FROM THE CHAIR
By Leigh Walton

I approach with trepidation the job of filling the shoes of Joel Greenberg, who has long been dubbed our “intellectual leader.” Joel completed a remarkably successful term, during which the Committee grew in size and stature. Joel, on behalf of the entire Committee, please accept our humble gratitude.

As I assessed how I would approach this role, I concluded early on that I needed a plan. Thus, I have worked extensively with our Committee leadership to craft a Strategic Plan to guide our efforts over the next three years. Our Committee has grown in size and complexity to the extent that a measure of coordination seems appropriate. Highlights from the Strategic Plan include the following:

• The primary concentration of our Section’s new leader, Nat Doliner, is membership. It therefore seems only appropriate that membership should be an area of emphasis for our Committee as well. The invigorated leadership of our Membership Subcommittee will strive to increase the number of involved Committee members, with a focus on attracting diverse members, less experienced lawyers, in-house counsel, and non-lawyers. Aspects of our membership initiative will be enhanced by our newly created Task Force on Diversity.

(continued on next page)
• We are approaching an exciting stretch as we release two long awaited publications. The year 2010 we believe will see the release of both the Model Public Company Merger Agreement and the Revised Model Stock Purchase Agreement. Both representing years of collaborative work, these publications will serve educational functions for the bar and enhance the stature of our Committee.

• Under Byron Egan’s leadership, we plan to establish the Executive Council of the Committee. Comprised of members of our Committee’s past leadership, the Council will strive to identify emerging trends, suggest new task forces, and enhance our position in the Section.

• We will continue to grow our International M&A Subcommittee, a hallmark of our Committee. The Private Equity M&A Subcommittee and the M&A Market Trends Subcommittee will continue to provide quality programming, including the ever-popular deal trends studies. The M&A Jurisprudence Subcommittee will follow judicial developments nationwide. A newly energized Task Force on the M&A Dictionary is exploring creative ways to deliver content that we believe will have a popular audience. Our newest task force, the Task Force on Distressed M&A, promises several more years of relevant content and programming.

• The talent of our Committee will be showcased by our own Programs Subcommittee – which will arrange for presentations at ABA meetings as well as through alternative content delivery mechanisms. Also, the Technology Subcommittee will continue to assure that the work of our Committee is broadly accessible.

• Finally, I believe that a legitimate goal of our Committee is to have fun. To that end, we will strive to create an environment in which lawyers and other professionals who contribute intensely as national and international M&A advisers can meet and socialize. As a by-product, we will continue to maintain and revitalize a network through which Committee members can serve their clients by their ability to refer them to competent counsel to meet their needs in any jurisdiction in the world.

I am pleased to announce that three very active Committee members have agreed to serve as Vice Chairs – Wilson Chu, Keith Flaum, and Mark Morton. We are all energized to continue the legacy of success of Joel and those Chairs who served before him.

We encourage all Committee members who desire a greater level of involvement to contact a member of the Committee leadership. A list of the Committee’s leadership can be found on page 29 of this issue of Deal Points. With teamwork and focus, we can continue the achievements and recognition that our Committee has long enjoyed.

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In the seminal case of Kahn v. Lynch Communication Systems, Inc., the Delaware Supreme Court settled the debate regarding the standard of review applicable to transactions in which a controlling stockholder “stands on both sides” of a transaction, such as a minority squeeze-out transaction, holding that the entire fairness standard of review applies ab initio to such transactions. Lynch and its progeny left unanswered, however, the question whether and to what extent the reasoning that animated those decisions would apply to a situation in which a controlling stockholder did not “stand on both sides” of the transaction, but instead utilized its control position (and power to veto a transaction) to negotiate with a third-party acquiror for different (and perhaps greater) consideration than that received by the minority stockholders. In a recent decision, captioned In re John Q. Hammons Hotels, Inc. Shareholder Litigation, the Delaware Court of Chancery considered that question and determined that, absent robust procedural protections, the entire fairness standard of review would apply to such a transaction. Importantly, the Court concluded that, unlike in Lynch, the business judgment standard of review could be invoked as the applicable standard of review in the circumstances at issue in Hammons if the transaction were both (i) recommended by a disinterested and independent special committee, and (ii) conditioned on the approval by the affirmative (and non-waivable) vote of the holders of a majority of the voting power of all outstanding unaffiliated shares.

Although Hammons provides guidance and clarity as to situations in which Delaware courts will apply the more exacting entire fairness standard of review, as well as particular ex ante steps that may be taken to ensure the application of the more favorable business judgment standard, the decision also raises a number of interesting questions and considerations for M&A practitioners.

The Factual Background

Hammons arose following the merger (the “Merger”) of John Q. Hammons Hotels, Inc. (“JQH”), a publicly traded Delaware corporation, with and into an acquisition vehicle indirectly owned by Jonathan Eilian (“Eilian”). John Q. Hammons (“Hammons”), who served as Chairman of the Board of Directors (the “Board”) and Chief Executive Officer of JQH, controlled approximately 76% of the total voting power of the outstanding capital stock of JQH.

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1 Mark A. Morton, Michael K. Reilly, and Daniel A. Mason practice law in the Wilmington, Delaware law firm of Potter Anderson & Corroon LLP. The views expressed are solely those of the authors and do not necessarily represent the views of the firm or its clients.


3 Id. at 1115-16; see also Kahn v. Tremont Corp., 694 A.2d 422, 428 (Del. 1997). The entire fairness standard may never be wholly obviated in such cases, regardless of any procedural protections deployed or utilized for the benefit of the minority stockholders. In re Cysive, Inc. S’holders Litig., 836 A.2d 531, 547-48 (Del. Ch. 2003).


5 Id. at *2. The capital stock of JQH consisted of two classes of common stock: (i) the Class A common stock; and (ii) the Class B common stock. Hammons and his affiliates owned approximately 5% of the outstanding shares of Class A common stock and all of the
In early 2004, Hammons informed the Board that he had begun discussions with third-parties regarding a potential sale of JQH or his interest in JQH. The Board thereafter formed a special committee of the Board (the “Special Committee”) to evaluate and negotiate a proposed transaction on behalf of the minority stockholders and to make a recommendation to the Board regarding any such transaction. The plaintiffs conceded, and the Court appeared to accept, that the members of the Special Committee were both disinterested and independent.6

In early 2005, Eilian, who had “no prior relationship with Hammons or JQH,”7 extended an offer of $24 per share for all outstanding shares of Class A common stock. Hammons informed the Board that he wanted to negotiate a transaction with Eilian,8 and thereafter representatives of Eilian spent several months negotiating with Hammons regarding the acquisition of his holdings of Class B common stock and separately negotiating with the Special Committee concerning the acquisition of the publicly held shares of Class A common stock.9 In June, Eilian and Hammons reached agreement and Hammons asked the Special Committee to consider the proposed transaction. After the Special Committee met to consider the proposed transaction and recommended that the Board approve the merger agreement, the Board, acting on the recommendation of the Special Committee, approved the merger agreement. Hammons recused himself from the Board vote.

The Merger Agreement

Under the terms of the merger agreement, each share of the publicly traded Class A common stock would be converted into the right to receive $24 per share in cash upon consummation of the Merger, which price reflected a substantial premium over JQH’s stock price, which had traded in the range of $4 to $7 before rumors of a possible merger began to circulate.10

The merger agreement further provided that Hammons, in exchange for his Class B common stock and his interest in a limited partnership controlled by JQH, would receive (i) a 2% interest in the cash flow distribution; (ii) a preferred equity interest in the surviving limited partnership, which preferred interest had a total liquidation preference of approximately $335 million; (iii) a $25 million short-term line of credit and a $275 million long-term line of credit; and (iv) various other contractual rights.11 Such deal structuring was “essential” to

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7 Id. at *1.
8 Hammons initially favored a transaction with Barceló Crestline Corporation (“Barceló”) and indicated that he would not do a deal with the ultimate acquirer, Eilian, “under any circumstances.” Id. at *5 n.5 Indeed, Hammons went so far as to instruct JQH’s general counsel not to provide due diligence materials to Eilian. Id. Negotiations between Hammons and Barceló ultimately proved fruitless and the Board voted (on the recommendation of the Special Committee) not to renew exclusivity with Barceló.
9 Id. at *11.
10 The plaintiffs alleged that the stock price had been artificially depressed by Hammons’s prior self-dealing conduct. Such alleged coercion was one of the unresolved factual and legal issues that the Court cited as a basis for refusing to grant summary judgment.
11 2009 WL 3165613, at *7-8. Hammons received (i) JQH’s Chateau Lake property in exchange for transferring certain assets and related liabilities; (ii) a right of first refusal to acquire hotels sold post-closing; (iii) an indemnification agreement for any tax liability from the surviving entity’s sale of any of its hotels during Hammons’s lifetime; (iv) an agreement whereby Hammons’s management entity would continue to
Hammons’s personal and tax objectives.\textsuperscript{12} The Special Committee’s financial advisor opined that the $24 per share price was fair to the minority stockholders, and further advised that the value received by Hammons (calculated to be $11.95 to $14.74 per share of Class B common stock)\textsuperscript{13} reflected a reasonable allocation of the merger consideration between Hammons and the minority stockholders.\textsuperscript{14}

Pursuant to the terms of the merger agreement, the Merger was conditioned on a waivable requirement that the merger agreement be adopted by the affirmative vote of a majority of the shares of Class A common stock held by unaffiliated holders present and entitled to vote at the stockholders meeting.\textsuperscript{15} At the

manage the hotels in exchange for payments of actual operating costs and expenses incurred (approximately $6.5 million); and (v) a $200,000 annual salary, plus benefits. Hammons also entered into reciprocal side agreements whereby he assumed certain additional obligations.

