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Rethinking Contractual Limits on Fiduciary Duties

Christina M. Sautter
Louisiana State University Law Center, christina.sautter@law.lsu.edu

RETHINKING CONTRACTUAL LIMITS ON FIDUCIARY DUTIES

CHRISTINA M. SAUTTER*

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*. Assistant Professor of Law, Paul M. Hebert Law Center, Louisiana State University; J.D., *summa cum laude* & *Order of the Coif*, Villanova University School of Law, 2002; B.S., *summa cum laude*, Florida State University, 1999. I would like to thank Kim Chanbonpin, Steven Davidoff, Trey Drury, Joan Heminway, Scott Hirst, Lee Ann Lockridge, Missy Lonegrass, David Millon, Jay Mirostaw, Glenn Morris, and Heiko Schiwek for their valuable input. I am grateful to participants in the New Scholars Workshop for Business Law at the 2009 Annual Meeting of the Southeastern Association of Law Schools during which this Article was presented as a work in progress as well as participants in the LSU 2010 Introductions Series. Finally, I am grateful to the LSU Law Center for its generous research support and to LSU Law Center students, Jennifer Dartez, Heather Crow, Philip Dore, and Kaitlin Dyer, for their work on this Article.

I. INTRODUCTION

A fundamental precept of corporate law is that boards of "directors owe fiduciary duties to the corporation and its shareholders."[1] An equally fundamental precept of both contract law and mergers and acquisitions law is that parties to a definitive merger agreement are bound by the covenants in the agreement and must honor their commitments.[2] These two fundamental precepts can clash due to events arising *after* the signing of a definitive merger agreement but *before* the transaction is completed. This Article addresses just such a clash: situations where a board of directors has a contractual commitment to recommend a transaction to its stockholders but where an event occurs after the signing of that agreement that would normally require a board, in honoring its fiduciary duties, to withdraw its earlier recommendation. This potential change in the board's recommendation places the completion of a proposed transaction at risk and leads to deal instability.[3] Although dealmakers are always cognizant of completion risk and generally use definitive agreements to distribute risks, the recent financial crisis has placed a renewed focus on completion risk.[4]

Mergers and acquisitions (M&A) dealmakers have responded to completion risk in their own transactions, in part, by creating new

1. *See* Kelli A. Alces, *Debunking the Corporate Fiduciary Myth*, 35 J. CORP. L. 239, 275 (2009) (recognizing that corporate law is based on the concept that boards of directors owe duties to the corporation and its stockholders).

2. *See* NACCO Indus., Inc. v. Applica Inc., Civil Action No. 2541-VCL, 2009 WL 4981577, at *14 (Del. Ch. Dec. 22, 2009) (recognizing "[i]t is critical" to enforce "bargained-for rights" in merger agreements).

3. Steven M. Haas, *Limiting Change of Merger Recommendations to "Intervening Events,"* 13 No. 8 M&A LAW. 15, 15 (Sept. 2009) (stating board's ability to change recommendation leads to "closing uncertainty").

4. *See* Afra Afsharipour, *Transforming the Allocation of Deal Risk Through Reverse Termination Fees,* 63 VAND. L. REV. (forthcoming 2010), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1568951 (recognizing use of acquisition agreement provisions to "mitigate, allocate or address" risks); William T. Allen, *Understanding Fiduciary Outs: The What and the Why of an Anomalous Concept*, 55 BUS. LAW. 653, 653 (2000) (stating economic function of contracts is to assign risks among parties); Robert A. Profusek, *Rethinking Dealcraft*, DEAL MAG., Sept. 11, 2009 ("Risk is, and for the foreseeable future, will remain, a four-letter word, especially in Washington and, more important, many corporate boardrooms."); *see also* Steven M. Davidoff, *The Deal Professor's 2009 in Review, Part I: No Exit*, N.Y. TIMES DEALBOOK (Dec. 28, 2009, 12:16 PM), http://dealbook.blogs.nytimes.com/2009/12/28/the-deal-professors-2009-in-review-part-i-no-exit/ (predicting more bargaining over "completion risk" in 2010); Michael Weisser & Christopher Machera, *Another View: New Prism for Post-Crisis Deal Terms*, N.Y. TIMES DEALBOOK (Feb. 2, 2010, 11:05 AM), http://dealbook.blogs.nytimes.com/2010/02/02/another-view-new-prism-for-post-crisis-deal-terms/ (observing wake of financial crisis dealmakers are tailoring " 'deal specific' solutions" while "weighing the impact of company, industry, market and deal specific considerations and scrutinizing the interplay between various provisions in the acquisition and related agreements").

provisions or altering formerly standard provisions to control risk.[5] As one practitioner has stated, "The recent meltdown of financial markets suggests that hundred- and thousand-year events with relevance to M&A may not be rare after all, and as seemingly improbable risks occur with increasing frequency, some common assumptions about risk and some common provisions of M&A drafting may be ripe for re-examination."[6] Among these provisions now "ripe for re-examination" are so-called "fiduciary outs."[7] Fiduciary outs within definitive acquisition agreements aim to relieve the tension between a board's corporate law-imposed fiduciary duties, on the one hand, and the binding covenants of the acquisition agreement on the

5. *See* Steven Davidoff, *Wall Street's Deal Factory Hits the Reset Button*, N.Y. TIMES DEALBOOK (Sept. 17, 2009, 12:15 AM), http://dealbook.blogs.nytimes.com/2009/09/17/wall-streets-deal-factory-hits-the-reset-button/ ("As they consider the transactions that failed . . . lawyers are likely to respond by shifting the details and structure of transactions, and with more explicit drafting and tighter 'material adverse change' clauses, which allow parties to walk away from a deal."); Steven M. Davidoff, *A New Approach to Deal Uncertainty*, N.Y. TIMES DEALBOOK (Apr. 27, 2009, 2:11 PM), http://dealbook.blogs.nytimes.com/2009/04/27/a-new-approach-to-deal-uncertainty/ (discussing novel transaction structures and twists on deal provisions); STEVEN M. DAVIDOFF, GODS AT WAR: SHOTGUN TAKEOVERS, GOVERNMENT BY DEAL, AND THE PRIVATE EQUITY IMPLOSION 301 (2009) ("[R]ecent event[s] have irrevocably changed our capital markets and the way deals are structured and completed. These coming changes, . . . and the unexpected events that will certainly occur, will make deal-making exciting both to watch and to participate in. It will result in more creativity in takeovers and a shift in deal-making profiles and structures, as lawyers and bankers struggle to accommodate this new regime."); David Fox & Daniel E. Wolf, *Kirkland M&A Update, Deal Protection — One Size Does Not Fit All* 1 (Nov. 10, 2009) http://www.kirkland.com/siteFiles/Publications/3D29446470001AB502BE765735086773.pdf [hereinafter Fox & Wolf, *Deal Protection*] ("Since the collapse of the credit markets in 2007 and with the emerging recovery, we have seen a noticeable trend toward ever tighter deal protection terms favoring buyers in many public merger agreements. While this trend is certainly not without exception, it does reflect a shift in perceived 'market terms' on many of these negotiated issues."); *see also* Frank Aquila & Melissa Sawyer, *A Series of Unfortunate Events: How 2008 Changed M&A and What It Means for the Year Ahead*, 12 No. 10 M&A LAW. 8 (Nov./Dec. 2008) ("We may have to file away our standard forms and start borrowing techniques from other practice areas. From an intellectual perspective, 2009 will be an interesting and challenging year for deal lawyers, filled with opportunities for creativity.").

6. Rod J. Howard, *Drafting for a Hundred-Year Storm*, *in* DRAFTING CORPORATE AGREEMENTS 2009, at 181 (PLI Corp. L. & Practice Grp., Course Handbook Series No. 18055, 2009); *see also* Profusek, *supra* note 4 (advocating for a change in the way deals are done and stating, "It's high time we stand back and completely revamp the basic terms of M&A papers, eliminating the boilerplate that is never relevant in the real world and advancing concepts that actually work when markets turn or expectations change."). *But see* David Fox & Daniel E. Wolf, *Kirkland M&A Update, Deal Certainty-The Fallacy of a New Market* 1 (Oct. 2, 2009) http://www.kirkland.com/siteFiles/Publications/5696D46D316C86CCD29B502D2E02AF62.pdf ("[A]ny attempt to identify a simplified new paradigm or market for basic deal certainty terms is an overly simplistic view of the deal market in these early days of recovery—rather, we believe that the perceived departures from traditional deal structures are largely a reflection of a complex equation of a dozen or so contractual variables that interact with overall deal dynamics, including company-specific and secular market conditions, to produce a deal-specific outcome in the relevant post-crash transactions.").

7. *See* Howard, *supra* note 6, at 196 ("Rapidly changing circumstances put new stress on 'fiduciary out' clauses, raising questions both for acquirers and targets . . . .").

other.[8] More specifically, these contractual provisions permit the target (and sometimes the acquirer) to take an action that the agreement otherwise prohibits, or to not perform an action that the agreement requires, provided such action or inaction is required to prevent a breach of the board's fiduciary duties.[9]

Although a public company merger agreement generally contains a number of "fiduciary outs," the fiduciary out that is most relevant to changes in the financial condition of one or both of the merger parties is the "merger recommendation fiduciary out."[10] The need for a merger recommendation fiduciary out arises from the M&A transaction process and the stockholder approvals required in M&A transactions. Under Delaware law,[11] when a board of directors adopts a merger agreement, the board must recommend the transaction to its stockholders.[12] Before submitting the agreement to the stockholders for a vote, the board must either reaffirm its recommendation or withdraw its recommendation.[13] A merger recommendation fiduciary out allows the board to withdraw or modify its recommendation of a transaction despite a contractual obligation to recommend the transaction. The negotiation and specific drafting of this fiduciary out determines whether a board of directors can withdraw or modify its recommendation between the time of adoption and signing of the merger agreement and the time of the stockholders' approval. Some versions of the out permit a board to withdraw its recommendation anytime a failure to do so would otherwise breach its fiduciary du-

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8. *See* William T. Allen, *Understanding Fiduciary Outs: The What and the Why of an Anomalous Concept*, 55 BUS. LAW. 653, 655-56 (2000) (describing the use of fiduciary outs to bridge the gap between corporate law fiduciary duties and contract law); *see also* Celia R. Taylor, *"A Delicate Interplay": Resolving the Contract and Corporate Law Tension in Mergers*, 74 TUL. L. REV. 561, 615 n.346 (1999) (recognizing fiduciary out allows directors to pursue alternative course from contract if fiduciary duties so require).

9. Christina M. Sautter, *Shopping During Extended Store Hours: From No Shops to Go-Shops- The Development, Effectiveness, and Implications of Go-Shop Provisions in Change of Control Transactions*, 73 BROOK. L. REV. 525, 535 (2008).

10. *See* John F. Johnston & Frederick H. Alexander, *Fiduciary Outs and Exclusive Merger Agreements—Delaware Law and Practice*, INSIGHTS: THE CORPORATE & SECURITIES LAW ADVISOR, Vol. 11 No. 2, Feb. 1997, at 19 n.2 (describing various fiduciary outs appearing in typical merger agreement).

11. The focus of this Article is on Delaware law due to Delaware's domination of the public company charter market and its well-developed body of case law in the mergers and acquisitions arena. As of 2009, 63% of Fortune 500 companies were incorporated in the state. 2009 DELAWARE DIV. OF CORPS. ANN. REP. 1, http://corp.delaware.gov/2009ar.pdf. Over half of the publicly traded U.S. companies are incorporated in Delaware. Dep't of State: Div. of Corps., About Agency, http://corp.delaware.gov/aboutagency.shtml (last visited Oct. 18, 2010). Moreover, a recent study of 1,020 public company merger agreements announced between 2004 and 2008 revealed that Delaware law was the governing law for 66.4% of those agreements. Matthew Cain & Steven M. Davidoff, *Delaware's Competitive Reach*, 4 (Jan. 8, 2010) (unpublished manuscript), *available at* http://ssrn.com/abstract=1431625.

12. *See infra* Part II.A.

13. *See infra* Part II.A.

ties.[14] Some boards, however, agree to a narrower out providing that the board may withdraw its recommendation only when there is a Superior Offer,[15] as that term is defined in the merger agreement.[16]

More recently, parties have adopted the practice of negotiating a variation on these two basic types of merger recommendation fiduciary outs.[17] This variation allows a board to withdraw its recommendation either when there is a Superior Offer *or* when there has been an Intervening Event.[18] An Intervening Event is often defined as an event that the board was not aware of or could not have reasonably foreseen at the time of signing.[19] Such contractual limitations on the board's ability to change its recommendation have revived the debate as to whether a board may limit by contract the fiduciary duties mandated by state law.[20]

More specifically, recent discussion centers on the validity of contractual limitations of fiduciary duties in the context of merger recommendations—an issue that the Delaware courts have yet to fully address.[21] Most of the jurisprudence regarding fiduciary outs has focused on fiduciary outs in the context of no shop provisions, by which target boards agree not to solicit third-party offers after signing a

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14. *See infra* Part IV.A.1.

15. The terms Superior Offer and Superior Proposal will be used interchangeably in this article. These terms appear in capitalized form because they are defined terms in a merger agreement.

16. *See infra* Part IV.A.2.

17. *See infra* Part IV.A.3.

18. Like Superior Offers and Superior Proposals, the term Intervening Event appears in capitalized form because it is a defined term in a merger agreement.

19. The definition of an Intervening Event varies among agreements such that a certain event may trigger one Intervening Event out but may not trigger another, differently defined Intervening Event out. *See infra* Part IV.A.3.

20. *See, e.g.,* Steven M. Davidoff, *Deal Lawyers Are Getting Creative*, N.Y. TIMES DEALBOOK (Apr. 14, 2009, 2:23 PM), http://dealbook.blogs.nytimes.com/2009/04/14/deal-lawyers-start-getting-creative/ [hereinafter Davidoff, *Getting Creative*] (discussing recent transactions in which boards have agreed to contractually limit their merger recommendation fiduciary out and describing the discussion between Vice Chancellor Strine of Delaware Chancery Court and Simpson Thacher & Bartlett partner, Rob Spatt, regarding the validity of such limitations); Haas, *supra* note 3, at 15 (discussing the trend in merger agreements of allowing boards to change their recommendations in favor of the deal due to Intervening Events); *Fiduciary Outs for Intervening Events: Are They Necessary?*, M&A LITIGATION COMMENTARY (July 11, 2009, 2:46 PM), http://mandalitigationcommentary.blogspot.com/2009/07/fiduciary-outs-for-intervening-events.html.

21. *See* Steven M. Davidoff, *Deal Failures: The Second Wave*, N.Y. TIMES DEALBOOK (Nov. 6, 2008, 1:37 PM), http://dealbook.blogs.nytimes.com/2008/11/06/deal-failures-the-second-wave/ [hereinafter Davidoff, *Deal Failures*] ("There is little Delaware case law on when a board can change its recommendation, but a Delaware board is allowed to do this (indeed must) if it determines that the acquisition is no longer in the best interests of [the target's] shareholders. And since it is within the board's discretion, it is a hard thing for [the acquirer] to challenge legally."); John F. Johnston, *A Rubeophobic Delaware Counsel Marks Up Fiduciary-Out Forms: Part II*, 14 INSIGHTS: THE CORP. & SEC. L. ADVISOR 2, 16, 17 (2000) (eluding to the limited case law on merger recommendation outs).

merger agreement.[22] Consequently, a majority of the scholarly and practitioner commentary also focuses on fiduciary outs in the context of no shop provisions and whether boards may contractually limit that fiduciary out.[23] To date, the Delaware courts have never directly addressed the validity of provisions limiting merger recommendation fiduciary outs to Superior Offers and/or Intervening Events. In addition, there has been minimal commentary, particularly in recent years, that focuses on the merger recommendation fiduciary out.[24] This recent lack of commentary is somewhat surprising considering the emergence of the Intervening Event language as well as recent transactions in which boards have chosen to exercise their right to withdraw recommendations due to a change in circumstances between signing and closing.[25]

This Article is designed to fill the void in recent academic commentary relating to the merger recommendation fiduciary out. It breaks new ground in arguing that a board of directors may agree to contractually limit its fiduciary duties in the context of the merger recommendation fiduciary out. Part II of this Article explores the merger adoption and recommendation process and describes the period between signing and closing, including the risks inherent in the period that may trigger the merger recommendation fiduciary out. In addition, this Part provides an overview of the board's fiduciary duties during the merger process. Part III examines jurisprudence relating to fiduciary outs generally, which sets the background upon which merger recommendation fiduciary outs must be interpreted. Part IV discusses recent trends in the drafting of merger recommendation fiduciary outs, including the differences among the outs, and describes events that would trigger a board's duty to withdraw its recommendation under each type of out. Furthermore, this section describes recent, rare examples of transactions in which boards of directors have withdrawn their recommendations due to events other

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22. For a discussion of Delaware case law regarding the no shop fiduciary out, see *infra* Part III.

23. *See, e.g.*, John F. Johnston et al., *Delaware Chancery Court Rulings on Fiduciary-Outs* (Feb. 5, 1999), http://www.mnat.com/assets/attachments/21.pdf; John F. Johnston, *Recent Amendments to the Merger Sections of the DGCL Will Eliminate Some—But Not All—Fiduciary Out Negotiation and Drafting Issues*, 1 BNA: MERGERS & ACQUISITIONS L. REP. 777 (July 20, 1998); Johnston & Alexander, *supra* note 10, at 18-19.

