

# MERGERS & ACQUISITIONS



# RUTAN

## RUTAN & TUCKER, LLP

### Pitfalls of Delaware Corporate Law

by Marc Boiron, Associate, Rutan & Tucker, LLP

In order to create the invaluable certainty that Delaware corporate law provides to boards of directors and stockholders with respect to corporate governance and capital structure, the General Corporation Law of the State of Delaware (the "DGCL"), and court decisions interpreting the DGCL, provide strict technical requirements that a board of directors and stockholders must follow when seeking to take certain actions.

The strict technical requirements create many pitfalls for a business owner who has incorporated a business in Delaware and the board of directors of that business. These pitfalls generally remain unknown until litigation arises or due diligence on the corporation is performed in connection with an important transaction. The business owner and board of directors then may discover that certain actions taken were invalid, which could have the effect, for example, of voiding stock that a person believed he or she owned. The following pitfalls are some of the most common:

#### Written Consents of Stockholders

Unless the right is eliminated in the certificate of incorporation, stockholders have the right to take action by written consent instead of at a meeting of stockholders. Although the right to act by written consent promotes efficiency, if the written consent is not dated properly or does not include exhibits referred to in the consent, then the consent likely is invalid.

A written consent of stockholders often is drafted with a date at the top of the first page. The date is meant to represent the effective date of the written consent. However, a consent with only a date at the top of the first page is not valid under Delaware law. Each stockholder must separately date the consent, preferably by hand.

In addition, a written consent of stockholders often refers to forms of agreements or other documents being approved that are attached as exhibits. It is common practice for stockholders to execute the written consent without having the exhibits at the time of execution and to attach the exhibits afterwards. This practice does not comply with the requirements of Delaware law and will render the written consent invalid.

The DGCL, which requires that every written consent "bear the date of signature of each stockholder" who signs the consent and every consent be delivered to the corporation "within 60 days of the earliest dated consent," is the source of the technical requirement that written consents of stockholders be dated by hand. Although the DGCL does not specifically have a handwriting requirement, Delaware courts have questioned the validity of individual pre-printed dates on written consents.

Similarly, the DGCL requires that any action taken pursuant to a written consent of stockholders be set forth in the consent. The Delaware courts have concluded that where a written consent refers to an exhibit, the stockholder must have the exhibit to execute a valid consent.

Best practice suggests that stockholders of a Delaware corporation should follow closely the formalities required by Delaware law when executing a written consent by individually hand-dating the consent and being in possession of all exhibits referred to in the consent.

#### Stock Issuances

Issuing stock may be the most important action taken in a corporation's existence because ownership of stock (including the related economic benefits) generally is the reason for organizing a corporation. Delaware law requires strict adherence to certain formalities when issuing stock to ensure certainty in the corporation's capital structure. Nevertheless, shares of stock often are issued without consideration of the DGCL's formalities. It is common to see evidence of a stock issuance on an electronic capitalization table, which, at times, refers only to percentage ownership interests in, and not the number of shares owned of, the corporation.

The DGCL requires that the board of directors of a corporation authorize the issuance of stock. Delaware courts have interpreted this requirement to mean that a written instrument evidencing board approval is necessary to issue shares of stock. The failure to approve the stock issuance in writing renders the issued stock void. Evidence of stock ownership in the form of spreadsheets, accounting

statements or tax filings is insufficient to overcome the lack of board approval in a written instrument.

Best practices in connection with the issuance of shares of stock are to approve resolutions at a meeting of the board of directors or by written consent specifying the number of shares of stock being issued and the consideration being paid for the shares.

#### Amendment to Certificate of Incorporation

The most common substantive reasons for amending a corporation's certificate of incorporation are to permit a change to the corporation's capital structure or the stockholders' relative rights and preferences. In most cases, the amendment impacts a fundamental reason for owning shares of stock in the corporation. Notwithstanding the nature of an amendment to a corporation's certificate of incorporation, many boards of directors and stockholders do not consider the ramifications of a misstep in connection with the amendment. As a result, the DGCL's formalities get overlooked, which unnecessarily increases risk of expensive litigation down the road.

