<u>Corporate Governance</u>

Directors have a responsibility to show:

1. Loyalty

    Put shareholder interests above their own, acting in a disinterested manner

2. Care

    Be well informed
    Must not be negligent or close their eyes to the facts

Business Judgment rule: Directors are assumed to meet these standards unless proven otherwise

    Principle: Courts do not want to second-guess board decisions
    You can have a stupid board, but you can't sue them unless they acted in their own self-interest or they violated their duty of care

Penalties:

1. Personal liability (rare)
2. Injunctive relief (much more common)

    Enjoin (or reverse) the decision of the directors, by the court

There are 3 big cases in M&A:

    Revlon
    Unocal
    Society for Savings

Case	**Pressure**	**Application**	**Court Finding**
Revlon	Most onerous	Auctions	Directors must maximize short-term value --> must take highest price
Unocal	Middle	Unsolicited hostile offers	The takeover defense must be proportional to the threat
SOCS	Least onerous	Strategic combinations	Not obliged to maximize short-term value in a strategic combination

Revlon Principle

Directors must maximize short-term value in the following situations:

- Auctions of the company
- A break-up transaction in response to a bid
- Engaging in a sale transaction that results in a change of control
    - Last condition can be tricky if there are a large # of shares held in the hands of the public, freely trading them

Example: Paramount

Had a deal with Viacom (controlled by Sumner Redstone)
QVC (controlled by Barry Diller) makes an offer for Paramount that matches and/or beats the Viacom deal
Paramount and Viacom try to "put the deal away" (I.e. to make it impregnable to a third-party bid)

- Termination fee of $100 mm payable to Viacom if deal is unfulfilled
- Lockup option on Paramount stock granted to Viacom in respect of 19.9% of Paramount common
    - Note: If there is an increase in shares outstanding by > 20% without a S/H vote, NYSE will delist the stock **17(e)**
    - Ensures Viacom handsomely compensated if QVC wins
- No shop clause: Paramount couldn't talk to another party unless that party had the ability to finance the deal immediately

Court held that the directors of Paramount were bound by Revlon

- If Viacom had succeeded, it would have been a change of control
- Rescinded the protective provisions

Example: Society for Savings

SOCS starts soliciting bids in 1991

- Received 9 bids, 2 of which are prominent
- Goldman - leveraged deal, complicated, $19.25/share
- Bank of Boston - all stock-for-stock deal

May 1992: Board of SOCS says that they want to be independent --> no bid accepted
August 1992: SOCS announces merger with BKB, stock-for-stock at $17.30/share
Goldman reiterates its $19.25/share bid in cash
SOCS directors tells GS no --> BKB deal is a better strategic fit
SOCS investors sue under the Revlon principle

Court: Not obligated to take the higher price in a strategic combination

Strategic combination: --> stock-for-stock as evidence of joint economic interest

Problem: Wasn't it an auction? Was there a 'decent' interval of time?

Example: Unocal Precedent in Unitrin

Unitrin --> 23% owned by Henry Singleton (also the CEO of Teledyne)
American General offers a 30% premium for Unitrin (skimpy-ish premium)
Unitrin response

Announces a shareholder rights plan in which anyone with over 15% of the stock needs a 75% S/H vote to do a merger
Announces a buyback of shares which if successful will give Singleton over 25% ownership (a blocking minority)

Court decided that the Unitrin response was excessive

Preclusive of a merger
Benefited a member of the Board