GOING-PRIVATE TRANSACTIONS: A PRACTITIONER'S GUIDE

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ABSTRACT

This article provides a practitioner's point of view of "going-private" transactions. Developments in Delaware case law beginning in 2001 have caused the judicial landscape upon which practitioners traditionally rested this type of transaction to shift. As a result, there are now two distinct approaches to implementing going-private transactions that merit consideration by practitioners in this field. The article sets out the legal, structural and strategic considerations underlying each approach from the practitioner's point of view by depicting how going-private transactions actually develop under the two models and providing corporate law practitioners with a guide and a checklist in this relatively novel field of corporate law practice.

I. INTRODUCTION: TWO ALTERNATIVE APPROACHES

This article provides a practitioner's point of view of "going-private" transactions. In going-private transactions, a controlling stockholder typically acquires the shares of the minority stockholders in a public company in exchange for cash, debt or stock, resulting in the delisting of the company. Developments in Delaware case law beginning in 2001 have caused the judicial landscape upon which practitioners traditionally rested this type of transaction to shift. As a result, there are now two distinct approaches to implementing going-private transactions that merit consideration by practitioners in this field. The purpose of this article is to provide corporate law practitioners with a guide and a checklist in this relatively novel field of corporate law practice.

In the first approach (the Traditional Approach), the controlling stockholder announces its intention to acquire the publicly held shares of

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the minority stockholders and then engages in direct negotiations regarding the terms and structure of the transaction with a special committee of the target company's board of directors. If these negotiations are successful, a merger agreement setting out the terms and conditions upon which the controlling stockholder will acquire the interests of the minority stockholders is signed by the target company (following the recommendation of the special committee and approval of the board) and the controlling stockholder. The controlling stockholder and the target company then complete the transaction pursuant to the terms of the merger agreement. Transactions structured under the Traditional Approach are subject to a heightened level of scrutiny by the Delaware courts referred to as the "entire fairness" standard of review.

In the second approach (the Unilateral Approach), the controlling stockholder unilaterally determines the price and other terms and conditions of a cash tender offer and makes that offer directly to the target's stockholders, without entering into negotiations with the target company or seeking prior approval of an independent special committee of the company's board. Assuming that the controlling stockholder controls at least ninety percent of the target's outstanding stock after the tender offer, the controlling stockholder then effectuates a second step short-form merger. In contrast to transactions following the Traditional Approach, transactions properly structured under the Unilateral Approach will not be scrutinized under the heightened entire fairness standard of review, but instead be subject to the more deferential "business judgment rule."

This article sets out the legal, structural and strategic considerations (including advantages and disadvantages) underlying each approach from the practitioner's point of view. It also considers certain trends relating to these two approaches based on recent statistical data published by Guhan Subramanian of Harvard Law School. Finally, to provide a sense of how transactions actually develop under the Traditional and Unilateral Approaches, the article refers to ten recent transactions and includes two illustrative timelines.

II. GENERAL STATE LAW REQUIREMENTS

A. *Fiduciary Duties Under State Law*

State law constitutes an important consideration in deciding how to conduct a "going-private" transaction. Given that Delaware courts are generally considered lodestars in adjudicating corporate law matters, this article focuses exclusively on Delaware law, recognizing that the law in other jurisdictions may differ from the principles outlined below.

Delaware law requires corporate directors to discharge a triad of fiduciary duties—the duty of due care, the duty of loyalty, and the duty of good faith—to the corporation's stockholders in determining whether to approve a corporate action.[1]

The duty of care applies in two areas of directorial responsibility. The first area is in the process of decision making.[2] The second area is in non-decision-making responsibilities such as delegation and oversight functions.[3] To fulfill the duty of due care, directors must perform their directorial tasks with the inquiry, skill, and diligence of a reasonably prudent person acting in similar circumstances.[4] Accordingly, in making decisions, directors must inform themselves and their fellow directors of all material information reasonably available regarding a transaction.[5] In the context of decision making, directors are presumed to have "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."[6]

A companion obligation to the duty of care is the duty of loyalty. Because the board of directors manages the corporation on behalf of and for the benefit of the stockholders, its members owe a duty of loyalty to the corporation and its stockholders.[7] The duty of loyalty prohibits the board or the individual directors from taking advantage of the corporation by means of fraudulent or unfair transactions when appearing on both sides of a transaction involving the corporation.[8] A director is, for example, "interested," if the director obtains a personal financial gain in a transaction as opposed to benefits that devolve upon the corporation or the stockholders generally.[9] Similarly, a director who, as a result of personal or other relationships, is so "beholden" to an interested person that his or

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[1]*See* Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 363 (Del. 1993), *modified*, 636 A.2d 956 (Del. 1994) (citing Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984)); Citron v. Fairchild Camera & Instrument Corp., 569 A.2d 53, 64 (Del. 1989). We do not comment on whether the duty of good faith is a separate duty.

[2]*In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 967 (Del. Ch. 1996).

[3]*Id.*

[4]Graham v. Allis-Chalmers Mfg. Co., 188 A.2d 125, 130 (Del. 1963).

[5]Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985) (citing Kaplan v. Centex Corp., 284 A.2d 119, 124 (Del. Ch. 1971)).

[6]Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984).

[7]Anadarko Petroleum Corp. v. Panhandle E. Corp., 545 A.2d 1171 (Del. 1988).

[8]David S. Ruder, *Duty of Loyalty—A Law Professor's Status Report*, 40 BUS. LAW. 1383, 1386-87 (1985).

[9]Cede & Co. v. Technicolor, Inc., 643 A.2d 345, 363 (Del. 1993); *see also Aronson*, 473 A.2d at 812 (differentiating self-dealing from benefits that are received by all shareholders); Cheff v. Mathes, 199 A.2d 548, 556-57 (Del. 1964) (holding the exercise of business judgment in good faith does not alone justify holding the board personally responsible).

her "discretion would be sterilized,"[10] lacks the requisite independence and will be considered interested.[11]

Finally, the board of directors is subject to a duty of good faith that requires its members to act in good faith and on an informed basis.[12] The members cannot appear as if they "*consciously and intentionally disregarded their responsibilities*, adopting a 'we don't care about the risks' attitude concerning the material corporate decision."[13]

B. *The Impact of the Business Judgment Rule*

The business judgment rule "operates as both a procedural guide for litigants and a substantive rule of law."[14] The rule recognizes a "cardinal precept of the General Corporation Law of the State of Delaware . . . that directors, rather than shareholders, manage the business and affairs of the corporation."[15] As such, the business judgment rule posits a rebuttable "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 was taken in the best interests of the company."[16] Absent a breach of fiduciary duty, lack of good faith, or self-dealing, any action of the directors will be presumed to be in the best interests of the corporation and the directors will be entitled to the benefits of the business judgment rule.[17] Thus, courts will neither "second-guess" board decisions, nor will they restrain or enjoin a transaction approved by the board.[18] Moreover, directors are not held personally liable for honest mistakes under such circumstances.[19] "The burden is on the party challenging the [board's] decision to establish facts rebutting the presumption."[20] A plaintiff can rebut the presumptive validity of the business decision by demonstrating that the directors, in arriving at the challenged decision, "breached any one

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[10]Orman v. Cullman, 794 A.2d 5, 24 (Del. Ch. 2002); *see also Aronson*, 473 A.2d at 815 (concluding allegations that a director is being controlled must be supported by facts).

[11]Kaplan v. Goldsamt, 380 A.2d 556 (Del. Ch. 1977).

[12]*See In re* Abbott Labs. Derivative S'holders Litig., 325 F.3d 795, 807-09 (7th Cir. 2003); *In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959 (Del. Ch. 1996).

[13]*In re* Walt Disney Co. Derivative Litig., 825 A.2d 275, 289 (Del. Ch. 2003).

[14]Citron v. Fairchild Camera & Instrument Corp., 569 A.2d 53, 64 (Del.1989).

[15]*Aronson*, 473 A.2d at 811.

[16]*Id.* at 812.

[17]*Cede & Co.*, 634 A.2d at 363.

[18]*Aronson*, 473 A.2d at 812.

[19]Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1374 (Del. 1995).

[20]*Aronson*, 473 A.2d at 813.

of the *triads* of their fiduciary duty—good faith, loyalty or due care"[21] or that such decision emanates from an abuse of discretion on the part of the board of directors, i.e., that the challenged business decision lacks a rational business purpose.[22]

In the context of going-private transactions, "[o]ne way for the plaintiff to overcome this burden . . . [would be] to allege facts demonstrating a squeeze out merger or a merger between two corporations under the control of a controlling shareholder."[23] If a plaintiff succeeds in rebutting the business judgment rule, then the burden of proof shifts to the defendant directors, who must demonstrate that the challenged transaction was entirely fair.[24]

C. *Entire Fairness Doctrine*—Weinberger v. UOP, Inc.

In *Weinberger v. UOP, Inc.* (*Weinberger*),[25] the landmark case enunciating the "entire fairness" standard of review, the Delaware Supreme Court was presented with a minority stockholder's challenge to a cash-out merger proposal from the controlling stockholder. Seeking to invest cash surplus, The Signal Companies, Inc. (Signal), a 50.5% stockholder of UOP, Inc. (UOP), decided to acquire the remaining outstanding stock of UOP through a cash-out merger.[26] After Signal's announcement of its intention to do so, UOP retained a financial adviser and (for the sole use and benefit of Signal) directed two UOP directors to prepare a feasibility study, which was based upon UOP confidential information.[27] Among other things, the study indicated that a price of up to $24 would be a "good investment," however, the conclusions of this study were never disclosed to UOP's

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[21] *See Cede & Co.*, 634 A.2d at 361. *See also* Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1284 n.32 (Del. 1988) (concluding the decision made by a board deceived by the benefactors of the deception will not be protected by the business judgment rule).