24. Examples of recent commentary include: Haas, *supra* note 3; *Fiduciary Outs for Intervening Events: Are They Necessary?*, *supra* note 20. Examples of older commentary include: R. Franklin Balotti & A. Gilchrist Sparks, III, *Deal-Protection Measures and the Merger Recommendation*, 96 NW. U. L. REV. 467 (2002) (analyzing contractual limitations on board's recommendation out); A. Gilchrist Sparks, III, *Merger Agreements Under Delaware Law—When Can Directors Change Their Minds?*, 51 U. MIAMI L. REV. 815 (1997) (discussing merger recommendations prior to Delaware's allowance of force-the-vote provisions).

25. For a further discussion of the types of merger recommendation fiduciary outs as well as examples of transactions where boards have withdrawn their recommendations, see *infra* Part IV.

than the receipt of a Superior Offer. Part V argues that a board of directors may agree to certain limitations on its merger recommendation fiduciary out. A board that has complied with its fiduciary duties at the time that it enters into a merger agreement should be aware of most events that could reasonably occur during the period between signing and closing. Thus, the board can take these events into account during negotiations and structure the transaction to adequately address these possible changed circumstances. This Part further argues that termination fees should be structured so that the fee varies based on the event triggering the recommendation withdrawal. Finally, this Part addresses provisions that explicitly allow the board to comply with its duty of disclosure without changing its recommendation. This Article argues that such provisions enable the board to comply with its fiduciary duty of disclosure, allow the board to abide by the merger recommendation covenant, and still permit the stockholders to make an informed vote for or against the proposed merger.

II. OVERVIEW OF THE TRANSACTION PROCESS

A. *Adoption of the Merger Agreement & Board Recommendation*

The target board of directors' obligation to adopt and recommend a merger agreement is long-recognized under Delaware law. Under Section 251(b) of the Delaware General Corporations Law (DGCL), prior to executing a merger agreement the board of directors of each company must adopt a board resolution approving, and declaring the advisability of, the merger agreement.[26] Declaring the advisability of the merger is what is known as the board's recommendation to the stockholders.[27] In reviewing whether a target board has made an informed decision in adopting the agreement and declaring the advisability of the merger, courts will consider only "the information *then* reasonably available to the directors and relevant to their decision to

26. *See* DEL. CODE ANN. tit. 8, § 251(b) (2010) (describing the procedure for the board's adoption of the merger agreement). In 1998, Section 251 was amended to include the "advisability" language that now exists in Section 251(b). S.B. 311, 71st Leg. 139th Gen. Assem., 2d Sess. (Del. 1998); *see also* Balotti & Sparks, *supra* note 24, at 473 (describing the amendments to Section 251(b)).

27. *See* Michael A. Stanchfield, *Voting Lock-ups Sales of Partially Owned Subsidiaries: Can Stockholders Love a Deal Too Early and Too Much?*, 28 WM. MITCHELL L. REV. 1325, 1329-30 (2002) (describing the recommendation process).

accept the . . . merger proposal."[28] Once the board of directors adopts the merger agreement, the agreement may then be executed.[29]

Following the board's adoption of the merger agreement and its subsequent execution, the agreement must be submitted to the stockholders of each corporation for a vote.[30] For the reasons discussed in Part II.B, there is usually a lengthy period between the execution of the merger agreement and the stockholders' meeting at which the stockholders vote on the merger.[31] When the company sends out the proxy statement for the stockholders' meeting, the board of directors is expected to include the advisability of the merger in the proxy statement.[32]

Until 1998, a board of directors could not submit a merger agreement to its stockholders without affirmatively recommending the merger.[33] However, in 1998, Section 251(c) was amended to allow for an agreement to be submitted to the stockholders for a vote even if the board determines that "the agreement is no longer advisable and recommends that the stockholders reject it."[34] In 2003, this provision

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28. Smith v. Van Gorkom, 488 A.2d 858, 874 (Del. 1985) (emphasis added). If the board had not made an informed decision at the board meeting adopting the merger agreement, then the next inquiry is whether the directors' subsequent actions were sufficient to alleviate any issues with its previous decision. *See id.* (stating that whether the board made an informed business judgment to sell company involved a two-part analysis—first, looking at the board's decision at the meeting adopting the agreement and then looking at any subsequent actions to cure any problems in the initial meeting).

29. *See* DEL. CODE ANN. tit. 8, § 251(b) (2010) (describing the procedure for the board's adoption of the merger agreement).

30. *See id.* § 251(c) (describing the procedure for the stockholders' adoption or rejection of the merger agreement).

31. *See infra* Part II.B.

32. 17 C.F.R. § 229.1012 (2010); DEL. CODE ANN. tit. 8, § 251(b) (2010); *see also* Frontier Oil Corp. v. Holly Corp., No. Civ. A. 20502, 2005 WL 1039027, at *27 (Del. Ch. Apr. 29, 2005) (stating that target directors have "continuing fiduciary duties to the shareholders to evaluate the proposed transaction").

33. *See* Van Gorkom, 488 A.2d at 888 (stating that under DEL. CODE ANN. tit. 8, § 251(b) as that section was then drafted, the board could not recommend that stockholders vote against the merger without rescinding the agreement, withdrawing its approval, and cancelling the stockholders' meeting); Dennis J. Block, *Public Company M&A: Directors' Fiduciary Duties and Recent Developments in Corporate Control Transactions*, in CONTESTS FOR CORPORATE CONTROL 2009: CURRENT OFFENSIVE & DEFENSIVE STRATEGIES IN M&A TRANSACTIONS, at 87 (PLI Corp. Law & Practice, Course Handbook Series No. 22685, 2009) (stating that prior to the 1998 amendments, boards had to affirmatively recommend mergers before they could go to shareholder votes).

34. S.B. 311, 71st Leg. 139th Gen. Assem., 2d Sess. (Del. 1998). This language combined with the "declaring advisability" language in Section 251(b) makes it unambiguous that the board must make the determination in the beginning that the transaction is in the best interests of the stockholders. *See* Johnston et al., *supra* note 23 (stating that 1998 amendments to Section 251 make clear that board must declare agreement "advisable" from outset). These amendments to Section 251 were prompted by:

> (i) *Van Gorkom's* holding that a board of directors must recommend a merger to stockholders in order for it to be presented to stockholders, (ii) the view that because directors owe fiduciary duties to stockholders they must be able to change their minds prior to a stockholder vote and to recommend against a

was removed from Section 251(c) and now appears in Section 146 of the DGCL as the following: "A corporation may agree to submit a matter to a vote of its stockholders whether or not the board of directors determines at any time subsequent to approving such matter that such matter is no longer advisable and recommends that the stockholders reject or vote against the matter."[35] These amendments to the DGCL permit what is known in practice as a "force-the-vote" provision to be included in the merger agreement.[36] That is, the agreement may provide that even if the board of directors has withdrawn its recommendation of a merger, the board is still obligated to submit the agreement to the stockholders for a vote.

B. Preclosing Period

To appreciate the role of merger recommendation fiduciary outs (hereinafter, "recommendation outs") in M&A, it is essential to first understand that, in the vast majority of public company acquisitions, there is an often rather lengthy delay between the execution of a definitive acquisition agreement and the closing of that transaction (when the stock or assets are transferred and the purchase price is paid).[37] In practice, this interim period is typically called the "preclosing period" or the "postsigning period."[38] The preclosing period exists for several reasons—the most significant of which are the need to obtain stockholder approval and antitrust clearance.

1. Source of the Delay—Conditions Precedent

a. Stockholder Approval

First, and foremost, because most large, public transactions are structured as statutory mergers, stockholder approval may be required under state law.[39] Under Delaware law, the target stockhold-

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> merger if appropriate, and (iii) the business reality that some merger partners will not enter into a merger agreement which is not binding except for the stockholder approval requirement . . . .

Balotti & Sparks, *supra* note 24, at 473.

35. DEL. CODE ANN. tit. 8, § 146 (2010).

36. *See* Block, *supra* note 33, at 87 (stating that allowing board to submit merger to stockholders even when board has withdrawn its support is known as a force-the-vote deal).

37. *See* JAMES C. FREUND, ANATOMY OF A MERGER § 5.2.2 (1975) (stating that most significant acquisitions do not simultaneously sign and close but instead have delays between the execution of the definitive acquisition agreement and the final closing); *see also* Ronald J. Gilson, *Value Creation by Business Lawyers: Legal Skill and Asset Pricing,* 94 YALE L.J. 239, 260 n.55 (1984) (describing investigation and other nonregulatory reasons for a delay between the execution of the agreement and the closing of the transaction).

38. Throughout this Article the interim period will be referred to as the "preclosing period."

39. *See* Robert T. Miller, *The Economics of Deal Risk: Allocating Risk Though MAC Clauses in Business Combination Agreements*, 50 WM. & MARY L. REV. 2007, 2017 (2009) (stating that the "most fundamental reason" for the preclosing period is that public compa-

ers must approve the merger.[40] Whether the acquiring corporation's stockholder approval is needed depends on the structure of the deal.[41] If the merger does not change the articles of incorporation or outstanding stock, as in a tender offer, the acquirer's stockholders need not approve the merger.[42] However, if the merger involves stock as consideration, usually the acquirer's stockholders must also approve the transaction because voting power may be altered.[43]

Obtaining stockholder approval requires time to organize and execute. First, a meeting must be called for the purpose of approving the transaction.[44] Notice must be sent to the stockholders at least twenty calendar days prior to the meeting date, or at least twenty days before action can be taken.[45] Proxy solicitations must be prepared and distributed to stockholders in advance of the meeting. These proxy materials must include a proxy statement and must be filed with the SEC.[46] A preliminary statement must be filed at least ten days before the date solicitations are sent or given to the stockholders.[47] The final copy of the proxy statement must be filed with the SEC as of the date proxies are sent to the stockholders.[48] Schedule 14A enumerates the requirements of the proxy statement, and includes, among other things, a financial statement, terms of the merger transaction, and appraisal rights.[49] It also requires a summary term sheet, which is governed by Regulation S-K, subpart Regulation M-A, which mandates a plain English summary term sheet.[50] Pursuant to both Dela-

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nies' transactions are "invariably structured as statutory mergers, and the corporate laws of all states require that the shareholders of the corporations engaging in a statutory merger approve the transaction."); *see also* John C. Coates, IV, *The Powerful and Pervasive Effects of Ownership on M&A*, 26 (Jan. 20, 2010) (unpublished manuscript) *available at* http://ssrn.com/abstract=1544500 (presenting the results of a statistical study of public and private company merger agreements and stating that the vast majority of public company deals are structured as one-step mergers); Lou R. Kling et al., *Summary of Acquisition Agreements*, 51 U. MIAMI L. REV. 779, 781 (1997) (explaining that the seller's, and sometimes the buyer's, stockholder approval may lead to delayed performance).

40. DEL. CODE ANN. tit 8, §251(b).

41. Short form and triangular mergers typically do not require acquirer corporate shareholder approval. Note that stock exchange rules may require shareholder approval as well.

42. DEL. CODE ANN. tit 8, § 251(f).

43. *Id.*

44. 17 C.F.R. §§ 240.14a-1 - 240.14b-2 (2010).

45. 17 C.F.R. § 240.14c-2(b) (2010). Generally, in the past, once the SEC cleared the proxy materials, the stockholders' meeting would be held within a month and the closing would occur shortly thereafter. *See* Peter S. Golden et al., *Negotiated Cash Acquisitions of Public Companies in Uncertain Time*, 13 No. 2 M&A LAW. 1 (Feb. 2009) (describing past practices with respect to the timing of the stockholders' meeting and the closing and stating that absent regulatory issues or buyer's right to delay closing to finalize financing, closing typically would occur shortly after the stockholders' meeting).

46. 17 C.F.R. § 240.14a-6 (2010).

47. *Id.*

48. *Id.*

49. 17 C.F.R. § 240.14a-101 (2010).

50. 17 C.F.R. § 229.1012 (2010).

ware state law[51] and Regulation M-A, the summary term sheet portion of the proxy statement must include a statement by the board of directors, which offers the board's recommendation as to the advisability of the transaction.[52] Furthermore, the SEC regulations require a statement of the reasons for taking this position by the board.[53] In addition, under Delaware law the board has a "well-established" duty of disclosure that "represents nothing more than the well-recognized proposition that directors of Delaware corporations are under a fiduciary duty to disclose fully and fairly all material information within the board's control when it seeks shareholder action."[54]

This duty of disclosure also arises in the context of tender offers, which are regulated by Regulation 14D.[55] Under Regulation 14D, Rule 14d-9 requires that the board of directors for the corporation that is the target of a tender offer take a position regarding the offer.[56] The target must file Schedule 14D in conjunction with this recommendation.[57] Furthermore, Regulation 14E contains additional rules regarding tender offers, and imposes requirements for disclosure procedures. Under Rule 14e-1, tender offers must be open for at least twenty business days.[58] Under Rule 14e-2, once the tender offer is first published or sent, the target company must provide stockholders a statement no later than ten business days, with a recommendation of whether to accept or reject the offer, a statement of neutrality, or a statement of inability to take a position; if no position is taken, the board must articulate the reason why it is not.[59] Furthermore, if any material changes occur, this information must be promptly given to stockholders.[60]

b. Regulatory Approvals

In addition to stockholder approvals, certain regulatory filings and

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51. DEL. CODE ANN. tit. 8 § 251(b); *see also* ODS Techs., L.P. v. Marshall, 832 A.2d 1254, 1261 (Del. Ch. 2003) ("Delaware law requires a full and fair explanation of the rationale for a proposal that directors are recommending stockholders to approve.").

52. 17 C.F.R. § 229.1012. The SEC, in proposing this requirement, explained, "As for merger proxy statements, we believe a summary term sheet should provide . . . the board's recommendation on how to vote or their position regarding the transaction . . . ." Regulation of Takeovers and Security Holder Communications, 64 Fed. Reg. 61408, 61423 (Nov. 10, 1999).

53. 17 C.F.R. § 229.1012(b) (2010).

54. Stroud v. Grace, 606 A.2d 75, 84 (Del. 1992). *See generally* Lloyd L. Drury III, *Private Equity and the Heightened Fiduciary Duty of Disclosure*, 6 N.Y.U. J. LAW & BUS. 33 (2010) (discussing heightened duty of disclosure).

55. 17 C.F.R. §§ 240.14d-1 - 240.14d-101 (2010).

56. 17 C.F.R. § 240.14d-9 (2010).

57. *Id.*

58. 17 C.F.R. § 240.14e-1 (2010).

59. 17 C.F.R. § 240.14e-2(a) (2010).

60. 17 C.F.R. § 240.14e-2(b) (2010).

approvals may be necessary.[61] For example, if either the acquirer or target are engaged in U.S. commerce, or in activities effecting U.S. commerce, and if the proposed acquisition or parties meet certain size tests, premerger notification filing may be required under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 (Hart-Scott-Rodino)[62] with the Federal Trade Commission (FTC) or the Antitrust Division of the Department of Justice (DOJ).[63] In order to file premerger notification under Hart-Scott-Rodino, a definitive acquisition agreement or letter of intent must have been executed.[64] This requirement, combined with the fact that the size tests are relatively easy to meet, result in most transactions being subject to Hart-Scott-Rodino filing. Therefore, most transactions cannot simultaneously sign and close.[65] Once premerger notification is filed with the FTC and the Assistant Attorney General in charge of the Antitrust Department of the DOJ, a waiting period commences during which time closing may not occur.[66] This waiting period is typically thirty days

61. *See* LOU R. KLING & EILEEN T. NUGENT, NEGOTIATED ACQUISITIONS OF COMPANIES, SUBSIDIARIES AND DIVISIONS § 1.04[1] (2009) (detailing antitrust and other regulatory filings that may be required); *see also* Miller, *supra* note 39, at 2020-23. In addition to the antitrust filings described in this section, if a foreign investor is involved in the acquisition of a U.S. company, a filing with the Committee on Foreign Investment in the United States (CFIUS) may be required. SIMON M. LORNE & JOY MARLENE BRYAN, ACQUISITIONS AND MERGERS: NEGOTIATED AND CONTESTED TRANSACTIONS § 8:4 (2010). The Exon-Florio Amendment to Title VII of the Defense Production Act of 1950 gives the President of the United States authority to suspend or prohibit the acquisition of a U.S. business by a foreign investor under two conditions. *Id.* First, the President must find that there is credible evidence that the foreign investor might take action that threatens national security. *Id.* Second, existing laws, besides the Exon-Florio provision and the International Economic Powers Act, do not provide adequate authority to protect national security. *Id.* While the President retains the sole power to prohibit or suspend a transaction under this provision, CFIUS implements the Exon-Florio Amendment. *Id.* CFIUS customarily receives notice of a transaction whereby a foreign investor is acquiring a U.S. company either by a transacting party or by a CFIUS member agency. *Id.* After receipt of notice, CFIUS reviews the transaction verifying whether the transaction will trigger the necessary conditions in the provision and gives the President a recommendation. *Id.* Thereafter, a transaction may either be suspended or prohibited. *Id.*

62. Hart-Scott-Rodino Antitrust Improvements Act of 1976, 15 U.S.C. § 18a (2006) [hereinafter "Hart-Scott-Rodino"].

63. *See id. See also* MARTIN LIPTON & ERICA H. STEINBERGER, TAKEOVERS AND FREEZEOUTS §§ 7.02[1][c], [d] (2009) (summarizing size and commerce tests under Hart-Scott-Rodino); Miller, *supra* note 39, at 2020-21 (describing Hart-Scott-Rodino filing requirements). The thresholds for the size tests change each fiscal year depending on the gross national product for that fiscal year. *See* Hart-Scott-Rodino, § 18(a)(2)(A) (describing adjustments made to thresholds for each fiscal year as a percentage change from gross national product for fiscal year ending September 30, 2003).

