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Leo E. Strine, Jr.

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Harvard Law School
Cambridge, MA 02138

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Leo E. Strine, Jr.[*] [**]

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[*] Leo E. Strine, Jr. is Chief Justice of the Delaware Supreme Court; Austin Wakeman Scott Lecturer on Law and Senior Fellow, Program on Corporate Governance, Harvard Law School; Adjunct Professor of Law, University of Pennsylvania Law School and Vanderbilt University Law School; and Henry Crown Fellow, Aspen Institute.

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Abstract

This article addresses what legal and financial advisors can do to conduct an M & A process in a manner that: i) promotes making better decisions; ii) reduces conflicts of interests and addresses those that exist more effectively; iii) accurately records what happened so that advisors and their clients will be able to recount events in approximately the same way; and iv) as a result, reduces the target zone for plaintiffs' lawyers.

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If you take to heart my remarks today, you will upset some of my good friends in the plaintiffs' bar. In other words, if you want to make the lives of plaintiffs' lawyers more difficult, listen up. If you don't, then disregard what I'm about to say. That will make them happy.

That is because the focus of my remarks is on what you can do as legal and financial advisors to conduct an M & A process in a manner that: i) promotes making better decisions; ii) reduces conflicts of interests and addresses those that exist more effectively; iii) more accurately records what happened so that you and your clients will be able to recount events in approximately the same way; and iv) as a result, reduces the target zone for your favorite plaintiffs' lawyers.

My discussion of these topics will be illustrative, not exhaustive. But, I will attempt to focus on aspects of typical M & A processes that give rise to litigable issues that could be defanged or avoided altogether by taking a more thoughtful approach.[1]

[1] The experiential base for this lecture is drawn largely from my years on the Delaware Court of Chancery from 1998-2013, my service as a corporate litigator at Skadden, Arps, Slate, Meagher & Flom LLP from 1990-1993, and many hours of discussions not only with my judicial colleagues, but perhaps more importantly, by countless hours of confidential, candid discussions with distinguished M & A transactional lawyers, litigators, investment bankers and directors. Contrary to the cynicism that can pervade discussions of the topic, many top level M & A advisors have a genuine concern about the integrity of large scale transactions and a desire for the fiduciaries involved to serve the interests they represent in a good faith and effective way. This is not to say that they do not seek to advance the interests of their clients in obtaining legitimate economic advantage, but they do want the game to be a fair one.

I have purposely decided not to lard the lecture with footnotes to specific cases illustrating the points I make. That would not be difficult because many of the problems I identify have surfaced in the reported decisions in rather famous cases, such as the iconic *Mills Acquisition Co. v. Macmillan, Inc.* decision decided in 1989. *See* 559 A. 2d 1261 (Del. 1989).

To do so, I ground the discussion in certain fundamental principles of corporate law that are too often slighted. Put succinctly, those principles give credit to impartial fiduciaries who make rational business judgments, and entitle those fiduciaries to rely upon the advice of impartial experts as a defense.

With those fundamentals in mind, I then examine some of the foundational stages of the deal process, including those involving the identification of managerial and board conflicts, the selection of advisors and the management of any conflicts, and the reasons why such advisors are hired.

Once I have discussed why impartial decision-making is so fundamental to our system, what that means for outside advisors in typical M & A deals when management has conflicts, and why directors are entitled to rely upon the advice of those advisors, I will address certain recurring issues in documenting the M & A process. Despite having the ability to write the play, too many advisors leave out critical parts of the story line, depriving their clients of reliable memory aids in situations where they may be unable to

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Many of the others, though, would be familiar to M & A litigators because they have arisen repeatedly in the context of depositions or trial testimony in major cases. The examples I give are, as indicated, illustrative, but they are ones that have left a deep impression over a lengthy period during which I handled many business disputes and regularly chewed over the business disputes before my Chancery colleagues. Obviously, it may be the case that a judge's sense of problematic issues is not something that should be taken seriously by M & A practitioners, who may subscribe to certain forms of deconstructionist thinking, under which nothing can be taken at face value.

That is of course up to them. But there may be some value in them for those who take a more traditional view, especially in a system where judges not only make legal rulings but find the facts. It is in a constructive spirit that I advance these thoughts, one in keeping with the spirit of some of my distinguished judicial predecessors. *See e.g.*, William T. Allen, *Independent Directors in MBO Transactions: Are they Fact or Fantasy?*, 45 Bus. Law. 2055, 2062 (1990).

accurately recollect the reasons for decisions they made. This contributes to the possibility that directors, managers and advisors will have different recollections of material events when they testify in litigation. Not only that, the record often fails to document the most important advice given by outside advisors, because the record is sanitized of their actual business advice, and leaves the impression that independent directors made all kinds of difficult strategic and tactical decisions in a context fraught with managerial self-interest, based on their own acumen and intuition, and with only the backstop of a caveat laden, liability insulating fairness opinion in which the financial advisor disclaims having done any independent thinking and professes to have relied exclusively upon information it was provided by management.

A credibility problem emerges with stockholders when the financial advisor and the directors remember the M & A process differently. Differences in memory also arm plaintiffs' lawyers with powerful arguments, and put the fact finder in a judicial proceeding in the difficult position of determining who to believe, in a context when many defendants will have had powerful economic incentives that the plaintiffs can plausibly argue skewed their thinking.

Like all my judicial colleagues in Delaware, I like to have cases decided, as much as human fallibility permits, on their genuine merits. If "what" directors decided is not subject to reasonable dispute, there is a better foundation for assessing "why" they acted. If, indeed, the directors' reasons for a decision are documented in board books and minutes and the managers and advisors remember the "whys" the same way, the plaintiffs

have a harder time convincing the court that the stated whys — which one assumes are reasonable business factors — were not the real reason. If conflicts were surfaced, contained, and addressed, and a strong hand was given to the impartial members of the board, the plaintiffs' ability to suggest that those conflicts infected the why is impaired. It will therefore be more difficult for the plaintiffs to get the deal enjoined or to press a damages case.

Perhaps most important, by rigorously focusing on what a board is supposed to do — make business judgments in the best interests of the company and its stockholders — and what advisors are supposed to do — give the directors the best advice possible to help them do their jobs — the resulting business decisions are likely to be more sound and to give stockholders a more favorable result.

Keeping A Focus On The Fundamentals

With that, we have reached what Churchill would call the end of the beginning. Let us press onward with a refresher course on corporate law principles. Many of the problems that arise in the course of M & A transactions stem from a failure to keep in mind basic concepts of corporate law and appropriate business and professional behavior. When these fundamentals are disregarded, key players fail to play their roles with fidelity, and the lawyers and bankers documenting the process focus on the wrong things.

Before I get into particular ways that M & A practitioners can reduce the target zone for plaintiffs' lawyers, it's important to underscore the fundamentals, starting with the normative premise of the business judgment rule. This premise is familiar but a key part of it is often forgotten by advisors in M & A deals, which has a tinge of irony, because the premise itself explains the ubiquitous presence of such advisors in M & A deals.

That premise is that it is bad for stockholders if courts are allowed to second-guess the good faith — *i.e.*, loyal — business decisions of directors. For diversified stockholders, the costs of inhibiting managerial risk-taking in the good faith pursuit of profit as a result of after-the-fact judicial umpiring would be very high, because managers would flinch before proceeding with projects that were not certain bets. Because few things in business are certain, the overall wealth generated from corporate activity would likely decline, far outweighing any benefit from damages cases.

Of course, this premise only applies when what is at issue is impartial decision-making, by fiduciaries whose interests are aligned with the stockholders. Many decisions in business are debatable and could go at least two ways. When those who make the decision have the same interests as the non-manager investors, we view errors through the lens of the business judgment rule because we can put down errors to the natural uncertainties of commerce and human fallibility. When, however, a decision could have gone another way and the key managers had a conflict of interest, there is understandably more skepticism and the judicial standard of review is different.

M & A transactions occupy a grey area, where the absence of conflict is not so clear as to make us confident enough to apply the business judgment rule, but where the conflicts differ enough from a pure self-dealing interest as to make the application of the entire fairness standard unwieldy, impractical, and injurious to investors themselves. Hence, the use of intermediate standards of review such as *Unocal*[2] and *Revlon*,[3] which hinge on shifting power toward the more impartial elements of the board and ensuring those directors are independent and effective proxies for third-party bargaining.[4] Consistent with that greyness, different directors are often differently situated in the M &

[2] *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985).
[3] *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986).
[4] The M & A cases tend overwhelmingly to focus on the conduct of whatever board is on the sell side. But the reality is that much of the risk of conflicts on the sell side is borne by the buying party in a merger transaction. If the conflicts on the sell side lead to unreasonable deal protections that are the subject of a judicial injunction, the target board may suffer reputationally but its stockholders get to accept a higher priced deal without the buyer getting any of the benefits of a termination fee. If the conflicts on the sell side lead to an appraisal action, the buyer is the party that pays any appraisal award. For that reason, buyers themselves have to be cautious in dealing with management or directors who appear to be laboring under a conflict or when facing negotiating adversaries who are outgunned.