[22] *In re* J.P. Stevens & Co. S'holders Litig., 542 A.2d 770, 780-81 & n.5 (Del. Ch.), *appeal denied*, 540 A.2d 1088 (Del. 1988); *Aronson*, 473 A.2d at 813; Puma v. Marriott, 283 A.2d 693, 695 (Del. 1971).

[23] *See* Orman v. Cullman, 794 A.2d 5, 20 (Del. Ch. 2002).

[24] *See* Emerald Partners v. Berlin, No. 9,700, 2003 Del. Ch. LEXIS 42, at *7-*8 (Del. Ch. Apr. 28, 2003), *reprinted in* 28 DEL. J. CORP. L. 1027, 1030 (2003); *see also Orman*, 794 A.2d at 20-22 (stating that the plaintiff must allege facts sufficient to rebut the business judgment presumption and lead to the application of the entire fairness standard); Kahn v. Lynch Communications Sys., 638 A.2d 1110, 1117 (Del. 1994) (citing Citron v. E.I. Du Pont de Nemours & Co., 584 A.2d 490, 500-02 (Del. Ch. 1990), and noting the view that "approval of a cash-out merger by a special committee of disinterested directors . . . shifts to the plaintiff the burden of proving that the transaction was unfair").

[25] 457 A.2d 701 (Del. 1983).

[26] *Id.* at 704-05.

[27] *Id.* at 706-07.

outside directors and stockholders.[28] The Signal board authorized the proposal of a cash merger at a price of $21 per share.[29] Unaware of the $24 per share price information, UOP's board (which included a number of Signal designees) discussed the proposed merger transaction with the Signal board.[30] Following the receipt of a hurriedly prepared, two-page fairness opinion suggesting that a price of $21 per share would be adequate, the board approved the transaction. The UOP stockholders subsequently voted in favor of the transaction at the annual stockholders meeting.[31]

Acknowledging that "[w]hen directors of a Delaware corporation stand on both sides of a transaction, they are required to demonstrate their utmost good faith and the most scrupulous inherent fairness of the bargain,"[32] the court applied the entire fairness standard of review.[33] Under this standard of judicial review, the defendant directors must establish that the challenged transaction is entirely fair to the target's stockholders; a demonstration, which, as discussed in detail below, encompasses inquiries into the fairness of the process applied and price paid.[34] While the court remanded the case to the lower court to ascertain a fair of price,[35] it concluded that the transaction did not "satisf[y] any reasonable concept of fair dealing"[36] because the controlling stockholder used UOP confidential information and failed to share this information with UOP's outside directors.[37]

Although *Weinberger* makes clear that the entire fairness of a transaction can only be determined after considering all aspects of the transaction in question, the two most important ones are "fair dealing" and "fair price."[38] Fair dealing "embraces questions of when the transaction was timed, [as well as] how it was initiated, structured, [and] negotiated."[39] Fair price, on the other hand, relates to the fairness of the consideration

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[28]*Id.* at 707.

[29]*Weinberger*, 457 A.2d at 707.

[30]Signal's conduct did not pass muster under the fair dealing prong of the entire fairness standard of review. *Id.* at 701 (finding, among other things, that (1) Signal determined the structure of the transaction, (2) certain UOP outside directors lacked material information, and (3) UOP's outside directors were not aware of the manner in which the financial advisor performed its diligence and provided the two-page fairness opinion).

[31]*Id.*

[32]*Id.* at 710.

[33]*Weinberger*, 457 A.2d at 710.

[34]*See generally id.* at 701.

[35]*Id.* at 714.

[36]*Id.* at 710, 712.

[37]*Weinberger*, 457 A.2d at 712.

[38]*Id.* at 711.

[39]*Id.*

(i.e., the amount of money, property, or other securities) paid to the stockholders, including "the economic and financial considerations of the proposed merger and all [other] relevant factors: assets, market value, earnings, future prospects, and any other elements that affect the intrinsic or inherent value of a company's stock."[40] From a practical perspective, it appears more difficult to establish that the price offered was fair than that the challenged transaction was the product of fair dealing. "[T]he test for fairness is not a bifurcated one as between fair dealing and price."[41] Instead, because the question is one of entire fairness, all aspects of the issue must be examined as a whole.[42]

Today, it is commonly recognized that "the rationale for imposing the 'entire fairness' burden is that in a self-dealing transaction, the minority stockholders' interests are not being adequately safeguarded because the fiduciaries charged with protecting the minority have a conflicting self-interest."[43] Delaware law, therefore, creates compensating procedural safeguards by subjecting those fiduciaries to the exacting requirement that they demonstrate "their utmost good faith and [the] most scrupulous inherent fairness of the bargain."[44]

The applicability of the entire fairness standard of review is often considered outcome determinative.[45] While in the context of the business judgment rule the complaining stockholder must prove that a director's conduct contravenes his or her fiduciary obligations,[46] under the entire fairness standard of review, the proponents of the transaction (i.e., the defendant directors and controlling stockholder) must affirmatively establish "fairness" before the protection of the business judgment rule

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[40] *Id.*

[41] *Weinberger*, 457 A.2d at 711.

[42] *Id.*

[43] Pinson v. Campbell-Taggart, Inc., Civ. A. No. 7499, 1989 Del. Ch. LEXIS 50, at *16 (Del. Ch. Feb. 28, 1989), *reprinted in* 14 DEL. J. CORP. L. 1095, 1106 (1989).

[44] *Id.* (quoting *Weinberger*, 457 A.2d at 710). Under New York law, the insiders must also demonstrate a valid business purpose for engaging in the transaction. A valid business purpose may be shown if it is related to the advancement of the general corporate interest or if the removal of the minority stockholders confers some general gain on the corporation. *See* Alpert v. 28 Williams St. Corp., 473 N.E.2d 19, 676-77 (N.Y. 1984); Tanzer Econ. Assocs., Inc. Profit Sharing Plan v. Universal Food Specialties, Inc. 383 N.Y.S.2d 472, 479, 481-83 (N.Y. Sup. Ct. 1976).

[45] Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361 (Del. 1995); *see also* Kahn v. Lynch Communications Sys., 638 A.2d 1110, 1115 (Del. 1994) (stating that a showing of each party's exerting its bargaining power as though at arm's length was strong evidence that the transaction was entirely fair).

[46] Orman v. Cullman, 794 A.2d 5, 20 (Del. Ch. 2002) (citing *Aronson*, 473 A.2d at 812, for the proposition that "[b]ecause a board is presumed to have acted properly, '[t]he burden is on the party challenging the decision to establish facts rebutting the presumption'").

becomes available.[47] Although the initial burden of proof in an entire fairness proceeding is on the directors, the controlling stockholder is able, and will typically seek, to shift the burden of proof back to the plaintiff by adopting certain procedural protections, such as conditioning the transaction upon (1) the approval of a majority of disinterested directors,[48] or the majority of the minority stockholders,[49] or (2) the approval or recommendation of a special committee.[50] Thus, strategic structuring of a going-private transaction can shift the burden of proving entire fairness back to the challenger and enhances the controlling stockholder's chances of prevailing in subsequent litigation.

In *In re Cysive, Inc. Shareholders Litigation*,[51] the court examined a controlling stockholder's going-private transaction and denied plaintiff's petition for an injunction, holding that the transaction was entirely fair. Following months of fruitless efforts by the board to sell Cysive, Inc. (Cysive), Carbonell, the founder and a large stockholder of Cysive, made an offer for all the outstanding shares of Cysive that he did not already own.[52] The Cysive board immediately formed a special committee consisting of independent directors to negotiate with Carbonell.[53] The special committee recommended, and the board subsequently approved, a transaction that required Carbonell to pay a premium to the value determined by the special committee's financial advisor.[54] Despite Cysive's history of unsuccessful attempts to sell the business, the agreement permitted the special committee to continue to entertain offers from third party bidders.[55] Following the announcement of the transaction, Cysive stockholders challenged it as procedurally and financially unfair. Applying the entire fairness standard of review, the court found that in light of (1) the presence of an independent board majority, (2) the active and aggressive search for third party bidders that preceded the execution of the merger agreement, (3) the diligent efforts of the special committee, which engaged

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[47]*See Kahn*, 638 A.2d at 1117.

[48]Chaffin v. GNI Group, Inc., No. Civ.A. 16211-NC, slip op. at 5 (Del. Ch. Sept. 3, 1999) (stating that "[a]bsent approval of the transaction by the disinterested director majority, the burden of proof falls upon the defendants to establish that the transaction was entirely fair to the shareholders").

