TIME TO HIT THE RESET BUTTON ON MERGER LITIGATION

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Over 90 percent of announced $100+ million M&A transactions in the U.S. result in shareholder lawsuits. The idea that corporate directors breach, or even possibly breach, their fiduciary duties at anything even remotely approaching this rate is absurd. There are many reasons for the nearly automatic filing of litigation upon public company M&A announcements, but the courts themselves bear a fair measure of responsibility since the financial crisis.

A disturbing number of post-financial crisis decisions have evidenced significant after-the-fact nitpicking over isolated aspects of M&A processes without requiring any showing of adverse consequence to shareholders, despite giving lip service to the most basic principle of U.S. corporate law – that the good faith business judgments of independent directors should not be second-guessed. This nitpicking is dangerous and ignores the fact that transactional processes are conducted by real people in real-life situations in which many difficult judgment calls need to be made in real time. It also costs shareholders money at the end of the day because experienced bidders, when determining the final price to shareholders, take defense costs and plaintiffs' attorneys' fees into account when preparing best and final bids, as the vast majority of these lawsuits are settled just prior to closing for additional disclosures that permit the plaintiff law firm to seek attorneys' fees.

TODAY'S DIRECTORS AS CORPORATE FIDUCIARIES

This kind of Monday-morning quarterbacking stems at least in part from the assumption that corporate boards of directors continue to be dominated by so-called imperious CEOs or are asleep at the switch. This is simply not the case, at least not today. Instead, boards are now independent bodies, consisting of highly experienced and respected business people – the days of boards being filled with a long-standing CEO's former fraternity brothers are long gone. In reality, the tenure of the average director in U.S. public companies is roughly twice that of the average CEO's tenure, and directors, not management, drive corporate sales processes today.

Today's directors make tough decisions – especially since the financial crisis – and put shareholder interests ahead of the personal relationships that all-too-many politicians and pundits seem to believe continue to govern the boardroom. And, anecdotally, most advisors who regularly are invited into corporate boardrooms would attest that boards are, in fact, genuinely independent and are equipped with a very clear understanding of their fiduciary responsibilities. Board members are individuals who have risen to the top of their professions, who take their jobs seriously and who work hard to oversee, and help to implement, the fundamental strategies of their companies. What incentive do directors really have, for example, to willfully blind themselves to maximizing value in circumstances in which they are essentially deciding to give up their jobs?

But despite the obvious answer to this question, it is beyond debate that the nature and extent of scrutiny by many courts and so-called governance experts of directorate decision-making and the role of "Wall Street" advisors in the transactional context has increased since the financial crisis. To us, this flies in the face of the long-standing principle that judges are not business people and that their role is not to second-guess the business decisions of engaged, sophisticated and experienced directors, whether in the context of a sale or merger of the company or otherwise.

HARBINGERS OF A RETURN TO FIRST PRINCIPLES

U.S. courts have long held that there are no bright-line process requirements and that a strategic assessment process overseen by an independent board working in good faith toward a positive goal for shareholders is all that can be reasonably expected. As a noted Delaware jurist eloquently wrote in litigation attacking the sale of Cogent, Inc., where the board chose a bidder who offered less but more certain consideration: "our case law makes clear that there is no single path that a board must follow in order to reach the required destination of maximizing stockholder value. Rather, directors must follow a path of reasonableness which leads toward that end."

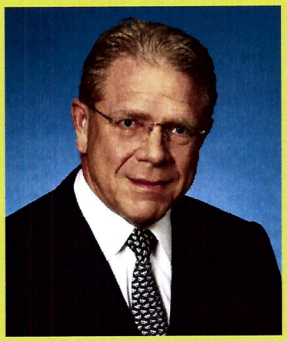
ISOLATED, SEEMINGLY INSIGNIFICANT ASPECTS OF SALE AND MERGER PROCESSES ARE NOW SINGLED OUT FOR CRITICISM NOTWITHSTANDING VERY POSITIVE RESULTS FOR SHAREHOLDERS.

We are hopeful that decisions in recent high-profile deals like the Dell take-private, in which Delaware Chancellor Strine, one of the country's most thoughtful and respected jurists, repeatedly gave deference to the independent committee's decisions, and the AboveNet merger, in which Vice Chancellor Noble systematically rejected the plaintiffs' allegations, expressing disbelief at every turn that a group of independent directors would engage in any sort of scheme to disfavor shareholders, are harbingers of a return to first principles in directorate decision-making.

PUSHING THE RESET BUTTON

But more than just a return to first principles is needed given the explosion of M&A litigation. At the height of the 1980s hostile takeover boom, the courts properly perceived that there was an inherent risk of conflict between director and shareholder interests when directors took steps to block unsolicited takeover bids. The reason was that, by seeking to thwart a hostile bid, however well-intended, directors might be perceived as trying to preserve their jobs, even if that were not, in fact, the case. The courts settled this dilemma by holding that automatic deference to the business judgment rule was no longer appropriate in these circumstances. Instead, an initial showing would be required by the directors to demonstrate that their actions were, in essence, the result of a sound process and were reasonable in relation to the threat perceived. Of course, this was in an era in which the reality of director independence was dramatically different than it is today.

Today's merger litigation is fundamentally different: isolated, seemingly insignificant aspects of sale and merger processes are now singled out for criticism notwithstanding very positive results for shareholders driven by independent directors who have, in virtually all cases, tried hard to make the right decisions on a sale or merger process that results in putting themselves out of work. In this setting, the burden should be on the plaintiffs to do much more than allege that there *might* have been some procedural defect that *might* have had some negative effect. Instead, the courts should turn the tables: plaintiffs should be required to make a strong showing that there was a material failure in director oversight that, in fact, did have an actual adverse effect on what the shareholders received in the deal. After all, maximizing shareholder value is what deals are supposed to be all about in the first place.



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