

# Debt Restructuring Issues and Opportunities

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**September 2009**

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LLP

# Recent Developments in Debt Restructuring

- Credit crisis and deteriorating economic conditions in 2008 and the first half of 2009
- Senior Term Loan/Bank Debt trading below par
- Bonds trading below par
- Possibility for opportunistic balance sheet management

# Discounted Repurchases of Bank Debt

- Unlike bonds, where tender offers or one-off negotiated repurchases below par are not unusual, traditionally senior bank lenders were reluctant to reduce exposure at less than par outside of a distressed transaction
- With senior term loan assignments and participations trading below par, operating companies or their private-equity owners may seek to reduce debt through opportunistic repurchases below par
  - Purchase of an assignment or “participation” from an existing lender
  - Non pro-rata pay-down at a discount

# Discounted Repurchases of Bank Debt

- Typical Credit Agreement provisions in the U.S. prevent one-off negotiated transactions with term loan lenders without an amendment or consent from the “required lenders” (51%)
- Pro-Rata Repayment
  - All prepayments by a borrower are applied to all outstanding term loan on a pro-rata basis
  - Administrative agent may argue that “borrower” includes affiliates, such as a private equity sponsor
  - Prevents discounted selective repayment without lender consent

# Discounted Repurchases of Bank Debt

- Sharing among lenders
  - Borrowers or their affiliates (parent entities, sister companies, unrestricted subsidiaries) may seek to avoid pro-rata pay-down by acquiring a participation in a loan from an existing lender
  - Participation provides economics of loan ownership but existing lender remains lender for purposes of the agreement and may avoid restrictions on assignment of loans, which are often limited to eligible assignees (typically certain financial institutions)
  - However, “sharing” provision among lenders may require that a lender selling a discounted participation treat the funds as a payment of the loan and share with other lenders

# Discounted Repurchases of Bank Debt

- Potential Solution through Amendment Process
  - “Tender Offer” (though loan participations historically not considered securities for purposes of tender offer rules)
  - “Modified Dutch Auction”
  - Potential amendment fees
  - Potential lender tightening of covenants
  - Carefully review covenants and ratio definitions
- Practice Points

# Debt Tender and Exchange Offers

- Unlike typical senior credit facility agreements governing bank term loans, high yield and investment grade note indentures often permit one-off negotiated repurchases at a discount (or premium) to par
  - Confirm no “most favored nations” or requirement to offer the deal to all note holders
- For larger transactions one-on-one negotiated buybacks will not suffice and issuers consider debt tender offers

# Debt Tender and Exchange Offers

- When does a series of negotiated transactions constitute a tender offer?
  - Eight-factor test that is focused on facts of specific series of repurchases
  - Widespread solicitation, presence or absence of negotiations, pressure to sell are among potentially relevant factors
- Debt tender offers are not subject to many of the rules governing equity tender offers
  - No Schedule TO is filed with the SEC
  - Withdrawal rights are not required by law but are typically provided for at least part of the tender period

# Debt Tender and Exchange Offers

- Debt tender offers are not subject to many of the rules governing equity tender offers (cont.)
  - Tender offer must remain open for 20 business days
  - However, SEC has granted no-action relief permitting offers lasting only 7 calendar days
    - Limited to “investment grade” notes
    - Offer for “any and all” notes with no expected proration
    - Dissemination of tender offer materials on an expedited basis
    - Often combined with pricing based on a “fixed spread” above treasury, sophisticated institutions do not need 20 business days to evaluate investment grade note offer

# Debt Tender and Exchange Offers

- Debt tender offer can be combined with a consent solicitation to amend underlying Indenture
- Consent premium often combined with 10 business day “early tender” deadline
- “Covenant strip” may provide incentive for holders to tender
- Exit consents permit selling note holders to provide votes necessary for amendment

# Debt Tender and Exchange Offers

- Fundamental terms, such as par value, interest, security and guarantees may require unanimous or super-majority approval
- Amendments that go beyond negative covenant relief may also implicate “new security” issues raising concern regarding need to register transaction
- Also consider any exchange requirements for listed debt
  - For example, rules of the Luxembourg Stock Exchange for euro-denominated notes

