CHANGE OF CONTROL SPECIAL COMMITTEE: BREATHING LIFE INTO CNX*

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ABSTRACT

Notwithstanding the excellence of the Delaware judiciary, the multiple standards of review under Delaware law for reviewing the actions of a target's directors involved in a merger or acquisition transaction are cumbersome, a source of needless litigation, and economically inefficient. Consequently, the Delaware General Corporation Law ("DGCL") should be amended to permit the shareholders of a corporation to adopt a provision requiring that if the corporation becomes a target of a bona fide acquisition proposal, the board of the corporation must petition the Delaware Court of Chancery for the appointment of an independent, disinterested, and knowledgeable special committee of the board (a "Change of Control Special Committee"). This Committee would have complete power over the acquisition transaction. At the discretion of the Delaware Court of Chancery, members of the current board or other persons could be appointed to the Change of Control Special Committee.

As long as the target followed the decisions of the Change of Control Special Committee, including any decision to employ, maintain, or terminate a poison pill, the deferential business judgment rule standard of review would apply to the actions of the Committee. As a consequence, litigation involving the actions taken by the Committee would be rare, if not essentially eliminated, and it could be expected that the decisions made by the Committee would be in the interest of the target's shareholders. As a practical matter, the role of the Court of Chancery in such transactions would be moved from the back-end to the front-end, in that the Chancery Court's determination of the independence, disinterestedness, and competence of the board members would be made on an ex ante as opposed to an ex post basis.

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This type of amendment to the DGCL is consistent with the concept of this statute as an "enabling" law, permitting shareholders to adopt provisions that the shareholders determine are in their interests.

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I. INTRODUCTION

In two previous articles, I proposed that Congress address the conflicts of interest that often arise in acquisitions of publicly held target corporations in both hostile and consensual merger and acquisition ("M&A") transactions by requiring the independent appointment of a disinterested Change of Control Board for the target. Under those proposals, once a public

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1Samuel C. Thompson, Jr., Change of Control Board: Federal Preemption of the Law Governing a Target's Directors, 70 Miss. L.J. 35 (2000) [hereinafter Thompson, Change of Control
corporation becomes the target of an M&A offer, the Office of Mergers and Acquisitions of the Securities and Exchange Commission ("SEC") would appoint a three-person independent and knowledgeable Change of Control Board for the target.  

The Change of Control Board would have complete authority over the acquisition process.  

The proposal would override all state takeover laws, some of which, in essence, permit a target's board to take whatever defensive measures it desires.  

The Change of Control Board would have the authority to hire its own counsel, investment banker, and other advisers. Furthermore, the corporation would be required to provide the funding for both the members of the Change of Control Board and its professional advisers.  

"Because of the obvious independence of the Change of Control Board, it would be presumed to act in the best interest of the target corporation and its shareholders."  

Therefore, a federal uniform standard of review, the business judgment rule, would apply in determining if the board acted properly. 

Application of this uniform standard would significantly reduce, if not completely eliminate, litigation involving the fiduciary duties of the board of a public company engaged in an M&A transaction. Under the current system, however, such litigation is common. By placing control of the M&A process in the hands of truly independent and disinterested directors and applying the business judgment rule in all cases in which a Change of Control Board acts, this proposal would significantly enhance the efficiency of the M&A marketplace. 

In The Missing Link, I argued that many features of the Change of Control Board proposal are similar to those provided for audit committees in


2Thompson, Change of Control Board, supra note 1, at 36.

3Id.

4Id. at 37.

5Id. at 85-88.

6Thompson, The Missing Link, supra note 1, at 83.


8Appendix § 102(b)(8)(viii)(b) provides similar language for the Change of Control Special Committee proposed in this Article.

9Thompson, Change of Control Board, supra note 1, at 91.

10Id. at 64.
the Sarbanes-Oxley Act of 2002.\textsuperscript{11} The Change of Control Board proposal is a logical extension of these audit committee provisions.\textsuperscript{12} I also argued that in the event Congress does not enact the Change of Control Board proposal, many of the concepts underlying the proposal should be implemented by the SEC through its rulemaking authority under the audit committee provisions.\textsuperscript{13} Finally, the proposal would allow the independent and disinterested shareholders of a public corporation to opt out of the provision.\textsuperscript{14}

To date, Congress and the SEC have not accepted my proposals regarding the Change of Control Board. In this Article, I tackle this problem through a proposed amendment to the Delaware General Corporation Law ("DGCL").\textsuperscript{15}

Notwithstanding the excellence of the Delaware judiciary, the multiple standards of review under Delaware law for reviewing the actions of a target's directors involved in a merger or acquisition transaction are cumbersome, a source of needless litigation, and economically inefficient.\textsuperscript{16} Consequently, the DGCL should be amended to permit the shareholders of a publicly held Delaware corporation to adopt a provision requiring that if the corporation becomes a target of a bona fide acquisition proposal, the board of the corporation must petition the Delaware Court of Chancery for the appointment of an independent, disinterested, and knowledgeable special committee of the board (a "Change of Control Special Committee"). This Committee would have complete power over the acquisition transaction. At the discretion of the Court of Chancery, a member of the current board could be appointed to the Change of Control Special Committee. As a practical matter, the role of the Delaware Court of Chancery in M&A transactions would be moved from the back-end to the front-end of the M&A process, because the Chancery Court's determination of the independence, disinterestedness, and competence of the target's board members would be made on an \textit{ex ante} as opposed to an \textit{ex post} basis.\textsuperscript{17}

\begin{itemize}
\item \textsuperscript{11}Thompson, \textit{The Missing Link}, supra note 1, at 83.
\item \textsuperscript{12}\textit{Id.} at 83-84.
\item \textsuperscript{13}\textit{Id.} at 112.
\item \textsuperscript{14}Thompson, \textit{Change of Control Board}, supra note 1, at 99.
\item \textsuperscript{15}Appendix § 102(b)(8).
\item \textsuperscript{16}See Thompson, \textit{The Missing Link}, supra note 1, at 92.
\item \textsuperscript{17}See, \textit{e.g.}, Yucaipa Am. Alliance Fund II, L.P. v. Riggio, 1 A.3d 310 (Del. Ch. 2010) (applying an \textit{ex post} inquiry into the disinterestedness and independence of a target's board), \textit{aff'd}, 15 A.3d 218 (Del. 2011).
\end{itemize}
The Change of Control Special Committee would have the plenary power of a board under section 141 of the DGCL, including the power to employ, maintain, or terminate a poison pill. Because of the independence, disinterestedness, and knowledge of the Special Committee, the deferential business judgment rule standard of review would apply to the actions of the Committee. As a consequence, litigation involving the actions taken by the Committee would be rare, if not completely eliminated, and it could be expected that the decisions made by the Committee would be in the interest of the target's shareholders.