The DGCL requires that the board of directors adopt resolutions that state the proposed amendment to the certificate of incorporation, declare that the amendment is advisable and direct that the amendment be proposed to the stockholders. The stockholders then must determine whether to approve the proposed amendment. On numerous occasions, the Delaware courts have made clear that under no circumstance may a proposed amendment be approved only by stockholders or by stockholders before the board of directors adopts resolutions approving the amendment. Delaware courts will look past the effective date of the resolutions to determine the order in which the resolutions were approved or the consents signed by, for example, reviewing emails containing signature pages of both the board of directors' written consent and the stockholders' written consent. In addition, the stockholders must approve the exact language of the amendment to the certificate of incorporation that the board proposed. The failure to satisfy these strict requirements will result in an invalid amendment to the certificate of incorporation.

Best practice in connection with amending a certificate of incorporation is for the board of directors to adopt the proposed language and declare it advisable at a meeting or by written consent, and then for the stockholders to approve the exact proposed amendment at a meeting or by written consent.

#### Conclusion

The pitfalls discussed above appear innocuous but satisfying the technical requirements of Delaware corporate law is crucial to avoid creating unnecessary risk down the road. Recent amendments to the DGCL permit Delaware corporations to validate most corporate acts taken in violation of the DGCL (including any issuance of stock in excess of the number of authorized shares of stock, any election of directors and any other act that is permitted to be taken under the DGCL). However, the significant legal expenses, costs to file necessary documents with the Secretary of State of the State of Delaware, distraction from business operations, difficulty to reach former stockholders and risk of delaying an important transaction, make it highly undesirable to rely on these procedures. The better approach is to comply in the first instance with the technical requirements of the DGCL.

#### Marc Boiron

Marc Boiron is a member of the Firm's Corporate/Securities/Tax section, where he focuses his practice on transactional matters involving corporations, including mergers and acquisitions, corporate governance and corporate finance. Marc counsels public and private corporations, boards of directors, board committees, officers and stockholders on a wide variety of transactional issues. His practice also involves rendering legal opinions on corporate law issues. Marc can be reached at 714.338.1861 or [mboiron@rutan.com](mailto:mboiron@rutan.com).



# GUIDING CLIENTS TO SUCCESS



Representation of Performance Team Freight Systems, Inc. in connection with a recapitalization & financing with Comerica Bank



Represented Fontis Solutions in its acquisition by Safeguard Acquisitions, Inc.



Represented owner in connection with the acquisition of Sacramento Kings for \$550 million



Represented Shrimpman, Inc. in purchase of Certi-Fresh Foods



Represented the world's largest wholesale rental company in its \$119.1 million secured credit facility



Represented Overhill Farms, Inc. (NYSE MKT: OFI) in \$80.9 million sale to Bellisio Foods, Inc., and stockholder class action litigation challenging the sale



Represented buyer in acquisition of Rockford Corporation for approximately \$82.6 million



Represented Collider, LLC in its acquisition by Yum Brands



Represented Reaction Design, a leading developer of chemistry simulation software, in sale to ANSYS (Nasdaq: ANSS)



Represented agent in \$110 million senior secured loan to training and compliance business



Represented private equity group and its portfolio company in acquisition of Ascender



Represented PICS Auditing, LLC in equity investment by Norwest Venture Partners. Terms not disclosed



Represented DAQRI in connection with a \$15 million private equity commitment by Tarsadia Investments



Representation of Universal Turbine Parts, Inc. in connection with its sale to Goldner Hawn Johnson Morrison, a private equity group. Terms not disclosed



Represented DxTerity Diagnostics in connection with a credit facility from SWK Funding, LLC



Represented buyer in connection with acquisition of D.E.E.P. Oil and Gas Lease



Represented Health Essentials and 5 other affiliated companies in their recapitalization transaction involving SV Life Sciences and Bessemer Venture Partners



Represented sellers, including Riordan Lewis & Haden Equity Partners, in their sale of CyberCoders to On Assignment, Inc. (NYSE: ASGN) for \$105 million



Representation of Pacific Precision Products in connection with its sale to Zodiac US Corporation. Terms not disclosed



Represented buyer in connection with acquisition of TEG Oil & Gas U.S.A., Inc.



