It is with some trepidation that I begin my term as Chair of the Committee on Negotiated Acquisitions. My predecessor, Nat Doliner, accomplished a great deal during his remarkably successful stint at the Committee’s helm, and I face the challenging and daunting task of attempting to sustain the considerable momentum that Nat has generated as our leader over the past four years. Nat, on behalf of our Committee, I humbly thank you once again for your spectacular efforts.

Fortunately, Nat intends to remain an active participant in the Committee’s activities going forward, particularly on the international front. Indeed, Nat has been the guiding force behind our upcoming stand-alone meeting in Paris – our first Committee meeting ever to be held outside North America. The Paris meeting was originally to have taken place in the Fall of 2001 during Nat’s term, but was cancelled in the wake of the 9/11 tragedy. So, while next month’s Paris meeting will nominally be my first as Chair, it is actually a product of Nat’s organizational efforts, and represents a fitting tribute to his vision and to his success in transforming our Committee into a truly international organization.

The Paris meeting of our Committee will take place at 10:30 a.m. on Saturday, October 5th, at Le Parc Paris Hotel. It will be preceded by...
various task force meetings on October 4th. On Thursday, October 3rd, the Committee will present the first International Institute on Mergers & Acquisitions, featuring speakers from the Committee and from leading European law firms and global investment banks. Special thanks to Reid Feldman for helping to orchestrate the upcoming Paris sessions and the related Committee dinner. I look forward to seeing many of you there.

Our Committee has experienced significant growth over the past decade, both in its size and in the diversity of its membership. With more than ten active subcommittees, task forces and working groups, the scope of the Committee’s activities has expanded greatly. In light of this expansion and the increasingly multifaceted nature of the Committee’s functions, I have decided to break with tradition and appoint two Vice Chairs to serve during my term as Chair.

I am pleased to report that Byron Egan and Joel Greenberg have agreed to serve as Vice Chairs of the Committee. Byron and Joel are accomplished lawyers who have been active contributors to the Committee for well over a decade. As many of you know, Byron was one of the co-chairs of the task force that produced the Model Asset Purchase Agreement, and Joel was instrumental in the preparation of the Model Stock Purchase Agreement. Both Byron and Joel have been regular speakers at the annual National Institute on Negotiating Business Acquisitions and a host of other educational programs sponsored by our Committee. I look forward to working closely with both of them over the coming years.

I also have a number of additional organizational changes to announce:

- Jon Hirschoff and Scott Whittaker will be serving as co-chairs of the newly formed Subcommittee on Recent Judicial Developments. Their inaugural report appears elsewhere in this issue of Deal Points.

- Betsy Dellinger has taken over as Chair of the Programs Subcommittee, replacing Donald McKenzie. Many thanks to Donald for his excellent efforts in that role over the past several years.

I will be announcing some further organizational changes in the next issue of Deal Points.

I welcome your continuing input and feedback on our Committee and its structure and activities. Please call me or e-mail me with your observations and suggestions.

**FEATURE ARTICLE**

The following article is part of an edited transcript from a panel presentation for the Committee Forum of the Negotiated Acquisitions Committee held in Washington, D.C. on August 12, 2002 at the Annual Meeting of the Business Law Section of the American Bar Association.1 The remainder of the transcript, which addresses a host of issues raised by “deemed liquidation” clauses, will be published in a future issue of this publication. The program, entitled “So what does THAT mean? Interpreting Preferred Stock Terms in the Negotiated Acquisition,” included the following panelists:

- Mark A. Morton (moderator) – Partner in the Corporate Group of Potter Anderson & Corroon LLP, Wilmington, Delaware
- Diane H. Frankle – Partner in the Palo Alto office of Gray Cary Ware & Freidenrich LLP, Co-Chair of the firm’s Mergers &

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1 In addition to an outline for the presentation that was distributed by the ABA, the panelists also distributed at the meeting a hypothetical and an appendix that included a memorandum summarizing applicable Delaware rules of contract construction, excerpts of certain key Delaware decisions, and sample preferred stock provisions.
Acquisitions Group and Co-Chair of the Public Companies Task Force of the Negotiated Acquisitions Committee.

- John F. Grossbauer – Partner in the Corporate Group of Potter Anderson & Corroon LLP, Wilmington, Delaware
- David A. Bronner – Partner in the Chicago office of Jenner & Block and Chair of the firm’s Mergers & Acquisition Practice
- Patricia O. Vella – Associate, Morris Nichols Arsh & Tunnell, Wilmington, Delaware

Morton: Good afternoon. Today’s program is particularly relevant in an economy like our current one. It has become, unfortunately, all too common to see companies struggling to address the tension between the interests of common stockholders – who may want to ride out a poor economy – with the interests of preferred stockholders – who may be underwater and looking for a way to get out. When companies structure transactions to address (and perhaps resolve) those tensions, we are often asked to address the consequences of the proposed transaction. For example, will a series or class vote of the preferred be required to approve the transaction? Clients are sometimes surprised by our advice on how a Delaware court would answer those questions. So, while such interpretational issues may, at first blush, seem like drafting, rather than deal, issues, ultimately they end up as both.