A context, and various possible transactions may present no apparent conflict for anyone, including management, whereas others do.[5] When, as is most common, it is management who faces disparate incentives depending on the nature of a deal that might be done (*e.g.*, being acquired by a strategic acquirer with no need for continuing management versus by a private equity buyer who wants to keep management), the natural order of things is upset.

In the ordinary course of business, the non-management directors rely principally upon management for advice, information, and specialized expertise. Under the DGCL, they are entitled to rely upon this input as a defense if they face a lawsuit.[6] When the directors' normal source of advice has become conflicted, the directors must scramble to seek substitute independent advice, a process that is itself complicated by the inability to place entire trust in key managers, such as the General Counsel or CFO (who work for the CEO), to help them find that independent advice.

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[5] Directors focused solely on the best interests of stockholders may also have differences because stockholders themselves have different perspectives in investment banking risk tolerance, and other values. Directors may also have different perspectives on how much choice stockholders themselves should be given in certain M & A situations. Professor Allen usefully framed a director's duty as making decisions to maximize the value for (hypothetical) stockholders who have permanently entrusted their capital to the firm. *See* William T. Allen, *Ambiguity in Corporation Law*, 22 Del. J. Corp. L., 894 (1997) ("[M]uch of the utility of the publicly traded corporate forum derives from the fact that shareholders will be passive and management [is] only loosely constrained in their exercise of discretionary judgment. Therefore, it can be seen that the proper orientation of corporate law is the protection of long-term value of capital committed indefinitely to the firm."). *See also TW Services, Inc. v. SWT Acquisition Corp.*, 14 Del. J. Corp. L. 1169, 1183 (Del. Ch. 1989); William T. Allen, Jack B. Jacobs, & Leo E. Strine, Jr., *The Great Takeover Debate: A Meditation on Bridging the Conceptual Divide*, 69 U. Chi. L. Rev. 1067, 1091 (2002). But, of course, he knew that in the real world, current stockholders have rights, disparate investment horizons, and expressed preferences that directors take into account for both legitimate normative and practical reasons.

[6] 8 *Del. C.* § 141(e).

But a huge aspect of the problem is often slighted. That is the lack of focus on the substantive needs of directors when they cannot place complete or even any confidence in management's advice because management has a serious conflict of interest. This situation arises, for example, if a CEO has corralled his top four managers, gone off without board authorization, baked up a proposal with his favorite private equity shop, and caused his managers and himself to make contractual commitments to vote for the private equity proposal and not to work for anyone else. This astonishing set of facts is not without precedent. The scenario happened in stronger and softer, but still troubling forms, on many occasions during the cappuccino markets of the late aught's.

In that circumstance, the independent directors need substantive business advice about how to respond to the proposal, whether to take employment action against the CEO and how to run the company in the meantime if they fire him, how to explore the marketplace for other proposals (and whether it even makes business sense to do that), and so forth. If the board is lucky, it may have a sitting or former CEO from another company with strong and up-to-date M & A experience. Of course, his own board will not be thrilled if he gets ensnared in another company's deal dynamics. But more commonly, the board may not have a current CEO and may even lack former ones. By predominant number, the board will be comprised of directors meeting the strong independence requirements of the stock exchanges, well-intended requirements that often have the effect of deterring service by people actively engaged in the industry in which the company operates (or even a related one). As important, even experienced business

people often have relatively little experience in M & A deals, and are not skilled in the tricks of that trade. Directors faced with M & A are, typically, playing out of position by necessity, not choice.

Thus, when a board hires a financial advisor, they are hiring just that: a financial advisor. They are not hiring someone to deliver a caveat-laden, liability-disclaiming two page fairness opinion. They are hiring advisors to give them important business advice about whether and how to proceed in considering a sale or merger, the price at which negotiations make sense, the balance that must be struck between deal certainty and the price, and the general skepticism factor they should apply to the ongoing managerial advice that both the directors and the financial advisor itself must, by necessity, continue to seek out.

The financial advisor cannot hope to have the depth of company-specific knowledge that management has. But the financial advisor has a breadth of deal and market experience it can draw upon to keep management honest and to help the independent directors make sure that the stockholders get treated fairly. But to do that requires understanding that the advisor's primary role is not giving a fairness opinion. It is everything that precedes the delivery of or — as important — the refusal to deliver such an opinion.

Together, the financial — and especially the legal — advisors are critical in ensuring that the independent directors remember their proper role.[7] Although the independent directors are supposed to be the CEO's boss, they are not often on the scene at the company, are dependent on management for information flow, and are not inclined to be assertive in the ordinary course of things. Too many directors act differently as directors than they do in running their own businesses and affairs. When doing their day

[7] As to this issue, my experience is that directors and managers who concentrate on doing the right thing by the stockholders in a business way do better in litigation than those who focus on managing litigation risk. Furthermore, when legal advisors put managing litigation risk first rather than helping their clients discharge their fiduciary duty to manage the affairs of the company in the manner best for its investors, they often make mistakes. Restructuring a transaction to make it take a form, for example, that does not invoke *Revlon* duties, does not mean that the transaction is a good one for investors. Just like there a billion or more stupid decisions that can be accounted for in conformity with GAAP, so too are there are a billion or more stupid transactions that can be entered into without triggering *Revlon* duties. At all times, directors have the duty to try to take the best course of action for the company and its investors. If the legal and financial advisors keep the directors focused on that primary duty of loyalty, they will simultaneously reduce any legal risk the directors face.

An incisive commentator indicated to me that many independent directors believe minimizing litigation risk is the right thing to do because it minimizes the potential criticism the directors will receive from key corporate governance constituencies and the press. In other words, the independent directors are doing right by their own perceived self-interest. That is, of course, not the right thing in the normative sense, because the right thing in the normative sense is doing what is best for the company and the stockholders, as far as human fallibility permits. But I do not ignore the fact that for many independent directors, their self-interest causes them to focus on litigation risk. In fact, it is precisely because I see that phenomenon all the time that I am speaking directly to those directors and advisors of like mind, and stating that in my own view the best way to in fact minimize litigation risk is in fact to focus on doing the best job you can for the company and its stockholders. By thinking like a well-motivated businessperson would when her own interests are at stake, directors will increase the chance of achieving a superior outcome for stockholders, which will also tend to produce the best litigation outcome. When dealing with one's own money, people tend to push back against conflicts of interest and be dubious about sales pitches. Corporate law gives great credit to independent directors who focus on the duty of loyalty and try to get the best business outcome for the stockholders. When, by contrast, the independent directors seem to be role-playing for an interested party and lending their credibility to endorse as fair a pre-ordained suboptimal result, the independent directors tend to come off looking shabby.

jobs, they know everything about the risks and rewards, can separate the real from the phony, and have a locked-in focus on generating sustainable cash flows. When serving as an advisor (*i.e.*, a director for someone else's firm), directors too often leave their business acumen, savvy, and perhaps most important, skepticism, back home. Instead of pressing management for answers and learning the company's business deeply, directors sometimes act more like well-mannered season ticketholders to a stylized interactive theatre, in which performing managers shepherd the audience through ritualized plays, listen to management give set piece reports, ask a few brief questions so as not to disrupt the actors' timing, and complete a series of management-driven acts, often written not in the blunt, earthy style of an Arthur Miller, but in the opaque, high-falutin style of a jejune drama student in a Master of Fine Arts program.

When an M & A situation occurs — especially one that requires independent directors to be adverse to management — the independent directors need to understand their role. If a CEO is proposing a going private transaction, the directors need to understand that the CEO is the one who changed their relationship, not them.[8] They cannot worry about being the CEO's buddy and if they are worried about that, they

[8] By highlighting a going private transaction as an example, I do not mean to suggest that this is the only situation in which managers may be conflicted regarding an M & A transaction. As an M & A specialist indicated to me: "I do not think there has been enough focus on the fact that management has 'conflicts' in every M & A deal that happens or doesn't happen. The 'conflict' relates to what the 'motivation' is of the CEO. Is the CEO selling the company because he or she is approaching retirement and does not want to hand over the reigns to a successor (or wants a payout on change of control)? Or is the CEO resisting a hostile bid because he or she wants to keep running a public company? Or is a friendly stock deal with huge synergies not happening because of the 'social issues' — *e.g.*, the CEO will not be running the combined company? So many deals happen or don't happen because of the ego or motivation of the CEO."

should disclose that worry and declare themselves non-independent for purposes of the matter before the board. A friend in need of a yes is no friend indeed.

Experienced, properly motivated advisors help the directors step up in the right way. They ensure that specific directors do not bear all the weight and that the directors use the considerable leverage the law and market forces give them.[9]

But unless the independent directors have received appropriate advice in advance of the inception of the M & A dynamics, they may have already lost the full range of action that would have been available to them to protect the stockholders.

The best way to prevent these situations is to have in place protocols that require the board to hear first if the CEO thinks a sale might be advisable.[10] These protocols should prevent the CEO from entering into any understandings with buyers, providing them with confidential information, or involving other employees without the prior approval of the board.[11] All outside advisors should be on notice that they cannot work

[9] An experienced director stressed to me the importance of comity and teamwork on the board. When directors work together as a group, and do not rely on particular directors to be the bad guy, the board will have an easier time overseeing management and board advisors, ensuring that they act appropriately.

