FROM THE CHAIR
By Nat Doliner

It’s time to mark your calendars for the next stand-alone meeting of our Committee, which will be held at the Vogue (Loews) in Montreal on September 22-23, 2000. The stand-alone meeting will be earlier this year because the ABA annual meeting is earlier than usual this year and because weather in Montreal is better in September. You will receive more details about this meeting in the coming months. We are planning our 2001 stand-alone meeting, which will be held in Paris in October, 2001.

Our Committee members enjoyed a great stand-alone meeting and weekend in Scottsdale, Arizona last October. The attendance was one of the highest, if not the highest, that we have ever had at a stand-alone meeting. Our stand-alone meetings provide a great opportunity for Committee members to spend a weekend obtaining great continuing legal education in the mergers and acquisitions field, participating in stimulating discussions and enjoying a lot of wonderful social activities. If you are not already an active participant on the Committee, we invite you to become one.

Our thanks to Samuel P. Gunther (New York, New York) for a great presentation in Scottsdale on accounting aspects of mergers and acquisitions.
Cheryl Walker (St. Louis, Missouri) has joined our Committee as a Business Law Section Fellow. There are a number of lawyers, who have previously participated in the Young Lawyers Division, who are being sponsored as “Fellows” on various Committees in the Business Law Section. The intent is to provide better entrees for younger lawyers into the Business Law Section. We welcome Cheryl as a member. The Committee is a great place for lawyers of various levels of experience to obtain a great education in the finer points of mergers and acquisitions.

We launched two great new projects in Scottsdale. The Task Force on the Model Stock Purchase Agreement chaired by Robert Harper (Pittsburgh) held its inaugural meeting to discuss the updating of the Model Stock Purchase Agreement and the preparation of a seller’s response document. We also launched a new Task Force on Acquisition Procedure chaired by Tom Thompson (Pittsburgh) that will produce a manual which will complement and supplement our other works such as the Model Stock Purchase Agreement and the Model Asset Purchase Agreement. The manual will contain chapters on such topics as the initial meeting between the client and acquisition counsel, conflicts of interest, valuation, purchase price formulations, managing the due diligence process, and other procedural aspects of an acquisition transaction. The Task Force will hold its initial meeting at the Business Law Section Spring Meeting in Columbus.

At the Business Law Section Spring Meeting in Columbus, our Committee and Task Force Meetings are scheduled as follows:

**Task Force on Public Companies**
Friday, March 24, 9:30 a.m. – 12:30 p.m.

**Task Force on Joint Venture Agreements**
Friday, March 24, 9:00 a.m. – 1:00 p.m.

**Task Force on Stock Purchase Agreement**
Friday, March 24, 9:00 a.m. – 12:00 noon

**Full Committee Meeting**
Friday, March 24, 2:30 – 4:30 p.m., including a Committee Forum from 3:00 – 4:30 p.m. on “Current Developments in Delaware Law with Significant Implications for M & A Practitioners.” Leading Delaware lawyers will discuss recent Delaware Chancery Court rulings relating to “fiduciary outs” and other recent developments in Delaware corporate law.

Chaired by Keith A. Flaum (Palo Alto)
Moderator:
   Mark A. Morton (Wilmington, DE)
Panelists:
   Frederick H. Alexander (Wilmington, DE)
   John F. Grossbauer (Wilmington, DE)
   C. Stephen Bigler (Wilmington, DE)
   Michael A. Pittenger (Wilmington, DE)

**Task Force on Acquisition Procedures**
Saturday, March 25, 8:00 – 9:00 a.m.

**Task Force on International Acquisitions**
Saturday, March 25, 8:00 – 11:00 a.m.

**Working Group on Ancillary Documents of the Task Force on Asset Acquisitions**
Saturday, March 25, 8:30 – 11:30 a.m.

**Working Group on Editorial of the Task Force on Asset Acquisitions**
Saturday, March 25, 9:00 a.m. – 5:00 p.m.

**Program: Opinions in Merger and Acquisition Transactions**
Saturday, March 25, 10:30 a.m. – 12:30 p.m.

This panel of transactional lawyers who have been involved in the development of third-party legal opinion practice will negotiate in real time from buyer’s original unreasonable request the form of the opinion to be delivered by seller’s counsel in an asset acquisition transaction.
Chaired by Donald I. N. McKenzie (Nashville, TN)

Panelists:
Thomas L. Ambro (Wilmington, DE)
E. Carolan Berkley (Philadelphia, PA)
John Cook (Columbus, OH)
Joel I. Greenberg (New York, NY)
Thomas N. Thompson (Pittsburgh, PA)

Working Group on Editorial of the Task Force on Joint Venture Agreements
Saturday, March 25, 2:00 – 5:00 p.m.

The Continuing Saga of Nonprofit Health Care Mergers and Acquisitions
Presented by Nonprofit Corporations, Health Law, and Negotiated Acquisitions Committee
Co-chaired by Lynn A. Howell and Nathaniel L. Doliner
Thursday, March 23, 1:30 – 2:30 p.m.

FEATURE ARTICLES

Recent Delaware Law Developments Concerning No-Talk Provisions – From “Just Say No” to “Can’t Say Yes”? by
Mark A. Morton
Michael A. Pittenger
and
Matthew E. Fischer

Summary: Three recent Delaware Court of Chancery rulings, Phelps Dodge v. Cyprus/Asarco, ACE Ltd. v. Capital Re and In re IXC Comms., Inc., represent the Court’s first efforts to address the validity of “no-talk” provisions in merger agreements. In our view, those cases suggest that the Delaware courts will be critical of such provisions – whether in the context of a strategic, stock for stock merger or in the cash out merger context – if a third party presents a potentially more favorable alternative proposal and the “no-talk” handicaps the board’s efforts to entertain, consider and respond to that proposal.

As fiduciary duty law in the merger and acquisition context evolved over the past decade, conventional wisdom held that a disinterested, independent board of directors had “the prerogative … to resist a third party’s unsolicited acquisition proposal or offer” in favor of a transaction negotiated by the board that did not involve a change of control.2 A trilogy of recent decisions of the Court of Chancery, however, has reinvigorated debate over the extent to which directors, consistent with their fiduciary duties, may effectively foreclose themselves from considering a future, potentially more favorable proposal by contractually committing to protect and “lock up” an existing strategic merger. Thus, while the existing case law makes clear that in appropriate circumstances a target board may “just say no” to a hostile bidder,3 the recent cases seem to suggest that the same target board “can’t say

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1 Mark A. Morton is a partner and Michael A. Pittenger and Matthew E. Fischer are associates with the law firm of Potter Anderson & Corroon LLP. The views and opinions expressed herein are those of the authors and do not necessarily represent those of Potter Anderson & Corroon LLP or its clients.


yes” (at least not unequivocally) to a preferred strategic partner, except in extraordinary circumstances.

**Phelps Dodge Corp. v. Cyprus Minerals Co./Asarco Inc.**

The first decision, *Phelps Dodge Corp. v. Cyprus Minerals Co./Asarco Inc.* (“*Phelps Dodge*”), addressed a hostile suitor’s challenges to a so-called “no-talk” provision and a 6.3% termination fee. Although a bench ruling – and one in which the Court ultimately declined to enjoin the challenged transaction – the Chancellor’s comments regarding the “no-talk” provision have called into question the validity of such provisions. In addition, the Chancellor’s observations regarding the termination fee have been interpreted as strong cautionary words against an over-aggressive approach to such fees.

Pursuant to the merger agreement, Cyprus Minerals and Asarco agreed that (i) the agreement would not include either a “fiduciary” or “superior offer” out allowing either company to terminate the agreement for a superior proposal, (ii) neither party would be permitted to negotiate with, or furnish information to, another bidder even though that bidder’s proposal may be superior, (iii) the board of each company was permitted to withdraw its recommendation of the merger only if it determined, in good faith, based upon the advice of outside counsel, that a failure to do so would constitute a breach of the board’s fiduciary duties. Finally, pursuant to Section 251(c) of the Delaware General Corporation Law, the board of each company also agreed to submit the proposed merger to a stockholder vote even if the board later withdrew its recommendation of the merger.

