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Revenue Recognition Representations: Impact of FASB's New Standard

By Steve Quinlivan, a Partner of Stinson Leonard Street LLP

Some have suggested that the FASB's new revenue recognition standard will result in particularized representations in M&A, underwriting and loan documents. It is easy to argue it is not necessary and is covered by the standard representation such as

> The Financial Statements have been prepared in accordance with GAAP applied on a consistent basis throughout the period involved … and fairly present in all material respects the financial condition of the Company as of the respective dates they were prepared and the results of the operations of the Company for the periods indicated.

Perhaps schedules or textual modification to the foregoing would note the adoption of the new standard to cover off on the reference to consistency.

But financial statements are often the subject of multiple representations for accounts receivable, inventory and the like. So it is entirely possible specific representations regarding the new standard will be required.

Background

To understand the types of representations that might be required it is useful to consider some background with respect to the transition rules for the new standard. The new standard permits two methods of transition:

- Retrospectively to each prior period presented, subject to the election of certain practical expedients ("full retrospective method"). A calendar year-end company that adopts the new revenue standard using this method must begin recording revenue using the new standard on January 1, 2018. In its 2018 annual report, the company would revise its 2016 and 2017 financial statements and record the cumulative effect of the change recognized in opening retained earnings as of January 1, 2016.
- Retrospectively with the cumulative effect of initially applying the new revenue standard recognized at the date of adoption ("modified retrospective method"). A calendar year-end company that adopts the new revenue standard using this method must begin recording revenue using the new standard on January 1, 2018. At that time, the company must record the cumulative effect of the change recognized in opening retained earnings and financial statements for 2016 and 2017 would remain unchanged.

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While required footnote disclosures for the two transition methods are similar, there are subtle differences regarding disclosure about the effects of adopting the new standard:

- Full Retrospective Method: Required disclosures are to include the effect of the change on income from continuing operations, net income (or other appropriate captions of changes in the applicable net assets or performance indicator), any other affected financial statement line item, and any affected per-share amounts. The foregoing disclosures are required *for each reporting period that has been retrospectively adjusted but not for the current reporting period in which the new standard is adopted*.
- Modified Retrospective Method: Required disclosures are to include the amount by which each financial statement line item is affected in the *current reporting period* by the application of the new standard as compared with the guidance that was in effect before the change and an *explanation of the reasons for any significant changes*.

Representations Before Adoption of the New Standard

For public companies, any such specific representations may begin to appear later in 2017 and the first quarter of 2018 before a company actually issues any financial statements reflecting the new revenue recognition standard. Counterparties to public companies in significant transactions will likely want some assurances adoption of the new standard is on track.

The representations for public companies could take the following form, although perhaps with more qualifiers if the issuance of financial statements is not imminent and work to adopt the standard is ongoing:

> The Company has developed disclosure controls and procedures required by Rule 13a-15 or 15d-15 under the Exchange Act which the Company anticipates will be effective to ensure that information required to be disclosed by the Company pursuant to Topic 606 and Subtopic 340-40 of the FASB Accounting Standards Codification (the "Revenue Recognition Standard") is recorded and reported on a timely basis to the individuals responsible for the preparation of the Company's filings with the SEC and other public disclosure documents. The Company has developed internal controls over financial reporting (as defined in Rule 13a-15 or 15d-15, as applicable, under the Exchange Act) which the Company anticipates are sufficiently designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with the Revenue Recognition Standard. The Company's disclosure of the impact of the adoption of the Revenue Recognition Standard set forth in [describe SEC filing] is true and correct in all material respects and is in accordance with Staff Accounting Bulletin No. 74 promulgated by the SEC.

Representations After Adoption of the New Standard

Once financial statements have been issued which reflect the adoption of the new standard, the representations could take the following form if an issuer has used the modified retrospective method to adopt the new standard:

> The Financial Statements [describe financial statements] have been prepared reflecting the adoption of Topic 606[1] and Subtopic 340-40[2] of the FASB Accounting Standards Codification (the "Revenue Recognition Standard"). The Company elected to utilize the modified retrospective method of transition beginning [January 1, 2018]. Footnote [insert reference] to the Financial Statements accurately states in all material respects (i) the amount by which each Financial Statement line item is affected [describe reporting period] by the application of the Revenue Recognition Standard as compared to GAAP that was in effect before the change and (ii) the reasons for each significant change identified.[3] Footnote [insert reference] to the Financial Statements accurately states in all material respects the judgments, and changes in judgments,

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[1] Topic 606 is the heart of the new standard.