[49]*Kahn*, 638 A.2d at 1116 (citing Rosenblatt v. Getty Oil Co., 493 A.2d 929, 937 (Del. 1985)).

[50]*Orman*, 794 A.2d at 20.

[51]836 A.2d 531 (Del. Ch. 2003).

[52]*Id.* at 534.

[53]*Id.*

[54]*Id.*

[55]*In re Cysive S'holders Litig.*, 836 A.2d at 534.

in true arm's-length negotiations with Carbonell, and (4) the ability of the special committee to abandon the transaction with Carbonell in favor of a better deal without an unreasonable penalty, the process leading to the execution of the agreement satisfied the entire fairness standard.[56] With respect to the price offered, the court found that the transaction represented a premium to the price determined by the special committee's financial advisor and concluded that it was financially fair.

D. *The Special Committee*[57]

Since the Delaware Supreme Court countenanced the use of special committees in conflict-of-interest transactions two decades ago, special committees have become a commonly used instrument in conflict-of-interest transactions.[58] A properly functioning special committee not only helps a controlling stockholder shift the burden of proof in anticipation of subsequent fairness proceedings, but it also strengthens the controlling stockholder's argument that the offer price was fair and that the transaction was the product of fair dealing.[59] The active participation of an independent special committee, with the ability to retain its own legal and financial advisors, in negotiating a going-private transaction is powerful evidence toward satisfying procedural fairness.[60] Similarly, the involvement of an independent financial advisor retained by the special committee and delivery of its fairness opinion is important evidence in satisfying the fair price requirement of the entire fairness standard.[61]

As previously discussed, special committees have become an integral part of the Traditional Approach,[62] and, although not mandated by law, also have become a frequently employed device in transactions modeled after the Unilateral Approach. To avail itself of the legal advantages of employing a special committee, however, the controlling stockholder must

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[56]*Id.* at 541.

[57]For a detailed practitioner's checklist regarding the formation and operation of special committees, see Annex A.

[58]1 R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, THE DELAWARE LAW OF CORPORATIONS & BUSINESS ORGANIZATIONS § 9.35 (3d ed. 1998 & Supp. 2002).

[59]*See* Emerald Partners v. Berlin, 726 A.2d 1215 (Del. 1999).

[60]*See* Kahn v. Lynch Communications Sys., 638 A.2d 1110, 1115 (Del. 1994).

[61]*See* Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1156, 1172 (Del. 1995) (quoting Weinberger v. UOP, Inc., 457 A.2d 701, 709-10 n.7 (Del. 1983), for the proposition that an "arm's length negotiation provides 'strong evidence that the transaction meets the test of fairness'").

[62]*See Weinberger*, 457 A.2d at 709-10.

ensure that the committee is composed of disinterested[63] and independent[64] directors, "fully informed, and ha[s] the freedom to negotiate at arm's length."[65] In the event that there are no disinterested and independent directors that could form the special committee, it appears that a controlling stockholder's only remaining option is to increase the size of the board of directors and add a sufficient number of directors. The special committee often enlists the services of legal and financial specialists, reporting solely to the special committee, to maintain its independence.[66] The special committee must understand its role as the aggressive promoter of minority stockholder interests. For the special committee to fulfill its responsibilities effectively it must negotiate at arm's-length and the controlling stockholder cannot dictate the terms of the agreement.[67] As a result, the burden-shifting objective will not be achieved unless the special committee acts independently, i.e., its decision-making process is unfettered by the influence of the controlling stockholder. In evaluating the integrity of and the action taken by the special committee, courts pay particular attention to the authority granted to it by the board of directors. At present, the law does not require the board of directors to grant special committees its full powers in order for courts to give effect to the actions taken by special committees. Instead, giving the special committee the authority to negotiate the terms of the transaction or formulate a

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[63]A "disinterested" director is one who "will [not] receive a personal financial benefit from the transaction that is not equally shared by the shareholders." *See* Rales v. Blasband, 634 A.2d 927, 936 (Del. 1993). The existence of continuing arrangements or affiliations with management may be viewed as a disabling interest and render the members of the special committee less than independent. *See* Kahn v. Dairy Mart Convenience Stores, Inc., No. 12,489, 1996 Del. Ch. LEXIS 38, at *20-*21 (Del. Ch. Mar. 29, 1996), *reprinted in* 21 DEL. J. CORP. L. 1143, 1157 (1996).

[64]An "independent" director is one who may not be "dominated or otherwise controlled by an individual or entity interested in the transaction." *See* Grobow v. Perot, 539 A.2d 180, 189 (Del. 1988). The concepts of interestedness and independence, although allowing room for overlap, are distinct notions. For a detailed judicial discussion, see Beam v. Stewart, 845 A.2d 1940, 1048-52 (Del. 2004); *Rales*, 634 A.2d at 936; Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 362 (Del. 1993); Aronson v. Lewis, 473 A.2d 805, 812, 816 (Del. 1984); Orman v. Cullman, 794 A.2d 5, 26 (Del. Ch. 2002).

[65]*Kahn*, 638 A.2d at 1120-21.

[66]*See* BALOTTI & FINKELSTEIN, *supra* note 58, § 9.35.

[67]*In re* Trans World Airlines, Inc. S'holders Litig., No. 9844, 1988 Del. Ch. LEXIS 139, at *21-24 (Del. Ch. Oct. 21, 1988), *reprinted in* 14 DEL. J. CORP. L. 870, 884-85 (1989); *see* Rabkin v. Olin Corp., No. 9212, 1990 Del. Ch. LEXIS 142, at *22 (Del. Ch. Sept. 19, 1990); *see also* Mills Acquisition Co. v. MacMillan, Inc., 559 A.2d 1261, 1282 (Del. 1989) (faulting the board of directors for its failure "to insulate the self interested management from improper access to the bidding process, and to ensure the proper conduct of the auction [of company stock] by truly independent advisors selected by, and answerable only to, the individual directors").

recommendation is sufficient.[68] Although the special committee's authority to respond to the offer must encompass "the critical power . . . to say no,"[69] it should be noted that the appointment of a special committee does not automatically empower the committee to solicit a competing bid.[70]

Typically, the authority granted by a board of directors to a special committee encompasses the authority to: (1) review, evaluate, negotiate the terms and conditions of, and make a recommendation to the board of directors with respect to, a particular offer, and (2) retain independent legal and financial advisors at the expense of the company, and (3) take any other actions that it deems necessary or desirable in connection with its responsibilities. Courts endorse, but do not mandate, a grant of authority exceeding the power to negotiate with the controlling stockholder at arm's length. For the board of directors' grant of authority to exceed the traditional scope of empowerment, the circumstances surrounding the transaction must be exceptional. In *In re Cysive, Inc. Shareholders Litigation*,[71] for example, the board failed to find a buyer for the company and, consequently, enabled the special committee to evaluate any offer or proposal submitted by a third party. In *Hollinger International, Inc. v. Black*,[72] the board empowered the special committee with the ability to adopt defensive measures to protect the company's evaluation of its strategic alternatives from the interference of a controlling stockholder. Absent such special circumstances, a board of directors will, however, refrain from granting powers that broad. It is extremely rare for a controlling stockholder to allow a company to authorize a special committee to run a competitive auction or to adopt defensive measures to protect against the controlling stockholder's takeover of the company.

As Part III explains, the principal role of the special committee arises after the controlling stockholder develops and delivers a proposal to the target company. At such time, the target board normally establishes a special committee authorized to evaluate and negotiate the proposal on behalf of the company's minority stockholders and to retain independent financial and legal advisors to assist in evaluating the proposal and

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[68] *See Kahn*, 638 A.2d at 1117.

[69] *In re* First Boston S'holders Litig., No. 10,338, 1990 Del. Ch. LEXIS 74, at *20 (Del. Ch. June 7, 1990).

[70] *See* Mendel v. Carroll, 651 A.2d 297, 306 (Del. Ch. 1994); Donald J. Wolfe, Jr. & Janine M. Salomone, Pure Resources, Printcafe *and the Pugnacious Special Committee*, 7 M&A LAW. 10 (2003) (discussing the holdings of the court in *In re* Pure Resources, Inc. S'holders Litig., 808 A.2d 421 (Del. Ch. 2002), and Creo, Inc. v. Printcafe Software, Inc., No. 20,164 (Del. Ch. Feb. 21, 2003)).

[71] 836 A.2d 531, 534 (Del. Ch. 2003).

[72] 844 A.2d 1022, 1034 (Del. Ch. 2004).

negotiating with the controlling stockholder. The special committee and its advisors then negotiate the price and other terms and conditions of the offer with the controlling stockholder.

