PRACTICE PERSPECTIVES: MERGERS & ACQUISITIONS

letter from the practice chairs

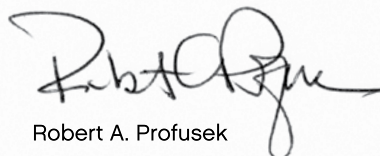
M&A volume last year exceeded $1.9 trillion globally on more than 30,000 deals, numbers that haven't been seen since the height of the technology boom in 2000. December 2004 alone saw $300.8 billion in announced deals, including five of the year's 10 biggest transactions, and accounted for 15.4 percent of the year's total. The high activity level continues, with more than $1.2 trillion in announced deals in the first half of 2005.

Jones Day's M&A Practice is enjoying a boom of its own. In 2004, the Firm (which since 2000 consistently has ranked #1 for number of deals worldwide) advised on more than 550 announced transactions. Some of our more notable deals last year included advising Nextel Communications in its $46.5 billion merger with Sprint, R.J. Reynolds in its $10 billion combination with Brown & Williamson, Morgan Stanley Real Estate in the $8.6 billion buyout of Britain's Canary Wharf, J.C. Penney in its $4.5 billion sale of Eckerd Drug to Jean Coutu Group and CVS, Albertsons in its $2.5 billion acquisition of Shaw's Supermarkets, and Sumitomo Chemical in its $2.2 billion merger with Dainippon Pharmaceutical. In 2005, we're continuing our winning streak, signing the $17 billion acquisition of May Department Stores for longtime client Federated and completing the $4.8 billion sale of International Steel Group for WL Ross.

During the last few years, as the corporate landscape transformed in the wake of passage of the Sarbanes-Oxley Act, increased shareholder activism, and other trends, we have observed a sea change in the way M&A deals are done. The capital markets are more cautious and, in some instances, skeptical regarding merger benefits, and top management is far less likely to take risks or reach for the "transforming" transaction. Corporate boards that may have approached deals from a presumption of acceptance have become more deeply engaged, asking penetrating questions about the potential risks and liabilities involved. In this setting, we recognize the need to change the way we do business. Instead of focusing our most valuable resources on the drafting and negotiation of merger documentation and SEC rules and filing requests, we are leading the way in the evolution of a multidisciplinary approach to M&A transactional advice. We address the issues that management and the board really care about, drawing on our depth of experience in a wide range of practice disciplines as well as our geographic diversity, to help our clients assess the potential risks in any proposed transaction, thereby better protecting their interests and those of their shareholders.

The articles that follow will provide you with an overview of our practice, along with a case study of one of our most complex, and successful, recent engagements. In addition, we offer three articles addressing recent developments affecting our practice: the effect of institutional shareholder activism on executive compensation, the Delaware courts' recent decisions on appraisal proceedings, and a comparison between the recently adopted EU directive on takeover bids and U.S. tender offer practices. We hope that you will find them informative and helpful. ■

Lyle G. Ganske



Robert A. Profusek

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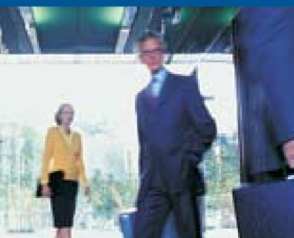

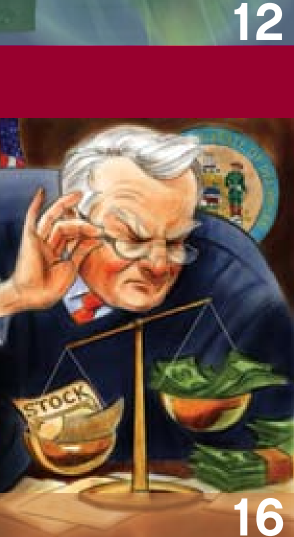

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JONES DAY'S MERGERS & ACQUISITIONS

Jones Day's Mergers & Acquisitions Practice is the largest single component of our nondisputes business and is among the largest M&A practices in the world.

We represent bidders, targets, financial advisors, merchant bankers, and other parties in deals ranging from small, privately negotiated transfers of shares or assets to leveraged buyouts, domestic and cross-border public company combinations, joint ventures and strategic alliances, bankruptcy buyouts and other distressed M&A transactions, going-private transactions, and contested takeovers. Our lawyers are effective at both the negotiating table and in the boardroom, with significant experience with respect to regulations under the Sarbanes-Oxley Act, including independence requirements for members of the board and financial expert and other audit committee requirements. We benefit from a broad and diverse client base, resulting in lawyers with knowledge and experience in a wide range of industries.

Jones Day regularly ranks among the top law firms for the representation of principals in M&A transactions in all published league tables. Since 2000, the Firm consistently has been ranked #1 for number of deals worldwide by both

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Thomson Financial and Bloomberg. In the past five years, Jones Day has advised on more than 2,750 completed M&A transactions worldwide, including more than 400 deals involving at least $100 million.

Interdisciplinary teaming is the central concept underlying our approach to substantial M&A assignments. Our M&A Practice team is composed of corporate, tax, and regulatory lawyers who are recognized for their substantial knowledge, creativity, and intensity. Our objective in any client engagement is to bring the Firm's extensive experience and scalable resources to bear on a real-time, cost-effective basis.

Parties to M&A transactions are increasingly likely to be based in two or more countries. Jones Day's global presence is a great benefit to companies involved in such transactions. With 30 locations in centers of business and finance throughout the world, Jones Day is positioned to do business where our clients do business. ■

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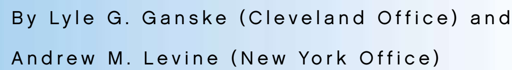
By Lyle G. Ganske (Cleveland Office) and
Andrew M. Levine (New York Office)

SHAREHOLDER ACTIVISTS ATTACK PARACHUTE PAYMENTS IN M&A TRANSACTIONS

It would be an understatement to say that the world of corporate governance has changed. While the first few rounds of reform were handed down to boards in the form of legislation, SEC implementation, and governance ratings criteria from independent firms, the tide has shifted to the shareholder/company relationship. The withholding of shareholder votes during Disney's 2004 proxy process is probably the most well-known recent manifestation of shareholder dissatisfaction, but Disney was by no means alone last year. According to an article by a representative of Institutional Shareholder Services, or ISS, an independent proxy and advisory firm, shareholders withheld 30 percent or more of the votes from at least one director of AOL Time Warner, Starwood Hotels & Resorts, and others. Not to be outdone, earlier in 2004, the California Public Employees' Retirement System, or CalPERS, was on pace to withhold votes for directors at 90 percent of its investments, and Vanguard Group, the second-largest U.S. mutual fund, approved only 29 percent of the full slates of nominated directors of companies in which it invested.

Of course, embedded in the media's coverage of Disney was the issue of executive compensation. Shareholders have joined the media's party and filed proposals targeted at executive compensation at a variety of companies, including HP, Alcoa, and Sprint, and it now seems clear that executive compensation has stolen the focus from the traditional anti-takeover targets of governance reformists, such as classified boards and poison pills. In fact, two highly publicized transactions, AXA Financial's acquisition of MONY and Anthem's acquisition of WellPoint, have brought shareholder activism and executive compensation into the M&A arena. This should come as no real surprise, given that the announcement of a transaction typically rings the bell for the final round of shareholder participation for the target company.

Disgruntled shareholders have a variety of tools at their disposal to further their agenda. The arsenal includes, in escalating order, making public statements criticizing the company, making precatory shareholder proposals, soliciting support from independent proxy firms, organizing and holding investor conferences, withholding votes, engaging in proxy contests, and initiating litigation, both in the traditional sense and pursuant to the exercise of dissenters' rights. In fact, given the emergence of new and flexible valuation models and courts' recent willingness to find dissenters' rights actions favorable for class certification, dissenters' rights have become an increasingly prevalent tool for shareholder attacks on M&A transactions. The MONY and WellPoint acquisitions, in which shareholders utilized several of these tools, provide a blueprint for institutional shareholders targeting parachute payments.

AXA FINANCIAL, INC.'S ACQUISITION OF THE MONY GROUP INC.

