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Waiting In Limbo: Deal Terms That Define The Rights And Obligations Of Merger Partners Post Board Approval And Prior To The Stockholder Vote

By Bruce L. Silverstein, Esquire[*]

"The directors of a Delaware corporation have a continuing obligation to discharge their fiduciary responsibilities, as future circumstances develop, after a merger agreement is announced."[1] Among other things, until such time as the stockholders vote on the proposed merger, the board has a continuing duty to (i) remain informed of all information reasonably available that is material to the stockholders' decision, (ii) respond to a competing acquisition proposal in a manner consistent with the best interests of the stockholders, and (iii) evaluate whether to maintain an affirmative recommendation that the stockholders vote in favor of the proposed transaction.[2]

In the case of a publicly-traded corporation, in order to comply with federal securities law (and any applicable stock exchange rules), there typically will be a time lag of no less than thirty to sixty days from the date of the board action approving a merger agreement until the date of the stockholder vote respecting the proposed merger. During that interim period, much can happen. Among other things, one or more suitors (sometimes referred to as "interlopers" by the parties to the merger agreement) may

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[1] *Omnicare, Inc. v. NCS Healthcare, Inc.*, 818 A.2d 914, 938 (Del. 2003).

[2] *See*, *e.g.*, *Paramount Communications Inc. v. QVC Network Inc.*, 637 A.2d 34, 48-49 (Del. 1994). *See also Cirrus Holding Co. v. Cirrus Indus.*, 794 A.2d 1191, 1207 (Del. Ch. 2001) ("[T]he fiduciary duty did not end when the Cirrus Board voted to approve the [agreement to transfer control of the company by issuing a majority of shares to the acquirer]. The directors were required to consider all available alternatives in an informed manner until such time as the [proposed agreement] was submitted to the stockholders for approval."); *Phelps Dodge Corp. v. Cyprus Amax Minerals Co.*, C.A. No. 17398, 1999 Del. Ch. LEXIS 202, at *3-5 (Sept. 27, 1999).

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express interest in a competing transaction or may even make a competing bid – either by way of a merger proposal or through a "hostile" tender offer. Alternatively, the fortunes of the target company may rise or fall (independent of any competing proposal) – thereby rendering the proposed merger more desirable for one of the merger partners and less desirable for the other. More recently, it has even been the case that the acquiror (or its banker(s)) may lose interest in the deal based on factors that are extraneous to the value of the target corporation – including the loss of financing (or the ability to provide financing) on sufficiently attractive terms to make the acquisition as valuable as originally believed.

How the constituent parties to a merger agreement deal with material events that arise during the interim between signing the merger agreement and stockholder approval (or, on occasion, disapproval) of the proposed merger is governed largely by the terms of the merger agreement – subject, on occasion, to common law restrictions on certain types of "deal protection" provisions. This paper examines some of the more common provisions in merger agreements that govern the merger partners' respective rights and obligations during the interim between signing the merger agreement and stockholder approval, and attempts to offer some guidance, based on legal precedent, respecting the permissibility, proper use, and operation of such contractual provisions.

A. Overview of Common Provisions of Merger Agreements

Although merger agreements come in many flavors, most agreements will include one or more (and sometimes all) of the following types of provisions:

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- "No Shop" and/or "No Talk" covenant, which prohibits the target company from soliciting competing acquisition proposals and from engaging in discussions with potential suitors unless certain contractually specified circumstances are satisfied – usually a determination by the target company's board of directors that an unsolicited proposal constitutes a "Superior Proposal" (as variously defined).

- "Recommendation" covenant, which requires the target company's board of directors to recommend that the target company's stockholders vote in favor of the merger unless certain contractually specified circumstances are satisfied.

- "Confidentiality Agreement" and "Standstill" covenants, which prohibit the target company from providing non-public information to a party that proffers a Superior Proposal unless that party agrees to be bound by the terms of a confidentiality agreement – which often will include a standstill provision – no less restrictive than the agreement that was entered into by the acquiring party in connection with the merger agreement.

- "Non-Waiver of Anti-Takeover Protection" covenant, which prohibits the target company from waiving its anti-takeover defenses (if any) for the benefit of a party making a competing acquisition proposal.

- "Match Right" provision, which afford the acquirer the opportunity to match a competing acquisition proposal within a specified number of days following a determination by the target company's board that the competing proposal is superior to the deal embodied in the merger agreement.

- "Termination Fee" provision, which requires the target company (and, sometimes, the acquiring company) to pay a specified fee for the privilege of terminating the agreement under contractually specified circumstances.

- "Force the Vote" provision, which requires that the merger be submitted to a vote of the target company's stockholders notwithstanding the target company's receipt of a Superior Proposal and/or a changed recommendation by the target company's board of directors.

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- "Support Agreements" or "Voting Lock-Ups," which are incorporated by reference in the merger agreement, and which contractually require that certain specified stockholders – typically members of the board, senior management and/or substantial stockholders – commit to vote in favor of the proposed merger.
- "Fiduciary Out" provision, which permits the target company to terminate the merger agreement under contractually specified circumstances.
- "Go Shop" provision, which authorizes the target company to actively solicit competing acquisition proposals for a specified period of time.

The foregoing provisions establish the merger partners' respective rights and obligations during the interim between signing the merger agreement and stockholder approval of the proposed merger. The acquiring company typically will seek to narrow the target company's options for avoiding the agreement, while retaining as much flexibility as possible to do so itself. Conversely, the target company typically will seek to narrow the acquiring company's options for avoiding the agreement, while retaining as much flexibility as possible to do so itself. Ultimately, the provisions of the merger agreement are determined by the relative negotiating leverage of the merger partners – subject, on occasion, to judicial oversight.[3]

[3] Just about every merger agreement also includes the concept of a "Material Adverse Change" ("MAC") or "Material Adverse Event" ("MAE"), which allows the acquiror to terminate the agreement (usually without the payment of any termination fee) in the event that the target company's business should materially deteriorate prior to the consummation of the merger. Additionally, some merger agreements contain an "Exclusive Remedy" provision, which limits the target company's remedy to a specified "Reverse Termination Fee" and prevents the target company from suing for specific performance. As a practical matter, merger agreements that provide for a reverse termination fee as an exclusive remedy are actually "option agreements" to acquire the target company. Provisions of this nature are beyond the scope of this paper.

It is noteworthy that merger agreements do not typically include a provision that would permit the target company to terminate the merger upon the occurrence of a material positive change in its business. As discussed herein, however, a minority of merger agreements do include a "fiduciary out" that permits the target company to terminate the

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B. Common Law Developments Respecting Merger Agreement Provisions

Without regard to how they are intended to operate, "deal protection" provisions in a merger agreement do, in fact, operate in a manner that both (i) limit the otherwise unfettered ability of the target company's board to satisfy the ongoing fiduciary duties that exist prior to the time the stockholders vote on the proposed merger, and (ii) influence (even if they do not control) the stockholders' decision to approve or disapprove the proposed merger. As the Delaware Supreme Court has observed:

> There are inherent conflicts between a board's interest in protecting a merger transaction it has approved, the stockholders' statutory right to make the final decision to either approve or not approve a merger, and the board's continuing responsibility to effectively exercise its fiduciary duties at all times after the merger agreement is executed. These competing considerations require a threshold determination that board-approved defensive devices protecting a merger transaction are within the limitations of its statutory authority and consistent with the directors' fiduciary duties. [4]

While the issue arguably remains open to continuing debate, the current state of the Delaware law appears to be that *Unocal*[5] and its progeny govern the standard of judicial review when "deal protection" provisions in a merger agreements are challenged.[6] Pursuant to that standard, "a court must first determine that those measures

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agreement based upon a changed recommendation by its board of directors. As such, a broad form of fiduciary out might be viewed as providing the target company with the ability to terminate the merger agreement upon the occurrence of a material positive change in the target's business.

