fects of the pandemic and the volatility of the market, a company may believe that its stock is significantly undervalued. In this case, consistent with the general fiduciary duties of the board, the company may wish to internally explore strategic alternatives to enhance shareholder value, such as acquisitions or other strategic transactions. Given that "exploring strategic alternatives" is a common platform for activists and the goal of a hostile acquiror, a target company that has preemptively examined such alternatives will be in a stronger position to react to and counter such unsolicited proposals.

A company may also wish to consider stock buybacks, which can be used as a potential response to a hostile offer and also serves as a common investment thesis of shareholder activists. Notably for companies that are evaluating whether to pursue federal stimulus funds, under section 4003 of the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act"), companies receiving loans, loan guarantees, or investments from the U.S. Treasury generally will not be permitted to repurchase their listed securities. This prohibition exists both during the term of the loan, loan guarantee, or investment and for 12 months after the loan or loan guarantee is no longer outstanding, unless a contractual obligation to repurchase shares was in effect on the date of enactment of the CARES Act.

Apart from the restrictions of the CARES Act, a company should also consider the reputational risks associated with buybacks. Following the 2008 financial crisis, companies were criticized for engaging in stock buybacks and a company may encounter similar criticism given the present economic and social climate. Companies should consider whether the benefits of buybacks outweigh their consequences, which may include lost revenue, destruction of shareholder value, or increased operating, capital or regulatory costs.

ENDNOTES:

[1]*SP VS Buyer LP v. L Brands, Inc.*, No. 2020-0297 (Del. Ch. Ct.).

[2]*Akorn, Inc. v. Fresenius Kabi AG*, No. 2018-0300 (Del. Sup. Ct.).

[3]*See* ISS Global Policy Board, *Impacts of the COVID-19 Pandemic*, April 8, 2020 and Glass Lewis, *Poison Pills and Coronavirus: Understanding Glass Lewis' Contextual Policy Approach*, April 9, 2020.

DELAWARE SUPREME COURT WEIGHS IN ON MATERIALITY STANDARD FOR DISCLOSURES TO BOARD IN CONNECTION WITH MERGER NEGOTIATIONS

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In *City of Fort Myers General Employees' Pension Fund v. Haley,*[1] the Delaware Supreme Court delivered its most recent admonition to directors and officers negotiating merger transactions to err on the side of disclosure to boards in connection with potential conflicts. The case arose out of negotiations over the 2016 merger between Towers Watson and Willis Group Holdings Public Limited Company. Plaintiffs alleged that the Chairman and CEO of Towers Watson, who led the negotiations for Towers, breached his fiduciary duties by fail-

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ing to disclose to the company's board a compensation proposal that he had received from Willis' second largest stockholder regarding his potential post-merger compensation as CEO of the combined entity. The Delaware Court of Chancery dismissed the claims, holding that the business judgment rule applied because a reasonable director would not have deemed the compensation proposal to be significant information, given that the board knew that if the transaction was consummated, the CEO was in line for a substantial pay increase. The Delaware Supreme Court reversed (in a 4-1 decision), finding that the Chancery Court erred in summarily discounting the undisclosed information as immaterial and holding that plaintiffs' allegations were sufficient to rebut the application of the business judgment rule.

The case is significant insofar as it provides a stark warning to deal negotiators who fail to disclose potential conflicts in connection with merger negotiations. While the Delaware Supreme Court was clear that personal interests will not necessarily disqualify an interested director or officer from negotiating on a company's behalf, the Court's decision highlighted the potential pitfalls of failing to disclose such conflicts to the board.