Shortly after the announcement of the strategic Cyprus Minerals/Asarco merger, Phelps Dodge made an offer to acquire all of the shares of either or both of Cyprus and Asarco at an approximately 25% premium. However, under the terms of the merger agreement’s “no-talk” provision, Cyprus and Asarco maintained they were prohibited from discussing, or responding to, Phelps Dodge’s proposal. In response, Phelps Dodge increased its offer and sued both companies.

Phelps Dodge argued that the directors of both companies had acted without due care when they failed to comprehend that the “no-talk” provision would preclude them from considering even superior proposals. Phelps Dodge further asserted that the directors’ ability to withdraw their recommendation of the merger if their fiduciary duties so required was rendered meaningless because the directors effectively had precluded themselves from obtaining information necessary to make such a decision on a fully informed basis. The directors responded by reminding the court that under *Paramount Communications, Inc. v. Time*, they had no obligation to consider superior proposals and therefore could not have contracted away any fiduciary duties.

In an oral ruling, the court seized the opportunity to express strong doubts as to the

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5Typically, “no-shop” clauses prevent a target company from shopping the existing deal (or soliciting a new deal) but permit the board to furnish certain information in the event a third party bidder makes a qualifying bid (some agreements simply require an acquisition proposal, while other agreements require a superior proposal or a proposal reasonably likely to lead to a superior proposal). In *Phelps Dodge*, however, the Merger Agreement prevented both Asarco and Cyprus (and their directors, officers, employees and representatives) from participating in any negotiations regarding any alternative acquisition proposal – even if that proposal was demonstrably superior to the original merger. In addition, the parties were not permitted to terminate the merger agreement in favor of a superior proposal.

6571 A.2d 1140 (Del. 1990).
validity of the “no-talk” and termination fee provisions of the merger agreement. While acknowledging that the directors had no duty to negotiate with other bidders in connection with a strategic merger, the court noted that the decision not to negotiate still must be an informed one. The court distinguished Paramount v. Time as a case in which the decision not to negotiate “was not claimed to be an uninformed one. That is, Time’s board had not ex ante bargained away its right to even become informed about whether or not to negotiate.” The court went on to observe:

Now, here, despite the presence of publicly exchanged information, the no-talk provision has apparently prevented either Cyprus or Asarco from engaging in nonpublic dialogue with Phelps Dodge. Now, this should not be understood to suggest that Cyprus or Asarco were legally required to or even should have negotiated, privately or otherwise, with Phelps Dodge. It is to say, rather, that they simply should not have completely foreclosed the opportunity to do so, as this is the legal equivalent of willful blindness, a blindness that may constitute a breach of a board’s duty of care; that is, the duty to take care to be informed of all material information reasonably available.\footnote{Id., Tr. at 4-5.}

Finally, although the court declined to address Phelps Dodge’s claim that the termination fee was unduly coercive, the court did note that a “6.3 percent [termination fee] certainly seems to stretch the definition of range of reasonableness and probably stretches the definition beyond its breaking point.”\footnote{Id., Tr. at 5.} In the end, however, the court refused to enjoin the merger because it was unconvinced that irreparable injury would result if the injunction were not granted.

**ACE Limited v. Capital Re Corp.**

Hard on the heels of the Phelps Dodge decision came the Court of Chancery’s far more expansive opinion in **ACE Limited v. Capital Re Corp.**\footnote{Phelps Dodge Corp. v. Cyprus Minerals Co./Asarco Inc, C.A. No. 17398, Chandler, C. (Del. Ch. Sept. 27, 1999) (Bench ruling), Tr. at 4.} The case involved a stock-for-stock merger agreement between ACE and Cap Re that included a “no-talk” provision that prohibited Cap Re from participating in third party discussions or negotiations unless the Cap Re board concluded in good faith, based on written legal advice, that not participating in such discussions was a breach of fiduciary duty.\footnote{By contrast, in Phelps Dodge, the Cyprus/Asarco merger agreement did not include a similar “fiduciary out” to the “no talk” clause.} At the time the parties executed the merger agreement, ACE, which itself held 12.3% of Cap Re’s outstanding stock, also had negotiated voting agreements with stockholders owning, in the aggregate, 33.5% of Cap Re’s outstanding shares. Those agreements obligated the Cap Re stockholders to support the merger “if the Capital Re board of directors did not terminate the Merger Agreement in accordance with its provisions.”\footnote{ACE Ltd. v. Capital Re Corp., C.A. No. 17488, Strine, V.C. (Del. Ch. Oct. 25, 1999), mem. op. at 3 (emphasis in original).} Thus, so long as the Cap Re board did not terminate the agreement, ACE was assured that the holders of approximately 46% of Cap Re’s outstanding stock would vote for the merger. That fact led the court to conclude that stockholder approval of the merger was a “virtual certainty.”

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\(\text{Phelps Dodge Corp. v. Cyprus Minerals Co./Asarco Inc, C.A. No. 17398, Chandler, C. (Del. Ch. Sept. 27, 1999) (Bench ruling), Tr. at 4.}\)

\(\text{Id., Tr. at 4-5.}\)
Following announcement of the merger, the price of ACE’s stock dropped precipitously. Nonetheless, absent termination of the agreement by Cap Re’s board, stockholder approval of the transaction was almost certain due to the voting agreements. After the price drop, Cap Re received an all-cash bid from XL Capital Ltd. that exceeded the value of the ACE transaction. Cap Re’s board convened an emergency meeting, at which the company’s counsel provided written advice that entering into discussions with XL was “consistent with” - as opposed to “required by” - the board’s fiduciary duties. After considering the advice, the Cap Re board determined to speak with XL, which thereafter raised its bid. The Cap Re board then determined that the XL bid was superior to the ACE merger and advised ACE that it intended to terminate the merger agreement unless ACE matched or topped XL’s offer. Although maintaining that Cap Re was not permitted to terminate the Agreement, ACE responded with a higher offer. XL promptly raised its bid again and Cap Re again advised ACE of its intention to terminate the merger agreement unless ACE submitted a higher bid.

Rather than raising its offer, ACE sued seeking to enjoin Cap Re from terminating the agreement. ACE’s primary argument was that Cap Re was prohibited in the first instance from entering into discussions with XL unless the directors received written advice from counsel stating that their fiduciary duties “required” discussions with XL. Because Cap Re’s board did not receive such written advice, ACE asserted that Cap Re had breached the agreement by entering into discussions with XL.

The court ruled that the actions of the Cap Re board did not constitute a breach of the merger agreement. The most reasonable interpretation of the merger agreement, according to the court, left it up to the directors to decide, in “good faith,” whether their fiduciary duties required them to enter discussions with XL. The court then explored the consequences of adopting ACE’s interpretation of the merger agreement. ACE contended that it had bargained for language prohibiting Cap Re’s board from entering into any discussions with other bidders unless the board was advised by counsel in writing that it was required to do so. The court recognized that the agreement was potentially susceptible to that interpretation but concluded that such a reading would likely render the “no-talk” provision invalid.

In so concluding, the court picked up where Phelps Dodge had left off and expressed strong doubts about the validity of “no-talk” clauses, but at the same time seemingly reaffirming the proper purpose often served by more traditional forms of “no-shop” clauses:

It is one thing for a board of directors to agree not to play footsie with other potential bidders or to stir up an auction. That type of restriction is perfectly understandable, if not necessary, if good faith business transactions are to be encouraged. It is quite another thing for a board of directors to enter into a merger agreement that precludes the board from considering any other offers unless a lawyer is willing to sign an opinion indicating that his client board is “required” to consider that offer in the less than precise corporate law context of a merger agreement that does not implicate Revlon but may preclude other transactions in a manner that raises eyebrows under Unocal. Such a contractual commitment is particularly suspect when a failure to consider other offers guarantees the consummation of the original transaction, however more valuable an alternative transaction may

\[13\]See id., mem. op. at 4.
be and however less valuable the original transaction may have become since the merger agreement was signed.\textsuperscript{14}

According to the court, a board’s decision to approve a “no-talk” provision in such circumstances would involve “an abdication by the board of its duty to determine what its own fiduciary obligations require at precisely the time in the life of the company when the board’s own judgment is most important.”\textsuperscript{15} The court held that “where the board is making a critical decision affecting stockholder ownership and voting rights, it is especially important that it negotiate with care and retain sufficient flexibility to ensure that the stockholders are not unfairly coerced into accepting a less than optimal exchange for their shares.”\textsuperscript{16}

The court ultimately denied ACE’s motion seeking to enjoin Cap Re from terminating the agreement, based predominantly on its finding that ACE was unlikely to succeed on the merits.