4 *Omnicare*, 818 A.2d at 930-31.

5 *Unocal Corp. v. Mesa Petroleum Co.* 493 A.2d 946 (Del. 1985).

6 *See*, *e.g.*, *Omnicare*, 818 A.2d at 930-35 (majority opinion). *See also Orman v. Cullman*, C.A. No. 18039, 2004 Del. Ch. LEXIS 150 at **23-35 (Del. Ch. Oct. 20, 2004) (employing *Unocal* standard to review challenged deal protection provisions of merger agreement and related voting agreement); *In re NCS Healthcare, Inc. S'holders Litig.*,

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are not preclusive or coercive[.]"[7] Once a challenged deal protection provision passes this threshold inquiry, then "[t]he board must demonstrate that it has reasonable grounds for believing that a danger to the corporation and its stockholders exists if the merger transaction is not consummated. . . . That burden is satisfied 'by showing good faith and reasonable investigation.'"[8] In addition, "any defensive devices must be proportionate to the perceived threat to the corporation and its stockholders if the merger transaction is not consummated."[9] Stated somewhat differently, deal protection provisions "must be reasonable in relation to the advantage sought to be achieved [by the merger it approved], or conversely, to the threat which a [competing transaction] poses to stockholder interests."[10]

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825 A.2d 240, 261 (Del. Ch. 2002) ("Our courts have applied [the *Unocal*] standard to examine deal protection devices, even in non-*Revlon* situations."), *rev'd on other grounds sub nom*, O*mnicare,* 818 A.2d 914 (Del. 2003); *McMillan v. Intercargo Corp*., 768 A.2d 492, 506 n.62 (Del. Ch. 2000); *ACE Ltd. v. Capital Re Corp.*, 747 A.2d 95, 107-08 (Del. Ch. 1999) (observing, without deciding, that *Unocal* provides "the appropriate doctrinal prism through which to evaluate [a] 'no-talk' provision" in a merger agreement); *Roberts v. General Instruments Corp.*, C.A. No. 11639, 1990 Del. Ch. LEXIS 138, at *24 (Aug. 13, 1990) (observing that "signing of an agreement, even an agreement with a fiduciary out, constitutes discrimination in favor of the party acquiring rights under the merger agreement"). *Accord Shaper v. Bryan*, 864 N.E.2d 876, 888 (Ill. App. 2007) (observing that Delaware courts "appl[y] the two-stage analysis of Unocal in the context of deal-protection devices set in place to protect a proposed merger"). *But see Omnicare*, 818 A.2d at 943 (Dissenting Opinion) (stating that "it is debatable whether *Unocal* applies" and that "we believe that the better rule in this situation is that the business judgment rule should apply"); *In re IXC Communications, Inc. S'holders Litig. v. Cincinnati Bell, Inc.*, 1999 Del. Ch. LEXIS 210 (Del. Ch. 1999) (Steele, V.C.) (applying business judgment rule to evaluate deal protection provisions in merger agreement).

7 O*mnicare,* 818 A.2d at 932.

8 *Id.* (quoting *Unocal*, 493 A.2d at 955).

9 *Id*.

10 *Id.* at 934 (*quoting Mills Acquisition*, 559 A.2d 1261, 1288 (Del. 1989) (alterations by *Omnicare* Court)).

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In addition to satisfying the *Unocal* standard of review, deal protection provisions must not run afoul of the common law proscription that they cannot "validly define or limit the directors' fiduciary duties under Delaware law."[11] As the Delaware Supreme Court has explained:

> Any board has authority to give the proponent of a recommended merger agreement reasonable structural and economic defenses, incentives, and fair compensation if the transaction is not completed. To the extent that defensive measures are economic and reasonable, they may become an increased cost to the proponent of any subsequent transaction. Just as defensive measures cannot be draconian, however, they cannot limit or circumscribe the directors' fiduciary duties.[12]

Lastly, if the proposed merger will result in a sale of the company or change of control, *Revlon*[13] and its progeny impose a further requirement that the target company's board must have had a reasonable basis to believe that agreeing to the merger agreement provisions in question was necessary to achieve the greatest valuable reasonably available for the stockholders.[14]

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[11] *Paramount Communications*, 637 A.2d at 55. *See also Omnicare*, 818 A.2d at 936 ("To the extent that a [merger] contract, or a provision thereof, purports to require a board to act or not act in such a fashion as to limit the exercise of fiduciary duties, it is invalid and unenforceable.") (quoting *Paramount Communications Inc.*, 637 A.2d at 51); *Orman* 2004 Del. Ch. LEXIS 150, at *21 (same). This common law proscription has its roots in Section 141(a) of the DGCL, which confers upon the board the ultimate responsibility for managing the business and affairs of a corporation. Thus, Delaware courts have invalidated "dead hand" and "delayed redemption" poison pill provisions on the ground, among others, that they would restrict a board's power in areas of fundamental importance to stockholders, such as a merger or sale of the corporation, in contravention of Section 141. *See*, *e.g.*, *Quickturn Design Systems, Inc. v. Mentor Graphics Corp.*, 721 A.2d 1281, 1291-92 (Del. 1998); *Carmody v. Toll Brothers, Inc.*, 723 A.2d 1180 (Del. Ch. 1998).

[12] *Omnicare*, 818 A.2d at 938.

[13] *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.,* 506 A.2d 173 (Del. 1986)

[14] *See*, *e.g.*, *Paramount Communications*, 637 A.2d at 48-49.

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1. The "No Shop" / "No Talk" Covenant

Although the Delaware courts have specifically identified the "no shop" / "no talk" covenant as being subject to the proscription against provisions in a merger agreement that purport to define or limit the ongoing fiduciary duties of the target company's directors,[15] the only form of such covenant that has been specifically criticized by the Delaware courts is one which purports to delegate to outside counsel and/or financial advisors the determination of whether the board should respond to an unsolicited acquisition proposal.[16] Accordingly, while most "no shop" / "no talk" covenants do require that the board "consult" with outside counsel and financial advisors before determining whether and/or how to respond to an unsolicited acquisition proposal, such covenants typically leave the board free to make its own determination of how to proceed after receiving such guidance.

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15 *See*, *e.g.*, *Paramount Communications*, 637 A.2d at 55 ("The No-Shop Provision could not validly define or limit the fiduciary duties of the Paramount directors. To the extent that such a contract, or a provision thereof, purports to require a board to act or not act in such a fashion as to limit the exercise of fiduciary duties, it is invalid and unenforceable."); *Cirrus Holding*, 794 A.2d at 1207 (observing both (i) that "directors cannot be precluded by the terms of an overly restrictive 'no-shop' provision from all consideration of possible better transactions" and (ii) that "directors cannot willfully blind themselves to opportunities that are presented to them, thus limiting the reach of 'no talk' provisions").

16 *See ACE Ltd.*, 747 A.2d at 106 (observing that such a no shop provision "involves an abdication by the board of its duty to determine what its own fiduciary obligations require at precisely that time in the life of the company when the board's own judgment is most important"). In a bench ruling in *Phelps Dodge*, Chancellor Chandler observed that "No-talk provisions . . . are troubling precisely because they prevent a board from meeting its duty to make an informed judgment with respect to even considering whether to negotiate with a third party." 1999 Del. Ch. LEXIS 202, at *4. The Court's ruling does not, however, reveal the nature of the circumstances, if any, under which the target company was permitted to engage in discussions with a party making an unsolicited acquisition proposal.