Today, we intend to identify some of the issues that may arise when interpreting preferred stock terms and to provide you with a foundation for determining how a Delaware court might interpret such provisions. We’ll start by considering voting rights and how you interpret preferred stock voting provisions under certain circumstances. With that introduction, let’s turn to the hypothetical.

In our hypothetical, we have posited that Dr. Alto, a software designer, in 1999 incorporated eEnterprise Software.com, Inc. in Delaware. Shortly after its formation, the company sold $50 million in Series A Preferred. The major investor of the Series A Preferred was a venture capital firm called Risk Capital. The Series A Preferred was convertible into about 50% of the common, voted on an as converted basis and, as set forth in the hypothetical, enjoyed basic voting rights that included a class vote for the Series A if, by amendment or otherwise, the terms were to be altered in a way that had an adverse effect on the Series A Preferred.

Before considering what vote may be triggered by different transactions, Tricia Vella is going to take a few minutes to walk us through the basic rules of construction that a Delaware court will apply when interpreting the terms of the Series A Preferred.

Vella: Thanks. The Delaware courts have described the rights of preferred stockholders as being contractual in nature, so when construing their terms the courts apply the basic rules of contractual interpretation. Perhaps the most important rule is that any rights and preferences need to be clearly stated in the terms of the preferred. If they are not clearly stated, the court is not going to assume or imply any rights or preferences of the preferred. When construing the terms, the court attempts to determine from the words used by the parties the intent of the parties. In discerning the intent of the parties, the court will look only to the four corners of the document and, absent an ambiguity, it will not consider any extrinsic evidence when determining the intent of the parties. However, if there is an ambiguity in the terms of the preferred stock, then the court will look beyond the terms of the charter to consider

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2 The full text of the hypothetical, as well as copies of the other materials that were distributed at the Committee Forum in connection with the presentation may be obtained by contacting Mark Morton, the editor of this publication, at mmorton@potteranderson.com.
extrinsic facts to help determine the parties’ intent. When considering extrinsic evidence, the courts will look, among other things, at the communications between the parties and the negotiations that went back and forth. Finally, there are a number of Delaware cases where the court, having failed to determine the intent of the parties from extrinsic evidence, has determined to construe an ambiguity against the corporate drafter because the drafter had control over the process and could have made it clear. However, on this last point, it’s worth mentioning one recent case from the Delaware Court of Chancery entitled *Benchmark Capital v. Vague*.

In that case, the court declined to construe a provision against the drafter because the evidence made it clear that the parties on both sides had engaged in extensive negotiations.

**Morton:** I’m always surprised by how common it is, when you work carefully through the terms of a preferred stock, to find language that you think is ambiguous (or at least arguably ambiguous). Clearly, we all should pay closer attention when drafting or interpreting preferred stock terms.

Let’s look at the hypothetical to see how the rules of construction would work on the voting provision for the Series A Preferred. Before we even turn to an M&A transaction, let’s just say the corporation wants to designate and issue a new series of Series B Preferred stock. Tricia, can the Corporation here designate and issue Series B Preferred that’s senior to the Series A Preferred without the consent of its holders?

**Vella:** Once again, you start with the words to determine whether the holders of the Series A Preferred are entitled to vote. You’ll note that it doesn’t say the holders of Series A Preferred have a right to approve the issuance of any senior security. They just have a right to vote on any change, by amendment or otherwise, that adversely affects the rights, preferences or powers of the Series A Preferred. So, if you have blank check preferred remaining, you can issue a new series of senior Series B Preferred without triggering the Series A Preferred vote.

The more interesting question, I suppose, is whether the Series A Preferred gets to vote if the Corporation has to amend its charter to create a new class of Series B stock. In an older case discussed in the materials, *Hartford v. Dickey Clay*, the court said that neither an increase in the number of authorized shares of preferred stock nor the creation of new preferred stock would adversely affect the peculiar rights or characteristics of the outstanding preferred stock. The subordination of the Series A Preferred to a newly created senior stock is not what the statute is trying to address when it provides for a class vote for adverse changes. So, if the Corporation had to amend its charter to create a senior preferred stock, that would not trigger a Series A voting right under this provision.

**Morton:** Okay, so we have answered the simple questions - you can designate and issue new preferred stock without the vote of the Series A Preferred. You can even amend the charter to create new preferred stock and issue that stock without creating an adverse effect. What if we actually have to amend the terms of the Series A Preferred themselves, John? Is that an adverse effect?

**Grossbauer:** Well, not necessarily. It depends on the nature of the amendment. Are you actually changing any of the rights, preferences or powers

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4 The voting provision in the hypothetical for the Series A Preferred provides:
   In addition to any other vote or consent required by law, the vote or written consent of the holders of a majority of the outstanding shares of Series A Preferred Stock shall be necessary to change, by amendment or otherwise, the rights, preferences or powers of the Series A Preferred Stock so as to affect them adversely.

of the preferred stock in question? There is a case in the outline, Mariner v. Stone Container where the corporation amended the terms of the preferred stock to add a voting right to the terms of the preferred. There, the Court said that was not an adverse change, because it gave the preferred more rights, and so they did not get a class vote on the amendment. Then there’s also case law, which we will talk about later in a little more detail, that distinguishes between amendments that are affected under Section 242, which is the section of the Delaware General Corporation Law (“DGCL”) authorizing charter amendments, and amendments which are effected in a merger pursuant to one of the sections of the DGCL authorizing a merger. Under that case law, a Section 242 class vote does not apply in Section 251 mergers. So, in a case like this, if the Corporation did a dummy merger, that is, created a wholly owned subsidiary and merged it up, you could amend the terms of the preferred without a class vote. The reason is that the preferred voting rights in the hypothetical track the Section 242(b)(2) class vote language. Delaware law makes clear that if the language in the preferred tracks 242(b)(2) and does not mention mergers, then the parties didn’t intend for the preferred to have a class vote on the merger. Once again, the lesson is that preferences must be clearly stated. In this case, a vote for the Series A on an amendment in a merger has not been clearly expressed.