# Debt Tender and Exchange Offers

- Potential alternatives to cash tender offers include 3(a)(9) equity exchanges and debt exchange offers
- 3(a)(9) equity exchanges
  - Securities received in the exchange will be subject to the same securities law restrictions as the exchanged security (e.g., “restricted securities” vs. freely transferable securities)
  - Exchanges must use the securities of the “same issuer”, must be offered only to existing security holders and must not provide remuneration for solicitation (e.g., investment bank fees)

# Debt Tender and Exchange Offers

- Debt-for-Debt exchange offers
  - Registered offers using Form S-4
  - Exempt exchange offers (Rule 144A limited to QIBs)
- Tax Issues
- Rating Agency action and “distressed” exchange offers, tender offers and debt repurchases
- Practice Points

# Representations and Warranties in Agreements Filed with the SEC

- Considerations regarding representations and warranties in agreements filed with the SEC
  - Titan Report
  - Glazer Capital Management, LP
- Practice Points



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Panel V:  
**BOARD OF DIRECTORS'  
FIDUCIARY DUTIES IN M&A:  
PERSONAL LIABILITY OF  
DIRECTORS**

*Presented by:*

**RICHARD J. BUSIS**

**SEPTEMBER 22, 2009**

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# Fiduciary Duties Generally



- Every director of a Delaware corporation must discharge his or her duties
  - in good faith, and
  - in a manner the director reasonably believes to be in the best interests of the corporation.
- Two basic duties:
  - Duty of care
  - Duty of loyalty



# Limitation of Monetary Liability for Breach of Fiduciary Duty



- Section 102(b)(7) of DGCL allows a corporation to eliminate the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, except for:
  - any breach of the director's duty of loyalty to the corporation or its stockholders;
  - acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law; or
  - any transaction from which the director derived an improper personal benefit.



# Limitation of Monetary Liability for Breach of Fiduciary Duty



- Exculpatory charter provision enacted in response to *Smith v. Van Gorkom* (1985):
  - Held board of Trans Union grossly negligent for approving a merger without substantial inquiry or receipt of any expert advice.
  - Directors' breached duty of care, even though they acted in good faith.
- Section 102(b)(7) eliminates directors' personal liability for monetary damages for breach of duty of care, but not for breach of duty of loyalty.



## Section 102(b)(7) of DGCL

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- Most Delaware corporations have adopted a charter provision limiting personal liability of directors.
- Much Delaware fiduciary litigation now focused on breach of duty of loyalty or lack of good faith, component of such duty, not breach of duty of care.
- In context of injunctive relief, both fiduciary duties still implicated.



## *Lyondell v. Ryan*

Delaware Supreme Court (March 25, 2009)



- July 2008 Chancery Court opinion raised concern that Section 102(b)(7) was dead – a return to *Van Gorkom*-esque liability.
- Board of Lyondell Chemical Company received, and later accepted, an unsolicited offer to purchase the company.
  - A substantial premium over the market price.
  - Acquisition overwhelmingly approved by Lyondell stockholders.



## *Lyondell Complaint*



- Stockholder plaintiff alleged directors violated their fiduciary duties of care and loyalty:
  - Directors motivated by self-interest.
  - Process of merger negotiation flawed.
    - only considered offer for one week.
    - didn't shop company to see if a higher value was attainable.
  - Transaction locked up with unreasonable deal protections.



## *Lyondell Basic Facts*



- In April 2006, Basell AF told Dan Smith (Chairman and CEO of Lyondell) it was interested in acquiring Lyondell.
  - Board determined that the price was inadequate and not interested in selling.
- In May 2007, an affiliate of Basell filed a Schedule 13D indicating its right to acquire a block of Lyondell stock and Basell's interest in a possible transaction with Lyondell.
  - Lyondell board recognized the 13D signaled to the market that the company was "in play."
  - Directors decided to take a "wait and see" approach.



## *Lyondell Basic Facts*



- In July 2007, Basell proposed to Smith an all-cash deal at \$40 per share.
- Basell later raised offer to \$48 per share, but required:
  - \$400 million break-up fee (slightly more than 3% of \$13 billion price).
  - Merger agreement to be signed in one week.
- Lyondell board decided it was interested in pursuing the offer rather than remaining independent.
  - Board hired a financial advisor and authorized Smith to negotiate a deal.