Represented private investment group in connection with equity raise and debt financing for acquisition of Aliso Creek Inn & Golf Course



Representation of Alignment Healthcare in connection with \$125 million in initial capital infusion from General Atlantic, a private equity group



Represented sellers in connection with sale of business to CIC Partners for approximately \$38.5 million



Representation of FMH Investors in connection with its sale to IGP Industries, Inc.

Rutan & Tucker, LLP has the knowledge and expertise to structure, negotiate and close all aspects of domestic and international mergers and acquisitions, financings and securities transactions. These are just a few of our recent notable transactions. We have experience covering a broad spectrum of industries and sectors, such as healthcare, education, software, construction, food and consumer products, aerospace, and oil and gas, among others. Whether you are a private business owner contemplating an exit or growth transaction, a private equity fund expanding or realizing on your portfolio, or a public company making strategic moves, we look forward to being your partner and trusted advisor in achieving your business objectives.

**RUTAN**  
RUTAN & TUCKER, LLP

611 Anton Boulevard, Suite 1400  
Costa Mesa, CA 92626 714.641.5100

3000 El Camino Real, Suite 200, Building 5  
Palo Alto, CA 94306 650.320.1500

[rutan.com](http://rutan.com)

# Snell & Wilmer

---

## LAW OFFICES

### What a Drag (-Along)!

#### *Dealing with minority owners in M&A deals*

by James J. Scheinkman, Partner, and Tak Sato, Associate, Snell & Wilmer

#### Why a Drag?

Many prospective sales of companies have foundered due to opposition by a minority of their owners. Minority shareholders may be able to disrupt a sale structured as a stock sale by refusing to tender their shares. In sales structured as mergers and in some circumstances asset sales, minority shareholders not voting in favor of the transaction can assert “appraisal rights” and invoke special appraisal proceedings which could result in a higher value paid to those owners than that provided for in the proposed transaction. The minority shareholders may also claim breach by the Board of Directors or the controlling owners of their fiduciary duties in effecting the transaction.

To address the risk of not being able to trigger a company sale at the time and on the terms of their choosing, controlling shareholders frequently insist that, well in advance of any transaction, all owners enter into a shareholders agreement which contains a so-called “drag-along” provision. A drag-along provision, which is sometimes referred to as the more benign-sounding “take-along” provision, typically allows controlling shareholders to require that all other shareholders vote in favor of and participate in a sale transaction approved by the controlling shareholders or by the Board of Directors. In fact, private equity and venture capital firms typically predicate their investment in a company on all shareholders having entered into an acceptable drag-along provision in a shareholders agreement.

#### Challenges to Enforcing a Drag

A decision this past February by the Delaware Chancery Court provides a helpful illustration of the challenges in enforcing a drag-along provision and the importance of both proper drafting and execution of a provision. In *Halpin v. Riverstone National, Inc.*, the Court refused to compel minority common stockholders to execute a written consent and accept a merger payment and thereby waive the minority’s appraisal rights. In *Halpin*, a 91% owner approved the merger, and the company closed the transaction. Only then did the company send minority shareholders a notice informing them of the transaction and invoking a drag-along right to compel the minority to consent to the transaction, thereby rendering them unable to assert appraisal rights. However, the drag-along provision relied upon provided only for the shareholders to vote in favor and participate in a *pending* transaction, not a *completed* transaction, and only after receiving *advance* notice, not *retrospective* notice, of the transaction.

In its decision, the Court noted that while Delaware courts have enforced contractual waivers of appraisal rights by *preferred* stockholders, Delaware courts have never ruled on whether waivers by *common* stockholders were enforceable, noting that common stockholders are entitled to greater fiduciary duty protections than preferred shareholders. The court also observed that the drag-along provision did not contain an express waiver of appraisal rights; instead, the parties had contracted for acts by the minority shareholders that would have the effect of waiving appraisal rights. It also noted that the remedy of specific performance to compel the minority to act is an extraordinary remedy imposing a high burden of proof on the controlling owner. Ultimately, the Court did not base its decision on the uncertainty in Delaware law concerning appraisal rights waivers by common shareholders; rather the Court determined that under the terms of the drag-along provision, the controlling shareholder was only entitled to rights exercised prospectively in advance of a pending merger, and the Court was unwilling to expand the provision to allow for retroactive exercise of rights.