In September 2003, AXA Financial and MONY announced that the financial services firms had entered into a merger agreement under which AXA Financial agreed to acquire MONY in a cash transaction valued at approximately $1.5 billion, representing an approximately 6 percent premium to MONY's closing share price on the day before the announcement. The merger agreement permitted MONY to pay a preclosing cash dividend to its shareholders of up to $12.5 million ($0.23 to $0.25 per share, according to AXA Financial and MONY public filings) and was conditioned on holders of not more than 10 percent of the outstanding shares perfecting their appraisal rights.

According to preliminary proxy materials filed by MONY, MONY executives had the potential to receive approximately $90 million (or 6 percent of the transaction consideration) under change-in-control agreements if their employment terminated for customary reasons following the transaction. MONY also disclosed that it amended its existing change-in-control agreements with 13 of its executive officers months earlier, in anticipation of the transaction, to reduce the potential payouts under the agreements. The original payouts would have netted management approximately 15 percent of the merger consideration, and the payment reduction resulted in a dollar-for-dollar increase to the public holders.

Between late September and early October 2003, 10 shareholders filed class action lawsuits in the Delaware Court of Chancery that were subsequently consolidated and followed by an amended complaint in early November. The complaint alleged inadequate merger consideration and a breach of fiduciary duties by the MONY board of directors for, among other reasons, improperly diverting merger consideration from shareholders to management under the change-in-control agreements.

Despite these lawsuits and two similar lawsuits filed in New York State Supreme Court, MONY filed its definitive proxy statement in early January 2004 and set a shareholder meeting date of February 24, 2004. The proxy statement indicated that 11.5 percent of MONY's shareholders had already demanded appraisal by this time.

In late January 2004, institutional shareholders Highfields Capital and Southeastern Asset Management (in its capacity as investment advisor to Longleaf Partners Small Cap Fund) announced their intent to vote their MONY shares against AXA Financial's offer. Southeastern Asset's initial press release indicated that the purchase price was significantly below MONY's book value. Southeastern Asset also noted that senior management's interests conflicted with the overall shareholder base (stating that a 1 percent to 1.5 percent payout to management was customary) and that "[i]n view of MONY's performance since the IPO and the inadequate price negotiated with AXA . . . senior management should be

Whereas judicial deference to the board's decision-making process, of course, can help boards in lawsuits, the use of the media and other tools to oppose payments to management bypasses the judicial process and therefore can render a board's rationale irrelevant in the forum of public opinion.

replaced, not rewarded." Similarly, Highfields Capital stated in a letter to shareholders that the sale was driven by "the desires of MONY's current management, which [had] failed miserably to enhance MONY's value." Both institutions indicated their intention to communicate with other shareholders through exempt proxy solicitations.

Amid additional public statements by the institutional shareholders, MONY filed a lawsuit in the U.S. District Court for the Southern District of New York seeking to enjoin the institutional shareholders from including MONY's proxy card in its correspondence with shareholders.

Later in February 2004, the Delaware Court of Chancery held in the class action suit that the MONY board had *not* breached its fiduciary duties in entering into the merger agreement. The court required MONY to amend its proxy disclosure to clarify that the change-in-control payments were in excess of the amount paid in comparable transactions (*i.e.,* above the 75th percentile, which was determined to be slightly lower than 5 percent).

Shortly thereafter, MONY announced that the merger agreement had been amended to permit an additional $0.10 dividend to MONY shareholders and to modify AXA Financial's closing condition relating to appraisal rights in MONY's favor. Senior management voluntarily agreed to give up certain contractual rights by reducing their change-in-control payments by $7.4 million ($4.8 million after tax) to fund the additional dividend on a dollar-for-dollar basis. At the same time, the board postponed the meeting until May 18, 2004, and established a new record date of April 8, 2004.

Also at the end of February, ISS issued a recommendation that MONY shareholders vote against the proposed merger, stating that "the lack of an auction process to sell the company, rich goodbye package to management and the company's historical underperformance to peers, creates a mosaic of management actions not serving shareholder interests." Glass, Lewis & Co., another proxy firm, issued a similar recommendation and noted that "the decision to throw in the towel was appreciated, no doubt, by the management team, which likely sees this transaction as a way to both mask its own failures and collect tens of millions in golden parachutes."

Despite the flurry of opposition and litigation, MONY shareholders voted in favor of the deal, although just barely, and the acquisition was completed in early July 2004.

ANTHEM, INC.'S ACQUISITION OF WELLPOINT HEALTH NETWORKS INC.

In October 2003, Anthem and WellPoint Health Networks announced that Anthem would acquire WellPoint for approximately $16.4 billion. While opposition to Anthem's acquisition has received significant press coverage, shareholders of both companies overwhelmingly approved the transaction in late June 2004.

Earlier in June 2004, CalPERS, a shareholder of both Anthem and WellPoint, announced that it would oppose the transaction as a result of executive compensation packages it estimated at more than $600 million for 293 executives. WellPoint consistently argued that the actual eligible payments were between

$147 million (if all executives stayed and received retention bonuses) and $356 million (if all executives were dismissed within three years). The California State Treasurer, who is also a CalPERS board member, joined in CalPERS' opposition and expressed his concern that California ratepayers would be indirectly funding the payments. According to the news media, other shareholder groups opposing the merger included the California State Teachers' Retirement System, the New York State Common Retirement Fund, the New York State Teachers' Retirement System, the Los Angeles County Employees' Retirement System, and the Illinois State Board of Investment.

Unlike in the AXA/MONY transaction, ISS issued a recommendation in favor of the WellPoint acquisition. In recommending the deal, ISS noted that, in the context of evaluating goodbye packages, it is "primarily concerned with the potential for rich exit payments to adversely affect the negotiation of deal terms from the perspective of the non-insider shareholder." As a result, ISS focused not on the aggregate payments to all executives, but rather on the payments to the top 12 executive officers—those likely to be at the negotiating table. Given Anthem's public representations that the vast majority of executives would stay and CalPERS' apparent double counting of severance and retention bonuses, ISS concluded that $200 million (or 1.1 percent of the deal value) was the more likely payout. Acknowledging that the size of the payout raised a "red flag," ISS concluded that the potential negative effects were outweighed by the significant premium paid in the transaction (approximately $4.6 billion), the strategic rationale for the transaction, the expected cost and revenue synergies, and Wall Street's response to the transaction.

Prior to the shareholder vote, the California State Insurance Commissioner made it clear that he would not support the acquisition unless Anthem agreed to invest hundreds of millions of dollars on health care programs, arguing that without the investment, the merger offered no benefit to state residents. In late July, he ultimately denied the approval request, despite Anthem's and WellPoint's offer to spend nearly $500 million in state programs and to defer $100 million of the compensation packages. Anthem subsequently sued the Commissioner in early August, and the case was dropped in November after the Commissioner dropped his opposition in exchange for the companies agreeing to spend $265 million on health programs and not to raise premiums to pay for the merger. In May 2005, the Commissioner began an investigation into whether post-merger premium increases were used to cover merger transaction costs.

Motivated by what they deemed to be "lavish rewards" as a result of mergers engineered by executives, several CalPERS board members, including the California State Treasurer, late last year requested that CalPERS take the lead in enlisting other institutional investors and setting tough new executive severance policies with the goal of mounting a national campaign against executive compensation and merger plans that do not comply with their guidelines. The suggested model policy would prohibit accelerated vesting of options for top executives in mergers, place limits on the size of severance payments, and preclude 280G gross-ups.

WHAT'S IN STORE

The MONY and WellPoint acquisitions have resulted in more than interesting reading. While it can be said that CalPERS picked the wrong battle in that it misunderstood the potential payments and that much of the opposition to the Anthem/WellPoint merger had at least as much to do with protecting California residents as Anthem shareholders, the transaction nonetheless instigated the CalPERS board members' announcement of their intention to reform a system that in their view unfairly compensates management at investors' expense. AXA Financial's acquisition of MONY, on the other hand, was the perfect storm for shareholder revolt—a seemingly excessive goodbye kiss for management in a deal priced at 75 percent of book value. The transaction also resulted in federal case law that restricts the use of a company's proxy card in communications by dissident shareholders and Delaware case law that requires increased disclosure regarding executive compensation in certain circumstances. More important, though, both transactions illustrate yet another avenue for chipping away at a board's decision-making ability.