Morton: And so another lesson from Delaware is that form prevails over substance and the judges are going to look at the express words. If the words don’t clearly grant the voting right to you, then court won’t imply it for you.

Bronner: Mark, I want to be sure that everyone in the room fully comprehends what the Delaware courts were saying here. It was as if the courts were saying to the preferred shareholders, you are now in the twilight zone. You’ve invested your money and negotiated your rights and now you’re being told that all the rights that you have just negotiated can be quickly emasculated if the corporation sets up a shell company and merges itself into the shell. In that case, all that you’re left with is appraisal rights. And we are not talking about something that’s new here - we’re talking about something that’s been around for sixty plus years.

As Mark said, this is form over substance. If you use the language that only references generally amendments of the charter, then you will get a class vote only in connection with a traditional amendment. If the transaction is structured as a merger and you haven’t used that word – “merger” - then you are not going to be entitled to a class vote on the merger and your rights can be amended away in a merger. You may well say that when you sign up for the game you understand that in a merger the corporation will be allowed to do various things that will impact you. But in this case the court is allowing your rights to be changed in a dummy merger without the need for a real separate business transaction.

Of course, if you go back to one of the earliest Delaware decisions addressing these issues, one of the judges said, “the average intelligent mind should be able to figure this out.” Well, my average intelligent mind wasn’t able to figure this out until I got deeply into these cases. So, what I’d like to do, briefly, is to walk through a couple of the cases to show you how this analysis works for the court. Let’s start with the Warner Communications case. Time had agreed to buy Warner Communications through a tender offer, coupled with a back end merger. Pursuant to the merger, the Warner charter would be amended and the Series B Preferred Stock would be converted into a new class of preferred stock with a significantly less rights. And the question was whether the consent of the preferred stock of Warner was necessary to effect the conversion.


Well, the Series B preferred stockholders certainly didn’t think the transaction could occur without their consent, but let’s look at the language the court considered. Section 3.3 provided that an affirmative vote was needed to alter or change any rights, preferences or limitations of the Series B preferred stock so as to affect the holders of all such shares adversely. Sounds pretty straightforward. Section 3.4 in turn provided that, unless the preferred stockholders consented, the court couldn’t amend, alter or repeal the provisions of certificate of incorporation so as to affect adversely any of the preferences, rights or powers of the Series B stock. Well, you might think that this language would be sufficient to prevent the Corporation from amending the terms of the Series B stock in a merger without the consent of the holders of the Series B. But the court said no - the language in Sections 3.3 and 3.4 borrows from the statutory amendment provisions of Delaware law, not the merger provisions. Since the transaction was a merger between Warner and Time, those provisions simply didn’t apply. Well, the preferred stockholder in back of the courtroom must have wanted to raise his hand and say “but Your Honor, the charter is being amended here. The merger provides for that amendment. Why aren’t we protected?” And the court’s response would have been that, while the amendment created the new class of preferred stock, that’s not the problem. What adversely affected the preferred stockholders was the conversion of the shares in the merger, not the amendment to the terms of the preferred in the merger.

Morton: It is a very fine distinction that the court is prepared to make here – is it the amendment or the merger that causes the adverse effect. That distinction takes you back directly to the language in the voting provision. So, once again it is so critical to look at the language carefully to make sure that it covers all of the events that you are hoping to see covered.

Grossbauer: The other undercurrent of the Delaware case law is that the courts are trying to balance the rights of the preferred with the rights of a majority to act. There is a strong line of cases in Delaware that say majority rule is what we like and we’re going to look very closely at anything that deviates from that rule. The other point here is the availability of appraisal rights in a merger. Unlike in some other states, where appraisal rights may be available in conjunction with certain charter amendments, in Delaware appraisal rights are only available in connection with certain mergers. So, while your class vote may be your protection for an amendment under Section 242, your ability to seek appraisal in a merger is your protection under Section 251 and that eliminates the need for a separate class voting right in a merger even when the merger amends the terms of the preferred.

Frankle: I think David was right when he said that in the back of the courtroom the preferred holder must have been sitting there thinking, “wait judge, you said that we should be explicit. We should be specific. We were pretty specific. We said we didn’t want any adverse effects by amendments. And you can see that from a Delaware court standpoint it’s just not enough to be explicit, you have to use the magic words, which you probably wouldn’t have known before this case came down.