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A minority of "no shop" / "no talk" covenants condition the board's ability to respond to an unsolicited acquisition proposal solely upon the board making a good faith determination (typically, following the receipt of advice from outside counsel and financial advisors) that doing so is required by and/or not inconsistent with the board's fiduciary duties.[17] As a hyper-technical matter, one might argue that such a provision purports to define or limit the board's compliance with its fiduciary duties inasmuch as the board is required to consult with outside advisors before making its own decision as to how to proceed. While it is conceivable that there might be a circumstance in which there is insufficient time to engage in such consultation and still comply with the directors' fiduciary duties, it is difficult to imagine that a Delaware court would have any problem with such a relatively benign limitation.

More commonly, a "no shop" / "no talk" covenant prohibits interaction with a party that makes an unsolicited acquisition proposal unless the proposal is deemed to be a "Superior Proposal" – as that term may be defined in the merger agreement. Such was the case in litigation involving the contest for control of Caremark RX, Inc., where the validity of the covenant was a subject of dispute.[18] Despite vigorous arguments by the litigants, however, the Court of Chancery declined to reach the issue, finding that it was unnecessary to do so under the procedural posture in which the issue was raised.

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[17] Additionally, recent merger and acquisition activity has included multiple examples of agreements with "go shop" provisions, as well as examples with "window" periods in which the target board is free to deal with any unsolicited acquisition proposal made within a specified time following the execution of the merger agreement. These provisions are addressed elsewhere in this paper.

[18] *See Louisiana Municipal Police Employees' Retirement System v. Crawford*, 918 A.2d 1172 (Del. Ch. 2007) ("*Caremark*").

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The merger agreement in *Caremark* contained a "no shop" / "no talk" covenant, which provided that Caremark could not "participate in any discussions or negotiations with, furnish any information to…or afford access to the business, properties, assets, books or records of [Caremark]…or otherwise cooperate in any way with…or knowingly assist…facilitate or encourage" any competing offer unless ***both*** (1) "the Board of Directors…has determined in good faith…[that such competing proposal] constitutes or is reasonably likely to lead to a Superior Proposal" ***and*** (2) "the Board of Directors…has determined in good faith…that failing to take [the prohibited] action would be inconsistent with its fiduciary duties under Applicable Law."

The plaintiffs in *Caremark* argued that the "no shop" / "no talk" covenant impermissibly constrained the Caremark directors' exercise of their fiduciary duties. Rather than allowing the directors to talk with a competing bidder whenever they had determined that their fiduciary duties so required, the "no talk" aspect of the covenant required that the directors first determine that the competing bid constituted a Superior Proposal or was reasonably likely to lead to a Superior Proposal. Thus, under the "no talk" aspect of the covenant, the Caremark directors could not obtain information from, negotiate with, share information with, or do anything to assist or encourage a competing bidder, even if the directors were to determine that their fiduciary duties otherwise required it, unless the competing bid already was reasonably likely to lead to a Superior Proposal. The plaintiffs also argued that the "no talk" aspect of the covenant prevented the Caremark directors from fulfilling their fiduciary duty to remain informed between the signing of the merger agreement and the stockholder vote on the merger.

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The defendants in *Caremark* argued that a provision similar to the "no shop" / "no talk" covenant was common-place in merger agreements and was materially identical to the covenant contained in a merger agreement in another case[19] in which the plaintiffs' challenge to the transaction was rejected by the Court. In addition, the defendants noted that the final version of the covenant reflected concessions for which Caremark had negotiated, particularly the loosening of the fiduciary-duty trigger from a determination that failure to consider a Superior Proposal was "reasonably likely to result in a breach of fiduciary duty," to a determination that failure to consider a Superior Proposal was "inconsistent with [the board's] fiduciary duties."

Although the Court of Chancery declined to address the merits of the parties' arguments, in a subsequent oral ruling denying an application to certify an interlocutory appeal, the Court of Chancery did note that it "has, on many occasions, addressed similar deal protection measures," and that "[t]heir validity is judged by their amount and structure and whether the measures act in a manner that is preclusive or coercive." (Transcript of Oral Ruling at 13).[20] It is unclear whether the Court of Chancery intended by this statement to reject the plaintiffs' argument in *Caremark* that a "no shop" / "no talk" covenant that is conditioned upon the receipt of a contractually defined "Superior

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[19] *In re Toys "R" Us, Inc., S'holder Litig.,* 877 A.2d 975 (Del. Ch. 2005). *See also McMillan v. Intercargo Corp*., 768 A.2d 492, 506 (Del. Ch. 2000) (observing that the use of a covenant that "permitted the [target company's] board to consider an unsolicited proposal that the board determined was likely to be consummated and more favorable to [the target company's] stockholders than the [proposed] merger" was "hardly indicative of a *Revlon* (or *Unocal)* breach").

[20] A copy of the transcript of the Court's oral ruling can be obtained from the authors, by sending a request to BSilverstein@ycst.com.

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Proposal" runs afoul of the common law proscription against contract provisions that define or limit the board's fiduciary duties.

2. The "Recommendation" Covenant

Somewhat surprisingly, the validity of covenants that purport to place restrictions upon a board's ability to change its recommendation has not been addressed, much less resolved, by the Delaware courts.

William Allen, formerly the Chancellor of the Court of Chancery, has offered the following observations regarding "recommendation" covenants:

> What has been said about lock-ups and no-shops does not apply to a third type of deal protective terms: undertakings to recommend the deal to shareholders. The nature of the recommendation as stating a present view and the directors' duty to make candid disclosures to shareholders make this a distinct topic. Obviously, recommendation of a transaction that one in fact no longer believes is in the shareholders' best interest is deeply problematic. Thus, any provision that commits the board to recommend the deal at a future time must be accompanied by a fiduciary out clause. Amendment of section 251(c) of the Delaware General Corporation Law now explicitly authorizes the board to submit a merger agreement to the shareholders without the board's recommendation. Thus, a board now may absolutely commit in a merger agreement to submit a merger proposal to shareholders (without a fiduciary out) so long as the board believes at the time of contracting that it is in the best interests of the corporation to so undertake. The recent amendment will not, however, change the board's fiduciary obligation of candor. Thus, the inclusion of such a provision without a fiduciary out threatens to put target directors in a nearly impossible disclosure situation in the event that a superior offer does emerge. A board may not suggest or imply that it is recommending the merger to the shareholders if in fact its members have concluded privately that the deal is not now in the best interest of the shareholders. Moreover, in light of the grounds of the Delaware Supreme Court's holding in *Quickturn Design Systems, Inc. v. Shapiro*, the Court of Chancery is very sensitive to the question of whether a

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> board may rightfully ever foreclose sources of information for a substantial period.[21]

As is the case with "no shop" / "no talk" covenants, there are differing forms of "recommendation" covenants – including (i) the relatively benign form that permits a changed recommendation whenever the target company's board determined (typically, following the receipt of advice from outside counsel and financial advisors) that it is necessary to do so in order to comply with the directors' fiduciary duties, and (ii) the more restrictive form that proscribes a changed recommendation unless the target company has received an unsolicited acquisition proposal that is a "Superior Proposal" (as defined in the merger agreement). Additionally, some merger agreement permit a changed recommendation only so long as the target company is otherwise in compliance with all other provisions of the merger agreement – including, the "no shop" / "no talk" covenant.

