

U.S. ANTITRUST AGENCIES TIGHTEN MERGER REMEDY STANDARDS

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Merger remedies have become a renewed focus for the U.S. Department of Justice (“DOJ”) and the Federal Trade Commission (“FTC”) in recent months. Officials at both agencies have publicly expressed skepticism of “behavioral” remedies (that is, settlement terms that require or prohibit certain conduct like forced arbitration and firewalls) and a preference for divestitures to cure problematic mergers (“structural” remedies). FTC senior staff have expressed skepticism about divestitures that require select assets to be sold rather than complete manufacturing capabilities. DOJ recently has revised its consent decree terms to enhance DOJ’s ability to enforce its settlements; most importantly, the new terms lower the evidentiary standard for proving a defendant has violated the terms of a consent decree settlement.

As a practical matter, these recent changes and commentary suggest that finding remedies to allegedly anticompeti-

tive mergers that the agencies will accept will be more difficult. Behavioral remedies, historically viewed as the way to address competitive problems in vertical mergers, may be less likely to be accepted. Certain structural remedies, especially for complex pharmaceutical products, may have to include the divestiture of manufacturing capabilities and ongoing businesses. Further, when dealing with DOJ, companies may face heightened legal exposure for alleged violations of consent agreement settlement terms; going forward, they must be especially careful to comply with settlement provisions to avoid a violation or perception of a violation, given the new, lower standard for a civil contempt action.

IN THIS ISSUE:

U.S. Antitrust Agencies Tighten Merger Remedy Standards	1
The Role of Section 220 in Stockholder M&A Litigation	6
Contracting Party Beware: The Implied Covenant Will Not Save You From Your Agreement If You Negotiated Away Your Rights	11
All Merger Side Letters Must Be Included in HSR Filings	14
From the Editor	17

J., *U.S. v. Transdigm Group Inc.*, No. 1:17-cv-02735 (D.D.C. Dec. 21, 2017), available at <https://www.justice.gov/opa/press-release/file/1019821/download>; Proposed Final J., *U.S. v. Vulcan Materials Comp.*, No. 1:17-cv-02761 (D.D.C. Dec. 22, 2017), available at <https://www.justice.gov/opa/press-release/file/1020536/download>.

¹⁶Press Release, *Justice Department Reaches Settlement with Henry Ford Allegiance Health on Antitrust Charges* (Feb. 9, 2018), available at <https://www.justice.gov/opa/pr/justice-department-reaches-settlement-henry-ford-allegiance-health-antitrust-charges>.

¹⁷Makan Delrahim, Assistant Att’y Gen., Antitrust Division, U.S. Dep’t of Justice, Antitrust Division, Improving the Antitrust Consensus, Remarks at the New York State Bar Association, Delivered by Andrew C. Finch, Principal Deputy Assistant Att’y Gen., Antitrust Division, U.S. Dep’t of Justice (Jan. 25, 2018), available at <https://www.justice.gov/opa/speech/remarks-assistant-attorney-general-makan-delrahim-delivered-new-york-state-bar>.

¹⁸Agencies could also pursue criminal contempt under 18 U.S.C.A. § 401.

THE ROLE OF SECTION 220 IN STOCKHOLDER M&A LITIGATION

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A stockholder plaintiff seeking to challenge a merger no longer has a clear path to discovery. Unless a competing bidder is waiting in the wings, an injunction seems improbable. As a result, before getting any discovery, a stockholder

plaintiff likely will bear the burden of alleging well-plead facts “that support a reasonable inference that the stockholder vote was uninformed or coerced. This is no easy task.”¹

But now another door has cracked open. In *Lavin v. West*, the Court of Chancery ordered production of documents to a stockholder plaintiff under Section 220 of the DGCL to investigate potential wrongdoing in a pending merger.² As discussed below, there are important lessons in the Court’s decision about how and when this door will be open to stockholders in the future, but the mere fact that stockholder plaintiffs now have another possible path to discovery in advance of a *Corwin* motion changes the landscape.