Factual Background

The action arose from the 2016 "merger of equals" between Towers Watson and Willis. Willis first began exploring strategic alternatives in late 2014, at the urging of ValueAct Capital Management, L.P., Willis' second-largest stockholder. In January 2015, Willis' CEO met with John Haley, the Chairman and CEO of Towers Watson, and discussed a potential business combination. They continued discussions over a potential transaction during the first few months of 2015. During that time, Haley kept one of the Towers Watson directors apprised of the discussions but did not disclose the discussions to the full board until May 2015. After being apprised of the negotiations, the Towers Watson board briefly convened a special committee to handle the negotiations but disbanded the committee after 11 days, believing that the full board could work just as efficiently, and delegated Haley (who had been proposed to serve as the CEO of the combined company) to lead the negotiations.[2]

In early June 2015, after further discussions, Haley and his management team proposed terms for a potential stock-for-stock combination, based on an exchange ratio that would result in Willis' stockholders owning approximately 50.1% and Towers' stockholders owning approximately 49.9% of the combined company, with Towers' stockholders receiving an additional $4.87 per share special dividend. On June 7, 2015, Haley met with Towers' CEO and agreed in principle to merge on the terms Haley and Towers proposed. Allegedly, Haley had reached the agreement without the approval of the full Towers Board, without the assistance of the company's financial advisor, and without considering standard valuation materials. Thereafter, the Towers Board met several times and received additional information, including a fairness opinion from the company's financial advisor advising that the proposed merger consideration was fair to Towers' stockholders (notwithstanding that it valued each share of Towers stock at a 9% discount to the company's unaffected trading price).[3]

The merger, which was subject to approval of both companies' stockholders, was publicly announced at the end of June 2015. Investors and analysts criticized the proposed transaction as a bad deal for Towers Watson, including because Towers Watson's recent financial performance had

been much more positive than Willis' performance, creating doubt as to whether its stockholders would approve the merger. In September 2015, amidst this uncertainty, a representative of ValueAct, who Haley believed could potentially serve on the combined entity's compensation committee, contacted Haley with a post-merger compensation proposal. The proposal would have been worth $140 million over three years, a more than five-fold increase over the $24 million that Haley could have expected to earn under his then-existing compensation plan. Haley did not disclose this proposal to the Towers Watson board, nor was it mentioned in the joint proxy later sent to stockholders.[4]

Around the same time, one of Towers' institutional stockholders began a public campaign against the merger. In a letter filed with the Securities and Exchange Commission, the stockholder expressed its view that the transaction will be voted down by Towers' stockholders. The letter also noted that Haley was likely in line for a pay raise and asked rhetorically whether "Towers management has skin in the game? Are incentives aligned?" ISS and Glass Lewis later recommended that Towers' stockholders vote against the merger.[5]

In light of the uncertainty around approval, the parties agreed to increase the special dividend to be paid to Towers' stockholders from $4.87 per share to $10 per share. Plaintiffs' complaint alleged that Haley did not believe this increase was the best deal that he could get for Towers' stockholders, but rather was the minimum that he thought was necessary to secure stockholder approval. In mid-November 2015, the Towers Board met to discuss the transaction. Again, Haley allegedly did not disclose his compensation-related discussions with ValueAct. Ultimately, both companies' boards approved the revised deal terms. ISS and Glass Lewis remained of the view that the transaction was unfavorable for Towers' stockholders, though 62% of the company's stockholders voted in favor of the merger, which closed on January 4, 2016. After the merger, Haley became the CEO of the combined entity and received a compensation package roughly similar to the one earlier proposed by ValueAct.[6]

The Chancery Court Decision

The merger resulted in a number of different lawsuits.[7] In the fiduciary duty litigation in Delaware, the plaintiffs claimed that Haley breached his fiduciary duties by failing to disclose his discussions with ValueAct over the proposed compensation package. The plaintiffs also alleged that Towers Watson's directors failed to provide adequate oversight over Haley's negotiations, and that ValueAct and its Chief Investment Officer aided Haley's alleged breaches of fiduciary duty.[8]

The Delaware Court of Chancery dismissed the claims, holding that the plaintiffs had failed to rebut the application of the business judgment rule. In particular, the court held that Haley's failure to disclose to the Towers Watson board his discussions with ValueAct over the proposed compensation package was not material because (1) the board already knew that Haley would be the CEO of the combined entity, that the combined entity would be much larger and that, as a result, Haley would be entitled to increased compensation; (2) despite this potential conflict, the board still appointed Haley as lead negotiator, and he kept the board generally apprised of the negotiations; and (3) the undisclosed compensation proposal was merely a proposal, reflecting "upside potential in the event of pie-in-the-sky outcomes unconnected to any business plan or forecast." Accordingly, the court concluded, the plaintiffs "failed to establish