As with the "no shop" / "no talk" covenant, it is difficult to imagine that a Delaware court would have any problem with the relatively benign form of "recommendation" covenant that conditions a changed recommendation solely upon a good faith determination by the board (albeit following consultation with outside advisors) that such a change is required by the directors' fiduciary duties. On the other hand, it is arguable that the form of covenant that conditions a changed recommendation upon the receipt of a "Superior Proposal" goes too far.[22] This is because there may be a

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21 William T. Allen, *Understanding Fiduciary Outs: The What and Why of an Anomalous Concept*, 55 BUS. LAW 653 (2000) (footnotes omitted)

22 *See* Bruce L. Silverstein & John P. Paschetto, *Never Mind, Please Vote No*, FINANCIER WORLDWIDE CORP. GOVERNANCE REV. 22, 23 (2006) (advocating that there can be no contractual restrictions on a board's ability to change its recommendation – other than that the board may not do so unless it determines that such a change is required by the

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number of reasons separate and apart from the receipt of a "Superior Proposal" that would cause a director to make a good faith determination that his or her fiduciary duties required a change in the board's recommendation. For example, there might be an unanticipated materially positive development (*i.e.*, the converse of a "materially adverse change") in the target company's business that causes the directors to believe that the company is worth materially more than the proposed merger consideration. If that were the case, it would be difficult to understand how the target company's directors could both (i) comply with their fiduciary duty to provide the stockholders with a good faith "recommendation," and (ii) comply with the "recommendation" covenant that precludes a changed recommendation in the absence of a Superior Proposal. This issue was specifically litigated in *Caremark*, but the Court expressed no opinion respecting this aspect of the parties' dispute.

An argument that could avoid the potential conflict between a strict form of "recommendation" covenant and the ongoing fiduciary duty of the target company's directors to provide the stockholders with a good faith and candid view of the merits of the proposed merger may be (i) to construe the covenant to require only a statement that the target company's board viewed the proposed merger to be in the best interests of the stockholders ***as of the date the merger agreement was approved by the board***, and (ii) to further construe the covenant as placing no restriction upon the directors' responsibility to inform the stockholders of new developments that might influence the stockholders to vote against the proposed merger – including the possibility that one or more directors

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exercise of fiduciary duty); R. Franklin Balotti & A. Gilchrist Sparks, III, *Symposium: Deal-Protection Measures and the Merger Recommendation*, 96 NW. U. L. REV. 467, 477-78 (2002) (same).

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has formed a different view respecting the merits of the merger. While this argument might seem to stretch the limits of a court's ability to construe the English language, it would serve the laudable goal of avoiding a construction that renders the covenant unenforceable or otherwise contrary to Delaware law.[23]

3. The "Confidentiality Agreement" and "Standstill" Covenant

Merger agreements often contain a covenant that prohibits the target company from providing confidential information to a competing suitor unless the competing suitor agrees to be bound by the terms of a confidentiality agreement – often containing a standstill component – no less restrictive than that agreed upon by the acquiror. Although Delaware courts have not specifically addressed the propriety such a covenant in a merger agreement, Delaware courts have sustained the propriety of a target company's insistence, on its own initiative, that a prospective bidder agree to be bound by a confidentiality agreement – even one containing a standstill agreement – as a condition to obtaining nonpublic information for use in formulating an acquisition proposal.[24] As the Court of Chancery recently explained: "When a corporation is running a sale process, it is responsible, if not mandated, for the board to ensure that confidential information is not misused by bidders and advisors whose interests are not aligned with the corporation, to establish rules of the game that promote an orderly auction, and to

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[23] *See*, *e.g.*, *Ace Ltd.*, 747 A.2d at 104 (rejecting acquiror's interpretation of "no shop" / "no talk" covenant that would, if accepted, cause the covenant to be "likely invalid"). *Accord JANA Master Fund, Ltd. v. CNET Networks, Inc.*, Del. Ch., C.A. No. 3447-CC, Chandler, C. (March 13, 2008) (construing bylaw in manner contrary to company's public description of bylaw because, among other things, the company's construction was contrary to Delaware public policy and arguably rendered the bylaw invalid).

[24] *See*, *e.g.*, *In re: The Topps Co. S'holders Litig.*, 926 A.2d 58, 91 (Del. Ch. 2007); *Golden Cycle, LLC v. Allan*, C.A. No. 16301, 1998 Del. Ch. LEXIS 237, at **46-48 (Del. Ch. Dec. 10, 1998).

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give the corporation leverage to extract concessions from the parties who seek to make a bid."[25] Accordingly, it seems improbable that the Delaware courts would find fault with a merger agreement covenant that prohibits the provision of non-public information about the target to a competing suitor without an appropriate form of confidentiality and/or standstill agreement.

In litigation involving the battle for control of The Topps Company, Inc., the Court of Chancery recently concluded that the directors of a target company had a fiduciary responsibility to release a prospective bidder from a standstill agreement under circumstances where (i) the target company had entered into a merger agreement by which the stockholders' equity interest in the company would be eliminated if the merger were approved by the stockholders, (ii) the prospective bidder had committed to make a non-coercive tender offer for any and all shares at a price in excess of the proposed merger consideration, and (iii) the merger agreement expressly permitted the target company to release the prospective bidder from the terms of the standstill agreement if the target company's directors were required to do so in order to comply with their fiduciary duties. As the Court explained:

> Because the Topps board is recommending that the stockholders cash out, its decision to foreclose its stockholders from receiving an offer from Upper Deck seems likely, after trial, to be found a breach of fiduciary duty. If Upper Deck makes a tender at $10.75 per share on the conditions it has outlined, the Topps stockholders will still be free to reject that offer if the Topps board convinces them it is too conditional. Indeed, Upper Deck is not even asking for some sort of prior restraint preventing the Topps board from implementing a rights plan in the event of a tender offer (although Upper Deck has indicated that will begin round two of this litigation if Topps does). What

25 *Topps Co.*, 926 A.2d at 91.

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> Upper Deck is asking for is release from the prior restraint on it, a prior restraint that prevents Topps's stockholders from choosing another higher-priced deal. Given that the Topps board has decided to sell the company, and is not using the Standstill Agreement for any apparent legitimate purpose, its refusal to release Upper Deck justifies an injunction. Otherwise, the Topps stockholders may be foreclosed from ever considering Upper Deck's offer, a result that, under our precedent, threatens irreparable injury.[26]

Rejecting the defendants' argument that allowing Upper Deck to proceed with a hostile tender offer created the risk that "stockholders will make an erroneous decision," the Court added:

> [I]t is notable that nothing in this decision purports to compel the Topps board to enter a merger agreement with Upper Deck that it believes to be unduly conditional. What this decision does conclude is that, on this record, there is no reasonable basis for permitting the Topps board to deny its stockholders the chance to consider for themselves whether to prefer Upper Deck's higher-priced deal, taking into account its unique risks, over Eisner's lower-priced deal, which has its own risks. If the Topps board sees the Upper Deck tender offer and believes it should not be accepted, it can tell the stockholders why. It can even consider the use of a rights plan to prevent the tender offer's procession, if it can square use of such a plan with its obligations under *Revlon* and *Unocal*. But it cannot at this point avoid an injunction on the unsubstantiated premise that the Topps stockholders will be unable, after the provision of full information, rationally to decide for themselves between two competing, non-coercive offers.[27]

It is notable that the merger agreement covenant in *Topps* expressly authorized Topps to release Upper Deck (or any other suitor) from the standstill aspect of the confidentiality agreement if it were necessary to do so for the members of Topps' board

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[26] *Id*. at 92.

[27] *Id*. (footnotes omitted).

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of directors to comply with their fiduciary duties.[28] Thus, the Court was not called upon to determine (i) whether the covenant would have been enforceable in the absence of such a "fiduciary out" or (ii) whether it would have been a breach of fiduciary duty for the Topps' board of directors to have agreed to a confidentiality agreement covenant that did not include a "fiduciary out."

4. The "Non-Waiver of Anti-Takeover Protection" Covenant

The Delaware courts have not been confronted with a challenge to a covenant that prohibits the waiver of anti-takeover defenses.

On the one hand, it is arguable that such a challenge should be resolved in the same manner as a challenge to a covenant prohibiting the waiver of a standstill agreement. Arguably, a standstill agreement is a form of anti-takeover protection. Moreover, the *Topps* decision was based, in part, upon prior decisions of the Delaware courts, which found fault with the continued use of anti-takeover defenses following the target company's entry into a definitive agreement to be acquired.[29] On the other hand, the decision in *Topps* was, at least in part, also animated by the fact that the target company had made materially false and incomplete statements about the hostile suitor, which the standstill agreement was preventing the hostile suitor from correcting.