#### Takeaway Pointers

When negotiating drag-along provisions, controlling shareholders should seek broad, flexible rights which anticipate, as much as possible, the prospect of different M&A deal structures and procedures. Such rights should include clear

and conspicuous waivers of appraisal rights and provisions applicable to both prospective and completed transactions and to actions to be taken either at a shareholder meeting or by written consent. Particularly given that companies may have different classes of stock and that in many M&A deals, there are often legitimate reasons for not treating all company shareholders the same, care should be taken to limit inflexible application of rules requiring the same deal terms to all owners. Also, given the high burden imposed to receive specific performance as a remedy, controlling owners may want to insist on “self-help” type remedies, such as voting proxies and powers of attorney to enforce the drag-along provisions. They may want to also consider organizing the company as a limited liability company rather than a corporation as in general with LLCs, there is more flexibility in limiting the application of fiduciary duties and other minority owner rights.

As the *Halpin* decision demonstrates, controlling owners must carefully follow the drag-along provisions when executing the transaction. Moreover, given the uncertainty at least in Delaware as to whether an advance waiver of appraisal rights against common shareholders is enforceable and judicial concern over fiduciary duties owed to common shareholders, care should be taken to be able to demonstrate that in the merger the Board and controlling shareholders appropriately took into account the interests of the minority owners.

Finally, acquirers should not blindly assume that controlling owners of the target company can force minority shareholders into a deal just because a drag-along right exists. An acquirer too should evaluate the drag-along provision and its use in the transaction and consider protective measures to ensure that the consequences of invalid use of a drag-along are not imposed on the acquirer. Such measures may include requiring as a condition of the merger the receipt of appraisal right waivers or deal approvals by a very high percentage of owners and indemnity and other provisions which place the risk of appraisal awards on the controlling shareholders rather than the acquirer.

#### James J. Scheinkman

James J. Scheinkman is a partner in the Orange County office of Snell & Wilmer and is a practice group leader of the firm’s Corporate & Securities Group. His practice regularly involves counseling companies involved in M&A transactions and representing companies and shareholders in shareholder disputes. Reach Jim at [jscheinkman@swlaw.com](mailto:jscheinkman@swlaw.com) or 714.427.7037.



#### Tak Sato

Tak Sato is an associate in the Los Angeles office of Snell & Wilmer and is a member of the firm’s Corporate & Securities Group. He regularly assists buyers and sellers in M&A transactions. Reach Tak at [tsato@swlaw.com](mailto:tsato@swlaw.com) or 213.929.2512.



Because no two clients  
are ever the same.™



Snell & Wilmer  
LAW OFFICES

Understanding  
what makes *you* unique.®

[www.swlaw.com](http://www.swlaw.com)

PLAZA TOWER | 600 ANTON BOULEVARD | SUITE 1400 | COSTA MESA, CA 92626

DENVER | LAS VEGAS | **LOS ANGELES** | LOS CABOS | **ORANGE COUNTY** | PHOENIX | RENO | SALT LAKE CITY | TUCSON



## The Crackdown on Private Equity Conflicts of Interest Regarding Fee and Expense Allocation

by Larry Cerutti, Managing Partner, and John McDonald, Partner, Troutman Sanders LLP

Private equity sponsors are coming under fire on multiple fronts from allegations of conflicts of interest, primarily focused on fee and expense allocation practices. For example, in June 2015, private equity sponsor Kohlberg, Kravis, Roberts & Co. (KKR) agreed to pay nearly \$30 million to settle SEC charges that it misallocated approximately \$17 million in broken-deal expenses to its flagship private equity funds (in which its LPs invested), rather than to co-invest vehicles through which KKR management members and other favored parties invested. A well-publicized June 2015 article in the *New York Times* entitled “When Private Equity Firms Give Retirees the Short End” alleged improprieties by private equity firms including private equity sponsors receiving discounts on attorneys’ and accountants’ fees for fund formation and other work performed for, and borne by, the sponsors and their affiliates, while attorneys’ and accountants’ fees for acquisition and divestiture work, which were borne by the funds’ LP investors, were billed at either “full freight” or “premium” rates. The allegations were based on disclosures in SEC filings made by private equity sponsors Carlyle Investment Management and the Blackstone Group.

