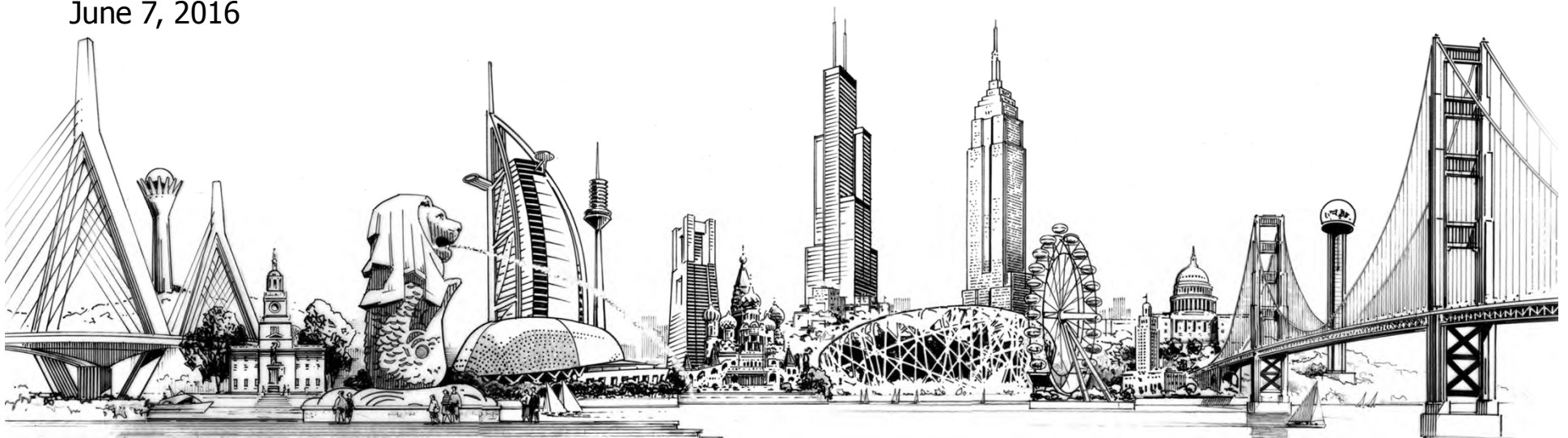


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WHAT TO EXPECT IN M&A LITIGATION / PRIVILEGED COMMUNICATIONS AND CONFLICT ISSUES IN M&A TRANSACTIONS

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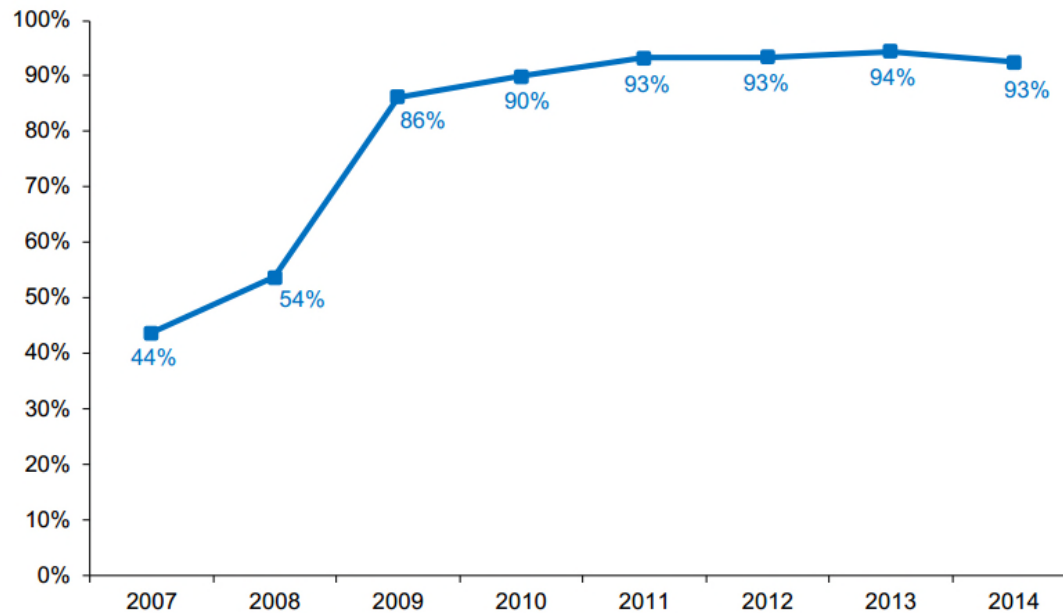
WHAT TO EXPECT IN M&A LITIGATION

