BY ROGER A. LANE AND COURTNEY WORCESTER

ASK THE LITIGATOR

HOW TO PREVENT A TRIP TO COURT BEFORE ENTERING A MAJOR TRANSACTION

IN DOWN MARKETS, more than at other times, significant corporate transactions, including M&A deals, buyouts, recapitalizations, private investments in public entities and other financings, are subject to material litigation risks. Involving seasoned litigators who are familiar with the transactional environment can help pinpoint and manage the litigation risks inherent in such transactions. The value added is not that litigators know "more" than their transactional counterparts, but that litigators appreciate the mechanisms by which disputes are generated and resolved. Bringing this perspective to the table before trouble is brewing can spark a constructive dialogue that may head off trouble—materially reducing the risk of litigation or its potential scope and duration.

Even before a specific transaction is contemplated, litigators can help to educate board members and management, including general and outside corporate counsel, about process points in which litigators may have a particularly evolved sensitivity. Educating board members on such topics on a clear day—without the pressure of a pending deal—is not only more effective; it builds a consistent record of appropriate process over time, which greatly enhances courtroom credibility. This is also the best time to review the basic elements of the corporate architecture to ensure they are in proper shape. Are the articles and bylaws up to date and consistent with each other? Does the directors' and officers' liability policy actually say what it is supposed to say? Is the board composition appropriate, or could it be enhanced by the addition of independent directors? Then, when faced with a proposed transaction, basic process points and infrastructure are already in place and do not require on-the-spot enhancement.

When a transaction is proposed, consideration must be given to the process the board will follow in considering and addressing the proposal, as well as its terms. Here, litigators can help ensure that if there is to be judicial review, the transaction offers as few colorable bases for challenge as circumstances permit. The potential issues here are plentiful, depending on the particular transaction at issue: Is the proposal hostile or friendly? Will insiders lead or participate in the transaction? Have potential conflicts of interest been addressed? Has the independence of nonparticipating directors been tested? Will all stockholders participate, be affected or benefit equally? Is the transaction below market or other valuations? Each of these issues points to a potential litigation risk, and each is susceptible of effective management.

As recent events have made all too clear, once a deal is agreed to, the risk management process may not be complete. In addition to the traditional risk of suits by disgruntled stockholders, boards also need to understand the circumstances under which a deal may fall apart and what new and different claims may then arise. For example:

- Is there a fiduciary out, and what does it mean in practical terms? Is there a go-shop clause allowing the company to solicit higher bids? Will a court consider it an effective market check? Do these terms create risk for this transaction?
- Is there a reverse termination fee? Could a buyer simply decide to turn over the fee and walk away? What is the associated risk?
- What does the material adverse effect clause mean in practical terms? Could a buyer walk due to an unanticipated short-term setback? Do changes in market or industry conditions count? How do these issues work out in court?
- Which law will govern disputes between the parties, and where must suits be filed? Is it a favorable forum? Is the same choice of law made in all the documents, or are different jurisdictions involved?

THE REALITY IS THAT TRANSACTIONS EFFECTED IN DOWN MARKETS TEND TO ATTRACT LITIGATION—EITHER BY STOCKHOLDERS OR COMPETING BIDDERS AT THE OUTSET, OR WHEN ONE PARTY SEEKS TO GET OUT, OR AFTER MARKET CONDITIONS HAVE IMPROVED AND SECOND-GUESSING SETS IN.

The reality is that transactions effected in down markets tend to attract litigation—either by stockholders or competing bidders at the outset, or when one party seeks to get out, or after market conditions have improved and second-guessing sets in.

As a result, risk management should be part and parcel of the transactional process and understood as a value-add—in reducing future legal expenses, to be sure, but also in reducing transactional uncertainty as well as board and management distraction. ■

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