Those actions came on the heels of a series of speeches by senior SEC officials in which those officials alleged improprieties by private equity sponsors relating to undisclosed and misallocated fees and expenses and warned that SEC enforcement actions would result from those improprieties. In May 2014, Andrew Bowden, who was then the Director of the SEC’s Office of Compliance Inspections and Examinations (OCIE), gave what has since become known as the “Sunshine Speech,” in which he noted that over 50% of OCIE compliance inspections of private equity sponsors identified violations of law or material weaknesses in controls, principally relating to collection of fees and allocation of expenses. Bowden expressed concern over (i) the use by private equity sponsors of affiliated “operating partners,” who provide advice to portfolio companies, but whose fees are not (in his view) adequately disclosed to LP investors or offset against the sponsor’s management fees, (ii) monitoring fees whose durations exceed the holding period of the portfolio company investment and accelerate upon sale of the portfolio company, and (iii) misleading statements made by sponsors in connection with their marketing and fundraising processes, including using interim valuations for portfolio companies calculated using methodologies that are different from those described in materials provided to LP investors, are “marked-up” from those used by the sponsors in their internal management processes, exclude the impact of fees assessed on internal rates of return, reflect “cherry picking” of comparables, improperly add-back items to EBITDA, or change from period to period (e.g., from trailing to forward) without disclosure of the change.

In May 2015, Marc Wyatt, the Acting Director of the OCIE, gave a speech further building on the Sunshine Speech, in which he noted that the OCIE had conducted inspections of more than 150 private equity sponsors which he said revealed numerous issues. Citing “expense shifting” and “hidden fees” as being among the most problematic of those issues, Wyatt asserted that private equity sponsors have “an affirmative duty to fully and fairly describe ‘the deal’ to investors, including discussing in a meaningful way how expenses will be assessed and fees will be collected.” Rebutting the assertion by some in the private equity industry that sophisticated LP investors were already aware of these expense allocation and fees assessment practices and did not have an issue with them, Wyatt observed that, since the Sunshine Speech, LP investors have increasingly focused on fee and expense issues. He further noted that private equity sponsors have already started to revise their practices in this area, which he viewed as a “positive change.”

So what can private equity sponsors do to help protect themselves from SEC compliance inspection deficiency assessments and the SEC enforcement actions that may follow? Fortunately, the SEC speeches described above provide a roadmap of some “good” practices that private equity sponsors can implement, and some “bad” practices that they can avoid, relating to conflict of interest issues.

On the “good practices to implement” side, private equity sponsors can do the following:

- ▶ Provide more robust disclosure of fee assessment and expense allocation

practices in the private placement memoranda for their funds.

- ▶ Empower their funds’ LP advisory committees by providing them with meaningful disclosure of important aspects of fund operations, including fee assessment and expense allocation practices.
- ▶ Retain an independent third party advisor to evaluate and provide recommendations concerning fee assessment and expense allocation practices between the fund and the sponsor.
- ▶ Devote increased resources to developing “world class” compliance operations, consistent with those of registered mutual funds, including splitting the Chief Compliance Officer function from the General Counsel and Chief Financial Officer functions.
- ▶ Provide clear disclosure in their funds’ private placement memoranda concerning payment by portfolio companies of fees to “operating partners” and consider including such fees within the scope of the management fee offset.
- ▶ Either clearly describe in their funds’ private placement memoranda how monitoring fees are calculated based on an assumed term of “x” years, which is accelerated upon sale of the portfolio company, or consider matching monitoring fee terms to the duration of the portfolio company investments.

On the “bad practices to avoid” side, private equity sponsors can do the following:

- ▶ Avoid allocations of broken-deal and other expenses that don’t result in the “main” fund and any co-investment vehicles bearing such expenses on a *pro rata* basis.
- ▶ Avoid billing practices with fund attorneys and accountants in which billing discounts (and premium billing arrangements) do not apply equally to expenses borne by the sponsor and its affiliates, on the one hand, and those borne by the fund’s LP investors (either directly or through portfolio companies), on the other hand.
- ▶ Either avoid non-*pro rata* allocation of co-investment opportunities among LP investors or clearly describe in their funds’ private placement memoranda how co-investment opportunities may be allocated to certain LP investors based on financial or non-financial criteria.