[10] One experienced director indicated to me that although sell-side CEOs rarely enter into formal arrangements with buyers before a discussion with their boards, they will often come to the board after they have engaged in a serious confidential discussion with the CEO of the buyer, without revealing all of the specific contents of that discussion to the board.

[11] The protocol should preclude the CEO from tampering with subordinate employees and for any of them to sign, discuss, much less voting or other arrangements with others without board approval. To ensure that the independent directors do not lose the value of inside advice except to the minimum extent necessary, it should be clear in the protocol what obligations managers have to come to the board early. If there are particular officers who ought to have a special relationship in terms of job tenure to the independent directors — such as the general counsel and head of internal audit — that should be made clear. Doing so will enable the independent directors to have continued access to their advice in an M & A situation, when it may be very

for the CEO personally absent prior, written authorization from the board.[12] If and when a decision to explore a sale is made, it should be made by the board. These simple principles should be written down and reviewed periodically.

The worst of all worlds is for independent directors to wake up one day, and find that they not only cannot rely upon the impartiality of management, but that management has also co-opted the company's long-standing financial and legal advisors, so all of the most knowledgeable sources of advice are suspect.

When that happens the independent directors must get the strongest possible outside advisors. But often, this does not happen. Instead of getting the best advisors, they often get second- or third-rate financial and legal advisors, while management (advantaged already by its deep knowledge of the company) arms itself with the best.

This is a DANGER SIGNAL, akin to the one at Niagara about the approaching falls. You don't guard Dwight Howard with Nate Robinson — however much you enjoyed their teamwork in the NBA slam dunk contest a few years ago. If independent

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helpful. And, although such officers must have the confidence of the CEO, formalizing the obligation will also ensure that the CEO recognizes that these officers have an important compliance role to play and that it is the independent directors who ultimately determine their tenure and compensation.

[12] An independent director who has served key roles in difficult M & A transactions noted that if the independent directors have the right understanding of their role vis-a-vis both the company's key advisors and management, then the results tend to be much better: "The advisor's sense of the outcome is to finish the job, get a transaction done, and get a fee. Their integrity will vary from case to case, and their ability to be independent and walk away from a CEO's wishes will vary with the size of their book. Most of this can be controlled up front, but not unless control is a goal of the board."

directors get weak advisors, they will screw up.[13] They will not do right by the stockholders, they will get sued, and they may lose or at the very least, get publicly embarrassed.

If the CEO or a controlling stockholder, wants to buy the company for cash, that is not the time to economize. It is time to get the best. And if the CEO or controlling stockholder has co-opted the company advisors without proper, prior authorization, the board should disqualify them and bar them from doing so. That will set the CEO or controller back on his heels. Remember this: a good advisor will clarify who has the real leverage in all these situations, and particularly in conflict situations — the independent directors, not the managers or controller. The law gives independent directors great power. If the independent directors refuse to endorse a tainted process, the conflicted party will face withering legal scrutiny if he attempts to cram down a deal. The easiest party to say no to ought to be the independent director's own CEO or controlling stockholder. If the directors are afraid of doing so, they should get another job.

Why Conflicts Matter And Must Be Identified, Disclosed, Monitored, And Addressed

Human beings have a marvelous capacity to, as my esteemed predecessor Bill Allen put it, "rationalize as right that which is merely personally beneficial."[14] This is a

[13] I do not imply there are not top-rate, formidable legal and financial advisors outside the traditional top-tier M & A law firms and banks. What I am saying is that if a board employs a legal or financial advisor, that advisor and her firm must be every bit as expert and capable as management's advisors. If you are sure you have identified the Mary Lipton, Joe Flom, or Charlie Munger of an emerging firm, go for it. But hiring just any partner at a firm or investment bank that is generally less highly rated and experienced than management's advisors is, if past history has any predictive power, not wise.

potential danger for M & A financial advisors. Investment bankers tend to forget that much of the reason for their presence in M & A transactions is not because any of the managers involved believe that a banker is necessary for substantive business reasons. Rather, many banker engagements are attributable to the conflicts of interest that M & A transactions pose for corporate managers, and the fact that the management possessing the necessary substantive expertise cannot be relied upon with full confidence by the independent directors. The bankers are on the scene to, in accord with legal precedent such as *Van Gorkom*,[15] provide the non-conflicted directors with the substitute, impartial business advice they need to fulfill their fiduciary duties so that the court can feel comfortable in giving their decisions credit under the business judgment rule.

Remember again that the business judgment rule depends on the assumption of impartial decision-making. When a debatable decision is made by impartial fiduciaries with no interest other than making the company more profitable for its stockholders within the limits of legal discretion, the decision may go wrong but there is no fear that the decision was made for an improper reason. When, however, a debatable decision is made by decision-makers who harbor a conflict of interest, and the decision can be attributable to that influence, stockholders understandably harbor suspicion and the business judgment rule may not apply.

For the impartial directors to check managerial self-interest in such a debatable situation, they also need good information and advice. If the advisor who is supposed to

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[14] *City Capital Associates Ltd Partnership v. Interco Inc.*, 551 A.2d 787, 796 (Del. Ch. 1988).
[15] *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985).

help the independent directors ensure that a business decision is informed and impartial brings to the table a conflict of interest of its own, the problem is rather obvious. You typically don't cure a conflict by layering on another one.

Now, of course, not all conflicts are the same. It is essential to get legal and financial advisors with the breadth and depth of experience to check management and to give excellent substantive advice.[16] That means some conflicts will be inevitable because

[16] Although not the central focus of this lecture, the selection process for advisors in terms of quality is important. For starters, by hearing from several qualified financial advisors seeking to be retained, the independent directors begin the necessary deepening of their knowledge base in a context when they may need to counter management. For another, it is important that the independent directors — in a situation when they have not made sure that the company's regular financial advisor owes its retention and tenure to the independent board majority and not management, and when they must therefore hire another financial advisor — seek out the best and not go with a singular recommendation of management. Does this mean management and general counsel should not be asked for their thoughts on who to retain? No. They should be asked, but this way: who are the very best, top-drawer financial advisory firms that should be considered in a bet the company situation? Who are the top dog M & A transactional and litigation firms? This is an especially useful time to have directors who are active executives at other public companies. These directors should ask, without disclosing anything confidential, the same question of the relevant managers at their other company. The stress, though, has to be on getting the very best in a bet the company situation. Obviously, if the company is a small or mid-cap one, financial realities will come into play. But in any situation, it is important that the independent directors receive advice from advisors who, if possible, would be considered to outgun management's advisors, and at the very least, be considered a genuine peer in quality. Directors should be reluctant to draw on their own prior experience in working with financial advisors and legal advisors unless that experience was equivalent. I have seen many cases where in a going private transaction, the independent directors have gone with an outgunned financial or legal advisor, and the record reflects that someone on the special committee had experience with the firm in a much less high-stakes situation (such as dealing with a small tax issue or non-conflict small asset sale). The other common situation involves independent directors hiring an outgunned bank and law firm because of cost concerns when management has expensive advisors on its side and the transaction on the table is a cash-out situation for the public stockholders. When this combines with another common situation — the CFO and general counsel recommended a package of advisors at a different level of the advisory food chain and the independent directors just accepted their advice — the economic results for stockholders and the litigation outcomes for the defendants are often poor.

advisors with the necessary expertise — *e.g.*, daily knowledge of financing markets — will have worked with many other clients. Companies cannot afford to pay pet advisors to stay on the shelf for their episodic, exclusive use.

But there is a difference between the typical conflicts that involve a bank or lawyer working semi-regularly on engagements for key players, such as private equity firms, and more unusual, more material conflicts. If a bank or law firm has an unusually thick relationship with a likely strategic buyer, it may not be well positioned to help a target run a sales process or, at least, there must be consideration of what happens if that client emerges as a real potential buyer. If, however, the bank has a private equity arm with a portfolio company making a bid for a client-target, common sense dictates that that is not an immaterial conflict or typical advisor client relationship — it is unusual and a straightforward instance of self-dealing that is no different than would be faced by a controlling stockholder seeking to take the company private. An advisor cannot simultaneously be the bidder and the target's financial advisor without raising legitimate concerns, and therefore subjecting their director clients and the entire process to suspicion and legal risk.

As to how to best engage counsel, a thoughtful independent director suggested this approach: "My recommendation is . . . that a committee of the board interview at least three different firms, and that an emphasis be placed on an appropriate degree of independence and competence. On the competence front, ask the firm about similar transactions on which it has advised. On the independence front, ask for all the bad news that could be presented in the worst possible light. Then, once it has counsel in place, the board is in a much better position to address the potential conflicts among other advisers."