## *Lyondell Basic Facts*

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- Parties negotiated the terms of a merger agreement in one week.
- Board instructed Smith to negotiate a higher price, a go-shop provision and a reduced break-up fee.
- Basell refused to change terms, other than to reduce break-up fee by \$15 million.
- Lyondell board approved the merger.
- Merger subsequently approved by more than 99% of the shares voted.

# Lyondell Chancery Court Decision



- Denied directors protection of exculpatory charter provision for alleged breach of duty of loyalty in connection with sale process.
  - Limited record of a passive board process in a CEO-dominated transaction with no market check raised potential matters of fact.
  - Summary judgment not granted.

# *Lyondell* Supreme Court Decision



- Del. Supreme Court noted record established that Lyondell directors:
  - were disinterested and independent;
  - were generally aware of the company's value and its prospects;
  - considered the offer, under the time constraints imposed by the buyer, with the assistance of financial and legal advisors.
- At most, record creates triable issue of fact on the question of whether the directors exercised due care.
  - Not relevant in current context.
- No evidence that directors knowingly ignored their responsibilities, thereby breaching their duty of loyalty.
  - Relevant standard.
- Court granted summary judgment to defendants.



## Analysis of *Lyondell* Decision



- Claims are aspects of a single claim under *Revlon v. MacAndrews & Forbes Holdings, Inc.*:
  - Directors failed to obtain the best available price in selling the company.
- *Revlon* did not create any new fiduciary duties.
  - In sale of control, board must perform its fiduciary duties in the service of a specific objective: maximizing the sale price of the enterprise.



## Analysis of *Lyondell* Decision



- Lyondell's charter eliminated personal liability of directors for breach of duty of care.
- Case turns on whether any shortcomings of Lyondell directors also implicate duty of loyalty.
- Trial court found that board was independent and not motivated by self-interest.
  - One type of breach of duty of loyalty.

# Analysis of *Lyondell* Decision



- Duty of loyalty also encompasses cases where a director fails to act in good faith.
- Trial court concluded that board's alleged failure to engage in a more proactive sale process may constitute a breach of the good faith component of duty of loyalty.
- Sole issue: did directors breach duty of loyalty by failing to act in good faith?

# Analysis of *Lyondell* Decision



- Del. Supreme Court examined "good faith" in two 2006 decisions.
  - *Walt Disney*
  - *Stone v. Ritter*
- *Walt Disney* discussed three different categories of fiduciary behavior that potentially could be deemed "bad faith."

# Analysis of *Lyondell* Decision



- Categories:
  - "Subjective bad faith" – conduct motivated by actual intent to do harm – clearly constitutes bad faith.
  - Opposite end of spectrum – lack of due care – *i.e.*, gross negligence without any malevolent intent.
    - Gross negligence, without more, does not constitute bad faith.

# Analysis of *Lyondell* Decision



- Third (intermediate) category – intentional dereliction of duty or conscious disregard for one’s responsibilities.
  - In some cases, this type of misconduct may be treated as violation of the fiduciary duty to act in good faith.

# Analysis of *Lyondell* Decision



- *Stone v. Ritter* addressed concept of bad faith in the context of an "oversight" claim and adopted the *Caremark* standard:
  - Liability of directors for corporate loss based on ignorance of liability-creating activities within the corporation.
  - Requires a sustained or systematic failure of the board to exercise oversight – such as an utter failure to attempt to assure a reasonable information and reporting system exists.

# Analysis of *Lyondell* Decision



- *Stone* clarified that imposition of liability requires a showing that directors knew they were not discharging their fiduciary obligations.
- Distinction between lack of good faith and gross negligence.
- If no intent to do harm, bad faith requires more than gross negligence.

# Analysis of *Lyondell* Decision



- Del. Supreme Court indicated that trial court reviewed the record under a mistaken view of the applicable law.
- Three factors contributed to that mistake.

## Analysis of *Lyondell* Decision



- First, trial court imposed *Revlon* duties on the Lyondell directors before they either had decided to sell or before the sale had become inevitable.
  - *Revlon* duties do not arise simply because a company is "in play."
  - Duty to seek best available price applies only when a company embarks on a transaction – on its own initiative or in response to an unsolicited offer – that will result in a change of control.