[2] Subtopic 340-40 is a corollary to the new standard and is captioned "Other Assets and Deferred Costs—Contracts with Customers."

[3] See ASC 606-10-65-1i.

made in applying the Revenue Recognition Standard that significantly affect the determination of the amount and timing of revenue from contracts with customers.[4]

The Company has implemented disclosure controls and procedures required by Rule 13a-15 or 15d-15 under the Exchange Act which are effective to ensure that information required to be disclosed by the Company pursuant to the Revenue Recognition Standard is recorded and reported on a timely basis to the individuals responsible for the preparation of the Company's filings with the SEC and other public disclosure documents. The Company has implemented internal controls over financial reporting (as defined in Rule 13a-15 or 15d-15, as applicable, under the Exchange Act) which are designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with the Revenue Recognition Standard.

For issuers that have used the full retrospective method of accounting, the first paragraph of the foregoing representations could be replaced with the following paragraph (changes from the foregoing are noted as well):

The Financial Statements [describe financial statements] have been prepared reflecting the adoption of Topic 606 and Subtopic 340-40 of the FASB Accounting Standards Codification (the "Revenue Recognition Standard"). The Company elected to utilize the ~~modified~~ <u>full</u> retrospective method of transition beginning [January 1, 2018]. Footnote [insert reference] to the Financial Statements accurately states in all material respects ~~(i) the amount by which each Financial Statement line item is affected [describe reporting period] by the application of the Revenue Recognition Standard as compared to GAAP that was in effect before the change and (ii) the reasons for each significant change identified~~ <u>the effect of the change on income from continuing operations, net income [or describe other appropriate captions of changes in the applicable net assets or performance indicator], any other affected financial statement line item other than the effect on financial statement totals and subtotals, and any affected per-share amounts for [list prior periods that have been retrospectively adjusted]</u>.[5] Footnote [insert reference] to the Financial Statements accurately states in all material respects the judgments, and changes in judgments, made in applying the Revenue Recognition Standard that significantly affect the determination of the amount and timing of revenue from contracts with customers.

[4] See ASC 606-10-50-1.

[5] See ASC 606-10-65-1e.

Tilting the "Proxy Contest" Playing Field: The Latest Tactic

By Steve Wolosky, Andrew Freedman and Ron Berenblat, Partners of Olshan Frome Wolosky LLP

Shareholder activists seeking to nominate director candidates for election to the boards of their portfolio companies are advised to be on the lookout for the latest trap for the unwary designed by company defense law firms to further entrench board members.

The trap is embedded in questionnaires and representation agreements that are now commonly required to be submitted by a nominating shareholder's director nominees under nomination procedures contained in company bylaws. Taking the bait can give the company a significant strategic advantage over the dissident in an election contest.

Consent of Dissident Nominee to Be Named on Company Proxy

Shareholder activists familiar with the nomination process know that it is now common practice for companies to require a nominating shareholder's nominees to submit a questionnaire and representation agreement as part of the nomination submission. The questionnaires are typically similar to director and officer questionnaires companies use internally in order to obtain information from insiders required to be disclosed in their proxy statements and annual reports.

The representation agreements typically require the dissident nominee to certify that such nominee will not have any undisclosed voting commitments with respect to his or her actions as a director, will not become a party to any agreement with any person other than the company with respect to compensation in connection with his or her service as a director, and will comply with the company's internal policies if elected.

We are beginning to see questionnaires and representation agreements seeking to obtain the written consent of dissident nominees to be named as nominees in the company's proxy materials.

By way of example, the following item was buried in the last page of a 23-page questionnaire that the nominees of one of our activist clients were recently asked to complete:

CONSENT TO SERVE.