Thus, when advisors are selected, the full factual situation must be made plain. If the bank itself has a conflict and is trying to argue that its "team is in an insulated silo," all the key facts about the team must be put on the table. Ultimately, it is the client's decision about whether and how to proceed. Full disclosure of relevant facts is important. In this regard, investment banks seem to be less well positioned than law firms because they seem to permit individual bankers to actively buy and sell securities in ways that law firms prohibit. In law firms, the idea is that limiting conflicts will result in the partners making more money because the firm will have more access to business. Also, the ethical rules are tighter for lawyers.[17]

But what is critical is that banks have a sensible and defensible disclosure policy that tracks and helps surface potential material conflicts. Again, this is an area where folks tend to say silly things. No one is interested if a banker owns an index fund. But if a bank itself owns a major equity position in a buyer who has expressed interest, the directors should know that in determining whether to hire the banker on the sell side. When that is the case, it is also perfectly reasonable for them to want to know if members of the proposed team also own material amounts of equity in the buyer, especially if the

[17] By indicating that law firms have more evolved systems of conflict identification and limitation, I do not mean to imply that it is easy for them, either. It is not. Just like investment bankers, the best law firms have many clients and corporations cannot afford to put them on retainer, particularly as standby counsel for conflict situations. I also am not purporting to say that setting up conflict identification and limitation processes for investment banks will be without complexity. But, there is likely much that investment banks can learn from the more evolved experience of law firms, and by focusing on this important issue, investment banks will do a better job of surfacing conflict issues and of addressing them with their clients forthrightly. This will improve the industry's reputation for integrity and minimize the litigation risk to their clients that banker conflicts sometimes generate.

bank is saying it can "manage" the conflict because the team is walled off from the private equity unit. The point is that conflicts can enter at the firm level and at the individual advisor level. Both require attention.

It is also vital that there not be a partial approach to conflict disclosure, which leaves open the possibility for "oh by the way" moments that were foreseeable. Disclosure is comforting to clients and the courts, as it suggests a forthright attempt to grapple with self-interest in principled, ethical way. Telling the directors that you wish to participate in the financing even though you are a sell-side advisor is upfront. Not indicating that you are simultaneously trying to play on the financing side in an industry rival's on-going strategic process is an omission that will generate legitimate suspicion when your side conduct is exposed. That is especially the case when the board has relied on your strategic advice in making difficult choices about how to run an auction.[18]

[18] Of course, the surfacing and management of conflicts is not limited to the advisors to the board or to management. It is critical that the questionnaires used to identify independent directors for stock exchange purposes be considered, but only as a starting point in identifying those directors who, in the specific M & A context, are independent and capable of serving on a special transactional committee or for other purposes where independence is vital. To identify potential director conflicts, it is vital to surface the interests of management, those of likely bidders, and of the advisors. If a director indicates that he is a "friend" of the CEO, the thickness of that friendship needs to be explored. A couple of rounds of golf a year is one thing, shared family vacations every year for a decade is quite another, because the friendship may be more in the nature of a familial one. Even more so are outside financial entanglements between a director and a CEO such as private investments even if unrelated to the corporations' business. Through this inquiry, counsel should also have a better chance to identify directors who seem to be (and ought to be) reluctant to play the required role. Furthermore, the purpose of the inquiry should not be a rote one of legal box-checking. Independence in fact, not just form, should be the goal. If an independent director has served for a lengthy time on the board with the same management team in place, it is natural if that director's relationship to management has changed over time, particularly if they have worked through difficult and challenging issues together and if the director came on board when the CEO was already in place. If such a director is on the board, it

As a practical matter, hiring the legal advisor early for the independent directors is critical to addressing both banker retention and conflicts, and reaching sound decisions about the approach the board should take to issues such as whether to have a special committee and who should serve on it.[19] Without experienced legal advice, the

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is important to inquire about how his relationship with management has changed and whether he is prepared to be adverse to them whenever it is necessary to protect the stockholders. If he is reluctant, that does not mean that he must recuse himself from all board activities, but it does likely mean that he is poorly positioned in terms of mindset and fortitude to serve on a special committee required to bargain with and if necessary say no to management.

[19] The fact that an M & A process might generate potential conflicts does not mean that a board should jump to create a special committee. If it is clear that the advisors owe their allegiance to the independent board majority, the deliberative advantages of including the full board should not be sacrificed lightly, especially when situational conflicts can be dealt with in a more measured way. In this regard, it is important to note that a manager with a conflict does not get a free pass from complying with her primary fiduciary duty to her employer. At all times, a conflicted party must be available to share her managerial, company-specific, and industry-specific expertise with the independent directors and their advisors. In a situation when the process may involve strategic buyers, management's expertise remains critical, even when there are qualified outside advisors. But it is important that directors continue to ask managers with conflicts hard factual and strategic questions. Doing so has two purposes: i) it ensures that the directors get the fullest information base because even people with conflicts may nonetheless have material information that cannot be obtained from others; and ii) asking the managers directly keeps them honest in the process generally, and they often will provide straightforward answers. The advisors and independent directors can then view any responses with the gimlet eye required when dealing with a conflicted party.

A related note of caution is in order, however. A savvy deal advisor suggested to me that in situations when the board is not operating through a special committee, there is a dangerous tendency for the board to step back from the process of hiring the legal and financial advisor. That advisor sees this as problematic because of the softer forms of conflict that management almost invariably faces in M & A situations. Management may prefer one buyer over another for self-interested reasons, and may, for example, evaluate an offer from a private equity buyer differently than an offer from a strategic rival because of its self-interest. This type of soft conflict can come together with the advisor's own soft conflicts and create issues that the independent directors could have avoided if they were involved in the advisor selection process more actively. This deal advisor fears that some of these issues never come to the surface in a way that is visible, but that they affect the outcomes of processes in a manner that injures stockholders.

independent directors cannot think through these and other important early-stage issues effectively.

The Dangers Of The "Pitch" Process

As a transition to giving some practical suggestions for helping your clients more effectively during M&A deals, I will highlight another early-stage danger and how it can result in deal risk and litigation opportunities for plaintiffs' lawyers. That danger results from the "pitch" process by which financial advisors are selected.

As should be the case, what financial and legal advisors "pitch" when they seek business is not that they will give a caveat-laden fairness opinion or cautiously qualified legal advice. They pitch their M & A savvy: their knowledge of relevant capital and industry markets, how to test the market, fend off adversaries, and get the best deal for their clients. They inform their prospective clients of their experience and successes. They entice them with the prospects of a rosy outcome.

And herein lies the origin of some of the disconnect between the reality of what financial advisors are hired to do, and how what they do is reflected in the record of board deliberations.

At the hiring stage, the focus is where it should be, which is on the full range of expertise a financial advisor can bring to bear as a financial advisor. That sounds tautological, but it is not. Rarely is the pitch about the amazingly careful way the bank crafts the tiny scope of its final fairness letter. Rarely is the pitch about the bank's mastery of forward beta estimation or the Gordon growth model. Rather, the focus is on

the bank's experience in advising clients in major strategic processes and obtaining successful economic outcomes. The bank's industry expertise, insight in relevant financing and other markets, and ability to help the client achieve a great outcome are central considerations.

But embedded in the pitch process is a real hazard. If a board is going to sell the company, it is logical that it will hope to do so at an excellent price. The board ought to try to get the best price, and to put the company's best foot forward. Management may well be genuinely optimistic about its plans, even in a sale process, and perhaps most of all if a private equity firm is the likely buyer, and believe that these plans will translate into strong future cash flow. The management team is likely to enjoy hearing a pitch that suggests that the company's management has market confidence and is therefore a "selling" strength. These tendencies toward bullishness, however, can bias the process against measured, more realistic pitches. A sober approach may be seen as a downer, as indicating a defeatist approach in comparison to pitchmasters who evince a confidence that the outcome will be highly favorable.

There is also danger in the opposite direction. A management team dreaming of rolling into the private Newco may not want the price to be so high that its ability to reap rewards down the road is under pressure. Directors' ears must be tuned in all directions.

Another important danger is present, too, which I will discuss later. The bullish "pitch book" usually becomes the documentary template for all the financial advisor's future board presentations, including the one supporting the fairness opinion. But the

first iteration is a sales document, in which the natural directional emphasis is toward being bullish, not balanced.

For all these reasons, the independent directors more than occasionally go into the early stages of a sales process with the financial advisor who had the most optimistic take on the company's prospects for a successful outcome, not the one with the most realistic take. Combined with managerial overconfidence, this can cause the selling assumptions to go beyond the responsibly aggressive (which is what the board is duty bound to use in order to get the best outcome) to what buyers might find as lacking in credibility. Because the independent directors depend on the financial advisor as their primary source of expertise in the process, particularly when management faces conflicts, this distorting effect can result in a process that goes backward. When that happens, lack of clarity in the record can create big targets for effective plaintiffs' lawyers, eager to show that managers, financial advisors, and directors accepted a deal at odds with their own recent estimates of the company's prospects.

That lack of clarity often relates to the most important advice a financial advisor gives to independent directors when a sales process involves management conflicts. In that situation, a special or transactional committee is often empowered to make the key decisions about how many potential buyers and what kind to solicit in the process, when it is the right time to reduce that number down to a smaller group of final bidders, how to generate competition among the bidders, and whether and on what terms management may talk to buyers who may wish to keep them after a deal.

At the early stages of the sales process, buyers, particularly private equity buyers, often send in expressions of interest that are as bullish as the pitches themselves. Early on, private equity firms can all write the entire equity check, make stockholders happy, and, of course, have more confidence in and love management more than anyone else in human history. After reasonable due diligence, they will be ready to do a binding deal.