# Analysis of *Lyondell* Decision



- Schedule 13D put Lyondell directors and market in general on notice that Basell was interested in acquiring Lyondell.
- Directors promptly held a special meeting to consider whether Lyondell should take any action.
- Directors decided not to put Lyondell up for sale and not to institute defensive measures to fend off a possible hostile offer.
  - Board took a "wait and see" approach.
  - An appropriate exercise of the directors' business judgment.

# Analysis of *Lyondell* Decision



- Time for action under *Revlon* did not begin until directors began negotiating the sale of Lyondell.
- During that one week:
  - the directors met several times;
  - Smith tried to negotiate better terms;
  - the board evaluated Lyondell's value, the price offered and the likelihood of obtaining a better price; and
  - at the end of the process, board approved the merger.

# Analysis of *Lyondell* Decision



- Second mistake: trial court erroneously read *Revlon* as creating a set of requirements that must be satisfied during the sale process.
- Only one *Revlon* duty – to get the best price for the stockholders at a sale of the company.

## Analysis of *Lyondell* Decision



- No court can tell directors exactly how to accomplish that goal.
  - In each case, directors will face a unique combination of circumstances, many of which will be outside their control.
- *Barkan v. Amsted Industries*: no single blueprint that a board must follow to fulfill its duties.
- So failure to take any specific act, such as market check, not dispositive.



# Analysis of *Lyondell* Decision



- Third mistake: trial court equated an arguably imperfect attempt to carry out *Revlon* duties with a knowing disregard of duties (which constitutes bad faith).
- Trial court acknowledged that directors' conduct might not demonstrate anything more than lack of due care.
- A vast difference between conduct that might give rise to a due care claim and conduct that constitutes an “intentional dereliction of duty.”
  - Difference between an inadequate or flawed effort to carry out fiduciary duties and a conscious disregard of those duties.



# Analysis of *Lyondell* Decision



- The former implicates the duty of care, while only the latter will implicate the good faith component of duty of loyalty.
- Breach of duty of loyalty established only if directors “knowingly and completely failed to undertake their responsibilities.”

# Analysis of *Lyondell* Decision



- Directors' decisions must be reasonable, not perfect.
- In transactional context, an “extreme set of facts required to sustain a disloyalty claim premised on the notion that disinterested directors were intentionally disregarding their duties.”

# Analysis of *Lyondell* Decision



- The Supreme Court pointed to directors’
  - meeting several times to consider the offer,
  - general awareness of the company’s value and the chemical company market,
  - solicitation and following the advice of their financial and legal advisers,
  - attempt to negotiate a higher offer even though the evidence indicated that buyer had offered a “blowout” price,
  - approval of merger because “it was simply too good not to pass along [to the stockholders] for their consideration.”

# Analysis of *Lyondell* Decision



- Trial court approached the record from the wrong perspective.
- Rather than questioning whether disinterested, independent directors did everything they should have done to obtain the best sale price, inquiry should have been whether those directors “*utterly failed to attempt to obtain the best sale price.*”

## *Lyondell* Implications



- Bar for a successful duty of loyalty claim against independent, disinterested directors is extremely high.
- Court suggested bar much lower when claim is based on a breach of duty of care.
  - Directors need to be concerned about exercising care and establishing a careful, deliberate and well-documented process in reviewing sale of control transactions.

## Lyondell Implications



- *Lyondell* may prompt shareholder plaintiffs to pursue injunctive relief prior to deal closing.
  - Relief of any kind may be difficult post-closing.
  - May be easier to survive initial motions to dismiss in duty of care context.
    - Duty of care cases may be more fact intensive.

# *Lyondell Practice Points*

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- Importance of board independence and disinterestedness when considering control transactions.
- Importance of creating good record of board deliberations.
- Desirable for directors to:
  - engage actively in sale process.
  - be able to confirm they have obtained the best available price either by conducting an auction or a market check, or by demonstrating "an impeccable knowledge of the market."