> If you are a nominee for director:
>
> I hereby consent to being named as a nominee for Director in the current Proxy Statement of the Company and agree to serve as a Director of the Company if elected at the Company's current Annual Meeting of Stockholders.
>
> Initial to indicate consent: ___________

At first, we chalked this up to poor drafting by companies in re-purposing their existing forms of director and officer questionnaire for use as a nominee questionnaire since existing company directors are expected to consent to being named in the company's proxy statement. However, overzealous defense advisors are beginning to seize on this seemingly inadvertent drafting error in an attempt to get a leg up on the dissident by purporting to require shareholder nominees to consent to being named in the company's proxy.

Providing the written consent of a dissident nominee to be named as a nominee in the company's proxy materials could be extremely detrimental to the dissident's campaign as discussed in further detail below. It is therefore critical that any materials a nominating shareholder and its nominees are asked to sign by a target company as part of the nomination process be reviewed by counsel experienced in shareholder activism.

Tilting Strategic Landscape in Favor of Target Company

Under Rule 14a-4(d)(1) of the Securities Exchange Act of 1934, a proxy may not confer authority to vote for any person for election to the board unless that person has consented to be named in the proxy statement and to serve if elected.

Under this provision, known as the "bona fide nominee rule," neither the company nor the dissident may include the other party's nominees on its proxy card without the nominee's consent. This consent is rarely provided by activists as allowing the company to include one or more of the dissident's nominees on its proxy card could give the company a significant strategic advantage in its solicitation.

These strategic advantages include the following:

- If the company's proxy card gives shareholders the optionality to vote for its nominees as well as one or more of the dissident's nominees, shareholders who wish to mix and match their votes among all the candidates may be inclined to complete the company's proxy card instead of the dissident's card.
- If a proxy advisory firm such as Institutional Shareholder Services (ISS) recommends that shareholders split their votes among the company's nominees and the dissident's nominees and the recommended dissident nominees also appear on the company's proxy card, the advisory firm may also recommend that the shareholders complete the company's proxy card (which gives the shareholders the optionality to vote for all its recommended nominees) instead of the dissident's card.
- If the company believes it is at a strategic disadvantage in the contest and that recommending and soliciting proxies for the election of one or more of the dissident's nominees could be advantageous to its campaign, it will be able to do so by naming the nominee(s) on its proxy card.

Engaged Capital vs Rent-A-Center

In Olshan client Engaged Capital's recently completed proxy contest at Rent-A-Center ("RCII"), Engaged Capital was forced to initiate litigation in the Delaware Court of Chancery to thwart any attempt by RCII to include Engaged Capital's nominees on its proxy card. RCII's nominee questionnaire and representation agreement each included a requirement that Engaged Capital's nominees consent to being named in RCII's proxy statement.

In a cover letter to RCII accompanying the completed questionnaires, signed representation agreements and other nomination materials, Engaged Capital asserted that such a requirement was completely inappropriate as Engaged Capital would be filing its own proxy statement. Engaged Capital also noted that its nominees had clarified in the questionnaires and representation agreements that they consented to only being named in Engaged Capital's proxy statement.

After RCII asserted that Engaged Capital's nomination materials were deficient by virtue of the nominees' failure to consent to being named in RCII's proxy statement, Engaged Capital sent a second letter to RCII reiterating that it did not believe that RCII's organizational documents required Engaged Capital's nominees to consent to being named in RCII's proxy statement in order for their nominations to be valid or that it would be equitable for RCII to name Engaged Capital's nominees in its proxy statement.

In an abundance of caution and subject to a full reservation of rights, Engaged Capital delivered to RCII revised nomination materials that included the nominees' consent to being named in RCII's proxy statement. Shortly thereafter, Engaged Capital filed a lawsuit against RCII in the Delaware Court of Chancery seeking an order declaring Engaged Capital's original nomination materials to be valid and prohibiting RCII from including Engaged Capital's nominees in its proxy statement. After the court granted Engaged Capital's motion to expedite its action, RCII notified Engaged Capital that it would not be including Engaged Capital's nominees in its proxy materials—rendering the claim moot.

At the June 8 annual meeting, all three of Engaged Capital's nominees were elected to RCII's board in place of three long-standing incumbents, including RCII's Chairman and CEO. Had Engaged Capital not challenged RCII's ability to include Engaged Capital's nominees on its proxy card, the outcome of the election contest may have been different.