Then the process begins in earnest. Three firms get selected to get to the final round. And at that stage, harder questions begin to be pressed. One of the company's key product lines seems to be fading in popularity. Or management's competence in projecting the future is suddenly more suspect, as indicated by various factors. Of course, these all could be real issues. Or some, or none, of them could be real.

But what has often been real is that a board gets to a point where it has three buyers expressing interest at prices levels above $24 per share, and then ends up doing a deal at $22.25. Not only that, but the record shows that under the management's base case assumptions used in the sales process, $22.25 is at the bottom end or even below the range of fairness. Two other buyers who made expressions of interest at $23.50 per share were excluded from the process earlier. The eventual buyer was a pairing of two of the original finalists, who concluded in the final round that their initial confidence that they could write the entire equity check was shaken. And, often, it will be the case that management is going to stay on with the buyers, and has reached an agreement to roll half of their equity, get a hit to the money machine from the other half, and thus has

different incentives than the other stockholders because a higher price for the rest of the equity is a higher hurdle for them to get over going forward with their new employers.

This situation will be viewed skeptically by the plaintiffs' bar. They will pose probing questions. Why are you doing a deal at all when the price is below the discounted cash flow value used as the base case in the sales process? Why did you not go back to the potential buyers you excluded earlier who expressed an interest at a higher price than the price paid in the eventual deal? Why did you not at least release them and other buyers from the "don't ask, don't waive" provisions of the standstill so that they could make a superior proposal under the final merger agreement? Why did you, as independent directors, go back and ask management to update their base case projections based on bidder feedback? Was it because your financial advisor told you it could not give a fairness opinion based on the original projections? Was this the same financial advisor that stood to get 1% of deal value for any deal, and only a much smaller fee if no deal ensued? Why did you let two buyers club when those buyers had insisted beforehand that they could write the whole check?

How well you are able to answer these questions can be the difference between getting a case resolved early and having it haunt you for a long time. And your clients' ability to answer those questions well, when asked years after the fact, will be determined not just by the substance of what the directors in fact did, but by whether they can remember what was done and why in essentially the same way and whether the written record helps them or itself generates grounds for skepticism.

As for substance, let's assume that at each stage all the right things were done. At the early stage, the base management case was put together rigorously, tested by probing questions of the board and by the financial advisor. It was genuinely based on management's best estimates and market conditions, and was supplemented by a more bullish stretch case.

The targets of the sales process were picked with care, and all logical strategic and financial buyers were included. The narrowing of the process made sense, and there was no reason for management to prefer those included in the final round over those excluded.

When the auction went south, the directors were taken through a thorough process. The objective factors that various bidders had raised in due diligence were considered and presented. Those factors came from the finalists and others, and were consistent in theme. Management conceded these factors were legitimate weaknesses and the financial advisors confirmed that the concerns seemed to be genuine because they emerged from many buyers. The directors and their advisors then reevaluated whether to sell in light of current information and the fact that the price was less than was earlier thought achievable. The directors also evaluated whether to go back to bidders who had been excluded. The directors received advice that those bidders were unlikely to maintain their previous price levels, because they would have the same concerns as the final bidders. The financial advisor and management also reported that the final bidders were waning in interest, and that two of them indicated they would drop out if they could not

partner with someone else. The directors asked all the right questions, and were told that the industry is weaker than it was at the beginning of the process, and that all factors weigh in favor of striking a deal now, which would still be at a solid premium to the pre-process price.

The directors asked whether the deal would be subject to a post-signing market check. The advisors indicated that it would be, but not as to players in the process, all of whom signed, as the board knew and had been advised, an assignable standstill. To gain better bids, the company had indicated to bidders that the winner would get an assignment against other players in the process. The board asked whether the company could pull the standstills now. The advisors indicated that they feared that the remaining bidders would drop out. As between any of the three remaining players, there was no material advantage to management, and the next tier bidders who had been excluded were all private equity buyers too, likely to treat management no worse.

Furthermore, the financial and legal advisors had fully disclosed any potential conflicts early in the process, and none of them had any greater relationship with the final round bidders than with many of the other private equity buyers in the process. No strategic buyers expressed a serious interest after the initial stages of the process, even though many were invited.

The board decided to sleep on it for a couple of days, but asked management to update its base case taking into account in a responsible way the feedback that emerged during the diligence process — a process that had been monitored at all stages by the

legal and financial advisors for consistency and quality. The financial advisor was asked to be involved in reviewing the base case and to raise any concerns about whether the revisions are sound.

When the board met again, it received a revised financial presentation. The board asked tough questions and the financial advisor indicated that it has done its own skepticism check. But the bottom line was that under the revised projections, a price anywhere above $22 was solidly within the top half of a discounted cash flow fairness range.

The board went over the process again, considering whether the process should be halted and have the company return to an independent strategy, but concluded to proceed and strike a bid, based on a final round of bidding between the one bidder that is willing to write the entire check, and the other two as a club. The winner was the club.

Now, of course, plaintiffs' lawyers will look at this darkly. But as told, this is a story where independent directors made a tough but fully-informed business judgment in pursuit of a good outcome for stockholders.

If this is the story the court accepts, the plaintiffs will lose. But for that story to emerge, it will be important that the written record do certain things.

First and foremost, the business advice given by the financial advisor has to be in the record. When the directors remember that they selected the buyers to target based on input from their financial advisor as well as management, they are entitled to see that in the board books themselves or the minutes, or best of all, both. When the directors

receive advice from the financial advisor about winnowing down the buyer pool, it should be documented. At all key stages, and particularly when the process begins to go backward, the input that the directors receive from their independent financial advisors should be documented.

But often it is not. There is a debate about why between management lawyers and investment banker lawyers that only NSA surveillance can resolve, but the only winner of that debate is the plaintiffs' bar.[20]

Too often, the record is sanitized to eliminate any real business advice given by the financial advisor about selling strategies, price, the viability of the company's projections and prospects; in sum, about all the things that matter and is the real reason why the financial advisor has been hired. The point of the sanitization seems to be to ensure that no advice is reflected in the record that would be inconsistent with the limited

[20] Many transactional lawyers who represent boards claim that the lawyers for the financial advisor are largely responsible, and that these lawyers try to sanitize the record or any advice of the financial advisor that is not strictly consistent with the caveats in fairness opinion letter. Meanwhile, senior investment bankers tell me that they recognize that the primary value they provide is not in delivering a fairness opinion, but in all the important business advice they give that leads to a good transaction (or results in avoiding a bad one). They claim that they want their full advice documented in the record and that their lawyers know that. It may be that the disconnect is this. The senior banker and the senior transactional lawyer are not necessarily as involved in documenting the deal as others, and the senior banker may have relatively little contact with her own lawyers, who are also necessarily less familiar with what actually goes on in the board room than the board's own law firm. Why? Because the banker's lawyer is usually not at director meetings. The disconnection potential is obvious, but the main point is that finger-pointing does not solve the problem, and only aids the plaintiffs.

fairness opinion letter, which is little more than a blanket disclaimer that any reliable advice was given.[21]

This sanitization is a disservice to the client and the bank itself. If directors are given advice orally, then the directors are entitled to have it documented. If an advisor wants to "unsay something," the only professional way to do that is to go in the board room and unsay it, and have the record reflect the original advice and the retraction.

Second and more generally, at each important moment of judgment, the record should reflect the reasons why the board acted and upon whose advice.[22] If particular

[21] I asked an accomplished corporate litigator why board minutes were sanitized of the banker's most important business advice. This litigator indicated that it resulted both from actions by the board's own counsel and by self-editing by the board's transactional counsel: "For whatever reason, the crucial advice often doesn't make it into minutes. Bankers want to advise as to fairness. They are happy to see that in writing. What they don't like to see in writing is their answer to the following question—'in your view, have we done all we could to get the highest price reasonably attainable?' They would never opine on that issue, and don't like to see their advice in black and white. I also agree that sometimes lawyers self-edit — doing their clients no favor."

[22] Because directors are entitled to rely upon legal advice as a defense, careful thought has to be given about how to reflect the advice of counsel. The Delaware courts have tried to enable directors to fairly use an advice of counsel defense by waving the privilege as to transactional advice, while not requiring them to broadly waive all privilege. But, as a matter of fairness and integrity, directors must be willing, if they are to rely on the advice of counsel as a defense, to waive as to the subject matter of the advice. *See Mennen v. Wilmington Trust Company*, 2013 WL 5288900 at *6 (Del. Ch. Sept. 18, 2013) ("A party's decision to rely on advice of counsel as a defense in litigation is a conscious decision to inject privileged communications into the litigation. That decision operates as a partial waiver of the privilege. The waiver is "partial" in the sense that it does not open to discovery all communications between the client and its attorneys, but only those communications that relate to the subject matter of the disclosed communications."); *Pfizer, Inc. v. Warner-Lambert Co.*, C.A. No. 17524 (Del. Ch. Dec. 21, 1999) (transcript) (recognizing that a defense based on reliance on the advice of counsel effected a waiver of the attorney-client privilege as to "any documents, notes of conversations, and advice of counsel that was given to the Warner-Lambert board concerning th[e] transaction," but that anything reflecting "discussions with the Warner-Lambert board concerning th[e] litigation brought by Pfizer" or any "attorney-client advice or product information presented to the board regarding [that] litigation" "would be an appropriate subject to redact" or withhold); *see*

situations raise conflicts, the record of how the conflicts were taken into account should be made clear. If key financial assumptions, such as base case projections, need to be revised, the reasons why should be made clear, the process for revising them should be included in the record, and the oversight of the revision process, including the role of the financial advisor in that process, explained.