Overview

- The Modern M&A Litigation Boom
- Recent Developments Intended to Curb M&A Litigation
- Evolving Appraisal Actions

The M&A Litigation Boom

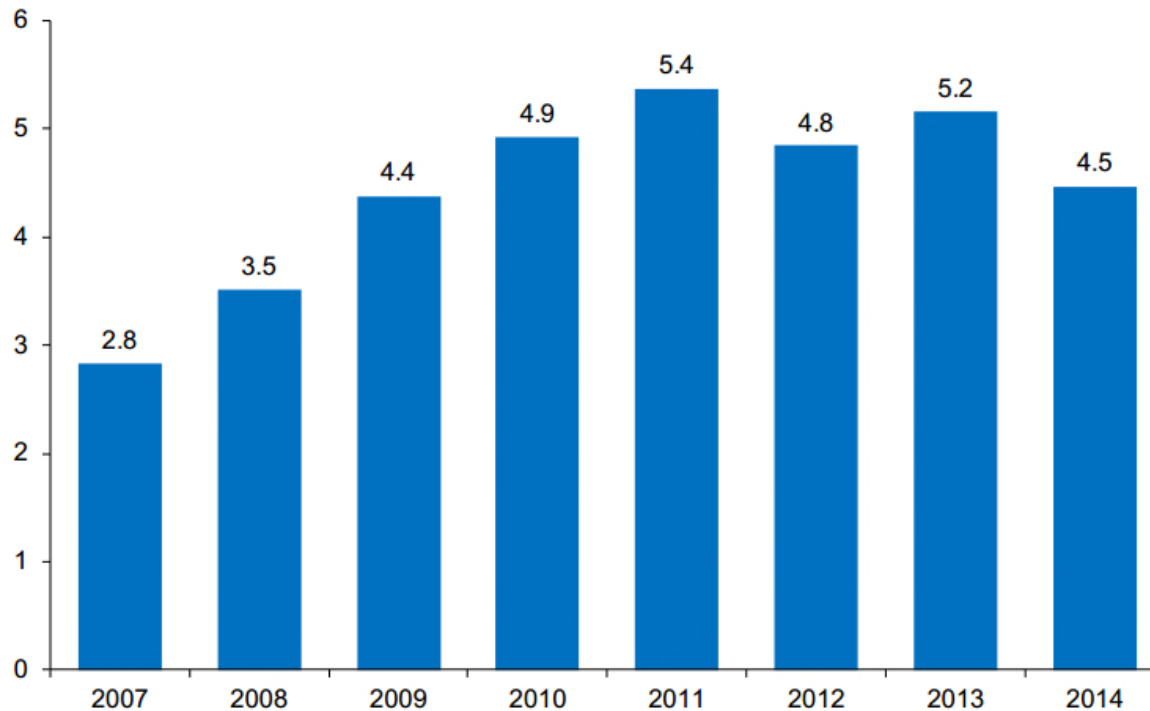
- Since 2009, the plaintiffs' bar sues on virtually *all* mergers involving large public companies (valued at more than \$100 million).



Source: Thomson Reuters SDC; SEC Filings
Note: Percentages have been rounded to the nearest whole number.

M&A Litigation Has Exploded

- Average of more than four lawsuits filed per deal.



Multi-Jurisdictional M&A Litigation

- In 2014, 40% of M&A litigation was filed in more than one jurisdiction.
- Some plaintiffs' firms have made it their business model to sue outside of Delaware.
- “[W]hy do we have multiple cases here? . . . [Q]uite frankly, it’s in the interest of *plaintiffs’ counsel*, not in the interest of stockholders. Stockholders don’t have any reason to want multiple forums. . . . This suit is in Minnesota because of . . . Robbins Geller and Robbins Umeda[.] . . . When Lerach Coughlin, the predecessor to Robbins Geller, split off from Milberg, they said, as their business plan, we are going to sue elsewhere. We’re not going to sue in Delaware. It was widely known among those of us who did this type of work, [and] it’s also documented in a law review article where the author interviewed one of the Robbins brothers.” Vice Chancellor Laster, *In re Compellent Technologies* (2011).