# *Wayne County Employees' Retirement System v. Corti* (Del. Ch. July 24, 2009)



- One of the first applications of *Lyondell*.
- Court's analysis focused on board process, not outcome of the process.
- Suit challenged conduct of the Activision board in negotiating and approving a transaction that resulted in Vivendi obtaining a majority of the voting stock of Activision.

## Wayne County Complaint



- Plaintiff alleged Activision's directors breached duty of loyalty by allowing two managers of Activision to control both negotiations with Vivendi and Activision's advisors.
- Plaintiff also asserted a claim under *Revlon* against the Activision directors for their conduct in negotiating and agreeing to a sale of control of Activision.

## *Wayne County Basic Facts*

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- In late 2006, Kotick and Kelly (directors and senior officers of Activision) entered exclusive, nonpublic discussions with Vivendi about a possible corporate combination.
- At April 30, 2007 board meeting, Kotick and Kelly first informed the Activision board of the ongoing discussions with Vivendi.

## *Wayne County Basic Facts*



- On May 11, 2007, board was updated by Kotick and Kelly and its advisors on discussions with Vivendi.
  - Board decided to involve a committee of outside directors in the sale process.
  - Kotick and Kelly had potential conflicts as members of management.

## *Wayne County Basic Facts*

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- Despite its authority to do so, the Committee never retained its own legal or financial advisors.
  - Used the company’s advisors.
- A combination agreement was finalized on December 1, 2007.

# Analysis of *Wayne County* Decision



- Case similar to *Lyondell*.
  - Transaction already closed.
  - No injunctive relief sought – just money damages.
  - Sale of control involved, so *Revlon* duties applicable.
- Activision’s charter eliminated personal liability of directors for breaches of duty of care.
- Plaintiff must allege facts sufficient to state a claim that directors violated duty of loyalty by:
  - acting in their own self-interest at the expense of Activision, or
  - otherwise failing to act in good faith.
- Court found no self-interest.



# Analysis of *Wayne County* Decision



- Like *Lyondell*, issue is whether directors breached duty of loyalty by failing to act in good faith.
- To establish failure to act in good faith, under *Lyondell*, relevant issue is whether directors “*utterly failed to attempt to obtain the best sale price.*”
- Merely showing directors failed to do all they should have done under the circumstances not adequate.
  - Only if directors knowingly and completely failed to undertake their responsibilities would they breach their duty of loyalty.

# Analysis of *Wayne County* Decision



- Plaintiff asserted three theories of a breach of the duty of loyalty by outside directors:
  - They allowed management directors to control the negotiations and advisors in the face of their conflict of interest.
  - They conducted no independent market check or canvass while management directors negotiated deal.
  - They obtained no control premium or other protective devices of substantial value for shareholders in the sale of control.

# Analysis of *Wayne County* Decision



- First charge – Management directors’ control of process.
- Board cannot completely abdicate its role in a change of control transaction.
  - Delaware law clear that in certain circumstances it is appropriate for a board to enlist management in negotiating a sale of control.

# Analysis of *Wayne County* Decision



- Committee met regularly through the negotiations and received updates on status of negotiations from management directors and financial and legal advisors.
- Committee instructed management directors to seek certain improvements in the deal.
- Court concluded that such actions “belie an inference that the outside directors completely abdicated their role” in negotiating and approving the transaction.



# Analysis of *Wayne County* Decision



- Second charge – No independent market check.
- Citing *Lyondell*, Court rejected claim that directors were required to conduct a market check to probe “for alternatives to demonstrate that they possess a reasonable basis to conclude that their choice is the best reasonable alternative.”
- *Revlon* does not prescribe any specific steps that must be taken by a board before selling control of the corporation.
  - So directors’ failure to take any specific steps during the sale process could not demonstrate a conscious disregard of their duties.



# Analysis of *Wayne County* Decision



- Third charge – Failure to obtain a control premium.
- Duty of directors in sale of control is to exercise their fiduciary duties in furtherance of the objective of obtaining the best price reasonably available for the shareholders.
- Any “control premium” would be included in the consideration received by the shareholders.
- No requirement that board obtain some consideration separately identified as a “control premium.”

## Analysis of *Wayne County* Decision



- Allegation that board failed to obtain a control premium – a thinly veiled attack on the adequacy of the price the board obtained.
- Plaintiff reversed proper order of inquiry if it suggested Court should evaluate whether the consideration received by the shareholders included a “control premium,” and then use the result of that inquiry to determine whether the directors breached their fiduciary duties.