Bronner: So how do you get the language right? Well, you start by going to the Avatex decision, which is discussed in more detail in the outline. That case involved a dummy merger. The parent was merging into its subsidiary and the preferred stockholders had the good fortune of becoming common stockholders. There was no transaction going on here other than a merger to turn the preferred stockholders into common stockholders. So to say the sympathies perhaps weren’t with Avatex may be an understatement. When we look at the relevant language of the charter, it says that the preferred stockholders had

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a right to vote on any amendment, alteration, or repeal of certificate, whether by merger, consolidation or otherwise, that materially and adversely affected the rights of the preferred stockholders. The court concluded that this language did the trick. It identified amendments that occur in mergers. Therefore they found in favor of the preferred stockholders. So, you can see that what happens to you as a preferred stockholder depends upon subtle changes in the language of the preferred stock terms.

Morton: Part of the tension here, of course, is that the investors, when sitting at the table negotiating the terms of the preferred, could have addressed this issue by demanding a blanket right to vote on any merger. But, in the give and take of negotiations, investors often are willing (or are pressured) to live with a limited class vote that is triggered only by certain types of mergers. Well, as you can see, you have to make rather fine distinctions when drafting to pick up the right kind of mergers.

Tricia, one final question before we move on. If the company wants to turn around in this case and amend the terms of the Series A, may the majority holder of the Series A just waive (on behalf of the entire series) the series right to vote on the amendment?

Vella: Once again, the basic rules of construction come into play. Let’s look at the words. Do they say that this voting right can be waived by anyone? If you take a look at the Series A provision that you have in the materials, it doesn’t provide for waivers. It says if you are going to do an amendment, then you need to get the vote or the written consent of the holders. But it doesn’t say that a waiver works to bind the entire series.

Morton: I’d like to summarize what we’ve heard from the panel. First, if Delaware law applies, remember that preferred stock terms must be explicit -- the court won’t imply them. Secondly, when you are issuing senior preferred, even when it requires a charter amendment, it may (or may not) be an adverse effect. You have to look at the express language to see whether it triggers a vote. Third, in Delaware there are two different ways to amend charter provisions. Depending upon the terms of the preferred, an amendment by merger may or may not trigger a vote for the preferred. And fourth, the effectiveness of a waiver by the preferred holders will depend upon the language of the preferred.

Let’s bring some closure to the discussion of the Series A and turn instead to a discussion of some of the voting issues with the Series B. Based on our discussion of the terms of the Series A, I think we can actually apply some of that analysis to a review of the Series B Preferred, which has, in different circumstances, either a supermajority vote or a majority vote. Diane, would you walk us through the Series B voting provision and tell us what the corporation may do without triggering the different votes?

9 According to the hypothetical, the Series B Preferred has the following voting rights:

(a) The Corporation shall not without first obtaining the approval (by vote or written consent, as provided by law) of the holders of at least seventy percent (70%) of the then outstanding shares of Series B Preferred Stock, voting together as a separate class, authorize the issuance of any class or series of capital stock having a preference over, or being on a parity with, the Series B Preferred Stock with respect to dividends or upon a liquidation, dissolution or winding up by the Corporation.

(b) The Corporation shall not without first obtaining the approval (by vote or written consent, as provided by law) of the holders of at least a majority of the then outstanding shares of Series B Preferred Stock, voting together as a separate class:

(i) authorize the issuance of any class of capital stock;

(ii) amend, alter, repeal or waive any provision of the Corporation’s Certificate of Incorporation or Bylaws so as to affect adversely the shares of Series B Preferred Stock; or
Frankle: Right. Well, this is practice to see if you’ve been paying attention because these cases are really pretty amazing when you look at them and realize that what you thought was plain English really wasn’t plain English. So, if you’ll turn to the hypothetical, Mark has now posed the question - what kind of voting rights do the A and the B have if you want to create a senior Series C Preferred? How might we advise the company with regard to that?

Of course, we already know the answer for the Series A Preferred. The Series A weren’t able to block our Series B and, for the same reason, they won’t have a vote on the senior Series C Preferred.

Now, let’s look at the Series B. If the corporation were proposing to create the Series C by an amendment to the charter, then you’d have to take a look at both paragraphs (a) and (b) of the Series B Preferred’s voting rights. Paragraph (a) establishes a 70% supermajority vote, while paragraph (b) provides for a simple majority vote. Why would somebody have both provisions?

Well, let’s suppose that an investor in the Series B wanted to make sure that she would have a blocking right and so she negotiated to include paragraph (a). So they’re sitting there now thinking they’ve got a supermajority vote.

Now if all we’re going to do is do a Section 242 amendment to the charter to issue the Series C Preferred, then paragraph (a) answers our question. They’ve got a series vote. Why do I say that? Well, it says that the Corporation must get the vote of the holders of 70% if you’re going to authorize the issuance of any class that has a preference or is parity with the Series B. So our Series C can’t be issued by a simple Section 242 amendment without getting the approval of 70% of the preferred.

But, if you’ve been paying attention here, you’re immediately asking yourself, well yeah, but what about a merger? What about this dummy merger that we were talking about, might that work? So let’s take a look at the supermajority provision. It doesn’t say you can’t authorize the issuance of any class or series “by merger, consolidation or otherwise.”