It is no secret why golden parachutes exist. Although it was largely ignored in the media coverage of these transactions, the governance community believes that golden parachutes serve as antitakeover protection and are therefore viewed

with suspicion as mechanisms to entrench management. This view, however, ignores the real purpose of change-in-control payouts, which is ironically the same reason that the governance community initially embraced parachutes. Golden parachutes are designed to attract and retain executives and make them neutral to mergers, thereby removing one impediment to a company sale. In other words, boards want management to act in the best interests of the shareholders, and sometimes that means deciding to sell the company in the face of a probable termination of employment. A golden parachute softens the landing.

But the opposition to the MONY and WellPoint acquisitions turned that logic on its head. The shareholders' complaints were based on the premise that management will in fact push for a transaction that is bad for the company and its investors in order to trigger their own compensation payments. Aside from the fact that this directly contradicts the governance community's view that golden parachutes inherently entrench management, this argument presupposes, as does most of the reformists' logic in the post-Enron world, that executives are motivated solely by greed. And it also presupposes that a board is unable to make determinations about executives' conflicts, their ability to act in the best interests of their shareholders, and other relevant factors when approving change-in-control contracts. Whereas judicial deference to the board's decision-making process, of course, can help boards in lawsuits, the use of the media and other tools to oppose payments to management bypasses the judicial process and therefore can render a board's rationale irrelevant in the forum of public opinion. Circumstances can be conveniently ignored because the bottom-line size of payments to executives evokes the most visceral public reactions.

Although the '80s and '90s helped prepare companies for attacks by corporate raiders, shareholder activism is a different kind of attack, and defending against it in the context of an M&A transaction arguably is as—or more—complicated than defending against a takeover. Boards, companies, and practitioners can, of course, hope that shareholder challenges to executive compensation in M&A transactions will be limited to outlying situations such as the MONY acquisition; however, given the fact that CalPERS' crusade was instigated by a transaction involving customary parachute payments and the overwhelming support of shareholders generally, it is probably naïve to count on it. As a result, companies can and should take preemptive measures to defend against these attacks, such as reviewing parachutes to ensure that executives are adequately protected and considering funding change-in-control payments upfront or in anticipation of a change in control. In addition, provisions can be added to parachute contracts to ensure that the payments will be triggered if the contract is terminated at the request of an acquirer prior to a change in control, in order to avoid manipulation of payments at executives' expense. ■

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THE EUROPEAN DIRECTIVE ON TAKEOVER BIDS: A COMPARISON WITH U.S. TENDER OFFER PRACTICES

by Jere Thomson (New York), Juergen Reemers (Frankfurt), Adrien Fournier De Launay (New York), Hanno Schultze Enden (Frankfurt), and Amanda Geday (London)

When the European Directive on Takeover Bids (the "Directive," available on the European Commission's web site at http://europa.eu.int/eur-lex/lex/LexUriServ/site/en/oj/2004/l_142/l_14220040430en00120023.pdf) went into effect on May 20, 2004, 30 years of controversial discussions among the EU Member States concerning the harmonization of national regimes on the acquisition of publicly listed companies finally came to an end. The key issue requiring compromise was the need for a level playing field in the market for corporate control of publicly listed companies in Europe.

Based on the U.K. takeover regime, the Directive provides for minimum standards that must be applied by the Member States. Although the Member States' takeover laws will follow the Directive's basic concepts, their laws will continue to differ in various areas.

This article describes certain key requirements imposed by the Directive and contrasts such requirements against U.S. tender offer practices, as appropriate.

THE DIRECTIVE'S KEY CONCEPTS AND CONTRAST AGAINST U.S. TENDER OFFER PRACTICES

The Directive's key concepts include the following topics:

Scope. The Directive applies if (i) the target company is organized under a Member State's laws, and (ii) the target's securities are admitted to trading on at least one of the Member States' regulated markets. Hence, the Directive does not apply to offers for shares issued by non-EU companies, even though such shares are admitted to trading on a Member State's regulated market. (For example, bids for Altria's (U.S.)

shares or Nestlé's (Swiss) shares on the Paris Euronext market would not fall within the scope of the Directive.)

In contrast, U.S. securities laws generally apply to all offers made in the U.S. or to U.S. persons, regardless of where the target is incorporated. The broad reach of U.S. securities laws reflects the SEC's fundamental goal of protecting U.S. investors regardless of the target's nationality.

Mandatory Bid. One of the Directive's key concepts is the equal treatment of the target's shareholders: *"all holders of the securities of an offeree company of the same class must be afforded equivalent treatment"* (Article 3.1(a)). In this spirit, bidders must make a mandatory tender offer for all of the target's outstanding shares upon reaching a Member State-specified ownership threshold. Minority shareholders must be offered an "equitable price" that reflects the highest price paid by the bidder for the target's shares over a six- to 12-month period prior to the offer.

In Europe, transfer of control has traditionally been effected through privately negotiated sales of large holdings. The Directive's mandatory tender offer requirement is meant to extend any premium paid for a control block in the target to the minority shareholders. In contrast, there is no similar mandatory tender offer concept under U.S. securities laws. In the U.S., a bidder purchasing a control block is generally not required to buy out the minority shareholders. In addition, the controlling shareholder selling its stake in the target need not share its premium with the minority shareholders.

The Directive's mandatory tender offer requirement also prevents a bidder from accumulating a large position in the target in the open market (*i.e.*, a "creeping takeover") without paying a premium for its stake or extending a tender offer for 100 percent of the target's shares. In the U.S., takeover defenses such as poison pills and state business combination statutes are available to target boards to protect against creeping takeovers.

It is unclear whether the Directive's mandatory tender offer mechanism will better protect minority shareholders' interests because Member States have a wide latitude in setting the triggering thresholds under the Directive and may choose relatively high thresholds (for example, 45 percent).

Disclosure. The Directive strengthens certain disclosure requirements regarding takeover defenses and employees. The Directive requires EU companies to disclose in their annual reports information relating to their capital structure, any restrictions on transfers of securities, any significant shareholdings and any special rights attaching to them, employee schemes, and restrictions on voting rights. EU companies must also disclose in their annual reports any shareholders' agreements of which they are aware, any significant agreements entered into by such companies that contain a change-in-control provision, and the effect of such provision. In addition, the board of directors must present an explanatory report on these disclosures to the general meeting of shareholders. In comparison, shareholders' agreements in the U.S. are disclosed by the shareholders themselves if they hold more than 5 percent of the target's outstanding securities.

Regarding employees, the Directive requires that the bidder and the target inform their respective employees of the bid once it is made public. In its offering documents, the bidder must disclose the impact of its strategic plans on the employees of both the target and the bidder, including the locations and places of business of both companies in the future. Similarly, the target board must give its views on the effects of the bid on employment, conditions of employment, and the locations of the target's places of business. In contrast, U.S. securities laws governing the content of tender offer documents do not specifically require the target or the bidder to address the implications of the bid on employment.

Type of Consideration. Under the Directive, the bidder may offer cash, securities, or a combination of both. However, the Directive imposes certain types of consideration in the circumstances described below.

If securities are offered as consideration without a cash alternative, such securities must be "liquid" and admitted to trading on a Member State's regulated market. As a consequence, a bidder with shares exclusively listed in the U.S. must obtain a secondary listing for its shares on a regulated market within the EU prior to offering such shares as consideration in a share-for-share transaction with an EU target. Obviously, this requirement will put U.S. bidders that do not have secondary listings in the EU at a serious disadvantage vis-à-vis other bidders that have listings in the EU.

The Directive also mandates a cash alternative in certain circumstances. A bidder must offer cash as an alternative to securities if it has paid cash for shares representing at least 5 percent of the voting rights in the target over a six- to 12-month period prior to the offer or during the offer. The exact length of this period will be defined by each Member State.