\textsuperscript{12} Id. at *4.

\textsuperscript{13} The financial advisor’s fairness opinion valued the $275 million line of credit at only $20 - 30 million and failed to account for Hammons’s personal tax benefits from the transaction, and was further undercut by the defendants’ alleged failure to disclose the financial advisor’s conflicted interest. Id. at *13, *16.

\textsuperscript{14} Although unclear from the decision, it is interesting to note that the financial advisor appears to have opined on the reasonableness of the allocation of the merger consideration. Although such an opinion may not have risen to the level of a fairness opinion, practitioners should take note of this precedent given the reluctance of financial advisors to provide a “relative fairness opinion” and the Delaware courts’ insistence on the advisability of such an opinion in the proper context. See Levco Alternative Fund Ltd. v. Reader’s Digest Ass’n, Inc., 2002 WL 1859064 (Del. Aug. 13, 2002); In re Tele-Comm’n’s, Inc. S’holders Litig., 2005 WL 3642727 (Del. Ch. Dec. 21, 2005).

\textsuperscript{15} The vote required in \textit{Hammons} – the affirmative vote of the holders of a majority of the unaffiliated shares voting at the stockholders meeting – is distinct from, and less onerous than, the affirmative vote of a majority of all outstanding unaffiliated shares. Since the transaction occurred in 2005, the parties did not have the benefit of a later Court of Chancery decision finding that the proper vote in at least one other context was the latter vote – a majority of all outstanding unaffiliated shares. See \textit{In re PNB Holding Co. S’holders Litig.}, 2006 WL 2403999, at *15 (Del. Ch. Aug. 18, 2006). The precondition that a merger be supported by the holders of a majority of all outstanding unaffiliated shares is herein referred to as a “majority-of-the-minority condition.”

\textsuperscript{16} 2009 WL 3165613, at *8. The Court’s opinion does not state whether these figures include the approximately 5% of Class A common stock controlled by Hammons and his affiliates. Regardless, a majority of the outstanding unaffiliated shares were voted in favor of the Merger.

\textsuperscript{17} The plaintiffs also asserted disclosure claims based upon alleged misstatements or omissions in the proxy statement, as well as claims against the third-party acquiror for aiding and abetting the alleged breaches of fiduciary duty. This article does not address those claims and the Court’s disposition thereof.
protections would affect the applicable standard of review.

The Applicability of the Entire Fairness Standard of Review

Hammons and the JQH directors argued that the Board’s decision to approve the Merger should be subject to the business judgment standard of review, because (i) Hammons was not on both sides of the transaction; (ii) the minority stockholders had been represented by the disinterested and independent Special Committee; and (iii) holders of a majority of the unaffiliated shares actually voted to adopt the merger agreement. The plaintiffs argued for the applicability of the entire fairness standard of review, claiming that (i) the Special Committee was “ineffective;” (ii) the majority of the minority vote was “illusory;” and (iii) Hammons had a conflict of interest in negotiating benefits for himself that were not shared with the minority stockholders. Further, the plaintiffs characterized the Merger as a “minority squeeze-out transaction” and argued that the entire fairness standard was therefore mandated by *Lynch*.

Chancellor Chandler first determined that *Lynch* did not apply to the facts in *Hammons*, reaffirming that *Lynch* applies only where the controlling stockholder “stands on both sides” of the transaction. The Court concluded that the controlling stockholder in *Hammons* did not stand on “both sides” of the transaction, as he did not extend the offer to the minority stockholders. Rather, the unaffiliated third-party acquiror had negotiated and dealt with the minority stockholders through the disinterested and independent Special Committee. Thus, the Court declined to extend *Lynch* to the present facts.

Although *Lynch* did not apply, Chancellor Chandler nevertheless held that the standard of review was entire fairness. In reaching that conclusion, the Court found as follows:

Although I have determined that Hammons did not stand ‘on both sides’ of this transaction, it is nonetheless true that Hammons and the minority stockholders were in a sense ‘competing’ for portions of the consideration Eilian was willing to pay to acquire JQH and that Hammons, as a result of his controlling position, could effectively veto any transaction. In such a case it is paramount – indeed, necessary in order to invoke business judgment review – that there be robust procedural protections in place to ensure that the minority stockholders have sufficient bargaining power and the ability to make an informed choice of whether to accept the third-party’s offer for their shares.

As a result, the Court concluded that the entire fairness standard of review would apply to the circumstances at issue in *Hammons*.21

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18 2009 WL 3165613, at *10, 12.

19 *Id.* at *11. The Court also rejected the plaintiffs’ argument that the Special Committee was “ineffective” merely because Hammons could, as a practical matter, veto any transaction.

20 *Id.* at *12.

21 *Id.* at *12-13. Applying the entire fairness standard, the Court rejected Hammons’s alternative argument that, regardless of the applicable standard, he would be entitled to summary judgment because he received less than $24 per share for his Class B common stock and therefore received no consideration at the minority’s expense. The Court found that lingering factual and legal disputes regarding the persuasive value of the financial advisor’s opinion precluded entry of summary judgment in the defendants’ favor on the issue of fair price. The Court also denied cross motions for summary judgment on the issue of fair dealing.
The Need for Robust Procedural Protections

Although the entire fairness standard of review applied in Hammons, the Court found that the business judgment standard of review could be invoked through the implementation of robust procedural protections. The Court determined that the procedural protections that would be necessary to invoke the business judgment standard of review in Hammons were (i) a fully-functioning and effective special committee comprised of disinterested and independent directors recommending the transaction,\(^{22}\) and (ii) approval by the holders of a majority of all outstanding unaffiliated stock in a non-waivable vote. The Court found that these procedural protections must be preconditions to the transaction, and must be clearly explained and disclosed to the minority stockholders.

Turning to the facts in Hammons, the Court refused to find that the procedural protections were sufficient to warrant invocation of the business judgment standard of review. Glossing over the effectiveness of the Special Committee,\(^{23}\) the Court raised concerns with respect to the minority stockholder vote condition and determined that it was flawed for two reasons. First, the condition was waivable by the Special Committee. The Court found that such a condition must be non-waivable to be effective in this case because it “serves as a complement to, and a check on, the special committee” in that it “provides the stockholders an important opportunity to approve or disapprove of the work of the special committee and to stop a transaction they believe is not in their best interests.”\(^{24}\) Second, the condition in the merger agreement did not require the affirmative vote of a majority of all outstanding unaffiliated shares. Requiring an affirmative vote by a majority of all outstanding shares held by minority stockholders, rather than those voting, ensures that there is not “passive dissent” amongst the minority stockholders.\(^{25}\) Because the minority stockholders’ affirmative “self-interested decision to approve” provides the requisite proof of fairness to obviate a judicial examination of that question, the Court concluded that the minority vote condition was ineffective.\(^{26}\)

Chancellor Chandler therefore held that, although the holders of a majority of all of the unaffiliated shares in fact voted to adopt the merger agreement, such approval was ineffective because it was subject to waiver by the Special Committee and the transaction was not conditioned on the requisite majority-of-the-minority condition. Accordingly, the procedural

22 With respect to the involvement of a special committee, the Court noted that it is not sufficient for the special committee merely to be disinterested and independent. The special committee also must have sufficient “authority and opportunity” to bargain on behalf of the minority stockholders. Id. at *12 n.38. Such authority to effectively bargain includes, but is not limited to, the ability to hire independent legal and financial advisors.

23 Although the Court did not analyze the effectiveness of the Special Committee, the Court may have been skeptical of its effectiveness due to, among other things, the appearance of certain conflicts of the Special Committee’s legal and financial advisors.

24 2009 WL 3165613, at *12.

25 Id. (citing In re PNB Holding Co., 2006 WL 2403999, at *15). The Court in PNB Holding explained that a stockholder’s failure to return a proxy in the merger context does not mean necessarily that the stockholder is a member of “a ’silent affirmative majority of the minority.’” In re PNB Holding Co., 2006 WL 2403999, at *15. Rather, a stockholder’s informed refusal to return a proxy in the merger context is more likely a “passive dissent” because of the Delaware law requirement that mergers be approved by the holders of a majority of the outstanding stock entitled to vote (i.e., the failure to return the proxy is a “de facto no vote”). Id.

26 Id. The presumption of “passive dissent” comports with the fact that minority stockholder claims are often coupled with allegations of inadequate pre-vote disclosures.
protections “were not sufficient to invoke business judgment review.”

Lessons and Implications of Hammons

The Hammons decision provides practitioners with valuable guidance concerning the procedural protections that may be utilized in transactions between a third-party acquiror and a corporation with a controlling stockholder in order to ensure the applicability of business judgment review. However, the decision raises a number of interesting questions regarding the applicable standard of review and the potential ramifications of agreeing to a non-waivable majority-of-the-minority condition.