\textit{In re IXC Communications, Inc.}

\textsuperscript{14}Id., mem. op at 25-26.

\textsuperscript{15}Id., mem. op at 26. The court recognized that there may exist “limited circumstances” in which a board “could prudently place itself in the position of not being able to entertain and consider a superior proposal to a transaction dependent on a stockholder vote.” Id., mem. op. at 27. One such circumstance, the court surmised, might arise if a board has actively canvassed the market, negotiated with several bidders in a competitive environment, and believes that the “no-talk” provision is necessary to close the deal – facts that were not present in the case before the court. Id., mem. op. at 27 n.36.

\textsuperscript{16}Id., mem. op. at 31-32.

The third of the recent trilogy of Delaware Court of Chancery decisions to consider the propriety of “no-talk” provisions in the context of strategic mergers is \textit{In re IXC Communications, Inc.}\textsuperscript{17} which was decided two days after \textit{ACE Limited}. In \textit{IXC}, the plaintiff stockholders sought to preliminarily enjoin the pending stockholder vote on a proposed merger of IXC with Cincinnati Bell, Inc., (“CBI”), as well as the enforcement of certain provisions of the merger agreement. In rejecting plaintiffs’ application, Vice Chancellor Steele appears to have viewed the use of “no-talk” provisions in the strategic merger context more positively than Chancellor Chandler did in \textit{Phelps Dodge} and Vice Chancellor Strine did in \textit{ACE Limited}. Indeed, Vice Chancellor Steele stated that such provisions “are common in merger agreements and do not imply some automatic breach of fiduciary duty.”\textsuperscript{18}

After contacting various parties, IXC agreed to merge with CBI in a stock-for-stock merger pursuant to which IXC’s stockholders would receive 2 shares of CBI and CBI would be the surviving entity. In connection with the merger, IXC gave CBI the right, under certain circumstances, to purchase 19.9% of IXC’s stock and agreed to include certain no-talk and termination provisions in the merger agreement. CBI also negotiated a side deal with General Electric Pension Trust (“GEPT”), IXC’s largest stockholder. CBI agreed to purchase half of GEPT’s IXC holdings for $50 per share and GEPT agreed to vote its remaining shares in favor of the merger.

Plaintiffs contended that the IXC Board breached its duty of care by, \textit{inter alia}, driving away all suitors other than CBI and agreeing to no-talk and termination fee provisions and stock

\textsuperscript{17}C.A. No. 17334, Steele V.C. (Del. Ch. Oct. 27 1999).

\textsuperscript{18}In re IXC Communications, Inc., C.A. No. 17334, Steele, V.C. (Del. Ch. Oct. 27, 1999), mem. op at 14.
option agreements. Plaintiffs also asserted that the Board breached its duty of loyalty by facilitating CBI’s side deal with GEPT, which plaintiffs claimed constituted an illegal vote-buying arrangement.

Seizing on Chancellor Chandler’s criticism of “no-talk” provisions in Phelps Dodge, plaintiffs also argued that the board’s approval of the “no-talk” provision in the IXC-CBI merger agreement (which prior to the Court’s consideration had been amended by the parties to permit IXC to consider “superior proposals”) evidenced a pattern of “willful blindness” by the directors in violation of their duty of care.19 The court rejected that contention:

[T]he assertion that the board “willfully blinded” itself by approving the now defunct “no-talk” provision in the Merger Agreement is unpersuasive, particularly considering how late in the process this provision came. Provisions such as these are common in merger agreements and do not imply some automatic breach of fiduciary duty.20

To the contrary, the Court observed, it was “comfortable concluding that the IXC board met its duty of care” where six months had passed between the board’s announcement that it had hired an investment banker, where the record reflected no third party interest in the company during the three months before the announcement of the IXC/CBI merger and where the merger agreement included a “fiduciary out” that allowed the board to consider a superior proposal. For these reasons, the Court concluded that plaintiffs had not demonstrated a reasonable likelihood of success on their claims for breaches of the duties of care and loyalty.

As to plaintiffs’ claim that the CBI-GEPT side agreement constituted an illegal vote-buying scheme, the Court noted that under Schreiber v. Carney,21 vote-buying arrangements are not illegal per se. Rather, such arrangements are only illegal if they defraud or disenfranchise other stockholders. Plaintiffs, however, did not contend that the GEPT deal defrauded other stockholders. They argued only that knowledge of the total number of outstanding shares committed to vote for the merger would cause the remaining holders of IXC’s stock to believe that their vote would be meaningless. The court noted that the facts of the case made that conclusion “illogical” because the holders of a majority of IXC’s stock were still in a position to avoid the allegedly onerous effect of the vote-buying transaction by voting against the merger.

Finally, with respect to plaintiffs’ challenges to the termination fee and stock options, the court noted that it was nearly impossible to evaluate those provisions independently of the merger agreement because the fees were “likely part of a careful balance of consideration from each side and the result of a give and take process.”22 The court held that enhanced judicial scrutiny was not applicable because the termination fee, the stock option agreement, and the non-solicitation provisions were not “defensive mechanisms instituted to respond to a perceived threat to a potential acquiror.”23 Thus, the court concluded that “[i]n the absence of a showing of disloyalty or lack of care in agreeing to the termination fee

19Id.

20Id., mem. op. at 14.

21447 A.2d 17 (Del. Ch. 1982).

22In re IXC, mem. op. at 22.

23Id., mem. op. at 23. This holding contrasts with the view express by Vice Chancellor Strine in ACE Limited to the effect that similar provisions of the Capital Re-ACE merger agreement implicated some of the policy concerns underlying the Unocal standard of review. See ACE Limited, mem. op. at 30-31.
those provisions are reviewable as business judgments and are, thus, granted deference.”24

**Conclusions**

In some respects, the Court’s decisions in *Phelps Dodge*, *Ace* and *IXC* may appear difficult to reconcile.25 Over time, of course, the development of a body of jurisprudence in this area will, in all likelihood, resolve many of the current ambiguities and seeming inconsistencies. In advance of that clarification, however, some preliminary conclusions still seem appropriate:

**Caveat Emptor** - The recent decisions in this area suggest that the Court has concluded that certain deal protection measures may be inherently suspect.26 Certainly, the Court’s position on these issues is still evolving27 and, pending definitive guidance from the Delaware courts, buyer’s counsel would be wise to exercise some restraint when negotiating certain deal protections. Otherwise, the buyer may risk having carefully negotiated provisions invalidated by a court that concludes the provisions have too tightly tied the hands of the target board. As the Court in *Ace* observed, if a “superior proposal out [is]... to mean anything, the board must be free to explore such a proposal in good faith.” If the provision “comes close to self-disablement by the board,” the court is likely to “take[] a dim view of the restrictions that tend to produce such a result.”28

Put another way, if the parties agree that it is appropriate for the target to have a “superior offer out” or a “fiduciary out” with respect to either termination of the merger agreement or changing the target board’s recommendation, then certain types of provisions that may tend to impair the target board’s ability to utilize such an “out” could be viewed as rendering the “out” illusory.29

24*In re IXC*, mem. op. at 23.

25For example, it may be difficult to reconcile the Court’s statement in *IXC* that “[n]either the termination fee, the stock option agreements nor the no-solicitation provisions are defensive mechanisms instituted to respond to a perceived threat to a potential acquiror” with the Court’s suggestion in *Ace* that a “no-talk” provision, coupled with stockholder agreements that locked up the support of a significant block of stock, might implicate “some of the policy concerns that animate the *Unocal* standard of review.”