Background Facts

In November 2016, the board of directors of West Corporation announced that it would explore strategic alternatives, including a sale of one or more operating businesses and a sale of the company. West explored widely, contacting 55 potential counterparties and entering into 30 confidentiality agreements. By January 2017, the board was focused on finding a buyer for the whole Company.³

It found Apollo Global Management, and on May 9, 2017, West and Apollo signed a merger agreement. West filed a preliminary proxy on June 15, and the definitive proxy 12 days later. “Within a few days,” five stockholder plaintiffs filed class action complaints in federal court challenging the company’s disclosures in connection with the merger. On July 19, West issued a supplemental proxy to moot those disclosure claims.⁴ The sale process was following a well-worn path and the deal was on track to close

without serious interference by stockholder litigation.

Then, a wrinkle: On July 19, plaintiff Mark Lavin demanded to inspect books and records pursuant to Section 220 of the DGCL. His stated purpose was to investigate possible wrongdoing in the merger and evaluate possible conflicts of interest among the directors.⁵

On July 26, West rejected the demand on the grounds that Lavin did not state a “credible basis” of wrongdoing and that the demand was overbroad. Later that day, West stockholders approved the merger.⁶

The next day, Lavin filed his Section 220 action to obtain the documents he requested in his demand. The parties stipulated to try the case on a paper record—without depositions or live testimony. Trial took place on October 9. The merger closed the next day.⁷

The Court of Chancery’s Decision

The Court of Chancery concluded that the plaintiff established a credible basis to suspect wrongdoing, which entitled him to some, but not all, of the documents he demanded.

Credible Basis: In seeking to establish that he had a “credible basis” to suspect wrongdoing in connection with the merger, the plaintiff made arguments that stockholder plaintiffs have traditionally made in the context of motions to expedite in support of preliminary injunction motions. He argued that the board had other, value-maximizing paths available—selling the company’s operating businesses rather than a sale of the whole company—that were better for stockholders, but worse for the board members, thus creating conflicts of interest. He argued that the sell-

side financial advisor was also conflicted. Finally, he argued that even after issuing the supplemental proxy, the company failed to disclose material information relating to the merger.⁸

In response, West made the argument that defendants typically make in the context of motions to dismiss post-closing merger litigation. It argued that the plaintiff’s disclosure claims were not viable, and as a result, that the stockholders approved the transaction on a fully informed basis, invoking a *Corwin*⁹ defense to the plaintiff’s Section 220 demand.

The Court rejected West’s attempt to accelerate application of a *Corwin* defense from the pleadings stage of a plenary case to a books-and-records action in advance of a plenary case. Instead, the Court of Chancery reasoned that it “should encourage stockholders, if feasible, to demand books and records before filing their complaints when they have a credible basis to suspect wrongdoing in connection with a stockholder-approved transaction and good reason to predict that a *Corwin* defense is forthcoming.”¹⁰

Having refused to apply the *Corwin* defense, the Court held that the plaintiff cleared the low bar that is the “credible basis” standard. That is, he presented “ ‘some evidence’ that West’s directors and officers may have breached their *Revlon* duties, possibly in bad faith.”¹¹

Scope of Inspection: The plaintiff requested 13 categories of documents that read more like discovery requests in a plenary case:

- Books and records referred to in drafting the proxy;

- Board minutes and materials relating to the sale process;
 - Bids received from potential acquirors;
 - Projections and financial information that West gave its financial advisor;
 - The financial advisor’s presentation materials;
 - West’s historical and projected financials;
 - West’s business plans, budgets, and projections;
 - Documents sufficient to show the interests of directors and officers in the merger;
 - Board materials about director independence;
 - Deal-related communications of West’s “key negotiators”;
 - Confidentiality agreements; and
 - West’s financial advisor engagement letter and conflict disclosures.¹²
- Financial analysis provided to the board during the sale process;
 - Bids received from potential acquirors;
 - Board minutes relating to the sale process;
 - Deal-related communications of West’s “key negotiators”; and
 - Board materials about director independence.¹⁴

Thus, despite limiting the scope of what the plaintiff demanded, the Court did order the production of directors’ emails in the context of a Section 220 action.