64. *See* KLING & NUGENT, *supra* note 61, § 5.04[1] (stating that execution of definitive agreement or letter of intent is precondition to Hart-Scott-Rodino filing).

65. *See* Miller, *supra* note 39, at 2021 (stating that "[b]ecause the relevant thresholds are quite low, all but the smallest acquisitions require approval under the [Hart-Scott-Rodino] Act" so there must be delayed closing).

66. *See* 15 U.S.C. § 18a(a), (b)(1)(A) (2006) (stating that voting securities or assets may not be transferred until waiting period expires and describing when waiting period commences).

(or fifteen days for cash tender offers) and may be extended further if the FTC or DOJ make a second request for information.[67]

c. Third Party Consents

In addition to stockholder approval and antitrust clearances, oftentimes third-party consents may be required.[68] These third-party consents arise because the target, and sometimes the acquirer are already parties to agreements that may limit their ability to undertake a change of control transaction.[69] For example, consent may be needed from the lessor of real property or equipment that the target leases, from the mortgagee of the target's property, or from other third parties with whom the target has entered into a contract.[70] Parties often wait until the preclosing period to obtain consent for the transaction from third parties.[71] As a result of the time necessary to accomplish these tasks the preclosing period can extend anywhere from a month to several months and, in some cases, can last up to a year.[72]

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67. *Id.* § 18a(b), (e)(2).

68. *See* FREUND, *supra* note 37, § 12.3.2 (addressing process for third-party consents during preclosing period). Other regulatory consents, besides antitrust and third-party consents, are often required by the regulatory agency supervising a particular industry. For example, "a merger between banks may require the approval of the Federal Reserve[; a] merger between communications companies may require the approval of the Federal Communications Commission[; and] . . . a merger between airlines may require the approval of the Federal Aviation Administration and the Department of Transportation." Miller, *supra* note 39, at 2021-22.

69. *See* Darian M. Ibrahim, *The Unique Benefits of Treating Personal Goodwill as Property in Corporate Acquisitions*, 30 DEL. J. CORP. L. 1 n.165 (2005) (stating if agreements contain change of control provisions consent may be required).

70. *See* FREUND, *supra* note 37, § 12.3.2 (providing examples of third-party consents).

71. *See id.* (stating that, except in circumstances involving a "crucial matter," obtaining third-party consents is usually done after signing).

72. *See* Stephen M. Bainbridge, *Exclusive Merger Agreements and Lock-Ups in Negotiated Corporate Acquisitions*, 75 MINN. L. REV. 239, 241 (1990) (explaining there is generally two to four months between signing and closing); John C. Coates IV & Guhan Subramanian, *A Buy-Side Model of M&A Lockups: Theory and Evidence*, 53 STAN. L. REV. 307, 310 (2000) (stating that time required to obtain stockholder approval ranges from a minimum of thirty days to up to six months); Ronald J. Gilson & Alan Schwartz, *Understanding MACs: Moral Hazard in Acquisitions*, 21 J.L. ECON. & ORG. 330, 333-34 (2005) (stating that preclosing period typically lasts from ninety days up to a year); Jessica Silver-Greenberg, *Dealmakers Tiptoe Back into the M&A Market*, BUSINESSWEEK (Feb. 18, 2009) (stating average deal now takes sixty days to close). Due to the recent volatility in the financial markets, deal makers may attempt to shorten this period. For example, some practitioners foresee that there will be increased demands on deal lawyers "to get proxy statements and regulatory applications filed within days, rather than weeks, of announcing transactions." Frank Aquila & Melissa Sawyer, *A Series of Unfortunate Events: How 2008 Changed M&A and What It Means for the Year Ahead*, 12 NO. 10 M&A LAW. 8 (Nov./Dec. 2008). Moreover, the same practitioners suggest that regulatory lawyers may be asked to structure deals so that regulatory approvals are not needed or "to avoid second requests and other extended waiting periods." *Id.* It appears that these methods may be working as the average time to close deals has decreased from 130 days to 60 days. Silver-Greenberg, *supra*.

2. *Consequences of the Delay*

During this month to year-long preclosing period, parties to an agreement face a number of potential changes in circumstances or risks that the parties try to limit contractually. The first risk is that a third party may attempt to interrupt, or "jump," the proposed transaction by submitting a better offer.[73] The possibility of a third party's later offer is viewed as a risk by most acquirers who, by the preclosing period, have likely devoted a substantial amount of resources, financial and otherwise, to the proposed transaction.[74] Conversely, target company boards may have varying reactions to a third party's offer depending on the nature of the offer, the identity of the third party, and, sometimes on management's personal goals.[75]

Risks faced by parties during the preclosing period are not limited to topping bids made by third parties. An additional and perhaps more prevalent risk in today's unstable economic environment is the risk there will be adverse changes in the financial markets or in the business or industries of the acquirer or target. In these situations, although there may arguably be a material adverse change, the party often will not want or be able to escape the agreement by invoking the material adverse effect clause.[76] However, a board may not want

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73. *See* Block, *supra* note 33, at 74 (recognizing the possibility that a third-party may make superior offer after signing).

74. *See id.* (stating merger agreements typically contain protective measures like no shop provision designed to reduce possibility of later offer); Kling et al., *supra* note 39, at 798 (stating buyers try to minimize " 'competitor risk' " and seek to complete transactions "without the constant threat of interference from a competitor which may overbid his price or undercut his other contract demands by taking positions which are more palatable to the seller . . . .").

75. *See In re* Topps Co. S'holders Litig., 926 A.2d 58, 72-73 (Del. Ch. 2007) (stating board of directors purportedly rejected third party's unsolicited offer due to antitrust risks); Sean J. Griffith, *The Costs and Benefits of Precommitment: An Appraisal of Omnicare v. NCS Healthcare*, 29 J. CORP. L. 569, 615-16 (2004) (describing the possibility that boards and managers may favor an initial merger over a third-party offer due to their own interests).

76. *See* Symposium, *Negotiating Acquisitions of Public Companies*, 10 U. MIAMI BUS. L. REV. 219, 259-60 (2002) (remarks made by Lou Kling) [hereinafter *Negotiating Acquisitions*]. In a 2002 symposium, Skadden Arps M&A partner Lou Kling addressed this type of scenario by stating:

> You can have a situation where the exchange ratio in the merger is fixed, and there's been an adverse change in the acquiring company's business that really drives down the dollar value of the deal to the target's stockholders, who will be receiving stock of the acquirer in the merger. As the target's counsel you may not feel sufficiently comfortable that this is actually a material adverse change for purposes of triggering a walk right, and your client may not wish to take the liability risk of declaring a MAC and walking. At the same time, the board may no longer believe the deal as originally priced makes sense. That's a perfect example of a situation where I would find it very hard to tell a board of directors, Even though you don't believe in this deal any more, you have to mail out a proxy statement that says you're still recommending it. I don't even know how you get up and say that to the board and expect to get hired again . . . . If they don't believe in it, they don't believe in it.

to continue to recommend the deal due to adverse changes.[77]

Yet another change that may occur after signing is one found in many a law school hypothetical. That is, the possibility that the target may increase substantially in value due to an unforeseen positive event—anything from the discovery of gold or oil on the target's property or, more likely, an event such as the discovery that the target has patent rights in a certain product.[78] A target board's response to each of these risks, or opportunities, is governed by the merger agreement's various fiduciary outs, including the recommendation out and other related merger agreement provisions.

C. *Fiduciary Duties of the Target Board in Mergers and Acquisitions*

Generally, courts review a board's business decisions, including a decision to engage in a merger or acquisition, using the deferential business judgment rule.[79] The business judgment rule is a "presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company."[80] However, depending on the transaction structure at issue additional standards of review may be applicable before the business judgment rule is applied.[81] The most prominent of these merger-specific duties are the duty to get the best price once the board decides to sell, and the duty to act reasonably when adopting defensive mechanisms.

In 1986, the Delaware Supreme Court, in *Revlon v. MacAndrews & Forbes Holdings, Inc.*, held that once the break-up of a company becomes inevitable, the board's "role change[s] from defenders of the corporate bastion to auctioneers charged with getting the best price

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Id.

77. *Id.*

78. *See* Balotti & Sparks, *supra* note 24 at 468; Block, *supra* note 33, at 83 (discussing situations where target board may decide to change its recommendation due to positive event like the discovery of patent rights); *see also* Stanchfield, *supra* note 27, at 1330 n.5 (listing changed conditions such as "changes in market conditions (including the parties' stock prices), litigation, [and] new product developments . . . .").

79. *See* Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 928 (Del. 2003) (describing deferential nature of business judgment rule). A board's fiduciary duties apply in the M&A setting during the negotiation and sale process and continue to apply after the execution of a definitive acquisition agreement. *See id.* at 938 (recognizing the "continuing obligation [of directors] to discharge their fiduciary responsibilities, as future circumstances develop, after a merger agreement is announced").

80. Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984). When this standard is applied, the party challenging the board's actions has the burden of rebutting the presumption. *Id.* If the presumption is not rebutted then "a court will not substitute its judgment for that of the board if the [board's] decision can be 'attributed to any rational business purpose.' " Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985) (quoting Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971)).

81. Revlon Corp. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986).

for the stockholders at a sale of the company."[82] As a result, courts apply an enhanced scrutiny standard to make certain the board has acted reasonably in maximizing stockholder value.[83]

Although it is unclear exactly when *Revlon* applies, it is clear from the jurisprudence that an all-cash transaction results in a change of control and thus triggers *Revlon*.[84] On the other end of the spectrum, most stock-for-stock transactions will not trigger *Revlon* duties. Instead, in reviewing the board's decision to enter into a stock-for-stock transaction, courts will defer to the board's business judgment.[85] However, *Revlon* duties may be triggered in a stock-for-stock transaction if one person or entity will acquire a controlling block of stock so that the target company's stockholders become minority stockholders in the surviving corporation.[86] When a transaction involves a mix of cash and stock uncertainty lingers as to exactly when *Revlon* may be triggered.[87] Delaware courts have held that when 33% of the consideration is cash *Revlon* is not triggered, while a transaction involving 62% cash would likely trigger *Revlon* and thus would be subject to that higher level of scrutiny.[88] However, where the courts will draw the line between 33% and 62% has yet to be seen.[89]

Another consideration is the applicable standard of review governing deal protection provisions, including the merger recommendation covenant. Specifically, the debate among jurists, scholars, and practitioners has centered on whether deal protection provisions in negoti-

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82. *Id.* at 182.

83. *See* Paramount Commc'ns Inc. v. QVC Network Inc., 637 A.2d 34, 43 (Del. 1994) (applying the enhanced scrutiny standard in reviewing board of directors' fiduciary duties in a sale of control context).

84. *See In re* NYMEX S'holder Litig., C.A. Nos. 3621-VCN, 3835-VCN, 2009 WL 3206051, at *5 (Del. Ch. Sept. 30, 2009) ("[I]n a transaction where cash is the exclusive consideration paid to the acquired corporation's shareholders, a fundamental change of corporate control occurs—thereby triggering *Revlon*—because control of the corporation does not continue in a large, fluid market.").

85. *See* Paramount Commc'ns, Inc. v. Time Inc. (*In re* Time Inc. S'holder Litig.), 571 A.2d 1140, 1151 (Del. 1989) (reviewing stock-for-stock transaction to determine whether it "was the product of a proper exercise of business judgment").

86. *QVC Network Inc.*, 637 A.2d at 42-43.

87. *See* Equity-Linked Investors, L.P. v. Adams, 705 A.2d 1040, 1055 (Del. Ch. 1997) ("How this 'change in control' trigger works in instances of mixed cash and stock or other paper awaits future cases."); *see also NYMEX*, 2009 WL 3206051, at *5 (recognizing uncertainty involved when a merger consideration that is a mix of cash and stock, and recognizing the amount of cash needed to trigger *Revlon* is uncertain).

88. *See In re* Santa Fe Pac. Corp. S'holder Litig., 669 A.2d 59, 70-71 (Del. 1995) (holding deal in which cash accounted for 33% of consideration did not trigger *Revlon*); *In re* Lukens Inc. S'holder Litig., 757 A.2d 720, 732 n.25 (Del. Ch. 1999) (stating deal in which cash accounted for 62% of consideration likely triggers *Revlon*).

89. Brian J.M. Quinn, *Triggering Revlon Duties*, M&A LAW PROF BLOG (Oct. 15, 2009), http://lawprofessors.typepad.com/mergers/2009/10/triggering-revlon-duties.html (recognizing uncertainty of how much cash is needed to trigger *Revlon*); *NYMEX*, 2009 WL 3206051, at *5 (recognizing uncertainty involved when consideration is a mix of cash and stock, and recognizing that the amount of cash needed to trigger *Revlon* is uncertain).

ated transactions should be reviewed under the deferential business judgment rule or whether the *Unocal Corp. v. Mesa Petroleum Co.*[90] enhanced scrutiny standard normally applicable to hostile takeovers should be applied.[91] Although the soundness of applying this enhanced standard has been questioned and criticized, the Delaware Supreme Court in *Omnicare, Inc. v. NCS Healthcare, Inc.*[92] applied the *Unocal* standard to deal protection provisions after analogizing these provisions to defenses adopted by a company to ward off a hostile tender offer.[93] Thus, following *Omnicare*, dealmakers must consider the application of this enhanced standard to deal protection devices in negotiated non-change-of-control transactions.[94] *Unocal* involves a two-stage inquiry that first requires the board to show that it "had reasonable grounds for believing that a danger to corporate policy and effectiveness existed" and then requires a demonstration that the defensive response adopted by the board was "reasonable in relation to the threat posed."[95] This second stage of the analysis is further broken down into a two-step inquiry that requires the board first to demonstrate that "the merger deal protection devices adopted in response to the threat were not 'coercive' or 'preclusive,' and then [the board must] demonstrate that [its] response was within a 'range of reasonable responses' to the threat perceived."[96] If the deal protection devices are found to be either coercive or preclusive, then the court will deem them to be "draconian and impermissible."[97] Even if they are not found to be coercive or preclusive, they must be found to be reasonable to be deemed valid.[98]

Thus, a target board's decision to engage in an M&A transaction with an unaffiliated third party, the negotiation process, and the board's actions during the preclosing period will be reviewed using either the deferential business judgment rule or the enhanced *Revlon*

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90. 493 A.2d 946 (Del. 1985).

91. *See, e.g.*, Wayne O. Hanewicz, *When Silence is Golden: Why the Business Judgment Rule Should Apply to No-Shops in Stock-for-Stock Merger Agreements*, 28 J. CORP. L. 205, 238 (2003) (arguing for application of business judgment rule to no shops).

92. 818 A.2d 914 (Del. 2003).

93. *Id.* at 932. With respect to the debate regarding the applicable judicial standard of review to deal protection devices in non-change of control transactions, see Sautter, *supra* note 9, at 538 n.63 (listing sources discussing applicable standard).

94. *See Omnicare*, 818 A.2d at 930-31 (recognizing that deal protections in nonchange of control transactions are subject to *Unocal* enhanced scrutiny standard); Orman v. Cullman, No. Civ. A. 18039, 2004 WL 2348395, at *6 (Del. Ch. Oct. 20, 2004) (recognizing *Omnicare* majority's application of *Unocal* to deal protection in stock-for-stock mergers); *see also* La. Muni. Police Employees' Ret. Sys. v. Crawford, 918 A.2d 1172, 1182 n.10 (Del. Ch. 2007) (stating deal protection provisions are reviewed for unreasonableness, preclusiveness, or coerciveness under *Unocal*).

95. *Unocal*, 493 A.2d at 955.

96. *Omnicare*, 818 A.2d at 935 (quoting Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1387-88 (Del. 1995)).

97. *Omnicare*, 818 A.2d at 935.

98. *Id.*

standard depending on the transaction structure. At the same time, the package of deal protection provisions contained in the agreement is likely subject to the enhanced *Unocal* standard.[99]

III. DELAWARE JURISPRUDENCE AND THE FIDUCIARY OUT

As previously mentioned, the Delaware courts have yet to address the validity of contractual limitations on a board's recommendation out. However, over the past quarter of a century, the Supreme Court of Delaware and the Delaware Court of Chancery have issued a number of decisions commenting on fiduciary outs in the context of no shop provisions. Although no shops and merger recommendations are related covenants, these covenants regulate different behavior. A no shop provision is a deal protection provision that helps to minimize the risk of a third party "jumping" the signed transaction.[100] More specifically, it is a covenant preventing a target company from

99. *See Orman,* 2004 WL 2348395, at *6 (applying *Unocal* standard in an all-cash transaction not resulting in change of control only to the issue of whether deal protection mechanisms were coercive); *see also In re* Toys "R" Us, Inc. S'holder Litig., 877 A.2d 975, 1016 (Del. Ch. 2005) (applying heightened *Unocal* standard in reviewing termination fee in all-cash transaction).