26In this regard, it is worth noting that in its decisions in both *Phelps Dodge* and *Ace*, the Court offered a more expansive examination of the issues than the legal question at issue demanded. In *Phelps Dodge*, for example, the Court’s finding that there was no irreparable harm would have allowed the Court to avoid any discussion of the merits of the “no-talk” provision at issue in that case. The Court instead elected to criticize (rather harshly) both the “no-talk” provision and the size of the termination fee. Similarly, in *Ace*, although the Court could have confined its discussion to a rather narrow legal question, the Court engaged in an extensive discussion regarding the appropriateness of certain deal protection mechanisms in a non-change of control context and the extent to which such deal protections may preclude the consideration – by either the board or the stockholders – of a superior proposal.

27In a recent presentation to members of the Task Force on Public Companies, the Chancellor of the Court of Chancery observed that the Court’s jurisprudence does not evolve in a vacuum; rather, the Court remains keenly aware of the corporate bar’s reaction to the Court’s actions. That observation offers an interesting insight into the recent decisions discussed herein. One wonders whether the decisions are a response to prior “reactions” of the bar (i.e. increasingly tighter lock ups), an invitation for a reaction of the bar moving forward (do the cases clarify or confuse the law?), or both.

28*Ace*, mem. op. at 28.

29The most evident examples include “no talk” provisions similar to the one addressed in *Phelps Dodge*. One can imagine, however, situations in which a Delaware court might hold to be unenforceable other types of provisions typically found in “no-shop” clauses, including provisions requiring prior notice to the buyer before entering into discussions or providing information to a third party and provisions requiring that a third party sign a confidentiality agreement before the target provides any non-public information. Even seemingly innocuous procedural provisions such as those could, in some circumstances, sufficiently impair a target board’s ability to inform itself...


**Hindsight is 20/20 Vision** - It is probably not coincidental that the Court of Chancery elected to express significant reservations about “no-talk” provisions in the Phelps Dodge and Ace decisions, both of which involved a third party bidder with an arguably superior proposal, while it adopted a more forgiving tone when considering the appropriateness of a “no-talk” provision, stock option agreements and termination fees in IXC, a case in which no third party bidder had appeared on the scene. Just as the most careful driver cannot predict all that may lurk around the next bend, even a diligent, seemingly well-informed board that has considered a host of alternatives may fail to appreciate all of the possible and reasonably available opportunities for the corporation. Experience informs us that it is all too common for such opportunities to come to light only after a board announces a strategic transaction. The Court’s decisions in both Ace and IXC expressly recognize that there are at least limited circumstances in which a board may agree to a “no-talk” provision that would preclude the board from considering a more favorable proposal. Nonetheless, it may be extremely difficult (although not necessarily impossible) for a board to explain the wisdom of a “no-talk” provision if post-execution developments reveal the existence of a superior proposal that had not surfaced at the time the agreement was signed. In view of the inherent limitations associated with “no-talk” provisions and the Court’s criticisms in Phelps Dodge and Ace, one may reasonably ask when, if ever, a target board’s decision to accept a “no-talk” provision (either without meaningful “fiduciary outs” or when coupled with significant lock-up agreements) will prove, in hindsight, to have been a wise decision.30

**An Informed Decision?** – In Phelps Dodge, the Court observed that “no-talk” provisions are “troubling precisely because they prevent the board from meeting its duty to make an informed judgment with respect to even considering whether to negotiate with a third party.” However, the Court’s statement, to some extent, begs the question. Under the terms of the Cyprus/Asarco merger agreement, neither board was permitted to terminate the agreement in favor of a superior proposal, but the boards were permitted to change or withdraw their recommendation of the merger (as permitted by the 1998 amendment to Section 251(c) of the DGCL). Thus, the boards’ ex ante decisions not to communicate or negotiate necessarily prevented each board from reaching an informed decision with respect to whether to continue to recommend the Cyprus/Asarco merger. While the transcript of the Court’s oral ruling does not expressly address this point (perhaps a result of the nature of the decision – an oral ruling in expedited litigation), it is clear from Phelps Dodge’s complaint and briefs that the issue was argued to the Court.31 For example, Phelps Dodge’s complaint stated:

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30The Court’s strongest criticism was, of course, reserved for the “no-talk” provision in Phelps Dodge, which provision failed to include any “fiduciary outs.” The Court also offered, however, significant criticism of the proffered narrow reading of the “no-talk” provision at issue in Ace. In Ace, while the “no-shop” included a “fiduciary out” to the prohibition against discussions, negotiations and providing information and a “fiduciary out” that permitted the board to terminate for a “Superior Proposal,” the plaintiff argued that the “fiduciary out” should be read narrowly to rendered it inapplicable unless legal counsel opined that the board was required to consider another proposal. The proffered narrow reading, coupled with stockholder agreements that locked up nearly a statistical majority of the stockholder vote, was enough to prompt the Court’s criticism of the provision.

31See, e.g., Plaintiff’s Opening Brief in Support of Their Motion for Preliminary Injunction filed September 21, 1999, C. A. No. 17398, at 41-42 (Dkt. 34).
[W]hile the Merger Agreement makes the gracious concession of supposedly permitting the directors to change or withdraw their recommendation of the ASARCO Cyprus Merger, it renders that right meaningless. A director cannot make an informed decision about the merits of a proposed transaction – or, equally important, the relative merits of two strategic alternatives – without the ability to communicate freely with interested parties. This Court has never sanctioned what this Merger Agreement purports to do: require directors to keep their eyes wide shut.32

Many commentators have accurately characterized the Phelps Dodge decision as a “duty of care” case. Importantly, however, it may be the first Delaware decision to recognize the bifurcated nature of the board’s duty to be informed in circumstances where it has reserved the ability to modify or withdraw its recommendation. Initially, when a board considers ex ante whether (and the extent to which) it will retain the ability to negotiate with third party bidders in the future, it must consider all material information available to it at that time. Second, in exercising its ongoing duty to assess whether its recommendation remains appropriate in view of changed circumstances, a board should consider all material information available to it at that later time. The board, of course, should consider ex ante that circumstances could change – e.g., the board could be faced in the future with a previously unsuspected and potentially superior alternative transaction. It thus should seek to ensure that it retains the contractually flexibility to become fully informed with respect to those changed circumstances. Thus, any “no-talk” or “no-shop” provision that effectively impedes the board’s future ability to consider and evaluate potentially superior alternative transactions and the impact that such transactions could have on its recommendation would be, in our view, suspect. Phelps Dodge and Ace suggest that such provisions will be enforceable, if at all, only in extraordinary circumstances. At the same time, those cases, together with IXC, reconfirm that no shop provisions containing meaningful outs that do not preclude a board from continuing to assess its recommendation on a fully informed basis serve a salutary purpose and should generally be enforceable.

Updates from the M&A Side: Is the World About to Change?

By

Daniel A. Neff and David A. Katz1

Notwithstanding the unprecedented merger boom of the last decade, there have been many years of relatively minor developments in the law and practice of mergers and acquisitions. Within the last nine months, this has all changed. The SEC has implemented significant changes to the tender offer rules with the adoption of Regulation M-A, has adopted a new scheme to regulate cross-border business combinations in an attempt to open them to U.S. holders and is now trying to eliminate selective disclosure. In addition, the Delaware Chancery Court recently addressed -- but has not provided clear guidance -- on a number of important issues confronted in fashioning deal protection in stock-for-stock mergers.

1 Daniel A. Neff and David A. Katz are partners with the law firm of Wachtell, Lipton, Rosen & Katz. The views and opinions expressed in this article are those of the authors and do not necessarily represent those of Wachtell, Lipton, Rosen & Katz.

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32See paragraph 2 of the Complaint for Declaratory and Injunctive Relief filed by Phelps Dodge filed on August 27, 1999 (Dkt. 1)
SEC Rules Amendments

In rules that became effective on January 24, 2000, the SEC has made sweeping changes in its basic rules governing takeovers. There are three major changes to highlight:

- The new rules vastly increase the ability of both a bidder and a target to continuously communicate with shareholders and the market about a pending or proposed transaction, even though a formal disclosure document has not been filed with or cleared by the SEC.

- The new rules improve the regulatory treatment of exchange offers in an attempt to put them on a comparable footing with cash tender offers. These changes make tender and exchange offers more comparable from a timing and disclosure perspective, but not equal.