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that a reasonable director would have considered the Compensation Proposal to be significant when evaluating the merger." The court dismissed the aiding and abetting claims for failure to plead a predicate breach of duty claim.[9]

The Supreme Court's Reversal

The Delaware Supreme Court reversed. Generally agreeing with the legal standard applied by the Chancery Court, the Supreme Court explained that, in order to state a claim based on the theory posited by plaintiffs, they would need to allege that (1) the defendant was materially self-interested in the transaction; (2) the defendant failed to disclose such self-interest to the board; and (3) a reasonable board member would have regarded the defendant's material self-interest to be a "significant fact" in his or her evaluation of the transaction.[10] But the Supreme Court disagreed with the application of that standard to the facts alleged.

The Court noted the "unremitting" duty of candor owed by fiduciaries and held that the undisclosed compensation proposal from ValueAct "altered the nature of the potential conflict that the Towers Board knew of in a material way."[11] The Court defined " 'Material,' in this context" as meaning "that the information is 'relevant and of a magnitude to be important to directors in carrying out their fiduciary duty of care in decision making.' "[12] Based on that definition, the Court concluded that the plaintiffs "adequately alleged that the Board would have found it material that its lead negotiator had been presented with a compensation proposal having a potential upside of nearly five times his compensation at Towers, and that he was presented with this Proposal during an atmosphere of deal uncertainty and before they authorized him to renegotiate the merger consideration."[13]

Takeaways and Practice Pointers

Deal Negotiators Should Take Care to Keep Boards Fully Informed, Especially Regarding Their Own Potential Conflicts

The Delaware Supreme Court's decision indicates that deal negotiators should err on the side of disclosure when it comes to keeping boards informed, particularly with respect to potential conflicts. The Court made clear that there is no inherent barrier to potentially conflicted individuals leading merger negotiations, but emphasized that it was important for boards to be able to fully consider such matters in delegating such authority and reiterated the importance of "unremitting" candor to fellow directors. The Court rejected the argument that the compensation proposal would not have been material to the Towers Watson board because the directors would have understood generally that the CEO was in line for a pay increase. A reasonable director, the Court determined, would have wanted to know that the CEO was aware of a specific, potentially attainable proposal that would have increased his compensation upside by more than five times and which could potentially have influenced his motivations in negotiating the deal. Indeed, a Towers Watson director specifically testified in the accompanying appraisal litigation that he would have wanted to know that the CEO discussed his compensation at the combined company—a fact on which the Supreme Court expressly relied in reaching its decision.[14] Of course, the fact that one Justice dissented from the Supreme Court's decision demonstrates that these issues are not always free from reasonable dispute (even in the face of such testimony), but erring on the side of greater candor with the board will mitigate the risks of deal challenges.

Boards Should Affirmatively Monitor, and Press Negotiators to Disclose, Potential Conflicts

Although the Supreme Court's decision focused on the CEO's failure to keep the Towers Watson board apprised of his discussions around post-merger compensation, boards need not rely solely on the relevant individuals involved in merger negotiations to disclose potential material conflicts. Rather, boards should consider asking affirmatively of directors or officers involved in negotiations about whether they are aware of any potential conflicts and checking in over time to ensure that circumstances have not changed.

Merger Counterparties Should Be Careful in Dealing with Potentially Conflicted Individuals

Having found that there was no predicate breach of fiduciary duty by the CEO, the Delaware Court of Chancery dismissed the aiding and abetting claims against ValueAct and its Chief Investment Officer. In reversing the Chancery Court's decision, however, the Delaware Supreme Court also reversed the dismissal of the aiding and abetting claims as well, remanding for further consideration by the Chancery Court as to whether plaintiffs had properly pleaded the other elements of an aiding and abetting claim. The Supreme Court did not provide any guidance as to whether the facts alleged supported such a claim. In any event, merger counterparties would be wise to consider potential conflicts that arise in connection with negotiations and be sensitive to creating situations that give rise to or exploit such conflicts, such as discussions about post-merger compensation.