Grossbauer: True, but that’s where the Benchmark Capital decision comes in. It adds a wrinkle that wasn’t addressed in Warner or Avatex, both of which considered language that more or less tracked the Section 242(b)(2) class vote language. In Benchmark, the language doesn’t track Warner or Avatex. Instead, it required the preferred’s consent if the company simply authorized or issued a senior preferred. Once again, however, the drafters failed to expressly tie that language to mergers.

Frankle: That’s right. And the court said that general language granting preferred stockholders a class vote when the company authorizes or issues senior series of preferred stock – and that’s our situation here too - will not be read to require a class vote on a merger in which a senior series will be issued. You lose, no supermajority vote.

But let’s take a look; maybe they’ve got a voting right under paragraph (b). Of course, we’re familiar with the trigger in (b)(i) – “authorize the issuance.” We just talked about that and concluded that there’s no vote there because the language is not specific enough.

How about (b)(ii)? That suffers from the problem identified in Warner and that we had with the Series A, so there’s no vote there.

How about (b)(iii)? It looks like they’re trying to address Avatex here. They say, without a vote, the corporation can’t do a merger if the effect of it would be to either a) authorize the

(iii) effect the voluntary liquidation, dissolution, winding up, recapitalization or reorganization of the Corporation, or the consolidation or merger of the Corporation with or into any other person, or the sale or other distribution of all or substantially all of the assets of the Corporation if the effect of such transaction would be to (A) authorize the issuance of any class of the Corporation’s capital stock, (B) amend, alter, repeal or waive any provision of the Corporation’s Certificate of Incorporation or Bylaws so as to affect adversely the shares of Series B Preferred Stock.
issuance of any stock or b) amend any provision of the charter so as to adversely affect the shares of Series B.

Now paragraph (b)(iii)(B) sounds a lot like Avatex. But the fact of the matter is that the provision doesn’t use the exact “magic words” of Avatex, which at least leaves the possibility that a court will conclude that the language is not express enough.

What about (b)(iii)(A)? Well that provision says you get a class vote in a merger that has the affect of authorizing the issuance of any class of capital stock. It doesn’t even have to have a preference. Again, looks like it might be clear, because that language seems to do what the language in the Benchmark case failed to do – it directly ties the merger to the prohibition on authorization of another class of stock. But you should study that case carefully first. Vice Chancellor spends quite a bit of time in the middle of the decision talking about the distinction between authorizing the issuance and the actual issuance. You might, I suppose, be able to argue that this merger only results in stock being issued, which is not precluded. Maybe you jump over the authorization of an issuance problem by using the merger technique.

Grossbauer: That’s a possible reading of it. I think this one is an interesting articulation because in the merger you’re actually issuing the stock that is not prohibited, but you know you are also, in effect, authorizing it.

Frankle: In the end, I think you can see that even a provision that, as Mark pointed out to me, seems to have been drafted by someone who was aware of the issues, still can have interpretative problems.

Morton: So, do you feel like you’re chasing your tail yet? That’s the way many of us feel with provisions like these. I think we need to draw it to a close, but we hope that we’ve conveyed that, even when you have very careful drafters who seem to understand the case law and who draft provisions that are quite specific on their face, you can still end up having ambiguities. Of course, under the rules of construction, that may be all that a judge needs to find (or deny) a voting right, whether or not you thought it existed. Thank you very much.

**TASK FORCE REPORTS**

**ACQUISITIONS OF PUBLIC COMPANIES**

We had a great meeting at the Hyatt Regency on Capitol Hill in Washington, DC, on Saturday, August 11, 2002, from 9:00 AM to 12:00 noon. Present were: Steve Knee (Co-Chair), Diane Frankle (Co-Chair), Steve Bigler, David Bronner, Richard Canady, Rick Climan, Ivette de Castro, Nat Doliner, Byron Egan, Saul Feilbogen, Mary Giesler, Joel Greenberg, Edward Kerwin, Henry Lesser, Jacques Meguire, Jim Melville, Mark Morton, Bill Payne, Jon Perry, Mike Pittenger, Peter Stone, Patricia Vella, and Scott Whittaker.

Bryan Davis, Keith Flaum, David Katz and Phil Stamatakos joined by teleconference.

After introductions, the Chairs reviewed our upcoming meetings. The Task Force will not be meeting in Paris, but we will be meeting instead in Chicago at Baker McKenzie’s offices (130 East Randolph Drive, Chicago, Illinois 60601), courtesy of Phil Stamatakos and Chris Bartoli, on November 16, 2002 from 9:00 AM to approximately 4:00 PM. We are planning a dinner the evening before (November 15) in Chicago; Phil and Chris will be advising us of more details, as we get closer to our dates.

Mark Morton is hosting the Task Force in Wilmington, DE on Saturday, January 11, 2003, at the offices of Potter Anderson (Hercules Plaza, 1313 North Market Street, Wilmington, DE 19801). Highlights of that meeting will be a
Delaware briefing on a topic of interest to the Task Force (tentatively, Section 203: Tricks and Traps for the Unwary). We also will have an informative session with members of the Chancery Court and Delaware Supreme Court and a Friday evening dinner to which members of the bench and other members of the Delaware bar will be invited.