- The new tender offer rules allow a bidder to provide for a subsequent offering period after it buys shares in a tender offer or exchange offer for all shares. This is a U.K.-style clean-up period where a bidder no longer has any conditions and tendering shareholders have no withdrawal rights -- it is not clear whether this is a good idea.

There are several other important changes to be aware of:

- The new rules virtually eliminate confidential treatment of merger proxy statements, which can impact tactics.

- Under the amended tender offer rules, there is no longer any requirement to commence cash tender offers by the fifth business day after announcing the material terms of the proposed offer -- this has been replaced with a new antifraud provision (Rule 14e-8).

- The new disclosure rules loosen some of requirements for bidders to provide financial information about themselves, which may be particularly valuable to foreign companies that do not want to (or cannot) comply with requirements to reconcile their financial statements to U.S. generally accepted accounting principles.

The first major change under the new SEC rules is the greatly increased ability for both bidders and targets to communicate continuously with shareholders and the market about a proposed transaction before a formal disclosure document has been filed with SEC and is publicly available. Under the new rules, the enhanced ability to communicate has a cost associated with it -- companies must file their press releases, analyst presentations, road show slides and other written materials with the SEC (and, therefore, make such materials publicly available) on the date of first use. We believe that the freewheeling nature of communications to “sell a deal” shortly after announcement will be inhibited by the filing requirement -- it is like having a constant chaperone -- but will meet the SEC’s goal to have additional public disclosure about pending transactions in order to eliminate concerns regarding selective disclosure. These new rules apply to tender offers, exchange offers, and other business combinations, such as stock-for-stock mergers.

Under the prior SEC rules, if companies announced a stock-for-stock merger, the parties involved would embark on a two-day media blitz, including one or more analyst conference calls or press conferences, and one-on-one meetings with large investors and analysts; then securities lawyers typically would require the parties to shut down market and shareholder communications to avoid SEC problems due to gun-jumping -- i.e., conditioning the market -- or offering securities.
without a formal prospectus and/or premature proxy solicitation. This became known informally among practitioners as the “48-hour rule” -- not a rule at all but a practice the SEC knew about and appeared to tolerate, while at the same time denying that it was appropriate. The difficulty was that companies have legitimate need to make disclosure of their transactions -- but when a deal is announced a formal disclosure document may be months away from being available -- and shareholders and the market needed to make their assessment of the deal quickly based on the 48-hour media blitz. Then, under prior practice, after companies generated excitement -- or, more problematically, a lukewarm or unfavorable response -- the parties and their advisors nevertheless had to go silent until a proxy statement was publicly filed or mailed or a registration statement was filed.

Under the new regime, the initial media blitz -- including the script for the analyst conference call and the slides for road show presentations -- must be filed with the SEC on the announcement date (or the date of first use), thus becoming an essential part of the public record of the transaction. As a practical matter, lawyers probably will argue to their clients that the road show presentations are too “puffy” -- insufficiently hedged -- and bankers will say that if the deal is poorly received initially, everyone will have a problem, so the lawyers will need to be more pragmatic. The importance of how the companies tell the story initially will be magnified, and these initial filed materials may be the most important public statements about the deal. These public statements do not necessarily become part of the transaction document sent to shareholders, although the SEC has said that, to the extent these early disclosures are material, they must be included in the materials ultimately sent to shareholders.

One clear benefit of the new SEC rules is that if a deal’s initial reception is not positive, the parties can keep selling their transaction and respond to problems and issues that the market raises (however, if written materials are modified or additional materials are provided, they must be filed with the SEC upon first use). Under the prior SEC rules, you were generally precluded from trying to improve the market’s perception of the transaction until a proxy statement was mailed or a registration statement or proxy statement was made publicly available -- this can be a two- to four-month quiet period, depending on the length of the SEC review process. Alternatively, parties had to make a tactical decision to file publicly the initial versions of their disclosure documents before any SEC review.

One obvious response to the new rules will be to omit certain details from the written materials that are required to be publicly filed and instead provide them orally. The new rules do not require that oral statements be filed publicly, but the SEC has strongly cautioned against selective disclosure. The SEC has indicated its intention to monitor whether companies are abusing the new rules by selectively making oral statements that are not in their written materials.

Another area where the new SEC rules will change current practice is in disclosures that target companies make in response to unsolicited tender offers. Under the prior rules, a target company could not take a position with respect to an offer or communicate a response to the market until it filed a formal Schedule 14D-9 Solicitation/Recommendation Statement with the SEC. Generally, target companies do not want to file their Schedule 14D-9 until late in the required ten-business-day period after commencement of the tender offer: the line-item disclosure

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3 Given the importance of the initial media and analyst blitz, companies may ask their financial advisors to bring their analysts “over the wall” late in the negotiations to help fashion the message to be communicated to the market and the professional analyst community; since many deals are judged a success or failure based upon how they are received by the market on the date of announcement, it is essential that the message regarding the benefits of the proposed transaction be explained properly.
requirements of the Schedule 14D-9 generally require targets to disclose their activities in response to a bid; and normally targets want to wait as long as possible to make disclosure so that they have time to develop some potential alternatives. However, by not responding immediately, target companies will lose the ability to caution arbitrageurs and other market professionals not to take a position in the target because the target intends to strongly oppose the bid. Under the new rules, before the time the unsolicited offer is commenced in accordance with the new tender offer rules, a target can clearly communicate its opposition to a bid without having to file a formal rejection, which, in turn, would require a target to lay out what extraordinary transactions are under consideration at the time of filing. This is a very subtle change, but could be important in some contested situations.

It is important to note that the SEC has defined the term “public announcement” very broadly under its amendments to the Securities Act rules, the tender offer rules and the proxy rules, and it is the initial public announcement of the transaction that triggers the filing requirements for communications. Thus, the SEC could attempt to take the position that publication of a bear-hug letter by a potential acquiror could be the initial public announcement triggering filing requirements for the initial and future communications by both the acquirer and the target company under the Securities Act, the tender offer rules and the proxy rules. In addition, these communications must contain the appropriate legends required under the various new rules.

The second major change under the new SEC rules is making exchange offers (i.e., offers to exchange bidder stock for target company stock) more viable as compared to cash tender offers. Under prior law, exchange offers required long timeframes and were rarely used. Under the old SEC rules, an exchange offer had to remain open for a minimum of 20 business days after the related registration statement was declared effective -- and it could take the SEC several months to review the registration statement before declaring it effective. In addition, under the old rules, exchange offers tended to be more cumbersome documents than cash tender offers documents, so additional time was required for their preparation, particularly in a competitive situation where each bidder explains the benefits of its proposed acquisition of the target in comparison to another bidder or the target’s existing merger partner. All in all, under the old rules the exchange offer took several months more to complete than a cash tender offer that could be prepared in several days, and launched and then closed 20 business days later. Moreover, the key to a cash tender offer’s speed is the absence of SEC prior review. Therefore, under the old rules, a less valuable cash tender offer could theoretically succeed against a higher valued exchange offer even though the exchange offer was announced first because the tender offer could still be consummated more quickly.

Under the SEC’s new rules, bidders can start exchange offers as early as the time of the initial filing of the exchange offer/registration statement document. As a result, the 20-business day minimum period that the offer must remain open can run concurrently with the SEC review of the related registration statement. The new rules do not resolve all of the issues with respect to exchange offers. Specifically, even under the new rules, an exchange offer cannot be completed until the SEC completes its review of the related registration statement and declares it effective; if that review process requires more than 20 business days, it effectively extends the offer. However, the SEC has committed to review exchange offer registration statements promptly.

Secondly, there is a recirculation risk: bidders commencing an exchange offer using a preliminary prospectus must furnish a supplement to shareholders if there is any material change
from the preliminary prospectus, either as a result of SEC Staff review or other material changes -- e.g., developments in the takeover situation -- and the exchange offer must remain open for a minimum five- or ten-business-day period after the supplement is sent, depending on significance of the changes. A ten-business-day extension is required for changes in price or number of shares sought “or other similarly significant change” and a five-business-day extension is required for material changes in the exchange offer other than price or share levels. An interesting question that will be addressed over time is whether SEC comments and necessary changes in response to SEC comments will result in a five-business-day delay because they will be regarded as “material changes” and who will make that determination -- the SEC or the bidder’s counsel. Absent SEC guidance, the bidder’s counsel will not be inclined to take risks on failing to extend the offer period.