Finally, the best documentation process builds on itself. If early in the process, board books and minutes are produced in an accurate and complete way, the board will be able to go over its steps again more accurately, assess whether it made any errors, and consider what to do about them. This can involve going over the bidder pool, the reasons for inclusion and exclusion, and whether they are still relevant. This can involve going over the evolution in the financial assumptions that management and the financial advisor were using, to ensure that any changes were principled and based on objective factors untainted by self-interest. If, by contrast, the board books are rote updates of the pitch book, and do not reflect the board's deliberative process or the advice given, the directors and the advisors are compromised in their ability to consider their options.[23]

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generally Zirn v. VLI Corp., 621 A.2d 773, 782 (Del. 1993) ("A party should not be permitted to assert the privilege to prevent inquiry by an opposing party where the professional advice, itself, is tendered as a defense or explanation for disputed conduct."). When independent directors are forthcoming with independent counsel, moreover, one would hope that legal advice, if revealed, would enhance, not detract, from the integrity of the director decision-making process. This line-drawing is necessary because directors will be sued as soon as public hint of an M & A situation arises.

[23] Consistent with being careful about the record, the legal advisor must also focus the board on the proxy statement that the company files in connection with any M & A transaction. In particular, the background section setting forth the basic events and process that led to the signed transaction is important. For starters, the entire proxy statement is something that the directors are responsible for under federal securities law and as fiduciaries under state law. More

And, the differences in recollection that will exist and the unexplained and debatable decisions that will permeate the process will be attributed by the plaintiffs to conflicts of interest harbored by management, the financial advisor, and perhaps even by the independent directors' own equity packages. With this context in mind, I will now turn to some specific topics that, if handled well, will reduce your client's target zone. Because humans seem to be more motivated by fear than reward, let me state it in the negative: if you mess these up, expect to take a lot of splatter in the game of M & A litigation paintball.

Be Clear About Your Approach To Minute-Taking

Lawyers and clients debate whether it is preferable to have short- or long-form corporate minutes. There are good arguments on both sides of the question.

Those who favor long-form minutes emphasize the importance of documenting in full why the directors made the decisions they did in a high-stakes situation that is likely to be the subject of litigation. Because directors may be cross-examined about events years after they occurred, many skilled lawyers believe it is critical that the minutes identify the key factors that the directors considered, including the input of advisors, and spell out why the directors took the action they did.

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practically speaking, that proxy statement — and often its preliminary public form — will form the core document from which early-filing plaintiffs will craft their complaints. Material accuracy and completeness is therefore important. Not only must the directors review the draft, it is also important that other key advisors, like the financial advisor, review it carefully. That does not mean a lawyer for the financial advisor who was not in the room for the key events, but the financial advisor team members themselves who were involved directly in the relevant events. Of course, if the process all along was documented with more care and completeness, this review process will be more accurate and easier to accomplish.

By contrast, those who favor short-form minutes note that long-form minutes sometimes look like a transcript without having the accuracy of one.[24] When long-form minutes are done poorly and identify what some directors said but do not mention others, plaintiffs' lawyers can be expected to claim that the unmentioned directors were inattentive or worse. Long-form minutes often combine a fulsome use of words with a

[24] In many cases, board minutes are written in broad, general terms, and omit the nuanced discussions that involve the board and management, even though those discussions demonstrate the duty of care and careful deliberations that the board is trying to maintain. This is likely because the general counsel and outside counsel are worried about the increased litigation costs (discovery, depositions, arguments about the implications of reported questions and comments, etc.) that will be generated by detailed notes attempting to capture or characterize what directors said during the meetings. That is understandable, but there is a difference between attributing statements or concerns to particular directors, and capturing the full range of factors that the board considered in its deliberations. The value of a group process, after all, is to benefit from different perspectives and expertise. It would therefore be surprising if each director gave identical weight to the same decisional factors. Documenting the range of factors the board considered will still result in directors having somewhat different recollections of what was most important, as is natural with all human attempts at memory, but it will provide a more reliable memory aid that will diminish material disputes regarding what the board did and why.

Some experienced corporate lawyers have made the point that there is a difference between quality long-form minutes that capture the relevant issues a board considered and what the board decided to do, and poor quality long-form minutes that read like haphazardly selected excerpts from a trial transcript:

> *Comprehensive v. Minimalist.* Meetings minutes documenting an M & A process should be comprehensive. Even if the company generally employs a more minimalist approach in preparing board and committee minutes, highlighting only high level topics of discussion, once a sales process or merger negotiation is underway, the board or committee, in consultation with counsel, should consider the benefits of more detailed minutes to document the meetings pertaining to such process.
>
> *Not Verbatim Transcript.* Although minutes should be comprehensive, they generally should not contain a verbatim transcript of conversations that occurred during board or committee meeting. They also need not identify which directors made particular statements or raised particular issues, as such a practice could have a chilling effect on the exchange of information and opinions during the meeting.

Michael A. Pittenger, Janine M. Salomone, Pamela L. Millard, Ryan T. Costa, & Jacqueline A. Rogers, *M&A Deal Counsel's Role In Creating a Winning Written Record for Defending Breach of Fiduciary Duty Litigation*, 2013 Section of Business Law Spring Meeting 31 (Apr. 4, 2013).

failure to identify with precision the actual decisions made by the board. Directors often testify that a particular subject received a lot of discussion, but the minutes either do not mention the subject at all, or cover it so briefly in contrast to other subjects as to suggest that the directors' testimony is not accurate, and perhaps intentionally so. Proponents of short-form minutes point out that you can focus on being more precise, and use other documents, such as the bankers' book, to provide more details about decisions made.

Plaintiffs' lawyers do look hard at minutes, and will focus upon disparities in the amount of space given to various topics. An incoherent approach to minute-taking can give them opportunities for great fun. For example, it is often possible for an experienced lawyer or judge to identify board minutes involving different minute-takers. I have seen several situations where what seemed like a rather mundane board determination regarding a routine tax matter, for example, was documented with three pages of minutes. Within the same meeting minutes, a brief paragraph dealt with an update regarding a strategic M & A search process. At trial, the directors insisted that the discussion of the strategic search took up most of the meeting time. But they could not explain why the minutes for the tax matter are three pages long, and contain all sorts of factors the directors supposedly pondered. Most likely, of course, is that the minute takers were different and the in-house counsel who prepared the tax resolution crafted minutes in advance with all of the relevant factors and considerations, and that the lawyer's text was put in the same document with the cryptic and short update about the strategic search.

My point for today is not to urge a long-form over a short-form approach. But it is to urge clarity about the approach taken.

For everyday board business, for example, it may be impractical for a small or mid-cap company to employ long-form minutes because the company cannot afford the in-house or external legal staff to do such minutes well. In that context, having a policy of using short-form minutes with clarity about what must be captured — the precise issue before the board and the precise action taken — might be optimal. But even then, there may be situations where it is advisable to deviate from the short-form default. For example, long-form minutes might be advisable if the audit committee is presiding over an important internal investigation and has employed outside counsel to advise it. The board should then document why it is using long-form minutes, and should be clear at full board meetings about how the minutes will be produced. For example, if only the minutes from the part of the board meeting dealing with an audit committee matter — or as is typical, an M & A matter — are to be in long-form, that should be clear in the minutes themselves.

This sort of situation, of course, commonly arises in the M & A context, particularly when a special committee is formed. In that case, outside counsel is often well equipped to prepare long-form minutes whose quality and accuracy justify the risks entailed. But always be clear what approach is being taken, so it is understood by all upfront, and is not the subject of after-the-fact skepticism and criticism by dissident stockholders.

The Power Of Red-Lining

One of the most powerful error-preventing tools in modern technology is the ability to generate drafts that can be accurately compared with their predecessors. No responsible transactional attorney fails to obtain a redline, blackline, compare rite or what you wish to call it when she receives a draft back from her negotiating adversary.

But this standard practice is not used in a sensible way by the advisors of boards of directors. And this standard practice would be helpful as to materials that are core evidence in every M & A litigation: the presentations made to the directors by the financial advisors.

I am told that the United States of America's technology capacity is not sufficient to allow for the production of a legible PowerPoint redline or compare rite version. Count me as patriotic. My law clerks over the years have demonstrated an ability to do a compare rite version of most anything. If this is the only hurdle, I believe our nation is capable of vaulting it. Only someone who does not like hot dogs, hamburgers, cheesesteaks, lobster rolls, clam chowder, shrimp and grits, jambalaya, pit beef sandwiches, brisket, barbecue ribs, Good Humor ice cream bars, spaghetti and meatballs, fish tacos, Kentucky Fried Chicken, or things fried at state fairs could question our nation's ability to do this; in other words, only someone who despises America itself.