This type of amendment to the DGCL is consistent with the statute's concept as an "enabling" law, permitting shareholders to adopt provisions that the shareholders determine are in their interests. Also, adoption of this proposal would breathe life into the proposal by Vice Chancellor Laster in CNX, where he suggested that the business judgment rule standard of review be applicable to freeze-out mergers where the transaction is (1) supervised by a special committee with all of the power of an independent board, and (2) conditioned upon the tendering or voting by a majority of the nonaffiliated shareholders.

Part II of this Article provides some background on CNX, and Part III addresses the major implication of CNX's embracing of the business judgment rule standard of review. Part IV outlines the proposal, and Part V concludes. The appendix contains the proposed statutory language needed to implement this proposal.

II. BACKGROUND ON CNX

In CNX, Vice Chancellor Laster of the Delaware Court of Chancery applied what he referred to as a "unified standard" for determining if the business judgment rule standard of review would apply to a controlling shareholder's acquisition of minority shares of a publicly held subsidiary in a freeze-out merger. In this transaction, CONSOL Energy, Inc. ("CONSOL"), the controlling shareholder, proposed to acquire the publicly

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19 In re Appraisal of Ford Holdings, Inc. Preferred Stock, 698 A.2d 973, 976 (Del. Ch. 1997) ("Delaware's General Corporation Law, like most general laws of incorporation in the twentieth century U.S., is an enabling statute.").
21 In re CNX Gas Corp. S'holders Litig., 4 A.3d 397, 400 (Del. Ch. 2010).
22 Id. at 413-14.
held stock of its partially owned subsidiary, CNX Gas, in a two-step tender offer followed by a short form merger.\textsuperscript{23} Vice Chancellor Laster subjected the transaction to the "entire fairness" standard of review because the transaction did not satisfy the "unified standard," which he concluded should give rise to the business judgment standard of review.\textsuperscript{24} He explains that under a unified standard "independent directors and unaffiliated stockholders [must be] given the tools to negotiate with controllers, backstopped by meaningful judicial review for fairness when those tools are withheld."\textsuperscript{25}

To satisfy the independent director prong of the unified standard, a special committee of independent and disinterested directors must have "authority comparable to what a board would possess in a third-party transaction,"\textsuperscript{26} including the authority to issue a poison pill to block the controller from acquiring the shares of the minority shareholders.\textsuperscript{27} The court explained:

> Because a board in a third-party transaction would have the power to respond effectively to a tender offer, including by deploying a rights plan, a subsidiary board should have the same power if the freeze-out is to receive business judgment review. This does not mean that a special committee must use that power. The shadow of pill adoption alone may be sufficient to prompt a controller to give a special committee more time to negotiate or to evaluate how to proceed. What matters is that the special committee fulfills its contextualized duty to obtain the best transaction reasonably available for the minority stockholders. Here, the Special Committee was deprived of authority that a board would have in a third-party transaction. Under Cox Communications, this fact provides a separate and independent basis to review a controlling stockholder freeze-out for entire fairness.\textsuperscript{28}

Furthermore, the court found that the second prong of the unified standard was not satisfied because "the plaintiffs have raised sufficient questions about the role of T. Rowe Price [which owned shares of both the

\textsuperscript{23} Id. at 400-04.
\textsuperscript{24} Id. at 414.
\textsuperscript{25} "CNX, 4 A.3d at 413-414.
\textsuperscript{26} Id. at 414.
\textsuperscript{27} See id.
\textsuperscript{28} Id. at 415-416.
parent and the subsidiary and agreed to tender its shares of the subsidiary] to undercut the effectiveness of the majority-of-the-minority tender condition.28 Based on these factors, the court found that neither prong of its "unified standard" was satisfied.29 Consequently, the entire fairness standard of review applied to the transaction.30

Vice Chancellor Laster's decision in support of CNX's interlocutory appeal of his decision to the Delaware Supreme Court illustrates the uncertainty present in Delaware law governing the standards of review of M&A transactions.31 The Vice Chancellor described the Delaware Court of Chancery's three approaches to combination tender offer/freeze-out, two-step transactions:

Decisions of the trial court conflict over the standard of review that governs a controller's unilateral two-step freeze-out. At least three different standards of review have been applied. My discussion of the standards sets aside disclosure issues, because each standard assumes full disclosure of all material facts.

The [CNX] Injunction Decision holds that entire fairness applies to a unilateral two-step freeze-out unless the transaction was structured to simulate arm's length third-party transactional approvals at both the board and stockholder levels. Consequently, if a first-step tender offer is both (i) recommended by a duly empowered special committee of independent directors and (ii) conditioned on the affirmative tender of a majority of the minority shares, then the business judgment standard of review presumptively applies. If either requirement is not met, then the transaction is reviewed for entire fairness. I refer to this approach as the "Cox Communications test."

A second line of Court of Chancery decisions holds that a unilateral two-step freeze-out will not be reviewed substantively if: (i) it is subject to a non-waivable majority of the minority tender condition; (ii) the controlling stockholder promises to consummate a prompt short-form merger at the

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28CNX, 4 A.3d at 416.
29Id. at 414-18.
30Id. at 413.
same price if it obtains more than 90% of the shares; (iii) the controlling stockholder has made no retributive threats; and (iv) the independent directors on the target board have free rein and adequate time to react to the tender offer. I refer to this approach as the "Pure Resources test."