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28 *See id.* at 91.

29 *See*, *e.g.*, *MacAndrews & Forbes Holdings, Inc. v. Revlon, Inc.*, 501 A.2d 1239, 1251 (Del. Ch. 1985) ("Although it has been concluded that the Rights Plan is not void *ab initio*, having served to permit the Revlon board full negotiating power, it cannot now stand in the way of the bidding process."), *aff'd,* 506 A.2d 173 (Del. 1986). *See also Robert M. Bass Group, Inc. v. Evans*, 552 A.2d 1227, 1242 (Del. Ch. 1988) (noting that directors are not free simply to block any and all acquisition offers that the board believes to be less than adequate, but that proper course of conduct is for the directors to offer the stockholders a "choice" between the disfavored offer and one that the directors believe to be in the stockholders' best interests); *AC Acquisitions Corp. v. Anderson, Clayton & Co.*, 519 A.2d 103, 113-16 (Del. Ch. 1986) (same).

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Additionally, the merger agreement in *Topps* expressly authorized the target company to release a hostile suitor from the terms of a standstill agreement if the target company's board determined that it was necessary to do so to comply with the directors' fiduciary duties.

Separate and apart from any lesson that might be drawn from *Topps*, it may be argued that a merger agreement covenant that prohibits the waiver of anti-takeover protection (without a fiduciary out) violates the principles that have animated Delaware courts to invalidate provisions in stockholder rights plans (more commonly known as "poison pills") that restrict the circumstances or time in which the board of directors may redeem the rights issued there-under.[30]

5. Match Right Provisions

The inclusion of a match right provision in a merger agreement has been sustained by the Court of Chancery in the few cases in which it was questioned.[31] As the Court recently observed:

> [M]atch rights are hardly novel and have been upheld by this court when coupled with termination fees despite the additional obstacle they [] present. And, in this case, the match right was actually a limited one that encouraged bidders to top [the acquirer] in a material way. As described, a bidder whose initial topping move was over

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[30] *See Quickturn Design Systems*, 721 A.2d at 1291-92; *Carmody*, 723 A.2d 1180.

[31] *See*, *e.g., Toys "R" Us*, 877 A.2d at 1017 ("As the plaintiffs must admit, neither a termination fee nor a matching right is per se invalid. Each is a common contractual feature that, when assented to by a board fulfilling its fundamental duties of loyalty and care for the proper purpose of securing a high value bid for the stockholders, has legal legitimacy."). *See also In re Lear Corp. S'holder Litig*., 926 A.2d 94, 120 (Del. Ch. 2007) (rejecting challenge to match right). *See also Topps Co.*, 926 A.2d at 86-87 (same). *In Re Pennaco Energy, Inc. S'holders' Litig.*, 787 A.2d 691, 707 n.16 (Del. Ch. 2001) (describing benefits to acquirer resulting from combination of termination fee and match right as "modest" and "reasonable").

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> $ 37 could limit [the acquirer] to only one chance to match. Therefore, a bidder who was truly willing to make a materially greater bid than [the acquirer] had it within its means to short-circuit the match right process. Given all those factors, and the undisputed reality that second bidders have been able to succeed in the face of a termination fee/matching right combination of this potency, I am skeptical that a trial record would convince me that the [target] board acted unreasonably in assenting to the termination fee and match right provisions in the Merger Agreement.[32]

6. Termination Fees

Termination fee provisions are invariably included in merger agreements. They are routinely challenged by stockholder plaintiffs, and almost routinely sustained by the Delaware courts. Litigation surrounding termination fees has tended to focus on (i) the amount of the fee, and (ii) the circumstances under which it is payable.

a. Amount of Termination Fee

There is no bright line rule for determining whether a termination fee of any particular amount is appropriate.[33] Indeed, the Court of Chancery has observed that "[i]t is very difficult to say that any termination fee is so excessive *on its face* that it is unenforceable."[34] As with any other "deal protection" provision subject to judicial review under the *Unocal* standard, a termination fee must not be coercive or preclusive,

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32 *Lear Corp.*, 926 A.2d at 120 (footnotes omitted).

33 *See Caremark*, 918 A.2d at 1181 n.10 (quoting *Toys "R" Us*, 877 A.2d at 1016).

34 *IXC Communications*, 1999 Del. Ch. LEXIS 210, at *28.

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and it must be reasonable in relation to the benefit obtained for its potential payment.[35]

As the Court of Chancery has explained:

> Our courts do not "presume that all business circumstances are identical or that there is any naturally occurring rate of deal protection, the deficit or excess of which will be less than economically optimal." . . . Rather, a court focuses upon "the real world risks and prospects confronting [directors] when they agreed to the deal protections." . . . That analysis will, by necessity, require the Court to consider a number of factors, including without limitation: the overall size of the termination fee, as well as its percentage value; the benefit to shareholders, including a premium (if any) that directors seek to protect; the absolute size of the transaction, as well as the relative size of the partners to the merger; the degree to which a counterparty found such protections to be crucial to the deal, bearing in mind differences in bargaining power; and the preclusive or coercive power of *all* deal protections included in a transaction, taken as a whole. The inquiry, by its very nature fact intensive, cannot be reduced to a mathematical equation.[36]

Notwithstanding the Court of Chancery's admonition, the Delaware courts have, almost routinely, sustained a target company's agreement to termination fees in the range of 2% to 3% of the "deal value."[37] A number of decisions also have sustained

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35 *See id.* (explaining, when specifically discussing a challenge to a termination fee, that "plaintiffs must specifically demonstrate how a given set of deal protections operate in an unreasonable, preclusive, or coercive manner, under the standards of this Court's *Unocal* jurisprudence"). *But see Brazen v. Bell Atlantic Corp.*, 695 A.2d 43 (Del. 1997) (applying a somewhat different form of analysis where merger agreement expressly provided that the termination fee was intended to serve as "liquidated damages").

36 *Caremark*, 918 A.2d at 1181 n.10. *See also Toys "R" Us, Inc.*, 877 A.2d at 1021-22 ("[t]his is not to say that . . . fees lower than 3% are always reasonable").

37 *See id*. (string-citing cases). *See also Brazen*, 69 A.2d at 49 (string-citing cases and observing that a termination fee equal to 2% of the target company's market capitalization "falls well within the range of termination fees upheld as reasonable by the courts of this State").

Whether the "deal value" means the total price to be paid for the equity of the target company or also includes the value of any liabilities assumed in the transaction remains

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termination fees of 3.5% and higher.[38] When confronted with a termination fee of more than twice that amount, however, the Court of Chancery has observed, in dictum, that "6.3 percent certainly seems to stretch the definition of range of reasonableness and probably stretches the definition beyond its breaking point."[39] On the other hand, the Delaware Supreme Court has affirmed the dismissal of a complaint challenging a merger where the termination fee was "about 7% of the value of the transaction."[40] Lastly, it is worth noting that the Court of Chancery has observed that multi-billion dollar termination

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unresolved. *See Pennaco Energy*, 787 A.2d at 702 n.16 ("While Delaware cases have tended to use equity value as the benchmark for measuring a termination fee, no case has squarely addressed which benchmark [equity or combined equity and debt] is appropriate"). *But see Lear Corp.*, 926 A.2d at 120 ("For purposes of considering the preclusive effect of a termination fee on a rival bidder, it is arguably more important to look at the enterprise value metric because . . . most acquisitions require the buyer to pay for the company's equity and refinance all of its debt.") In any event, it does not appear to be the case that the "deal value" means the value of the combined post-merger enterprise in the case of a stock-for-stock merger.