Marcato vs Buffalo Wild Wings

In the recently concluded election contest waged by Marcato Capital Management ("Marcato") against Buffalo Wild Wings ("BWLD"), both Marcato and BWLD included Sam Rovit, who was originally nominated by Marcato, in their respective slates of director nominees and Mr. Rovit was named on each of their respective proxy cards.

According to public filings, after Marcato nominated its slate of directors, members of its slate, including Mr. Rovit, were interviewed by BWLD's governance committee to discuss their interest in serving on the board. BWLD subsequently announced that it had nominated Mr. Rovit. BWLD's proxy disclosure discussing its nomination of Mr. Rovit illustrates how a target company can use a highly qualified candidate put forward by a dissident as a strategic measure to bolster its own campaign:

> Notably, Mr. Rovit was initially nominated by Marcato and, after careful and deliberate evaluation by our Governance Committee, we believe Mr. Rovit will contribute to our Board.
>
> We therefore enthusiastically nominated him ourselves.

The circumstances surrounding the provision of a written consent BWLD would have been required to obtain from Mr. Rovit in order to name him on the company's proxy card are unclear from the disclosure contained in the proxy statements filed by both sides. BWLD's proxy statement suggests that Mr. Rovit had provided his written consent to be nominated by the company prior to the announcement of his nomination, stating:

> [The Chairman of the Board] spoke with Mr. Rovit by telephone and Mr. Rovit confirmed his prior written statements indicating his willingness to be nominated by the company for election to the Board of Directors.

However, according to Marcato's proxy statement, immediately after BWLD announced that it had nominated Mr. Rovit, BWLD requested that he sign a consent to be nominated by the company and to be named in its proxy statement and that such request was denied:

> After this announcement, the Company's general counsel . . . sent an email to Mr. Rovit asking him to sign a form of consent to being nominated by the Board for election at the 2017 Annual Meeting and to be named as such in the Company's proxy statement for the 2017 Annual Meeting and other proxy soliciting materials. Mr. Rovit did not sign such consent.

Nevertheless, in the days leading up to this announcement, Marcato was clearly concerned with the possibility that BWLD would nominate one or more of its nominees and the strategic advantage BWLD could gain in its solicitation if a subset of Marcato's nominees were named on the company's proxy card.

One week prior to the announcement, Marcato counsel sent a letter to BWLD counsel expressing these concerns and suggesting that both sides agree to using a "universal" proxy card listing all candidates in order to level the playing field. BWLD rejected this proposal.

Subsequently, Mr. Rovit sent a letter to BWLD expressing similar concerns that his inclusion on the company's slate was a tactical measure intended to entrench the board and his view that both sides should agree to use a "universal" proxy card. Mr. Rovit stated:

> It is my understanding that the Company has rejected Marcato's proposal to use a proxy card that would provide shareholders the option to vote for each of the nominees proposed by Marcato or the Company, regardless of which proxy card is used. By excluding the other Marcato nominees from its proxy card, the Company has deprived shareholders of the ability to make a real choice in the upcoming director election. I therefore worry that my inclusion on the Company's proxy card is a tactic meant to help entrench the current board, and I would not appreciate my candidacy and name being used in that manner.

In its report recommending that shareholders vote for the election of Mr. Rovit, among other candidates, ISS echoed Marcato's concerns that BWLD's nomination of Mr. Rovit appeared to be tactical. ISS stated:

> Moreover, certain decisions, such as the company's inclusion of Marcato nominee Rovit on the management slate, come across as gamesmanship rather than a proactive assessment of the facts and circumstances.

At the June 2nd annual meeting, Mr. Rovit together with two of the other three Marcato nominees and six of the other eight BWLD nominees were elected to the board. We can only speculate as to the degree of impact BWLD's tactic had on the results of the election contest.

Dissident's Disclosure Lawsuit Leads to ISS Recommendation Change

By Steven Haas and Charles Brewer, Hunton & Williams LLP*

In a recent proxy contest, a dissident stockholder brought a lawsuit against the company claiming that the company's disclosures about certain incumbent directors were deficient. The court agreed, and enjoined the company's annual stockholders meeting until at least 10 days after the company supplemented its disclosures.