A third line of Court of Chancery decisions holds that a unilateral two-step freeze-out will not be reviewed for entire fairness unless the offer is structurally coercive. I refer to this approach as the "Siliconix test."33

Notwithstanding these three different approaches, the Delaware Supreme Court declined to grant CNX's motion for an interlocutory appeal of the Vice Chancellor's decision.34

III. IMPLICATION OF CNX’S EMBRACING OF THE BUSINESS JUDGMENT RULE STANDARD OF REVIEW

Vice Chancellor Laster embraced the business judgment standard of review for a freeze-out merger by a controller, provided (1) an independent and disinterested special committee of the subsidiary has the power of an independent board, and (2) an effective majority of minority tendering condition is present.35 The Vice Chancellor's approach raises the prospect that the business judgment standard of review should apply to all types of M&A transactions in which these two CNX conditions are present.36 If their presence in a freeze-out merger by a controlling shareholder should give rise to the business judgment standard of review, then surely their presence in consensual and hostile deals should give rise to the same standard of review.

Indeed, when these two conditions are satisfied in reality, not only is there no need for the Kahn v. Lynch37 entire fairness standard of review for freeze-out mergers by controllers, there is also no need for any of the other standards of review in Delaware. That is, there is no need for (1) the Revlon requirement of getting the best price reasonably available when a target is sold in a change of control transaction,38 (2) the Unocal two-pronged enhanced business judgment rule for defensive measures,39 or (3) the Blasius

33Id. at *3-*4 (citations and footnotes omitted).
34In re CNX Gas Corp. S'holders Litig., 2010 WL 2690402 (Del., July 8, 2010).
35CNX, 4 A.3d at 412-13.
36Id.
37Kahn v. Lynch Commc'ns Sys., Inc., 638 A.2d 1110, 1116 (Del. 1994).
compelling justification standard for actions that interfere with shareholder voting rights. When the two CNX conditions are satisfied, it can be assumed that the transaction is in the best interest of the shareholders.

The most important CNX condition is the requirement of an independent and disinterested special committee with full power to employ any defensive tactics necessary, including a poison pill. In the discharge of its duties, any such committee would ensure that the transaction is conditioned on the approval of a majority of nonaffiliated shareholders, without respect to the form of the transaction.

While the proposal in CNX goes in the right direction, it is fundamentally flawed for several reasons. First, where the controller attempts to comply with the conditions, there would be significant litigation regarding whether the conditions were actually satisfied because many controllers would attempt to comply in form but not in substance with the conditions. Second, many controllers would not even attempt to comply with the conditions because they would not want to give the special committee unlimited power to block the transaction. This result would occur because many controllers would face the following scenario regarding the acquisition of minority owned shares of a controlled sub in a freeze-out transaction. Assume the subsidiary's shares are traded at $70 per share in the market. If a truly independent special committee is appointed with the power of a non-controlled board, the committee would insist upon a price of $100 per share. Further assume that the controller can force through the transaction with something less than the CNX conditions at $90 per share, a $20 premium. The controller calculates that as a result of litigation, it may be faced with an entire fairness hearing, which will likely find that the fair value of the target's shares is no more than $95 per share. The cost of litigating the issue is estimated at $2 per share. Thus, the expected total cost of proceeding without a CNX special committee is at most $97, three dollars less than the price that would be paid with a CNX special committee.

Under the above circumstances, which I believe would be present in many freeze-outs and other interested party transactions, the interested party will "roll the dice" on a transaction that does not comply with the CNX

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41 Id. at 415-16.
42 Id. at 416.
43 Controllers have been successful in entire fairness hearings. See, e.g., Kahn v. Lynch Comm'n Sys., 669 A.2d 79 (Del. 1997) (the controller prevailed in establishing that the deal price was entirely fair). For a more recent example, see In re John Q. Hammons Hotels Inc. S'holder Litig., 2011 WL 227634 (Del. Ch. Jan. 14, 2011) (the controller prevailed in establishing that the deal price was entirely fair).
conditions simply because it is in its economic interest to do so. In other words, the interested party will decide that it is in its economic interest not to comply with the CNX conditions. On the other hand, the proposal below would breathe life into the CNX conditions by allowing the Nonaffiliated Shareholders\textsuperscript{44} of a corporation to decide that if the corporation becomes the target of an M\&A transaction, the transaction will be vetted by a truly independent and disinterested special committee appointed by the Court of Chancery.\textsuperscript{45} With regard to the transaction, the committee would have all of the power of the firm's normal board including the power to issue a poison pill.\textsuperscript{46} Because the shareholders would be confident that the special committee would operate in the best interest of the target and its shareholders, the committee's actions would be subject to the business judgment rule standard of review.\textsuperscript{47} Consequently, four of Delaware's standards of review would not apply to the board: \textit{Kahn v. Lynch} entire fairness,\textsuperscript{48} \textit{Revlon} best price reasonably available,\textsuperscript{49} \textit{Unocal} enhanced business judgment rule for defensive measures,\textsuperscript{50} and \textit{Blasius} compelling justification.\textsuperscript{51} As a result, it could be expected that there would be a significant reduction in the amount of litigation relating to M\&A transactions.

IV. OUTLINE OF THE PROPOSAL

A. Introduction

The Appendix sets out the proposed statutory language that would implement the Change of Control Special Committee. The proposal would be implemented by adding a new paragraph (8) to section 102(b), which sets out provisions that may be included in a corporation's certificate of incorporation, such as the director exculpation provision in section 102(b)(7).\textsuperscript{52}

\textsuperscript{44}All capitalized terms are defined in the Appendix § 102(b)(8)(i).
\textsuperscript{45}Appendix § 102(b)(8)(vi).
\textsuperscript{46}Appendix § 102(b)(8)(v)(a).
\textsuperscript{47}Appendix § 102(b)(8)(viii)(b).
\textsuperscript{48}\textit{Kahn}, 638 A.2d at 1116.
\textsuperscript{50}\textit{Unocal Corp. v. Mesa Petroleum Co.}, 493 A.2d 946, 955 (Del. 1985).
\textsuperscript{51}\textit{Blasius Indus., Inc. v. Atlas Corp.}, 564 A.2d 651, 661 (Del. Ch. 1988).
\textsuperscript{52}\textit{Del. Code Ann. tit. 8, § 102(b)(7) (2006).}
B. Provision Requiring Appointment of a Change of Control Special Committee

Proposed section 102(b)(8) [hereinafter section 102(b)(8)] would permit the inclusion in the certificate of incorporation of a publicly held Delaware corporation (a "Public Corporation") a provision requiring the appointment by the Court of Chancery of a Change of a Control Special Committee in the event the corporation becomes the target of an M&A transaction (i.e., a Trigger Event occurs with respect to such corporation). In such event, under section 102(b)(8)(ii), the board of directors would be required to petition the Court of Chancery for the appointment of the Change of Control Special Committee, and if the board did not timely file the petition, under section 102(b)(8)(iii), the petition could be filed by certain shareholders.