Multi-Jurisdictional M&A Litigation (cont'd)

- Delaware Chancery Court (often the state of incorporation):
 - Most experienced bench for corporate/M&A litigation
 - Vast body of well-developed case law, supporting predictability of outcomes
- Other state courts:
 - Plaintiffs seek to avoid scrutiny of their claims by experienced Delaware bench
 - Plaintiffs also seek to gain a seat at the settlement bargaining table.
- Federal courts for securities law claims
- Defendants' strategy is usually a motion to stay the non-Delaware actions

Types of M&A Claims

- Breach of fiduciary duty by the target company's board of directors
- Aiding and abetting breach of fiduciary duty by the acquiring company
- Securities law claims (e.g., Section 14(a) disclosure claims)

Typical Breach of Fiduciary Duty Claims

- *Revlon* claims (the board must act to get the highest price reasonably available)
 - Unfair price claims
 - Unfair process claims
- Disclosure claims
- The “ubiquitous” shareholder claims are that “the target board breached its fiduciary duties by failing to maximize the value of the entity, locking up the deal impermissibly in the acquirer’s favor, and disseminating a proxy statement containing material misstatements or omissions.” Vice Chancellor Parsons, *Dent v. Ramtron* (2014).

Revlon Unfair Price Claims

- Plaintiff alleges that the target company's board undersold the company.
- Price claims are made even when premiums exceed 50%-60% above market price.
- Complaints often include quotes from companies' optimistic press releases announcing deal and industry commentary to suggest that the target company's prospects were better than the deal the board made.

Revlon Unfair Process Claims

- Plaintiff alleges that the board failed to conduct an adequate sales process.
 - Board failed to conduct an adequate pre-agreement market check.
 - Process favored eventual acquirer over potentially better alternatives; often paired with claims regarding post-merger employment agreements and change-of-control payments for executives.
 - Board “locked up” the proposed transaction with restrictive deal-protection devices (e.g., “no-shop” clause, matching rights, termination fee, voting agreements).

Disclosure Claims

- Plaintiff alleges that the proxy omitted material information (shareholders cannot make informed vote).
- “Material” means a reasonable shareholder would consider the information important in making a decision about shares (not “more details please”).
- Common claims include failure to disclose:
 - Management’s projections.
 - Specific financial metrics used in the banker’s financial analyses, such as discounted cash flow analysis (standard is a “fair summary of the banker’s work”).
 - Perceived conflicts of interest for banker, legal advisor (*Del Monte* is archetypal conflicts case).

Disclosure Claims Are the Plaintiffs' Key Claims for Leveraging a "Deal Tax" Settlement

- The failure to disclose material information in the proxy results in irreparable harm
- When there is the threat of irreparable harm, courts may award injunctive relief – i.e., enjoin the merger
- Plaintiffs seeking a preliminary injunction will therefore move for expedited discovery
- If permitted, expedited discovery is costly and distracting
- Most cases quickly settle thereafter

“Disclosure Only” Settlements

- Most frequent form of resolution of M&A litigation
- Target agrees to make supplemental disclosures
- Plaintiffs agree to a broad release on behalf of class
- Target agrees not to oppose plaintiff’s motion for an award of attorney’ fees, not to exceed \$ _____ (typically between \$300k and \$500k)
- According to Cornerstone, nearly 80% of all settlements were “disclosure only” settlements for 2011-2014

Plan Of Attack – Capitalizing on Recent Developments Curbing M&A Litigation

- Forum Selection Clauses
- Opposing Motions to Expedite
- Mooting Disclosure Claims

Plan Of Attack – Forum Selection Clauses

- In response to multi-district M&A litigation, some companies began to adopt forum selection by-laws, requiring all disputes concerning the internal affairs of the company to be litigated in Delaware
- On 2015, Delaware approved legislation permitting Delaware corporations to adopt forum selection clauses in their charter or by-laws specifying Delaware as the exclusive forum for litigating internal corporate claims
- Several states have enforced these forum selection clauses, rejecting plaintiffs' attempts to litigate outside of Delaware (California, New York, Texas)
- Moreover, courts have approved target boards adopting forum selection by-laws in conjunction with approving a merger

Plan of Attack – Opposing Motions To Expedite

- Opposing plaintiff's motion to expedite—the key battleground in current M&A litigation
- Standard to obtain expedited discovery:
 - Colorable claim, and
 - Sufficient threat of irreparable harm
- Irreparable harm arises typically by inadequate disclosure
- Courts have acknowledged the M&A litigation boom and heightened the standards for plaintiffs to obtain expedited proceedings
- *Acme Packet* and *LeCroy* cases