100. *See* Kling et al., *supra* note 39, at 799 (stating buyers try to lessen possibility of third-party bidders after signing by negotiating for no shop provisions). Matching rights are another type of deal protection device often paired with no shop provisions and with the merger recommendation covenant. *See In re Toys "R" Us,* 877 A.2d at 1017 (stating matching rights are not per se invalid and are "common contractual feature[s]"). Although these provisions can appear in a number of variations, generally, matching rights allow the initial buyer the opportunity to match, or exceed, the third party's offer before the target may terminate the agreement in favor of the third party's proposal. Block, *supra* note 33, at 99. These provisions typically provide that the target board give notice to the initial buyer that the board has received an unsolicited third-party proposal and that the board has determined that the offer is, or is reasonably likely to be, a Superior Offer. *Id.* Some forms of matching rights may prevent a board from even considering a third-party offer until the target has provided notice to the initial buyer. *See* Transmeta Corp., Current Report (Form 8-K, Exhibit 2.1), § 4.3(c)-(d) (Nov. 20, 2008) (providing after receipt of Superior Proposal that the target company must first give notice to the acquirer before the target may consider the proposal and before the acquirer's matching right is triggered). Once notice is provided to the initial buyer, a period must elapse before the target may terminate the agreement. Block, *supra* note 33, at 99. This period generally ranges from three to five business days. *See* American Bar Ass'n's Business Law Section, 2009 Strategic Buyer/Public Target Mergers & Acquisitions Deal Points Study (For Transactions Announced in 2008), Slide 64, http://blogs.law.harvard.edu/corpgov/files/2009/10/Deal-Point-Study-9-10-09.pdf [hereinafter ABA 2008 Study] (indicating most deals contain three to five business day matching right period). During this period, the target company may be obligated to negotiate in good faith with the initial buyer. Block, *supra* note 33, at 99. When matching rights are paired with a merger recommendation covenant, the target board may have to inform the initial buyer that it intends to change its recommendation and then allow the waiting period to expire prior to actually changing its recommendation. *See, e.g.*, Sun Microsystems, Inc., Current Report (Form 8-K, Exhibit 2.1), § 6.03(d) (Apr. 20, 2009) (providing that target may, after receipt of Superior Proposal, change its recommendation to shareholders only after acquirer first receives notice of the Superior Proposal and has opportunity to negotiate with target and match the offer). This waiting period allows the initial buyer time to negotiate with the target company in an attempt to cure the situation forcing the change in recommendation.

actively soliciting offers from third parties after the signing of a definitive acquisition agreement.[101] A pure no shop provision, or a no talk provision, also prevents a target company from providing information to a third party who has made an unsolicited proposal and prohibits the target company from negotiating with that third party.[102] These provisions are often paired with fiduciary outs that allow for the provision of information to a third party if the target's board of directors determines that the third party's unsolicited offer is superior, or is reasonably likely to become a Superior Offer.[103] In addition, the fiduciary out allows the target board to terminate the preexisting agreement to accept a superior, unsolicited offer if the board determines it is necessary to do so to avoid violating the board's fiduciary duties.[104]

Despite the differences between the no shop covenant and the recommendation covenant, the Delaware jurisprudence on no shop fiduciary outs provides helpful insights into when a target board may val-

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101. *See* Block, *supra* note 33, at 74 (describing no shop provisions).

102. *Id.* Practitioners tend to view pure no talk provisions that are not paired with a fiduciary out as invalid because boards are unable to satisfy their fiduciary duties, which is the "legal equivalent of willful blindness." Phelps Dodge Corp. v. Cyprus Amax Minerals Co., Nos. CIV. A. 17398, CIV. A. 17383, CIV. A. 17427, 1999 WL 1054255, at *1 (Del. Ch. Sept. 27, 1999) ("No-talk provisions . . . are troubling precisely because they prevent a board from meeting its duty to make an informed judgment with respect to even considering whether to negotiate with a third party.").

103. Block, *supra* note 33, at 74; *see also* Coates, *supra* note 39, at 26 (presenting results of statistical study of public and private company merger agreements and stating 85% of public company merger agreements studied contained fiduciary out allowing target termination right if superior offer emerged after signing); LIPTON & STEINBERGER, *supra* note 63, § 1.07[3][b] (noting it is increasingly more common to include fiduciary outs allowing termination of merger agreement in favor of superior offer). A study of 103 strategic transactions announced in 2008 revealed that in 93% of the deals surveyed the board simply had to determine that the third party proposal was "expected to result in a superior offer" to satisfy the no shop fiduciary out. *See* ABA 2008 Study, *supra* note 100, at Slide 46 (presenting pie chart with no shop fiduciary out statistics). An actual superior offer was required in 3% of deals and just an acquisition proposal was required in 2%. *See id.* It should be noted that when paired with a no shop provision, the fiduciary out does *not* allow the target company to actively solicit offers. *See* Kling et al., *supra* note 39, at 799 (stating fiduciary out does not typically apply to no-solicitation covenant). If the target would like to *actively* solicit offers after signing, the target would instead negotiate a go shop provision. *See generally* Sautter, *supra* note 9 (discussing go shop provisions); *see also* Guhan Subramanian, *Go-Shops vs. No-Shops in Private Equity Deals: Evidence and Implications*, 63 BUS. LAW. 729 (2008).

104. *See* Block, *supra* note 33, at 74-75 (describing outs in relation to window shop provisions). When a no shop is paired with a fiduciary out, these provisions are technically called window shops. *See id.* at 74. Practitioner, Dennis Block, has stated that in the context of a *Revlon* transaction, the target company will opt for a window shop provision so that the target is able to consider third party offers after signing. *Id.* at 77. However, Block also indicates that pure no shop provisions are more likely to be upheld in the context of a non-*Revlon* transaction which is subject to a lower standard of review. *Id.* at 78.

idly agree to limit its recommendation out.[105] This is the case, in part, because the same Superior Offer may trigger action under both the no shop out and the recommendation out. As a result, the Superior Offer out for the no shop provision is inextricably tied to the recommendation out. Therefore, although the two provisions regulate different behavior—the no shop covenant regulates the corporation's interaction with third party offerors while the recommendation covenant regulates the board's ability to withdraw its recommendation—the two provisions are closely related. This section provides an overview of some of the most significant Delaware cases addressing fiduciary outs, mainly in the context of no shop or no talk provisions.

A. Recommendation Outs and Freedom of Contract View

A quarter of a century ago, the Supreme Court of Delaware issued its landmark decision, *Smith v. Van Gorkom*.[106] In that case, Van Gorkom, the Chairman and CEO of the target company, stated that his "understanding" of corporate law was that "directors always have an inherent right, as well as a fiduciary duty, to accept a better offer notwithstanding an existing contractual commitment by the Board."[107] However, the Delaware Supreme Court rejected Van Gorkom's "understanding" of corporate law. The court, instead, focused on the language of the recommendation out as well as the board's perception of what the agreement provided for at the time the board authorized it.[108] The agreement provided:

> The Board of Directors shall recommend to the stockholders of [the target company] that they approve and adopt the Merger Agreement . . . and to use its best efforts to obtain the requisite votes therefor. *[The acquirer] acknowledges that [the target company] directors may have a competing fiduciary obligation to the shareholders under certain circumstances*.[109]

The court found that this italicized language did not create an effective fiduciary out allowing the board to either accept a better offer or to provide information to third parties.[110] In addition, the court de-

105. *But see* Johnston, *supra* note 21, at 19 (stating recommendation outs are "fundamentally different" from no shop outs as former involves board's duty to communicate freely with stockholders).

106. 488 A.2d 858 (Del. 1985).

107. *Id.* at 879.

108. *Id.* Testimony revealed the board had sought amendments to the agreement allowing the provision of information to other bidders and the right to accept a better offer if one were to come along. *Id.* In fact, two outside directors "maintained that the Agreement as submitted was approved on the understanding that, 'if we got a better deal, we had a right to take it.' " *Id.* One of the directors further testified that if the management had not put that into the agreement then the management did not follow the board's instructions. *Id.*

109. *Id.*

110. *Id.*

termined that this language did not allow the board to change its recommendation with respect to the transaction if circumstances changed.[111] As a result, many commentators point to *Van Gorkom* as setting forth a contract primacy, or freedom-of-contract, view of fiduciary duties.[112] Under this view, the executed merger agreement takes precedence over the board's fiduciary duties and the board may not terminate a merger agreement unless it is allowed to do so under the agreement.[113]

B. Freedom of Contract and No Shop Fiduciary Outs

In 1995, ten years after *Van Gorkom*, the Delaware Court of Chancery addressed a similar perception of fiduciary duties as Van Gorkom's "understanding" that fiduciary duties trumped contract language. In that case, *Renaissance Communications Corp. v. NBC, Inc.*,[114] Outlet Communications held an auction to sell itself and ultimately entered into a merger agreement with Renaissance Communications pursuant to which Renaissance would pay $42.25 per share in an all-cash transaction.[115] The Renaissance-Outlet agreement contained a no shop provision with a fiduciary out allowing the Outlet board to terminate the agreement if it would be a breach of the board's fiduciary duties not to do so.[116] After the agreement was executed, NBC offered $47.25 per share.[117] Renaissance then sought a temporary restraining order seeking to prevent the termination of the Renaissance-Outlet agreement and to prevent Outlet from entering into a new agreement with NBC.[118] The then Vice Chancellor, Professor William Allen, denied the motion.[119] In denying the motion,

111. *Id.*

112. *See, e.g.*, Balotti & Sparks, *supra* note 24, at 468-74 (describing *Van Gorkom* as adopting contract primacy approach to fiduciary duties).

113. Corwin v. DeTrey, CIV. A. No. 6808, 1989 WL 146231, at *4 (Del. Ch. Dec. 4, 1989) ("[T]he directors of the selling corporation are not free to terminate an otherwise binding merger agreement just because they are fiduciaries and circumstances have changed The buyers, likewise, are not required to give up their rights under a binding contract simply because they are fiduciaries and changed circumstances make their bargain more favorable." (citations omitted) (citing *Van Gorkom*, 488 A.2d at 888)).

114. No. CIV.A. 14446, 1995 WL 1798510 (Del. Ch. Aug. 1, 1995).

115. *Id.* at *1. During the auction, Outlet's investment bank, Goldman Sachs solicited indications of interest from potential buyers and "45 companies . . . expressed potential interest in purchasing Outlet." *Id.* at *7. There were two rounds of bidding with the second round narrowing the field of bidders to seven. *Id.* Both Outlet and NBC submitted bids during the second round and Outlet won the auction. *Id.* at *7-8.

116. *Id.* at *6.

117. *Id.* at *2.

118. *Id.* at *3.

119. *Id.* at *26. In denying the motion for a TRO, the Vice Chancellor stated,

> [T]he right is essentially a contract right. It is a right that is subject to a condition precedent and is subject to a provision regarding a fiduciary out. I certainly am not in the position today to make the evaluation that there is no way that a responsible attorney familiar with the corporate law of this state could

Allen recognized that people often think of fiduciary duties as "supervening."[120] But the Vice Chancellor went on to explain that there must be situations, like auction sales of corporations, where the board can agree to remove its discretion because "[o]therwise, the auctions won't work."[121]

C. The Fiduciary Limits of Freedom of Contract

1. Ace and the Non-Delegation Principle

Vice Chancellor Allen's opinion regarding auctions was echoed in the 1999 Delaware Chancery Court case of *Ace Ltd. v. Capital Re Corp.*[122] That case involved a stock-for-stock deal pursuant to which Capital Re stockholders were to receive six-tenths of a share of Ace stock for each Capital Re share they held.[123] Ace was a 12.3% stockholder of Capital Re stock at the time the agreement was executed and had entered into stockholder voting agreements with stockholders representing an additional 33.5% of Capital Re shares.[124] Pursuant to those agreements, the stockholders agreed to vote for the merger "*if the Capital Re board of directors did not terminate the Merger Agreement in accordance with its provisions*."[125] The agreement contained a no talk provision that prevented the board from soliciting offers and from negotiating with or providing information to a third party who made an unsolicited offer unless certain conditions were satisfied.[126] These conditions included a requirement that the Capital Re board make a good faith determination based on its outside legal counsel's written advice that it would be breaching its fiduciary duties if it did not negotiate with or provide information to a third party.[127] The Capital Re board could then terminate the merger agreement if the board authorized the entry into an agreement with a third party that had made a Superior Offer.[128]

> conclude that the fiduciary out provision has no applicability in these circumstances.

Id.

120. *Id.* at *15.
121. *Id.*
122. 747 A.2d 95 (Del. Ch. 1999).
123. *Id.* at 97.
124. *Id.*
125. *Id.*
126. *Id.* at 98.
127. *Id.* at 98-99. The other conditions required that the board conclude that the unsolicited offer is "reasonably likely to be or to result in a Superior Proposal"; the third party had to enter into a confidentiality agreement; and the Capital Re board had to provide "contemporaneous notice of their intent to negotiate or furnish information." *Id.*
128. *Id.* at 99. In addition, Capital Re could not be in material breach of the merger agreement, a five day matching right period had to have expired without Ace making an offer at least as favorable as the Superior Proposal, and Capital Re was required to pay Ace a $25 million termination fee. *Id.*

A day prior to the stockholder vote, XL Capital entered the picture with an offer to purchase Capital Re for $12.50 per share which it later raised to $13 per share.[129] The board promptly sought written advice from its outside counsel which stated that negotiating with XL Capital was " 'consistent with' " the Capital Re board's fiduciary duties.[130] The Capital Re board sent notice to Ace that it considered the XL Capital offer a Superior Offer and a bidding war ensued between Ace and XL Capital, during which Ace increased its offer so that the stockholders would receive a mix of stock and cash with a value of at least $13.[131] XL Capital then increased its offer to $14 in all cash, which prompted the Capital Re board to send another termination notice to Ace.[132] At this point, Ace filed a motion for a temporary restraining order to prevent Capital Re from terminating the merger agreement.[133]

Ace's main contention was that the no talk out required Capital Re's attorney to issue an opinion that the Capital Re board was required to negotiate with XL Capital.[134] Because the attorney's written advice did not say that Capital Re was *legally mandated* to negotiate with XL Capital, Ace argued that Capital Re was in breach of the merger agreement.[135] Vice Chancellor Leo Strine, Jr. rejected this argument, stating that if that was the proper interpretation of the provision, it would likely be found invalid.[136] Strine stated a board cannot delegate its "duty to determine what its own fiduciary obligations require at precisely that time in the life of the company when the board's own judgment is most important."[137] The Vice Chancellor stated that this provision was "particularly suspect" because, due to the stockholder voting agreements, the original transaction was guaranteed if Capital Re did not consider other offers.[138]

Despite these findings, Strine suggested there were some "limited circumstances" where a board may be able to limit its ability to consider superior proposals.[139] According to Strine, these "limited circumstances" may include transactions "where [the] board has actively canvassed the market, negotiated with various bidders in a competitive environment, and believes that the necessity to close a

129. *Id.* at 99, 100.
130. *Id.* at 99.
131. *Id.* at 100.
132. *Id.*
133. *Id.* at 100.
134. *Id.*
135. *Id.* at 100-02.
136. *Id.* at 106.
137. *Id.*
138. *Id.*
139. *Id.* at 107.

transaction requires that the sales contest end."[140]

2. Omnicare *and the Limits of Board Discretion*

In 2003, the Delaware Supreme Court issued its controversial three-to-two decision in *Omnicare, Inc. v. NCS Healthcare, Inc.*[141] The majority assumed, arguendo, that the business judgment rule applied to the stock-for-stock transaction pursuant to which Genesis Health Ventures, Inc. would acquire NCS Healthcare, Inc.[142] In this case, two of the directors who owned over 65% of NCS's voting stock entered into voting agreements pursuant to which they granted Genesis irrevocable proxies to vote their shares in favor of the Genesis merger.[143] The agreements were also specifically enforceable by Genesis, meaning that so long as the proposed merger went to a stockholder vote, the shares would be voted for the Genesis merger.[144] In addition, the merger agreement with Genesis contained a no shop provision with a fiduciary out allowing the board to enter into discussions with a third party making an unsolicited offer if the board determined that the offer "was or was likely to result in" a Superior Proposal.[145] Furthermore, the agreement contained a force-the-vote provision.[146]

After the NCS-Genesis merger agreement was executed, Omnicare, Inc. submitted a proposal to purchase NCS.[147] The NCS board was unable to determine whether the Omnicare offer constituted a Superior Proposal, as that term was defined in the agreement, and received a waiver from Genesis allowing it to enter into discussions with Omnicare regarding its offer without first determining whether the offer was a Superior Proposal.[148] Shortly thereafter, in light of the

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140. *Id.* at 107 n.36. Strine went on to state that "where a board has not explored the marketplace with confidence and is negotiating a deal that requires stockholder approval and would result in a change in stockholder ownership interests, a board's decision to preclude itself—and therefore the stockholders—from entertaining other offers is less justifiable." *Id.*

141. 818 A.2d 914 (Del. 2003).

142. *Id.* at 929.

143. *Id.* at 919, 926.

144. *Id.* at 926.

145. *Id.* at 925-26.

146. *Id.* at 925.

147. *Id.* at 926. Omnicare had submitted a proposal to purchase NCS prior to the execution of the NCS-Genesis merger agreement. *Id.* at 924. However, that proposal was conditioned on negotiating a merger agreement, completing due diligence, and obtaining third party consents. *Id.* By this time, NCS had already entered into an exclusivity agreement with Genesis that prevented NCS from participating in discussions with a third party regarding a competing proposal. *Id.* Despite this, NCS's independent committee met to consider a response to Omnicare's proposal. *Id.* During that meeting the committee determined that if NCS were to enter into discussions with Omnicare, there was an "unacceptable risk that Genesis would abandon merger discussions" and the "risk of losing the Genesis proposal was too substantial." *Id.*

148. *Id.* at 926.