# Analysis of *Wayne County* Decision



- Court declined to investigate the adequacy of the price to determine if it evidenced a breach of fiduciary duty.
- If directors fulfilled their fiduciary duties in the sale of control, Court will not second guess the business decision of the board.
- Court described its analysis as a “process-based” approach to evaluating director action.

# *Wayne County Practice Points*



- Thoroughly vet potential or actual conflicts of interest in individuals leading negotiations.
- If potential conflicts of interest exist, either remove conflicted individuals from the process or appoint a committee of disinterested directors to oversee the process and those individuals' involvement.

# *Wayne County Practice Points*



- If board appoints a committee of independent directors to oversee process, board should authorize the committee to retain independent financial and legal advisors
  - Committee should consider retaining its own outside advisors to independently evaluate the transaction and potential alternatives.
- Board should receive regular updates from individuals involved in negotiations, as well as from financial and legal advisors.



# *Wayne County Practice Points*

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- Board should maintain a clear record of involvement in the process, including directions given to individuals leading the negotiations.
- Board should consider what pre- and post-signing market check mechanisms (e.g., “go-shop” provisions) should be requested and document negotiation process.

*Police & Fire Ret. Sys. of The City of Detroit v. Bernal*  
(Del. Ch. June 26, 2009)



- In March 2009, Data Domain and NetApp began discussions of a possible business combination.
- In May 2009, Data Domain board was informed that another company in the industry, EMC Corporation, was also interested in acquiring Data Domain.
- A week before the scheduled meeting with EMC, Data Domain and NetApp entered into a merger agreement.



## *Bernal Basic Facts*

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- Agreement contained several deal protection provisions:
  - NetApp granted a five-day window to amend its offer to match a superior proposal from any third party.
  - Data Domain agreed to a “no-solicitation” provision.
  - Termination fee payable if Data Domain board accepted a superior proposal.
  - Data Domain directors and officers, holding 20% of stock, pledged to vote in favor of merger.

# Analysis of *Bernal* Decision



- EMC launched all cash tender offer for Data Domain.
- Plaintiff shareholder sought to enjoin application of NetApp deal protections.
- Different procedural posture from *Lyondell* and *Wayne County*.
  - Motion for preliminary injunction – deal not yet closed.
- Plaintiff claimed that Data Domain board, upon deciding to sell the company to NetApp, had a fiduciary duty under *Revlon* to maximize the sale price of the company.



# Analysis of *Bernal* Decision



- Only issue before Court: should plaintiff's request for an injunction proceed on an expedited schedule.
  - Permit hearing to take place before merger closed.
- Court found that plaintiff had stated a colorable claim that Data Domain board "is favoring one bidder over others, thereby deterring bids from third parties that could provide greater value to Data Domain shareholders."

## Analysis of *Bernal* Decision



- In procedural context of requesting injunctive relief, exculpatory charter provision not relevant.
- Plaintiff could get relief for breach of duty or care or breach of duty of loyalty.
- One requirement for granting injunctive relief – irreparable harm.

# Analysis of *Bernal* Decision



- Data Domain has a charter provision exculpating its directors from personal liability for monetary damages for breach of duty of care.
- If merger consummated, shareholders would be limited to seeking monetary damages for breach of duty of loyalty.
- Referring to high standard for liabilities in such cases as prescribed by *Lyondell*, Court stated because such burden is so difficult to meet, “injunctive relief may be only relief reasonably available to shareholders” for breach of duty of loyalty.



## *Bernal* Implications

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- Case may show that in contested takeover situation, courts more likely to review board actions.
- Breach of duty of care may be easier to demonstrate than breach of duty of loyalty.
- Injunctive relief may be easier to obtain than post-closing monetary damages.

# Oversight vs. Transactional Cases



- Previous cases discussed were transactional – *i.e.*, in context of a takeover.
- Delaware courts have also addressed concept of good faith in “oversight” context.
  - *Stone v. Ritter*
  - *Caremark*
- Oversight cases involve alleged breach of fiduciary duty for failure to properly oversee operations of company.
- In light of recent financial difficulties, more litigation in oversight cases may be expected.