The Materiality Standard for Board Disclosures Is Distinct from, but Similar to, the Standard for Stockholder Disclosures

In connection with their legal arguments, the parties disputed the relevance of precedent cases addressing materiality in the context of stockholder, as opposed to board, disclosures. The Delaware Supreme Court reiterated, as it explained in *Brehm v. Eisner*, that the materiality inquiry in connection with the two contexts is "distinct."[15] But the Court observed that in most cases, where information is material in one context, it is likely to be material in the other. The Court cited, for example, its recent decision in *Morrison v. Berry*, in which the Court addressed allegations that a CEO had concealed from the Board that he and a bidder had an agreement that contemplated an equity rollover, finding that such information was material in the context of stockholder disclosures.[16] In doing so, the Court appeared to reject any contention that stockholder disclosure cases are necessarily irrelevant to cases involving board disclosures. Accordingly, when litigating materiality issues in either context, counsel should feel free to rely on precedents addressing either situation, as appropriate, while still taking care to recognize that the two lines of cases remain distinct and that materiality determinations can be fact-specific.

Conclusion

As discussed above, *City of Fort Myers General Employees' Pension Fund* provides useful guidance regarding the materiality standard applicable to board disclosures and the potential risks of failing to disclose potential conflicts related to merger negotiations.

ENDNOTES:

[1]*City of Fort Myers General Employees' Pension Fund v. Haley*, 2020 WL 3529586 (Del. 2020) (the "Opinion").

[2]*Id.* at *1-3.

[3]*Id.* at *4.

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[4]*Id.* at *5.

[5]*Id.* at *6.

[6]*Id.* at *7-9.

[7]In addition to the fiduciary-duty litigation, the transaction garnered several additional lawsuits, including an appraisal case, also brought in Delaware Chancery Court, and a federal securities action brought in the United States District Court for the Eastern District of Virginia. After some discovery, the appraisal case settled in September 2017. The federal action was initially dismissed but the United States Court of Appeals for the Fourth Circuit reversed that decision, holding that it was substantially likely that the failure to disclose Haley's potential conflict would have been material to Towers' stockholders in voting on the merger. *In re Willis Towers Watson plc Proxy Litigation*, 937 F.3d 297, 304-05, Fed. Sec. L. Rep. (CCH) P 100554 (4th Cir. 2019).

[8]Opinion, at *10.

[9]*Id.*

[10]*Id.* at *11.

[11]*Id.* at *12.

[12]*Id.* (quoting *Brehm v. Eisner*, 746 A.2d 244, 259 n.49 (Del. 2000)).

[13]*Id.*

[14]*Id.* at *16.

[15]Opinion, at *13 (citing *Brehm*, 746 A.2d at 259 n.49).

[16]*Morrison v. Berry*, 191 A.3d 268, 284 (Del. 2018), as revised, (July 27, 2018).

EU MERGER CONTROL: THE FAILING FIRM DEFENSE AND COUNTERFACTUALS IN THE TIME OF COVID-19

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Businesses around the world continue to grapple with the effects of the COVID-19 outbreak. In the coming months and years, many struggling businesses may need to seek merger partners, while acquisitive companies in better financial condition may be looking for bargains. However, would-be merger partners with significant European activities must be prepared to run the gauntlet of European Union ("EU") merger review, which is notoriously strict especially in concentrated markets.

The pandemic has focused attention on the EU's "failing firm defense" ("FFD"), which can justify approval of transactions that would normally be prohibited under the EU's Merger Regulation ("EUMR").[1] Similar discussions arose during the 2008 financial crisis, when the Organization for Economic Cooperation and Development ("OECD") debated whether the FFD criteria should be loosened in times of economic downturn. The delegates concluded that there was no need for such a change and warned that excessively lax merger standards could harm consumers.[2]

Similarly, European Commission ("Commission") representatives—echoed by antitrust authorities in other jurisdictions—have recently stressed that the pandemic will not lead to a relaxation of EU merger review standards. Commission Executive Vice-President Margrethe Vestager stated that it was not necessary to relax the normal merger control rules, despite the "uncertain times."[3] Vestager emphasized that the crisis "shouldn't be a shield to allow mergers that would hurt consumers and hold back the recovery."[4]

But whether the pandemic will or should lead to revision of the FFD is arguably the wrong question.