Omnicare offer, the NCS board withdrew its recommendation and advised that the NCS stockholders vote against the Genesis merger.[149] The board acknowledged, however, that because the board was subject to a force-the-vote provision and because 65% of the voting shares were already locked-up, NCS stockholder approval was already ensured.[150] Omnicare subsequently brought suit "seeking to invalidate a merger agreement between NCS and Genesis on fiduciary duty grounds" while NCS stockholders brought suit seeking to invalidate the NCS-Genesis merger on the ground that the NCS directors violated their fiduciary duty of care "in failing to establish an effective process designed to achieve the transaction that would produce the highest value for the NCS stockholders."[151]

The majority stated that the irrevocable voting agreements, the force-the-vote provision, and the lack of an effective fiduciary out "completely prevented the board from discharging its fiduciary responsibilities to the minority stockholders when Omnicare presented its superior transaction."[152] The majority declared that "the NCS board was required to negotiate a fiduciary out clause to protect the NCS stockholders if the Genesis transaction became an inferior offer" and by failing to do so, it had "disabled itself from exercising its own fiduciary obligations . . . ."[153] In reaching this conclusion, the majority cited heavily to *Paramount Communications, Inc. v. QVC Network, Inc.*[154] in which the Delaware Supreme Court declared invalid certain defensive provisions in the Paramount-Viacom change of control transaction, including a stock option agreement, a no shop provision that was paired with a fiduciary out, and a termination fee that was triggered if, among other events, the Paramount board recommended a competing transaction.[155] The *QVC* court found that these provisions prevented the Paramount board from negotiating with third parties, including QVC, who had expressed an interest in Paramount before Paramount had executed an agreement with Viacom.[156] As a result, the *QVC* court held that the Paramount board had violated its fiduciary duties, particularly its *Revlon* duties, by engaging in an unreasonable sale process and agreeing to these defensive provisions.[157]

Chief Justice Veasey and Justice Steele authored rare dissenting

149. *Id.* at 926, 927.
150. *Id.* at 927.
151. *Id.* at 919. These suits were brought separately but were consolidated on appeal. *Id.*
152. *Id.* at 936.
153. *Id.* at 938.
154. 637 A.2d 34 (Del. 1994).
155. *Id.* at 39, 49-50.
156. *Id.* at 49.
157. *Id.* at 36, 51.

opinions in *Omnicare*.[158] Chief Justice Veasey's opinion, which Justice Steele joined, took issue with the majority's application of *Unocal* to the facts of the case.[159] They also disagreed with the majority's conclusion that the board had breached its fiduciary duties by failing to negotiate a fiduciary out.[160] Chief Justice Veasey distinguished the facts of *Omnicare* from *QVC* by stating that in *QVC* the Paramount board had received a Superior Offer but "turn[ed] away from it to lock up a less valuable deal" whereas in *Omnicare* the NCS board had locked up "the *only* value-enhancing transaction available" at the time.[161]

IV. RECENT TRENDS IN RECOMMENDATION OUTS

A. *Types of Recommendation Outs*

Recommendation outs break down into three general categories, with variations within each category. These outs can be thought of as a continuum ranging from the broadest to the narrowest form of the out. The broadest form is one that allows the board to withdraw or modify its recommendation if the board determines that its fiduciary duties require it to do so. The narrowest out allows a recommendation modification or withdrawal only in the case of a Superior Offer (or a Superior Proposal, depending on the term used in the agreement). Finally, there is an intermediate form that allows a board to withdraw or to modify its recommendation in the case of a Superior Offer *or* an Intervening Event. This last category is the newest version of the recommendation out and has renewed the question as to whether narrower recommendation outs are valid under Delaware law. The following section addresses each of these fiduciary outs and some of the variations within each category.

1. *Broadest Form—Fiduciary Duties*

The first and broadest form of recommendation out allows for a withdrawal or change in recommendation if the board finds that do-

158. *Omnicare,* 818 A.2d at 939 (Veasey, C.J., dissenting); *id.* at 946 (Steele, J. dissenting). In his dissenting opinion, Chief Justice Veasey acknowledged the rarity of split decisions in the Delaware Supreme Court. *Id.* at 939 n.90 ("Split decisions by this Court, especially in the field of corporation law, are few and far between.").

159. *Id.* at 943-44.

160. *Id.* at 945.

161. *Id.* Others have a similar view of the *QVC* holding stating,

> [w]e believe the holding was premised on the failure of the target board to have satisfied its fiduciary duties *prior* to agreeing to the limitations. However, some have read it to impose a broader fiduciary duty "overlay," prohibiting boards from approving merger agreements that preclude directors from addressing competing bids.

Johnston et al., *supra* note 23.

ing otherwise would be a breach of the board's fiduciary duties or if the board determines that continuing to recommend the transaction would be inconsistent with the board's fiduciary duties. This type of recommendation out is the most popular form as indicated in American Bar Association (ABA) studies of strategic transactions executed in 2007 and 2008. The ABA study of strategic transactions executed in 2007 found that 45% of deals studied contained this out while 55% of transactions executed in 2008 included this broad out.[162]

These broad outs are drafted in a variety of ways. For example, this out may require the board to determine that the failure to change its recommendation is "inconsistent with" the board's fiduciary duties while other outs require the board to make the determination that the failure to change its recommendation would be a "breach of" the board's fiduciary duties.[163] Thus, there appear to be varying standards which may be incorporated into this type of out—the "inconsistent with" language is a lower standard to meet than the "breach of" fiduciary duties standard.[164] Furthermore, the out may require that the board consult with its legal counsel and/or financial advisor in making the determination that the out has been triggered.[165] However, consistent with the Delaware Court of Chancery's

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162. American Bar Association's Section of Business Law, 2008 Strategic Buyer/Public Target Mergers & Acquisitions Deal Points Study (For Transactions Announced in 2007), Slide 51, http://blogs.law.harvard.edu/corpgov/files/2008/12/dealpoints-2008.pdf [hereinafter ABA 2007 Study] (setting forth statistics regarding types of merger recommendation fiduciary outs in public strategic deals with transaction values of $100 million or more); ABA 2008 Study, *supra* note 100, at Slide 59.

163. *Compare* Am. Land Lease, Inc., Current Report (Form 8-K, Exhibit 2.1), § 6.4(c) (Dec. 11, 2008) (providing board may change recommendation if board "determines in good faith, after consultation with its outside legal counsel, that the failure to do so would be *inconsistent with* the directors' fiduciary duties to the stockholders of the Company under applicable Law" (emphasis added)), *with* Kosan Biosciences Inc., Current Report (Form 8-K, Exhibit 2.1) § 5.02(b) (May 29, 2008) (providing board may change recommendation if it "determines in good faith, after consultation with its outside legal counsel and a financial advisor of nationally recognized reputation, that the *failure to do so would result in a breach of its fiduciary duties* to the stockholders of the Company under applicable Law . . . ." (emphasis added)).

164. Haas, *supra* note 3, at n.21.

165. *See* Indevus Pharms., Inc., Current Report (Form 8-K, Exhibit 2.1) § 6.5 (Jan. 6, 2009). The Indevus Pharmaceuticals, Inc. merger agreement provided as follows:

> [A]t any time prior to Offer Closing Date, the Company Board may make a Company Adverse Recommendation Change if a majority of the Company Board determines (*after consultation with outside counsel*) that it is necessary to take such actions in order to comply with its fiduciary duties to the stockholders of the Company under applicable Law.

Id. § 6.5(b) (emphasis added). An example of an out requiring consultation with both legal counsel and financial counsel is seen in Autonomy Corporation's acquisition of Interwoven, Inc. *See* Interwoven, Inc., (Form 8-K, Exhibit 2.1) (Jan. 22, 2009). The merger recommendation fiduciary out in that agreement provided as follows:

> [T]he Company Board may make a Company Adverse Recommendation Change if the Company Board determines in good faith (*following consultation with its*

decision in *Ace* this duty to determine what the board's fiduciary duties are cannot be delegated to either legal counsel or financial counsel.[166] As a result, these outs simply require consultation with legal counsel or financial counsel rather than a delegation of the determination to legal or financial counsel.

Despite the varying linguistic formulations of this out, an argument can be made that this out encompasses all events that one may be concerned with during the preclosing period so long as the board makes the determination that exercising the out is required by, or is consistent with, its fiduciary duties. For example, the receipt of a Superior Proposal would trigger this out. Furthermore, as will be discussed in Part IV.D, a board is able to invoke this out following an event leading to an adverse change in stock prices.[167] Finally, a positive event, like the unexpected substantial increase in value of the target's stock, would also trigger this broad out.[168]

In the context of the no shop fiduciary out, as well as general termination provisions, some have argued in the past that similarly worded vague references to fiduciary duties actually benefit the target stockholders.[169] However, others have rejected this argument contending that targets who insist on such broad references to fiduciary duties risk being perceived as "unreliable contracting partners."[170] Instead, these commentators argued that no shop provisions paired with the broader fiduciary out and provisions allowing termination of an agreement for fiduciary duty reasons "may be illusory, or just wishful thinking."[171] These commentators advocated language explicitly setting forth circumstances in which the target company would be able to pursue Superior Offers or terminate the agreement.[172] They argued that such specifically defined language would "provide a level of clarity that is not supplied by references to 'fiduciary duties.' "[173] Since these arguments were raised over ten years ago, the

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> *financial advisor and its outside counsel*) that failure to take such action would be reasonably likely to result in a breach of its fiduciary duties to the stockholders of the Company under applicable Law.

Id. § 5.2(b) (emphasis added).

166. *See supra* Part III.C.

167. *See infra* Part IV.D; *see also* Balotti & Sparks, *supra* note 24, at 477-78 (arguing for broad recommendation out language and implying that broad out would be triggered by "changing conditions at the acquirer, or events in the industry or the economy as a whole").

168. *See* Balotti & Sparks, *supra* note 24, at 477-78 (arguing for broad recommendation out language and implying that broad out encapsulates changing conditions at target).

169. *See* Johnston & Alexander, *supra* note 10, at 19 (stating that some may think broader outs benefit stockholders).

170. *Id.* (arguing that broader outs may work to stockholders' "detriment" instead "making such entities [that insist on broader outs] unreliable contracting parties").

171. *Id.* at 18-19.

172. *Id.* at 19.

173. *Id.*

fiduciary duty termination trigger has been eschewed in favor of specific termination events.[174]

174. Block, *supra* note 33, at 94-95 (listing common termination events).

2. *Narrowest Form—Only for a Superior Offer or Superior Proposal*

The narrowest form of the recommendation out allows a board to withdraw its recommendation *only* if it has received a Superior Offer or Superior Proposal (for ease of reference, the term "Superior Offer" will be used throughout the remainder of this Article). The ABA study of strategic transactions executed in 2007 found that 48% of deals studied contained this out, while only 23% of transactions executed in 2008 included it.[175] As will be discussed in the next section, a substantial number of deals allow a board to withdraw its recommendation for either a Superior Offer or an Intervening Event. So while the statistics set forth above contain a wide disparity, they do not take into account deals containing a Superior Offer paired with an Intervening Event.

The definition of a Superior Offer varies among agreements, but the definitions used are generally the same as with the no shop fiduciary out. As a result, as discussed in Part III, the Superior Offer out for the no shop provision is inextricably tied to the recommendation out. When the recommendation out appears in its narrowest form, or is limited *solely* to a Superior Offer, a board would be violating the merger recommendation covenant if it withdrew its recommendation for anything other than a Superior Offer. Accordingly, some have argued that the narrowest form of recommendation out is invalid as it prevents the board from withdrawing its recommendation even when changed circumstances have arisen causing the board to no longer believe the transaction contemplated by the merger agreement is in the stockholders' best interests.[176] Although some members of the Delaware bench have made extrajudicial statements relating to these narrow outs, the Delaware courts have yet to formally address the validity of these outs in the context of a judicial opinion. Nevertheless, some commentators have alluded to dicta in a 2005 Delaware Chancery Court decision as suggesting that Superior Offer outs may be invalid.[177] Specifically, they point to the following language from *Frontier Oil Corp. v. Holly Corp.*:[178]

> The Merger Agreement, of course, was not an ordinary contract. Before the Merger could occur, the shareholders of Holly had to

175. ABA 2007 Study, *supra* note 162, at Slide 51 (setting forth statistics regarding types of merger recommendation fiduciary outs in public strategic deals); ABA 2008 Study, *supra* note 100, at Slide 59 (same).

176. *See* Balotti & Sparks, *supra* note 24, at 477-78.

177. Wachtell, Lipton, Rosen & Katz, *Takeover Law and Practice 2009*, 68-69 (2009) http://financial.rrd.com/wwwFinancial/Docs/Resources/Events/2009/Panel_4_Handout_9_Katz_TakeoverLawandPractice.pdf.

178. No. Civ.A. 20502, 2005 WL 1039027 (Del. Ch. Apr. 29, 2005).

> approve it. The directors of Holly were under continuing fiduciary duties to the shareholders to evaluate the proposed transaction. The Merger Agreement accommodated those duties by allowing, under certain circumstances, the board of directors to withdraw or change its recommendation to the shareholders that they vote for the Merger.[179]

One should note, however, that the merger agreement being referenced in *Frontier Oil* contained a broad fiduciary out, *not* a Superior Offer.[180] Despite this, these commentators further suggest that practitioners have begun to use the intermediate form of recommendation out, discussed in the next section, for fear that the Superior Offer out may be deemed invalid on the grounds that the board's duty of disclosure requires the board to be able to change its recommendation at anytime.[181]

3. *Intermediate Form—Superior Offer or Intervening Event*

The third general category of recommendation outs are those outs that allow the board to withdraw its recommendation if there is a Superior Offer *or* an Intervening Event or, in some cases, if there is *solely* an Intervening Event. The "Intervening Event" language dates back to at least 2005 when it was used in Verizon Wireless's acquisition of MCI, Inc.[182] A year and a half later, in August of 2006, the "Intervening Event" out emerged again in two separate acquisitions by IBM.[183] At least three more transactions in 2006 included the Intervening Event out.[184] The ABA study of strategic transactions executed in 2007 found that 6% of deals studied contained an out limited

179. Wachtell, Lipton, Rosen & Katz, *supra* note 177, at 68 n.202 (quoting Frontier Oil Corp. v. Holly Corp., No. Civ.A. 20502, 2005 WL 1039027, at *27 (Del. Ch. April 29, 2005)).

180. *Frontier Oil Corp.*, No. Civ.A. 20502, 2005 WL 1039027, at *27 n.178 (quoting a recommendation out which was *not* a Superior Offer out).

181. Wachtell, Lipton, Rosen & Katz, supra note 177, at 68-69. One should also note that there is at least one deal signed *before* the *Frontier Oil* decision that included an Intervening Event out. *See infra* note 182 and accompanying text (discussing Verizon Wireless-MCI Intervening Event out included in agreement executed on February 14, 2005). Thus, any argument that the Intervening Event out arose as a result of the *Frontier Oil* dicta is unsound.

182. *See* MCI, Inc., Current Report (Form 8-K, Exhibit 2.1) § 6.5(c) (Feb. 17, 2005) (including Intervening Event out); *see also* Haas, *supra* note 3, at 17 (acknowledging Intervening Event language began being used around 2005).

183. *See* FileNet Corp., Current Report (Form 8-K, Exhibit 2.1) § 4.02(b) (Aug. 10, 2006) (including Intervening Event out); Internet Security Sys., Inc., Current Report (Form 8-K) § 4.02(b) (Aug. 23, 2006) (including Intervening Event language). In both transactions, Cravath, Swaine, & Moore LLP represented IBM. *See* FileNet Corp., Current Report (Form 8-K, Exhibit 2.1) § 8.02 (Aug. 10, 2006); Internet Security Sys., Inc., Current Report (Form 8-K, Exhibit 2.1) § 8.02 (Aug. 23, 2006).

184. *See* Premium Standard Farms, Inc., Current Report (Form 8-K, Exhibit 2.1), §4.02(b) (Sept. 20, 2006); ICOS Corp., Current Report (Form 8-K, Exhibit 2.1), §6.3(b) (Oct. 17, 2006); Per-Se Techs., Inc., Current Report (Form 8-K, Exhibit 2.1), §6.04(b) (Nov. 8, 2006).

to a "Superior Offer or Intervening Event," while 1% contained an out limited solely to an Intervening Event.[185] The out continues to be growing in popularity as the ABA study of 2008 transactions found that 13% of deals studied contained a "Superior Offer or Intervening Event" out while another 1% contained a recommendation out limited solely to an Intervening Event.[186] Finally, in the first half of 2009, at least four transactions contained an Intervening Event out appearing either alone or paired with a Superior Offer out.[187] Thus, the use of Intervening Event language is certainly gaining momentum. However, as is the case with the Superior Offer out, the Delaware courts have yet to either interpret these Intervening Event outs or speak to their validity.[188]

The term Intervening Event is defined in myriad ways in merger agreements. Generally, an Intervening Event is some event that is not known or reasonably foreseeable. However, the actual triggering event as well as the lack of knowledge standard tends to be defined differently among agreements. For example, some definitions require actual knowledge as of the execution date of the definitive agreement. For instance, in its 2008 acquisition by Vistara Corporation, Performance Food Group Co.'s Intervening Event out was defined as "a material development or change in circumstances . . . that was *not known to* [Performance Food Group] or the Company Board of Directors . . . (and not relating to any Acquisition Proposal) . . . ."[189] Others

185. ABA 2007 Study, *supra* note 162, at Slide 51 (setting forth statistics regarding types of merger recommendation fiduciary outs in public strategic deals).

186. ABA 2008 Study, *supra* note 100, at Slide 59.

187. *See* thinkorswim Group, Inc., Current Report (Form 8-K, Exhibit 2.1), § 6.7(b)(i) (Jan. 12, 2009); Merck & Co, Inc., Current Report (Form 8-K, Exhibit 2.1), § 6.4(e) (Mar. 11, 2009); Sun Microsystems, Inc., Current Report (Form 8-K, Exhibit 2.1) (Apr. 20, 2009), § 6.03(d)(ii); NATCO Group Inc., Current Report (Form 8-K, Exhibit 2.1), § 5.4(e) (June 4, 2009).

188. *Fiduciary Outs for Intervening Events: Are They Necessary?*, *supra* note 20 (stating author was not aware of cases interpreting Intervening Event language).