C. The Shareholder Vote to Include a Section 102(b)(8) Provision

The shareholders who are not officers, directors, controlling shareholders, or certain related persons (i.e., Nonaffiliated Shareholders) would have the power to decide whether to include a section 102(b)(8) provision in the corporation's certificate of incorporation.\(^5\) Under section 102(b)(8)(xii)(a), the first annual meeting of shareholders of a Public Corporation occurring after the later of (1) the effective date of section 102(b)(8), and (2) the first date on which the corporation becomes a Public Corporation, must contain a resolution proposing the inclusion of a section 102(b)(8) provision in the corporation's certificate of incorporation, together with full disclosure of the impact of the provision. The resolution could be accompanied by the recommendation of Nonaffiliated Shareholders, but not by a recommendation of the board of directors. Under section 102(b)(8)(xii)(b), a vote would have to be held at least every six years. Thus, the shareholders of a Public Corporation would be given the opportunity either to (1) adopt a section 102(b)(8) provision if they previously decided against adopting the provision, or (2) abandon a previously adopted provision.

Under section 102(b)(8)(xii)(c), a section 102(b)(8) resolution would be "adopted only if a majority of the outstanding stock of the corporation

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\(^5\) Appendix § 102(b)(8)(xii)(c).
entitled to vote and held by Nonaffiliated Shareholders [is] voted for the adoption of the resolution."

D. Appointment by the Court of Chancery of a Change of Control Special Committee.

After the receipt of a petition, the Court of Chancery would, pursuant to section 102(b)(8)(iv), promptly appoint a Change of Control Special Committee for the Public Target. The Committee will generally consist of three members, one of whom may be from the corporation's regular board. In making the selection, the Court of Chancery will make a determination that each appointee is disinterested, independent, and competent. In an appropriate case, the Court of Chancery may require a potential appointee to have knowledge of the industry. To insure protection under the business judgment rule set out in section 102(b)(8)(viii)(b), the Court of Chancery should be satisfied that each appointee will make a proper inquiry, will act in good faith, and will make decisions that he or she reasonably believes to be in the best interest of the corporation.

Many M&A transactions will be an "end game" for the target's directors, and for that reason, these directors may be inclined to look after their own interests rather than the interests of the target's shareholders. Vice Chancellor Laster discussed this "end game" or "last period" problem in Reis v. Hazelett Strip-Casting Corp., a 2011 decision:

Final stage transactions give rise to what economists refer to as the last period problem. "Simply put, in a situation where parties expect to have repeated transactions, the recognition that a party who cheats in one transaction will be penalized by the other party in subsequent transactions reduces the incentive to cheat. However, when a transaction is the last (or only) in a series—that is, the final period—the incentive to cheat reappears because, by definition, the penalty for doing so has disappeared."

In the corporate context, the ability of managers to shirk or self-deal ordinarily is constrained not only by legal duties but also by a range of markets, including the product markets,

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54Appendix § 102(b)(8)(xii)(c).
capital markets, employment markets, and the market for corporate control. But when managers are in their final period, market consequences have less traction, making managers more likely to favor their own interests. In connection with a final stage transaction, the target corporation's board and management may demand side payments from the acquiror, thus effectively diverting a portion of the merger consideration from the shareholders to the management team. If the management team is able to protect the self-serving transaction with deal protection provisions, it will be further insulated from the disciplinary effect of the market for corporate control, leaving the outgoing management team free to serve their own self-interest with relative impunity.

In addition to the unrestrained pursuit of their own self-interest, directors and managers in the last period may depart from the best interests of the corporation and its shareholders due to a variety of non-pecuniary, but equally selfish, motivations. Directors and managers may favor one deal over another because it is more in line with their self image and view of the world or because it is more likely to cause them to be remembered fondly by employees or the business press.\textsuperscript{56}

However, an M&A transaction would not present a similar "end game" or "last period" problem for the members of the Change of Control Special Committee because if they do a good job for the shareholders of the Public Target, they likely will be appointed to other Change of Control Special Committees.

E. Responsibilities and Authority of Members of a Change of Control Special Committee

Under section 102(b)(8)(v), the Change of Control Special Committee will have responsibility for making all decisions and performing functions normally within the scope of authority of the Public Target's board of directors relating in any way to an Applicable Merger or Acquisition. These include: (A) whether to consider, accept, or reject a proposal to enter into a merger or acquisition transaction; (B) the preparation of a proxy statement,

\textsuperscript{56} Id. (quoting Sean J. Griffith, Deal Protection Provisions in the Last Period of Play, 71 FORDHAM L. REV. 1899, 1947 (2003)).
information statement, or other disclosure document for shareholders relating to the Applicable Merger or Acquisition; (C) the preparation of the Public Target's response to a tender offer on Schedule 14D-9 under the Securities Exchange Act of 1934; (D) the implementation of defensive tactics, such as the issuance of poison pills; (E) the entering into of lock-up agreements, such as share options and share exchange agreements, and asset option agreements; (F) the payment of termination fees; and (G) any other matters relating to the Applicable Merger or Acquisition.

The Change of Control Special Committee may hire its own independent attorney, investment banker, and any other professionals required by the circumstances. Because the members of the Change of Control Special Committee will have experience with the M&A process, it is highly unlikely that a Committee would be misled in the way the Barclays investment bank misled the Del Monte Board. As Vice Chancellor Laster explained:

Here, the taint of self-interest came from a conflicted financial advisor rather than from management. Like the directors in Mills, the Del Monte Board was deceived. At a minimum, Barclays withheld information about its buy-side intentions, its involvement with KKR, and its pairing of KKR and Vestar. As in Mills, "there can be no dispute but that such silence was misleading and deceptive. In short, it was a fraud upon the board." I therefore conclude that the plaintiffs have established a reasonable likelihood of success on the merits of their claim that the director defendants failed to act reasonably in connection with the sale process.