Plan of Attack—Opposing Motions To Expedite

- Alleged inadequate disclosure generally falls into two categories:
 - Materially incomplete disclosures
 - “More information please”
- Convince the court that the disclosure claims merely seek more information, not *material* information
- Numerous Delaware cases now rejecting motions to expedite for failure to plead a colorable disclosure claim
 - *In re Stourbridge Investments* – defendants *consented* to expedited discovery, Chancellor Laster denied:
“Given the nature of the complaint and its significant weaknesses, I have to believe that ***this case is really a harvesting case not a litigating case. I am not going to facilitate leverage to create a harvest settlement in a case like this where there’s been absolutely no colorable reason for anyone to be concerned about this deal.*** The fact that the defendants have agreed to expedition, I think, is entirely logical given the fact that the Brodsky firm opened a second front. That doesn’t mean that it is a good investment of social resources or this Court’s resources to expedite something under these circumstances. So for all those reasons, I am denying the motion.”

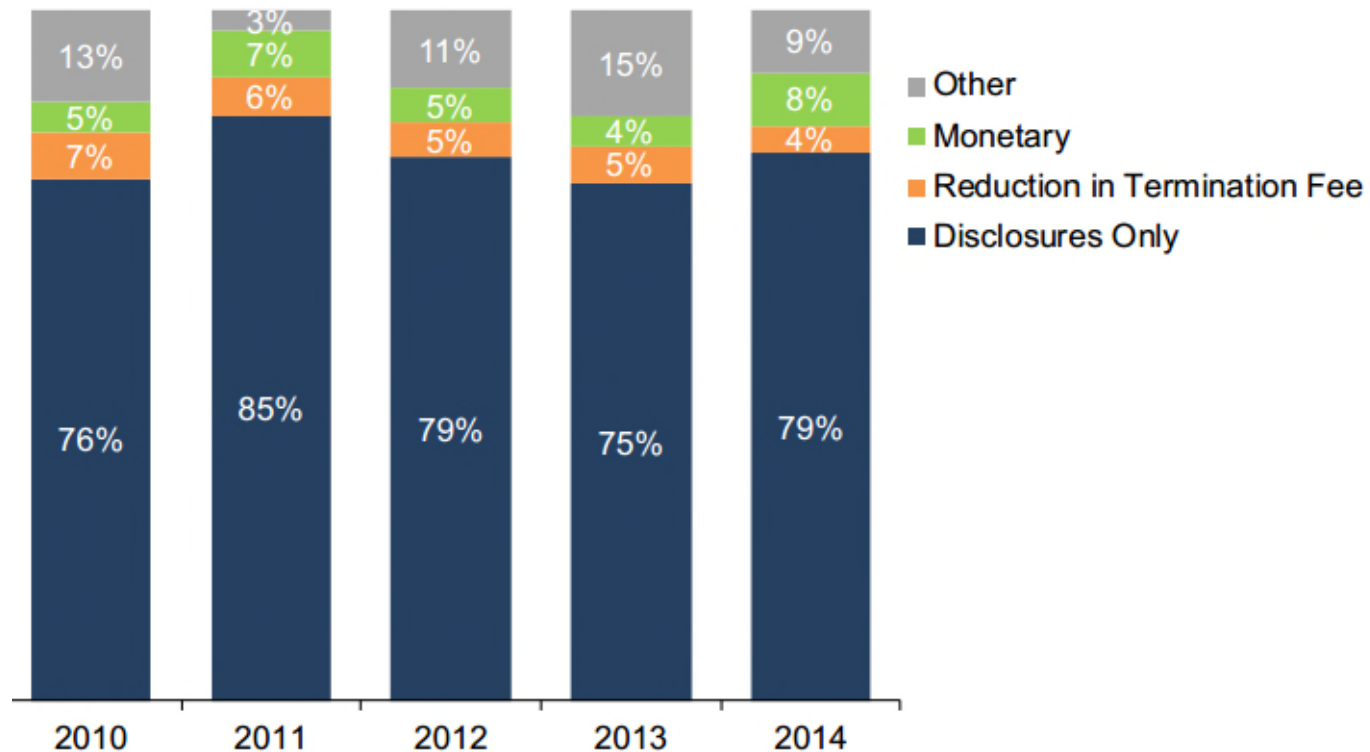
Plan of Attack – Mooting Disclosure Claims

"Disclosure-only" Settlement: A negotiated resolution of an M&A case where the target agrees to make supplemental disclosures and will not object to plaintiffs' motion for attorney fees up to some stated amount (often \$300k-\$500k) in exchange for a broad release that is binding on all shareholders

- "Disclosure-only" settlements have received increased scrutiny in recent years
- The Chancery Court has become more skeptical that the supplemental disclosures are not in fact material, yet the settlement includes a broad release that is binding on all shareholders

Plan of Attack – Mooting Disclosure Claims

- Despite a slight decline in 2014, the vast majority of settlements are still disclosure-only.