As experienced drafters know, the use of redlining is essential when dealing with a document that, in basically the same format, has been in use for some time. When that happens, there is a lulling effect. There is a tendency to miss additions because of the

difficulty of reading with enthusiasm and concentration a document that repeats information the reader has seen many times before.

Bankers books hazard this lulling effect at its most anesthetizing level. Whether it makes sense or not, the final presentation made by a financial advisor to a board of directors in connection with delivering its fairness opinion on a merger agreement is typically the ultimate iteration of the pitch book that the advisor used to obtain the engagement in the first place.[25] That pitch book will often contain illustrative valuation information that looks identical in form to that which the financial advisor later begins to tailor based on client-specific input and more current market information. The so-called football field will already be lined with a broad array of methods to value the company.

During an active M & A process, there is a lot going on and things are happening fast. The financial advisor uses a team, and more junior analysts help the more senior bankers update their financial analyses. During the representation, key inputs to valuation models can be altered, for myriad reasons, most of which are appropriate. But altered they often are, and these alterations can have a real effect on the bottom line indication of value.

Changes made to board books that make the deal look fairer are often viewed with suspicion by plaintiffs' lawyers. They will argue that the changes, rather than being a principled application of corporate valuation theory to updated facts, are an attempt by

[25] In some pitches, admittedly, financial advisors do not do a football field. But they usually do one in a board book very early after retention if they did not do one earlier, and the form of that first board book tends to become the basic template for all the rest.

the financial advisor to justify a suboptimal economic result, such as an auction process that has yielded a price less than was initially hoped. When the changes are shown to directors in cross-examination and the directors cannot identify why the changes were made, the directors are embarrassed and fumble through the moment. When the senior banker himself is less than certain about the why, as is not infrequently the case, particularly when a junior banker made the change, only one side of the v. benefits — and it's not the one where the defendants' names reside.

The deployment of a redline version minimizes this risk. Producing a redline will help the banking team itself focus on the changes being proposed and make sure they are correct, including making sure that it made the change (*e.g.*, cost of debt) in all valuation methods to which it is applicable.[26]

Thus, from a quality control perspective, attaining and focusing on a redline is valuable, and should be done by all advisors, including legal advisors, who present a document that is an update of a similar presentation.[27] The team that uses the redline for

[26] This is a real life issue. In one previous case, I remember the difficulties defendants and their advisors had in addressing just that situation in a challenge to the fairness of a merger. Why, the plaintiffs asked, would the company's cost of debt be changed? Could it be to make the deal look fairer? And if the old cost of debt was no longer reliable, why was it still present in another valuation in the same presentation? The Delaware Court of Chancery is historically careful not to hang defendants on what could be the normal, good faith infelicities that creep into all complex documents that are produced under time pressure. But when the change cannot be explained persuasively and tends to justify a result that is under a fair challenge, the Court cannot ignore its duty to consider that factor along with the other evidence. And, of course, not every case is heard in the Delaware Court of Chancery.

[27] There is, of course, a danger to redlining itself, which must be kept in mind, particularly by advisors, but also by directors. Although redlining is vital in enabling the reader to focus on the aspects of a document that are changing over time, it is also important that the clean version be read periodically. If the clean document is not read, mistakes can be missed early and never get

that purpose should not be limited to whatever advisor is presenting the document that is an update of a similar presentation but also the legal advisor. The financial advisor and legal advisor should review the redline, and ensure that the key changes are highlighted to the directors, with an explanation of why the changes have been made.

If, by way of example, management updated the cash flow estimates, that should be noted, and the reasons for the adjustment made clear as part of the record. If an important valuation input has been altered, that should be flagged and explained.

Documenting material changes is essential. From the most high-minded perspective, you are fulfilling your duty to give your clients the best possible advice and maximizing their ability to ask probing questions and to make informed decisions. From a more cynical perspective, you ensure that when your client sees a subpoena, your senior banker and key director will "remember" — I put this word in quotes — things the same way. Why? Not because they will necessarily in fact remember it — although by highlighting the changes in a redlined draft before each meeting you are in fact making that more probable — but because the senior banker and key director will prepare to testify by reading the board presentations and minutes. Whether or not senior bankers and key directors are always great real-time readers, they are keen readers in advance of their own depositions, and they are likely good at blarney. If the record explains the

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corrected, or information may not be digested in the unaltered parts of the document. It is critical to carefully read the clean version of important documents, including contracts, at key intervals.

reason why important valuation inputs — or search targets in an auction — were changed, your witnesses will tend to testify to the same essential version of events.

Here is a concrete example of how this practice can turn something that might be a weakness into a litigation strength. Imagine a board book that comes out five months into a process with a host of adjustments to key valuation inputs. The book now uses a historical cost of equity that is half a percentage higher than the previous book, and that uses different betas for the comparables. These changes are then baked into the final fairness presentation. These changes have the tendency to make the deal the board accepts look fairer than if the original assumptions, which remained constant for the first five months of negotiations, had remained in use.

At trial, neither the senior banker nor the lead director remembers why the changes were made. That would not be good, right? But what if the investment bank in question has a rigorous central committee that makes a periodic — say, annual — determination regarding valuation inputs that should not vary across representations. For example, what if the bank determined that the best evidence on the historical cost of equity to use was 6.25%, rather than 5.75%, and directed that the higher figure be used in all representations, because it should not vary by client? Likewise, imagine the committee had decided that all forward-looking uses of beta should give the comparable's own beta a two-thirds weight, and give the remaining one-third weight to the number one, on the intuition that the beta of all companies should revert to the mean over time.

Those sorts of changes can come in the middle of real-world deals and can affect the outcomes that valuations produce. But why something happens matters, and if the reason why something happened makes sense, the target zone is reduced.

Redlining helps advisors identify changes of this kind, prepare a contemporaneous explanation for the change for their clients, and, as important, catch changes that cannot be justified in good faith (because the proposal has no good faith basis) or are just the result of human error. By doing so, the reliability of advice is enhanced and so is the integrity of the process.

But the advisors should not be the only ones who see the redline. The directors themselves should see it. Giving the director the redline does not obviate the duty of the advisors to explain explain the changes that they believe to be material. That should be done.

But directors should have a chance to see for themselves in an easy way how key information on which they are entitled to rely has changed since the last time they saw it. A director may, because of past experience or insight, identify a change that merits extended discussion despite the advisors' failure to identify it as material. A director may note areas where changes have been made inconsistently. Put simply, a director can act as part of the quality control process and be better positioned to make good decisions if she is given the courtesy of a redlined draft that enables her to focus with accuracy on the moving parts in a document that she has seen before. Human beings cannot read the same formatted document time and again from front to back with enthusiasm and

accuracy. But they can go over such a document in redline form, refresh their knowledge, and focus keenly on how the document has been modified.[28]

Directors are entitled to rely on the advice they are given. Reasonable reliance involves understanding what advice is being given and how it is changing over time.

Your Clients Are Entitled To Rely Upon Your Advice, So Give Them Your Best Judgment And Document It

One of the most common scenarios in which directors and financial advisors find themselves remembering things differently involves the football field. As mentioned, investment bankers have a slide in their pitch books that lists virtually every possible way to value the company, and that illustrates the value range they generate. It is called a football field because it resembles one.[29]

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[28] An accomplished corporate lawyer indicated to me the following after reading a draft of this essay: "Far too often the bankers go through their books too quickly. Perhaps someone has told them they have 30 minutes. Perhaps they want to catch the 5 o'clock plane. Whatever the reason, they go through the books so quickly that, as to any given slide, if someone stopped and gave the directors a short quiz about the most important information reflected in that slide, far too many of the directors would fail or receive a gentleman's C. It seems to me that bankers literally should stop after discussing key slides and ask 'does everyone get that?' 'Everyone understand why we've narrowed the focus to these 3 potential bidders and excluded those 3?' 'If not, please speak up and we'll do a better job of explaining.' I think this approach would really help lots of boards. I can tell you from first-hand experience, it is very difficult to teach a director something she never knew when preparing her for her deposition. It is so much easier to remind her of something she once understood."

[29] I do not mean to imply that the depiction of all relevant analyses on a football field cannot be useful in a decision-making process. It is sensible to think that a comprehensive visual depiction of the overall valuation range reflected by all relevant and reliable valuation techniques would be useful as a thinking aid. If all techniques center closely around a price, that is comforting. If three techniques go sharply in a different direction than two others, that could trigger a valuable set of questions about why that could illuminate important underlying business and economic issues important to value. What I am implying is that if the football field is comprised of both relevant and reliable techniques, on the one hand, and irrelevant and

When not used with care, the football field can cause serious problems. For starters, it has its origin in the pitch itself. As we have discussed, there are dangers in the pitch process's bullish tilt, which can result in overly optimistic premises for the sales process. I focus now on another danger.

When there is a trial on a disputed deal — an appraisal hearing or entire fairness case — it is common for a financial advisor to testify that a valuation method on the football field that is less than helpful to his client, is not of material importance because it is not a valuation method that was reliable under the circumstances. The financial advisor will often say that he advised the client to focus its attention on only a subset of the valuation methods on the football field, because those were the most relevant and reliable indications of value in the industry space in which the company operated. .