The Change of Control Special Committee will have the same authority to act with respect to the Applicable Merger or Acquisition as the Public Target's normal board would otherwise have, and any action required by a board under any provision of the DGCL (including section 251, relating to long form mergers, section 253, relating to short form mergers, and section 271, relating to sales of all or substantially all of a corporation's

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57 In re Del Monte Foods Co. S'holders Litig., 25 A.3d 813, 817 (Del. Ch. 2011) ("On multiple occasions, Barclays protected its own interests by withholding information from the Board.").
58 Id. at 836 (quoting Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1283 (Del. 1988)).
assets) will be satisfied by action by the Change of Control Special Committee to the extent such matter relates to the Applicable Merger or Acquisition. The normal board will have no authority with respect to the Applicable Merger or Acquisition and will take no action out of the ordinary course of business that could have an impact on the Applicable Merger or Acquisition. The board of directors of the Public Target and all officers and other employees of the Public Target are required to cooperate fully with the Change of Control Special Committee.

Section 102(b)(8)(v)(e) provides that, except in extraordinary circumstances, the Change of Control Special Committee will include in any acquisition agreement it negotiates a condition requiring that the agreement be approved by a majority of the disinterested and independent shareholders of the Public Target. This provision is similar to the shareholder voting requirement in the CNX unified approach, however, it is not mandatory and, in an appropriate case, the Change of Control Special Committee may not insist upon this condition.

Section 102(b)(8)(v)(f) makes it clear that the appointment of a Change of Control Special Committee will have no impact on a shareholder's appraisal rights. However, shareholders will exercise those appraisal rights rarely where a Change of Control Special Committee is appointed.

F. Will the Change of Control Special Committee Suffer from a Lack of Knowledge of the Public Target?

Concern has been expressed that the Change of Control Special Committee would not have sufficient knowledge of the Public Target to act in the M&A transaction. Although the Change of Control Special Committee will not have as much knowledge of the company as the regular board, there are at least four offsetting factors that respond to this concern.

First, in an appropriate case, the Court of Chancery may appoint a member of the regular board to the Change of Control Special Committee. Second, the Court of Chancery may require a potential appointee to have knowledge of the industry. Third, the regular board and all officers of the

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62 Appendix § 102(b)(8)(v)(d).
63 In re CNX Gas Corp. S'holders Litig., 4 A.3d 397, 413-14 (Del. Ch. 2010).
64 I reference, at least in part, comments received at the Delaware Journal of Corporate Law Symposium, "Irreconcilable Differences: Director, Manager, and Shareholder Conflicts in Takeover Transactions" sponsored by Widener University School of Law on April 10, 2011.
65 Appendix § 102(b)(8)(iv).
66 Appendix § 102(b)(8)(iv).
Public Target are required to cooperate fully with the Change of Control Special Committee.47 Fourth, the Change of Control Special Committee would likely have much more knowledge of the M&A market and process than the regular board. The importance of such knowledge was emphasized recently by Vice Chancellor Laster in Del Monte, where he explained, "[w]hen responding to a takeover bid or considering a final-stage transaction, the directors' advisors play a pivotal role."48

G. Compensation of the Change of Control Special Committee and Its Advisers

Under section 102(b)(8)(vi), the members of the Change of Control Special Committee will be compensated by the Public Target on a fee for services basis pursuant to rules promulgated by the Court of Chancery. It is anticipated that the compensation would be similar to the compensation that would otherwise be paid by the Public Target to members of a special committee of its board that had similar responsibilities. Similar rules apply under section 102(b)(8)(vii) to the compensation of professional advisers, and in certain circumstances the professional advisers may be paid a contingent fee.

H. Duty of Care and the Business Judgment Rule

Section 102(b)(8)(viii)(a) requires that the members of a Change of Control Special Committee "perform his or her functions in good faith, in a manner he or she reasonably believes to be in the best interests of the corporation, and with the care that an ordinarily prudent person would reasonably be expected to exercise in a like position and under similar

47 Appendix § 102(b)(8)(v)(d).
48 In re Del Monte Foods Co. S'holder Litig., 25 A.3d 813, 831 (Del. Ch. 2011). Chancellor Allen has elaborated:

Frequently, the outside directors who find themselves in control of a corporate sale process have had little or no experience in the sale of a public company. They are in terra incognito [sic]. Naturally, they turn for guidance to their specialist advisors who will typically have had a great deal of relevant experience.

circumstances." The business judgment rule is set out in section 102(b)(8)(viii)(b), which provides:

A member of a Change of Control Special Committee who makes a business judgment in good faith fulfills his or her duty under this section if: (1) he or she is independent and not interested in the subject of the business judgment; (2) he or she is informed with respect to the subject of his or her business judgment to the extent he or she reasonably believes to be appropriate under the circumstances; and (3) he or she rationally believes that his or her business judgment was in the best interests of the corporation.69

It would be a rare situation in which a member of a Change of Control Special Committee would not receive the benefit of the business judgment rule.

I. No Personal Liability

Section 102(b)(8)(ix) makes it clear that, in the absence of fraud, a member of the Change of Control Special Committee does not have any personal liability. This provision also provides for insurance and indemnification.

J. Arbitration in Majority Control Freeze-outs

Section 102(b)(8)(x) provides for arbitration if a controlling shareholder and the Change of Control Special Committee reach a deadlock on a controlling shareholder's proposal to acquire the shares of the minority shareholders.

K. Dissolution of Change of Control Special Committee

Section 102(b)(8)(xi) provides that once the Public Target is no longer the subject of a proposed merger or acquisition, the Target's normal board is required to ask the Court of Chancery to order the dissolution of the Change of Control Special Committee.

69Appendix § 102(b)(8)(viii)(b).
V. CONCLUSION

The DGCL is an "enabling" law, permitting shareholders to adopt provisions that the shareholders determine are in their interests. Adoption of proposed section 102(b)(8) will simply expand the enabling nature of the DGCL by offering shareholders the opportunity to opt for the appointment of a Change of Control Special Committee in the event the corporation becomes the target of an M&A transaction. If this proposal is economically efficient, as I believe, presumably shareholders will in many instances adopt the provision; if it is not economically efficient, shareholders in large measure will not adopt it. In any event, section 102(b)(8) would only apply if the Nonaffiliated Shareholders adopted it.

The Court of Chancery would choose the members of the Change of Control Special Committee on an ex ante basis, and because of the independence, disinterestedness, and knowledge of the members of the Committee, the business judgment standard of review would apply to the Committee's actions. Consequently, the need for the Court of Chancery to conduct, on an ex post basis, a searching inquiry into the actions of a target's board in an M&A transaction would be eliminated. Thus, the costly litigation that inevitably accompanies M&A transactions involving publicly held Delaware corporations would be substantially reduced, if not eliminated.