Discerning the Applicability of the Entire Fairness Standard of Review and the Import of Procedural Protections

Perhaps the most notable lesson from Hammons is the Court of Chancery’s eagerness to narrow the reach of Lynch. Although the Court’s decision may not be a surprise to practitioners, the decision can be viewed as welcome precedent confirming that Lynch will be limited to its facts and that there will be an opportunity in certain situations, and with proper structuring, to invoke business judgment protection in transactions in which a controlling stockholder does not “stand on both sides” of the transaction.

Although Hammons may be viewed as a positive development in that regard, it also raises a number of doctrinal questions. As an initial matter, it is interesting to consider why the Court concluded that entire fairness applied as a threshold matter to the facts at issue in Hammons. Given the fact that the Court determined that Lynch did not apply, one might ask why entire fairness would apply automatically where the stockholder was not on “both sides” of the transaction and the interests of the minority stockholders were being protected by an independent and disinterested special committee (and potentially a majority independent and disinterested board of directors). Should the Court have at least required well-pled allegations that a majority of the members of the board of directors or special committee were interested and/or not independent with respect to the particular transaction or that the decision was otherwise the result of a breach of the directors’ fiduciary duties?

27 2009 WL 3165613, at *2. Although the business judgment standard of review is unobtainable where a controlling stockholder stands on both sides of the transaction, the use of either a disinterested and independent special committee or a majority-of-the-minority condition will shift the burden of proving entire fairness to the plaintiff. Cysive, 836 A.2d at 553. As the Court of Chancery has acknowledged, the “modest procedural benefit” of such a burden shift is “slight,” as the defendant’s conduct will still be intensely scrutinized to determine whether it was, in fact, entirely fair. In re Cox Comm’ns, Inc. S’holders Litig., 879 A.2d 604, 616-17 (Del. Ch. 2005) (hereinafter, “Cox Communications”); Cysive, 836 A.2d at 548. In Hammons, the Court noted that the protections employed, while insufficient to invoke business judgment protection, might be sufficient to shift the burden of demonstrating entire fairness to the plaintiffs. 2009 WL 3165613, at *14. The Court reached no determination with respect to any such burden shift in light of the remaining unresolved material issues of fact.

28 Although decided before Lynch and its progeny and thus of uncertain utility, it is interesting to consider the Court of Chancery’s decision in Van de Walle v. Unimation, Inc., 1991 WL 29303 (Del. Ch. Mar. 7, 1991). In that case, a majority stockholder did not “stand on both sides” of the transaction and allegedly negotiated for and received benefits from the third-party acquiror that were not shared by the minority stockholders, including a preferred equity interest in the post-merger entity and benefits from certain side agreements with the acquiror. The Court of Chancery found no colorable evidence that the controlling stockholder had benefited at the minority’s expense, and therefore held that “[b]ecause in substance and in form the merger was a bona fide arm’s-length transaction negotiated with a third party, the business judgment rule is the appropriate standard for evaluating its legality and the claims against the defendants.” Id. at *11 (emphasis added). Moreover, the Van de Walle court held that, even if entire fairness was
stockholder and the competition for the consideration enough to warrant invocation of the entire fairness standard from the outset (albeit with the ability to invoke business judgment with robust procedural protections)? With respect to the particular factual situation at issue in Hammons, such questions are answered and the mere fact that a controlling stockholder with the power to veto the transaction is competing for the same consideration is enough for entire fairness to apply absent robust procedural protections.

The Court clearly finds that robust procedural protections are necessary to invoke the business judgment standard of review in the particular circumstances at issue in Hammons. One might ask, however, why the Court determined that the procedural protections necessary to invoke the business judgment standard of review include both a special committee and a majority-of-the-minority condition. Certain current and former members of the Court of Chancery have suggested, in prior decisions and other writings, that there may be intellectual and practical justifications for a paradigm in which the business judgment standard of review could be invoked even in situations in which the controlling stockholder was on “both sides” of a transaction so long as arms’ length bargaining was replicated through the use both a special committee and a majority-of-the-minority condition. Indeed, the Chancellor noted in Hammons his recognition of the recent suggestions to harmonize the standards of review applicable to different forms of transactions that have the effect of cashing out minority stockholders.30

Since the Court concluded that Lynch did not apply to the facts at issue in Hammons, the question arises as to why the Court believed it necessary to require both procedural protections to invoke the business judgment standard of review in a circumstance in which less judicial scrutiny would appear to be warranted. Should the business judgment standard of review be available if only a special committee is employed in a situation in which Lynch does not apply? The answer would seem to be that the Court was driven by the same concerns underlying Lynch (i.e., the potential coercive effects of the “proverbial 800 pound gorilla”).31 As a result, the Court required the same procedural protections that may also be sufficient, if the Delaware Supreme Court were to revisit Lynch and adopt the approach suggested in dicta, to invoke the business judgment review even where the controlling stockholder is on “both sides” of the transaction. It remains an open question whether the operation of an effective special committee alone may be sufficient procedural protection to warrant business judgment review ab initio in a situation with different facts than Hammons.

Finally, practitioners should remain mindful that, although the entire fairness standard of review applied to the facts of Hammons, each transaction will be considered on a case-by-case basis. Indeed, the Court’s

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29 Vice Chancellor Leo E. Strine, Jr., has advocated, in dicta, that the Lynch line of authority be adapted to provide business judgment protection to interested mergers that are negotiated by a special committee and a majority-of-the-minority condition. Certain current and former members of the Court of Chancery have suggested, in prior decisions and other writings, that there may be intellectual and practical justifications for a paradigm in which the business judgment standard of review could be invoked even in situations in which the controlling stockholder had acted with entire fairness in receiving less per share than minority. Id. at *13.

30 2009 WL 3165613, at *12 n.37.

31 Cox Comm’ns, 879 A.2d at 617.
decision in *Hammons* may be limited to the particular fact of that case. Those facts include the presence of a controlling stockholder who (i) could effectively veto any transaction; (ii) negotiated directly with the third-party acquiror on its own behalf; and (iii) received distinct and potentially greater consideration than that received by the minority stockholders. In other situations in which one or more of those facts are absent or the context otherwise is different, the Court’s decision as to the applicable standard of review may be different.

**The Non-waivable Majority-of-the-Minority Condition**

The Court’s decision is clear that for a majority-of-the-minority condition to be a sufficiently robust procedural protection in the circumstances at issue in *Hammons* it must be non-waivable, even by a special committee. That conclusion raises several important and practical questions. First and foremost, how might such a non-waivable majority-of-the-minority condition impact *ex ante* bargaining? Will a rational third-party buyer, asserting the lack of closing certainty, discount the target company’s value when the target insists on such a condition? Will a target’s insistence on such a condition preclude the target from getting the best price reasonably available? Will a special committee of a target be prepared to trade a majority-of-the-minority condition for a higher transactional price?

In *Hammons*, for example, Chancellor Chandler noted without comment that another third-party, Barceló, offered $21 per share for JQH’s Class A common stock if a potential transaction was subject to approval by a simple majority of shares (including those owned by Hammons), but would only pay $20 per share if a majority-of-the-minority condition was required. With respect to that transaction, at least, the potential buyer had concluded that a majority-of-the-minority condition justified a five-percent discount to the value of JQH’s shares. Moreover, the potential gain from ceding such a condition may increase dramatically where the risk or consequences of transactional failure are heightened, as an offeror facing such risks might pay a substantial premium to obtain increased transactional certainty. In such circumstances, how will a target board conclude that its insistence upon (or even willingness to accept) a non-waivable majority-of-the-minority condition is consistent with its duties?

In *Cox Communications*, Vice Chancellor Strine acknowledged the distinct possibility that an independent, well-motivated special committee could “drive a better deal for circumstances (for example, where the controlling stockholder is not asserting its right to a control premium) in which the transaction will be reviewed under *Revlon*. See, e.g., *McMullin v. Beran*, 765 A.2d 910 (Del. 2000). In any event, a board of directors always has a fiduciary duty to get the best deal available under the circumstances. *See Mendel v. Carroll*, 651 A.2d 297 (Del. Ch. 1994).

2009 WL 3165613, at *5.

36 The authors can posit at least one scenario – where a special committee is concerned that potential plaintiffs may raise a litigable question concerning the committee’s effectiveness – in which the committee may be unwilling to trade the majority-of-the-minority condition, for fear of losing an advantageous burden shift.
stockholders” by trading a majority-of-the-minority condition for a higher transactional price in a traditional freeze-out merger context, but concluded that the possibility of obtaining a better deal by forgoing the condition is “outweighed by the general utility of ensuring that controllers and special committees both know that the transactions they agree upon will be subject to approval by the disinterested minority.” In short, in the Lynch context, Delaware law generally does not regard the maximization of transactional price as a valid basis for trading procedural safeguards to protect the interests of minority stockholders, even where such a trade may appear economically rational under the circumstances. However, in a transaction such as the one in Hammons, where the controlling stockholder is not on “both sides,” it is less clear that there is a “general utility” to precluding a target from trading a majority-of-the-minority condition for an increase in the transaction price.

Beyond the possible impact upon the transaction price, widespread insistence upon a majority-of-the-minority condition that is non-waivable may cause the risk of deal failure to increase, particularly in light of the inherent and unavoidable baseline rate of nonparticipation in stockholder voting, or “dead vote.” In nearly every transaction, some percentage of the shares are unlikely to be voted without regard to the transaction being considered. As the size of the majority’s control position increases, the anticipated “dead vote” imposes an increasingly larger supermajority vote requirement and becomes an increasingly greater obstacle to minority approval – a consequence unaccounted for in the decisions to date that have addressed the value of a non-waivable majority-of-the-minority condition.