But the independent directors do not remember that advice during cross-examination. And when the financial advisor claims it to be true, the plaintiffs' ask him to show where it is reflected in the relevant committee or board minutes. He cannot because it is not reflected there. The plaintiffs ask him where in any of the board decks the advice is reflected, including the final one given in advance of the board's approval of the deal and the financial advisor's own indication it would give a fairness opinion. He cannot because none of the decks indicate that any of the valuation methods on the football field should be given more weight than the others.

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unreliable ones, on the other, the resulting big picture will itself be unreliable as an aid to good thinking.

This is an unfortunate situation because it puts the financial advisor and its clients in a compromised position that could have been avoided. The plaintiffs may not agree that the only relevant indications of value were a discounted cash flow, comparable companies, and comparable transactions analysis, but they should not be able to argue whether the financial advisor gave that advice. The directors should have been able to rely upon the advice they were given, as a matter of statute, and you have now put them in peril.

Related to this is an important quality control issue. M & A deals happen fast, a lot of work is done, and the banking team may be stretched thin. Errors get made even in the core areas of valuation. When a banking team has told its clients that only four valuation metrics are relevant, it is natural and sensible for the banking team to concentrate on getting those right and not attend as much to others. That is not dangerous if the advice that the bankers gave was accepted by the directors. Imagine, for example, that a special committee agrees with the advice in large part, but one director with some M & A expertise notes that another method of valuation (say a leveraged recap) should be kept in mind, especially if private equity buyers emerge as serious candidates. The committee agrees that the idea makes sense and the bankers agree it has some utility.

What should happen then is simple. The advice, the directors' reaction, and the decision to focus on the five methods should be documented. Under our law, so long as this decision was made in good faith and not for any improper purpose, there is no reason why the remaining methods of valuation should remain on the football field. The next

board deck could — and probably should — exclude those methods, with a footnote indicating that the football field from then on will include only the methods that were determined to be reliable.

If this were to occur, the banking team could focus on what is important, and getting that as right as humanly possible. The directors get credit for relying on your advice and there is no dispute that the judgment was made and why it was made. Then the plaintiffs can only attack the judgment, which is difficult to do.

Meanwhile, because the banking team is now working only on what is important, they will make fewer mistakes, the valuation work will be better, and the plaintiffs' bar will find their job even harder.

Of course, even if you lack the intestinal fortitude to take the irrelevant metrics off the football field, the judgment made should still be documented, and it should be made clear that the banking team will focus its attention on the key metrics in order to get them right.[30]

A New Danger That I Fear Hasn't Been Spotted

Before I finish, I want to identify another emerging issue that relates to an old one.

One of the worst optics that can be presented at a trial is that the independent directors haven't been trusted to take home, study, mark up, and ask questions about key information. I had a trial in which a distinguished lawyer insisted on filing an affidavit to rebut testimony of his clients' own financial advisor after that advisor testified that

[30] A distinguished transactional lawyer told me that certain bankers have begun to do this, by putting analyses that have been deemed irrelevant "below the line" on the football field.

directors had been advised to destroy documents. The lawyer seemed sincere to me, but that the record reflected uncertainty about whether the independent directors were adults who could be trusted to possess and keep safe confidential documents only helped the plaintiffs.

Complex documents require scrutiny. Notations and sticky-notes help users keep track of important points, identify areas for follow-up questions, and otherwise help fallible humans make better use of information. When directors are not given key information in advance of meetings, they may not absorb it.[31] If directors are not allowed and in fact encouraged to review documents again after they have been discussed, they will not bring to bear their collective judgment and thus risk not making the best decision.[32]

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[31] The word "key" is important. Boards of directors are entitled to receive information that they can realistically absorb and use to make good decisions. M & A transactions involve thousands of pages of various documents. The directors need not receive all information, and the advisors should be sure that management does not overwhelm the directors with too much paper, thereby burying key points. Even as to key documents like the definitive acquisition agreement, it is not realistic for lay directors to read, much less master, that document word for word. Rather, what is important is that the directors understand the material terms, the conditions on which the company must close, the escape hatches for the other side, and the potential consequences if the parties interests diverge and someone refuses to close or sues after closing.

Another reason for distributing key documents in advance is to avoid "hypnotizing the chickens," a military term used by a distinguished director to refer to the phenomenon where a lengthy power point presentation takes up most of a meeting and that leaves little time for the participants to ask questions, deliberate, or object to the presenter's preferred course of action. The director noted that this is a technique often used by management and their advisors with presentations to independent directors. If the independent directors and their own advisors insist on receiving a useful, focused set of materials in advance, which they can use to formulate key questions and issues for consideration, there will be more time at the meeting for quality deliberation.

[32] This is not to say that directors should not be instructed in being responsible and careful in taking notes on important documents or about board deliberations. Such notes may be the

This is a long-standing problem. Bull rushes by management or advisors without genuine time exigencies should be avoided. Directors should be presented with information in an orderly way and the key facts should not be learned for the first time at the meeting itself. Rather, information should be presented in advance for study so that the directors can reflect upon it before the meeting, develop questions and thoughts for management and advisors, hear their answers and oral gloss at the meeting, and then deliberate together on the implications. Even in a fast-moving M & A process, getting the directors information in advance is often feasible and should be the goal.

But there is now another issue. It is now common for printed versions of key documents to not be sent to directors at all. Instead, documents are only posted to online sites. The directors may not even be permitted to print them out.[33] Count me as skeptical about this as an exclusive practice for a few reasons.

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subject of discovery. Even more important, directors are not court reporters, do not document their own third trip to the cookie tray or lapse in attention, and should therefore be cautious about trying to record what others say or do at meetings. But, that practice is different than taking notes on an advisor's presentation and using those notes to ask good questions. Most important, directors must be allowed to do the tasks we all do as professionals to generate good quality thinking and work product. That often involves taking notes, highlighting, and other techniques that help the human being remember and pinpoint key issues.

[33] An experienced director who has been involved in many M & A situations indicated that most financial advisors did not provide the directors with advance copies of their presentations and did not want the directors to take them home after the meeting, forcing the directors to try to read and absorb the materials during the meeting itself. Another veteran director has had that same experience, but indicated that financial advisors have recently been more willing to distribute materials in advance. Of course, the directors themselves have the leverage to demand the right to get materials in advance, in a form that can be notated and studied, and to have changes clearly identified. But it is the legal advisor who often must tell the directors, who are not corporate lawyers, that they are in charge as the client.

For starters, complex documents remain complex. Having a copy with tabs and notations is useful. Online readers are great, but there are documents important enough that they bear reading and rereading in printed form.

Second and relatedly, although it is possible to mark up a document on a computer or iPad and refer to it again when needed, it takes training to learn how to do that. Directors are often older than management and the advisors. Although old dogs can learn new tricks, that takes effort and education. I fear that many boards are getting information solely online without corresponding training on how to notate, edit, and otherwise use those e-documents as a decision-making reference and aid.

Finally, anyone who is a parent of children or who is the boss of 20 year olds knows that what the personal phone call was a generation ago is now the use of school or work technology to send a text, Instagram, or Google the current state of the first family's marriage (I mean by that, of course, Beyonce and JayZ). Directors are not immune to these temptations. When someone is reading a printed financial presentation, it is easier for them to concentrate than when they are on a device that operates much like a television with unlimited channels. On a long flight, a director's iPad with the board deck also provides him with the means to watch Game of Thrones Season 2, send personal emails, attend to his day job, and otherwise engage in far more diverting entertainment than reviewing board materials. Due diligence is now largely an online exercise, and targets monitor how much time bidders spend in the data room and on which parts. The case is coming when a plaintiff demonstrates that a particular director,

because of evidence of indolence or because he is the director the plaintiff designated as a witness in a case with limited expedited discovery, should have to turn over his laptop or iPad to show how much time he spent with the board documents. My sense is that it may be possible, as with a data room, to determine how much time a director has spent with the board materials. If it turns out that the answer is not nearly enough for any serious consideration, the director will not look good, and there will be implications for the credibility of the entire process.

The bottom line is that you must think carefully about how you communicate information to your clients, ensure that they have a chance to digest it, and impress upon them their duty to do so. If the court doubts that the directors brought their judgment to bear, that will increase the chances for the plaintiffs to obtain an injunction or something even worse.

Conclusion

With that, I will conclude. There are, to be sure, other topics and examples to be considered. But the most important lesson can be summarized this way.

You and your clients get to write the play. Not only is there nothing wrong with that, but done properly and with integrity, there is everything right with that. If the play is one where your clients appear to have made sensible, good faith judgments for legitimate, well-documented reasons, those judgments are likely to withstand judicial scrutiny. By focusing on the quality of the deliberative process, you maximize the directors' ability to bring their best collective judgment to bear on the difficult decisions

they must make in the M & A context. And if avoiding legal embarrassment is a motivating factor for directors, use that factor for all it is worth to help them live up to what should be their overriding objective: doing the right thing for the company and its stockholders.