As a result of the court's ruling, Institutional Shareholder Services reevaluated its support for the company's nominees and changed its voting recommendation in favor of the dissident, who ultimately prevailed at the stockholders meeting. Although litigation in proxy contests—whether actual or threatened—is not new, this ruling illustrates how dissident stockholders can use offensive disclosure litigation to influence proxy advisors' recommendations and win a stockholder vote.

The Situation

In February 2017, the founder, former CEO, and largest stockholder of Cypress Semiconductor Corporation announced a proxy contest to replace the Company's executive chairman and lead independent director with two new independent directors. As part of that campaign, the dissident argued that the executive chairman had an irreconcilable conflict of interest due to his affiliation with a private equity firm (the "Affiliated PE Firm"), which allegedly competes with the Company for acquisitions and might be a potential acquirer of the Company.

The dissident also targeted the Company's lead independent director, claiming he should be held accountable for the Company's alleged corporate governance failures. The dissident believed the Company had failed to disclose material information that would demonstrate the need to replace the executive chairman and lead independent director. To compel disclosure of that information, the dissident filed a lawsuit in the Court of Chancery.

Despite the Company having filed two supplemental proxy statements in an apparent attempt to moot the lawsuit, the court agreed with several of the dissident's claims.[1] It explained that "[u]nder Delaware law, directors have an affirmative duty to disclose fully and fairly all material information in the board's control when stockholder action is sought."[2] Most importantly, "once directors have traveled down the road of partial disclosure, they must provide the stockholders with an accurate, full, and fair characterization of the disclosed events."[3]

In this case, the Company's second supplemental proxy statement disclosed that an investment banker told the Company that the Affiliated PE Firm "might be one of 30" potential acquirers of the Company.[4] In fact, however, the investment banker's presentation identified the Affiliated PE Firm as one of the four most likely acquirers of the Company. The court held that "having traveled down the path of partial disclosure," full and fair disclosure required the Company to disclose the Affiliated PE Firm's apparent status as one of the Company's four most likely acquirers.[5]

The court also ordered additional disclosure with regard to certain other information concerning the executive chairman's activities with the Affiliated PE Firm, but notably did not require the Company to disclose that the executive chairman had recently resigned from the board of another public company due to concerns over his role with the Affiliated PE Firm. The court found that the circumstances surrounding that resignation would not be material to the Company's stockholders.

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[1] *See Rodgers v. Bingham,* C.A. No. 2017-0314-AGB (Del. Ch. June 1, 2017) (TRANSCRIPT).

[2] *Id.* at 3.

[3] *Id.* at 3-4.

[4] *Id.* at 4 (quoting the Company's second supplemental disclosure).

[5] *Id.* at 4-5.

The Change in Recommendation

When the annual stockholders meeting was finally convened, both of the dissident's nominees were elected to the Company's board of directors. Of particular importance, before the court's ruling, ISS had recommended that stockholders vote management's proxy card but withhold support from the Company's lead independent director. After the ruling, however, ISS issued a new recommendation that stockholders vote the dissident's proxy card to replace both the lead independent director and the Company's executive chairman. Moreover, it appears that the executive chairman's resignation from the other public company troubled ISS more than the court.

In its updated report, ISS wrote that it was "harder to accept" the board's assertion that the executive chairman's role with the Affiliated PE Firm was an "easily manageable situation that poses no threat" to the Company given the other public company's response to that potential conflict.[6] Overall, ISS believed that the Company's "piecemeal, selective disclosure [was] more consistent with a board intent on sanitizing the information provided to shareholders than with one willing to allow shareholders to make fully-informed decisions" and, as a result, changed its voting recommendation in favor of the dissident.[7]

Although it is not clear whether ISS's change in recommendation affected the outcome of the vote, the dissident's offensive disclosure litigation caused ISS to reevaluate—and ultimately withdraw—its support for the executive chairman. Litigation in proxy contests is not new, but this case shows how a dissident can use offensive litigation strategically to bolster the dissident's arguments and influence stockholders and proxy advisors.