III. SPECIAL COMMITTEE PROCEDURE UNDER THE TRADITIONAL APPROACH

As the above discussion illustrates, "going-private" transactions in Delaware traditionally are structured according to an established set of legal principles and customary procedures developed both to satisfy these legal requirements as well as facilitate completion in the most efficient manner. Transactions structured according to the Traditional Approach usually have the following key events:

1. The controlling stockholder develops and delivers a proposal to the target company and simultaneously files an amendment to its Schedule 13D or Schedule 13G, as applicable, with the Securities and Exchange Commission (SEC) describing its proposal. The disclosure in the (amended) Schedule 13D/G is particularly important because it must describe the controlling stockholder's intention to execute the proposed transaction.
2. The target board establishes a special committee comprised solely of disinterested and independent directors authorized to evaluate and negotiate the proposal on behalf of the company's minority stockholders and retain independent financial and legal advisors to assist in evaluating the proposal and negotiating with the controlling stockholder. Only in rare circumstances would a public company forego the formation of a special committee (i.e., there were no disinterested directors to serve on such a committee or the transaction was subject to the approval of the majority of the minority stockholders).
3. The special committee and its advisors negotiate the price and other terms and conditions of the offer with the controlling stockholder. This process can take a significant amount of time. In the Expedia Transaction,[73] negotiations between the special committee and the controlling stockholder lasted 288 days (which was partially due to the fact that discussions were

[73]For more detailed information on each of the transactions referred to in this article, please refer to Annexes B and C.

put on hold while InterActiveCorp finalized other transactions). In the Nortek Transaction and the Sodexho Marriott Transaction, which are more representative of the process, discussions lasted seventy-five and ninety-two days, respectively.

4. The controlling stockholder's public announcement of its proposal usually triggers stockholder litigation, and, as a result, negotiations between the special committee and its advisors and the controlling stockholder may involve representatives of the plaintiffs in an effort to settle such litigation. In certain transactions, this stockholder litigation can be significant. In the Springs Industries Transaction, for example, the stockholder litigation was so pervasive that the closing of the transaction was subject to settlement of such litigation.
5. If such negotiations are successful, a merger agreement setting out the terms and conditions upon which the minority stockholders are to be cashed out is recommended by the special committee, approved by the company's board of directors, and then signed by the company and the controlling stockholder. The most important provisions of the merger agreement relate to (1) the consideration paid, (2) the voting requirements (in particular, whether there is a "majority of the minority" provision), and (3) other conditions that affect closing (which, in most cases, are the typical conditions required in a public merger). Given that all five of the transaction case studies organized under the Traditional Approach (and listed in Annex B) involved the formation of a special committee, none of these transactions required a "majority of the minority" voting condition in the transaction agreement. Additionally, a settlement agreement may be entered into with the stockholder plaintiffs, as was the case in the Springs Industries Transaction.
6. The controlling stockholder and the company subsequently complete the transaction pursuant to the terms of the merger agreement.
7. The company prepares a proxy or information statement and seeks stockholder approval, with the transaction closing thereafter. Stockholders who are dissatisfied with the consideration offered can seek an equitable remedy or statutory appraisal of the value of their stock.

In connection with such a negotiated transaction, the special committee will negotiate vigorously to ensure that completion of the transaction be conditioned upon approval by a majority of the minority stockholders. Such a condition is not legally required, but, as noted above, it shifts the burden of proof to any plaintiff stockholders to show that the transaction is not entirely fair. The proponents of the transaction, however, retain the burden of demonstrating that adequate disclosure regarding the transaction was provided to the minority stockholders.

A recent study[74] has shown that seventy-two percent of all recent going-private transactions—those following the Siliconix/Glassman line of cases and the introduction of the Unilateral Approach—were executed under the Traditional Approach. Not surprisingly, in most transactions, the board formed a special committee with which the controlling stockholder negotiated the pending transactions.[75] All transactions that were recommended by the special committee and approved by the full target board of directors were consummated.[76] On average, approximately 190 days passed between signing and closing.[77] Finally, it is striking that out of all transactions modeled after the Traditional Approach, only three quarters were ultimately consummated. This may be attributable to the lengthy negotiation process and the involvement of the special committee.

IV. GOING PRIVATE OUTSIDE OF ENTIRE FAIRNESS

A recent line of cases in the Delaware courts has established a transactional structure that can result in a going-private transaction being subject to the business judgment rule rather than the heightened entire fairness standard of review.

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[74] A recent study by Guhan Subramanian of Harvard Law School presented an informative view of going-private transactions, outlining a number of interesting trends in this area of practice. We have described certain of the Study's findings below. *See* Guhan Subramanian, Post-*Siliconix* Freeze-Outs: Theory, Evidence & Policy, Harvard Law School Olin Center Discussion Paper #472 (Apr. 2004), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=530284 (last visited Apr. 10, 2005) [hereinafter Subramanian Study]).

[75] *Id.*

[76] *Id.*

[77] *Id.*

A. *In re* Siliconix Inc. Shareholders Litigation

In *In re Siliconix Inc. Shareholders Litigation*,[78] a minority stockholder of Siliconix Inc. (Siliconix) sought to enjoin an exchange offer initiated by Vishay Intertechnology, Inc. (Vishay), the eighty percent majority stockholder of Siliconix. Following Vishay's initial announcement of an all-cash tender offer for the remaining shares of Siliconix' stock, Siliconix, at the urging of Vishay, appointed an independent committee to negotiate the terms of the offer for the benefit of the company's minority stockholders.[79] After approximately three months of unfruitful negotiations, Vishay announced its intention to extend a stock-for-stock offer without first obtaining the input or approval of the special committee.[80] The exchange offer, which was conditioned on the acceptance of the offer by the majority of Siliconix's minority stockholders, proposed exchanging 1.5 shares of Vishay common stock for each share of Siliconix common stock.[81] A minority stockholder challenged the offer contending that the offer was unfair, coercive, and contained numerous disclosure violations and, thus, could not pass muster under the doctrine of entire fairness.[82] The court held that absent coercion or a violation of the controlling stockholder's disclosure obligations, entire fairness did not apply to a controlling stockholder's tender offer for the shares of the minority.[83]

B. Glassman v. Unocal Exploration Corp.

In *Glassman v. Unocal Exploration Corp.*,[84] the Delaware Supreme Court considered the fiduciary duties owed by a controlling stockholder to the minority stockholders in the context of a short-form merger squeeze out transaction. Unocal Corporation (Unocal) held a ninety-six percent interest in its subsidiary, Unocal Exploration Corporation (UXC) and decided to acquire the minority's interest in order to save costs and reduce taxes and overhead expenses.[85] In accordance with the then-current practice, the

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[78]No. 18,700, 2001 Del. Ch. LEXIS 83 (Del. Ch. June 19, 2001), *reprinted in* 27 DEL. J. CORP. L. 1011 (2002).

[79]*Id.* at *8-*13, *reprinted in* 27 DEL. J. CORP. L. at 1014.

[80]*Id.* at *14-*15, *reprinted in* 27 DEL. J. CORP. L. at 1016.

[81]*Id.* at *14, *reprinted in* 27 DEL. J. CORP. L. at 1017.

[82]*In re Siliconix*, 2001 Del. Ch. LEXIS 83, at *2-*20, *reprinted in* 27 DEL. J. CORP. L. at 1012.

[83]*Id.* at *22, *reprinted in* 27 DEL. J. CORP. L. at 1121.

[84]777 A.2d 242 (Del. 2001).

[85]*Id.* at 248 (relying on Stauffer v. Standard Brands. Inc., 187 A.2d 78, 80 (Del. 1962)).

boards of both companies appointed independent committees to evaluate the fairness of a possible merger.[86] After the committees agreed to acceptable exchange ratios, the companies' businesses began to recover, and UXC announced the discovery of a valuable asset.[87] Notwithstanding the objections of the special committee of UXC, Unocal consummated a short-form merger with UXC and paid the minority stockholders of UXC the previously agreed upon merger consideration.[88] That consideration did not reflect the value arguably attributable to UXC's discovery and the improving business climate. As a result, a minority stockholder challenged the short-form merger on equitable grounds.[89] The supreme court affirmed the lower court's conclusion, holding that "absent fraud or illegality, appraisal is the exclusive remedy available to a minority shareholder who objects to a short-form merger."[90]

C. *In re* Pure Resources, Inc. Shareholders Litigation

In *In re Pure Resources, Inc. Shareholders Litigation*,[91] the court of chancery granted a minority stockholder's request to enjoin the tender offer of Unocal Corporation's (Unocal) for the shares of common stock of Pure Resources, Inc. (Pure) that it did not already own.[92] Unocal's offer included the following conditions: (1) a sufficient number of shares of Pure common stock had to be tendered so that, upon completion of the tender, Unocal, as a ninety percent stockholder, could effect a short-form merger; and (2) a majority of the minority must tender their shares.[93] Provided that the ninety percent condition was satisfied, the offer also included Unocal's undertaking to effect a short-form merger offering the same consideration as in the tender offer.[94] Dissatisfied with Unocal's tender offer proposal, minority stockholders of Pure sought to enjoin the offer.[95]

The court reaffirmed prior case law that holds a controlling stockholder owes no duty to offer the minority a fair price and, assuming full disclosure and no actionable coercion, the entire fairness standard of

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[86] *Id.*

[87] *Id.*

[88] *Glassman*, 777 A.2d at 243.

[89] *Id.* at 244.

[90] *Id.*

[91] 808 A.2d 421 (Del. Ch. 2002).