Overall, putting exchange offers on a more level footing with cash tender offers is a good development. This change should enable bidders to use exchange offers in the right circumstances and, perhaps more importantly, to make credible the threat of using it as a tactic in the context of an unsolicited offer. However, exchange offers still generally have several drawbacks:

- To be eligible for pooling-of-interests, the preferred accounting method for stock-for-stock transactions, the exchange offer would need to satisfy a 90% minimum condition. This requirement, which is based upon an interpretation of the SEC’s accounting staff, is difficult to satisfy, especially in a hostile bid situation. Obviously, this issue goes away if pooling is abolished, which is expected to occur later this year.
- As with any stock-based deal or offer, the bidder will face pressure on its own securities while its transaction is outstanding -- the bidder can expect its accounting and organic growth rate to be closely scrutinized or attacked in the context of a hostile transaction.
- A bidder may need approval of its shareholders because of state law, insufficient authorized stock, or stock exchange requirements. This can eliminate the timing benefits of the recent improvements in the SEC rules.

In addition to adopting the new rules, the SEC has reiterated that the acquisition shelf procedure -- a strategy used by habitual acquirers -- continues to be available to make stock or stock and cash acquisitions. In the proper circumstances, it will be more practical to use an acquisition shelf registration statement that already has been declared effective by the SEC rather than preparing a new registration statement for each deal. The acquisition shelf can be very effective, especially in circumstances where the acquirer is much larger than the target and the target’s shareholder base meets the necessary requirements.

The third major change arising from the new SEC rules is the adoption of the subsequent offering period. The subsequent offering period is a U.K.-style clean-up period that commences immediately after acceptance of shares for payment in the main part of the offer. The stated purpose of the subsequent offering period is to enable bidders to reach the level of share ownership (typically 90% of the target’s outstanding shares) that is required by state law for a short-form merger without requiring clearance and mailing of a proxy statement.

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4 It is also important to note that the expedited timetable for exchange offers is not available for “going private” transactions. This makes SEC determination of whether a transaction is in fact a going private transaction critical to a deal’s timing.
following expiration of the initial tender offer. Under the old rules, a clean-up period after the acceptance of shares in a tender offer was not permissible. The new rules provide that there will be no withdrawal rights during the subsequent offering period.

To be eligible to provide a subsequent offering period, a bidder must meet the following requirements:

- The offer is for all shares and, if the bidder is offering different types of consideration, there can be no maximum limitation on any form of consideration offered;

- The initial offer period remains open for at least 20 business days and has expired;

- All conditions are deemed satisfied/waived by close of the initial offer period;

- The bidder accepts tendered shares for payment on closing of the initial offer period and promptly pays; and

- The bidder has previously disclosed, in its initial offering materials or in a supplement, that there will be a subsequent offering period.

If a bidder provides for a subsequent offering period by amending its tender offer materials, the amendment will be regarded as a material change to the offer requiring extension of the offer period by five business days. If, on the other hand, a bidder has announced its intention to have a subsequent offering period and decides to cancel it, that would also be a material change to the terms of the offer requiring a five-business-day extension.

The minimum subsequent offering period is three business days and the maximum is 20 business days. A bidder can start with a short subsequent offering period and then extend it to the extent necessary. During the subsequent offering period, the bidder must accept and promptly pay for all securities as they are tendered, and the same form and amount of consideration must be provided in the subsequent offering period as was provided during the initial offer period.

An obvious issue is whether a subsequent offering period is worthwhile in view of the potential hold-out problem. It is possible that the implementation of a subsequent offering period will create the problem it was designed to solve. There is a viewpoint that tender offers succeed precisely because they are coercive -- if a shareholder refuses to tender and a bidder gets 85% of the target securities tendered and closes its offer, the shareholder would have to wait two to three months to be paid (assuming that the bidder wants to close the back-end quickly). The question is whether arbitrageurs will decide to wait until a subsequent offering period to tender their shares and this will depend in part on whether there is any possibility of a topping bid coming in at the end of initial offer period.

Our experience is that bidders have not faced problems getting 90% or more of the target stock tendered in friendly deals -- precisely because of the coercion exerted by the risk to non-tendering holders of a two- or three-month delay. In contested transactions, bidders want to close their offers as quickly as possible. Moreover, in the context of a friendly deal, if the minimum condition is not satisfied by end of the initial offer period, perhaps because arbitrageurs have considerable influence over the situation, potential second bidders who would consider jumping in, but are unwilling to risk an embarrassing quick loss, may be induced to look harder at launching a competing bid. In the new Internet economy, with chat rooms and the renewed prevalence of market rumors, even a slight hint of potential competition could cause a minimum condition not to be met as sophisticated shareholders hold out. A subsequent
offering period could make this result more likely. This new subsequent offering period seems like a fix for a problem that currently does not exist and it is not without risk for bidders. For all of these reasons, we suspect that, at least initially, subsequent offering periods will not be prevalent.

Another interesting change implemented under the new rules is the virtual elimination of confidential treatment of merger proxy statements. Under the new rules, if a target company limits its statements to what is permitted by Securities Act Rule 135 -- which realistically is impossible in the context of a substantial transaction -- a company can maintain confidential treatment of its preliminary proxy statement when it is filed with the SEC. However, under the restrictions set forth in Rule 135, a company would not be able to sell its transaction to the market or even explain it sensibly. By virtually eliminating confidential treatment of merger proxy statements, the whole merger proxy process will be more open to public scrutiny. Under the old rules, the market (as well as potential competing bidders) only knew where a deal stood when the proxy statement was mailed or the related registration statement was publicly filed. Thus, a potential bidder that was considering competing with the announced transaction had to guess whether the parties had filed proxy materials, where they stood in terms of the SEC review process and what the companies would say about the background of the transaction. Under the new rules, all of this information (except the specifics of the SEC review process) will be publicly available with the filing of the preliminary merger proxy statement.

SEC Cross-Border Rules

On October 19, 1999, the SEC adopted new rules (effective January 24, 2000) that provide significant exemptions to the U.S. federal tender offer and registration rules governing cross-border transactions. The new cross-border rules are intended to facilitate the inclusion of U.S.-based security holders of foreign companies in cross-border transactions. The guiding principle of the SEC approach is that the regulatory burdens imposed by the Exchange Act and the Securities Act on cross-border transactions will be relaxed based upon the percentage of target securities subject to the offer that are held of record by U.S. residents. If U.S. security holders hold of record 10% or less of the target class of securities that is the subject of the offer, the offer will be exempt from almost all of the requirements of the U.S. federal tender offer rules, except for anti-fraud requirements, and securities offered will be exempt from the Securities Act registration requirements (the “Tier I” exemption). If the threshold percentage ownership is 40% or less but greater than 10%, the offer will be exempt from several provisions of the U.S. federal tender offer procedural rules that commonly conflict with foreign regulations and practice, and as to which the SEC has granted no-action relief in the past (the “Tier II” exemption).

