20 business days before holding the stockholder meeting. In addition, stock exchange rules may contain separate requirements and recommendations regarding the notice and timing of record and meeting dates.

[78] Generally, appraisal rights are not available to holders of stock that is either listed on a national securities exchange or held of record by more than 2,000 holders. However appraisal rights are available for holders of stock that (i) are required by the merger agreement to accept any consideration for their shares other than stock of the surviving corporation or another entity that is listed on a national securities exchange or held of record by more than 2,000 holders and (ii) are acquired by a parent corporation pursuant to a short-form merger.

[79] Specifically, the stockholder must (a) continuously own the shares from the date of demand of appraisal through the effective date of the merger, (b) deliver a written demand for appraisal prior to the stockholder vote on the merger, (c) file a petition with the Delaware Court of Chancery within 120 days of the effective time of the merger, and (d) serve a copy of the petition on the surviving corporation. In the case of a short-form merger, the stockholder must make a written demand for appraisal within 20 days of the mailing of notice of the merger.

fractional share. By specifying a fraction that leaves the acquiror with at least one whole share and each minority stockholder with only a fraction of a share, the acquiror can squeeze out the minority holders by paying cash for their fractional share interests. Like a long-form merger, a reverse share split requires approval of both the target's Board and its stockholders, which requires compliance with the proxy solicitation rules. More importantly, a reverse share split transaction conducted by a controlling stockholder would—like a merger or a tender offer—be subject to entire fairness review.[80]

B. Disclosure Requirements and Litigation Risk Related to Acquisitions by a Controlling Stockholder

In situations where a stockholder or other affiliate of the acquiror is deemed to stand on "both sides" of the transaction, generally because the acquiror also controls the target by virtue of its existing stock ownership, the acquiror is deemed to have an inherent conflict of interest. As a result, federal securities law and corporate case law subject the circumstances surrounding such transactions to significantly greater disclosure requirements and scrutiny than other transactions.

1. Rule 13e-3

Rule 13e-3 under the Exchange Act applies to transactions between an issuer and an affiliate pursuant to which the issuer is "going private."[81] This includes any of the transactions discussed above used to eliminate minority stockholders, unless the transaction falls within one of the exceptions to the rule. Importantly, such transactions effected within one year of a tender offer in which the acquiror became an affiliate of the target are exempt if (i) the consideration paid in the second step transaction is the same as that offered pursuant to the tender offer and (ii) the second step transaction is part of a plan or agreement that was fully disclosed in the tender offer.[82] Accordingly, two-step transactions negotiated and agreed to before the acquiror obtains an interest in the target are exempt from Rule 13e-3. Also exempt are transactions in which the target

[80] In addition, while minority stockholders cashed out in a reverse share split are not entitled to appraisal rights, DGCL §155 requires that the cash paid in lieu of fractional shares be at "fair value."

[81] Rule 13e-3 generally applies to transactions involving: (a) a purchase of any equity security by the issuer or an affiliate of the issuer; (b) a tender offer for any equity security made by the issuer or an affiliate of the issuer or (c) a solicitation of any proxy, consent or authorization of any equity security holder by the issuer or an affiliate of the issuer in connection with (i) a merger, consolidation, reclassification, recapitalization, reorganization or similar transaction of the issuer or between the issuer and its affiliates, (ii) the sale of substantially all assets of an issuer to an affiliate or group of affiliates or (iii) a reverse stock split involving the purchase of fractional interests of the issuer. In addition, the transaction must have a reasonable likelihood of, or be undertaken with the purpose of, producing one of the following effects: (x) causing a class of equity securities of the issuer that is registered under section 12(g) or 15(d) of the Exchange Act to become eligible for the termination of registration or (y) causing any class of equity securities of the issuer listed on a national securities exchange or eligible to be quoted in an inter-dealer quotation system of a registered national securities association to cease to be listed or eligible for quotation.

[82] Rule 13e-3(g)(1).

stockholders receive substantially equivalent equity securities as consideration for their target shares.[83]

If a transaction is not exempt, the target must file with the SEC a Schedule 13E-3 disclosing additional information about the transaction. Schedule 13E-3 calls for detailed disclosure about the transaction, including its purpose, the reasons for its structure and timing, whether the issuer believes the transaction is fair to unaffiliated stockholders, the specific factors considered in determining such fairness, and whether the terms of the transaction were negotiated on behalf of the unaffiliated stockholders by an independent representative.