[92] *Id.*

[93] *Id.* at 429.

[94] *Id.*

[95] *In re Pure Res.*, 808 A.2d at 429.

review does not govern controlling stockholder tender offers. Additionally, the court explicated that Delaware

> law should consider an acquisition tender offer by a controlling stockholder non-coercive only when 1) it is subject to a non-waivable majority of the minority tender condition; 2) the controlling stockholder promises to consummate a prompt § 253 merger at the same price if it obtains more than 90% of the shares; and 3) the controlling stockholder has made no retributive threats.[96]

D. *Summary*

When read together, the above cases create a blueprint for controlling stockholders to acquire the interest of the minority without having its actions reviewed under the onerous standard of entire fairness.[97] By first making a tender offer directly to the company's stockholders (without having to negotiate with or seek the approval of an independent special committee) and then completing a short-form, second-step merger, a controlling stockholder achieves the exact same result as under the Traditional Approach. In planning going-private transactions under this approach, practitioners should keep in mind that the transaction must meet the following criteria:

1. The offer must be subject to a non-waivable majority of the minority provision, i.e., for the tender offer to succeed, a majority of the shares held by the minority stockholders (excluding those shares held by officers and directors of the company as well as any other stockholders controlled by the controlling stockholder) must be tendered in the offer;[98]
2. The controlling stockholder must commit to consummate a short-form merger at the same price promptly after completion of the tender offer if the tender offer results in the

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[96]*Id.* at 445.

[97]Bradley R. Aronstam et al., *Delaware's Going-Private Dilemma: Fostering Protections for Minority Shareholders in the Wake of* Siliconix *and* Unocal Exploration, 58 BUS. LAW. 519, 520 (2003); *see also* Bradley R. Aronstam et al., *Revisiting Delaware's Going Private Dilemma Post-*Pure Resources, 59 BUS. LAW. 1459 (2004). It should be emphasized that the Delaware Supreme Court has not addressed the combined use of the *Siliconix* and *Unocal Exploration* models to avoid an entire fairness review.

[98]*In re Pure Res.*, 808 A.2d at 445.

controlling stockholder's owning ninety percent of the shares of each class of voting stock;[99]

3. There must not be any retributive threats by the controlling stockholder to minority stockholders (i.e., to halt dividends, to execute a subsequent cash-out merger at a lower price or to delist the company's shares) if they do not tender into the offer;[100] and
4. The disclosure documents must contain information about the transaction that adequately prepare the minority stockholders to make an informed decision about the offer, including "a fair summary of the substantive work performed by the investment bankers upon whose advice the recommendations of their board as to how to vote on a merger or tender rely."[101]

V. UNILATERAL APPROACH: TENDER OR EXCHANGE OFFER

Transactions structured according to the Unilateral Approach usually have the following key events:

1. The controlling stockholder determines the price and other terms and conditions of its cash tender offer without entering into prior negotiations with the company or seeking approval of a special committee of directors.
2. The controlling stockholder publicly announces an intention to commence a tender offer (and amends its Schedule 13D), usually with sufficient time prior to launching the offer to allow the company and its board to formulate an adequate response. The time between the announcement and commencement of the offer can be quite long, sixteen days in the Travelocity Transaction and eleven days in the Prodigy Communications Transaction, for example. There are, however, a few exceptions to this general rule. In the Euroweb International Transaction, the transaction was announced and launched on the same day.
3. The controlling stockholder launches the tender offer, satisfying the criteria set forth in Part IV above.
4. The company's board establishes a special committee comprised solely of disinterested directors authorized to

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[99] *Id.*

[100] *Id.*

[101] *Id.* at 449.

evaluate the controlling stockholder's proposal on behalf of the company's minority stockholders and to retain independent financial and legal advisors to assist in evaluating the proposal. In the universe of the Study, all but one board of the target companies hired outside financial and legal advisors.

5. The special committee publicly recommends acceptance or rejection of the tender offer, or expresses no position.[102] In the majority of cases, the special committee ultimately recommends the offer. This was the case in the Travelocity, Prodigy Communications, and NRG Energy Transactions, where the special committee, after initially declaring the offer inadequate, subsequently recommended the offer to stockholders. In the Study results, for the Unilateral Approach context, sixty-seven percent of the special committees recommended the tender or exchange offer, eleven percent remained neutral and fifteen percent rejected it.
6. If more than ninety percent of the shares of each class of voting stock are obtained in the tender offer, the controlling stockholder completes a short-form merger by filing a certificate with the Secretary of Delaware to freeze out any non-tendering stockholders. Under Delaware law, in the absence of coercion and disclosure inadequacies, the only remedy available to stockholders frozen out in this manner is an appraisal action. It is worth noting that transactions executed under the Unilateral Approach exhibit a higher degree of success in reaching completion than transactions executed according to the Traditional Approach.

As a practical matter, most transactions that have been successfully completed under the Unilateral Approach were first recommended by special committee.[103] The Travelocity Transaction, the Prodigy Communications Transaction, and the NRG Energy Transaction were, for example, completed successfully following the special committee's endorsement of the transaction. In the Spectra-Physics Transaction, the special committee refused to take a position, and the controlling stockholder was still able to complete the transaction. In the Euroweb

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[102]Rule 14d-9, Recommendation or Solicitation By the Subject Company and Others, 17 C.F.R. § 240.14d-9 (2004).

[103]Subramanian Study, *supra* note 74, at 14.

International Transaction, the special committee recommended against the offer and the transaction failed, reinforcing the view that, even under the Unilateral Approach, the approval of the special committee plays an important role in the successful completion of the transaction.

Since the emergence of the Unilateral Approach in 2001, only twenty-eight percent of all going-private transactions adopted this new model.[104] Almost all transactions succeeded and, on average, closed within 100 days of signing.[105] Absent a mandatory legal requirement to form a special committee, the fact that the majority of unilaterally structured transactions involved a special committee begs the following question: to what end was it formed? Because the formation of a special committee is sensible only for purposes of burden-shifting and procedural fairness in the context of an entire fairness proceeding, the practical explanation for the formation of special committees in the tender offer context does not appear to be the controlling stockholder's fear of subsequent litigation, but rather the target board's effort to comply with its disclosure obligation under the federal securities laws.[106] The target board is, for example, required to form a special committee to take an impartial position in its Schedule 14D-9 filing. Two-thirds of the special committees formed under the Unilateral Approach, the Study observes, ultimately recommend the transaction to their stockholders.[107] Thus, not only do controlling stockholders adopt the transaction model that will likely be subjected to the more lenient business judgment standard of review, but, in the majority of cases, the target company forms a special committee in order to comply with its obligations under the federal securities laws.

Despite its timing advantages alone and the higher probability of its success, it is curious that fewer controlling stockholders have chosen to proceed on the basis of a Unilateral Approach than one would expect. Despite the Traditional Approach's persistence as the preferred going-private model, these facts paint an interesting picture with respect to the possible success of the controlling stockholder and suggest that transactions structured under the Unilateral Approach are more likely to be completed than those under the Traditional Approach.

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[104] *Id.*

[105] *Id.* at Tbl. 1.

[106] It should be noted that by negotiating with a special committee, the controlling shareholder exposes itself to the risk of entire fairness review. In *Hartley v. Peabod, Inc.*, the court, adjudging the challenge of a merger agreement providing for a two-step cash-out transaction (a first step tender offer followed by a second step short-form merger), determined that *Siliconix* and *Unocal Exploration* would not shield the transaction from entire fairness review. Hartley v. Peapod, Inc., No. 19,025, 2002 WL 31957458 (Del. Ch. Feb. 27, 2002).

[107] Subramanian Study, *supra* note 74, at 21.

It is worth noting that the increase from the initial price to the final price in the two types of transactions differs substantially.[108] In transactions effectuated pursuant to the Traditional Approach, the controlling stockholder increased its offer by seventeen percent on average, while in a Unilateral Approach transaction the controlling stockholder only increased it by seven percent on average.[109] The Study attributed a portion of this difference to the fact that Unilateral Approach transactions are subject to a lower standard of judicial review and that, consequently, the special committee has less bargaining power with which to compel an increase in price.[110] The Study also observes that, under the Unilateral Approach, the controlling stockholder makes an initial offer closer to its view of the target's true value.[111] In this regard, the Study notes one important trend. Significant controlling stockholders are less likely to increase their first offer, but if they do, the increase is usually smaller under the Unilateral Approach than the Traditional Approach.[112] Where the controlling stockholder holds more than sixty-five percent of the target company, the study observes the premium over the initial offer increases to nineteen percent under the Traditional Approach and 4.6% under the Unilateral Approach, concluding that, "a controlling shareholder has considerable bargaining power against the special committee and minority shareholders when it holds a large pre-deal stake in the target, but not when it holds a small pre-deal stake."[113] As a result, it appears that the outcomes in prior transactions may be more dependent upon the size of a controlling stockholder's equity interest than the procedures and mechanics of the Traditional or Unilateral Approach.[114] It is our view, however, that the *Siliconix* and *Unocal Exploration* doctrines allow a controlling stockholder to effect a going-private transaction without having to enter into substantive negotiations with the special committee, which results in the controlling stockholder not having to increase the consideration as much as is typically the case under the Traditional Approach. In addition, in the context of an unsolicited tender or exchange offer under the Unilateral Approach, there is less flexibility to adjust the initial offering price (given that the appropriate offer documents must be amended and filed with the SEC and, depending on the modifications made, a supplemental distribution to the

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[108] *Id.* at 20 & tbl. 1, fig. 3.