Our Chicago and Delaware meetings will also be designed to facilitate work on the draft. At the November meeting, we will discuss the schedule for the entire draft. We have agreed that the definitions should be assigned to the person with responsibility for the section in which the term appears; where a term appears in multiple sections, we will assign primary responsibility at the November meeting. We will also determine which ancillary agreements should be completed by publication and assign drafting responsibility for each.

We will review the following provisions with commentary:

- Representations (Joel Greenberg)
- Covenants (Drew Fuller, Curt Hearn, Peter Koerber)
- Article I (Eileen Nugent)
- No Shop/Fiduciary Out (Keith Flaum)

In January 2003, we will review the following with commentary:

- Termination Provisions (Jim Melville, Mark Morton)
- Recommendation and Meeting Covenants (Keith Flaum)
- Introduction

We will be making new drafting assignments at the November meeting, so if you want to get involved in a project, this is a great meeting to attend!

Specialty Representations

At our last meeting, we had agreed to have specialists review the tax, environmental, employment and benefits representations. We believe it would be appropriate to treat the intellectual property representations the same way. Phil Stamatakos has provided his tax partners’ comments on the tax representations with the August 2002 meeting materials. At the August meeting, the Chairs encouraged Task Force members to send out the specialty representations to their respective experts in their firms. Jon Perry of Gray Cary will be working with Joel Greenberg to solicit comments and will be convening teleconferences over the next three months with the respective experts to discuss comments to the specialty representations and develop commentary. Members should respond to these requests for comments by putting Jon or Joel in touch with experts on the relevant sections.

Termination Commentary

Drew Fuller had revised the commentary for the termination and breakup fee sections based on our April discussion. The Task Force agreed that the commentary should be submitted to our Delaware task force members for the commentary from Delaware. Jim Melville, chair of the subtask force on the termination section, agreed to revise the commentary to add more detail regarding negotiation and drafting points as appropriate. Committee members should give comments directly to Jim Melville.

No Shop Commentary

We then turned to the no shop commentary prepared by Keith Flaum. We agreed that the level of detail regarding negotiation points was generally appropriate, and that in this regard the draft was an excellent model for other commentary. We then addressed general comments, resolving what overview issues should be tackled in the introduction and then how those issues would be dealt with in the no shop commentary.

Stephen H. Knee
Diane Holt Frankle
Co-Chairs
THE INTERNATIONAL TRANSACTIONS TASK FORCE

The International Transactions Task Force met for three hours at the Washington annual meeting and had an extremely well attended meeting. We had over 50 participants from 15 countries in attendance. There were two principal issues covered at our meeting.

Firstly, a substantive presentation was made by Lawson Hunter, the former Director of Investigation and Research under The Competition Act (Canada), on the global antitrust aspects of the recent acquisition by Bayer of the crop protection and crop production business of Aventis Crop Science. The case was reviewed closely by the antitrust authorities, particularly in Europe, the United States and Canada. Mr. Hunter discussed the interplay between the different jurisdictions and some practical considerations in dealing with these types of cases in the current regulatory environment. He also discussed the work of the international competition network in providing convergence in merger review.

The second part of our meeting focused on the current project of the task force, which is an international overview of a public company stock acquisition in a number of jurisdictions. Like our other projects, the basic objective is to provide an overview of the key issues in doing a cross-border acquisition. We have concluded in this project to focus on fewer jurisdictions, but provide a more detailed overview of the key issues. A revised draft of the questionnaire, which will be used to generate the responses from our correspondents, was discussed at the meeting.

We also spent some time talking about the project next in line for publication, which is a private company stock acquisition international overview. The form of questionnaire has now been finalized and we have an editorial committee that has been formed led by John Grossbauer which is now coordinating the responses from counsel in the different jurisdictions. This project is intended to be a stand-alone publication. We are currently projecting publication some time in the year 2003.

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

MANUAL ON ACQUISITION PRACTICE & PROCESS

At the Washington Annual Meeting we had a strong turnout including a number of new volunteers for the Task Force. Rob Ouellette prepared and circulated a revised master outline of the Manual, and the Task Force discussed missing topics, overlaps and revisited our overall approach.

The Task Force continued the process of reviewing and refining topic outlines prepared by Task Force members. The Task Force discussed outlines developed by Henri Bybelezer on due diligence from the seller's perspective and Murray Perelman on the first draft and controlling the drafting process.

The Chairs will be making assignments of the remaining topic outlines with a target of completing all outlines and finalizing the Master Outline by the end of 2002. In addition, the Chairs have asked the authors of four of the completed chapter outlines to begin drafting text under fairly broad style guidelines.

The ABA Publications Committee has asked the Task Force to submit the Manual for publication by 2004. In addition to the Paris meeting in October, the Task Force will be scheduling a meeting/conference call for January.

Tom Thompson
Vince Garrity
Co-Chairs
REVISIONS TO MODEL STOCK PURCHASE AGREEMENT

Our Task Force held two very productive Working Group meetings at the 2002 ABA Annual Meeting in Washington, DC. The Working Group on Revisions to MSPA spent the bulk of its time reviewing drafts of various provisions of Article 2 pertaining to the “Sale and Transfer of Shares; Closing.” Drafts of other sections of the Model Agreement were introduced to the Working Group and additional project assignments were made. The Working Group on Sellers’ Response Document met later in the afternoon and continued its review of the materials submitted to date. Additional assignments were also made at this meeting.