In Hammons, for example, the holders of more than 18% of the Class A common stock did not vote on the adoption of the merger agreement, and therefore more than 61% of the participating voting power would have had to have supported the transaction to obtain a simple majority of outstanding unaffiliated shares. Where a desired transaction has the support of a substantial supermajority of minority stockholders, but fails to garner a majority of all outstanding minority votes due to the “dead vote,” should the special committee have the capacity to draw its own conclusions as to the differences between the “dead vote” and possible “passive dissent” and waive the majority-of-the-minority condition? As the special committee makes so many critical decisions regarding an interested transaction, why should it be restrained or discouraged from deciding, under such circumstances, that it is in the best interests of the stockholders to waive the majority-of-the-minority condition?

41 As described in Table A (set forth on page 12 of Deal Points), the larger the expected dead vote, the higher the percentage of disinterested shares that must be voted in favor of the transaction to obtain a majority of all disinterested shares.

42 2009 WL 3165613, at *8. Only 4,293,264 (or fewer) of the 5,253,262 issued and outstanding Class A shares participated in the Merger vote, reflecting a combined “dead vote” and “passive dissent” vote of at least 18.274%.

43 One response is that the procedural protections afforded by minority approval stand upon a higher theoretical footing, relative to the use of a special committee, “because by definition minority stockholders are not conflicted and their approval of an interested merger could not be challenged on that ground.” William
For the foregoing reasons, it is unclear whether *Hammons*, which will incentivize boards and special committees in certain contexts to insist upon a non-waivable majority-of-the-minority condition, will drive a change in deal practice, particularly if the imposition of such a condition actually decreases deal certainty or reduces merger prices.44

**Conclusion**

In *Hammons*, Chancellor Chandler applied the entire fairness standard of review to a merger between a third-party acquiror and a corporation with a controlling stockholder that did not stand on “both sides” of the transaction but competed for merger consideration with the minority stockholders. Although raising interesting doctrinal questions, *Hammons* should be a helpful precedent for transactional planners as it limits the reach of *Lynch* and simultaneously provides a roadmap for the robust procedural protections—a disinterested and independent special committee and a non-waivable majority-of-the-minority condition—


44 To the extent either of these concerns is merited or becomes manifest, perhaps Delaware courts, while maintaining a strong preference for non-waivable conditions, will allow for the possibility that a special committee may wish to either forego a majority-of-the-minority condition (for example, to secure a greater deal price) or waive such condition (for example, because of the impact of the expected “dead vote”). This approach would be consistent with the Delaware courts’ preference to favor context-specific inquiries over the imposition of bright-line rules. *See In re Toys “R” Us, Inc. S’holder Litig.*, 877 A.2d 975, 1016 (Del. Ch. 2005).

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**Table A**

Percentage of Disinterested Shares That Must Be Voted In Favor of the Transaction To Obtain A Majority of All Outstanding Unaffiliated Shares:

<table>
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<th>Percentage Held by Affiliated Stockholders</th>
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Volume IX, Issue 3
Fall 2009
Planning for Canada-US Tax Treaty
Changes Affecting Hybrid Entities

By
Marc Darmo and Jeff Oldewening

Introduction

The fifth protocol to the Canada-US Tax Convention, 1980 (the “Canada-US Treaty”) introduced important changes of interest to US multinational enterprises with hybrid entities, such as unlimited liability companies (“ULCs”) and limited liability companies (“LLCs”), in their cross-border structures. M&A practitioners should be mindful of these changes in connection with cross-border transactions that may involve the Canada-US Treaty when advising US multinational enterprises.

ULCs

A ULC is a Canadian corporate entity that may be created under the corporate statutes of three Canadian provinces—Nova Scotia, Alberta and British Columbia. It is like any other Canadian corporate entity except that its shareholders are, in certain circumstances, jointly and severally liable for its debts and liabilities. The Canada Revenue Agency (“CRA”) treats a ULC as a regular corporation for Canadian tax purposes.

Upon the introduction of the “check-the-box” regulations under the Internal Revenue Code (US), the ULC became a popular vehicle to use for inbound investment into Canada from the US. The “check-the-box” regulations permit a ULC to elect not to be treated as a corporation for US tax purposes but to be treated instead as a partnership (if it has multiple shareholders) or a disregarded entity (if it has a single shareholder). The “hybrid” nature of the ULC has traditionally made it suitable for a wide variety of uses by US residents investing in Canada, such as using foreign tax credits arising from Canada efficiently while avoiding Canadian branch tax, consolidating Canadian-source income and losses in a US consolidated group, or implementing certain debt pushdown structures that achieve a double-dip interest deduction in both Canada and the US.

The Fifth Protocol

The fifth protocol to the Canada-US Treaty introduced certain rules in Article IV that effectively grant or deny treaty benefits to US residents that derive or receive an amount of Canadian-source income, profit or gain through or from certain hybrid entities by treating the particular amount as having been, or not having been, derived by a person who is a US resident for purposes of the Canada-US Treaty. The new rules enter into force on January 1, 2010.

Articles IV(6) and (7)(a) work together to codify the principle that an amount of Canadian-source income, profit or gain realized by a non-Canadian fiscally transparent entity will be considered to be derived by a US resident to the extent that US tax law would treat such amount similarly whether the US resident had realized the amount directly or through the non-Canadian fiscally transparent entity. This rule grants treaty benefits to the US resident in respect of such an amount. Importantly, the rule effectively grants treaty benefits to the members of US LLCs provided that such members satisfy the other requirements of the Canada-US Treaty (including that such members must be residents of the US, entitled to treaty benefits under the limitation on benefits provision in Article XXIX A and, in respect of passive property income such as dividends, interest or royalties, constitute the beneficial owner of the particular

1 Marc Darmo and Jeff Oldewening practice law at McCarthy Tétrault LLP.
amount). By its terms, however, Article IV(6) is not so limited and extends treaty benefits to other fiscally transparent entities resident in any jurisdiction other than Canada.

On the other hand, Article IV(7)(b) denies treaty benefits to US residents in limited circumstances. It provides that an amount of Canadian-source income, profit or gain will be considered not to be paid to or derived by a US resident where the US resident is considered under Canadian tax law to have received the amount from a Canadian-resident entity, but by reason of the Canadian-resident entity being treated as fiscally transparent under the laws of the US, the treatment of the amount under US tax law is not the same as its treatment would be if the Canadian-resident entity were not treated as fiscally transparent under US tax law. This means that Canadian withholding tax should be exigible on such an actual dividend at the rate of 25 percent, without any treaty relief. As noted above, Article IV(7)(b) enters into force on January 1, 2010. The approaching entry-into-force date may prompt affected taxpayers to review their corporate structures and consider reorganizations.

Options to Avoid the Application of Article IV(7)(b)

This article examines the Canadian tax implications of certain restructuring options, and one option that does not require a restructuring, that are potentially available to avoid the detrimental impact of Article IV(7)(b) in the context of a simplified corporate structure comprising a US-resident C corporation that owns a Canadian-resident ULC. The options considered here are grouped into two categories: (i) those that preserve the flow-through status of the group for US tax purposes; and (ii) those that do not. Whether preserving such flow-through status is important depends on the facts of each case and the reasons the US resident employed the ULC in the first place. Any of these structures should be reviewed by Canadian and US counsel before implementation.2

Options That Preserve Flow-Through Status for US Tax Purposes

One option potentially available to avoid the application of Article IV(7)(b) to distributions in the nature of dividends does not involve a restructuring but instead involves a two-step cross-border distribution economically equivalent to an actual dividend. As a first step, the Canadian-resident ULC would increase the stated capital of its shares by a particular amount. As a second step, the Canadian-resident ULC would decrease the stated capital of its shares by the same amount and distribute such amount to the US-resident C corporation as a return of capital.3 For Canadian tax purposes, each step of the cross-border distribution should be considered separately according to its legal substance.

On the first step, subsection 84(1) of the Income Tax Act (Canada) would deem the Canadian-resident ULC to have paid, and the US-resident C corporation to have received, a dividend equal to the amount of the increase in the paid-up capital of the shares of the Canadian-resident ULC (namely, the amount of the increase in the stated capital of the shares of the Canadian-resident ULC for purposes of

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2 The comments herein in respect of US law are based solely on the authors’ understanding and have not been independently reviewed by US counsel; therefore, they should not be interpreted as expressions of opinion concerning such US law.

3 A similar tax treatment might result from the payment of stock dividends, with such modifications as the circumstances require.
corporate law). Canadian withholding tax would apply to the deemed dividend under subsection 212(2) of the *Income Tax Act* (Canada). The second step would be treated as a return of capital and would not be subject to Canadian withholding tax.

The issue becomes what rate of Canadian withholding tax applies on the deemed dividend arising on the first step — namely, the domestic rate of 25 percent or the treaty-reduced rate of five percent under Article X(2)(a) of the Canada-US Treaty? The answer depends on whether Article IV(7)(b) applies to cause the amount to be considered not to be paid to or derived by a US resident.