Finally, the Directive mandates a bidder to ensure that it can pay in full any cash consideration prior to announcing a cash bid. If the bidder intends to offer securities, it must take all reasonable measures prior to the announcement of the offer to "secure the implementation" of such consideration.

In the U.S., generally securities laws do not mandate a certain type of consideration to be offered to the target shareholders, apart from the requirement that the target shareholders must be afforded equal rights to elect any type of consideration among those offered by the bidder. U.S. securities laws require appropriate disclosure of the terms and conditions of the offer so as to allow the target shareholders and the target board to make a fully informed decision. Similarly, U.S. tender offer rules do not require bidders to secure appropriate financing prior to launching a cash bid or to take all reasonable measures prior to the announcement of an exchange offer to secure the implementation of the related stock consideration. Instead, the bidder must disclose the terms and conditions of its offer and its sources of funds.

Price. In a mandatory bid, a bidder must offer a set minimum "equitable price" for the target company's shares. Under the Directive, a price is deemed "equitable" if it equals the highest price paid by the bidder, or a party related to the bidder, for shares in the target over a six- to 12-month period prior to the offer. However, if the bidder offers a higher price to any shareholder during the offer, the "equitable price" must be raised to such higher price. In addition, Member States' supervisory authorities may adjust this highest price upward or downward in certain clearly defined circumstances, including: (i) bidder and seller set the highest price by agreement; (ii) market prices of the securities in question have been manipulated; (iii) market prices generally, or "certain market prices" specifically, have been "affected by exceptional occurrences"; and (iv) to enable the rescue of a firm "in difficulty."

In contrast, U.S. securities laws do not require the bidder to offer an "equitable" price to the target shareholders. Instead, the consideration paid to any target shareholder pursuant to the offer must be the highest consideration paid by the bidder to any other target shareholder during the offer.

Defensive Measures. Under Articles 9 and 11 of the Directive, shareholder approval must be obtained before a target board takes any action that may frustrate an offer. This rule, which is derived from the U.K. regulatory regime, is based upon the principle that target shareholders should have the right to decide on the merits of an offer without any management interference. By the same token, in a general meeting to approve such defensive measures, any voting restrictions contained in the target's charter or any shareholders' agreements would be deemed unenforceable. Similarly, provisions of the target's articles of association contemplating multiple voting rights would also be deemed unenforceable.

Because the implementation of Articles 9 and 11 would render EU companies vulnerable to non-EU bidders, such as U.S. companies that enjoy stronger defense mechanisms, each Member State may opt out of the implementation of these Articles. Even if a Member State decides to opt in, it may still

securities if it has paid cash for shares
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exempt targets from these Articles' application if the EU bidder is incorporated in a jurisdiction that has not adopted the same rules. This latter rule may disadvantage U.S. bidders in contested offers while competing with EU bidders incorporated in jurisdictions where the Articles are applicable. In addition, any Member States that opt out of Articles 9 and 11 must give EU companies with registered offices within their respective territory the option to opt in. Articles 9 and 11 have been the most controversial provisions of the Directive and will likely create many disparities among the takeover laws of the Member States.

In contrast, U.S. target boards are able to respond to hostile tender offers with a wide variety of defensive measures without the need for shareholder approval (*e.g.*, implementing poison pills, selling the target's crown jewels, granting lockup options to a white knight, and contractually binding the target to make severance payments to incumbent managers in the event of a change in control). In fact, almost 60 percent of S&P 500 companies have shareholders' rights plans in place, and 60 percent make use of a staggered board to retard a bidder's ability to gain control of the board and terminate the rights plan. However, the use of such defensive measures by U.S. boards is subject to the proper exercise of their fiduciary duties, and such actions are frequently challenged in court.

Squeeze-Out. The Directive mandates that Member States provide bidders with the right to squeeze out minority shareholders within a three-month period immediately following the end of the acceptance period "in one of the following situations": if the bidder (a) holds not less than 90 percent of the target's securities and 90 percent of the target's voting rights (Member States may increase this threshold up to 95 percent), *or* (b) acquires at the bid's closing 90 percent of the target's securities it did not already hold at the commencement of the offer. While scenario (a) refers to the post-offer shareholder structure in the target, scenario (b) refers to the degree to which the offer has been accepted. As a result, the bidder's strategy as to how to acquire control in the target may affect its ability to perform a subsequent squeeze-out of the remaining shareholders under scenario (b).

With regard to the type of consideration offered for the remaining shares, the Directive provides that it must be either the same as under the preceding offer or in cash, but Member States may require that cash must be offered as an alternative. The price for the remaining shares must be "fair." If a mandatory offer preceded the squeeze-out, the price set forth in that offer is always deemed fair. If a voluntary offer preceded the squeeze-out, the offer's price is deemed fair only if shares representing 90 percent of the share capital sought in the offer have been tendered thereunder.

In contrast, a 50.1 percent shareholder in the U.S. may cash out the remaining shareholders subject to such shareholders' appraisal rights. However, appraisal rights are not often exercised and provide limited relief to the cash-out shareholders. In addition, under New York, Delaware, and California corporate law, a shareholder owning 90 percent of a public or closely held company may squeeze out the remaining 10 percent shareholders without a shareholders' meeting, subject to such shareholders' appraisal rights.

Sell-Out. Under the Directive, if the bidder may perform a squeeze-out (as described above) at the end of the acceptance period, the remaining shareholders may in turn request the bidder to purchase their shares during a

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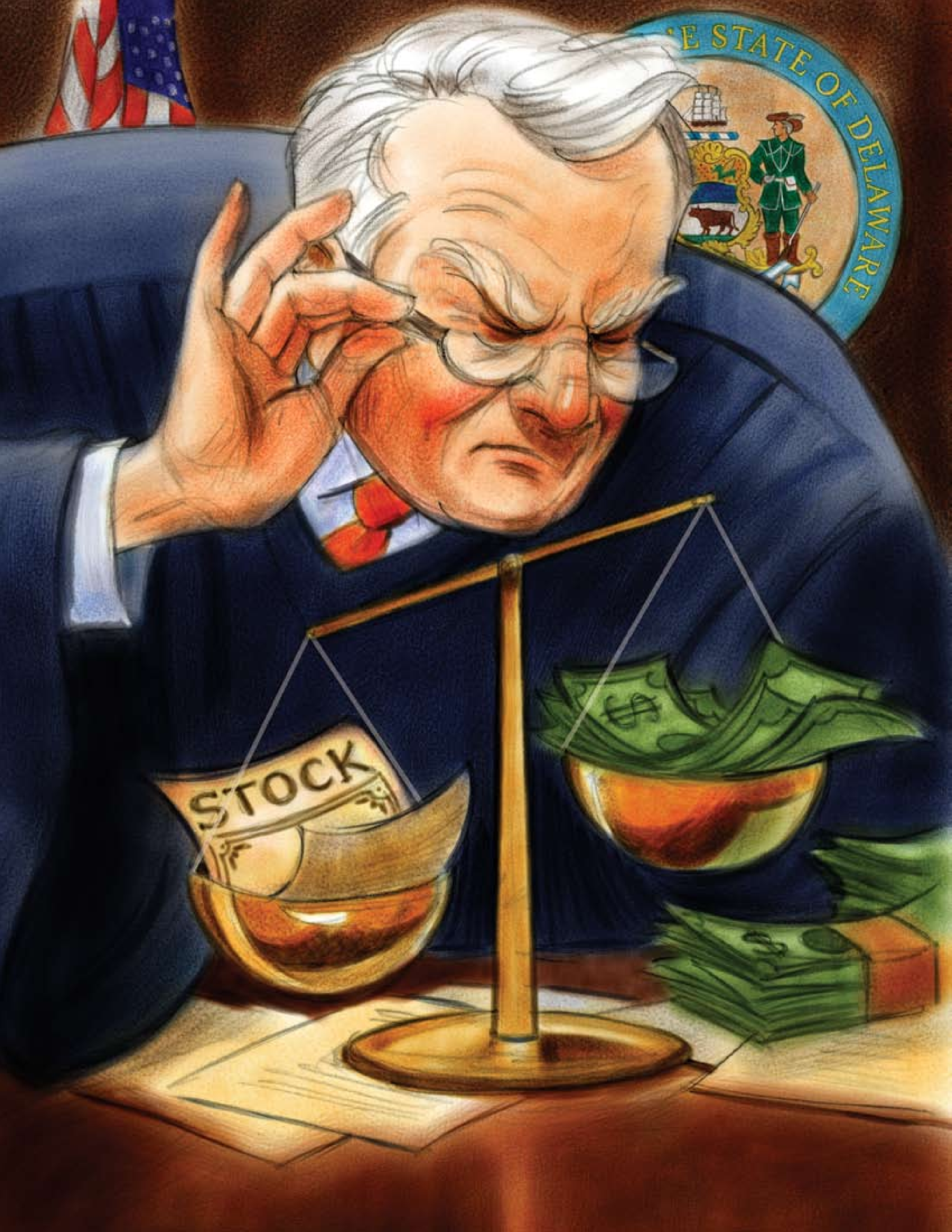