The principal provisions of the new cross-border rules are as follows:

- The Tier I exemption provides that tender offers for the securities of foreign private issuers will be exempt from the filing, disclosure and procedural provisions of the Exchange Act when U.S. security holders hold of record 10% or less of the target class, the offer is made in the U.S. on the same terms as in the foreign jurisdiction (except that cash consideration may be paid to U.S.-based holders in lieu of securities) and an English language version

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6 All of the exemptions require the foreign company to be a “foreign private issuer,” which is defined as any foreign company except one that has (1) 50% or more of its outstanding voting securities held of record by U.S. residents and (2) either (A) U.S. residents or citizens as a majority of its executive officers or directors, (B) more than 50% of its assets in the U.S., or (C) its business administered in the U.S.
of the offering document is provided to U.S. security holders. In addition to a bidder, the target company, and any officer, director or other person who otherwise would have an obligation under the Exchange Act to file a Schedule 14D-9, may also rely on the exemption to the same extent as the bidder;

- Tender offers that qualify for the Tier I exemption will be exempt from new Rule 14e-5 (formerly Rule 10b-13) under the Exchange Act, so that, during the pendency of the offer, purchases by the acquiror will be permitted outside the tender offer;

- The Tier II exemption provides that tender offers for the securities of foreign private issuers will be exempt from mandatory withdrawal rights requirements during a “subsequent offering period,” notice of extensions requirements, prompt payment requirements, and waiver or reduction of minimum conditions provisions under the Exchange Act when U.S. security holders hold of record 40% or less of the target class;

- Securities Act Rule 802 provides that when U.S. security holders hold of record 10% or less of the subject class, securities issued in an exchange offer for the securities of a foreign private issuer and certain business combinations involving foreign private issuers will be exempt from the registration requirements of the Securities Act and, with respect to debt securities, the qualification requirements of the Trust Indenture Act;

- In calculating the percentage of securities held by U.S. security holders, for purposes of the exemptions, securities held by the offeror and holders that hold more than 10% of the target class are excluded and securities underlying ADRs are included. Furthermore, the residency of holders of securities held of record by a broker, dealer, bank or other nominee located in (1) the United States, (2) the foreign company’s jurisdiction of incorporation, and (3) the jurisdiction that is the foreign company’s primary trading market for voting securities, if different from the jurisdiction of incorporation, for the account of customers must be determined by reference to the residency of such customers. This “look through” requirement, which was not in the rules as initially proposed, may run counter to the SEC’s objective of increasing U.S. participation in cross-border transactions because it may be difficult in a negotiated transaction for a target company to effect the “look through” and maintain the confidentiality of the transaction;

- In hostile tender offers, unless the bidder knows or has reason to know the actual percentage of U.S. security holders, a bidder will be permitted to make the percentage threshold determination for the Tier I, Tier II and Rule 802 exemptions based on the percentage of target’s aggregate worldwide trading volume that occurs in U.S. markets; and

- If an offeror commences a competing tender offer or business combination during another party’s pending tender offer or business combination for securities of the same class that are the subject of the first offer, the second offeror will be eligible to use the same exemption (Tier I, Tier II, or Rule 802) as the first offeror, so long as all the conditions of the exemption, other than the limitation on U.S. ownership, are satisfied by the second offeror.
The exemptions apply to tender offers without regard to the domicile or reporting status of the bidder -- allowing a U.S. bidder to take advantage of the exemptions. The exemptions will not apply, however, if the target company is an investment company registered or required to be registered under the Investment Company Act, unless the target company is a registered closed-end investment company.

The SEC will continue to consider requests for relief on a case-by-case basis where there are conflicts with provisions not exempted under the new rules. In adopting the exemptions, the SEC emphasized that U.S. anti-fraud and anti-manipulation rules and civil liability provisions continue to apply in cross-border transactions. These new rules address many of the problems that have prevented U.S. security holders of foreign companies from being provided the opportunity to participate in cross-border transactions. It remains to be seen whether companies will avail themselves of these new exemptions or whether they will continue to exclude U.S. security holders.

**Delaware Court Developments**

In addition to the recent changes in the SEC’s rules, in the last several months, there has been a burst of activity in the Delaware courts relating to business combinations, directors’ fiduciary duties and break-up fees. Three recent cases (*Phelps Dodge v. Cyprus Minerals/Asarco*, vii *ACE Limited v. Capital Re* viii and *In re IXC Communications, Inc.* ix) address non-*Revlon* transactions (i.e., stock-for-stock mergers) and try to ascertain whether there are limits on directors’ freedom of action and ability to protect such a transaction.

For the entire period of the current merger boom (dating from late 1980s), practitioners generally have understood -- or thought that they understood -- the rules governing merger agreements that applied to the key transaction protections: no-shop clause (covering solicitation, discussions/negotiations, and providing information), the right of the target company to terminate for a preferable transaction, and break-up fee compensation paid to a failed suitor.

The universe is bifurcated:

- **Revlon deals**: The Delaware Supreme Court has defined directors’ duty in the sale of control context as achieving the *highest value reasonably available* for stockholders and the Delaware courts will subject such transactions to enhanced judicial scrutiny. In *Revlon*, the Delaware Supreme Court found that, once the directors had decided to sell control of the company, “[t]he directors’ role changed from defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders at a sale of the company.” x

  The Delaware courts require a reasonable decision, but not a perfect decision, in this regard.

- **Non-Revlon deals**: Transactions not involving a sale of control (such as most stock-for-stock mergers) generally will continue to be evaluated under the well-established traditional business judgment rule, and directors approving such a transaction will not be subject to enhanced judicial scrutiny. The two leading Delaware Supreme Court cases (*Time-Warner* xi and *QVC* xii) verify that a

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stock-for-stock merger between two truly public companies will not constitute a change of control under Delaware law, and thus will not trigger the requirement under Revlon that the seller’s board seek, through auction or otherwise, the highest value reasonably available to stockholders. The doctrinal explanation for this application of the business judgment rule is that most stock-for-stock combinations simply shift “control” of the seller from one unaffiliated group of public stockholders to another such group, i.e., the larger post-merger combined group of public stockholders of seller and acquiror. In such situations, there is no change of control, even though the stockholders of one company as a group may own less than a majority of the equity of the combined company.

If Revlon applies to a particular transaction, a target company generally is required to be able to respond to proposals made by potential bidders and to terminate the agreed-upon transaction if a better transaction became available. Historically, break-up fees centering around 3% of equity value (and higher, in the proper circumstances) were understood to be acceptable. Break-up fees at this level generally are seen as a minor impediment but not preclusive for subsequent bidders if entered into for appropriate reasons in the context of a Revlon transaction. One area within Revlon not fully developed is whether these rules -- which are designed to enable a second bidder to succeed but at a meaningful cost -- apply if a full auction has occurred. From a theoretical perspective, Delaware case law would appear to permit an auction-ending lock-up, but practitioners typically have been reluctant to utilize this power/authority, through a combination of anxiety that the fully shopped company might receive a still higher bid and, more recently, a disinclination to sell companies by utilizing an open, public auction process.

The more interesting situations have been non-Revlon transactions: if there is not a “sale” of the company, then what limits, if any, apply to locking up the deal? Practitioners generally have assumed that there were some limits, particularly concerning how large and preclusive a break-up fee could be, but there was no agreement on what these limits are.

Against this backdrop of larger and larger stock-for-stock mergers and lack of clear rules are three recent decisions of the Delaware Chancery Court, all rendered in the preliminary injunction or temporary restraining order context. Viewed together, the decisions are a warning that limits do exist in the non-Revlon context but the rules remain unclear and the decisions appear to be inconsistent in philosophy.8 Ultimately, it will be left to the Delaware Supreme Court to decide what limits (if any) there should be on a board of directors in the context of a non-Revlon transaction.

Conclusion

With the recent amendment SEC rule changes and the Delaware courts apparently reconsidering their guidance on non-Revlon transactions, M&A practitioners are faced with a changing world that is likely to have the greatest impact upon unsolicited transactions.

8 For a full discussion of the three recent cases, reference is made to the incisive accompanying article entitled Recent Delaware Law Developments Concerning No Talk Provisions -- From “Just Say No” to “Can’t Say Yes?”, by Mark A. Morton, Michael A Pittenger and Matthew E. Fischer.
Force, several members joined our meeting by conference call. We discussed the recent Delaware case, Phelps Dodge, and its impact on negotiations of lockup provisions in public company deals. We continued these discussions in our conference call on November 21, 1999, in light of two additional Chancery Court decisions, *ACE Limited v Capital Re Corporation* and *In re IXC Communications Inc.* We also discussed a revised covenant to hold a stockholders meeting ("force the vote" covenant). Our Task Force has switched to a new "core" draft agreement incorporating many of our recent discussions.

We met in Wilmington, Delaware at the offices of Mark Morton’s firm, Potter Anderson, on Saturday, January 22, 2000 from 9:00 AM to 5:00 PM. We discussed the revised “no-shop” and termination. Mark arranged a special dinner with Chancellor Chandler of the Delaware Chancery Court. We enjoyed this special evening and look forward to our March meeting in Columbus Ohio!