Plan of Attack – Mooting Disclosure Claims

- *In re Trulia Shareholder Litigation*

In *Trulia*, Chancellor Bouchard refused to approve the typical disclosure-only settlement, and, in a strongly worded opinion, stated that *the court will no longer approve disclosure-based settlements unless*

- (a) the supplemental disclosure to be made is “plainly material” and
- (b) the release is narrowly crafted.

- *Trulia* sounds the death knell of disclosure-only settlements where the alleged disclosure inadequacies are not “plainly material” – or as Chancellor Bouchard writes, “not a close call.”
- It also negates the benefit that defendants received in these settlements – absolute protection of additional litigation with a broad release

Plan of Attack – Mooting Disclosure Claims (cont'd)

- In *Trulia*, the Chancellor endorsed the “mootness fee scenario” as a mechanism to resolve disclosure claims.
- Defendants make the disclosures requested, and claims become moot.
- Plaintiff’s attorneys can then petition the court for a “mootness fee” and the defendants can object to the amount of the fee .
- Thus the court can assess the value of the supplemental disclosures in the context of an adversarial proceeding.
- While disclosures mooting a claim do not include a class-wide release, other stockholders would be unlikely to commence litigation after a mootness dismissal.

Appraisal Actions

- Issue: What is the fair value of the plaintiff's shares at the time of the company's proposed sale?

WHAT IS FAIR VALUE?

- In Delaware, the "market price" in an arm's-length deal without a seriously flawed sale process will control. *See In re Appraisal of Ancestry.com.*
- If not an arms' length transaction, the court will be willing to consider standard valuation methods – like DCF.
 - *In re Appraisal of Dell*: May 31, Vice Chancellor Laster held Michael Dell's going-private deal undervalued shares by 22%, applying DCF

Appraisal Actions – Timing

- Governed by statute.
- Company must notify shareholders of appraisal rights at least 20 days before shareholder meeting.
- Shareholders electing appraisal must deliver a written demand to the company before the vote occurs (perfecting appraisal rights).
 - Voting against the merger does not automatically perfect appraisal rights.
 - Failing to vote against the merger precludes appraisal. *See In re Appraisal of Dell* – ISS mistakenly voted T. Rowe Price's shares in favor; \$100 million loss.
 - Election for appraisal means you're not entitled to the merger consideration.
- Within 10 days of the merger, the company must notify those seeking appraisal that the merger has been executed.
- Within 120 days of the merger, shareholders electing for appraisal must file appraisal petitions; if they do not, appraisal rights can be lost.

Appraisal Actions – Interest

- Also governed by statute.
- Interest is paid on any appraisal award (no matter what it is) at 5% above the Federal Reserve discount rate, compounded quarterly, unless the court decides for good cause that the interest should be otherwise (which is very unlikely).
- Interest is calculated from the effective date of the merger through the date of payment of the judgment.
- Interest can be paid even if merger consideration is deemed fair value. *See In re Ancestry.com.*

Appraisal Arbitrage

- An investment strategy of acquiring an equity position in a cash-out merger target with the specific intention of exercising appraisal rights
 - Both *Dell* and *Ancestry.com* were arbitration cases
- Unlike shareholder derivative litigation, plaintiffs need not own shares at the time the merger is announced – i.e., they can purchase the shares any time prior to the meeting for the purpose of bringing litigation
- The pay-off is any award of value above the merger consideration, with statutory interest added – a near risk-free return five% above the Federal Discount rate

Appraisal Arbitrage – Possible Legislative Responses

- **The Corporation Law Section of the Delaware State Bar Association recently approved proposed legislation to amend the DGCL.**

De Minimis Exclusion

- Under the proposed rules, stockholders otherwise entitled to appraisal rights will not be entitled to appraisal under the following circumstances:
 - Total number of shares is less than or equal to 1% of the outstanding shares of the class or series; or
 - The value of the consideration (based on the deal price) for the total number of shares for which appraisal is sought is less than or equal to \$1 million.
 - Applies only to shares previously listed on a national stock exchange and does not apply in connection with a short-form merger pursuant to Section 253 or 267 of the DGCL.