STATE OF DELAWARE
STOCK

by Mark E. Betzen (Dallas Office) and Matthew R. Shurte (Columbus Office)

AN OUNCE OF PREVENTION:

Managing the Increased Threat of Appraisal Proceedings Under Delaware Law

Except in the case of certain stock-for-stock mergers, stockholders of Delaware corporations that are acquired in merger transactions generally have a statutory right to a court appraisal of the value of their shares. Historically, this appraisal remedy has been pursued relatively infrequently, and significant disincentives to seeking an appraisal continue to exist. Nonetheless, acquirers should be cognizant of the risk that some target stockholders may be dissatisfied with the consideration offered in a merger and, consequently, may seek an appraisal of their shares. This risk may be heightened by various judicial decisions that have liberalized the valuation methodologies used, and the results obtained, in appraisal proceedings. Consequently, acquirers may want to take appropriate action to manage this risk to the extent practical in the circumstances presented.

OVERVIEW OF DGCL SECTION 262

Section 262 of the Delaware General Corporation Law (the "DGCL") provides appraisal rights to the holders of record of shares of any corporation that is a party to a merger or consolidation, subject to specified exceptions and to compliance with specified procedural requirements.

Significant exceptions to the availability of appraisal rights include the denial of appraisal rights in respect of (i) shares of the corporation surviving the merger if the merger does not require the approval of the stockholders of such corporation and (ii) shares of any class or series that is listed on any national security exchange, quoted on the NASDAQ national market system, or held of record by more than 2,000 holders. These exceptions do not apply, however, if the holders of such shares are required to accept in the merger any consideration in exchange for such shares other than (i) shares of stock of the corporation surviving or resulting from the merger or consolidation, (ii) shares of stock of any other corporation that will be listed on a national securities exchange, quoted on the NASDAQ national market system, or held of record by more than 2,000 holders, (iii) cash in lieu of fractional shares, or (iv) any combination of the foregoing. In addition, these exceptions do not apply in respect of shares held by minority stockholders that are converted in a short-form merger.

Significant procedural requirements in connection with the perfection of appraisal rights include (i) continuous record ownership of the relevant shares from the date of the demand for appraisal through the effective date of the merger, (ii) not voting in favor of the merger or consenting to it in writing, (iii) delivery of a written demand for appraisal prior to the taking of the stockholder vote on the merger (or, in the case of a short-form merger or a merger approved by a written consent of stockholders, within 20 days of the mailing of a notice to stockholders informing them of the approval of the merger), (iv) filing of a petition with the Delaware Court of Chancery within 120 days after the effective date of the merger, and (v) service of a copy of such petition on the corporation surviving the merger.

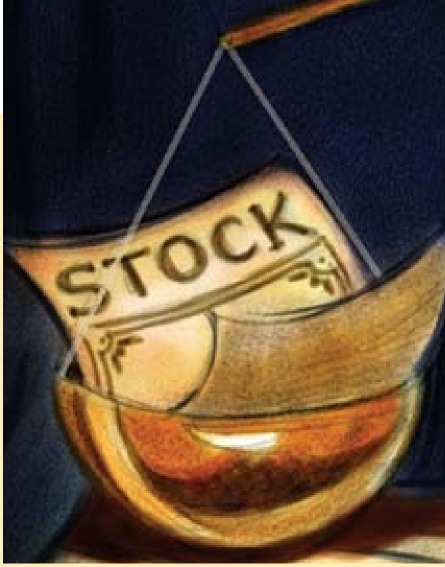
Within 20 days of being served with a copy of the petition, the surviving corporation must file with the court a list containing the names and addresses of all stockholders who have demanded payment of fair value for their shares and with whom agreements as to such value have not been reached. Thereafter, the court will hold a hearing on the petition and determine the stockholders who have perfected their appraisal rights.

After determining the stockholders entitled to an appraisal, the court will appraise the shares, determining their fair value exclusive of any element of value arising from the accomplishment or expectation of the merger. The court will also determine the fair rate of simple or compound interest, if any, to be paid upon such fair value. Thereafter, the court will direct the surviving corporation to make payment of the applicable amounts to the stockholders entitled to it. The costs of the appraisal proceeding may be assessed by the court against the parties to it in such manner as the court deems equitable in the circumstances.

From and after the effective date of the merger, stockholders who have demanded appraisal rights are not entitled to vote their shares or to receive any dividends or other distributions (including the merger consideration) on account of these shares unless they properly withdraw their demand for appraisal. Following the filing of a petition, no stockholder may withdraw its demand without the court's approval, which may be conditioned upon terms the court deems just.

LIMITING THE EXERCISE OF APPRAISAL RIGHTS

The use of the appraisal process to assert a serious challenge to the sufficiency of the consideration offered in a merger is relatively rare. According to an article by S. Travis Laster published in the April 2004 issue of *Insights*, only 33 Delaware cases dealing with appraisal challenges had been reported since 1983. Appraisal cases are rare because various factors ordinarily operate to result in stockholders receiving merger consideration that is fair, and because there are a number of practical disincentives to the pursuit of an appraisal remedy.



After determining the stockholders entitled to an appraisal, the court will appraise the shares, determining their fair value exclusive of any element of value arising from the accomplishment or expectation of the merger.

Except in the case of a short-form merger, mergers require the approval of the acquired corporation's board of directors and stockholders. In most cases, the interests of these approving bodies are substantially aligned with those of the stockholders of the target corporation generally. In addition, the directors of the target corporation are required by their fiduciary duties to endeavor to act in the best interests of the corporation's stockholders and, in circumstances involving a change in control of the target corporation, to seek to maximize the value received by the corporation's stockholders. In circumstances in which directors of the target corporation who participate in the approval of the transaction or controlling stockholders who stand on both sides of the transaction have interests that differ materially from those of the corporation's stockholders generally, the fiduciary duties of such directors or controlling stockholders require that they act in a manner that is entirely fair to all of the corporation's stockholders, including with respect to the merger consideration offered to these stockholders.

The factors described above ordinarily would be expected to result in the stockholders of target corporations receiving fair value for their shares, or at least sufficient value to render the exercise of appraisal rights unattractive. In practice, appraisal rights tend to be exercised most frequently in the context of acquisitions by controlling stockholders of the minority interests in a corporation, presumably because the potential for overreaching tends to be greatest in this context.

Even in circumstances in which legitimate issues regarding the sufficiency of the consideration offered in a merger may exist, there are a number of factors that tend to make appraisal an unattractive remedy. Among other considerations are the following:

- A dissenting stockholder's failure to comply with relatively complex requirements will result in a forfeiture of its appraisal rights.
- A dissenting stockholder will not receive any value from the merger or otherwise on account of its shares until the appraisal process, which may take several years, has been completed.
- A dissenting stockholder must initially (and, in most cases, ultimately) bear the costs of its legal counsel and valuation experts, subject to any apportionment of costs among dissenters that a court may implement in its discretion.
- The outcome of the court's appraisal is subject to substantial uncertainties, and the appraised value payable to the dissenting stockholder may be less than the consideration offered to stockholders in the merger.
- The amount of interest, if any, awarded on the appraised value payable to the dissenting stockholder is subject to substantial uncertainties.