189. Performance Food Group Co., Current Report (Form 8-K, Exhibit 2.1), § 5.2(g)(i) (Jan. 18, 2008) (emphasis added). Another example of the actual knowledge standard was seen in United Online, Inc.'s acquisition of FTD Group, Inc. More specifically, the United Online-FTD Group deal defined Intervening Event as:

> a fact, event, change, development or set of circumstances with respect to or otherwise affecting Purchaser or any of its Subsidiaries or its or their business, properties, assets, liabilities, results of operation or condition (financial or otherwise) occurring or arising after the date hereof that is materially adverse to Purchaser and its Subsidiaries taken as a whole and that was *not known* to the Board prior to the execution of this Agreement . . . .

FTD Group, Inc., Current Report (Form 8-K, Exhibit 2.1) § 7.10(e) (May 6, 2008) (emphasis added); *see also* HireRight, Inc., Current Report (Form 8-K, Exhibit 2.1), § 8.1(73) (June 10, 2008) (defining Intervening Event as "an event, *unknown* to the Company Board as of the date hereof, which becomes known . . . ." (emphasis added)); thinkorswim Group, Inc., Current Report (Form 8-K, Exhibit 2.1), § 6.7(b)(i) (Jan. 12, 2009) ("[A] material fact, event, change, development or set of circumstances (other than an Acquisition Proposal occurring add a "reasonably foreseeable" standard to the definition. For example, Oracle Corporation's agreement to acquire Sun Microsystems, Inc. included an Intervening Event, defined as "a material fact, event, change, development or set of circumstances (other than an Acquisition Proposal occurring or arising after the date of this Agreement) that was *not known to the Company Board nor reasonably foreseeable by the Company Board* as of or prior to the date of this Agreement . . . ."[190] Professor Steven Davidoff has suggested that a similarly worded out would cover declines in the other party's stock price when the consideration in a transaction was a mix of cash and stock.[191] In particular, Professor Davidoff was referring to Intervening Event language appearing in a September 2009 merger agreement pursuant to which Xerox Corporation agreed to purchase Affiliated Computer Services, Inc.[192] The Xerox-Affiliated Computer Services Intervening Event was defined, in pertinent part, as

> a material event or circumstance that *was not known to the Board of Directors of such party on the date of this Agreement (or if known, the consequences of which are not known to or reasonably foreseeable by such Board of Directors as of the date hereof)*, which event or circumstance, or any material consequences thereof, becomes known . . . .[193]

However, as of the date of this writing, whether Professor Davidoff's interpretation of this Intervening Event definition, or a similarly worded definition, will hold true has yet to be tested in the courts.

Some Intervening Event outs specifically exclude certain events such as a change in financial condition of the target company, unless that event would rise to the level of a material adverse effect (as that term is defined in the agreement). For example, Merck & Co.'s 2009 $41.1 billion cash and stock acquisition of Schering-Plough, Inc. included an Intervening Event out with the following carve-out:

> provided, that . . . (iii) in no event shall any Event or Events that has or have an adverse effect on the business, financial condition, assets, liabilities, results of operations, or the market price of the securities of, a party or any of its Subsidiaries constitute an Inter-

or arising after the date of this Agreement, . . . that was *not known* by the Company Board as of or at any time prior to the date of this Agreement (and not relating in any way to any Acquisition Proposal) . . . ." (emphasis added)).

190. Sun Microsystems, Inc., Current Report (Form 8-K, Exhibit 2.1), § 6.03(d)(ii) (Apr. 20, 2009) (emphasis added).

191. Steven M. Davidoff, *Finding the Real Issues in the ACS Deal*, N.Y. TIMES DEALBOOK (Oct. 2, 2009, 12:28 PM), http://dealbook.blogs.nytimes.com/2009/10/02/finding-the-real-issues-in-the-acs-deal/ (describing ability of company to withdraw its recommendation if other party's " 'stock declines too much' ").

192. *Id.*; Xerox Corp., Current Report (Form 8-K, Exhibit 2.1), §§ 4.02(b), 4.03(b), 8.03(f) (Sept. 28, 2009).

193. Xerox Corp., Current Report (Form 8-K, Exhibit 2.1), § 8.03(f) (Sept. 28, 2009).

> vening Event with respect to the other party unless such Event or Events has had or would reasonably be expected to have a [Schering-Plough] Material Adverse Effect (if such other party is [Merck & Co.]) or a [Merck & Co.] Material Adverse Effect (if such other party is [Schering-Plough]).[194]

M&A practitioner, Stephen Haas, recently argued that Intervening Event outs, like the one above, that pose more substantive limits on the board's ability to change its recommendation are more likely to be invalid.[195] Further he contended that even the weakest forms of the Intervening Event definition "cannot be squared with a strict subjective analysis of the director's belief—namely, *does the director believe the merger is in the stockholders' best interest*?"[196] However, as will be explained in Part V, the more precise question posed by these limited outs is whether the board of directors believes that the transaction as a whole *as set forth in the merger agreement* is in the stockholders' best interest. This is the more appropriate question, as the board should have negotiated an agreement addressing many of the potential changed circumstances in other portions of the agreement, specifically in the consideration section.

B. Disclosure and the "Back Door" Fiduciary Out

The question as to whether the board *believes* the merger, as set forth in the merger agreement, to be in the best interests of the stockholders may be alleviated, in part, by another provision often included in merger agreements. This provision, called by some the "back door" fiduciary out, expressly allows the target board to disclose information if the board's fiduciary duties would require it to do so or if required to do so under federal securities laws, including Rules 14e-2 and 14d-9, and Item 1012 of Regulation M-A.[197] This pro-

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194. Merck & Co., Inc., Current Report (Form 8-K) (Mar. 11, 2009) (filing Agreement and Plan of Merger, made as of March 8, 2009, by and among, Merck & Co., Inc., Schering-Plough Corp., Blue, Inc., and Purple, Inc., as exhibit 2.1, with merger recommendation provision in art. VI, sec. 6.4(e)); Merck & Co., Inc., Current Report (Form 8-K) (Mar. 9, 2009) (filing press release as exhibit 99.1 with estimated deal value based on March 6, 2009 closing price of Merck stock).

195. Haas, *supra* note 3, at 19 (stating that what he refers to as "strong-form" Intervening Event definitions are more likely to be found invalid). In particular, Haas argues that Intervening Event definitions that remove "material factors from the board's consideration [are] difficult to reconcile with the board's ongoing fiduciary duty to make a candid and meaningful recommendation to the company's stockholders." *Id.*

196. *Id.*

197. *See* ABA 2008 Study, *supra* note 100, at Slide 59 (describing "back door" fiduciary out). An example of such a provision is as follows:

> Nothing in this Section 5.4 shall prohibit the board of directors of the Company from taking and disclosing to the stockholders of the Company a position contemplated by Rule 14e-2(a), Rule 14d-9 or Item 1012(a) of Regulation M-A promulgated under the Exchange Act, or other applicable Law, if the board of directors of the Company determines, after consultation with outside legal

vision is usually paired with a recommendation out that is limited to a Superior Offer and/or an Intervening Event but the "back door" fiduciary out itself does not actually contain an out allowing the board to withdraw its recommendation.[198] In fact, some of these clauses explicitly provide that if after making the disclosure the board fails to reaffirm its recommendation, the disclosure will be deemed a change in the board's recommendation.[199] Thus, at first glance, the "back door" fiduciary out appears to be a misnomer. However, upon closer examination, the provision may actually act as a "back door" out because it directly implicates the board's fiduciary duty of disclosure to the stockholders and allows the stockholders to make their own decisions with respect to the transaction.

This provision is meant to allow the board to comply with the board's duty of disclosure while still complying with the terms of the negotiated contract. Presumably under this type of fiduciary out, the target board would be able to disclose information showing that the board has become aware of information that would make it unable to support the transaction if the transaction were subject to the broadest fiduciary out. However, after disclosing such information, the board would then continue to recommend the transaction. This would likely achieve a similar result as occurred following a comparable disclosure made in 2000 by Zions Bancorporation to its stockholders relating to its acquisition of First Security Corp. On June 6, 1999,

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> counsel, that failure to so disclose such position would constitute a violation of applicable Law; *provided*, *however*, that the board of directors of the Company shall not recommend that the stockholders of the Company tender their shares in connection with any tender or exchange offer (or otherwise approve or recommend any Takeover Proposal) or effect a Company Adverse Recommendation Change, unless in each case the applicable requirements of Section 5.4(e) and Section 5.4(f) shall have been satisfied. In addition, it is understood and agreed that, for purposes of this Agreement (including Article VII), a factually accurate public statement by the Company that describes the Company's receipt of a Takeover Proposal and the operation of this Agreement with respect thereto, or any "stop, look and listen" communication by the board of directors of the Company pursuant to Rule 14d-9(f) of the Exchange Act or any similar communication to the stockholders of the Company, shall not constitute a Company Adverse Recommendation Change or an approval or recommendation with respect to any Takeover Proposal.

Getty Images, Inc., Current Report (Form 8-K, Exhibit 2.1), § 5.4(g) (Feb. 26, 2008).

198. *See* ABA 2008 Study, *supra* note 100, at Slide 59 (describing "back door" fiduciary out).

199. An example of this is seen in Project Victor Holdings, Inc.'s acquisition of SM&A, which provided, in pertinent part, as follows:

> provided, however, that any such disclosure . . . shall be deemed to be a Change of Company Recommendation . . . unless the board of directors of the Company expressly reaffirms its recommendation to its stockholders in favor of the adoption of this Agreement and the Merger at least two (2) Business Days prior to the Stockholders Meeting.

SM&A, Current Report (Form 8-K, Exhibit 2.1), § 6.2(f) (Oct. 31, 2008).

Zions entered into a merger agreement pursuant to which it would acquire First Security in a stock-for-stock transaction valued at approximately $5.9 billion.[200] The merger agreement contained a merger recommendation covenant but *did not contain* a recommendation out for either company's board.[201] After First Security issued a press release revealing that its earnings had declined, Zions issued a supplemental proxy statement that stated in pertinent part:

> A proxy statement/prospectus dated February 17, 2000 was mailed to you on or about that date. Subsequent to such mailing, First Security has publicly announced information relating to its earnings and revenues for the first quarter of 2000 and our financial advisor has withdrawn its fairness opinion and advised Zions that it was no longer able to conclude that the exchange ratio was fair, from a financial point of view, to Zions shareholders. The purpose of this proxy statement supplement is to inform you of that information and to update other disclosures in the proxy statement/prospectus. In order to permit you to consider the information in this supplement, our special shareholders meeting has been postponed to March 31, 2000.
>
> *Your vote is very important. We cannot complete the merger unless our shareholders adopt the merger agreement at the shareholder meeting.*[202]

Despite the board's emphasis in the supplemental proxy statement that the merger could not be completed without the stockholders' affirmative vote, the Zions Bancorporation's stockholders voted down the agreement at the special meeting held on March 31, 2000.[203] The following day, First Security terminated the merger agreement.[204] Notwithstanding the outcome of this transaction, some have criticized the supplemental proxy statement because "on its face [it] didn't do anything to undercut its recommendation of the deal, but basically said our financial advisor has now concluded that this is a

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200. Zions Bancorporation, Current Report (Form 8-K, Exhibit 99.1) (June 7, 1999).

201. Zions Bancorporation, (Schedule 13D, Exhibit 99.1) § 6.02(b) (June 16, 1999). Specifically, the recommendation provision provided, in pertinent part:

> Such boards of directors shall at all times continue such recommendations in effect without qualification and shall use, and cause Zions and First Security, respectively, to use reasonable best efforts to obtain such adoption (it being understood and agreed that the obligations under this sentence shall not be altered by the commencement, proposal, disclosure or communication of any Acquisition Proposal).

Id.

202. Zions Bancorporation, Supplemental Proxy Statement (Schedule 14A Information), at 1 (Mar. 15, 2000) (emphasis added).

203. *See* Zions Bancorporation, Quarterly Report (Form 10-Q), at 8 (May 11, 2000).

204. *Id.*

terrible deal for stockholders."[205]

Vice Chancellor Strine raised similar criticisms in remarks made in 2006 at the 33rd Annual Securities Regulation Institute. Specifically, he stated, "for those of you who say that you can disclose all the other material facts that suggest why your recommendation is false and then supposedly recommend in favor of the deal, you might remember that a lot of stockholders actually trust you . . . ."[206] Other than in extrajudicial statements like this one, Delaware courts have not yet addressed the validity of this type of provision.

C. Termination Fees and the Recommendation Out

Another significant consideration with respect to recommendation outs is the termination, or break-up, fees that are, or sometimes more importantly *are not*, triggered when a board withdraws its recommendation. Although termination fees are a common deal protection device, a variety of termination events may trigger these fees.[207] For purposes of this Article the most common and important termination fee triggers are: (1) a change or withdrawal in the board's recommendation of the existing merger agreement, (2) a failure to reaffirm the board's recommendation or a failure to include the recommendation in the proxy statement, (3) a stockholder "no" vote on the proposed deal, and (4) termination of a merger agreement in favor of a third party's Superior Offer.[208] With respect to each of these events, the exact triggering language as well as the conditions that must be satisfied prior to the payment of the termination fee varies from deal to deal. As a general matter, however, once a board changes or withdraws its recommendation, the other party may terminate the merger agreement, and upon that termination, the termination fee becomes payable.

Another consideration with respect to termination fees is when the fee becomes payable in the event that the agreement contains a force-the-vote provision. If the agreement allows the buyer to terminate the agreement upon the change in board recommendation, a

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205. *Negotiating Acquisitions, supra* note 76, at 260 (2002) (remarks made by Joel Greenberg).

206. Keith A. Flaum, *2007 M&A Deal Points Studies—Public Targets*, 12 No. 2 THE M&A LAW. 1 (Feb. 2008).

207. *See In re* Toys "R" Us, 877 A.2d 975, 1017 (Del. Ch. 2005) (stating termination fees are not per se invalid and they are "common contractual feature[s]"). Termination fees are considered deal protection provisions because they make third-party topping bids more expensive as well as compensate the acquirer for expenses incurred in negotiating the agreement. Sautter, *supra* note 9, at 536-37.

208. *See* Block, *supra* note 33, at 94 (setting forth typical events triggering termination fees); *see also* ABA 2007 Study, *supra* note 162, at Slides 56-61 (describing termination fee triggers appearing in strategic deals executed in 2007); ABA 2008 Study, *supra* note 100, at Slides 65-70 (describing termination fee triggers in strategic deals executed in 2008).

force-the-vote provision does not prevent the buyer from exercising this termination right. Thus, once the target board changes its recommendation, the buyer is allowed to call the shots with respect to whether it would like to immediately terminate the agreement and likely obtain the termination fee or force the target stockholders to vote on the transaction.[209] In the event that the buyer forces the vote, the target board would disclose the reasons for withdrawing its recommendation prior to the stockholders' meeting.[210] If the stockholders subsequently vote down the transaction, the buyer would then obtain the termination fee if the agreement provides a termination fee trigger for stockholder "no" votes.[211] Thus, a force-the-vote provision acts as a deal protection device because it allows the buyer to determine whether the transaction should be submitted to the stockholders for a vote and provides the buyer with a greater assurance that the agreement is binding with the exception of the stockholder vote.[212]

The deal certainty sought by the inclusion of termination fees, and sometimes force-the-vote provisions, may be threatened when the contract language varies from this typical procedure. For example, some recent deals have included a broad fiduciary out yet provided that the termination fee would *only* become payable if the board withdrew its recommendation and the company subsequently entered into a transaction with a third party who had made an acquisition proposal.[213] Thus, if the board withdraws its recommendation due to an event outside of the receipt of a Superior Offer, the company may not end up paying a termination fee at all.[214] Instead, the company may be simply required to reimburse the other party up to a prede-

209. *Negotiating Acquisitions, supra* note 76, at 264-65 (2002) (remarks made by Rick Climan describing buyer's choices following target's change of recommendation in deal including force-the-vote provision).

210. *See* Block, *supra* note *33*, at 87 (noting that if the target board withdraws its recommendation and the buyer forces a vote, the target board must still disclose the information required for the shareholders to vote on merger).

211. *Negotiating Acquisitions, supra* note 76, at 264-65 (2002) (remarks made by Rick Climan describing the buyer's choices following the target's change of recommendation in a deal including a force-the-vote provision); *see also* Steven M. Davidoff, *Disney's Firm Grip on the Hulk*, N.Y. TIMES DEALBOOK (Sept. 2, 2009, 3:45 PM), http://dealbook.blogs.nytimes.com/2009/09/02/disneys-firm-grip-on-the-hulk/ (describing the possible outcomes of a Disney-Marvel deal that included force-the-vote if the Marvel board were to change its recommendation); Stephen I. Glover, *Designing Termination Fee Payment Triggers*, 6 NO. 1 THE M&A LAW. 14 (2002) (describing results of survey of ten transactions and stating that in five of the ten transactions surveyed termination fees were payable so long as board withdrew its recommendation, even if stockholders voted for agreement).

212. *See* Balotti & Sparks, *supra* note 24, at 473 (explaining force-the-vote provisions that arose in part due to the buyer's desire to have a binding agreement).

213. *See, e.g.*, Corn Prods. Int'l, Inc., Current Report (Form 8-K, Exhibit 2.1) § 9.03(b)(i) (June 23, 2008); *see also* Corn Prods. Int'l, Inc., Current Report (Form 8-K) (Nov. 13, 2008) (describing termination fee provision).

214. *See infra* text accompanying note 238.

termined amount for fees and expenses.[215] The use of this termination fee trigger reduces deal certainty. If a board of directors may withdraw its recommendation for something other than a Superior Offer and a termination fee is not triggered, how does the other party ensure that the board is acting because of its fiduciary duties and not for some other reason?