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[6] Press Release, *CypressFirst, ISS Changes Recommendation—Now Recommends Cypress Stockholders Vote The Gold Proxy To Elect CypressFirst Nominees Martino And McCranie To Replace Bingham And Benhamou On Cypress Board* (June 6, 2017), *available at* http://www.prnewswire.com/news-releases/iss-changes-recommendation—now-recommends-cypress-stockholders-vote-the-gold-proxy-to-elect-cypressfirst-nominees-martino-and-mccranie-to-replace-bingham-and-benhamou-on-cypress-board-300469686.html (quoting ISS report titled "Cypress Semiconductor Corp. (CY): Further Down the Rabbit Hole").

[7] *Id.*

DFC Global: A Few Observations from Delaware

By Brad Davey, a Partner of Potter Anderson & Corroon LLP

The Delaware Supreme Court recently issued its much-anticipated decision in *DFC Global v. Muirfield Value Partners* (Del. Sup.; 8/17), addressing, among other things, the weight the Court of Chancery should ascribe to the deal price in determining fair value. The decision is a warm, 85-page long embrace of efficient market theory—a concept with a checkered past in Delaware's jurisprudence.

While the Court declined to establish a bright-line rule requiring that the Court of Chancery defer to the deal price established through a robust, conflict-free sale process, it concluded the Court of Chancery abused its discretion in failing to accord the deal price greater weight under the circumstances of this case.

Because I know you all either have already read the decision or will do so soon, I will not summarize the decision, but rather offer a few observations about its practical import.

How Close is *DFC Global* to a "Bright Line" On the Deal Price?

If it's an abuse of discretion not to defer to the deal price, isn't there a bright-line rule requiring deference to the deal price? Though, perhaps a bit tongue-in-cheek, the question focuses on what, if any daylight, there is between the Court's decision and a bright-line rule in robust, conflict-free sale processes. I think the opinion provides a few hints.

First, by implication, the decision suggests that deal price may not be the most reliable evidence of fair value "where things like synergy gains or minority stockholder discounts are … contested." That suggestion does not reveal a great deal of daylight.

Where synergy gains are contested, assuming the deal price is the product of a robust, conflict free sale process, the Court of Chancery would likely start with the deal price and adjust for synergy gains. And, it will be the rare "conflict-free" sale process that gives rise to a situation in which minority stockholder discounts are contested.

Second, the decision's emphasis on efficient market theory suggests that the Court of Chancery could refuse to defer to the deal price that is the product of a robust, conflict-free sale process where the record demonstrated that the market had inadequate or inaccurate information.

Of course, that is a situation that most commonly arises in the context of private companies. So, here again, in the public company context, there does not appear to be a great deal of daylight between the Court's decision and a bright-line rule requiring deference to the deal price.

Decision Makes It Very Hard to Justify Departures from the Deal Price

Whatever might allow the Court of Chancery to depart from the deal price, two of the most common justifications don't work. Right? Or was that just a factual finding that the next petitioner can fix?

Although the Delaware Courts have, in recent years, frequently deferred entirely to the deal price, there have been some notable exceptions. Almost universally, those exceptions have involved some combination of the two justifications advanced by the Court of Chancery in *DFC Global* to depart from the deal price: the sale process coincided with a trough in the subject company's performance and the buyer was a financial sponsor seeking a particular internal rate of return on the acquisition. Here, the Supreme Court concluded it was an abuse of discretion for the Court to depart from the deal price for those reasons.

The careful readers will note that the Supreme Court held it was an abuse of discretion because those justifications lacked support in the record. But, the Supreme Court's analysis does not suggest that this was a failure of proof that a different petitioner can fix in the next appraisal proceeding.

Rather, the decision appears to conclude that the justifications are inconsistent with accepted economic theory. Thus, absent an evolution in accepted economic theory, it is difficult to see how these two justifications can be employed again as the basis for departing from the deal price.

"Abuse of Discretion" Standard Amplifies the *DFC Global* Holding

The standard—abuse of discretion—amplifies the holding. Abuse of discretion is an extremely deferential standard. Where applicable, the Supreme Court accepts the Court of Chancery's findings "if supported by the record and the product of an orderly and logical deductive process."

The Supreme Court cannot simply reverse because, on balance, it would have decided the case differently. Rather, it may only reverse findings "when they are clearly wrong and the doing of justice requires [the Court] to do so."