[109] *Id.* at 20.

[110] *Id.* at 21, 24.

[111] Subramanian Study, *supra* note 74, at 21.

[112] *Id.* at 24.

[113] *Id.* at 26.

[114] *Id.*

target's stockholders may become necessary). Consequently, under the Unilateral Approach, the controlling stockholder generally seeks to approximate the initial offering price to the final offering price for the target stock.[115]

VI. ADVANTAGES AND DISADVANTAGES OF THE TWO ALTERNATIVE APPROACHES

In deciding which transaction model to use, practitioners will need to consider the advantages and disadvantages of each. The following discussion attempts to set forth these advantages and disadvantages succinctly, recognizing that each transaction will have its own unique issues, which will also influence the selection of the approach.

A transaction structured according to the Traditional Approach has several advantages from a controlling stockholder's perspective, which are described below:

1. It enjoys the endorsement and support of the company's disinterested directors. This can be particularly important if a significant percentage of the company's stockholders are retail accounts and individuals, who might place value on such an endorsement.
2. If the process is conducted properly, including a well-functioning special committee with independent legal and financial advisors, then the transaction has, notwithstanding the application of the entire fairness standard of review, a strong likelihood of prevailing in court. To ensure that the special committee is functioning well, please consider the detailed practitioner's checklist regarding the formation and operation of special committees in Annex A.
3. It allows the controlling stockholder to complete the transaction even if it cannot obtain ninety percent of the shares of each class. This becomes an important issue where a group of stockholders holds more than ten percent of the target company's shares enabling it to block a second step short-form merger. Therefore, during the initial stages of a transaction, the practitioner should conduct an analysis of the institutional stockholders invested in the target company and determine whether a potential blocking position exists.

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[115]Subramanian Study, *supra* note 74, at 21.

Conversely, the primary disadvantages of structuring a transaction according to the Traditional Approach are as follows:

1. It creates a risk that, notwithstanding good faith negotiation, the special committee rejects the proposed transaction or requires the controlling stockholder to pay a higher price than it might otherwise have been willing to offer.
2. The process of negotiating with the special committee is a costly one and can be time-consuming.
3. A transaction that is subject to the entire fairness standard of review may attract more stockholder litigation than a transaction subject to a lower standard of review.

A transaction structured according to the Unilateral Approach has several advantages from a controlling stockholder's perspective, including the following:

1. It is not subject to the heightened entire fairness standard of review.
2. It avoids the often time-consuming and intricate process of negotiating with a special committee and allows the controlling stockholder to proceed even if the special committee rejects the offer. (Despite the absence of such a requirement, controlling stockholders typically opt for the formation and involvement of special committees in unilaterally structured transactions.)
3. It gives the controlling stockholder the ability to modify the terms and conditions of its original offer without obtaining approval of the special committee.

A transaction structured according to the Unilateral Approach also has several disadvantages from a controlling stockholder's perspective.

1. It does not necessarily have the benefit of the endorsement and support of the target company's directors and, as a result, has a higher risk of being perceived negatively by the market. This holds true for only a third of all transactions though—the vast majority of going-private transactions adopting the Unilateral Approach involve a special committee.
2. It will be more difficult for the controlling stockholder to raise financing for all or a portion of the transaction consideration. As demonstrated in the facts underlying the recent *Hollinger*

decision, the controlling stockholder will also have significant limitations on its ability to share confidential information with third parties.[116]

3. In the event that the acquisition of ninety percent of the shares of each class of target stock turns out to be difficult, the controlling stockholder may be forced to pursue a long-form merger (which would include many of the steps in the Traditional Approach and would be subject to the enhanced scrutiny of the entire fairness standard).

VII. FEDERAL LAW DISCLOSURE CONSIDERATIONS

A. *Rule 13D/13G Disclosure*

As an initial matter, a controlling stockholder must be mindful of its obligation to amend its Schedule 13D or Schedule 13G if any material change occurs in the information set forth, including with respect to plans or proposals the controlling stockholder has regarding a going-private transaction.[117] A controlling stockholder should take care to ensure that its analysis and evaluation of a potential going-private transaction does not inadvertently trigger a public disclosure obligation. Disclosures made in response to this item often include a statement by the controlling stockholder that it has submitted a proposal as well as the text of the actual proposal. In both the Bancwest transaction, implemented under the Traditional Approach, and the Prodigy Communications transaction, implemented under the Unilateral Approach, the controlling stockholder chose to announce its proposal in its amended Schedule 13D and attached the actual text of its proposal letter delivered to the board of the target company.

B. *Rule 13e-3 Disclosure*

Rule 13e-3 of the Securities Exchange Act of 1934 imposes certain disclosure requirements upon the bidder and the target in an acquisition transaction, such as that contemplated here, where the controlling stockholder is an affiliate of the target and the target's stock will cease to be publicly traded. For purposes of the federal securities laws, a Rule 13e-3 transaction[118] is defined as

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[116] *See* Hollinger Int'l, Inc. v. Black, 844 A.2d 1022 (Del. Ch. 2004).

[117] 17 C.F.R. § 240.13e-3 (2004).

[118] *Id.*

> any transaction or series of transactions involving a purchase of equity securities of an issuer or a solicitation of stockholders of an issuer (which solicitation is subject to the U.S. proxy rules), in each case, by an affiliate of such issuer, where the effect is to cause (1) any class of the issuer's securities which is registered under the Exchange Act to cease to be held of record by less than 300 persons or (2) any class of equity securities of the issuer which is either listed on a national exchange or authorized to be quoted on an inter-dealer quotation system to be neither listed nor quoted on such systems.[119]

In the particular type of going-private transaction discussed in this article, the controlling stockholder would be an affiliate of the public company.

Because of the potential for abuse that arises when a controlling stockholder is on both sides of a going-private transaction, the SEC seeks to maximize procedural fairness by requiring, and closely scrutinizing, substantial disclosure related to the terms and the fairness of the transaction. Rule 13e-3 requires the issuer and any of its affiliates engaging in a Rule 13e-3 transaction to file a Schedule 13E-3 Transaction Statement with the SEC and to disseminate the additional disclosure to stockholders with the tender or exchange offer or proxy solicitation materials related to the merger, depending on the form of the transaction and whether it is organized under the Unilateral or Traditional Approach. If the transaction is structured as a tender offer, it will be governed by the Exchange Act and the other related offer materials will consist of: (1) a Schedule TO filed with the SEC; (2) an offer to purchase distributed to the target company's stockholders; and (3) a variety of documents used to encourage and assist the company's stockholders in tendering their shares. The rules relating to disclosure in the context of such an offer will provide basic information about the trading price and dividend history of the target company's shares over the preceding two years and certain financial information (e.g., audited financials for the last two years, unaudited balance sheets, income statements, cash flow statements, and material pro forma information). To the extent applicable, the requisite financial information can be incorporated by reference from other recent filings made by the company with the SEC. In the case of the exchange offer, a prospectus registering the securities that will be issued in exchange for the company's shares must

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[119]Rule 13 Filing of Schedules 13D and 13G, 17 C.F.R. § 240.13d-1(2004). An "affiliate" of an issuer is a person that directly or indirectly through one or more intermediaries controls, is controlled by, or is under common control with such issuer.

be filed with the SEC on a Form S-4 and be disseminated to the target company's stockholders with the offer materials. The Form S-4 must provide a business description of the controlling stockholders and the target company and describe the terms of the offer in detail.

The Schedule 13E-3 Transaction Statement is generally considered a more onerous disclosure document because, in addition to the ordinary disclosure items required, the Schedule 13E-3 requires a significant number of additional disclosures. In particular, disclosure will need to be made about the fairness of the transaction to the minority stockholders and additional exhibits will need to be filed with the SEC. Among other things, Schedule 13E-3 must include detailed disclosure of:

1. The structure and purpose of the transaction, including descriptions of alternatives considered, reasons for the structure and timing of the transaction, and the effects on the unaffiliated stockholders of the target (Schedule 13E-3, Items 6,7);
2. The reasonable judgment of the bidder and target regarding whether the transaction is fair to unaffiliated target stockholders (Schedule 13E-3, Item 8);
3. The material factors relied upon by the bidder and target in making such fairness evaluation, including the weight given to each factor (Schedule 13E-3, Item 8); and
4. All outside reports, opinions, and appraisals materially related to the transaction, including any related to the consideration to be offered or the fairness of the transaction to unaffiliated stockholders (Schedule 13E-3, Item 9).

C. *Schedule 14D-9 Disclosure*

Pursuant to Rule 14e-2, the target company must publicly state its position with respect to the tender or exchange offer within ten business days of the offer's commencement by filing a Schedule 14D-9 with the SEC.[120] The Schedule 14D-9 typically requires:

1. Information with respect to the company and the securities subject to the offer (Schedule 14D-9, Item 1);

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[120] 17 C.F.R. § 240.14e-2 (2004).