On November 24th, at the CRA Roundtable of the Canadian Tax Foundation’s annual conference, the CRA took the position that Article IV(7)(b) would not apply provided that the deemed dividend resulting from the increase in the paid-up capital of the shares of the ULC is disregarded under the taxation laws of the US and would be similarly disregarded if the ULC were not fiscally transparent.

In the CRA’s view, the application of the Canadian general anti-avoidance rule would depend on all of the facts and circumstances. However, the CRA would not normally expect the general anti-avoidance rule to apply if the ULC is used by the US-resident C corporation to carry on an active branch operation in Canada and the C corporation and the ULC enter into the arrangement so as to continue to qualify for the five percent withholding tax on the distribution of ULC’s after-tax earnings to the C corporation.

Besides this type of planning for distributions in the nature of dividends, a number of restructuring options are available to avoid the application of Article IV(7)(b) to other types of Canadian-source income, profit or gain that preserve the flow-through status of the group for US tax purposes.

The first restructuring option involves the interposition between the US-resident C corporation and the Canadian-resident ULC of a Luxembourg-resident Société à Responsabilité Limitée (SARL) that elects to be fiscally transparent for purposes of US tax law. With respect to a dividend paid by the Canadian-resident ULC to the Luxembourg-resident SARL, Article IV(6) might apply (and Article IV(7)(b) might not apply) to the amount of the dividend. As a result, the US-resident C corporation should be entitled to treaty benefits under the Canada-US Treaty in respect of such amount. More specifically, Article IV(7)(b) might not apply because the US-resident C corporation would not be considered under Canadian tax law to have derived the amount of the dividend through the Canadian-resident ULC. By contrast, Article IV(6) might apply because the US-resident C corporation would be considered under US tax law to have derived the amount of the dividend through the Luxembourg-resident SARL, a fiscally transparent entity that is not a resident of Canada, and by reason of this entity being treated as fiscally transparent under US law, the treatment of the amount under US tax law is the same as its treatment would be if that amount had been derived directly by the US-resident C corporation.

If this result obtains, then the provisions of both the Canada-US Treaty and the *Canada-Luxembourg Tax Convention, 1999* (Canada-Luxembourg Treaty) would apply concurrently. In order to comply with both treaties, the Canadian-resident ULC should withhold and remit Canadian withholding tax at the lower of the two treaty-reduced rates applicable to dividends — in this case, the rate is the same under both treaties, namely, five percent. Naturally, the other requirements of the Canada-US Treaty and the Canada-Luxembourg Treaty must be satisfied before treaty relief would apply. In addition, the
potential application of the general anti-avoidance rule (GAAR) in subsection 245(2) of the *Income Tax Act* (Canada) should be considered.

This planning (in particular, the preservation of the flow-through status of the group for US tax purposes) might be frustrated by a proposal contained in the US federal budget released in May 2009, which is proposed to apply to taxation years ending after 2010. The budget proposed that a foreign hybrid entity may be treated as a disregarded entity for US tax purposes only if the single owner of the foreign hybrid entity is created or organized in, or under the law of, the foreign country in, or under the law of, which the foreign hybrid entity is created or organized. The proposal would generally not apply to a first-tier foreign hybrid entity wholly owned by a US person, except in cases of US tax avoidance.

In our example, the Canadian-resident ULC and its single owner, the Luxembourg-resident SARL, were created in different foreign countries; so the Canadian-resident ULC would be treated as a corporation for US tax purposes under the proposal. This would cause the Canadian-resident ULC to be taxed as a corporation in the US, and not as a fiscally transparent entity. Some simple planning might be available to avoid this rule as proposed, but much will depend on the actual language of the provision as enacted in law.

A second restructuring option involves the US-resident C corporation selling some shares of the Canadian-resident ULC to another related US-resident C corporation. In this way, the Canadian-resident ULC would be treated not as a disregarded entity but as a partnership for purposes of US tax law. As the *Internal Revenue Code* (US) might recognize the payment of, for example, interest by a partnership to a partner for US tax purposes, the rule in Article IV(7)(b) might not apply to such amounts. This is because the treatment of such interest for purposes of US tax law might be the same whether or not the Canadian-resident ULC were treated as a partnership or as a corporation for purposes of US tax law. On the other hand, the *Technical Explanation* to the Canada-US Treaty suggests that the same result should not obtain in respect of the payment of dividends by the Canadian-resident ULC to one or both of the US-resident C corporations, because the treatment of the amount for purposes of US tax law differs depending on whether the Canadian-resident ULC is fiscally transparent for purposes of US tax law (that is, if the ULC were treated as a partnership, the amount would be treated as a partnership distribution — but if it were treated as a corporation, the amount would be treated as a dividend).

### Options That Do Not Preserve Flow-Through Status for US Tax Purposes

Other restructuring options are available to avoid the application of Article IV(7)(b), but these structures do not preserve the flow-through nature of the group for US tax purposes. Where the Canadian business is wholly owned and all foreign tax credits arising from Canada may be claimed in the US, however, the elimination of flow-through status might not be particularly detrimental.

The simplest option involves the Canadian-resident ULC converting into a regular corporation under Canadian corporate law that is treated as a corporation for US tax purposes. Alternatively, the Canadian-resident ULC could elect to be treated as a corporation for US tax purposes. This option might trigger adverse US tax consequences to the US-resident C corporation, such as the realization of a gain on the conversion.

Another option involves the Canadian-resident ULC continuing in a US jurisdiction such as the State of Delaware. The continued
corporation would be treated as a corporation, and not as a fiscally transparent entity, for US tax purposes. It would retain its residence in Canada at common law in order to, among other things, avoid a deemed disposition of its assets for Canadian tax purposes and the incidence of Canadian departure taxes. Article IV(7)(b) might not apply to dividends paid by the continued corporation to the US-resident C corporation because the continued corporation would not be treated as fiscally transparent under US law.

A number of issues arise in this context. One issue is whether the continued corporation’s dual residence must be resolved by the Competent Authorities pursuant to the tie-breaking rule in Article IV(3)(b) — and, if so, whether there is a risk that the Competent Authorities could determine that the continued corporation is a resident of the US, defeating the purpose of retaining its residence in Canada at common law. Further, the potential application of the GAAR should be considered.

Yet another option involves the Canadian-resident ULC contributing its property to a Canadian partnership in consideration for a partnership interest on a tax-deferred basis. The Canadian partnership would elect to be treated as a Canadian corporation for US tax purposes. Arguably, Article IV(7)(b) might then not apply to dividends paid by the Canadian-resident ULC to the US-resident C corporation because the treatment of the amount for US tax purposes should be the same whether or not the Canadian-resident ULC is disregarded under US tax law. As the US-resident parent is a C corporation, it might claim a foreign tax credit in the US to mitigate the leakage arising as a result of the Canadian income tax payable by the Canadian-resident ULC on its Canadian-source taxable income realized as a result of its allocation of the partnership’s profits. This structure also requires carefully considered analysis, including detailed consideration of the potential application of the GAAR.

One simple option that has been suggested on behalf of taxpayers with more limited means involves the US-resident C corporation incorporating a new Canadian-resident corporation. The Canadian-resident ULC would make contributions of contributed surplus (or, alternatively, simply gift the amounts) to the Canadian-resident corporation, which would in turn pay such amounts to the US-resident C corporation as dividends. Again, this proposal raises a number of issues, including whether the Canadian-resident corporation has a source of income or otherwise must include the contributions in computing its income under paragraph 12(1)(x) of the Income Tax Act (Canada), and whether a deemed dividend to the US-resident C corporation might arise under the combined operation of paragraph 214(3)(a) and subsection 56(2) of the Income Tax Act (Canada) on the transfer of amounts from the Canadian-resident ULC to the new Canadian-resident corporation. These issues might be resolved by further planning using cross-shareholding and dividend-sprinkling techniques. Further, the potential application of the GAAR should be considered.

The above options are only some of those being discussed in the marketplace. These and all other options should be discussed with Canadian and US counsel.

Conclusion

As a result of the changes introduced by the fifth protocol to the Canada-US Treaty, it is recommended that US multinational enterprises with hybrid entities in their cross-border structures review such structures and consider their options. M&A practitioners should be aware of these issues in connection with cross-border transactions that may involve the Canada-US Treaty.

* * *
Task Force on Acquisitions of Public Companies

Our Task Force met in Chicago in August in connection with the ABA Annual Meeting. At our meeting on Saturday, August 1, we discussed the termination section using the revised draft prepared by the termination task force (Jim Melville, Mark Morton, Drew Fuller, and Bryan Davis). We decided to expand the termination right relating to change of recommendation to include all of the events in the old triggering event definition (which will not be used), and the defined term “change of recommendation” will be narrowed in Section 4.6. We also decided to add a discussion of the use of an MAE as a termination provision—why it is useful (timing difference, absence of cure right) even if buyer has a right to terminate for breach of the “no changes” rep—and a cross-reference to the discussion in the conditions section on MAEs, deleting the duplicative discussion in Section 7. In the introduction to the termination section we decided to add a short paragraph on the board’s consideration of its fiduciary duties in the context of reviewing the termination section. We also decided to add a sample provision in the commentary extending the drop dead date in the event of a regulatory issue.

We also agreed that there would be an alternative buyer draft providing a fiduciary termination right (with a match right), along with target commentary. There were a variety of other changes discussed. We also discussed the revisions Ryan Thomas had proposed to the third party beneficiaries discussion in the “miscellaneous” section and approved the revised commentary, subject to any further comments which Task Force members are invited to send along to Ryan Thomas and Byron Egan for consideration.