One of the author's students had the following comment on this proposal: "It is a good idea, but it will never happen, because the M&A litigators would be put out of business." Hopefully, in deciding whether the shareholders of publicly held Delaware corporations should be given the opportunity to vote on this proposal, the Delaware legislature will seek the views of shareholder advocacy groups and other interested parties, as well as the views of the Delaware bar. In seeking the views of all interested parties, the Delaware legislature should put the statute proposed in the Appendix into its own legislative form and send it out for comments. If those comments largely support the adoption of this proposal, then the legislature should adopt it notwithstanding any opposition from the Delaware bar.

70See Veasey & Di Guglielmo, supra note 20, at 203-04.
APPENDIX: PROPOSED NEW SECTION 102(b)(8) OF THE DGCL

Section 102(b) of the Delaware General Corporation Law is amended by adding at the end the following new section 102(b)(8):

(b) In addition to the matters required to be set forth in the certificate of incorporation by subsection (a) of this section, the certificate of incorporation may also contain any or all of the following matters:
* * *

(8) **Provision Requiring Appointment of a Change of a Control Special Committee.** In the case of a Public Corporation (all capitalized terms are defined in section 102(b)(8)(i)), a provision requiring the appointment by the Court of Chancery of a Change of Control Special Committee in the event a Trigger Event occurs with respect to such Public Corporation, thereby causing the Public Corporation to become a Public Target.\(^1\)

(i) **Defined Terms.**

"Applicable Merger or Acquisition" means the transaction that resulted in the occurrence of a Trigger Event.

"Change of Control Special Committee" means a committee of the Public Target that is appointed pursuant to section 102(b)(8)(iii).

"Nonaffiliated Shareholders" means a shareholder who (1) is not an officer, director, or controlling shareholder of the Public Corporation, (2) does not control and is not controlled by such officer, director, or controlling shareholder, (3) is not the spouse (other than a spouse who is legally separated from the individual under a decree of divorce or separate maintenance), child, grandchild, or parent of such officer, director, or controlling shareholder, (4) is not a trust or estate in which such officer, director, or controlling shareholder has a more than 5% actuarial interest, and (5) is not a trust of which the officer, director, or controlling shareholder is considered to any extent the owner under subpart E of part I of subchapter J of the Internal Revenue Code.\(^2\)

\(^1\) *Comment:* This provision would be adopted pursuant to the shareholder voting rules in section 102(b)(8)(xii).

\(^2\) *Comment:* The concept of the Nonaffiliated Shareholder is important in determining if the shareholders of a Public Corporation have voted to include a section 102(b)(8) provision in the corporation's certificate of incorporation.
"Public Corporation" means a corporation organized under the Delaware General Corporation Law that has its shares registered under section 12(g) of the Securities and Exchange of 1934.

"Public Target" means a Public Corporation with respect to which a Trigger Event has occurred.

A "Trigger Event" shall occur if:

(A) Arm's Length Mergers, Management Buyouts, and Freeze-outs. The board of directors of a Public Corporation receives a bona fide proposal:

(1) to engage in a merger, consolidation, or mandatory share exchange, whether effected directly or by means of a subsidiary, or
(2) to purchase all or substantially all of such corporation's assets, or
(3) to give the board's endorsement to a tender offer for a controlling position in such corporation, or
(4) to engage in any other transaction having a similar effect;

(B) Self Initiated Mergers and Acquisitions. The board of directors of a Public Corporation initiates negotiations designed to lead to the acquisition of the corporation in a merger or acquisition transaction;

(C) Target of Tender Offer. A Public Corporation becomes the subject of an unsolicited bona fide tender offer under section 14(d) of the Securities and Exchange Act of 1934 for a controlling interest in such corporation;

(D) 13D Filed. A Schedule 13D under the Securities and Exchange Act 1934 is filed with respect to a Public Corporation and the purpose of the filer or filers, as reflected in Item 4 of Schedule 13D, is, or may be for, the acquisition of a controlling interest in such corporation.

(E) Reverse Acquisition. In exchange for the equity securities or assets of another corporate issuer, a Public Corporation issues its stock amounting to:

(1) in excess of 50% of such corporation's outstanding voting stock, and
(2) in excess of 50% of the value of such corporation's outstanding stock.

(ii) Petition by Board of Directors. In the event that a provision requiring the appointment of a Change of a Control Special Committee is adopted in accordance with the rules set out in this section, upon the happening of a Trigger Event, the board of directors of the Public
Target shall promptly and in accordance with the rules of the Court of Chancery petition the Court of Chancery for the appointment of a Change of Control Special Committee.\textsuperscript{73}

(iii) \textbf{Petition by Shareholders.} If the board of directors of a Public Target does not promptly file the required petition after the happening of a Trigger Event, then any shareholder or group of shareholders of such corporation owning voting shares of the corporation with a value of at least $10,000 may, in accordance with the rules of the Court of Chancery, petition the Court of Chancery for the appointment of a Change of Control Special Committee.

(iv) \textbf{Appointment of a Change of Control Special Committee.} After the receipt of a petition, the Court of Chancery shall promptly, but in no case later than five business days, appoint a Change of Control Special Committee for the Public Target. In appropriate cases, the Court of Chancery may order that both the petition and the action on the petition be conducted \textit{in camera}.\textsuperscript{74} Such Special Committee shall consist of three persons unless, in the sole judgment of the Court of Chancery, it is appropriate under the circumstances to have more than three members, but in no event shall more than five persons be appointed to a Change of Control Special Committee. In making the selection, the Court of Chancery shall make a determination that each appointee is not interested in the contemplated merger or acquisition and is independent of any person who is so interested. The Court of Chancery shall also give consideration to the appointee's experience in dealing with merger and acquisition transactions, and where appropriate, to the appointee's knowledge of the industry in which the Public Target operates. The Court of Chancery may in appropriate circumstances appoint to the Change of Control Special Committee one member of the Public Target's regular board who is otherwise qualified to serve. Also, in making the appointments, the Court of Chancery, in its sole discretion, may consider recommendations from Nonaffiliated Shareholders of the Public Target. To ensure protection under the business judgment rule set out in section 102(b)(8)(viii)(b), the Court of Chancery should be satisfied that each appointee will make a proper inquiry, will act in good faith, and will make decisions that he or she reasonably believes to be in the best interest of the corporation. The members of the Change of Control

\textsuperscript{73} \textbf{Comment:} The Court of Chancery will promulgate rules relating to section 102(b)(8).