Taken together, the factors described above suggest that an appraisal remedy is likely to be viable only if a stockholder (i) has a substantial investment at stake, (ii) is reasonably confident that the appraisal process will result in a valuation substantially in excess of the consideration offered in the merger, (iii) has sufficient liquidity to pay the costs of proceeding in advance of receiving any consideration on account of its shares, and (iv) meticulously complies with all relevant procedural requirements.

The Delaware courts have held that a dissenting stockholder is entitled to receive a proportionate share of the fair value of the target corporation as a going concern.

EVOLUTION OF THE APPRAISAL PROCESS

General. Section 262 provides for an appraisal by the Court of Chancery. If neither of the parties to an appraisal proceeding establishes its proposed valuation by a preponderance of the evidence, the court will make its own determination of value. In so doing, the court is free to accept or reject, in whole or in part, the valuations and methodologies proposed by either or both of the parties.

The Delaware courts have held that a dissenting stockholder is entitled to receive a proportionate share of the fair value of the target corporation as a going concern. Consequently, the Delaware courts value shares in an appraisal proceeding by first valuing the target corporation as a whole and then assigning a pro rata share of that value to the dissenting stockholder. Significantly, this approach does not allow for the application of a "minority discount" in valuing a dissenting stockholder's shares.

Prior to *Weinberger v. UOP*, 457 A.2d 701 (Del. 1983), the Delaware courts employed the so-called "Delaware block" valuation methodology to arrive at a value for the corporation as a whole. This methodology, which involved the assignments of weights to various elements of value (*e.g.*, assets, earnings, market price, etc.) and the summation of the resulting values, often produced values lower than those that would be expected to result from negotiations between a willing buyer and seller. In *Weinberger*, the court rejected this practice, holding that a proper valuation approach "must include proof of value by any techniques or methods which are generally considered acceptable in the financial community and otherwise admissible in court." The *Weinberger* court also held that the valuation should include elements of future value that are known or susceptible to proof, excluding only speculative elements.

The more liberal approach to valuation mandated by the *Weinberger* court has led the Delaware courts to consider a much broader array of factors in determining the fair value of a target corporation's stock. While the additional factors being considered may not necessarily lead to increased valuations, the results are substantially less predictable than those obtained using the Delaware block methodology.

Valuation Methodologies. Since *Weinberger*, the discounted cash flow ("DCF") valuation methodology has become the primary valuation tool used by Delaware courts in appraisal proceedings. Under this methodology, the target's equity value is derived from projecting the target's future cash flows and discounting them to their present value. The assumptions built into a particular DCF model, which ultimately drive the resulting valuation, can require complex analysis of the target corporation's business and prospects and are often the subject of much debate. Consequently, appraisals using the DCF methodology have become a "battle of experts," in which each side presents competing models based on different assumptions. In the end, the use of competing DCF models can result in highly unpredictable judicial determinations of the value of the target. For example, in *Taylor v. Am. Specialty Retail Group, Inc.*, No. Civ. A. 19239, 2003 WL 21753752 (Del. Ch. July 25, 2003), the court appraised the value of the

petitioner's stock at $9,079.43 per share after considering valuations of $2,200.00 per share and $14,666.67 produced by the parties' competing DCF valuation models.

The Delaware courts sometimes employ other valuation methodologies, including methodologies that value the target corporation's stock on the basis of attributes of purportedly comparable companies, including multiples obtained by dividing the market capitalization or acquisition prices of these other companies by specified financial metrics of other such companies (*e.g.*, sales; net income; earnings before income taxes, depreciation, and amortization; net income before taxes; etc.). One or a combination of these valuation methodologies may be used by a court in combination with, or in lieu of, the DCF valuation methodology. Because Section 262 does not mandate any specific valuation method, and because *Weinberger* permits the consideration of virtually any reasonable method presented, no party to an appraisal action can ever be sure of what method or methods the court will use or what valuation the court will ultimately determine.

Elements of Future Value. Following *Weinberger*, Delaware courts also began including other elements of future value in their valuation processes, so long as these elements were not "speculative." As illustrated by the following cases, the consideration of these additional elements has led to further uncertainty as to the results of appraisal actions.

In 1983, MacAndrew & Forbes Group, Inc. ("MAF") sought to acquire Technicolor, Inc. ("Technicolor") through a tender offer, followed by a short-form merger. MAF gained control of a majority of Technicolor's stock in the tender offer and immediately instituted a breakup plan. The short-form merger that followed cashed out the remaining minority interest at the tender offer price, and certain stockholders demanded an appraisal of their shares. A critical factor in the initial valuation determined by the court was that MAF had instituted a breakup plan for Technicolor prior to completion of the short-form merger. The court (in *Cede & Co. v. Technicolor, Inc.*, 684 A.2d 289 (Del. 1996)) held that the breakup plan could be used to calculate the value of the Technicolor stock. The defendants argued that the benefits derived from the acquisition and the resulting breakup plan should not be included in the valuation because they were dependent upon the accomplishment of the merger. The court rejected this argument, holding that the statutory exclusion of value arising from the accomplishment or expectation of the merger is very narrow and is designed to exclude only speculative elements of any value to be derived from the completion of the transaction. After numerous appeals and remands, the *Cede* litigation was finally resolved in 2005, with the final value of the dissenters' shares determined to be approximately 24 percent higher than the tender offer price.

In *ONTI, Inc. v. Integra Bank*, 751 A.2d 904 (Del. Ch. 1999), minority stockholders of OTI, Inc. ("OTI") were cashed out for approximately $6 million in a short-form merger of OTI with and into the New Treatment Companies. Douglas Colkitt controlled 60 percent of OTI at the time of the merger. After the first merger, the New Treatment Companies were merged into Colkitt Oncology Group, a company completely owned by Colkitt. Colkitt Oncology Group then merged with EquiVision, Inc., a publicly traded company of which Colkitt owned 30 percent. The plaintiffs presented valuation models that took into account the value the subsequent mergers added to premerger OTI. This methodology arrived at a value for the cashed-out stock of almost $94 million. The defendants urged the court to exclude this methodology on the basis that the valuation should be determined for premerger OTI on a "going concern basis, not including speculative hopes for future synergies." Citing *Cede*, the court held that the plaintiff's proposed valuation must be considered and eventually awarded the minority stockholders approximately $16 million.

Control Premiums. Considerable confusion exists in Delaware case law as to whether the appraised value of the target corporation should include any adjustment to add a control premium or to eliminate a minority discount. This confusion appears to have resulted, at least in part, from the failure of courts to analyze whether a particular valuation methodology employed gives effect to an inherent control premium or an inherent minority discount.

Delaware case law is clear that the value of a dissenting stockholder's shares is not to be reduced to impose a minority discount reflecting the lack of the stockholders' control over the corporation. Indeed, this appears to be the rationale

Delaware courts have the discretion to determine whether to award simple or compound interest. Throughout most of Delaware's appraisal history, courts have awarded simple interest. More recently, however, Delaware courts have been more generous in awarding compound interest.

for valuing the target corporation as a whole and allocating a proportionate share of that value to the shares of the dissenting stockholder. At the same time, Delaware courts have suggested, without explanation, that the value of the corporation as a whole, and as a going concern, should not include a control premium of the type that might be realized in a sale of the corporation.

The DCF methodology values a corporation on the basis of its projected future cash flows, which are independent of the manner in which control of the target corporation is allocated. Consequently, no adjustment to eliminate a minority discount from a DCF-based valuation is necessary or appropriate. Indeed, it might be argued that a DCF-based valuation inherently reflects a control premium that should be eliminated. On the other hand, if a valuation methodology based upon market trading prices of shares of a comparable company is employed, it is arguable that such reference share prices inherently reflect a minority discount that should be eliminated in valuing the target corporation. Conversely, if a valuation methodology based on the acquisition price of a comparable company is employed, it is arguable that such reference price inherently reflects a control premium that should be eliminated in valuing the target corporation. Unfortunately, the Delaware courts have been inconsistent in their treatment of these concepts, thereby further impairing the predictability of outcomes in appraisal proceedings.