At our Editorial Board meeting on Sunday, August 2, we continued discussions on the termination section and also talked about the revised representations and warranties, prepared by Leigh Walton, Ed Deibert, and Ryan Thomas. We also had a wonderful Task Force dinner at Ditka’s in Chicago!

Since August, the Editorial Board has been working hard on the Model Agreement. We had a two day drafting session in early November, hosted by Diane Frankle in Silicon Valley, and almost finished revisions on the termination section. The Editorial Board had two other telephonic meetings on the termination section in November. We will next turn to the meeting covenants and no shop covenant. Keith Flaum has already made revisions to the meeting covenants section to bring it into conformity with the more recent work on termination. Ed Deibert and Ryan Thomas are working on the representations and warranties sections. Jim Walther is reviewing the current draft of the exchange ratio article.

In Washington, D.C., the Editorial Board plans to spend most of Friday and half of Saturday working on the Model Agreement, focusing on the meeting and no shop covenants, the exchange ratio article, and the voting agreement. Our goal is to publish in 2010 and we are on schedule to do so.

We will however have a very important Task Force meeting in Washington, D.C. We have invited Michelle Anderson, Chief, Office of Mergers & Acquisitions, to spend an hour with our Task Force. Michelle would like the opportunity to get to know the members of the Task Force and is hoping to learn more about our concerns and practice issues, while conveying the current state of regulatory efforts to the extent she is permitted to comment. We thank Jim Griffin for arranging for Michelle’s visit to the Task Force and hope you can all attend.
As is typical for Committee stand-alone meetings, there will not be a Task Force dinner in Washington, D.C. In addition, we have been advised that our annual sojourn to Wilmington, Delaware will not be held in 2010. Due to a variety of conflicts in schedules, we were not able to find a weekend in the first quarter of 2010 that worked for the Delaware judiciary. The Editorial Board will be meeting in Dallas in the first quarter to continue work on the Model Agreement, but there will be no stand-alone Task Force meeting in 2010. We look forward to future meetings, both in Wilmington in 2011, and at the ABA’s 2010 spring and summer meetings.

Diane H. Frankle
Stephen H. Knee
Co-Chairs

Task Force on Distressed M&A

Just like distressed deals continue to flourish, membership in the Task Force on Distressed M&A continues to grow! I am happy to report that we have been active in discussing various issues relating to distressed deals and have some exciting projects up our sleeve.

The Task Force held a successful meeting at the ABA Annual Meeting in Chicago. We featured multiple speakers including Stephen Spencer, the head of Houlihan Lokey’s restructuring practice in Minneapolis (who provided an overview of the distressed M&A market), John Iwanski of Grant Thornton (who shared perspectives on due diligence in distressed deals), and David Weinstein, a leading Los Angeles-based bankruptcy attorney (who discussed the implications of recent prominent bankruptcies to deal lawyers). We also co-sponsored a CLE program on distressed M&A featuring Chief Justice Myron Steele, Vice Chancellor Travis Laster and William Savitt of Wachtell Lipton, as well as our own Leigh Walton and Mark Morton.

We plan to have a robust discussion on distressed deal-making at our meeting on Friday, December 4, from 9:00 a.m. until 10:30 a.m., in Washington D.C. (dial-in is available through 888-209-3787; Passcode: 1214753). J. Patrick Cave of The Cypress Group will give a unique presentation on how legislative changes may impact distressed M&A in 2010 and beyond. The Cypress Group is a boutique advisory group based in Washington D.C. and I suspect Patrick’s presentation will be highly thought-provoking. In addition, Sylvain Vauclair of McCarthy Tétrault will discuss issues that non-Canadian acquirers should consider when purchasing a Canadian business. Jennifer Muller will also give a distressed M&A update. Finally, we intend to discuss, and enlist members in, our new deal point analysis of 363 asset purchase agreements and sale orders. To our knowledge, this deal point study will be the first of its kind. And December 4 is the time to get involved, right from the start, with this project.

See you in Washington D.C.!

Hendrik Jordaan
Chair

Task Force on the Model Stock Purchase Agreement

The Editorial Committee has completed a working draft of the Revised Model Stock Purchase Agreement for initial submission to the ABA Publishing Group. A small group of Task Force members will be working with the ABA to finalize the working draft. Once this process has been completed and leadership input has been received, a new draft will be circulated to the Editorial Committee for final comment.

Neal Brockmeyer, a member of the Editorial Committee, participated in a webinar with members of the AICPA on October 22, 2009. The title of the program was “Pitfalls To
Avoid When Assessing Damages in M&A Disputes.”

We look forward to seeing you in Washington, D.C.

Robert T. Harper
Chair

SUBCOMMITTEE REPORTS

International M&A Subcommittee

The International M&A Subcommittee met on Sunday, August 2, in connection with the ABA Annual Meeting in Chicago.

Recent Developments in French Reorganization and Insolvency Procedures

The meeting began with a presentation by Reid Feldman on Recent Developments in French Reorganization and Insolvency Procedures.

Post-Closing Dispute Resolution Project

Guy Harles and Katrin Vorlat summarized a number of issues arising out of the Post-Closing Dispute Resolution Project, with input from a number of contributors to the project.

Projects and Programs

There was a discussion of possible future Subcommittee projects and programs, including the following:

- Post-contract dispute resolution techniques, based on our current project. This is a possible program at the 2010 ABA Annual Meeting.
- Cross-border acquisitions of insolvent companies (which could be co-sponsored with the Task Force on Distressed M&A headed by Hendrik Jordaan).
- Use of U.S. and offshore corporate entities in M&A (various, including Jörg Lips).
- Mock negotiation of cross-border acquisitions (using results of the International Market Trends study).
- Public company questionnaire, based on the project commenced some years ago but put on hold pending publication of the work product of the Task Force on Acquisitions of Public Companies (John Leopold and Franziska Ruf).
- Various joint venture topics were considered, including termination methods (Francisco Portolano) and the different vehicles for cross-border JVs.
- Virtual data rooms in cross-border M&A (Francisco Portolano).
- Extraterritorial effects in M&A, including anti-trust and securities issues (Jean-Paul Chabaneix).
- China deals update, including state-owned enterprises (Brett Kagetsu).
- Program featuring in-house counsel, covering their expectations in cross-border M&A deals and in counsel advising them in such deals (Jim Walther).

It was noted that the Subcommittee had presented two excellent programs the previous day. The programs were as follows:

“Don’t Fall at the First Cross-Border Hurdle – Preliminary Agreements in Cross-Border M&A”

Christiaan de Brauw and Alfredo Rovira summarized some of the issue that had arisen in the program and commented that there had not been time to cover non-compete and secrecy issues. It was noted that Murray Perelman had
been unable to participate in the panel as a result of being unwell and the Subcommittee conveyed its best wishes for a full and speedy recovery. Anthony Milazzo was thanked for having stepped in on very short notice to cover Canadian issues on the panel.

“IP and IT Reps and Warranties in Cross-Border Acquisition Agreements”

Peter Haver commented that the program had raised a number of comments from IP specialists on the IP and IT provisions in the Committee’s model forms.

Current Developments Discussion

The meeting concluded with our customary general discussion by Subcommittee members regarding legal developments in their jurisdictions relevant to M&A practice. Points raised included:

• Nick Dietrich and Catherine Pawluch updated the meeting on a number of Canadian issues including the commencement by the Canadian government of legal proceedings against a U.S. investor under the Investment Canada Act, two China-related developments, and the publication of proposed changes to the Investment Canada Act regime.

• Brian Yao updated the meeting on a number of Chinese developments of interest.

• Alfredo Rovira described increasing Argentinian government involvement in the affairs of nationalized corporations. Jim Walther highlighted parallels with the U.S. government’s involvement in the banking and automotive industries.

• Shivpriya Nanda commented on increasing levels of M&A activity in India.

• Daniel Rosenberg outlined developments relevant to closing deals in the U.K. using signature pages.

Subcommittee Website

The Subcommittee’s website is located at www.abanet.org/dch/committee.cfm?com=CL560016 and contains the following information:

• The program materials from the Subcommittee’s program entitled “Don’t Fall at the First Cross-Border Hurdle—Preliminary Agreements in Cross-Border M&A.”

• The presentation by Reid Feldman on the changes in French reorganization and insolvency procedures.

• Notes by Nick Dietrich and Catherine Pawluch summarizing the Canadian developments they discussed in the meeting.

• A memorandum by Brian Yao summarizing the Chinese developments he discussed in the meeting.

• A memorandum by Daniel Rosenberg summarizing the developments relevant to closing deals in the U.K. using signature pages referred to in the meeting.

• Details of the Subcommittee’s publications, future meetings, work-in-progress and past program materials.

We look forward to seeing you in Washington, D.C.

Daniel P. Rosenberg
James R. Walther
Co-Chairs
Membership Subcommittee

Our membership is still growing! Since our July 2009 report, we have seen membership numbers in all categories increase. Our total Committee membership increased by 147 during this time, so we are currently at 3,765 members in 44 countries and 49 states. Our in-house counsel members and “associate” members (non-lawyers) have grown to 382 and 304, respectively.