While these are not exhaustive lists, private equity sponsors that take the above actions can help avoid some of the more common mistakes that SEC compliance inspectors and enforcement attorneys may cite in assessing compliance deficiencies and commencing enforcement actions against their funds.

### Larry Cerutti

Larry Cerutti is the managing partner of the firm’s Orange County office, where he is a senior member of the firm’s corporate section. His practice focuses on mergers and acquisitions, public and private securities offerings, corporate governance, and related corporate and securities counseling. Larry can be reached at 949.622.2710 or [Larry.Cerutti@troutmansanders.com](mailto:Larry.Cerutti@troutmansanders.com).



### John McDonald

John McDonald is a partner in the firm’s New York office where he counsels clients on a full range of corporate transactional and general commercial matters. His practice focuses on private equity and strategic mergers and acquisitions transactions, venture capital and other financing transactions, and private equity fund formation. He can be reached at 212.704.6234 or [John.McDonald@troutmansanders.com](mailto:John.McDonald@troutmansanders.com).



# Proven Expertise in M&A

<p>\$1,910,000,000</p>  <p>Acquisition of Diamond Foods</p>	<p>\$150,000,000</p>  <p>Strategic Investment by Pamplona Capital Management</p>	<p>\$75,000,000</p>  <p>Acquisition of Albert Tire, LLC</p>	<p>\$146,000,000</p>  <p>Acquisition by POZEN, Inc.</p>
<p>\$175,000,000</p>  <p>Acquisition of Aventine Renewable Energy Holdings Inc.</p>	<p>Value Not Publicly Disclosed</p>  <p>Acquisition by FCR Media Group</p>	<p>\$77,000,000</p>  <p>Acquisition of 25% Undivided Ownership Interest in 585 MW Silverhawk Generating Station</p>	<p>\$10,000,000</p>  <p>Merger with Maple Power Capital Corporation</p>
<p>\$108,000,000</p>  <p>Acquisition by Newforest Limited</p>	<p>\$240,500,000</p>  <p>Merger with Palmetto Bancshares, Inc.</p>	<p>\$2,100,000,000</p>  <p>Acquisition of Pace plc</p>	<p>\$41,000,000</p>  <p>Acquisition of Okanagan Specialty Fruits Inc.</p>
<p>\$6,200,000,000</p>  <p>Acquisition of Rockwood Holdings</p>	<p>\$2,600,000,000</p>  <p>Merger with LIN Media LLC</p>	<p>Value Not Publicly Disclosed</p>  <p>Acquisition by B.I. Incorporated</p>	<p>\$135,000,000</p> <p>A-C Atlas Acquisition, LLC</p> <p>Acquisition of ActiveVideo Networks, Inc.</p>

**At Troutman Sanders every deal is important.** With a strong Orange County presence and recognized national expertise, our mergers & acquisitions lawyers are ready to assist clients in structuring, negotiating and implementing a wide variety of business transactions both domestically and internationally. We represent public and private companies and their separate business units, acquirers, targets, investors, venture funds, management buyout groups, private equity funds, lenders and equity participants. We serve clients ranging from Fortune 500 corporations, emerging growth and middle-market companies to investment banks, private equity funds and community banks.