The Chancellor and Vice Chancellor now have a data point—it is an abuse of discretion to refuse to defer to the deal price in a robust, conflict-free sale process. To be sure, you have to add "under the circumstances of this particular case" to that data point. But, the abuse of discretion finding is an unmistakable signal to the Court of Chancery that deference to the deal price is a much safer approach than departing from it.

What is a "Robust" Sale Process?

What's "robust"? The sale process at issue in *DFC Global* was easy to categorize as robust. The company retained a financial advisor and, over the course of two years, contacted at least thirty-five financial sponsors and three strategics. But, something well short of that may suffice.

In *Longpath Capital v. Ramtron* (Del. Ch.; 6/15) for instance, the subject company engaged in a public search for a white knight to fend off a hostile takeover bid. Although the process did not result in competitive bidding, the Court of Chancery deemed it to be an effective market check. I think that analysis would be affirmed by the Supreme Court.

Indeed, given the reasoning of *DFC Global* and its full-throated endorsement of efficient market theory, I think there is a more than colorable argument that the Chancery Court should defer to a deal price that is the product of a single-bidder process with a passive post-signing market check, where the subject company has a deep base of public stockholders, with active trading, and the unaffected market price is consistent with the deal price.

What is a "Conflict Free" Sale Process?

There is a spectrum of conflicts. At the most-conflicted end, you have controller cash-outs. Similarly, you have a third-party sale of a controlled company, where the controller demands a premium.

At the other end, you have various management conflicts. The more serious being management lead buyouts and private equity deals with management roll-over. And, as some entrepreneurial plaintiffs' counsel might argue, management is conflicted in every sale transaction, because a sale—in addition to triggering various employment benefits—is the only means for them to diversify their risk as they typically have a disproportionate exposure to the subject company's equity.

Then Vice-Chancellor Strine appeared to recognize this conflict in *In re Lear Corp. S'holder Litig.* (Del. Ch.; 9/08), in which he required the company to disclose the CEO's desire to sell the company in order to diversify his holdings. But, absent unusual circumstances, the Court of Chancery consistently recognizes that the management equity aligns their interests with stockholders. So, in the coming months, we can expect to see the Delaware Courts endeavor to identify where on this spectrum of conflicts is a deal no-longer considered conflicted.

Must the Sale Process be Both Robust & Conflict Free?

Is it a conjunctive test? Must the sale process be robust AND conflict free? It's not clear. The thrust of the *DFC Global* decision, however, indicates that the Court of Chancery should be focused on whether the process, combined with other evidence, provided an effective means for price discovery. And, the *Dell* appeal will provide guidance on that front.

That case involved a management-led buyout; it was not conflict free. But, there was a very robust, competitive bidding process post-signing. While the Court of Chancery found that the bidding process could not cure the initial conflict because it was anchored by the original, conflicted deal price, the Supreme Court may very well find the presence of active, post-signing bidding provided more than adequate price discovery. Stay tuned.

A Shrinking Strike Zone for Appraisal Arbitrageurs

Undeniably, one consequence of *DFC Global* is a shrinking strike zone for appraisal arbitrageurs. At a Tulane conference a number of years ago, when the rise of appraisal arbitrage was the subject of considerable angina for transactional planners and defense-side litigators, Chief Justice Strine urged everyone to relax. Peering into his crystal ball, he predicted that appraisal arbitrageurs would not earn the types of returns that would justify the investment.

Of course, the Chief Justice has a particular advantage in predicting judicial outcomes and, in this instance, he appears to have been right. On balance, the arbitrageurs have had a rough run. Sure, there was *Dole Food* (Del. Ch.; 8/15), *Dell* (Del. Ch.; 5/16) and *DFC Global* (Del. Ch.; 8/15). But, those were followed by *PetSmart* (Del. Ch.; 5/17), *SWS* (Del. Ch.; 5/17) and *Clearwire* (Del. Ch.; 7/17). And, now *DFC Global* has been reversed.

These decisions suggest the appraisal remedy has its greatest utility in private company transactions, where the appraisal arbitrage model does not work, and in the substantially smaller universe of conflicted public company transactions. While it remains to be seen whether arbitrage funds will be able to continue to raise money for appraisal proceedings, from where I sit, it is becoming an increasingly unattractive investment.