Finally, four members of the Task Force, Gary Apfel, Rick Climan, Diane Frankle and Joel Greenberg presented a 1-1/2 hour program to the staff of the Securities and Exchange Commission on Negotiating Public Company Acquisitions on Friday, January 21, 2000 at the invitation of former Task Force member Mike McAlevey.

Diane Holt Frankle and Steven Knee, Co-Chairs

**International Transactions Task Force**

The International Transactions Task Force met on October 15, 1999 in Scottsdale. The meeting, focused principally on the current project of the Task Force which will provide an overview of the big picture issues in doing stock transactions in different jurisdictions around the world. The work product will be in the form of responses to a questionnaire and will cover approximately 35 countries. At our meeting, the current form of the questionnaire was finalized.

On the program front, the Task Force organized and co-chaired a program in Atlanta on cross-border acquisitions involving Argentina, Brazil and Mexico. The program was co-sponsored by the Committee on International Business Law. Two members of our Task Force were involved in the program: Darrel Rice, who co-chaired the program, and Alfredo Rovira, who was one of the panelists. The Task Force is also looking to organize a program in New York and London for the Year 2000 meeting. Both programs would have a transatlantic focus.

The work product of the Task Force has been in the hands of the ABA since October of 1998. The editorial review process is expected to be completed shortly. Given that our foreign correspondents generated their responses during the course of the summer of 1998, we will have to do an update, the timing of which will be determined once we know the publication schedule for the Model Asset Purchase Agreement.

Finally, as the Task Force begins a number of new exciting projects, it would be a very opportune time for those who have an interest to join our group.

Guy-Martial A.X. Weijer and John W. Leopold, Co-Chairs

**Joint Venture Agreements Task Force**

The Editorial Committee met in January and further reviewed the latest version of the Model Joint Venture Agreement. A number of issues resulted from that review and it is intended to bring these issues to the full task force at our March meeting in Columbus. A revised version of
the agreement plus an issues list will be circulated prior to that March meeting. At the same time, we are hoping that the drafters of the commentary will be in a position to finalize the commentary so we can make that the focus of the stand-alone meeting in the Fall.

Tom Hyman and Alison Youngman, Co-Chairs

Asset Acquisitions Task Force

As the Asset Acquisitions Task Force continues in the finalization of the Model Asset Purchase Agreement, new developments continue to arise that have to be dealt with. A case in point is the January 4, 2000 of the U.S. Court of Appeals for the Fifth Circuit in *Fina, Inc. v. ARCO* which invalidated an asset acquisition agreement provision dealing with indemnification for environmental liabilities. In the *Fina* case, the asset acquisition agreement indemnification provision provided that "[Buyer] shall indemnify [seller] against all claims . . . arising from the use or operation of the Assets . . . and accruing from and after closing." The Fifth Circuit, applying Delaware law pursuant to the agreement's choice of law provision, held that the indemnification provision did not satisfy the Delaware requirement that indemnification provisions that require payment for liabilities imposed on the indemnitee for the indemnitee's own negligence or pursuant to strict liability statutes such as CERCLA must be clear and unequivocal. The court explained that the risk shifting in such a situation is so extraordinary that to be enforceable the provision must state with specificity the types of risks that it is transferring to the indemnitor.

The *Fina* case is anticipated by Section 11.11 of the current draft of the Model Asset Purchase Agreement, which provides that the indemnification provided thereby shall be applicable whether or not the liability resulted from the negligence of the indemnified party or a strict liability imposed on the indemnified party. Section 11.11 is in bold face type based on a series of Texas cases cited in the commentary and holding that such a risk shifting must both be expressly stated within the four corners of the agreement and the expression of intent must be conspicuous. The *Fina* case shows that the concepts underlying this Texas express negligence rule, which has been discussed at past meetings of the Negotiated Acquisitions Committee, has nationwide applicability.

Byron F. Egan and H. Lawrence Tafe, III, Co-Chairs

SUBCOMMITTEE REPORTS

Committee Forums

Subcommittee

Title

Current Developments in Delaware Law With Significant Implications for M&A Practitioners

Speakers:

1. **Mark A. Morton** (a partner in the Wilmington, Delaware office of Potter Anderson & Corroon LLP)

2. **Frederick H. Alexander** (a partner in the Wilmington, Delaware office of Morris, Nichols, Arsh & Tunnell)

3. **C. Stephen Bigler** (a partner in the Wilmington, Delaware office of Richards, Layton & Finger, P.A.)

4. **John F. Grossbauer** (a partner in the Wilmington, Delaware office of Duane Morris & Heckscher LLP)
5. Michael A. Pittenger (an associate in the Wilmington, Delaware office of Potter Anderson & Corroon LLP)

Description

Leading Delaware lawyers will discuss recent Delaware Chancery Court rulings relating to “fiduciary outs” and other recent developments in Delaware law with significant implications for M&A practitioners. The discussion will be interactive and will encourage a lively interchange of various points of view from speakers and the members of the Negotiated Acquisitions Committee as a whole.

Keith Flaum, Chair

Membership Subcommittee

The Membership Subcommittee is actively seeking to increase the diversity of the Committee and to encourage younger lawyers to join in its activities. To this end, we will be actively seeking ways of reaching out to other groups within the ABA Business Law Section. A description of the Committee and its activities has been posted on the ABA's web site at www.abanet.org.

Alison Youngman, Chair

Programs Subcommittee

The Committee will be involved in a number of programs at the Spring Meeting of the Business Law Section in Columbus, Ohio and during both parts of the ABA Annual Meeting in New York and London.

At the Spring Meeting, on Saturday, March 25, 2000, from 10:30 a.m. to 12:30 p.m., the Committee will be co-sponsoring, with the Legal Opinions Committee, “Opinions in Merger and Acquisition Transactions”. A distinguished panel will play the role of counsel for the buyer and the seller, respectively, in negotiating the form of a closing opinion to be delivered by seller’s counsel in a hypothetical asset acquisition. The New York based financial buyer will be represented by Tom Ambro and Joel Greenberg. The seller, a manufacturing concern, will be represented by Tom Thompson and Carolan Berkley. John Cook, III from Columbus, Ohio will play the role of the opinion committee for their firm. The panel will take an outrageous initial request from buyer’s counsel through a mock negotiation to the non-Accord form of opinion of Seller’s counsel which is being prepared as part of the model asset acquisition documentation.

This year’s transatlantic ABA Annual Meeting has given the International Transactions Task Force the opportunity to participate in a trilogy of programs in New York City and London. Each of these programs will address legal and cultural issues that are encountered in acquisitions on either side of the Atlantic Ocean. They will be based on hypothetical acquisitions which will vary depending upon the anticipated audience. During the New York part of the Annual Meeting, on Monday, July 10, 2000, from 10:30 a.m. to 12:30 p.m., Henry Lesser will chair the North American leg of the trilogy of internationally oriented Annual Meeting programs. This program will address a hypothetical acquisition by an English public company of a private U.S. corporation. Moving to London, on Monday, July 17, from 11:30 a.m. to 1:30 p.m., in the Common Room, Law Society of England and Wales, the Committee will be co-venturing a program with the International Law Section of the ABA. On Thursday, July 20, from 8:00 a.m. to 10:00 a.m., the Committee will be presenting its own program at the Hilton Hotel, London, under the chairmanship of John Leopold and Guy Weijer. This program will reverse the hypothetical fact pattern used in New York, addressing an acquisition by a U.S. public company of a private company in the United Kingdom with significant
operations in several other European Union countries.

The Committee is co-sponsoring two additional programs in New York, on Monday, July 10, from 2:30 p.m. to 4:30 p.m. Keith Flaum will chair a “nuts and bolts” program on M&A transactions (claimed specifically at relatively inexperienced practitioners) to be co-sponsored with the Young Lawyers Division of the ABA. At the same time, the Committee will be one of the co-presenters, with a number of other Business Law Section committees and the ABA Litigation Section, of a program on ADR.

We continue to look for program ideas for future meetings, as well as speakers for scheduled programs. Please contact me at (615) 742-4529 or at dmckenzie@sherrardroe.com if you have any ideas for programs or if you would be interested in participating as a speaker.

Donald I.N. McKenzie, Chair