[38] *See*, *e.g.*, *Lear Corp.*, 926 A.2d at 120 (rejecting challenge to termination fee that slightly exceeded 3.5% of the equity value of the deal, and 2.4% of the enterprise value of the target company); *Topps Co.*, 926 A.2d at 86 (observing that a termination fee amounting to 4.3% of the deal price was "a bit high in percentage terms," but "can be explained by the relatively small size of the deal" and "is not of the magnitude that . . . was likely to have deterred a bidder with an interest in materially outbidding [the acquirer]"); *McMillan*, 768 A.2d at 505 (observing that a termination fee of 3.5% was "at the high end of what our courts have approved," while concluding that the fee was "still within the range that is generally considered reasonable").

[39] *Phelps Dodge*, 1999 Del. Ch. LEXIS 202, at *5. *See also Toys "R" Us, Inc.*, 877 A.2d at 1021-22 ("This is not to say that this court is, or has been, willing to turn a blind eye to the adoption of excessive termination fees, such as the 6.3% termination fee in *Phelps Dodge* that Chancellor Chandler condemned . . . .").

[40] See *Malpiede v. Townson*, 780 A.2d 1075, 1081 n.10 (Del. 2001). The Delaware Supreme Court simply noted the amount of the termination fee and did not specifically address whether it was reasonable. *See also IXC Communications*, 1999 Del. Ch. LEXIS 210 (declining to enjoin vote on merger agreement that provided for termination fee amounting to 6.3% of deal value).

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fees might be viewed differently from the multi-million dollar (even multiple hundred million dollar) termination fees.[41]

b. Trigger for Termination Fee

Some termination fees are payable only if the target company enters into an alternative acquisition transaction within a specified period of time. Assuming that the termination fee provision is otherwise appropriate, there can be no dispute that this form of triggering provision is appropriate. In such a situation, the only "cost" of the termination fee is the pro-rata reduction in the additional premium available to the target company's stockholders resulting from the alternative (and, presumably, superior) transaction.

It also is relatively common for the payment of a termination fee by the target company to be triggered where the acquiror, itself, has elected to terminate the merger agreement following a changed recommendation by the target company's board of directors. Sometimes, this termination fee payable in such a circumstance will be staged – with a lesser termination fee payable if the merger agreement is terminated without an alternative acquisition transaction, and with a higher termination fee payable if the target company elects to pursue an alternative acquisition transaction. Less common, but occasionally utilized, is a provision that triggers the payment of a termination fee simply because the target company's stockholders have voted against the proposed merger (even in the face of a positive board recommendation, and even in the absence of a competing acquisition proposal).

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41 *See Toys "R" Us*, 877 A.2d at 1022 n.79.

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Although litigants have occasionally raised challenges to the triggering provisions that do not require the consummation of an alternative transaction, the Delaware courts have declined to sustain such a challenge.[42] There is, however, language in some decisions of the Court of Chancery suggesting that it is a helpful factor if the termination fee cannot be not triggered based exclusively upon a negative stockholder vote.[43]

7. "Force the Vote" Provisions

A "force the vote" provision is one that compels the target company to conduct a stockholders meeting to vote on the proposed merger, without regard to whether intervening events – including, but not limited to, the receipt of a Superior Proposal – might cause the target company's board of directors to withdraw its support for the proposed merger.

Prior to 1998, it generally was believed that it was impermissible for a board to approve a merger agreement that required the transaction to be submitted to a stockholder vote if the board no longer supported the deal on account of intervening circumstances. This belief stemmed from the 1985 decision of the Delaware Supreme Court in *Smith v. Van Gorkom*,[44] which noted, in dictum, that the main Delaware merger statute (Section

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[42] *See*, *e.g.*, *Brazen*, 69 A.2d at 49-50 ("we agree with the Court of Chancery that, although the termination fee provision may have influenced the stockholder vote, there were 'no structurally or situationally coercive factors' that made an otherwise valid fee provision impermissibly coercive in this setting").

[43] *See*, *e.g.*, *In re Netsmart Techs., Inc. S'holder Litig*., 924 A.2d 171, 177 (Del. Ch. 2007) ("[t]he modest termination fee in the Merger Agreement is not triggered simply on a naked no vote"); *McMillan*, 768 A.2d at 505 (observing that the termination fee was "structured ensured that the [target company's] stockholders would not cast their vote in fear that a 'no' vote alone would trigger the fee"). *Accord Orman*, 2004 Del. Ch. LEXIS 150, at *36 (identifying as a positive factor under a *Unocal* analysis that the stockholders "knew that no termination fee would be paid if they rejected the proposal").

[44] 488 A.2d 858 (Del. 1985).

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251 of the DGCL) implicitly provided that directors could submit a merger to a stockholder vote only if they continued to recommend approval of the merger through the date of the stockholder meeting.

In 1998, Section 251(c) of the DGCL was amended to overrule the dicta in *Smith v. Van Gorkom*, by making clear that force-the-vote provisions are permissible in merger agreements.[45] Typically, but not always, a merger agreement containing a force-the-vote provision also will omit a "fiduciary out" that allows the board to terminate the agreement in the event of a changed recommendation. Although the 1998 amendment does not specifically address the validity of such a practice, it is generally believed that the omission of such a fiduciary out fits "hand-in-glove" with the inclusion of a force-the-vote provision.

In *Omnicare*, a majority of the members of the Delaware Supreme Court (with two of five members dissenting) held that it was a *per se* breach of fiduciary duty for a target company's board of directors to authorize a merger agreement that ***combined*** (1) a "force-the-vote" provision, ***and*** (2) a "stockholder lock-up," by which one or more stockholders controlling the number of votes needed to approve the merger had contractually agreed to vote in favor of the transaction. The *Omnicare* Court reasoned that these two deal-protection devices, taken together, "operated in concert to have a preclusive and coercive effect" that made approval of the merger, which was inconsistent with the fiduciary responsibilities of the directors under *Unocal*.[46]

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45 In 2003, a new Section 146 was added to the DGCL in order to clarify that force-the-vote provisions were permissible with respect to any "matter" submitted to a stockholder vote, and not simply merger agreements.

46 *See Omnicare*, 818 A.2d at 936. *Accord ACE Ltd.*, 747 A.2d at 108 ("As a practical matter, it might therefore be possible to construct a *plausible* argument that a no-escape

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The factual underpinning of the majority decision in *Omnicare* was that combined operation of the force-the-vote and voting lock-up assured that the merger would be approved by a majority of the stockholders from the moment the merger agreement was approved by the target company's board of directors – without regard to whether the company might thereafter receive an unsolicited superior offer and/or any other reason why the proposed merger might no longer be in the best interests of the stockholders at the time of the stockholder vote. As the Delaware Supreme Court observed, from the moment the merger agreement was approved by the target company's board, ultimate stockholder approval of the merger was a "*fait accompli*."

The *Omnicare* Court expressly noted that it was not criticizing the use of either of a force-the-vote provision or a majority voting lock-up when used independent of the other.[47] Thus, *Omnicare* did not invalidate force-the-vote provisions when not used in combination with a stockholder lock-up. (Nor, for that matter, did *Omnicare* invalidate stockholder lock-ups when not used in combination with a force-the-vote provision.) Moreover, force-the-vote provisions are expressly authorized by the DGCL. As long as the outcome of the stockholder vote is not a *fait accompli* (as was the case in *Omnicare*) it is improbable that there is any *per se* rule of fiduciary responsibility that would

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merger agreement that locks up the necessary votes constitutes an unreasonable preclusive and coercive defensive obstacle within the meaning of *Unocal.*").

It is worthy of noting that the majority opinion in *Omnicare* did not address, much less resolve, the question of whether the combined defensive measures utilizes therein could be sustained upon a showing a "compelling justification" under *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651 (Del. Ch. 1988), and its progeny.

