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Cooley U: M&A for the Board of a Small Company

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Sell Side M&A Scenarios

- Bidder or potential bidder approaches the Company
- The Company decides to embark on a sale process
- Investor pressure
- ***What next?***

Setting the Stage: Constituents

- Stockholders (stockholder support)
 - VC Investors/Preferred Stockholders
 - Common Stockholders/Optionholders
- Management (equity incentives, change in control payments, post-closing employment and non-competes)
- Employees (acqui-hires)
- Lenders/Creditors

Setting the Stage – Preliminary Matters

- Confidentiality
 - Importance of Confidentiality
 - ▶ Protecting Confidentiality
 - ▶ Running Competitive Process
 - ▶ Setting the Tone for Negotiations
 - Access to Confidential Information
- Term-Sheet Discussions
- Exclusivity
- Attorney-Client Privilege
- Board Committee – do you need one?
- Board Minutes

Fiduciary Duties

- Importance of Process as well as Substance
 - Overall focus on active, informed, deliberative decision-making process
- **Duty of Care**
 - Directors must inform themselves of all material information reasonably available to them and act with due deliberation and requisite care in discharging their duties
 - ▶ Access to relevant information
 - ▶ Delivery of materials sufficient time in advance of board meetings
 - ▶ Deal-related board meetings
 - Discuss alternatives, including the alternative of remaining independent
 - Each director should consider all factors that he or she deems relevant to assessing the merits of the proposed transaction as compared with alternative courses of action

Fiduciary Duties

- **Duty of Care (contd.)**
 - Factors to be considered by the board include:
 - The company's business, financial performance, financial condition and prospects
 - The terms and conditions of the transaction, including the price to be paid for the company and the likelihood of consummation of the transaction
 - In certain transactions, buyer's business, financial performance, financial condition, strategy and prospects
 - In certain transactions, the ability to integrate operations smoothly, to attain synergies and to achieve strategic objectives

Fiduciary Duties

- **Duty of Care (contd.)**
 - Directors may rely on reports of management and advice of counsel, accountants, investment bankers and others whom they reasonably believe are acting in areas of their professional expertise and have been selected with reasonable care
 - Although directors may rely on the advice of advisors, the directors cannot substitute their advisors' judgment for their own
 - **There is no duty to sell the company; however, it is important to provide appropriate consideration to legitimate acquisition proposals**

Fiduciary Duties

- **Duty of Loyalty**

- ▶ In general, directors may not engage in self-dealing/act for a personal or non-corporate purpose
- ▶ Directors must timely disclose to the board any personal interests in a transaction, such as:
 - ▶ Interests in, or relationships with, the possible buyer or any of its affiliates
 - ▶ Employment or change-in-control benefit discussions or arrangements
- ▶ Directors must act in good faith and with the reasonable belief that their actions are in the best interests of the company and its stockholders

Fiduciary Duties

- **M&A-Specific Duties**
 - **Business Judgment Rule**
 - Some board decisions are covered by the Business Judgment Rule
 - Under Delaware law, if certain prerequisites are satisfied, the Business Judgment Rule will apply to the decision by a board of directors to enter into certain M&A transactions
 - The Business Judgment Rule provides that when directors act in good faith, on an informed basis; and with the honest belief that the action taken (or not taken) is in the best interests of the company and its stockholders, their actions will be upheld so long as they are attributable to a rational business purpose

Fiduciary Duties

- **M&A-Specific Duties**

- There are several prerequisites to the application of the Business Judgment Rule, including that the board must fulfill the following fiduciary duties:
 - Duty of care
 - Duty of loyalty (including good faith)

- **Duty of Candor**

- When soliciting votes from stockholders, directors must disclose all facts that would have a material effect on the stockholders' decision to approve or reject the transaction

Fiduciary Duties

- **“Revlon” Duties**
 - When they apply
 - Actions designed to obtain the highest short-term value reasonably attainable
- **Strategies**
 - Hiring financial advisor
 - “Market Check” and deal-protection
 - Auction

Fiduciary Duties

- **When Business Judgment may not apply**
 - Where a “controlling shareholder” is buying out the minority
 - Where management is on the “buy-side” (e.g., teams up with a private equity buyer) and where a majority of directors are not independent
- Highest level of scrutiny to a challenged transaction – entire fairness
 - Directors have burden to prove both fair price and fair process
 - However, burden can sometimes be shifted (special committee, etc).