Murray Perelman, Chair of the Working Group on Ancillary Documents, announced that his Group is now getting underway. He solicited volunteers for specific projects and a number of assignments were made.

It is significant to note that many Task Force members attended all of the Working Group meetings. The exchange of ideas that occurs when Task Force members attend multiple Working Group meetings will enhance project coordination and will help simplify the Editorial Committee’s work on integrating the final document.

The Chairs of the various Working Groups are hopeful that current drafting assignments will be completed and circulated via email by the authors to Working Group members at least thirty days prior to a Stand Alone Meeting of the Task Force which will be held in Dallas, Texas on January 18 and 19, 2003. Authors are encouraged to circulate all work product via the email addresses listed on the Task Force Roster.

Our Task Force will meet for two hours in Paris, France at the Committee’s Stand Alone Meeting. We will focus on the further integration of the projects undertaken by the various Working Groups and recruiting volunteers to help with the numerous unassigned projects. We hope you are planning on attending the first meeting of our Committee to be held in Europe.

I look forward to seeing everyone in Paris and Dallas. In the meantime, if you have any questions please send me an email at rtharper@klettrooney.com

Robert T. Harper, Chair

ANCILLARY DOCUMENTS WORKING GROUP

Although the MSPA Ancillary Documents Working Group intentionally lagged behind the other two working groups, it has now begun its work in earnest in anticipation of the Dallas MSPA standalone meeting. Our Working Group is responsible for the preparation of updates of seven existing MSPA Exhibits, updates of three existing MSPA ancillary documents and the creation of two new ones, and the creation of six brand new MSPA Appendices including one dealing with a protocol for remote closings, one dealing with relevant considerations where the sale is a sale of a subsidiary (including a form of transitional services agreement), and one dealing with sales of non-share entities. Our Working Group is still looking for more volunteers to assist with the drafting of these documents.

Murray J. Perelman

SUBCOMMITTEE ON RECENT JUDICIAL DEVELOPMENTS

As Rick Climan announced at our meeting in Washington, D.C., the Negotiated Acquisitions Committee is undertaking a new project - to publish a periodic review of significant judicial decisions in the area of mergers and acquisitions. We are pleased to serve as Co-Chairs of the subcommittee that has been formed to pursue this project. Utilizing the diverse membership of the Negotiated Acquisitions Committee, we hope to produce a resource that will prove useful to both
committee members and M&A practitioners in general.

The working title for our group is the “Subcommittee on Recent Judicial Developments.” Our primary goal will be to disseminate to our Committee members, and publish in The Business Lawyer, an annual survey of significant judicial decisions in the area of mergers and acquisitions. 2002 will be the first year surveyed.

We currently envision the subcommittee as consisting of between six and eight people who would review decisions submitted for inclusion and write the decision summaries. At this time, we are seeking volunteers for that task. To volunteer, please send an email either to Scott Whittaker at swittaker@stonepigman.com, or to Jon Hirschoff at jhirschoff@fdh.com.

We also are asking for the help of all members of the Negotiated Acquisitions Committee in identifying significant judicial decisions to include in this survey. If you become aware of a decision that was published during 2002 and is a candidate for inclusion, please inform either of us by email at our email address above, or fax the case either to Scott Whittaker at (504) 596-0836 or to Jon Hirschoff at (203) 348-5777. The first criterion for inclusion is that the decision must involve a merger, an equity sale of a controlling interest, a sale of all or substantially all assets, a sale of a subsidiary or division, or a recapitalization resulting in a change of control. The second criterion is that the decision must (a) interpret or apply the provisions of an acquisition agreement or an agreement preliminary to an acquisition agreement (e.g. a letter of intent, confidentiality agreement or standstill agreement), (b) interpret or apply a state statute that governs one of the constituent entities (e.g. the General Corporation law for the State of Delaware, or the Louisiana Limited Liability Company Law), (c) pertain to a successor liability issue, or (d) decide a breach of fiduciary duty claim. We are currently excluding cases dealing with federal law, securities law, tax law, and antitrust law.

We may expand the scope of the survey after we “get our feet wet.” So if you feel a case dealing with an M&A transaction is significant, please send it even if it does not meet the foregoing criteria. If you submit a case, please provide a brief statement as to why you consider it to be significant. We look forward to receiving your submissions.

Our first column, set forth below, addresses the recent decision of the Delaware Chancery Court in Levco Alternative Fund Ltd. v. The Reader’s Digest Association, Inc.

Jon T. Hirschoff
Scott T. Whittaker
Co-Chairs

Recapitalization Enjoined on Fairness Grounds

On August 13, 2002, the Delaware Supreme Court issued an Order in Levco Alternative Fund Ltd. v. The Reader’s Digest Association, Inc. that addresses the proper role of an independent committee in the context of a recapitalization involving two classes of common stock.