On the other end of the spectrum are termination fees that are triggered no matter whether the board has withdrawn its recommendation consistent with the relevant recommendation out or not. For example, some agreements provide that the other party may terminate the agreement upon a change in recommendation *whether or not* the change in recommendation was actually permitted under the agreement.[216] In such a case, the termination fee will become payable.[217] Thus, the possibility exists that a board may withdraw its recommendation for a reason *not* permitted by the recommendation out but will pay the same termination fee as the termination fee payable if it were to withdraw its recommendation consistent with the recommendation out.[218]

Yet another issue that should be considered with respect to recommendation outs is the fee size. In the past several years, the Delaware courts have upheld as reasonable termination fees ranging from 1% to 6% of a deal's transaction value.[219] At the same time, the Delaware Court of Chancery has indicted, in dicta, that a 6.3% termination fee "seems to stretch the definition of range of reasonableness and probably stretches the definition beyond its breaking point."[220] Recently, commentators have noted a gradual shift upwards of termination fees.[221] When in the not too distant past, termination fees of 3% were common place, in recent years, termination fees have hovered increasingly closer to 4%.[222] No matter if the ter-

215. *Id.*

216. *See, e.g.*, Merck & Co., Inc., Current Report (Form 8-K, Exhibit 2.1) Art. VIII (Mar. 11, 2009) (including termination fee triggered on change of recommendation whether or not permitted under agreement).

217. *Id.*

218. *Id.*

219. Block, *supra* note 33, at 90; *see also* Sautter, *supra* note 9, at 536 n.54, 547-48, 548 n.112 (describing termination fees Delaware courts have upheld).

220. Phelps Dodge Corp. v. Cyprus Amax Minerals Co., Nos. CIV. A. 17398, CIV. A. 17383, CIV. A. 17427, 1999 WL 1054255, at *2 (Del. Ch. Sept. 27, 1999).

221. *See, e.g.*, Steven M. Davidoff, *Examining the Terms of the Sun-Oracle Deal,* N.Y. TIMES DEALBOOK (Apr. 23, 2009, 3:03 PM), http://dealbook.blogs.nytimes.com/2009/04/23/examining-the-terms-of-the-sun-oracle-deal/ [hereinafter Davidoff, *Sun-Oracle*] (stating termination fees have been creeping upward in Delaware).

222. Davidoff, *Sun-Oracle*, *supra* note 221 ("According to Factset MergerMetrics, for transactions with a value greater than $100 million the average termination fee was 3.5 percent and 3.53 percent in 2008 and 2007, respectively. But 22 percent and 23.2 percent of deals in 2008 and 2007, respectively, had a greater than a 4 percent termination fee."); Fox & Wolf, *Deal Protection*, *supra* note 5, at 1 (noting shift over past twenty-four months of termination fees closer to 4% as compared to 3% in past). In November 2009, the invest-

mination fee is 3% or 4%, the same termination fee tends to apply regardless of the event triggering the fee. Stephen Haas has argued that this formulation of one standard termination fee should be reconsidered and that dealmakers should adopt a staggered fee structure as an alternative to narrower recommendation outs.[223] More specifically, he argues that a "*sizeable*" termination fee should be triggered if a board changes its recommendation for something other than a Superior Offer.[224] Haas contends that such a significant termination fee acts as a check on the board's determination of whether it should withdraw its recommendation.[225] Furthermore, he raises a compelling argument that a larger fee which becomes payable only if the board withdraws its recommendation for something other than a Superior Offer would withstand the *Unocal* enhanced scrutiny test because it is neither coercive nor preclusive as it is would not be triggered by a stockholder "no vote" or Superior Offer.[226] In Part V of this Article, I argue that dealmakers should adopt a staggered termination fee framework as proposed by Haas. However, I contend that such a staggered termination fee should not be an alternative to narrower recommendation outs as Haas appears to propose but rather should be paired with intermediate recommendation outs. This type of formulation avoids the outcome described earlier in this section where the board withdraws its recommendation for something other than a Superior Offer and ends up only having to reimburse the buyer for its expenses.

D. Recent Examples of Target Boards Exercising Their Recommendation Withdrawal Rights

The current recommendation out drafting trends and related termination fees take on an even greater significance when one considers recent, unprecedented actions that two different boards of directors took in withdrawing their recommendations in favor of signed

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ment bank, Houlihan Lokey, published its annual study of termination fees. *See* Houlihan Lokey 2008 Transaction Termination Fee Study (Nov. 2009), *available at* http://www.hl.com/email/pdf/fas_transaction_terminal_study_2008.pdf (summarizing results of 2008 termination fee study and comparing results to 2006 and 2007). In that study of 145 transactions, Houlihan Lokey found that the mean termination fee as a percentage of *transaction value* for 2008 was 3.4% while the mean termination fees as a percentage of transaction value for 2007 and 2006 were 3.1% and 3.2%, respectively. *Id.* at 6. The mean termination fees as a percentage of *enterprise value* for 2008, 2007, and 2006 were as follows: 3.8%, 3.0%, and 2.6%, respectively. *Id.* at 8.

223. Haas, *supra* note 3, at 20.

224. *Id.*

225. *See id.* (stating that more significant termination fees limit "circumstances that can influence the board's view of the merger").

226. *Id.*

merger agreements.[227] Both boards withdrew their recommendations not because a third party came forward with a Superior Offer; rather, they attributed their changes of recommendation to "changed circumstances." Both transactions involved the broadest recommendation out—an out based on a breach of fiduciary duties—and both deals were stock-for-stock transactions.[228] Moreover, in both cases, the boards withdrew their recommendations during the midst of the financial crisis, and in neither case were the recommendation withdrawals followed by a law suit.

On November 10, 2008, Corn Products International's board of directors withdrew its recommendation of a merger agreement that it had entered into approximately four months earlier with Bunge Ltd.[229] Pursuant to that June 21, 2008 merger agreement, Corn Products stockholders were to receive Bunge shares with a market value of $56 for each share of Corn Products stock.[230] The agreement included a price collar but the collar was not paired with walk-away rights.[231] This figure represented "a 31 percent premium to [Corn Products'] closing price" on the previous trading day.[232] On the day the deal was announced a Citibank analyst was quoted as saying, " '[T]his is a good deal for both companies . . . Corn Products gets a substantial premium to its prior closing price . . . and Bunge uses its very strong stock as its currency to do the deal.' "[233]

The Corn Products-Bunge merger agreement provided that the Corn Products board could change its recommendation if it determined that the "failure to make a Change in Company Recommendation would be inconsistent with the directors' exercise of their fiduciary obligations to [Corn Products] and its stockholders under applicable Law . . . ."[234] On November 4, 2008, the Corn Products board sent notice to Bunge that it intended to withdraw its recommendation of the agreement and six days later the board announced it had withdrawn its recommendation.[235] While the press releases never

227. Professor Steven Davidoff summed up the unprecedented nature of these actions best by writing "Corn Products' board did something Wednesday that M&A attorneys often talk about, but I can't remember when it last happened." Davidoff, *Deal Failures, supra* note 21.

228. As of the date of this writing, it does not appear that a board of directors has withdrawn its recommendation of a transaction pursuant to an Intervening Event out.

229. *See* Corn Prods. Int'l, Inc., Current Report (Form 8-K, Exhibit 99.1) (Nov. 10, 2008).

230. *See* Corn Prods. Int'l, Inc., Current Report (Form 8-K, Exhibit 99.1) (June 23, 2008).

231. *See* Corn Prods. Int'l, Inc., Current Report (Form 8-K, Exhibit 2.1) (June 23, 2008) (including exchange ratio but no walk-away rights).

232. *Update 6—Bunge to Buy Corn Products, for $4.4 billion*, REUTERS, June 23, 2008, http://www.reuters.com/article/idUSN2345070820080623.

233. *Id.*

234. *See* Corn Prods. Int'l, Inc., Current Report (Form 8-K, Exhibit 2.1) §7.05(e) (June 23, 2008) (including merger recommendation covenant).

235. *See* Corn Prods. Int'l, Inc., Current Report (Form 8-K, Exhibit 99.1) (Nov. 5, 2008) (announcing Corn Products board notice to Bunge regarding intent to withdraw recom-

formally stated the reason why the Corn Products board decided to withdraw its recommendation, they mentioned the decline in value of both companies' stock thus alluding that the recommendation withdrawal was for financial reasons.[236] Although the agreement contained a force-the-vote provision permitting Bunge to require Corn Products to hold a stockholders meeting to vote on the existing agreement, Bunge chose to terminate the merger agreement in accordance with its terms.[237] The termination fee provision in that deal was drafted so that if the Corn Products board withdrew its recommendation, the termination fee of $110 million only became payable if the company entered into a definitive agreement with a third party who had submitted an acquisition proposal within twelve months of the withdrawal.[238] However, under the agreement Bunge could seek reimbursement for its fees and expenses associated with the transaction for up to $10 million.[239]

The Corn Products board was not the only target company board to change its recommendation without having received a Superior Offer. On January 20, 2009, the Zygo Corporation board of directors withdrew its recommendation in favor of the agreement it had previously executed with Electro Scientific Industries, Inc., or ESI.[240] The October 15, 2008 merger agreement provided that the Zygo board could withdraw or modify its recommendation if the board "determined in good faith, after consultation with outside counsel, that failure to take such action would be inconsistent with [Zygo's] directors' fiduciary duties to the [Zygo] stockholders."[241] The agreement did not contain a price collar and instead contained a basic fixed exchange ratio of 1.0233 shares of ESI common stock for each share of Zygo common stock held.[242] Unlike Corn Products, Zygo directly cited economic reasons for its change of heart. In particular, a Zygo press

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mendation of merger agreement); Corn Prods. Int'l, Inc., Current Report (Form 8-K, Exhibit 99.1) (Nov. 10, 2008) (announcing Corn Products board withdrew its recommendation of Corn Products-Bunge merger agreement and recommended against adoption of agreement).

236. In a press release issued by the Bunge board after receipt of Corn Products' change of recommendation notice, the Bunge board refers to the "effect[s] of unprecedented turmoil in the equity markets on our companies' stocks . . . ." Corn Prods. Int'l, Inc., Current Report (Form 8-K, Exhibit 99.1) (Nov. 5, 2008).

237. *See* Corn Prods. Int'l, Inc., Current Report (Form 8-K) (Nov. 13, 2008) (announcing Bunge's termination of merger agreement); *see also* Corn Prods. Int'l, Inc., Current Report (Form 8-K) § 7.01(b) (June 23, 2008) (including force-the-vote provision).

238. *See* Corn Prods. Int'l, Inc., Current Report (Form 8-K, Exhibit 2.1) § 9.03(b)(i) (June 23, 2008) (including termination fee trigger); *see also* Corn Prods. Int'l, Inc., Current Report (Form 8-K) (Nov. 13, 2008) (describing termination fee provision).

239. *See* Corn Prods. Int'l, Inc., Current Report (Form 8-K), Exhibit 2.1) § 9.03(c) (June 23, 2008); *see also* Corn Prods. Int'l, Inc., Current Report (Form 8-K) (Nov. 13, 2008) (describing reimbursement of fees and expenses).

240. *See* Zygo Corp., Current Report (Form 8-K, Exhibit 99.1) (Jan. 21, 2009) (filing notice of withdrawal letter).

241. Zygo Corp., Current Report (Form 8-K, Exhibit 2.1) §5.4(e) (Oct. 21, 2008).

242. *Id.* § 2.1(a) (containing exchange ratio).

release stated that the Zygo board reevaluated the merger because of "changes in conditions since the merger agreement was executed on October 15, 2008, and the ZYGO Board's view of the impact of these changes on the current and expected performance and operations of ZYGO and ESI."[243] This deal did not include a force-the-vote provision and the parties agreed to terminate the merger agreement.[244] Although a $6.6 million termination fee was triggered under the agreement, Zygo paid ESI $5.4 million pursuant to a settlement agreement.[245]

Because the Corn Products-Bunge and Zygo-ESI deals involved the triggering of the broadest fiduciary outs, we can only speculate as to how these transactions would have played out had these deals involved a more narrowly worded out. It is with this backdrop that we arrive at the unanswered question as to whether a narrower recommendation out, such an out simply for a Superior Offer or an out for a Superior Offer or Intervening Event, would be upheld under Delaware law.

V. RETHINKING THE RECOMMENDATION OUT

A. *The Validity of Narrower Recommendation Outs*

Delaware courts have never addressed the validity of the intermediate or narrower forms of the recommendation out. In fact, outside of *Smith v. Van Gorkom*, the Delaware courts have not directly tackled recommendation outs and what types of recommendation outs are permissible under Delaware law. As a result of *Van Gorkom* and Delaware and federal statutory provisions, practitioners are well aware that recommendation covenants must be accompanied by a fiduciary out. But how narrow that out may be drafted is an open question. In addressing whether boards may contractually limit their fiduciary duties in the context of a recommendation out, one would be remiss in failing to address a well respected Delaware Court of Chancery judge's repeated statements that limitations on a board's recommendation out are, in his opinion, invalid.[246] Specifically, with respect to the Superior Offer out, Vice Chancellor Strine has stated:

243. Zygo Corp., Current Report (Form 8-K, Exhibit 99.2) (Jan. 21, 2009).

244. *See* Zygo Corp., Current Report (Form 8-K, Exhibit 2.1) §1 (April 3, 2009).

245. *See* Zygo Corp., Current Report (Form 8-K, Exhibit 2.1) §§ 8.3(c), 8.1(b)(ii) (Oct. 21, 2008) (providing for $6.6 million termination fee payable by Zygo upon withdrawal of recommendation); Zygo Corp., Current Report (Form 8-K, Exhibit 2.1) § 3 (Apr. 3, 2009). The Settlement Agreement and Mutual Release provided for Zygo to pay an additional $1.2 million to be paid if Zygo were to approve another proposal within six months. *See id.* § 4.

246. *See* Davidoff, *Getting Creative*, *supra* note 20 (describing Vice Chancellor's Strine's comments at the 2009 Tulane Corporate Law Institute regarding his doubt of validity of contractual limitations on recommendation out); Flaum, *supra* note 206 (describing Vice Chancellor Strine's remarks on January 18, 2006 at the 33rd Annual Securities Regulation Institute regarding skepticism of merger recommendation fiduciary out limitations).

> If you're going to put out a proxy statement containing a board recommendation 45 days before the vote, and there's a contract that says the board must recommend the deal unless there's a higher bid, and the board really doesn't like the deal and the reason it doesn't like the deal is because something positive happened to the target's business or "you've been . . . looking for some food and up from the ground came bubblin' crude" . . . if the board nonetheless recommends the deal, I think it's violated its fiduciary duties . . . I'd also say that if you are giving advice that puts the board in that predicament, I think that it's kind of dumb advice . . . . This whole thing is better dealt with in the termination fee context, rather than in promising to tell a lie.[247]

Vice Chancellor Strine's statements, and similar statements made by practitioners over the years, raise the issue of whether these statements are any indication of future decisions or practice. It is worth noting that Vice Chancellor Strine made similar comments at conferences questioning the validity of go shops, or provisions allowing the target company to actively solicit third party offers after signing.[248] But within a few months of making those comments, he issued two back-to-back opinions validating the use of go shops.[249] Thus, Strine's extrajudicial statements must be taken with a grain of salt and one cannot expect him, when he is finally confronted with the same issue in the context of a comprehensive fact pattern, to rule the same way as his extrajudicial statements may suggest. Rather a judge's (or a practitioner's) statements criticizing narrower recommendation outs should be viewed as that person's ideal outcome—not necessarily an indication of their future action.[250] These articulations of an ideal outcome should not necessarily result in a rule that a narrower recommendation out is a *per se* violation of Delaware law.

Instead of concluding that narrower recommendation outs are *per se* violations of Delaware law, Delaware courts should address these cases on a case-by-case basis. As is required under *Van Gorkom*, courts must consider the process by which the board agreed to the narrower recommendation out and consider the information the board had at its disposal at that time. The courts should evaluate the possibility that entering into a narrower recommendation out pro-

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247. Flaum, *supra* note 206. Professor Edward Rock has stated that such "extrajudicial utterances can . . . be read as attempts to be heard on a critical matter in the absence of a case raising just the right issue and in the absence of the articulation (or articulability) of a governing rule" and that such statements are "advisory opinions." Edward B. Rock, *Saints and Sinners: How Does Delaware Corporate Law Work?*, 44 UCLA L. REV. 1009, 1095 (1997).

248. *See* Sautter, *supra* note 9, at 564 & n.205 (describing Strine's statements of skepticism regarding go shop provisions and noting his later blessing of the provisions).

249. *See id.*

250. For an example of a practitioner's skepticism of narrower recommendation outs, see *supra* note 76.

vides a corporation with more options to structure a transaction in a manner that maximizes deal certainty. Such deal certainty should result in a better deal for stockholders—buyers should be willing to pay more for a more certain deal. If, instead, a buyer is faced with uncertainty, it may be inclined to discount the price it is willing to pay—an outcome that comprises stockholder value and is thus contrary to the target company's fiduciary duties.[251] The presence of a narrower recommendation out provides the buyer with an increased certainty that the deal will be finalized, which in turn provides both peace of mind and the incentive to pay a higher price for the target company.[252] In his dissent in *Omnicare*, Chief Justice Veasey, alluded to this very situation by stating:

> Certainty itself has value. The acquirer may pay a higher price for the target if the acquirer is assured consummation of the transaction. The target company also benefits from the certainty of completing a transaction with a bidder because losing an acquirer creates the perception that a target company is damaged goods, thus reducing its value.[253]

Moreover, as then Vice Chancellor, Professor William Allen, articulated in *Renaissance Communications*, and Vice Chancellor Strine postulated in *Ace*, a board of director must be able to agree to remove its discretion in order for the auction sale of a company to work. In such a situation, if the board has fully shopped the target company, the board should have the right to limit its change of recommendation to certain defined circumstances. Allowing the board to do so furthers the policies set forth by both Allen and Strine in the context of no shop outs.