The M&A Market Trends Subcommittee, which has 1,385 members, is still our largest group. Below is a list of the other larger subcommittees and task forces:

- Private Equity M&A 1,165
- Acquisitions of Public Companies 755
- International M&A 771
- Model SPA Revisions 704
- M&A Jurisprudence 607

The Task Force on Distressed M&A, which is our newest task force, has also grown and is now comprised of 257 members. Also, women now represent 17% of the total membership of the Committee. This percentage is an improvement but the Committee continues to push forward to involve others and substantially increase this number. With two new women as Co-Chairs, we hope it will be contagious!

Also to be noted are our Canadian members who represent almost 5% of all our members. They are active and growing. Did you know that the Canadian Bar (in Quebec and British Columbia) has implemented the continuous legal education credits and that the ABA CLE accredited programs can also be accredited in those provinces? We hope this helps to attract new members and increases our valuable Canadian membership!

With respect to our “associate” members, indeed the number is rising and their involvement in the various subcommittees certainly contributes to making our meetings that much more beneficial and interesting. Spread the word!

We will provide the Committee with a more detailed report in the next issue of Deal Points and will illustrate the revised strategic membership plan and some exciting new initiatives we hope to put in place.

Mireille Fontaine
Ryan Thomas
Tracy E. Washburn
Co-Chairs

M&A Jurisprudence Subcommittee

The M&A Jurisprudence Subcommittee has two working groups. The Annual Survey Working Group identifies and reports to the Committee on recent decisions of importance in the M&A area, and prepares the Annual Survey of Judicial Developments Pertaining to Mergers and Acquisitions, which is published annually in The Business Lawyer. The Judicial Interpretations Working Group examines and reports to the Committee on judicial interpretations of specific provisions of acquisition agreements and ancillary documents, looking not only for recent M&A cases of special interest, but also examining the entire body of case law on the specified type of provision. The work product of the Judicial Interpretations Working Group consists of memoranda summarizing our findings regarding these acquisition agreement provisions and M&A issues. The memoranda are posted in an extranet library, to which only M&A Jurisprudence Subcommittee members have access currently, but which we are preparing to make available to all members of the Committee.

The Annual Survey Working Group will meet in Washington D.C. on Friday, December 4, from 2:00 p.m. until 3:00 p.m., in the Ritz
Carlton Hotel. The Judicial Interpretations Working Group will meet immediately thereafter, from 3:00 p.m. until 4:30 p.m.

**Annual Survey Working Group**

The seventh Annual Survey of Judicial Developments Pertaining to Mergers and Acquisitions will be published in the February 2010 issue of *The Business Lawyer*. Our working group has collected and summarized thirteen cases for inclusion in our 2009 annual survey, and we thank all Committee members who have suggested cases. In Washington D.C., we will discuss those cases, how they are being presented in the annual survey, and any additional cases presented at the meeting. We will also begin planning the 2010 annual survey. Among the cases we will discuss is the *Sonoran Scanners, Inc. v. PerkinElmer, Inc.* case, which is summarized below.

We are asking all members of the Committee to send significant judicial decisions to us for possible inclusion in the survey. Submissions can be sent by email either to Jon Hirschoff at jhirschoff@fdh.com or to Michael O’Bryan at mobryan@mofo.com. You may fax cases to Jon at (203) 325-5001 or to Michael at (415) 268-7522. Please state in your email or on the fax cover sheet why you believe the case merits inclusion in the survey.

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 (i) 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), (ii) interpret or apply a state statute that governs one of the constituent entities (e.g., the Delaware General Corporation Law or the Louisiana Limited Liability Company Law), (iii) pertain to a successor liability issue, or (iv) decide a breach of fiduciary duty claim. We are currently excluding cases dealing with federal law, securities law, tax law, and antitrust law. But if you feel a case dealing with an M&A transaction is particularly significant please send it, even if it does not meet the foregoing criteria.

To join our working group, please email either Jon Hirschoff at jhirschoff@fdh.com or Michael O’Bryan at mobryan@mofo.com, or simply attend the working group meeting in Washington D.C.

**Decision to be Discussed at the Washington D.C. Meeting**


In *Sonoran Scanners, Inc. v. PerkinElmer, Inc.*, the United States Court of Appeals for the First Circuit held that, under Massachusetts law, the buyer under an acquisition agreement that included an earnout as part of the purchase price was bound by an implied covenant to use reasonable efforts to develop and promote the technology and products of the acquired business.

Sonoran Scanners, Inc. (“Sonoran”) was founded by Joseph P. Donahue (“Donahue”) to develop and market high-speed computer-to-plate technology to the newspaper and graphic arts industries. Facing a cash shortage after the investment of $3.5 million of his own money, Donahue sought a buyer for the business. PerkinElmer, Inc. (“PerkinElmer”) agreed to buy substantially all of the business pursuant to an Asset Purchase Agreement (the “Agreement”), paying $3.5 million cash at the closing and agreeing to make earnout payments if certain sales targets were met over a five year period.
The business, as operated by PerkinElmer, was a failure, and no earnout payments were made. Sonoran and Donahue sued PerkinElmer on four theories: (i) breach of the express terms of the Agreement; (ii) breach of the implied covenant of good faith and fair dealing by engaging in bad faith conduct; (iii) breach of the implied terms of the Agreement by failing to make reasonably competent and diligent efforts to develop, market, and sell Sonoran’s products; and (iv) unfair and deceptive conduct in violation of a Massachusetts statute.

Following discovery, the District Court granted summary judgment to PerkinElmer on all four claims. The Court of Appeals affirmed with respect to each claim except the third. The Court cited Eno Sys., Inc. v. Eno, 41 N.E.2d 17, 19-20 (Mass. 1942) as holding that it is implied that one who obtains the exclusive right to manufacture a product under a patent has an implied obligation to exert reasonable efforts to promote sales and to establish, if reasonably possible, extensive use of the invention. PerkinElmer argued that (i) Eno and similar Massachusetts cases are limited to exclusive licensing arrangements, and (ii) an implied obligation is only appropriate where there is no other consideration supporting the existence of a contract, and not, as here, where PerkinElmer had already paid $3,500,000 at closing. The Court rejected those arguments.

The Court stated in its opinion that “various aspects of the . . . Agreement in addition to the contingent nature of Sonoran’s compensation support its argument that the reasonable efforts term was implicit. The earnout compensation was substantial (potentially $3.5 million) in relation to the up-front payments made by PerkinElmer ($3.5 million). A significant portion of the $3.5 million was paid to Sonoran’s creditors and did not benefit the shareholders directly. The Purchase Agreement contemplated a campaign to market the Sonoran technology over the next five years. . . . There was no language in the [A]greement negating an obligation by PerkinElmer to use reasonable efforts or conferring absolute discretion on PerkinElmer as to the operation of the business.”

The Court remanded the case to the District Court for a determination as to whether PerkinElmer had breached its implied obligation, recognizing that PerkinElmer had made a substantial investment in Sonoran and therefore had a substantial interest in making the business succeed, so that it “may not be easy for Sonoran to show a lack of reasonable efforts.”

M&A practitioners should recognize that in many jurisdictions the Sonoran Scanners case may be read to offer sellers in earnout cases a theory that, unlike the implied covenant of good faith and fair dealing, does not require the seller to show bad faith on the part of the buyer. While in many cases it may not be possible, as a practical matter, for a buyer to negotiate a term expressly “negating” an obligation to use reasonable efforts with respect to the business, many buyers do succeed in negotiating a term conferring on the buyer absolute discretion as to the operation of the business. The question arises, then, as to whether such an “absolute discretion” provision, without more, would have been enough to cause the Court to reach a different decision in the Sonoran Scanners case.

Judicial Interpretations Working Group

The Judicial Interpretations Working Group has thus far completed memoranda summarizing our findings regarding the judicial interpretation of: (i) financial statement representations, (ii) no undisclosed liabilities representations, (iii) full disclosure (“10b-5”) representations, (iv) material adverse change clauses, (v) survival clauses and contractual statutes of limitations, (vi) tortious interference
claims in M&A transactions, and (vii) attorney-client privilege and conflicts issues in M&A transactions. Currently we have working group teams in various stages of preparation of 13 memoranda regarding additional acquisition agreement provisions and M&A issues. The completed memoranda are posted in an extranet library, to which only M&A Jurisprudence Subcommittee members have access at this time.

Our goal for 2010 is to make available to all members of the Committee an on-line research library of memos on acquisition agreement provisions and M&A issues. To do this we are seeking the help of all interested Committee members. Because extensive M&A transactional experience is not necessary, and we have a virtually unlimited pool of topics to work on, the Judicial Interpretations Working Group is a good way to become involved in the Committee.

The Judicial Interpretations Working Group met during the ABA Annual Meeting in Chicago. During the meeting we had a spirited discussion of the paper by Gabe Saltarelli and Mark Klein on judicial interpretations of financial statements representations, and the paper by Nicholas Dietrich on fraud in circumstances when indemnification is stated to be the sole remedy under an acquisition agreement.

The Washington D.C. meeting of the Judicial Interpretations Working Group will be held on Friday, December 4, from 3:00 p.m. until 4:30 p.m., in the Ritz Carlton Hotel. We will discuss current memoranda in progress, and our plans for 2010. Around 4:00 p.m., we will join the M&A Market Trends Subcommittee and have a joint discussion regarding market trends and judicial interpretations pertaining to financial statement representations.