2. Stockholder Litigation

(a) Overview. Litigation over acquisitions of public corporations in the U.S. is common. Following the announcement of a transaction, plaintiff's lawyers frequently seek to identify a stockholder as a plaintiff and bring a lawsuit on behalf of the class of stockholders who may tender or receive the merger consideration. These lawsuits typically allege that the target's Board breached its fiduciary duties by entering into the transaction because (i) the transaction consideration is inadequate, (ii) the target's Board did not take sufficient steps to obtain a higher price, including by seeking out other potential bidders, (iii) the directors and officers are seeking to obtain improper personal benefits by means of the transaction or (iv) the target's disclosure relating to the transaction are misleading or incomplete. In the case of tender offers, plaintiffs can also add claims against the acquiror based on the federal laws governing the conduct of tender offers.

While such lawsuits are common, they generally do not present an impediment to completing a successful transaction. Many lawsuits are resolved based on agreed-upon changes to the public disclosures about the transaction or other changes to the mechanics of the transaction and either an agreed-upon fee or a fee determined by the court to be paid to the plaintiffs' attorney. Plaintiffs often pursue these stockholder class actions more aggressively in situations where there are multiple bidders who allegedly received different treatment by the target or where one interested bidder claims to have been thwarted. Plaintiffs also tend to be more aggressive in pursuing litigation when a controlling stockholder or other insider obtains a unique benefit that is not shared with the target's other stockholders.

(b) Standard of Review. Delaware courts apply different levels of scrutiny to the actions of the target's Board depending on the facts of the case and the nature of the alleged conduct.

- *Business Judgment Rule*. The business judgment rule is the default standard of review in most U.S. jurisdictions, including Delaware. The rule creates a presumption in litigation that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that

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[83] Rule 13e-3(g)(2).

the action taken was in the best interests of the corporation. When the business judgment rule applies, courts will not evaluate the substantive merits of the decision that the directors made. A plaintiff can overcome the business judgment rule by providing evidence that a majority of directors, in reaching a challenged decision, were grossly negligent, acted in bad faith, or engaged in a self-interested transaction.

- *Enhanced Scrutiny*. In Delaware, the business judgment rule does not automatically apply, in the first instance, to business decisions involving: (1) a sale of control, a change of control or a break-up of the corporation or (2) the adoption of defense mechanisms in response to a threat to corporate control or policy. A sale of control or change of control is synonymous with those circumstances in which *Revlon* duties arise. In these cases, the courts usually will apply an intermediate standard of review called "enhanced scrutiny." The enhanced scrutiny standard exists to ensure that directors act with scrupulous concern for fairness to stockholders. While the amount of scrutiny increases, the target's Board retain broad discretion when deciding how to pursue a transaction and on what terms so long as they are acting in the best interests of stockholders and act reasonably to achieve this goal. The increase in scrutiny applied by the courts generally increases the likelihood that plaintiffs may be successful in the pursuit of a claim.

- *Entire Fairness*. The most exacting standard of review applied to directors' decisions is the entire fairness standard. It typically applies: (1) where a plaintiff overcomes the presumption of the business judgment rule, as when a majority of directors face a conflict of interest; (2) where a Board fails to meet the standards of conduct required under the *Unocal* and *Revlon* lines of cases or (3) in connection with certain transactions in which a controlling stockholder is buying out minority stockholders. The entire fairness test puts the burden on defendants to demonstrate both "fair dealing and fair price." "Fair dealing" focuses on the process that led to a transaction from initiation to final approval. "Fair price" focuses on the economic and financial considerations of the proposed transaction. A fair price is one that a reasonable seller, under all of the circumstances, would regard as within a range of fair value. In some circumstances, the target corporation's directors or the controlling stockholder will bear the burden of proving that the transaction is entirely fair. As a result, the likelihood that a defendant will obtain a dismissal through a motion to dismiss or for summary judgment is reduced, and the likelihood that the case will proceed to discovery or beyond is correspondingly higher. This generally makes the cost of defending the litigation and the cost of a settlement higher.

(c) <u>Procedural Steps Used When a Conflict of Interest May Arise</u>. Under an evolving body of case law, Delaware courts have held that in transactions, such as acquisitions of the minority's shares, in which a conflict of interest may arise for the directors, the corporation can change the level of review or shift the burden of proof by adopting certain procedural devices to complete the transaction. The two procedures that courts primarily recognize as protecting the interests of the minority stockholders are (i) approval of the transaction by a special committee composed solely of independent directors; and (ii) subjecting the transaction to a non-waivable condition that a majority of the unaffiliated stockholders vote to adopt the merger agreement or tender into the offer, as applicable (frequently called a "majority-of-the-minority condition"). Whether a corporation must use one or both and whether their use changes the standard of review or the burden of proof is a matter that has been evolving in Delaware and elsewhere. To the extent that a transaction involves a controlling stockholder or a potential conflict of interest with respect to a director, a corporation should give careful consideration with counsel of the use of these procedural steps as a part of the transaction.

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