## *In re Citigroup Inc. S'holder Deriv. Litig. (Del. Ch. February 24, 2009).*



- Shareholder derivative action against Citigroup board seeking to recover for company's losses from subprime market.
- Suit alleges Citigroup directors breached their fiduciary duties by failing to properly monitor and manage risks related to subprime market.

# Analysis of *Citigroup* Decision



- *Caremark* provided that directors could be liable for a failure to monitor only if there is a sustained or systematic failure of the board to exercise oversight.
- *Stone v. Ritter* made clear that director oversight liability is based on concept of good faith imbedded in duty of loyalty.
  - Bad faith is a necessary condition to director oversight liability.
- Imposition of liability requires a showing that the directors knew that they were not discharging their fiduciary obligations.



## Analysis of *Citigroup* Decision



- Typical *Caremark* case based on a failure to properly monitor or oversee employee misconduct or violations of law.
- *Citigroup* based on defendants' alleged failure to properly monitor Citigroup's *business risk*.
- Plaintiff's theory was that certain "red flags" should have put defendants on notice of problems in the subprime market.

# Analysis of *Citigroup* Decision



- Court rejected the claim.
- Claims are more properly claims for breach of duty of care and subject to protection of business judgment rule.
  - Liability under business judgment rule is predicated on concept of gross negligence.
- Citigroup has charter provision eliminating personal liability for breach of duty of care.
- Any recovery must be based on breach of duty of loyalty
  - *i.e.*, bad faith.

# Analysis of *Citigroup* Decision



- Fundamental difference between failing to oversee employee fraudulent or criminal conduct and failing to recognize the extent of a company's business risk.
- Court contrasted *Citigroup* with *AIG* (Del. Ch. Feb. 10, 2009) – recent case involving failure to monitor by AIG directors.
  - In *AIG*, Court rejected motion to dismiss a complaint that included well-pled allegations of pervasive, diverse, and substantial financial fraud involving managers at the highest levels of AIG.

# Analysis of *Citigroup* Decision



- Obligation to implement and monitor a system of oversight “does not eviscerate the core protections of the business judgment rule – protections designed to allow corporate managers and directors to pursue risky transactions without the specter of being held personally liable if those decisions turn out poorly.”
- Citigroup did have procedures and controls in place designed to monitor risk.
- Citigroup in the business of taking on business risk.
- Court dismissed claims for breach of fiduciary duty for failing to monitor risky investments.

## Fiduciary Duty of Officers – *Gantler v. Stephens* (Del. Supreme Court January 27, 2009)



- Complaint that officers and directors of First Niles violated their fiduciary duties by rejecting a valuable opportunity to sell the company
- *Gantler* confirms that officers of a Delaware corporation have the same fiduciary duties of loyalty and care as directors.

## Fiduciary Duty of Officers – *Gantler*



- Does not mean that consequences of a fiduciary breach by directors or officers would necessarily be the same.
- Section 102(b)(7) of DGCL permits a corporation to exculpate its directors from monetary liability for breach of duty of care.
- Although legislatively possible, there currently is no statutory provision authorizing comparable exculpation of corporate officers.



# *Gantler Practice Points*



- Review officer indemnification provisions in bylaws and any individual indemnification agreements with officers.
  - Particularly important in view of recent Delaware decision holding bylaw indemnification provisions can be altered to the detriment of former directors and, presumably, former officers.
- Review language in D&O policy to assure it provides protection, to the extent possible, for claims of officer breach of fiduciary duties.



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## **PANEL V.**

# **BOARD OF DIRECTORS FIDUCIARY OBLIGATIONS IN M&A AND RESTRUCTURINGS**

## **Going Private Transactions**

John B. Wright, II

## WHO CHOOSES TO GO PRIVATE?

- Thinly traded
- Trading at low multiples – takeover targets
- Market cap below national securities exchange requirements
- Concentrated ownership / poor analyst coverage

## WHY GO PRIVATE?

- Eliminate public company costs – especially SOX
- Escape public company scrutiny
- Avoid public company disclosure requirements
- Focus on the long term
- Have concentrated, more responsive ownership