Future Implications for Section 220 Demands Arising Out of Public Company Mergers

Will the issue of standing create another race to the courthouse? In *Weingarten v. Monster Worldwide, Inc.*, the Court of Chancery addressed standing for a stockholder of the target corporation who seeks books and records in connection with a merger.¹⁵ In a Section 220 action filed after the merger closed, the Court held that the former stockholder lacked standing to proceed, concluding that Section 220 requires that a plaintiff be a stockholder at the time of filing.¹⁶

Unlike *Weingarten*, the plaintiff in *Lavin* unquestionably was a stockholder when he made his Section 220 demand and filed his Section 220 action. He remained a stockholder through trial but was merged out the next day. West did not challenge Lavin’s standing to pursue his Section 220 claim,¹⁷ and the Court did not analyze the issue, even though it could have.¹⁸ It remains possible, therefore, that a court in a future case could hold that a stockholder loses standing if the

West argued that this was overbroad.

The Court ruled that the plaintiff would receive only those documents “necessary” to permit the plaintiff to investigate the suspected wrongdoing for which he established a credible basis—“whether the Board knew a sale of segments separately would be more valuable to stockholders than the Merger, and whether the Board pursued the Merger nevertheless for the benefit of its members, senior management, and private equity investors and to the detriment of the other stockholders.”¹³ The court ordered West to produce a subset of what the plaintiff requested:

merger closes before he has received production of the requested documents.¹⁹ And, by analogy to a derivative plaintiff who involuntarily violates the continuous ownership requirement as a result of a merger, there is support for that argument.²⁰

Going forward, the standing rules remain unsettled. A plaintiff must be a stockholder at the time of filing, and thus may not file her Section 220 action after a merger closes. But what if the plaintiff in *Lavin* filed his complaint one day before the merger closed, instead of trying his case that day? A plaintiff probably prefers not to take the risk that a court would conclude that she lost standing when the merger closed in that scenario.

But that creates a perverse incentive of, once again, urging plaintiffs' lawyers to move quickly when one would hope they would move judiciously.²¹ It creates the mirror image perverse incentive on the defense side of encouraging merger targets to rush to closing while stalling their Section 220 litigations in the hopes of strengthening the standing argument. The resulting race between a plaintiff's Section 220 case and the closing of a merger would be systematically wasteful and counter-productive.

What will plaintiffs have to show to satisfy the "credible basis" standard? As the Court of Chancery explained in its decision, the "credible basis" standard that a Section 220 plaintiff must meet "is the lowest burden of proof known in our law; it merely requires that the plaintiff present 'some evidence' of wrongdoing."²² As a result, the "credible basis" standard applicable to Section 220 demands should not filter out any more cases than the "colorable claim" standard on a contested motion for expedited proceedings.²³ As

a result, Section 220 could be used to pry open the floodgates of discovery that *Corwin* and *C&J* helped to close.²⁴

What will be the scope of production? Section 220 only permits plaintiffs those documents that are "necessary and essential" to investigate the suspected wrongdoing.²⁵ In *Lavin*, the Court granted the plaintiff a facsimile of the "core documents" that defendants often willingly gave to stockholder plaintiffs instead of opposing expedition²⁶—board minutes and materials relating to the challenged transaction.

But the Court went further. It also granted emails of the sell-side negotiators, which significantly increases the cost and the risk of a Section 220 production. From the standpoint of a defendant trying to mitigate the risk of a plenary case, avoiding email production is probably the most important and litigable issue in a Section 220 case for a merger target.

ENDNOTES:

¹*Lavin v. West Corporation*, 2017 WL 6728702, at *8 (Del. Ch. 2017), judgment entered, 2018 WL 565492 (Del. Ch. 2018).

²See generally *Lavin v. West Corporation*, 2017 WL 6728702 (Del. Ch. 2017), judgment entered, 2018 WL 565492 (Del. Ch. 2018).

³*Id.* at *4.

⁴*Id.* at *5.

⁵*Id.* at *6.

⁶*Id.*

⁷*Id.* at *5 n. 46 and *6.

⁸*Id.* at *6.

⁹See generally *Corwin v. KKR Financial Holdings LLC*, 125 A.3d 304 (Del. 2015) (establishing business judgment rule as the standard of

review for third-party transactions approved by fully informed stockholder vote).