To join our working group, please send an email addressed to either Scott Whittaker at swhittaker@stonepigman.com or Jim Melville at jcm@kskpa.com, or simply attend the working group meeting in Washington D.C.

Jon T. Hirschoff  
Subcommittee Chair

Michael G. O’Bryan  
Chair, Annual Survey Working Group

Scott T. Whittaker  
James C. Melville  
Co-Chairs, Judicial Interpretations Working Group

M&A Market Trends Subcommittee

We want to thank everyone for their participation at our standing room only meeting in Chicago in August. At that meeting, members of the working groups for the 2009 Private Target M&A Deal Points Study and the 2009 Strategic Buyer/Public Target Deal Points Study gave us a sneak preview of selected results from those studies, including mock negotiations of certain deal points, and Jennifer Muller discussed deal stats for the first six months of 2009.

The members of the M&A Market Trends Subcommittee have been very busy since our meeting in Chicago.

• In September 2009, we released the 2009 Strategic Buyer/Public Target Deal Points Study led by study chair Jim Griffin.

• In November 2009, study chair Wilson Chu shared selected preliminary data points from the 2009 Private Target M&A Deal Points Study with attendees at the ABA’s M&A Institute in New Orleans as part of a mock negotiation of those data points.
Also in November 2009, the chairs and issue group leaders for each of those studies conducted ABA teleconferences discussing the results of the relevant study.

As this newsletter was going to press, we were poised to release the 2009 Private Target M&A Deal Points Study.

All published studies are posted on the M&A Market Trends Subcommittee website. Thanks to all of the participants in those studies for their incredibly hard work! We hope you are finding the new data useful out there in the trenches.

Our next meeting will be held on Friday, December 4, in Washington, D.C., from 3:00 p.m. until 4:30 p.m. At that meeting:

- Jennifer Muller will discuss updated data on the state of the M&A market.
- We will get an update on the status of the next studies for Canada and Europe.
- Wilson Chu and Jim Griffin and other members of their respective working groups will compare and contrast selected results from the 2009 Private Target M&A Deal Points Study and the 2009 Strategic Buyer/Public Target Deal Points Study.
- We will discuss the buy and sell side arguments around the representation regarding no undisclosed liabilities in financial statements and Scott Whittaker and Gabe Saltarelli will join us from the Judicial Interpretations Working Group to discuss judicial interpretations pertaining to financial statement representations.

The dial-in number and passcode for the meeting for those of you who cannot attend in person are as follows:

Number: 888-209-3753  
Passcode: 6964625  

We look forward to seeing you in Washington, D.C.

Jim Griffin  
Jessica Pearlman  
Co-Chairs

**Private Equity M&A Subcommittee**

The Private Equity M&A Subcommittee met in Chicago on Friday, July 31, in conjunction with the ABA’s Annual Meeting. At the session, the Subcommittee received materials and discussed events and developments affecting the private equity markets during the past 6 – 12 months. In addition, the Subcommittee discussed the topic of private equity investments in financial institutions given recent marketplace activity in the area. Several guest speakers joined the session to share their perspectives. Emily McNeal, Executive Director, UBS Securities LLC, reviewed the latest data points on the M&A and private equity landscape generally, and the Subcommittee also heard from Dan Dwyer, Director of Charter Applications, Office of Thrift Supervision, and Andrea Tokheim, Counsel at the Federal Reserve Board, each of whom shared the views of their respective agencies with regard to private equity investments in financial institutions. The Subcommittee also heard from B.J. Sanford, Managing Director, Promontory Financial Group, who advises private equity clients on acquisitions of financial institutions. The Subcommittee meeting was well-attended, and the Subcommittee thanks all attendees and participants for contributing to the session.

John K. Hughes  
Chair
Programs Subcommittee

Our stand-alone meeting in Washington, D.C. will feature the following Committee Forum, on Saturday, December 5, immediately following the full Committee meeting:

“The Future of M&A, Perspective from the Deal Professor”

Professor Davidoff, the “Deal Professor,” will share his insights on the current M&A landscape, and have an extensive question and answer session with the Committee. This program follows our Committee’s two programs at the ABA Annual Meeting in Chicago – “Distressed M&A – Practical Insights from a Mock Negotiation” and “Don’t Fall at the First Cross-Border Hurdle – Preliminary Agreements in Cross-Border M&A,” as well as our co-sponsored program “A Whirlwind Tour Through an Acquisition Agreement.”

The Programs Subcommittee is currently working on the Committee’s program slots for the 2010 spring meeting in Denver, Colorado, and the 2010 ABA Annual Meeting in San Francisco, California. If you have any interest in organizing and presenting a program, participating on a panel, or working with our Programs Subcommittee generally, please feel free to contact any of the undersigned co-chairs.

David I. Albin
Robert G. Copeland
Yvette Austin Smith
Co-Chairs

COMMITTEE MEETING MATERIALS

MERGERS & ACQUISITIONS COMMITTEE MEETING RITZ CARLTON WASHINGTON, D.C. DECEMBER 4-5, 2009

SCHEDULE OF MEETINGS AND OTHER ACTIVITIES

Friday, December 4, 2009
Registration
8:00 a.m. – 5:00 p.m.

Continental Breakfast
8:00 a.m. – 10:00 a.m.

Editorial Working Group of the Task Force on Acquisitions of Public Companies (Part 1)
9:00 a.m. – 12:00 p.m.
The Lincoln Room

Task Force on Distressed M&A
9:00 a.m. – 10:30 a.m.
Plaza II

Private Equity M&A Subcommittee
10:30 a.m. – 12:30 p.m.
Salon III

Lunch (ticket required)
Remarks by Molly S. Boast, Deputy Assistant Attorney General for Civil Matters, Antitrust Division of the Department of Justice
12:30 p.m. – 2:00 p.m.
Task Force on Acquisitions of Public Companies

Remarks by Michele Anderson, Chief, Office of Mergers and Acquisitions, Division of Corporation Finance, U.S. Securities and Exchange Commission
2:00 p.m. – 3:00 p.m.
Salon III

Annual Survey Working Group of the M&A Jurisprudence Subcommittee
2:00 p.m. – 3:00 p.m.
Plaza II

Judicial Interpretations Working Group of the M&A Jurisprudence Subcommittee
3:00 p.m. – 4:30 p.m.
Plaza II

M&A Market Trends Subcommittee
3:00 p.m. – 4:30 p.m.
Salon III

Editorial Working Group of the Task Force on Acquisitions of Public Companies (Part 2)
3:00 p.m. – 4:30 p.m.
The Lincoln Room

Committee Leadership Meeting
4:30 p.m. – 5:30 p.m.
Salon III

Committee Reception and Dinner (ticket required)
6:30 p.m. Reception/7:30 p.m. Dinner
Café Milano
3251 Prospect St., NW
Washington, DC 20007
Phone: 202-333-6183

Saturday, December 5, 2009

Registration
8:00 a.m. – 5:00 p.m.

Continental Breakfast
8:00 a.m. – 10:00 a.m.

International M&A Subcommittee
8:00 a.m. – 10:30 a.m.
Plaza I

Task Force on the Dictionary of M&A Terms
9:00 a.m. – 10:30 a.m.
Salon I / II

Editorial Working Group of Task Force on the Acquisitions of Public Companies (Part 3)
9:00 a.m. – 12:30 p.m.
Salon IIIB

Lunch (ticket required)
12:30 p.m. – 2:00 p.m.
The Roosevelt Room

Full Committee Meeting
2:00 p.m. – 4:30 p.m.
Plaza I

Committee Forum: The Future of M&A, Perspective from the Deal Professor

Committee Reception and Dinner (ticket required)
6:30 p.m. Reception/7:30 p.m. Dinner
Charlie Palmer Steak
101 Constitution Ave., NW
Washington, DC 20001
Phone: 202-547-8100

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COMMITTEE LEADERSHIP

Chair
Leigh Walton

Vice Chairs
Wilson Chu
Keith Flaum
Mark Morton

Chair –Executive Council
Byron Egan

Editor of Deal Points
Michael Reilly

Task Force on Acquisitions of Public Company
Diane Frankle
Steve Knee
Jim Griffin (Vice Chair)
Lorna Telfer (Vice Chair)

Task Force on the Model Stock Purchase Agreement
Robert Harper
Murray Perelman

Task Force on the M&A Dictionary
David Katz
Rick Climan
Michael O’Bryan (Vice Chair)

Task Force on Distressed M&A
Hendrik Jordaan

International M&A Subcommittee
Daniel Rosenberg
Jim Walther

Membership Subcommittee
Mireille Fontaine
Ryan Thomas
Tracy Washburn

M&A Jurisprudence Subcommittee
Jon Hirschoff

Annual Survey Working Group
Michael O’Bryan

Judicial Interpretation Working Group
Scott Whittaker
Jim Melville

M&A Market Trends Subcommittee
Jim Griffin
Jessica Pearlman

Private Equity M&A Subcommittee
John Hughes

Programs Subcommittee
David Albin
Robert Copeland
Yvette Austin Smith

Technology Subcommittee
George Taylor
Dave Lipkin (Vice Chair)

Diversity Initiative
Ed Deibert
Franziska Ruf
Jen Muller

Regulatory Liaison
Joel Greenberg

Judicial Advisor
Chief Justice Myron Steele

Representatives to Section’s Publications Committee
Wilson Chu
John Clifford
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