Interest Awards. Section 262 authorizes the court to add simple or compounded interest to the appraised value payable to a dissenting stockholder. The purpose of an interest award is both to require the acquirer to disgorge any benefit it received from its temporary retention of the value of the dissenting stockholder's shares and to compensate the dissenting stockholder for the delay in receiving such value. In light of the dual purpose of an interest award, the court may consider both the acquirer's actual cost of borrowing and the notional return that could have been achieved by the prudent investment of funds in an amount equal to the appraised value of the dissenting stockholder's shares.

If neither of the parties to an appraisal proceeding establishes its proposed award of interest by a preponderance of the evidence, the court will make its own determination with respect to it. In some cases, the court simply awarded the

legal rate of interest, or the Federal Reserve discount rate plus 5 percent. In other cases, the court has awarded interest equal to the average of the acquirer's cost of borrowing and the so-called "prudent investor" rate.

Delaware courts have the discretion to determine whether to award simple or compound interest. Throughout most of Delaware's appraisal history, courts have awarded simple interest. More recently, however, Delaware courts have been more generous in awarding compound interest. Factors considered by the courts in making these determinations include the amount of the appraised value of the relevant shares and the amount of time that has elapsed since the completion of the merger.

Effects of the Evolution. Since the *Weinberger* decision, courts have exercised greater discretion in determining what valuation methods to use and in assigning weights to individual methods when multiple methods are used in combination. As a result, appraisal outcomes have become increasingly uncertain. Some cases result in appraised values at or below the merger consideration. More frequently, appraisal proceedings have resulted in values significantly higher than the merger consideration. Of the 33 reported cases noted in Laster's article, the mean adjudicated premiums were 449.14 percent over the merger consideration, with a median premium of 82.1 percent. Because the appraisal remedy tends to be pursued in only the most egregious circumstances, these statistics do not imply that merger transactions generally involve consideration that is less than fair. Nevertheless, the statistics suggest that, in at least some instances, the appraisal risks for acquirers can be substantial.

MANAGING APPRAISAL RISKS

Except in the case of a short-form merger, meticulous attention by the target corporation's directors to their fiduciary duties should ordinarily prevent the corporation from being acquired at a price that is less than fair value. Accordingly, an acquirer should seek, with the assistance of its legal and financial advisors, visibility into the target's information gathering and analytical and deliberative processes and the manner in which they are documented in order to ensure that a defensible record is produced. In addition, an acquirer should be sensitive to the potential consequences of overreaching in the context of deal protection measures such as exclusivity and no-shop provisions and termination fees (none of which should be problematic unless, in the circumstances presented, they are unduly preclusive of alternative transactions or are otherwise unreasonable).

The disclosure document provided to the target corporation's stockholders in order to solicit their approval of the merger or to inform them of their appraisal rights should fully apprise them of relevant facts that support the fairness of the merger consideration. Relevant matters in this regard might include, among other matters, historical operating results and future prospects, competitive and other risks, levels of liquidity and capital resources, internal and external indicia of value, efforts to explore strategic alternatives and the results thereof, opportunities for interested parties to submit competing acquisition proposals, and fairness opinions obtained from financial advisors and supporting analyses. As long as the disclosure does not misstate material facts or omit facts necessary to make the statements therein not misleading, informing stockholders of facts supporting the putative fairness of the merger consideration is entirely consistent with helping stockholders to make well-informed decisions.

If one or more stockholders nonetheless make a demand for appraisal, additional communications regarding the reasons why the transaction parties believe that the merger consideration is fair, and why the pursuit of an appraisal may be costly, time-consuming, and counterproductive, may result in the withdrawal of the demand. Communications of this type tend to be particularly effective where the demanding stockholder has a relatively modest investment and may not fully appreciate the factors supporting the fairness of the merger consideration and the costs and risks associated with the pursuit of an appraisal.

In addition to the foregoing, certain structural mechanisms may provide a degree of protection to acquirers from the potential consequences of stockholder demands for appraisal. These mechanisms include, among others, conditioning the acquirer's obligation to consummate the transaction on the absence of demands for appraisal in respect

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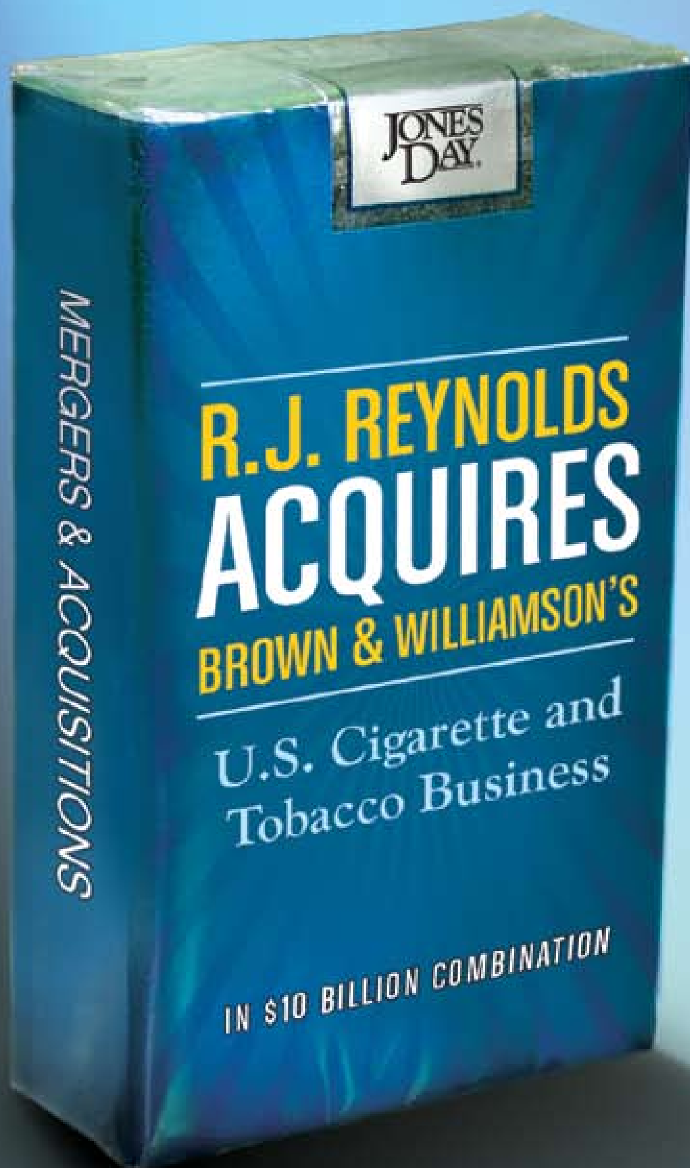
CASE STUDY



R.J. Reynolds Tobacco Holdings, Inc. ("RJR"), the parent company of R.J. Reynolds Tobacco Company, a leading manufacturer of cigarette and tobacco products, completed its acquisition of the U.S. business of Brown & Williamson Tobacco Corporation ("B&W"), a U.S. subsidiary of British American Tobacco p.l.c. ("BAT"). The transaction combined the second- and third-largest U.S. cigarette and tobacco businesses. In addition, RJR acquired Lane Limited, a former BAT subsidiary that manufactures various tobacco brands and distributes Dunhill cigarettes. As part of the transaction, a new publicly traded company, Reynolds American Inc. (RAI), was formed, with an equity value of approximately $10 billion.

As a result of the transaction, former RJR public stockholders own 58 percent of RAI, and BAT owns the remaining 42 percent. Based on 2002 results, RAI would have annual revenues of approximately $10 billion and account for more than 30 percent of U.S. cigarette sales. The parties expect synergies from the transaction to generate at least $500 million in annual cost savings.

Jones Day served as RJR's primary counsel in the transaction, involving more than 30 Jones Day lawyers in New York, Washington, London, Chicago, Cleveland, and Columbus. BAT and B&W were represented by Cravath, Swaine & Moore.

This was a virtually unprecedented transaction posing complex challenges. There are few, if any, comparisons to a transaction of this magnitude involving the combination of a public company with a private company and the creation of a public company with a 42 percent stake in the hands of a single stockholder.