## TROUTMAN SANDERS

Orange County Office • 5 Park Plaza, Suite 1400, Irvine, CA 92614 • Phone: 949.622.2700

[troutmansanders.com](http://troutmansanders.com)

ATLANTA BEIJING CHARLOTTE CHICAGO HONG KONG NEW YORK ORANGE COUNTY PORTLAND RALEIGH  
 RICHMOND SAN DIEGO SAN FRANCISCO SHANGHAI TYSONS CORNER VIRGINIA BEACH WASHINGTON, DC

# The Delaware Court of Chancery May Shake Up the “Sue-On-Every-Deal” Phenomenon

by Christopher H. McGrath, Howard M. Privette and Christopher R. Ramos

It is no secret that nearly every merger of any magnitude in the U.S. today will attract lawsuits by shareholders complaining about the deal. Public company transactions valued over \$100 million currently result in litigation nearly 95 percent of the time. These lawsuits typically seek to enjoin the proposed deal, alleging breaches of fiduciary duty on the part of the target company’s directors with respect to share price, the sales process and/or disclosures regarding the sale. Rather than risking an injunction, many targets seek to settle these cases quickly, often through disclosure-only settlements—where shareholders receive supplemental disclosures in proxy filings in exchange for dismissing the lawsuits and providing defendants with releases from liability. The shareholders’ lawyers also commonly collect fee awards. Cornerstone Research reports that in 2014 approximately 80 percent of merger lawsuits were resolved through disclosure-only settlements. Increasingly, however, these disclosure-only settlements are being criticized by the courts that are asked to approve them, most notably by the Delaware Court of Chancery.

The Delaware Court of Chancery’s mounting distaste for lawsuits on every merger and disclosure-only settlements was on full display on October 9, 2015, when Vice Chancellor J. Travis Laster not only rejected a proposed settlement in *In re Aruba Networks, Inc. Stockholder Litigation*, but dismissed the plaintiffs’ case altogether. The *Aruba* plaintiffs challenged Hewlett-Packard’s \$2.7 billion purchase of Aruba Networks alleging price inadequacy. Discovery failed to yield evidence of price inadequacy, but revealed that a proxy statement may have been inaccurate concerning the retention of certain Aruba Networks employees. The parties agreed to a settlement, including proposed attorneys’ fees of \$400,000. The Court rejected the settlement and fee award, expressing skepticism over whether plaintiffs had diligently investigated all potential claims within the scope of the proffered release. Vice Chancellor Laster further found the proposed class representative inadequate for having consented to the settlement.

Prior to *Aruba*, the Delaware Court of Chancery had found troubling the sometimes “intergalactic” breadth of releases granted to defendants in disclosure-



McGrath



Privette



Ramos

PAUL  
HASTINGS

only settlements. In July, Vice Chancellor Laster rebuffed another disclosure-only settlement in *Acevedo v. Aeroflex Holding Corporation*, noting that stockholders would receive only “therapeutic relief” as consideration for granting the defendant “protection against a vast universe of unknown unknowns.” In September, Chancellor Andre Bouchard questioned the breadth of releases in *In re Trulia, Inc. Stockholders Litigation*, ordering supplemental briefing on the subject. That same month, Vice Chancellor Samuel Glasscock was similarly critical of disclosure-only settlements in *In re Riverbed Technology Stockholder Litigation*, observing that plaintiffs generally have little actual stake in the outcome, and it is often in their counsels’ best financial interest to enter into a quick settlement for a modest fee. Defendants, on the other hand, have an interest in “purchasing” a broad release. In *Riverbed Technology*, the Court approved the settlement, in part because courts had previously approved such arrangements, but warned parties not to rely on such precedent going forward.

The Court of Chancery’s recent focus on the “sue on every deal” phenomenon may alter the *status quo*. How this exactly changes things, however, remains to be seen. For example, rather than refraining from suing on nearly every deal, plaintiffs’ counsel may elect to pursue such claims in non-Delaware forums in instances where issuers do not have Delaware forum selection clauses. Defendants in Delaware or elsewhere may choose to contest plaintiffs’ applications for expedited discovery. Or, defendants may move to dismiss in whole or in part, or simply choose to defend the action on the merits at a preliminary injunction hearing. Stockholders’ counsel may be forced to accept reduced fee awards, though this may also require defendants to accept more narrow releases. In all events, it appears that change is afoot in merger litigation.

Chris McGrath and Howard Privette are partners and Chris Ramos is an associate in the Costa Mesa office of Paul Hastings LLP, where they focus their practice on shareholder litigation, including litigation arising from mergers and acquisitions. For additional information, please call 714.668.6200 or visit [www.paulhastings.com](http://www.paulhastings.com).