\textsuperscript{74} \textbf{Comment:} The Court of Chancery could consider a petition and act on the petition \textit{in camera}. Such action could be appropriate if, for example, a board decides to have the corporation sell itself, and to prevent the premature disclosure of the appointment of a Change of Control Special Committee, the board asks the Court of Chancery to consider its application \textit{in camera}.\textsuperscript{74}
Special Committee shall continue in office until resigning or dissolution of the committee under section 102(b)(8)(xi). To facilitate the expeditious appointment of Change of Control Special Committees, the Court of Chancery shall, pursuant to rules adopted by the Court of Chancery, maintain lists of qualified persons who are willing to serve as members of a Change of Control Special Committee. Without respect to any other provision of the corporation's certificate of incorporation relating to the number of directors, the certificate is hereby amended to permit the appointment of additional directors to the Change of Control Special Committee.\footnote{Comment: The members of a Change of Control Special Committee will be disinterested, independent, and experienced. Also, for them, the transaction is not an "end game," because if they do a good job for the shareholders of the Public Target, it is likely that they will be appointed to other Change of Control Special Committees.}

(v) Responsibilities and Authority of Members of a Change of Control Special Committee.

a. Basic Responsibilities. The Change of Control Special Committee will have responsibility, pursuant to a majority vote, for making all decisions normally within the scope of the authority of the Public Target's board of directors relating in any way to a Applicable Merger or Acquisition, including:

1. Deciding, pursuant to the authority contained in section 102(b)(8)(v)(c), whether to consider, accept, or reject a proposal to enter into a merger or acquisition transaction;

2. Preparation of a proxy statement, information statement, or other disclosure document for shareholders relating to the Applicable Merger or Acquisition;

3. Preparation of the Public Target's response to a tender offer on Schedule 14D-9 under the Securities Exchange Act of 1934;

4. The making of severance payments conditioned on a change of control transaction (i.e., golden parachutes);

5. The repurchase at a premium of the stock of the issuer from a potential acquirer (i.e., greenmail);

6. The implementation, pursuant to the authority contained in section 102(b)(8)(v)(c), of defensive tactics, such as the issuance of poison pills, that may have the foreseeable effect of blocking an unsolicited tender offer;

7. Entering into lock-up agreements, such as share option and share exchange agreements, and asset option agreements;

8. The payment of hello fees or goodbye (i.e., termination) fees; and
(9) Any other matters relating to the Applicable Merger or Acquisition.

b. Hiring of Professionals. The Change of Control Special Committee may hire its own independent attorney, investment banker, and any other professionals as required by the circumstances.

c. Authority of a Change of Control Special Committee and Its Actions Considered Action by Board. The Change of Control Special Committee shall have the same authority to act with respect to the Applicable Merger or Acquisition as the Public Target's normal board would otherwise have, and any action required by a board under any provision of the Delaware General Corporation Law (including section 251, relating to long form mergers; section 253, relating to short form mergers; section 271, relating to sales of all or substantially all of a corporation's assets; and section 275, relating to the dissolution of a corporation) shall be satisfied by action by the Change of Control Special Committee to the extent such matter relates to the Applicable Merger or Acquisition. The normal board shall have no authority with respect to the Applicable Merger or Acquisition and shall take no action out of the ordinary course of business that could have an impact on the Applicable Merger or Acquisition. Consequently, the Change of Control Special Committee, in the exercise of its business judgment, may approve, reject, or decline to consider a proposal to the Public Target to engage in a merger or acquisition transaction and may take an action that has the foreseeable effect of blocking an unsolicited tender offer.76

d. Cooperation of Regular Board. The board of directors of the Public Target and all officers and other employees of the Public Target shall cooperate fully with the Change of Control Special Committee. In the event the Court of Chancery, upon petition by the Change of Control Special Committee, determines that the board of directors is not cooperating, the Court of Chancery shall have the authority to suspend the board and replace it with the Change of Control Special Committee.

e. Majority of Disinterested Shareholder Voting or Tendering Condition. Except in extraordinary circumstances, it is anticipated that the Change of Control Special Committee will insist on the inclusion in any merger or other acquisition agreement negotiated by the

76Comment: A Change of Control Special Committee may, inter alia, issue a poison pill, provided the Public Corporation's charter documents permit. The adoption by a Change of Control Special Committee of a resolution approving an agreement of merger pursuant to which the Public Target will be acquired shall constitute the action required by a corporation's board under section 251, relating to long form mergers. Also, the approval by the Special Committee of a resolution relating to the sale of all or substantially all of a Public Target's assets would constitute the action required by a corporation's board under section 271.
Committee on behalf of a Public Target, a condition requiring that the agreement be approved (by voting or tendering or both) by a majority of the disinterested and independent shareholders of the Public Target.  

f. No Impact on Appraisal Rights. The appointment of a Change of Control Special Committee shall have no impact on a shareholder's appraisal rights.  

(vi) Compensation of Members of Change of Control Board. The members of the Change of Control Special Committee shall be compensated by the Public Target on a fee for services basis pursuant to rules and a periodically updated fee schedule promulgated by the Court of Chancery. In promulgating such rules, the Court of Chancery shall take into consideration such factors as the size of the parties, the complexity of the transaction, and the level of fees that would be payable in the open market for comparable work by similar professionals for comparable companies. The members shall also be reimbursed for their reasonable expenses, pursuant to rules promulgated by the Court of Chancery.