47 *Omnicare*, 818 A.2d at 939 ("The issues in this appeal do not involve the general validity of either stockholder voting agreements or the authority of directors to insert a Section 251(c) provision in a merger agreement. In this case, the [target company's] board combined those two otherwise valid actions and caused them to operate in concert as an absolute lock up, in the absence of an effective fiduciary out clause in the [] merger agreement.").

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preclude a board from authorizing a merger agreement that requires that it be submitted to a stockholder vote, regardless of the directors' change of heart.

Notwithstanding the absence of a *per se* rule that would prohibit the inclusion of a strict force the vote provision in a merger agreement, a target company's board should recognize that agreeing to such a provision could preclude the company from capitalizing upon the rare alternative acquisition opportunity that might arise following the announcement of the proposed merger and may be available only for a limited period of time. As such, a target company's board should be cautious about agreeing to a strict force-the-vote provision where there has been no pre-agreement market check or other investigation sufficient to satisfy the directors that such a circumstance is not likely to occur.[48]

8. "Support Agreements" and "Voting Lock-Ups"

Although there are a wide variety of support agreements and voting lock-ups, these arrangements tend to come in three varieties: (i) agreements to vote in favor of the proposed merger without regard to whether a "Superior Proposal" is made by a competing suitor and without regard to whether the target company's board continues to recommend that the stockholders approve the proposed merger; (ii) agreements to vote in favor of the merger that are terminable in the event that a "Superior Proposal" is made by a competing suitor and/or the target company's board changes or withdraws its recommendation that the stockholders approve the proposed merger; and (iii) agreements

[48] Of course, there may be countervailing factors that would cause reasonable directors to agree to a merger agreement with a strict force the vote provision, even in the absence of a body of information sufficient to rule out the probability that doing so may cause the company to lose out on opportunity to capitalize upon a post-agreement superior

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to refrain from voting for any alternative acquisition proposal for a specified period of time, without regard to whether the merger agreement in connection with which the voting agreement is formed might be terminated.

Technically, a support agreement or voting lock-up is a private arrangement between an acquirer and certain individual stockholders of the target company (albeit, stockholders who may be directors or officers). Additionally, such arrangements are extrinsic to the merger agreement – although they typically are referenced in the merger agreement, and many merger agreements are expressly conditioned upon their execution. Accordingly, one might argue that these arrangements should not be subject to a standard of judicial review created to judge the compliance of directors with their fiduciary duties.[49] As a practical matter, however, it is a rare case where an acquiror does not require that the target company's board authorize the formation of support agreements or voting lock-ups (mainly because such approval is required to avoid the restrictions of Section 203 of the DGCL). Moreover, even without a request for approval of a support agreement or voting lock-up, the target company's board could require that the merger agreement prohibit the formation of such arrangements as a condition to approving the merger agreement. Thus, the Delaware courts have tended to evaluate challenges to support agreements and voting lock-ups under the rubric of *Unocal* and its progeny.[50]

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alternative. Those factors will differ from case-to-case and the target board's evaluation of the circumstances, when challenged, will be subject to judicial review under *Unocal.*

[49] *See*, *e.g.*, Thanos Panagopoulos, *Thinking Inside The Box: Analyzing Judicial Scrutiny of Deal Protection Devices in Delaware*, 3 BERKELY BUS. L.J. 437, 461-62 (2006) (asserting that "[t]he standard of review does not affect stockholders' ability to execute voting agreements," and advocating the reversal of *Omnicare*).

[50] *See*, *e.g.*, *Omnicare*, 818 A.2d at 934-36; *Orman*, 2004 Del. Ch. LEXIS 150 at **23-34.

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Pursuant to the majority opinion in *Omnicare*, it is a *per se* breach of fiduciary duty for the directors of a target company to approve a merger agreement that ***combines*** (i) a voting lock-up by stockholders holding the requisite number of shares to approve the proposed merger, ***and*** (ii) a force-the-vote provision.[51] *Omnicare* does not address whether it is permissible for a target company's board to agree to permit a voting lock-up of a sufficient number of shares to approve the proposed merger in connection with a merger agreement that does not include a force-the-vote provision. Nor does *Omnicare* address whether it is permissible for a target company's board to agree to permit a voting lock-up of a significant, but less than majority, interest.[52] In the wake of *Omnicare*, prudent practitioners have tended to avoid voting lock-ups in excess of 40% – without regard to whether the merger agreement contains a force-the-vote provision. At the same time, it is generally believed that a voting lock-up that extends to 40% or less of the voting power of the target company will be sustained under a *Unocal* / *Omnicare* analysis (subject, of course, to the target company's board having had an appropriate reason for agreeing to the voting lock-up in the first instance).[53] Where, if anywhere, above 40% triggers *Omnicare* is unresolved.

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[51] *See Omnicare*, 818 A.2d at 942 (Dissenting Opinion) (describing the holding of the majority as being that "A merger agreement entered into after a market search, before any prospect of a topping bid has emerged, which locks up stockholder approval and does not contain a 'fiduciary out' provision, is per se invalid when a later significant topping bid emerges.").

[52] Additionally, as noted above, the majority opinion in *Omnicare* did not address the question of whether the combined defensive measures utilizes therein could be sustained upon a showing a "compelling justification" under *Blasius*.

[53] *Accord IXC Communications*, 1999 Del. Ch. LEXIS 210 at **33-34 (concluding that injunctive relief was inappropriate because, among other reasons, the holders of "60% of the IXC outstanding shares" were free to accept or reject the merger). *See also Unitrin, Inc. v. American General Corp.*, 651 A.2d 1361, 1388-89 (Del. 1995) (instructing that defensive measures are not coercive nor preclusive under *Unocal* unless their result

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Prior to *Omnicare*, the Court of Chancery had acknowledged (in the hurried context of resolving an application for a temporary restraining order) that a target company could, under appropriate circumstances, agree to a merger agreement that was combined with a lock-up of 45% of the stock, in a case in which the merger agreement had reserved a "fiduciary out" for the target company's board that permitted termination of the merger agreement if a "Superior Proposal" were made by a competing suitor.[54]

Post *Omnicare*, the Court of Chancery has sustained the use of a voting lock-up by which persons holding a majority of the voting power of the company (through ownership of a class of super-voting stock) covenanted to refrain from selling their shares or voting in favor of any alternative acquisition proposal for eighteen months following the termination of the merger agreement (if that were to occur). Rejecting the plaintiff's argument that such a voting lock-up was prohibited under *Omnicare*, the Court of Chancery wrote:

> [T]he argument that *Omnicare* applies in the circumstances here is misplaced. The General Cigar board retained a fiduciary out, allowing it to consider superior proposals and recommend against the Swedish Match deal. Importantly, a majority of the nonaffiliated public shareholders could have rejected the deal on its merits. Unlike *Omnicare*, nothing in the merger or stockholder agreements made it "mathematically certain" that the transaction would be approved. If the shareholders believed $ 15.25 per share (a 75% premium over the market price) did not reflect General Cigar's intrinsic value (and the market also misunderstood that value), they could have said, "no thanks, I would rather make an investment bet on the long term prospects of this company." These shareholders were fully informed about the offer. They knew that no other offer or potential buyer had appeared, although nothing

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would cause a stockholder vote to "either be mathematically impossible or realistically unattainable").

54 *See Ace Ltd.*, 747 A.2d at 98, 107.