2. A summary of the background of the negotiations between the special committee and the controlling stockholder (Schedule 14D-9, Item 3); and
3. The recommendation of the special committee, stating whether the stockholders should accept or reject the tender offer or take other action, the reasons for such recommendation and whether any executive officers or directors of the target company currently intend to tender their shares into the offer (Schedule 14D-9, Item 4).

Given its importance to the target company, this part of the disclosure can be fairly detailed. In the Sodexho Marriott Transaction, which was structured under the Traditional Approach, the special committee gave a number of reasons for its ultimate recommendation in favor of the transaction, including the operating and financial condition of the target company, the premium for the offer price per share to recent market prices per share, the form of consideration (i.e., cash), the statement by the controlling stockholder that it would not consider a sale of its interest in the company, the fairness opinion of its financial advisor and the limited conditions to closing. In the Travelocity Transaction, which was executed pursuant to the Unilateral Approach, the special committee presented a similar set of reasons and, in addition, considered the volatile nature of the industry and the long-term prospects of the target company when determining whether to recommend the offer.

D. *SEC Review*

The Schedule 13E-3 and related materials described above will be reviewed by the staff of the SEC, which may (and usually does) elect to issue written comments on such filings. In the event that the SEC issues comments, the filer will be required to address the SEC's concerns by amending the filed materials. In the event that the required revisions are sufficiently substantial, the revised offer documents may also have to be recirculated to the stockholders. Aside from the significant resources a bidder and the target company will have to expend in preparing, printing and distributing supplementary filing materials, such a recirculation, although a rare event, can cause a considerable delay in closing the contemplated transaction. This could further delay the transaction by requiring the tender offer to be held open longer. In our experience, however, the SEC is more likely to issue comments requiring substantial revision, and perhaps recirculation of offer documents, if the customary procedures intended to help achieve procedural fairness are not observed.

VIII. CONCLUSION

This article has approached going-private transactions from a practitioner's point of view. Although the Unilateral Approach has not been fully accepted by the marketplace, its future significance is beyond question. Given that the Unilateral Approach (1) allows for a speedier and less burdensome implementation of going-private transactions, (2) results in more modest price increases as a result of negotiations between the special committee and the controlling stockholder and (3) avoids the exacting entire fairness standard of review, it is surprising that the Unilateral Approach has not yet been adopted more widely.

The tardy evolution of the Unilateral Approach may in part be due to the fairly recent development of the underlying case law. The court of chancery issued its *Siliconix* and *Glassman* decisions in June and July 2001, respectively, and the *Pure* decision in October 2002. While *Weinberger*'s entire fairness decision has dominated the transactional universe since 1983, the Unilateral Approach is a relative newcomer subject to the skepticism of many practitioners. As a result, practitioners appear to be more comfortable with the Traditional Approach, which firmly established the use of special committees to protect against the onus of entire fairness review. It seems that practitioners have been wary about the Unilateral Approach's survival in the Delaware courts and have, as a precautionary matter, relied on the well-established Traditional Approach. In considering the alternatives available to a client seeking to go private, the development of Delaware law in this field bears close watching. While the Delaware judiciary has established a number of well-defined parameters for such transactions, it is likely to refine its jurisprudence in the coming years. Practitioners, as they review the options available to them and select between the two competing models, are likely, however, to see a shift in the transactional landscape towards the Unilateral Approach.

ANNEX A

SPECIAL COMMITTEE PROCESS AND BEST PRACTICES CHECKLIST[1]

1. FORMATION

Following the receipt of the controlling shareholder's proposal, the board of directors should take the following actions:

- Creation: The board of directors should create a special committee by appointing disinterested and independent directors to be its members.[2]
- Selection: Management should be excluded from the selection of special committee members.
- Size of the Special Committee: The committee should be composed of at least, but preferably more than only, one member.
- Power of the Special Committee: The committee should be given the authority to respond to the proposal by negotiating the price, the terms and conditions, and to approve or reject the offer or make requisite recommendations.

2. FIRST STEPS OF THE COMMITTEE

The special committee should:

- Retain disinterested legal and financial counsel in order to:
  - Recognize the special committee's role as an aggressive promoter of the interests of minority shareholders;
  - Commence the diligence process as early as possible;
- Shield the selection of advisors against the influence of the controlling shareholder, management or the target's in-house counsel;
- Understand that advisors owe duties to the corporation and shareholders, not to management;

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[1]This checklist incorporates the list presented in Patricia R. Hatler et al., *Bulletproof Your Special Committees in Interested Fiduciary Transactions*, J. AM. CORP. COUNSEL ASS'N DOCKET (2001) at 36, 50.

[2]If no disinterested and independent directors are available, the directors may increase the size of the board.

- Expect legal advisors to take an active role in the negotiation process; and
- Ask for written fairness opinions from financial and legal advisors.

3. OPERATION OF THE SPECIAL COMMITTEE

The special committee should:

- Replicate an arm's-length negotiation, i.e., negotiate the price and terms and conditions of the offer;
- Act in a fully informed manner—use its advisors to gather the necessary information and have access to all relevant information; and
- Freely function without interference and resist any favoritism toward management or a controlling shareholder.

4. SUCCESS OF THE NEGOTIATION AND COMPLETION OF THE TRANSACTION

- If such negotiations are successful, (1) a merger agreement setting out the terms and conditions upon which the minority stockholders are to be cashed out is recommended by the special committee, approved by the company's board of directors, and then signed by the company and the controlling stockholder and (2) a settlement agreement is entered into with the stockholder plaintiffs;
- The controlling stockholder and the company complete the transaction pursuant to the terms of the merger agreement;
- If the transaction is structured as a long-form merger, the company prepares a proxy or information statement and related filings and seeks stockholder approval, with the transaction being closed thereafter;[3]
- If the transaction is structured as a two-step tender offer/short-form merger, the controlling stockholder launches a cash tender offer for the minority shares in the first step, and accomplishes a short-form merger (by filing a certificate with the Secretary of State of Delaware, if ninety percent of the

[3]Stockholders who vote against the merger will have appraisal rights under Delaware law. For a comprehensive discussion regarding the appraisal remedy, see Jesse A. Finkelstein & Travis Laster, *Appraisal Rights in Mergers and Consolidations*, 38-4th C.P.S. (BNA).

shares of each class are obtained in the tender offer) in the second step to freeze-out any non-tendering stockholders (or a long-form merger by seeking shareholder approval as described above, if ninety percent of each class is not obtained in the tender offer);

- The special committee should negotiate to ensure that completion of the transaction be conditioned upon approval by a majority of the minority stockholders. Although not legally required, such a condition, as noted above, would shift the burden of proof in a fairness hearing to the plaintiff stockholders. The burden of demonstrating adequate disclosure would, however, remain with the proponents of the transaction.

ANNEX B

CASE HISTORIES: CERTAIN TRANSACTIONS CONDUCTED ACCORDING TO THE TRADITIONAL APPROACH

I. EXPEDIA TRANSACTION

Controlling Stockholder:	InterActiveCorp (f/k/a USA Interactive)
Controlling Stockholder Interest Prior to Offer:	95% voting control; 64% ownership interest
Transaction Value:	$2.8 billion
Date Announced:	June 2002; March 2003
Date Commenced:	March 18, 2003
Consideration:	Initial exchange ratio of 1.35 to 1; final exchange ratio of 1.94 to 1
Conditions:	No majority of the minority-voting requirement. Transaction subject to approval of holders of majority of outstanding voting shares of expedia; since IAC holds 95% of voting shares, approval was ensured.
Special Committee:	Formed June 3, 2002 and March 13, 2003. Initially declared offer inadequate, dissolved and then reconstituted committee after revised offer, later recommended offer after price increase.
Result:	IAC controlled 100% of stock following exchange offer. Executed as a forward subsidiary stock-for-stock merger.

II. BANCWEST TRANSACTION

Controlling Stockholder:	BNP Paribas
Controlling Stockholder Interest Prior to Offer:	45%
Transaction Value:	$2.5 billion
Date Announced:	Mid-February, 2001
Date Commenced:	May 8, 2001

Consideration:	$32 per share, raised to $35
Conditions:	No majority of the minority voting requirement. Transaction subject to approval of holders of two thirds of outstanding voting shares of BancWest; BNP agreement to vote its 45% of voting shares in favor of transaction.
Special Committee:	Formed on April 6, 2001. Initially declared offer inadequate, later recommended offer after price increase.
Result:	BNP controlled 100% of stock following transaction. Executed as a forward subsidiary stock-for-stock merger.

III. NORTEK TRANSACTION

Controlling Stockholder:	Kelso & Company LP (a/k/a K Holdings Inc.)
Controlling Stockholder Interest Prior to Offer:	16% Shareholder, 92% Voting Power
Transaction Value:	$1.2 billion
Date Announced:	Mid-February, 2002
Date Commenced:	June 20, 2002
Consideration:	$40 per share, raised to $46
Conditions:	No majority of minority voting requirement. Transaction subject to affirmative vote of majority of outstanding common shares
Special Committee:	Formed on April 6, 2002. Initially declared offer inadequate, later recommended offer after price increase.
Result:	Kelso controlled 100% of stock following recapitalization. Executed as a recapitalization transaction.