## A RECOGNIZED LEADER IN CLIENT SERVICE EXCELLENCE

Paul Hastings ranked 1st on  
*The American Lawyer’s A-List*  
of the Most Successful Firms  
in the U.S. in 2014 and 2015

PAUL  
HASTINGS

Paul Hastings LLP | [www.paulhastings.com](http://www.paulhastings.com)



## A Seller's Market: Looking Past the Closing

by Jason Wisniewski, Dorsey & Whitney LLP

**S**tatistics from recently published deal studies suggest that a “seller’s market” has developed. This market is evidenced by an abundant supply of active buyers, increasing valuations and less onerous escrow and indemnity provisions. When negotiating indemnity provisions against this backdrop, legal counsel to sellers should ensure that hard won concessions from the buyer are not eviscerated by overly broad post-closing remedies for the buyer. Conversely, legal counsel to buyers should provide for adequate and clearly defined post-closing remedies to ensure full protection for any indemnifiable obligations that arise post-closing.

When negotiating indemnity and post-closing remedy provisions, buyers, sellers and their legal counsel should carefully address these common issues:

► **Defense and Settlement of Third-Party Claims.** Acquisition agreements frequently provide that buyers or sellers will have the right to defend third-party claims under certain circumstances. Buyers and sellers should address how to properly select appropriate legal counsel to defend those claims, regardless of which party controls the defense, to ensure not only that competent attorney are retained, but also that the legal fees to be incurred will be commensurate to the claim asserted. Additionally, many third-party claims will ultimately be settled out of court pursuant to a negotiated settlement agreement, and buyers and sellers should address to what extent payments made in settlement without the indemnifying party’s consent are evidence of actual damages incurred by the indemnified party. Finally, the agreement should provide for what happens to funds released from escrow to defend a third-party claim that is ultimately resolved in favor of the indemnifying party.

► **Damage Exclusions.** Damage exclusions are frequently the subject of intense negotiations between buyers and sellers, as buyers generally resist any type of limitation or exclusion on damages, and seller’s frequently want all damages other than those resulting from a direct breach of the acquisition agreement excluded (e.g., incidental or exemplary damages). Buyers should carefully review damage exclusions to ensure they do not impair the ability to recover for the potential liabilities resulting from the transaction, and the agreement should also clearly indicate what is specifically not excluded as well. Sellers should be careful to craft damage exclusion provisions that clearly limit damages to those negotiated by the parties.

► **Fraud.** Fraud is typically an unconditional exception to any negotiated limits on liability, and many acquisition agreements simply rely on the concept of common law fraud as an exception. Buyers and sellers should consider whose fraud is subject to indemnification, the remedies of the buyer if fraud is committed by someone other than the seller or certain named individual representatives of the seller, the level of knowledge and intent on the part of a party necessary to constitute fraud and whether or not the buyer was required to rely upon the fraudulent action.

Indemnification provisions with respect to acquisition agreements are extensive, and the issues discussed above are only a few of the many issues that are typically negotiated. Buyers and sellers must retain experienced legal counsel that can ensure their respective interests are effectively protected.

### Jason Wisniewski

Jason Wisniewski is a partner in Dorsey & Whitney’s Corporate Group and concentrates his practice in corporate transactional work. He focuses on private equity, mergers and acquisitions, venture capital, the public and private placement of securities and SEC compliance. Jason’s clients are privately held high growth, technology, life sciences and manufacturing companies located in Southern California and Silicon Valley. Contact him at 714.800.1456 or [wisniewski.jason@dorsey.com](mailto:wisniewski.jason@dorsey.com).



# in litigation, efficiency matters

Beginning with the end in mind  
results in savings.

Dorsey’s trial law DNA leads to more efficient strategy, process and litigation execution. One third of our lawyers are litigators with deep courtroom experience. US News ranks us as a Tier 1 national firm for commercial litigation. We focus on resolving litigation quickly, through dispositive motions or dispute resolution outside the courtroom. We only try cases and argue appeals for clients whose disputes cannot be sensibly resolved in a more expedited way. We’ve made the case for efficiency with our [LegalMine™](#) division, which has pioneered the use of technology-assisted document reviews to reduce review time and budgets.



[dorsey.com](http://dorsey.com)