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> prevented it. They knew that no termination fee would be paid if they rejected the proposal. It is true, as plaintiffs repeatedly point out, that the Cullman vote against any future, hypothetical deal was "locked-up" for 18 months. It was this deal or nothing, at least for that period of time. Again, however, no other suitor was waiting in the wings. And, assuming a shareholder believed that General Cigar's long term intrinsic value was greater than $ 15.25 per share, was an 18 month delay a meaningful "cost" that could be said realistically to "coerce" the shareholders' vote? The Cullman lock-up hardly seems unreasonable, given the absence of other deal protection devices in this particular transaction and given the buyer's understandable concern about transaction costs and market uncertainties. Unless being in a voting minority automatically means that the shareholder is coerced (because the minority shareholder's investment views or hopes have been precluded by a majority), plaintiff's concept of coercion is far more expansive than *Omnicare* or any other decisional authority brought to my attention. As a matter of law, therefore, the approval of the Swedish Match proposal by a fully informed majority of the minority public shareholders was not impermissibly coerced.[55]

9. "Fiduciary Out" Provisions

A "fiduciary out" provides the target company with a contractual right to terminate the merger agreement (typically subject to the payment of a termination fee) if the target company's board of directors should determine that it is necessary to exercise that contract right in order to comply with the directors' fiduciary duties. Many fiduciary out provisions permit the target company to terminate the merger agreement only where the target's board has determined that it is necessary to do so ***both*** (i) to comply with the director's fiduciary duties, ***and*** (ii) to accept a "Superior Proposal" (as defined in the merger agreement). Some fiduciary out provisions, however, permit the target company to terminate the merger agreement if the target company's board has changed or

[55] *See Orman*, 2004 Del. Ch. LEXIS 150, at **35-37.

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withdrawn its recommendation (where there is no limitation on that action – other than a good faith determination that a changed recommendation is necessary or appropriate).[56]

The decision to include or exclude a fiduciary out in a merger agreement is a significant one. Although the issue has never been squarely addressed by the Delaware courts, it is probable that the fiduciary duties of the target company's directors, which "continue" after the board's approval a merger agreement, will not excuse a breach of the merger agreement by the target company. Thus, even in circumstances where a target company's board should determine (after approving a merger agreement) that the proposed merger is not in the best interests of the stockholders, the target company may not have a common law right (as contrasted with any right specified by the provisions of the merger agreement) to terminate (*i.e.*, breach) the merger agreement.[57]

This is not meant to suggest that a court may not invalidate a merger agreement, or certain provisions thereof, based on a determination that it was a breach of fiduciary duty for the target company's board to agree to the merger agreement or certain terms thereof in the first instance – either because of (i) the circumstances surrounding such agreement, or (ii) the nature of the terms, themselves.[58] Where, however, a target company's board enters into a merger agreement in circumstances where doing so does

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56 A broad fiduciary out that permitted termination of the merger agreement upon a changed recommendation (without the presence of a Superior Proposal) was included in the merger agreement that was the subject of dispute in *Frontier Oil Co. v. Holly Corp.*, C.A. No. 20502, 2005 Del. Ch. LEXIS 57 (Del. Ch. Apr. 29, 2005).

57 *See*, *e.g.*, *Kontrabecki Group, Inc. v. Triad Park, LLC,* C.A. No. 16256, 1998 Del. Ch. LEXIS 246 (Del. Ch. Mar. 17, 1998) (restraining target company from terminating merger agreement in order to pursue an alternative acquisition proposal that did not amount to a "Superior Proposal" within the meaning of the merger agreement).

58 *See*, *e.g.*, *Omnicare*, 818 A.2d at 938-39; *Paramount Communications*, 637 A.2d at 50-51 (invalidating various deal protection devices based on determination that target company's board committed a breach of fiduciary duty in agreeing to them); *ACE Ltd.*, 747 A.2d at 109-10.

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not breach any fiduciary duties, and where the terms of the agreement do not otherwise violate any legal principles, it is difficult to imagine that the target company would have any "fiduciary justification" to terminate the merger agreement in the absence of an applicable contractual "fiduciary out" provision in the merger agreement. Indeed, in the absence of such a provision, a court might even award specific performance if the target company were to seek to avoid the merger agreement based on fiduciary principles.[59]

If it is the case that the "continuing" fiduciary duties of the target company's directors would not justify the termination of a merger agreement that does not contain an applicable fiduciary out provision, it might be argued that there is no circumstance in which the continuing fiduciary duties of the target company's directors would ever "require" that the directors terminate the agreement – even where the target company has negotiated for a "fiduciary out" provision in the merger agreement. If that were the case, however, the fiduciary out provision would be rendered meaningless – a result that is unlikely to be sustained by a reviewing court.[60]

In a sense, the inclusion of a "fiduciary out" provision in a merger agreement causes the agreement to be the functional equivalent of providing the target company with an option to sell the company, or a "put" (subject, of course, to any optionality that might be provided to the acquiror by the combination of "reverse termination fee" and "exclusive remedy provisions"). As such, including a fiduciary out provision in a merger agreement is the diametric opposite of including a "force the vote" provision. Inasmuch

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59 *See*, *e.g.*, *Kontrabecki Group*, 1998 Del. Ch. LEXIS 246 (granting injunctive relief functionally equivalent to specific performance).

60 *Accord Ace Ltd.*, 747 A.2d at 107 (reasoning that the acquioror's argument that the contractual exception to a disputed "no shop" / "no talk" covenant "provides no 'out' at all" would render the provision "meaningless, a result that as a matter of contract construction is disfavored").

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as Delaware law permits a target company to agree to a "force the vote" provision in a merger agreement, it would seem to follow that Delaware law does not require the inclusion of a "fiduciary out" that permits the target company to terminate the merger agreement in the event of a changed recommendation by the target company's board of directors.[61] If such a fiduciary-out were necessary, force-the-vote provisions would not have much value, as directors who decide that they can no longer recommend a merger would, in most cases, have reason to invoke the fiduciary-out, terminate the merger agreement, and thereby avoid a stockholder vote after all. Nonetheless, in situations where the target company has sufficient bargaining leverage to obtain a broad fiduciary out, the target company should seek to include such a provision in the merger agreement.

10. "Go Shop" Provisions

In the past few years, a small minority of merger agreements have contained "Go Shop" provisions, which authorize the target company to actively solicit competing acquisition proposals for a specified period of time.[62] By way of contrast with "deal protection" provisions, "Go Shop" provisions might be thought of as "deal enhancement" provisions.[63]

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[61] *See* William T. Allen, *supra*, note 21; Bruce L. Silverstein & John P. Paschetto, *supra,* note 22, at 23.

[62] *See*, *e.g.*, *Lear Corp.*, 926 A.2d 94 (Del. Ch. 2007) (45 day period); *Topps Co.*, 926 A.2d 58, 91 (Del. Ch. 2007) (40 day period).

[63] It is, of course, arguable that all provisions in a merger agreement are "deal enhancement" provisions inasmuch as there arguably would be no deal if the provisions were not agreeable to the acquiror. In this sense, all "deal protection" provisions enhance the chance of a deal being done. Nonetheless, for present purposes, the term "deal enhancement" is meant to refer to a provision in a merger agreement that facilitates the potential for a "Superior Proposal."

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The decision to include a "Go Shop" provision in a merger agreement is not readily susceptible to challenge, as the inclusion of such a provision can only result in a better deal for the stockholders. Nonetheless, there have been challenges to the efficacy of "Go Shop" provisions. In the *Topps* litigation, for example, the stockholder plaintiffs complained that "that time period [40 days] was too short and that the break-up fee and match right provided to [the acquiror] were, in combination, too bid-chilling."[64] This argument was rejected by the Court of Chancery under the facts of that case.[65]

C. Conclusion

With rare exception, there are no "black letter" rules that determine the validity or invalidity of provisions in merger agreements designed to govern the merger partners' respective rights and obligations during the interim between signing the merger agreement and stockholder approval. Both parties to a merger agreement should strive to avoid agreeing to contract provisions that prevent the target company's directors from complying with their ongoing fiduciary responsibilities. For the most part, judicial review of such contract provisions is highly contextual and will turn largely on the good faith of the directors who authorized the challenged provisions.

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64 *Topps Co.*, 926 A.2d at 82.

65 *Id.* at 84-87.