The DeWitt Wallace-Reader’s Digest Fund and the Lila Wallace-Reader’s Digest Fund (the “Funds”) held fifty per cent of the Class B Voting Common Stock (“Class B Stock”) of The Reader’s Digest Association, Inc. (“RDA”). RDA entered into a recapitalization agreement with the Funds providing for the purchase of 3,636,363 shares of Class B Stock for approximately $100,000,000 in cash. In addition, RDA agreed (among other things) to recapitalize each share of its Class A Nonvoting Common Stock (“Class A Stock”) into one share of Common Stock (“Common Stock”) entitled to one vote per share and to recapitalize each share of Class B Stock into 1.24 shares of Common Stock. Following the recapitalization, the Funds would hold fourteen per cent of the
Common Stock, which would be the sole remaining class of RDA common stock. The recapitalization was to be effected through a merger of a wholly owned subsidiary into RDA unless holders of $5,000,000 in stated value of RDA preferred stock exercised appraisal rights, in which case it would be effected through an amendment of RDA’s certificate of incorporation.

In either event, holders of Class A Stock were not entitled to vote on the recapitalization, and the Funds had agreed to vote (and had given irrevocable proxies to vote their shares) in favor of the proposed recapitalization. Thus, it must have seemed to RDA that stockholder approval at the stockholders’ meeting scheduled for August 14, 2002 was a foregone conclusion.

Because two directors of RDA were also directors of the Funds, RDA’s board of directors appointed a special committee of three other directors. That committee, according to RDA’s proxy statement, was “to act as disinterested negotiators on behalf of the company and to negotiate, review and, if appropriate, recommend the recapitalization to the entire board of directors of the company.” The special committee negotiated with the Funds on behalf of RDA and eventually recommended the recapitalization as being in the best interests of the corporation and its stockholders. It was not charged with representing, or even taking into account, the separate interests of the holders of the Class A and Class B Stock, respectively.

Goldman, Sachs & Co. (“Goldman”) acted as financial advisors to the special committee. RDA’s proxy statement described Goldman’s opinion as stating Goldman’s opinion as stating that the repurchase of 3,636,363 shares of Class B Stock from the Funds for approximately $100,000,000 and the recapitalization ratios of 1.24 shares of Common Stock per share of Class B Stock (other than the Class B Stock repurchased from the Funds) and one share of Common Stock per share of Class A Stock, “taken as a whole, pursuant to the recapitalization agreement, was fair from a financial point of view to the holders of Class A Nonvoting Common Stock and Class B Voting Common Stock (other than the Funds)”.

The Goldman opinion stated explicitly, however, that Goldman expressed no view “as to the relative fairness of the Recapitalization to the holders of Class A Common Stock as compared to the holders of Class B Common Stock.”

Holders of Class A Stock sought to block the recapitalization on the ground, among others, that the RDA directors, including the special committee, were subject to the control of the Funds and thus required to demonstrate the entire fairness of the transaction. The Court of Chancery ruled that regardless of who had the burden of proof, the evidence did not indicate that the plaintiffs would ultimately demonstrate that the activities of the special committee did not result in a fair and genuinely negotiated price.

On this issue, the Supreme Court reversed, rejecting the defendants’ argument that the directors discharged their fiduciary duty to the Class A stockholders through the intensive negotiations between the Funds and the special committee. Noting that the special committee never sought, and Goldman did not tender, an opinion as to whether the transaction was fair to the Class A stockholders, the Supreme Court held that the special committee’s actions did not serve to shift the burden on entire fairness.

In the Supreme Court’s view, taking into account the effect of the payment of $100,000,000 to the Funds, the plaintiffs’ claim with respect to entire fairness had a reasonable probability of success.

The Supreme Court noted that given the constraints of time, its ruling was necessarily brief. Perhaps in a longer opinion the Court would have given less weight to the fact that the fairness opinion did not address the fairness of the recapitalization ratios to the Class A as compared with the Class B stockholders. As it stands, the Supreme Court’s Order could be read to imply that a fairness opinion is necessary to shift the burden of proof on “entire fairness” to the plaintiff. At the very least, practitioners are left in some uncertainty as to what the result in the case might
have been if the special committee had been specifically charged with considering the fairness of the entire recapitalization to the Class A stockholders, but had determined that it needed a fairness opinion only as to the fairness to the entire corporation of the $100,000,000 repurchase of Class B Stock from the Funds, and not as to the special interests of the Class A stockholders.

In any event, the Supreme Court’s opinion underlines the importance to practitioners of paying careful attention to the fairness opinion in recapitalizations and other transactions involving disparate treatment of shareholder classes. As is pointed out by the Delaware Supreme Court in this opinion, in such transactions the independent committee must not only consider the interest of the corporation as an entity, but it must also balance the conflicting interests of the two distinct classes of shareholders. If possible, the fairness opinion should address both of those areas. Because Goldman’s opinion in this case failed to address the relative fairness of the recapitalization to the holders of the Class A Stock as compared to the holders of the Class B Stock, the Court found the functioning of the independent committee to be flawed and enjoined the transaction.
The Negotiated Acquisitions Committee Newsletter is published approximately three times a year by the American Bar Association, Section of Business Law, Negotiated Acquisitions Committee. The views expressed in the Negotiated Acquisitions Committee Newsletter are the authors’ only and not necessarily those of the American Bar Association, the Section of Business Law or the Negotiated Acquisitions Committee. If you wish to comment on the contents, please write to the Negotiated Acquisitions Committee, Section of Business Law, American Bar Association, 750 North Lake Shore Drive, Chicago, Illinois, 60611.