Working with RJR's in-house counsel, Jones Day helped create solutions to many potentially deal-breaking issues. Among the most serious challenges were the following:

- Devising arrangements that would address corporate governance concerns arising from BAT's owning what would normally be a controlling stake in RAI.
- Resolving many legal issues implicated by the integration of the two businesses, particularly the allocation of post-closing liabilities and indemnification obligations.
- Addressing antitrust concerns arising from the consolidation of the U.S. tobacco industry from four leading businesses to three.
- Structuring the transaction on a tax-free basis for both RJR's public stockholders and BAT.
- Obtaining timely SEC clearance of the RJR proxy statement in coordination with all other required regulatory approvals.

The creation of RAI's corporate governance structure involved reconciling the interests of the majority public shareholding body with those of a 42 percent stockholder that under ordinary circumstances might have the ability to dominate the company's board of directors and management. The contractual solution provides that "independent" directors will constitute 10 out of the 13 members of a classified board. Their successors are to be chosen by a board committee whose majority is selected by independent directors other than those nominated by BAT. BAT's interests are protected by being enabled to nominate five directors (of which three must be independent) and having its nominees serve on each of the board's committees. In addition, BAT was granted certain veto rights as to future RAI or RAI subsidiary activities that might significantly affect its interests, such as equity securities issuances or sales of cigarette brands with international significance. BAT also entered into a 10-year standstill precluding it from acquiring additional RAI shares, subject to limited exceptions.

Notwithstanding the obvious antitrust issues raised by the combination, the FTC (by a unanimous vote) decided not to challenge the transaction. Jones Day was the leader of a three-firm legal team that achieved this result by providing the FTC with a detailed factual and economic analysis of cigarette sales in the United States. This analysis focused heavily on the significant changes that had occurred in the industry since the Master Settlement Agreement ("MSA") resolved state litigation challenges. These changes include the dramatic and continuing market entry of numerous smaller manufacturers not subject to the MSA (so-called "discounters"). Based on this record, the Jones Day-led team persuaded the FTC commissioners that the business combination would not facilitate anticompetitive behavior following the transaction. In addition, we assessed merger-reporting requirements in non-U.S. jurisdictions and coordinated the filing of required merger notifications in countries such as Brazil and Germany.

Jones Day played an integral role in designing a complex and innovative transactional structure to address the differing—and initially irreconcilable—requirements of the businesses to be combined under U.S. and non-U.S. tax laws. The legal team was then able to obtain, in a short time, favorable rulings from the Internal Revenue Service, confirming that the transactions would be tax-free to RJR, its stockholders, BAT, and B&W.

Jones Day's representation of RJR necessitated the design and delivery of highly integrated solutions to complex issues without clear precedents. Accomplishing this result required the efforts of lawyers from six Jones Day offices in at least eight different areas of practice (M&A, capital markets, antitrust, tax, environmental, employee benefits, intellectual property, and litigation). We were extremely gratified to have the opportunity to assist our longtime client in bringing about this transforming event in its history. ■

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three-month period immediately following the end of the acceptance period. In this occurrence, the principles applicable to a squeeze-out procedure also apply to the sell-out of the remaining shares.

In the U.S., sell-out provisions are generally not available. However, controlling shareholders tend to cash out the minority for fear of legal actions based on alleged breaches of fiduciary duties owed by the board and the majority shareholder to the minority shareholders.

CONCLUSION

The Directive will provide minority shareholders with more protection and harmonize a number of issues in European takeover regimes following its implementation by May of 2006, including the equitable price, the cash offer, the mandatory bid, and certain disclosures. In addition, the squeeze-out and sell-out rights find a balance between the bidder's and shareholders' interests. However, the Directive is a real political compromise that establishes more of a unified framework for the different takeover regimes of the Member States, as opposed to a completely level playing field. Takeover rules in individual Member States will vary due to each Member State's additional or more stringent takeover rules. For example, Member States will be able to opt in or out of certain defensive measures provided for in Articles 9 and 11 of the Directive. Nevertheless, the Directive is an important step toward a level playing field for European public companies. ■

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of a specified maximum number of shares and, if the target corporation is closely held, requiring nondissenting stockholders to indemnify the acquirer from the consequences of appraisals demanded by their dissenting cohorts. It may also be desirable to obtain commitments from target stockholders to vote in favor of the proposed transaction (thereby effectively waiving their appraisal rights), although such arrangements may need to be limited to directors, officers, and substantial stockholders of the target corporation due to securities law concerns. Finally, it may be desirable for the acquirer to seek to purchase shares in advance of the merger in transactions that do not give rise to appraisal rights, such as tender offers, market purchases, and privately negotiated transactions. Or, less commonly, it may be possible to effect the acquisition by means of a transaction, such as an asset purchase, that does not give rise to appraisal rights.

Acquirers should also be aware that the development and implementation prior to the completion of the acquisition of the plans to enhance post-acquisition value may result in a greater appraised value for any dissenting stockholders. However, as is the case in considering any of the foregoing or other means of managing appraisal risks, it is necessary to analyze carefully all of the related pros and cons.

CONCLUSION

For the most part, the appraisal remedy provided by Section 262 of the DGCL continues to be used only sparingly. Other safeguards result in the fair pricing of most acquisition transactions, and the costs and risk-adjusted rewards associated with the appraisal remedy tend to make it unattractive in many situations where the sufficiency of the merger consideration may be questionable. In short, pursuit of the appraisal remedy is likely to be viable only where a stockholder or group of stockholders acting in concert have both a substantial investment at stake and a reasonably high degree of confidence that a court will arrive at an appraised value that is substantially higher than the merger consideration.

Factors that have contributed to the recent rise in appraisal actions include more accommodating judicial attitudes toward dissenters and the valuation theories and evidence that they proffer, and the concentration of the shares of many companies in the hands of large institutional investors. The former of these factors increases the risk that a court appraisal will substantially exceed the merger consideration, while the latter increases the risk that enough value will be at stake to motivate one or more stockholders to incur the costs associated with pursuing an appraisal.

Consequently, at least in some circumstances, the availability of appraisal rights may pose a significant risk to the acquirer. Acquirers should therefore evaluate the appraisal-related risks presented by any particular transaction and carefully consider strategies designed to minimize the likelihood of a successful appraisal action. ■

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Mark, a partner in the Dallas Office, has more than 20 years of experience in assisting principals and other participants in a wide variety of sophisticated corporate, securities, and business transactions. He has extensive experience in mergers, acquisitions, and dispositions involving publicly traded and closely held companies and in equity and debt financing transactions. Mark co-heads the Mergers & Acquisitions Practice in the Firm's Dallas Office.

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BOB PROFUSEK NAMED DEALMAKER OF THE YEAR

New York partner Bob Profusek was named Dealmaker of the Year by *The American Lawyer* in its April 2005 issue. "Dealmaker of the Year" is a prestigious accolade (only a dozen or so lawyers receive it in any given year), and in the six-year history of these awards, Profusek is the first M&A lawyer from Jones Day to be named.

The magazine cited Profusek's remarkable string of 10 noteworthy deals in 2004, which in many ways was his best year in a distinguished 29-year career. Two of Wall Street's savviest dealmakers, Wilbur Ross and Bruce Wasserstein, each turned twice last year to teams led by Profusek, for such deals as the groundbreaking creation of International Coal Group, the industry-redefining sale of International Steel Group, and the highly publicized acquisition of *New York* magazine.

The year's crowning deal, on which *The American Lawyer* focused, was Jones Day's representation of Nextel in its merger with Sprint, shepherding a tricky $46 billion "merger of equals" to conclusion. Profusek's prior history of big-ticket, innovative M&A has ranged from representation of Gillette in its celebrated takeover defenses and GM in its joint venture with Toyota in the 1980s to Federated in its unsolicited takeover of Macy's and Ernst & Young in the spinoff of its consulting business in the 1990s.

To read *The American Lawyer*'s profile of Profusek, we invite you to visit our web site at www.jonesday.com/profusek. ■