IV. SODEXHO MARRIOTT TRANSACTION

Controlling Stockholder:	Sodexho Alliance SA
Controlling Stockholder Interest Prior to Offer:	47%
Transaction Value:	$1.2 billion

Date Announced:	January 24, 2001
Date Commenced:	May 1, 2001
Consideration:	$27 per share, raised to $32
Conditions:	Tender of majority of the shares outstanding on a fully-diluted basis.
Special Committee:	Formed on January 29, 2001. Initially declared offer inadequate, later recommended offer after price increase.
Result:	SBC controlled 93% of stock following tender offer. Executed as two-step transaction: first-step tender offer, followed by second-step merger.

V. SPRINGS INDUSTRIES TRANSACTION

Controlling Stockholder:	Heartland Industrial Partners LP
Controlling Stockholder Interest Prior to Offer:	41%
Transaction Value:	$466 million
Date Announced:	February 20, 2001
Date Commenced:	April 24, 2001
Consideration:	$44 per shares, raised to $46
Conditions:	No majority of minority voting requirement. Transaction subject to affirmative vote of majority of outstanding common shares.
Special Committee:	Formed on February 22, 2001 Initially declared offer inadequate, later recommended offer after price increase.
Result:	Heartland controlled 100% of stock following tender offer. Executed as two-step transaction: first step tender offer, followed by short-form merger.

ANNEX C

CASE HISTORIES: CERTAIN TRANSACTIONS CONDUCTED ACCORDING TO UNILATERAL APPROACH

I. TRAVELOCITY TRANSACTION

Controlling Stockholder:	Sabre Holdings Corporation
Controlling Stockholder Interest Prior to Offer:	70%
Transaction Value:	$422 million
Date Announced:	February 19, 2002
Date Commenced:	March 5, 2002
Consideration:	$23 cash per share, raised to $28
Conditions:	Minimum condition of 90% after tender offer. Tender of majority of the minority shares.
Special Committee:	Initially declared offer inadequate, later recommended offer after price increase.
Result:	Sabre controlled 96% of stock following tender offer. Sabre completed a short-form merger.

II. SPECTRA-PHYSICS TRANSACTION

Controlling Stockholder:	Thermo Electron
Controlling Stockholder Interest Prior to Offer:	79%
Transaction Value:	$33 million
Date Announced:	August 22, 2001
Date Commenced:	November 16, 2001
Consideration:	$20 per share, reduced to $17.50 before offer commenced
Conditions:	Minimum condition of 90% after tender offer. Condition non-waivable unless majority of the minority tender.
Special Committee:	Refused to take a position.
Result:	Thermo Electron controlled 94% of stock following tender offer.

	Thermo Electron completed a short-form merger.

III. PRODIGY COMMUNICATIONS TRANSACTIONS

Controlling Stockholder:	SBC Communications Inc.
Controlling Stockholder Interest Prior to Offer:	42%
Transaction Value:	$407 million
Date Announced:	September 21, 2001
Date Commenced:	October 2, 2001
Consideration:	$5.45 cash per share, raised to $6.60
Conditions:	Tender of majority of the minority shares. No 90% minimum.
Special Committee:	Initially refused to take a position, later recommended offer after price increase.
Result:	SBC controlled 91% of stock following tender offer. SBC completed a short-form merger.

IV. EUROWEB INTERNATIONAL TRANSACTIONS

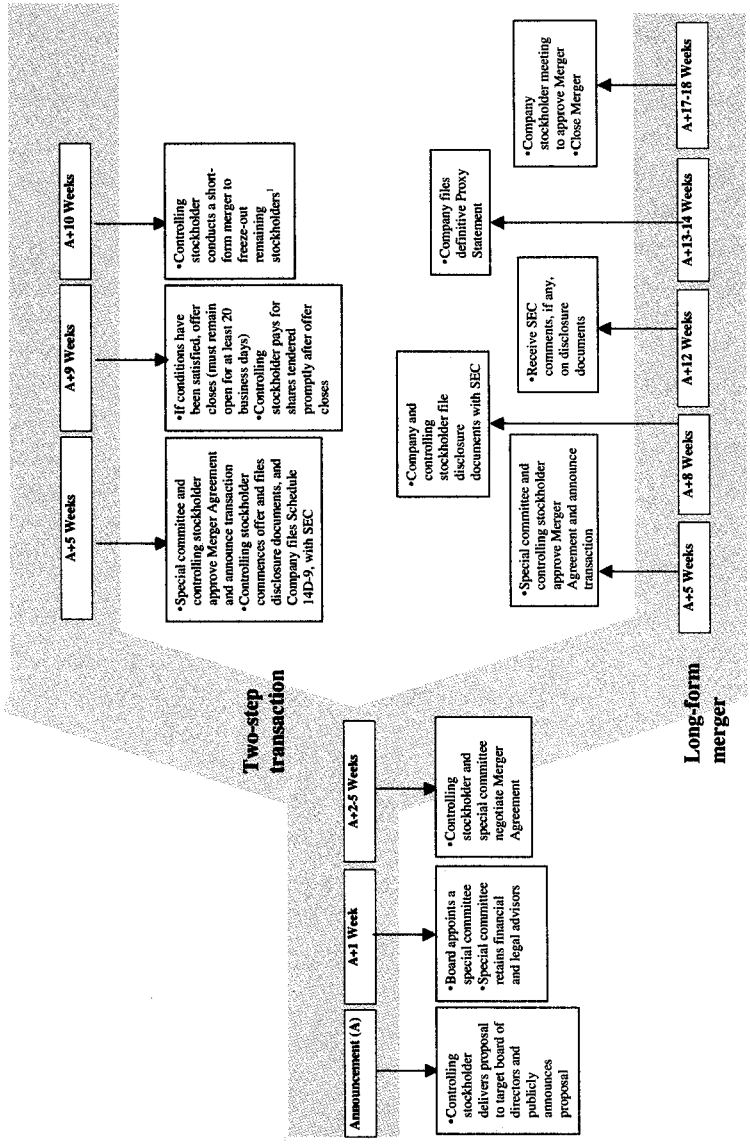
Controlling Stockholder:	Everest Acquisition Corp. (wholly owned subsidiary of Koninklijke KPN N.V.)
Controlling Stockholder Interest Prior to Offer:	52.8%
Transaction Value:	$11.7 million
Date Announced:	February 20, 2002
Date Commenced:	February 20, 2002
Consideration:	$2.25 cash per share, raised to $2.70
Conditions:	90% minimum condition, non-waivable, if less than a majority of the minority shares were tendered.
Special Committee:	Determined offer was inadequate and recommended stockholders reject offer and not tender shares.

Result:	KPN did not accept any tendered shares, and all shares previously tendered were returned.

V. NRG ENERGY TRANSACTION

Controlling Stockholder:	Xcel Energy Inc.
Controlling Stockholder Interest Prior to Offer:	74% shareholder, 97% voting power
Transaction Value:	$510 million
Date Announced:	February 13, 2002
Date Commenced:	March 13, 2002; April 4, 2002
Consideration:	Initial exchange ratio of 0.49 to 1; final exchange ratio of 0.5 to 1
Conditions:	Minimum condition of 90% of the outstanding common stock of NRG
Special Committee:	Formed on March 4, 2002. Initially declared offer inadequate, later recommended offer after price increase.
Result:	Xcel controlled 96% of stock following tender offer. Executed as two-step transaction: first-step tender offer, followed by second-step merger.

ANNEX D



[1]This illustrative timeline presumes that in a two-step transaction with a first-step tender offer, the offer results in the controlling stockholder controlling at least 90% of each class of the stock of the target. If this does not occur, the controlling stockholder will have to undertake a long-form merger, which will follow a process similar to the long-form merger after A+5 weeks.

ANNEX E

ILLUSTRATIVE SUMMARY TIMELINE FOR UNILATERAL APPROACH[1]

Announcement (A)	Following Announcement	A+2 Weeks	A+2-4 Weeks	A+6 Weeks	A+7 Weeks
•Controlling stockholder publicly announces intention to commence tender offer and key terms of offer	•Board appoints a special committee to evaluate proposal •Special committee retains financial and legal advisors and begins to evaluate controlling stockholder's proposal	•Controlling stockholder commences offer and files disclosure documents with SEC	•Special committee determines whether to recommend acceptance or rejection of offer, or to express no opinion, and files Schedule 4D-9 (within 10 business days of commencement of offer)	•If conditions have been satisfied, offer closes (must remain open for at least 20 business days) •Controlling stockholder pays for shares tendered promptly after offer closes	•Controlling stockholder conducts a short-form merger to freeze out remaining stockholders[1]

[1]This illustrative timeline presumes that the tender offer remains open for the minimum amount of time permitted, and results in the controlling stockholder controlling at least ninety percent of each class of the stock of the target.