(vii) Compensation of Professional Advisers.

a. Fee for Services. The professional advisers to the Change of Control Special Committee will be compensated by the Public Target on a fee for services basis pursuant to rules and a periodically updated fee schedule promulgated by the Court of Chancery. Professional advisers shall also be reimbursed for their reasonable expenses, pursuant to rules promulgated by the Court of Chancery;

b. Contingent Compensation. In an appropriate case, pursuant to rules promulgated by the Court of Chancery, a Public Target may enter into a contingent fee arrangement with an investment banker.


a. Duty of Care. In exercising his or her business judgment, each member of the Change of Control Special Committee has a duty to the Public Target to perform his or her functions in good faith, in a manner he or she reasonably believes to be in the best interests of the corporation, and with the care that an ordinarily prudent person would reasonably be expected to exercise in a like position and under similar circumstances. The duty set forth above includes the obligation to make, or

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77Comment: This provision is similar to the shareholder voting requirement in the CNX unified approach; however, it is not mandatory and in an appropriate case the Change of Control Special Committee may not insist upon this condition.

78Comment: Although the appointment of a Change of Control Special Committee will not eliminate appraisal rights, the fact that such a Committee has acted for the Public Target will likely reduce the instances in which shareholders seek appraisal rights.
cause to be made, an inquiry when, but only when, the circumstances would alert a reasonable director or officer to the need therefor. The extent of such inquiry shall be such as the director reasonably believes to be necessary. In performing his or her functions, a member of a Change of Control Special Committee may rely on materials and persons in accordance with the principles in section 141(e).

b. Business Judgment Rule. A member of a Change of Control Special Committee who makes a business judgment in good faith fulfills his or her duty under this section if:

(1) He or she is independent and not interested in the subject of the business judgment;

(2) He or she is informed with respect to the subject of his or her business judgment to the extent he or she reasonably believes to be appropriate under the circumstances; and

(3) He or she rationally believes that his or her business judgment was in the best interests of the corporation.

c. Burden of Proof. A person challenging the conduct of a member of the Change of Control Special Committee has the burden of proving by clear and convincing evidence that there has been a breach of the duty of care, including the inapplicability of the business judgment rule as set forth in paragraph b above, and such person has the burden of proving that the breach was the legal cause of damage suffered by the corporation.

(ix) No Personal Liability, Insurance, and Indemnification.

a. No Personal Liability. In addition to any protection against personal liability under the Public Target's charter provision under section 102(b)(7), absent proof by clear and convincing evidence that a member of a Change of Control Special Committee acted with an intent to defraud, no member of a Change of Control Special Committee shall have any personal liability for actions taken or not taken as a member of a Change of Control Special Committee.

b. Insurance and Indemnification. Upon the appointment of a Change of Control Special Committee, the Public Target shall pursuant to rules promulgated by the Court of Chancery promptly provide indemnification and insurance for the members of the Change of Control Special Committee. Such insurance and indemnification shall cover all actions taken in connection with the member's activities on the Change of Control Special Committee, except for any actions amounting to fraud.

(x) Arbitration in Majority Control Freeze-outs. If

a. a controlling shareholder controls sufficient votes of the Public Target to unilaterally effectuate the acquisition by merger, sale of assets or otherwise, of all of the Public Target's stock, or substantially all of its assets, and
b. the controlling shareholder and the Change of Control Special Committee do not, within the time period specified in rules promulgated by the Court of Chancery, reach a decision on the price and other terms for such transaction,

then the price and other terms shall be determined pursuant to a binding arbitration proceeding in accordance with rules promulgated by the Court of Chancery.

(xi) **Dissolution of Change of Control Special Committee.** Once the Public Target is no longer the subject of a proposed merger or acquisition, the Target's normal board shall petition the Court of Chancery to, pursuant to its rules, dissolve the Change of Control Special Committee. If the normal board does not within a reasonable period file such a petition, then such a petition may be filed by a shareholder or shareholders of the Public Target owning at least 3% of the Public Target's outstanding voting stock.

(xii) **The Shareholder Vote**
  
a. **First Annual Meeting Requirement.** Notwithstanding the provisions of section 242(b)(1) (requiring that any amendment to a corporation's certificate of incorporation be proposed by the board of directors), the first annual meeting of shareholders of a Public Corporation occurring after the later of:

  (1) The effective date of this section 102(b)(8), and

  (2) The first date on which the corporation becomes a Public Corporation,

shall contain a resolution in the following form (or having the following effect):

RESOLVED, that the [applicable Public Corporation] shall include in its certificate of incorporation the following provision:

Pursuant to section 102(b)(8) of the Delaware General Corporation Law, in the event a Trigger Event, as defined in such section, occurs with respect to the corporation, the board of directors shall, in accordance with the provisions of such section, petition the Court of Chancery for the appointment of a Change of Control Special Committee, which shall promptly operate in accordance with the principles set out in such section.

The resolution shall be accompanied by an accurate description of the impact on the Public Corporation of the adoption of the resolution and shall contain the recommendation of any Nonaffiliated Shareholder or group of Nonaffiliated Shareholders owning at least 3% of the voting stock of such
corporation. The board of directors of such corporation may not recommend that the shareholders vote against the resolution.  

b. *Vote at Least Once Every Six Years.* Notwithstanding the provisions of section 242(b)(1) (requiring that any amendment to a corporation's certificate of incorporation be proposed by the board of directors), at least once every 6 years, the annual meeting of shareholders of a Public Corporation shall contain a resolution in the form (or having the effect) of the resolution set out in section 102(b)(8)(xii)(a) together with the disclosures required by such section. The vote may be held more frequently if scheduled by the normal board or pursuant to shareholder proposal.  

c. *Votes Required for Adoption of the Resolution.* The resolution required by section 102(b)(8)(xii)(a) and (b) shall be adopted only if a majority of the outstanding stock of the corporation entitled to vote and held by Nonaffiliated Shareholders shall be voted for the adoption of the resolution.

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79 Comment: Section 14A(a)(1) of the Securities and Exchange Act of 1934, as amended by section 951 of the Dodd-Frank Act, has the requirement of an advisory shareholder vote on pay. The above provision gives the Nonaffiliated Shareholders a final say on the Change of Control Special Committee.  

80 Comment: Section 14A(a)(2) of the Securities and Exchange Act of 1934, as amended by section 951 of the Dodd-Frank Act, provides for a shareholder advisory vote every six years on the frequency of the say on pay shareholder vote. The provision here gives the shareholders an up or down vote on the Change of Control Special Committee every six years. Thus, the adoption of the Change of Control Special Committee is not necessarily permanent.  

81 Comment: For example, if a Public Corporation has 100,000 shares outstanding and 80,000 are held by Nonaffiliated Shareholders, then the resolution regarding the Change of Control Special Committee will be adopted if it is supported by 40,001 shares.