Pre-Judgment Payments

- A company may reduce the amount of interest that accrues during the appraisal process by making a cash payment to stockholders seeking appraisal in advance of the court's final judgment determining the fair value of the stock. The amount of any such prepayment will be at the discretion of the company. Under the current regime, unless the court determines otherwise for good cause, interest will accrue on the ultimately appraised value of the shares from the effective date of the merger at a rate of 5% over the Federal Reserve discount rate, compounded quarterly.

PRIVILEGED COMMUNICATIONS IN THE M&A CONTEXT

Topics Covered

- Issues on Preserving Privilege in the M&A Context
- Post-closing Disputes and Privilege
- Certain Conflict Issues

Attorney-Client Privilege

- Any communication
- made between privileged persons
- in confidence
- for the purpose of obtaining or providing legal assistance for the client.

“Privileged persons” include the client, the attorney(s), and any of their agents that help facilitate attorney-client communications or legal representation.

Restatement (Third) of the Law Governing Lawyers §§ 68, 70 (2000)

Attorney Work-Product Immunity

- Work product consists of tangible material or its intangible equivalent... prepared by a lawyer for litigation then in progress or in reasonable anticipation of future litigation.
- Work product is generally immune from discovery and other compelled disclosure.

Restatement (Third) of the Law Governing Lawyers § 87 (2000)

Attorney-Client Privilege Waiver

- The attorney-client privilege is waived if the client, the client's lawyer, or another authorized agent of the client voluntarily discloses the communication in a non-privileged communication.

Restatement (Third) of the Law Governing Lawyers § 78 (2000)

Attorney Work-Product Immunity Waiver

- Work-product immunity is waived if the client, the client's lawyer, or another authorized agent of the client...discloses the material to third persons in circumstances in which there is a significant likelihood that an adversary or potential adversary in anticipated litigation will obtain it.

Restatement (Third) of the Law Governing Lawyers § 91 (2000)

The Real World of M&A

- Purchaser is negotiating a possible merger with Seller. During negotiations, Seller discloses a privileged document to Purchaser regarding either pending or potential litigation against Seller. The negotiations break down. Later on, another party seeks discovery of that document.
- Is the document still privileged?

The Modern Common Interest Doctrine

- In general terms, the Common Interest Doctrine allows:
 - two or more clients with a common interest
 - in a litigated or nonlitigated matter
 - that are represented by separate lawyers
 - who agree to exchange information concerning the matter
 - in a communication that otherwise qualifies as privileged if made between an attorney and client
 - to be privileged as against third persons
- Unless the clients have agreed otherwise, a communication is not privileged as between the clients in a subsequent adverse proceeding between them.

The Questions in the M&A Context

- What state law will apply to privilege issues?
- Do the parties have a common interest?
 - If so, when does it arise? How far along must negotiations be?
 - Does the applicable state law require that litigation be anticipated at the time of disclosure?
 - Under applicable state law, does the Common Interest Doctrine extend to communications among advisors to the contractual parties (for example, bankers) as compared to the parties themselves?

Practical Tips for Protecting Privileged Documents

- Best to satisfy disclosure and due diligence concerns without disclosing privileged materials. In preparing data rooms or other general due diligence disclosures, assume that all material disclosed will not be privileged. So – do not put privileged materials in a data room before assessing the risk of losing the privilege.
- Disclosure of privileged materials later in the process is better, e.g., after a signed merger agreement or letter of intent.
- In assessing disclosure risks, determine what laws could apply. The issue of waiver will be litigated in the forum in which the litigation takes place and use the law of that jurisdiction.
 - Federal Rule of Evidence 501
- A common interest agreement provides evidence of a reasonable expectation of confidentiality required to invoke the Common Interest Doctrine and can help protect attorney work-product immunity.

Practical Tips for Protecting Privileged Documents

- Use confidentiality agreements that limit the receiving party's use of the material. Include copying restrictions and require that the materials be returned.
- The structure of the transaction matters.
- Disclosure to financial advisers or lenders will likely lead to a waiver of privilege.
- The communication should only be shared with the attorneys for the parties—preferably outside counsel. Sharing the communication directly among the parties may destroy the privilege.

Post-closing Disputes and Privilege

Question – After the sale of a company, who holds the attorney-client privilege relating to the target company's communications with counsel:

- Target?
- Seller?
- Buyer?

Post-Closing Disputes and Privilege

Fact pattern

- Seller has negotiated the sale of its subsidiary, Target, to Buyer.
- There are many pre-closing communications between Target management and counsel to the Seller.
- In a post-closing dispute, Seller asserts attorney-client privilege with respect to these communications.
- Who owns the privilege?