B. Narrower Recommendation Outs are Preferable

As discussed in Part IV.A, despite Strine's extrajudicial statements and other commentary arguing against narrow recommenda-

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251. I should note, however, that although I am advocating for the use of a narrower recommendation out, I am not advocating for anything less than a Superior Offer out. In other words, in all deals, the target's board of directors should be able to withdraw its recommendation if it has received a Superior Offer.

252. Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 943 (Del. 2003) (Veasey, C.J., dissenting). Numerous scholars have also debated whether the deal certainty created by deal protection devices leads to higher prices. *See, e.g.*, Griffith, *supra* note 75 (arguing that "transactional certainty is an item of value that targets may offer acquirers in exchange for an increase in price or other concessions in the merger agreement."); Thanos Panagopoulos, *Thinking Inside the Box: Analyzing Judicial Scrutiny of Deal Protection Devices in Delaware*, 3 BERKELEY BUS. L.J. 437, 444 (2006) (arguing that a buyer will pay a premium for increased transaction certainty); Brian J.M. Quinn, *Bulletproof: Mandatory Rules for Deal Protection*, 32 IOWA J. CORP. L. 865, 877-80 (2007) (arguing that "bulletproof" transactions do not result in higher prices because "bulletproof" transactions limit competition).

253. *Omnicare, Inc.*, 818 A.2d at 942 (Veasey, C.J., dissenting).

tion outs, practitioners have continued to include solely Superior Offer outs, and now more recently, Intervening Outs, in their merger agreements.[254] In these deals, boards and their advisors are making a strategic negotiating decision that the narrower fiduciary out will allow the board to change its recommendation for the unforeseen events it deems most likely to occur during the preclosing period. More specifically, these dealmakers are negotiating provisions that "reflect a reasonable balance of the competing interests of the two parties to a transaction within the framework of the relevant market and deal-specific framework."[255] In a quest for deal certainty, particularly in uncertain economic times, the narrowing of the fiduciary out provides parties with greater certainty as to when a board may be able to withdraw its recommendation of a transaction. However, parties are accepting the risk that courts may deem these narrower fiduciary outs invalid if challenged. But, if the almost complete lack of case law on recommendation outs is any evidence of the lack of litigation in this area, the risk of these narrower outs being litigated and deemed invalid is far outweighed by the deal certainty created by the narrower outs.

Dealmakers sought a similar certainty several years ago when they debated whether fiduciary duties alone should provide a basis for terminating a merger agreement.[256] Nowadays, the general fiduciary duties trigger has been rejected as a basis for terminating a merger agreement in favor of certain defined events.[257] Dealmakers who continue to use narrower recommendation outs, and specifically Superior Offer outs, are trying to achieve that same level of certainty that is achieved by eschewing general fiduciary duties as a trigger for terminating a merger agreement.

Articulating the events upon which the board may withdraw its recommendation provides a level of certainty for dealmakers. After many years of case law and commentary interpreting and applying the Superior Offer out in the context of the no shop provision and many examples of this out being triggered, dealmakers are better

254. *See* Flaum, *supra* note 206 (noting that despite Strine's comments narrower recommendation outs continue to be used, and actually *increased* in usage). For an example of practitioners' comments regarding fiduciary outs, see *supra* note 76.

255. Fox & Wolf, *Deal Protection*, *supra* note 5, at 2. These commentators have summed up the objectives of parties in the negotiating process as follows:

> The twin goals should be to achieve a reasonable outcome that weighs the economic interests of both parties, while at the same time avoiding the risk that a court will find that a seller's board breached its fiduciary duties by agreeing to overly burdensome protections (and thereby also exposing the buyer to the risk that some or all of the protections will be voided by the court).

Id.

256. *Supra* text accompanying notes 169-74.

257. *See* Block, *supra* note 33, at 94-95 (listing common termination events).

able to draft provisions relating to the Superior Offer. Accordingly, they understand how to react when a Superior Offer arises and boards understand that the receipt of a Superior Offer should trigger its fiduciary duty to withdraw its recommendation of a transaction. As previously discussed, all formulations of the recommendation out encompass Superior Offers and thus allow a target board to withdraw its recommendation if it were to determine that a Superior Offer has been received. Therefore, the ambiguity centers on the more obscure events that may or may not occur during the preclosing period. Specifically, the issue is whether, upon the occurrence of one of these events, the board can withdraw its recommendation pursuant to the recommendation out contained in the merger agreement or whether by withdrawing its recommendation, the board would be breaching the merger recommendation covenant. Because these events are rare and there is limited to no case law in this area, boards have minimal guidance in how to react to such events.

C. *Does the Satisfaction of a Board's Fiduciary Duties Presigning Permit the Use of a Narrower Recommendation Out?*

While referring to Vice Chancellor Strine's comments regarding narrower recommendation outs, Professor Davidoff inquired,

> [I]s the question being asked wrong? Should it not be whether a board can limit its fiduciary duties, but rather phrased as, "Can a target board having shopped the company and being fully informed pre-agree to limit its recommendation to only new items?" I suspect that this question might be answered differently.[258]

Professor Davidoff's rephrasing of the question to be asked, as well as his suspicion that this question would be answered in a different manner merits further exploration. This rephrasing brings to the forefront the board's fiduciary duties during the acquisition process. In determining to enter into the merger itself, the board should have become informed as to the value of the business that it is selling (or acquiring) as well as to any claims that may increase or decrease the firm's value. Moreover, if a transaction has triggered a board's *Revlon* duties, the board should have "shopped" the company to some degree to determine whether the offer it is accepting maximizes stockholder value.[259] In deciding to enter into a particular transaction, the board

258. Davidoff, *Sun-Oracle*, *supra* note 221.

259. *See* Sautter, *supra* note 9, at 538-42 (describing "shopping" process of company that satisfies board's *Revlon* duties). Moreover, in *Ace*, Vice Chancellor Strine alluded to this very notion when he stated that when the board has "actively canvassed the market, negotiated with various bidders in a competitive environment, and believes that the necessity to close a transaction requires that the sales contest end" the board may be able to limit its ability to consider Superior Proposals. Ace Ltd. v. Capital Re Corp., 747 A.2d 95, 107 n.36 (Del. Ch. 1999). In such a case, if the board is able to limit its ability to consider

must have determined, consistent with its applicable fiduciary duties, that the transaction is in the best interests of the corporation and its stockholders. Thus, an informed board that has acted consistently with its fiduciary duties as of signing will only be presented with a limited number of events during the preclosing period which may require it to withdraw its recommendation so as not to violate its fiduciary duties.

In a *Revlon* transaction, there are two circumstances that may occur during the preclosing period which may trigger the board's continuing duty to maximize stockholder value. First and foremost, is the receipt of a Superior Offer. As previously discussed, the receipt of a Superior Offer would, in most cases, trigger a board's no shop out and should trigger the board's recommendation out, no matter how that out is drafted. The less likely change of circumstances is that of an unexpected and unforeseen positive event causing the company's value to increase such that the value to be received in the proposed transaction no longer maximizes stockholder value. If such an event occurs, the board would be able to change its recommendation under the broadest recommendation out and under most forms of the intermediate out. The only out that would not be triggered is the narrowest out—the out that is limited *solely* to a Superior Offer. Thus, limiting a board's recommendation to the intermediate out, "Superior Offers or Intervening Events," would still permit the board to act consistently with its *Revlon* duties during the preclosing period.

In the context of non-*Revlon* deals, the board's continuing duties during the preclosing period take on a different light. As we have seen with the Corn Products-Bunge and Zygo-ESI deals, a primary concern of boards negotiating such a transaction are events triggering an adverse change in stock prices.[260] This concern is applicable not only in a non-*Revlon* deal but also in a *Revlon* deal that includes any amount of stock as consideration. However, in such instances, boards expect that stock prices will fluctuate generally. Boards are typically in a better position presigning to structure the transaction and adopt a specific framework, such as using price collars paired with walk-away rights, to deal with these fluctuations. As such, the recommendation out may not be the best provision to deal with these types of changes to begin with. Thus, a board should be able to agree at signing to limit its recommendation out to certain *unforeseen* events.

Superior Proposals (and thus withdraw its recommendation in favor of a Superior Proposal), the board should be able to limit its recommendation to other events that are even less likely to occur.

260. *See supra* Part IV.D.

D. Improving the Narrower Recommendation Out through Staggered Termination Fees

A critical issue with respect to the recommendation out is the corresponding termination fee that may or may not be triggered. As we have seen, the receipt of a Superior Offer and the withdrawal of a recommendation due to a Superior Offer triggers the payment of a termination fee in most cases.[261] Therefore, the issue centers on whether a recommendation withdrawal for something other than a Superior Offer will trigger a termination fee and what that fee should be.

When an agreement includes the intermediate form of recommendation out, an out for either a "Superior Offer or Intervening Event," generally one termination fee applies whether the board withdraws its recommendation due to a Superior Offer or to an Intervening Event.[262] Moreover, if the agreement includes a broad recommendation out such that the board may withdraw its recommendation "consistent with its fiduciary duties" then the board may withdraw its recommendation for a Superior Offer or for some other event. In such a case, the same termination fee typically applies no matter the reason for the withdrawal, *if* the termination fee becomes payable at all.[263] As some termination fee provisions are currently worded, it is certainly plausible that a board of directors may withdraw its recommendation for something other than a Superior Offer and not have to pay a termination fee. In fact, we saw this exact scenario play out in the Corn Products-Bunge deal in which the Corn Products board withdrew its recommendation due to changed circumstances but a termination fee did not become payable because Corn Products did not enter into a definitive agreement with a third party. Instead of promoting deal certainty, termination fee triggers like the one in the Corn Products agreement, allow a board of directors to change its mind for any reason and then argue that it was permitted to withdraw its recommendation because otherwise it would have breached its fiduciary duties.

To promote deal certainty, dealmakers should negotiate a staggered termination fee so that a varying fee applies depending on the

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261. In these cases, the payment of the termination fee is sometimes conditioned on the target company entering into a definitive agreement with a third party making the Superior Offer or acquisition proposal during a certain period after termination of the agreement. *See* ABA 2008 Study, *supra* note 100, at Slide 69 (indicating 7% of deals studied provided that third party transaction be consummated after termination of recommendation).

262. *See* Haas, *supra* note 3, at 20 (stating same termination fee is generally applicable to Superior Offer and Intervening Event outs).

263. *See supra* Part IV.C.

reason why the board is withdrawing its recommendation. A lower termination fee should be applicable when a board withdraws its recommendation due to a Superior Offer while a higher termination fee should apply if the board withdraws its recommendation for something other than a Superior Offer. In addition, the fee applicable to these "other events" may also be varied so that dealmakers may place greater value on certain events. The end result of such a structure would be that a lower termination fee would apply to common or expected events while a higher termination fee would apply to less certain events. This staggered fee structure provides an incentive to the other party who may have bargained for a narrower recommendation out and, perhaps more importantly, it incentivizes the board of directors to withdraw its recommendation only for a reason that the board values as being worth more than the termination fee.[264] As a result, this staggered fee structure encourages deal certainty.

E. Interplay between "Back Door" Fiduciary Outs and Narrower Recommendation Outs

No matter the termination fee and no matter if the deal is subject to *Revlon* or to the lower business judgment standard, the board must still comply with its fiduciary duty of disclosure arising under both state and federal law. In fact, it is this duty of disclosure that many point to as being a reason for narrower recommendation outs being invalid.[265] For example, Professor Allen has stated that:

> The nature of the recommendation as stating a *present* view and the directors' duty to make candid disclosures to shareholders make this a distinct topic. *Obviously, recommendation of a transaction that one in fact no longer believes is in the shareholders' best interest is deeply problematic.* Thus, any provision that commits the board to recommend the deal at a future time must be accompanied by a fiduciary out clause.[266]

Professor Allen's statement, however, does not address the inclusion of a "back door" fiduciary out, or other provisions explicitly allowing for the disclosure of information to stockholders. In his extrajudicial statements, Vice Chancellor Strine seems to discount these types of provisions as being dishonest. But this raises the question of how the disclosure of information can be dishonest *if* the board is disclosing information that it is required to disclose while continuing to recommend the transaction under the terms of the negotiated agreement.

264. *See* Haas, *supra* note 3, at 20 (arguing that higher termination fees would force board to decide that "magnitude of the intervening event is greater than the termination fee").

265. For an example of such an argument, see *infra* note 267 and text accompanying *supra* note 206.

266. Allen, *supra* note 4, at 658 (emphasis added).

Under this scenario, the board is being honest with its stockholders and is also complying with the terms of the contract as well as with its fiduciary duty of disclosure. The real issue with situations where boards may disclose changes in circumstances while continuing to recommend a transaction is that it tends to undermine the limited out for which the other party negotiated. If such undermining indeed occurs then it is simply an inescapable consequence of a board complying with its fiduciary duty of disclosure.

The backdoor fiduciary out brings to the forefront another argument raised by some that stockholders tend to follow the board's recommendation so the board should not have the authority to contractually limit situations in which it can withdraw its recommendation.[267] Proponents of this particular argument contend that even if there is a material change of circumstances during the preclosing period which raises serious doubts as to the desirability of the merger, the stockholders would nonetheless overlook this change of circumstances because they would be swayed by the board's recommendation.[268] However, those who raise this argument do not cite to any authority supporting such a proposition. Such an argument is inconsistent with recent events, including Lear Corp. stockholders voting down a proposed merger with a Carl Icahn-led private equity group despite the board's recommendation of the transaction.[269] In the case of Lear, there were no Superior Offers pending and the board had disclosed that the agreement had been amended to reflect an increase in merger consideration but the stockholders still voted down the proposed deal.[270] If a supplemental proxy statement is issued disclosing changed circumstances but the board continues to recommend the transaction, it is implausible that the stockholders will view the recommendation in a vacuum and fail to take into consideration the other disclosures. The more likely outcome when a narrower recommendation out is paired with a back door out is that stockholders discount the board recommendation because they are aware that the situations in which the board may withdraw its recommendation are

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267. *See* Haas, *supra* note 3, at 17 (stating "[w]hile parties must look to the contract to determine whether a recommendation change gives rise to a termination right, stockholders will almost always follow the board's recommendation."); Stanchfield, *supra* note 27, at 1330 ("Any adverse change in the board's recommendation is virtually certain to cause the stockholders to reject the merger.").

268. For an example of this argument, see *supra* note 267 and text accompanying *supra* note 206.

269. *See* Lear Corp., Current Report (Form 8-K) Item 1.02 (July 17, 2007) (stating that the Agreement and Plan of Merger, dated as of February 9, 2007, as amended, by and among Lear, AREP Car Holdings Corp., and AREP Car Acquisition Corp. did not receive an affirmative vote of the stockholders); Lear Corp. (Schedule 14A, Supplement No. 2 to Proxy Statement) (July 9, 2007) (containing board recommendation in favor of proposed transaction).

270. Lear Corp. (Schedule 14A, Supplement No. 2 to Proxy Statement) (July 9, 2007) (disclosing increased consideration).

limited. In fact, in the Zions Bancorporation-First Security Corporation deal stockholders voted down a transaction after the board issued a supplemental proxy statement disclosing that its investment banker had withdrawn its fairness opinion but the company continued to recommend the transaction. Thus, if the Zions and Lear deals are any indication, when presented with information that may conflict with the board's recommendation, most stockholders will likely vote their shares *not* how the board recommends, but in the manner the stockholders determine best suits their interests as stockholders. Such an outcome is consistent with the efficient capital markets hypothesis which assumes stockholders are making decisions based on all of the information publicly available in the market and that such publicly available information is incorporated into the stock price. Accordingly, the limitation of a recommendation out does not prevent an informed stockholder vote. Such an informed vote by the owners of a corporation is the closest to deal certainty that parties to a merger agreement may achieve under M&A law.

VI. CONCLUSION

In concluding an M&A transaction, a target's board of directors is confronted with two fundamentally antagonistic obligations: the board's fiduciary duty to the corporation and its stockholders on the one hand, and the board's duty to honor the provisions of the merger agreement on the other. The tension between these conflicting duties ruptures when a target's board of directors is contractually bound to recommend a merger agreement, yet an event occurs after the signing of that agreement which normally would require the board, in honoring its fiduciary duties, to withdraw its earlier recommendation. To alleviate this tension, merger agreements often include a recommendation out allowing the board to withdraw its recommendation under certain circumstances. Whether a board can contractually limit the situations in which a recommendation out may be exercised is an issue that Delaware courts have not yet addressed.

This Article argues that a board of directors should have the freedom to limit a recommendation out to certain unforeseen events. A board that has complied with its fiduciary duties at the time of entry into a merger agreement should be aware of most events that could reasonably occur during the period between signing and closing and may thus address these circumstances in the merger agreement. A narrow recommendation out is preferable because it promotes deal certainty, which ultimately allows the target board to maximize stockholder value. To this end, deal certainty is enhanced when a narrow recommendation out is accompanied by a staggered termination fee. Finally, this Article argues that the inclusion of a "backdoor" fiduciary out with a narrow recommendation out allows the board to comply with its fiduciary duty of disclosure while also remaining faithful to the provisions of the merger agreement. This disclosure of information will allow target stockholders to reject a merger agreement that has become repugnant to their interests as stockholders. Ultimately, narrow recommendation outs allow the target boards to best perform the delicate task of balancing two duties that are competing at best and contradictory at worst.