## WHY NOT GO PRIVATE?

- Going private is costly
- Going private is time-consuming
- Loss of public company advantages
- Exposure to personal liability in transaction
- Risk of encountering competing buyers

## ALTERNATIVE TRANSACTION STRUCTURES

- Tender offer / short-form merger
- Long-form merger
- Reverse stock split
- Sale of assets and dissolution

## DEMONSTRATING “FAIRNESS”

- Key Standards:
  - Business Judgment Rule v. Entire Fairness
- Business judgment rule:
  - Presumption that directors act in good faith and with an honest belief that action is in the best interests of the corporation
- Entire Fairness:
  - If directors are “interested,” then directors must establish “entire fairness”

## ENTIRE FAIRNESS

- Two components but considered as a whole
- Fair dealing:
  - How the transaction was timed, initiated, structured, negotiated, disclosed to directors and approved
- Fair price:
  - Consideration of price in light of all relevant economic and financial considerations, e.g., market value, future prospects and earnings
- Only if the directors establish entire fairness does burden shift back to minority shareholders to prove otherwise

## SPECIAL COMMITTEES

- One approach to demonstrate fairness: a Special Committee
  - Consist solely of independent and disinterested directors
  - Negotiate aggressively on behalf of shareholders
  - Directors must attend and participate
  - Must review advisors' reports critically
  - Committee charter should give broad flexibility

## SPECIAL COMMITTEES (cont'd)

- Must act prudently, in good faith and in the interests of all shareholders
- May have to consider competing bids
- Actions should be carefully documented
- Minutes must be carefully kept

## SPECIAL COMMITTEES (cont'd)

- Outside advisors
  - Should retain its own independent legal counsel
  - Should retain an independent financial advisor or investment banker knowledgeable about the company and going private transactions
  - The company should be responsible for all fees and expenses

## SPECIAL COMMITTEE PROCESS

- Investment banker completes financial and business review of seller and buyer and meets with management of both parties
- Analysis of transaction, with methodologies selected depending on transaction structure and type of business
- Investment banker answers the questions of the Special Committee
- Opinion whether offer price falls within the range of fairness
- If not, Special Committee may engage in further negotiations

## FEDERAL REGULATION: SEC RULE 13e-3

- Generally applies to going private transactions –
  - Involving the purchase of an equity security of –
  - Issuer with a class of equity securities registered under Exchange Act Section 12 or subject to the reporting requirements under Exchange Act Section 15(d)

## RULE 13e-3 TRANSACTIONS

- Any transaction –
  - By an issuer or an affiliate of the issuer
  - Having the effect of causing a class of equity securities
    - not to be listed on an exchange
    - not to be authorized to be quoted on an inter-dealer system
    - to be held of record by fewer than 300 persons

## RULE 13e-3 TRANSACTIONS (cont'd)

- Includes
  - Purchases of equity securities
  - Tender offers
  - Solicitations of proxies or consents under Regulation 14A in connection with
    - Merger, consolidation, etc. between issuer and affiliate
    - Sale of assets of issuer to its affiliate or group of affiliates
    - Reverse stock split with the purchase of fractional interests

## TRANSACTION BETWEEN ISSUER AND AN “AFFILIATE”

- “Affiliate” means “a person that directly or indirectly through one or more intermediaries controls, is controlled by or is under common control with” the issuer
- Broader than the ownership of a specific percentage
  - Common Board membership
  - Management retained with favorable treatment
  - Significant management equity participation in acquirer

## TRANSACTION COMMENCEMENT

- Transaction deemed to commence upon occurrence of earliest transaction in a series of transactions that is reasonably likely to produce, or has the purpose of producing, the effect specified in the rule.

## FILINGS REQUIRED BY RULE 13e-3

- Schedule 13E-3 with all exhibits
- Amendments if applicable
- Final amendment reporting results

## DISCLOSURE REQUIRED

- Summary Term Sheet
- Purpose of transaction
- Fairness of transaction
- Fairness opinion
- Legends, appraisal rights, etc.

## OTHER INFORMATION RE RULE 13e-3

- Some transactions exempt: e.g., clean-up mergers within a year
- January 2009: SEC issued Compliance and Disclosure Interpretations (“C&DIs”)



Triumph Group, Inc.

**Thank you!**