Post-Closing Disputes and Privilege

Two courts have come up with different results

Delaware – Great Hill Equity Partners VI L.P. v. SIG Growth Equity Fund I, LLP

- Delaware court held that, in connection with a merger of a Delaware corporation, the surviving corporation owns and controls any attorney-client privilege that might attach to pre-merger communications.
- The court relied on Delaware General Corporation Law, Section 259, which provides that following a merger, “all property, rights, privileges, powers and franchises, and all and every other interest shall be thereafter as effectually the property of the surviving or resulting corporation...”
- The court noted, however, that parties to a merger agreement can negotiate and have negotiated, special contractual agreements to prevent privileged information from transferring to the surviving corporation in the event of a merger.

Post-Closing Disputes and Privilege

New York – Tekni-Plex, Inc. v. Meyner & Landis

In connection with a merger, several months after the merger, new Tekni-Plex (the acquiror) commenced an arbitration against Tom Y.C. Tang (the former sole stockholder) alleging breach of representations and warranties contained in the merger agreement regarding old Tekni-Plex's compliance with environmental laws.

One of the issues before the court was whether confidential communications between old Tekni-Plex and its counsel generated during the law firm's prior representation of the company on environmental compliance matters passed to new Tekni-Plex. In evaluating this issue, the court separated these communications into two categories:

- General business communications
- Communications relating to the merger negotiations

Post-Closing Disputes and Privilege

With respect to general business communications, the court found that new Tekni-Plex's management continued the business operations of the pre-merger entity. Control of the attorney-client privilege with respect to business operations therefore passed to the new management, and new Tekni-Plex had the authority to assert the attorney-client privilege to preclude disclosing the contents of these communications. (89 N.Y.2d at 136-37.)

However, with respect to communications arising out of the merger negotiations, new Tekni-Plex did not succeed to old Tekni-Plex's right to control the attorney-client privilege. The court found that:

- New Tekni-Plex's claims did not derive from the rights it inherited from old Tekni-Plex, but from the rights retained by the buyer, TP Acquisition, with respect to the transaction.

Post-Closing Disputes and Privilege

- Under the merger agreement, the rights of old Tekni-Plex with regard to disputes arising from the merger transaction remained independent from, and actually adverse to, the rights of the buyer. Therefore, during the dispute, new Tekni-Plex could not both pursue the rights of TP Acquisition and assume the attorney-client privilege of the buyer's adversary, old Tekni-Plex.
- Because one individual, Tang, solely owned and managed the seller company, allowing new Tekni-Plex access to the confidences conveyed by the seller to its counsel during the negotiations would be the equivalent of turning over to the buyer all of the seller's privileged communications conveying the very transaction at issue. Under these circumstances, granting new Tekni-Plex control over the attorney-client privilege as to communications concerning the merger would thwart, rather than protect, the purposes underlying the privilege.

Post-Closing Disputes and Privilege

As discussed above, Delaware and New York courts have taken different approaches to determining ownership of pre-merger attorney-client communications post-closing. In general, however, the trend emerging seems to follow a “practical consequences” approach, which focuses on the degree of control transferred rather than the particular mechanics of the transaction.

Under this approach, the authority to assert or waive the attorney-client privilege will follow to the new ownership if the practical consequences of the transaction result in both:

- The transfer of control of the business, and
- The continuation of the business under new management.

Post-Closing Disputes and Privilege

What Companies Can Do to Protect the Privilege Regarding Pre-Closing Communications

Given the focus on the specific facts of each transaction and the lack of a bright-line rule as to which entities will control the attorney-client privilege after a corporate transaction, companies should be proactive and account for what will happen to attorney-client communications post-closing. Specifically, companies should:

- Determine under which state law the agreement is governed and whether there is an applicable statute.
- Consider which categories of communications are particularly sensitive to disclosure.
- Take permissible proactive steps to indicate that certain communications are privileged.
 - Removal of material from Target's computer files.
 - Archiving certain records.
- Specify in the agreement which entity and what types of communications will retain control of the privilege post-closing, to the extent allowed under applicable law.
- Consider determining the monetary value of attorney-client communications and allocating consideration to a provision dealing with privilege.

Certain Conflict Issues

Question – Can a law firm (or internal counsel) who represented the Seller and the Target in a sale subsequently represent the Seller in claims asserted by the Buyer and the Target?