¹⁰*Lavin v. West Corporation*, 2017 WL 6728702, at *9 (Del. Ch. 2017), judgment entered, 2018 WL 565492 (Del. Ch. 2018).

¹¹*Id.* at *13.

¹²See Plaintiff's Opening Trial Brief, *Lavin v. West Corp.*, C.A. No. 2017-0547-JRS, at 27-38 (Del. Ch. Sept. 6, 2017)..

¹³*Lavin v. West Corporation*, 2017 WL 6728702, at *14 (Del. Ch. 2017), judgment entered, 2018 WL 565492 (Del. Ch. 2018).

¹⁴*Id.*

¹⁵See generally *Weingarten v. Monster Worldwide, Inc.*, 2017 WL 752179 (Del. Ch. 2017).

¹⁶*Id.* at *5 (“The language of Section 220(c) is plain and unambiguous. By requiring that a plaintiff under Section 220, to seek relief from this Court, demonstrate both that it ‘has’—past tense—complied with the demand requirement, and that it ‘is’—present tense—a stockholder, the legislature has made clear that only those who are stockholders at the time of filing have standing to invoke this Court’s assistance under Section 220.”).

¹⁷*Lavin v. West Corporation*, 2017 WL 6728702, at *5 n. 46 (Del. Ch. 2017), judgment entered, 2018 WL 565492 (Del. Ch. 2018).

¹⁸*Thornton v. Bernard Technologies, Inc.*, 2009 WL 426179, at *4 (Del. Ch. 2009) (“Standing is a threshold question, and, because standing is jurisdictional in nature, the Court may raise it *sua sponte*.”).

¹⁹But see *Deephaven Risk Arb Trading Ltd. v. UnitedGlobalCom, Inc.*, 31 Del. J. Corp. L. 292, 2005 WL 1713067, at *7 (Del. Ch. 2005) (holding that post-trial merger did not sever plaintiff’s standing).

²⁰*Cf. El Paso Pipeline GP Company, L.L.C. v. Brinckerhoff*, 152 A.3d 1248 (Del. 2016) (rul-

ing that plaintiff lost standing to recover \$171 million judgment as a result of a merger that closed between trial and the court’s decision).

²¹See, e.g., *Biondi v. Scrushy*, 820 A.2d 1148, 1162 (Del. Ch. 2003), aff’d, 847 A.2d 1121 (Del. 2004) (discussing the “public policy interest favoring the submission of thoughtful, well-researched complaints—rather than ones regurgitating the morning’s financial press”); *Cf. La. Mun. Police Emps.’ Ret. Sys. v. Pyott*, 46 A.3d 313, (Del. Ch. 2012) (describing in depth the “fast-filer” problem in derivative litigation).

²²*Lavin v. West Corporation*, 2017 WL 6728702 (Del. Ch. 2017), judgment entered, 2018 WL 565492 (Del. Ch. 2018).

²³See generally *Giammargo v. Snapple Beverage Corp.*, 1994 WL 672698, at *2 (Del. Ch. 1994).

²⁴See generally *Corwin v. KKR Financial Holdings LLC*, 125 A.3d 304 (Del. 2015) (establishing business judgment rule as the standard of review for third-party transactions approved by fully informed stockholder vote); *C & J Energy Services, Inc. v. City of Miami General Employees’*, 107 A.3d 1049 (Del. 2014) (reversing preliminary injunction and holding that there is no irreparable harm when stockholders have the right to vote on pending transaction).

²⁵*Lavin v. West Corporation*, 2017 WL 6728702, at *14 (Del. Ch. 2017), judgment entered, 2018 WL 565492 (Del. Ch. 2018).

²⁶*In re Trulia, Inc. Stockholder Litigation*, 129 A.3d 884, 892 (Del. Ch. 2016) (“[M]any defendants self-expedite the litigation by volunteering to produce ‘core documents’ to plaintiffs’ counsel, obviating the need for plaintiffs to seek the Court’s permission to expedite the proceedings in aid of a preliminary injunction application and thereby avoiding the only gating mechanism (albeit one friendly to plaintiffs) the Court has to screen out frivolous cases and to ensure that its limited resources are used wisely.”).