Following *DFC Global*, where the sale process provides effective price discovery, it will likely be the rare case in which the Court of Chancery does not ascribe significant, if not full, weight to the deal price in determining the fair value of a public company.

29 Tips for Young Deal Lawyers

By John Jenkins, Editor, DealLawyers.com[1]

Shortly after I joined DealLawyers.com, a young lawyer sent Broc a request for some advice on what he should be reading. Broc made a number of suggestions, but his question got me thinking—what would I say to somebody just starting out who wanted some advice on how to become an effective deal lawyer?

There are lots of places to get substantive information about corporate and securities law, but there aren't a lot of places to get advice on developing the "soft" skills that young lawyers need to move ahead in their careers. So, I thought about that, and came up with my own admittedly idiosyncratic list of tips for young deal lawyers. Your mileage may vary, but here it goes:

Welcome to the profession! Here are some suggestions for you, in addition to daily and extended visits to our sites:

1. Join your local & state bar and the ABA, and sign up for the federal regulation of securities & negotiated acquisitions sections of the ABA & the corresponding ones for state & local bars.
2. Visit the blogs on TheCorporateCounsel.net & DealLawyers.com blog rolls and subscribe to them.
3. Read the *Wall Street Journal* and the *New York Times DealBook* every day.
4. Read the Delaware corporate statute and your home state's corporate statute regularly. There's stuff in there that people who've practiced for 50 years have never thought about.
5. Visit the SEC's website regularly, but don't just look at what comes out of Corp Fin—review the speeches from the Commissioners and senior staff and the enforcement proceedings as well.
6. You probably had a good corporate law course in law school. Start keeping up with changes in Delaware right away—the DealLawyers.com blogroll can help you do that.
7. You're going to be doing a lot of document review. People will tell you to look for specific things, but also remember that this is how you learn your way around contracts and other documents, so keep a broader perspective as you review this stuff.
8. Talk to litigators about litigating deals. Too many corporate lawyers operate in a vacuum, and don't understand how the approach they're taking will play to a judge or jury.
9. Don't be ashamed to take vacation, BUT. . .
10. Forget about work-life "balance" if you want to be good at what you do. Balance is not for corporate lawyers in their first decade of practice.
11. It won't take you long to find out who the superstars at your firm are. Watch what they do and how they do it.
12. Return all your phone calls & emails the same day you get them, preferably within an hour of receipt.
13. Answer your own phone. Don't let your assistant grab it when you're in the office and don't let it go to voicemail.
14. Check email and voicemail regularly when you're out of the office, including when you're on vacation.
15. Keep your supervising attorneys and clients informed about what you're doing.
16. Don't cross your assistant. Ever.
17. Be friendly, gracious and kind to all of your firm's support staff and everyone you deal with at your client's organization.

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18. Apologize if you make a mistake—and remember that acting like a jerk falls under the heading of a mistake.
19. Listen, watch, listen some more. Earn the right to speak up by consistently showing commitment, competence, and insight in your work product.
20. Develop good judgment. The trick here is not to learn good judgment by exercising bad judgment. How do you do that? Watch, listen and think.
21. Ask questions, but don't expect to be spoon-fed. Learn to figure things out for yourself.
22. Develop a bit of a thick skin—expect more criticism than praise. When it comes to praise, Don Draper put it best—"That's what the money's for!"
23. Be a self-starter and try to stretch yourself—seek more responsibility on every new transaction than you had on the last one.
24. When you ask a senior lawyer a question, be sure that you have done your homework first. Expect a senior lawyer to respond to your question by saying: what does the statute or rule say? You'd better know.
25. Learn to be resourceful. Don't start every assignment with a blank sheet of paper.
26. The SEC's Edgar database is the greatest legal form file in the history of civilization.
27. Treat opposing counsel with respect. Do not embarrass another lawyer in front of her client.
28. Start looking for ways to make yourself indispensable—find a niche that isn't being filled and work to become the firm or law department expert.
29. Be patient with yourself. It takes years before you begin to feel competent, and decades before you realize that you really aren't competent but that that's okay, because nobody else is either.

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