Fact Pattern:

- ABC law firm represents Seller and Target in connection with the sale of Target to Buyer.
- The acquisition agreement provides that Seller will indemnify the Buyer and Target against certain liabilities.
- Post-closing, Buyer and Target make asset indemnification claims, and seek to disqualify ABC firm from representing Seller.

Certain Conflict Issues

Legal Issues:

- Sometimes it is unclear whether ABC law firm represented Seller, or Target, or both.
- Under applicable ethical rules, ABC law firm may be precluded from representing Seller in disputes with Target, a former client, on matters that related to the scope of the engagement with Target.

How to address – With a waiver by Target and Buyer waiving any conflict and agreeing that ABC law firm can represent Seller.

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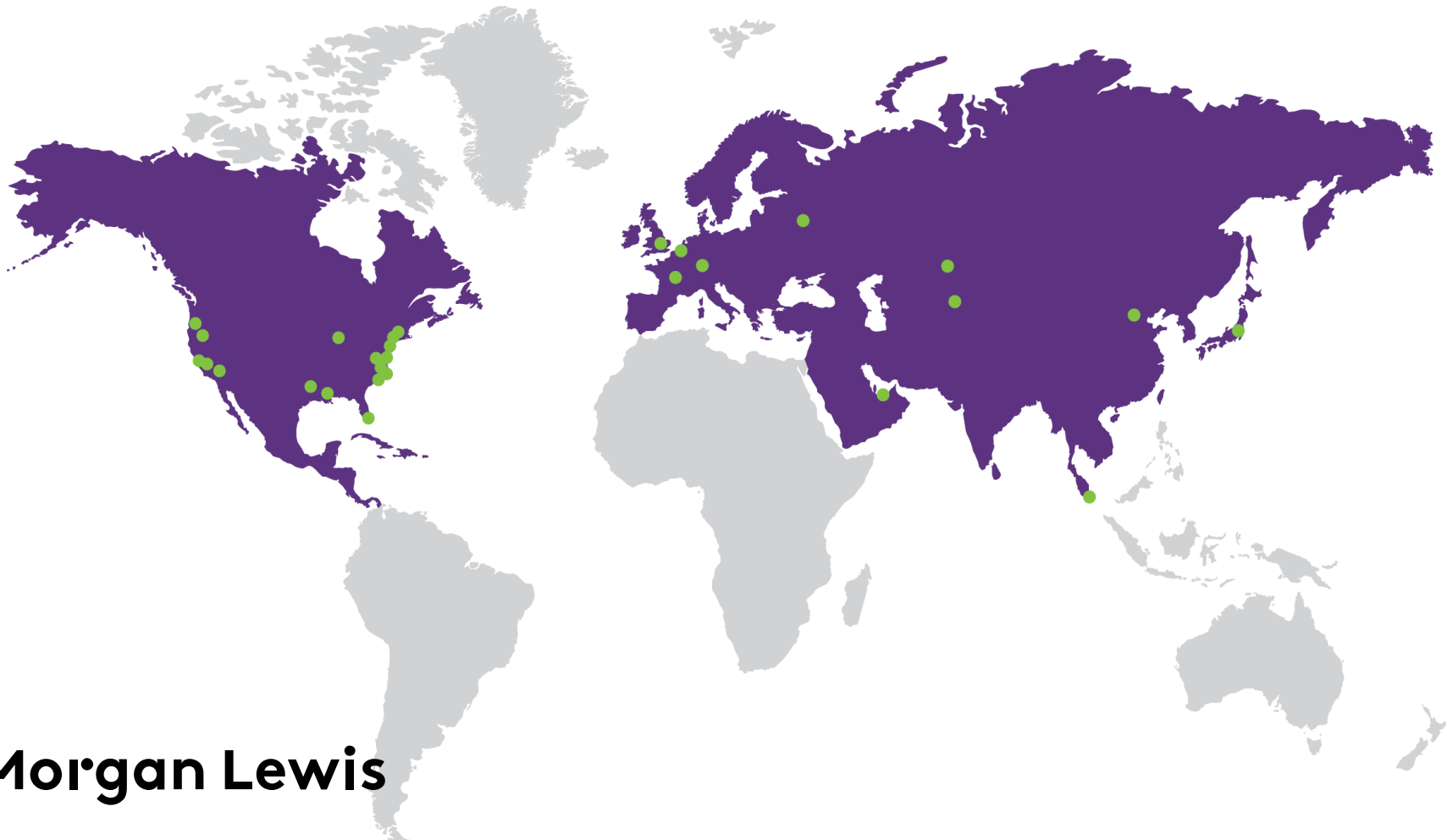
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