University of Illinois College of Law
Examination Cover Sheet

Mergers & Acquisitions
Professor Amitai Aviram
Spring Semester 2018
Number of Pages: 5 (including this page)
Time Allotted: Until 10am on the day following the day you received the exam
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Exam Instructions

1. **Permissible material**: This is an open book exam. You may use any materials you want, whether in hardcopy or electronic format.
2. **Anonymity**: The exams are graded anonymously. Do not put your name or anything else that may identify you (except for your four-digit exam ID number) on the file that contains your answer to the exam.
3. **Receiving and submitting the exam**
   a. Notify my assistant immediately (within 1 hour) if you did not receive by e-mail a copy of the exam by 10am on the day you selected (or on the default date, if you did not select an exam date).
   b. You must submit your response as a .doc/.docx (Microsoft Word) file e-mailed to my assistant no later than 10am on the day after you received the exam. The file name should be your 4-digit exam ID number.
4. **Confidentiality**: Once you receive this exam form, you are not allowed to discuss the exam with anyone until after the last day of the exam period. Students enrolled in this course are not allowed to solicit or receive information about the exam if the source of the information (directly or indirectly) is a person who has seen the exam.
5. **Length limit**: The total length of your answer may not exceed 1,000 words. For every 10 words in excess of the length limit (rounded up), one point will be taken off the exam's raw score.
6. **Answering the exam**: Cite relevant case and statutory authority. Subject to the length limit, answer all relevant issues that arise from the fact pattern, even if your conclusion on one of the issues is dispositive to other issues.
7. **Assumptions**: Unless the exam question specifies otherwise, assume that -
   a. The relevant jurisdiction applies the Restatement (Third) on Agency, Delaware corporate law, UPA, and U.S. securities law.
   b. Each corporation's charter states that: the corporation is a stock corporation, has limited liability and perpetual existence; the corporation may conduct any lawful act or activity; director fiduciary duty is limited to & director/agent right to indemnification is extended to the maximum degree allowed under DGCL §102(b)(7) ; the board may amend the bylaws.
   c. Each corporation's bylaws state that: the chairperson of the board is authorized to call a board meeting; and the board is authorized to call both annual & special shareholder meetings.
   8. **"Fact" patterns are fiction**: The "facts" presented in this exam are not necessarily true in real life.

Sandra Lyme began to post videos on YouTube while she was in high school. A self-professed "chemistry geek", Sandra posted videos in which she conducted chemistry experiments using household materials. Within a few years, she cultivated enough subscribers to earn her a modest income – enough to allow her to rent an apartment in her first year in college, rather than live in the dorms.

Slimy Business: During her second year in college, Sandra posted a few videos in which she combined glue with a variety of other chemicals to create what she called "slime" – a thick yet flexible mix that was fun to knead.

Slime turned out to be a hit. The number of subscribers grew by three, four, and then ten times. Other YouTubers began to post their own videos on creating slime. The trend was large enough that glue companies reported an increase in their sales. Newell Brands, Inc. ("Newell"), a publicly traded Delaware corporation that owned the Elmer's glue brand provided her with glue free of charge as long as she mentioned in her videos that she used their products.

From that point on, Sandra focused her YouTube channel on slime, and regularly posted experiments in finding new and better slime components. She decided to hire some experts to improve the quality of video production and to get some assistance planning and producing the videos, so that she would still have time to go to classes. This required some upfront costs, so she decided to bring in an investor and incorporate her business.

Angel, a wealthy investor, was interested in Sandra's business. Sandra formed SLyme Inc. ("SLyme"), a Delaware corporation. She assigned the copyrights of her videos and ownership of her YouTube channel to SLyme, and signed an employment agreement with SLyme that gave her a salary of $40,000 a year (enough, Sandra felt, to cover her living expenses) in return for serving as CEO of SLyme and producing at least two slime videos per week. Copyrights and income from her videos would belong to SLyme.

Angel then paid SLyme $300,000 in return for one-third of SLyme's shares; Sandra owned the remaining two-thirds. SLyme's board was composed of three directors: Sandra, Angel, and Rob, a video producing expert who was also hired as SLyme's Chief Operating Officer. Sandra and Angel, acting by written consent as shareholders, ratified Sandra's employment agreement.

April Fool's Prank: On April 1, Sandra decided to pull an April Fool's Day prank in a video. She took a very fancy, small cosmetics container, filled it with slime, and created a label: "Sandra Lyme's Premium Slime", mimicking the understated design of luxury product labels. Her video was a fake commercial for the slime, describing it as the "slime of royalty", produced from "100% artificial chemicals". This "free-range slime" was poured into spacious containers that gave the slime plenty of space to breath (which really meant that there was very little slime in each container), unlike rival slimes that were "cramped tightly in inhuman conditions."

Sandra thought of this as a joke, but within hours, she was inundated with e-mails and comments on her YouTube page asking where they could buy this slime and how much it cost. Several e-mails begged her not to charge more than $30 per container. Sandra chuckled at the price; the materials cost less than $2.

She decided to test the market by having Rob create a website for SLyme, in which customers could securely purchase "Sandra Lyme's Premium Slime" for $20 a container. The website received several hundred orders and then crashed. Sandra realized that SLyme hit a gold mine. She had Rob fix the website and enhance it to handle a large number of customers, and then hired employees to buy materials, create the slime, and ship it to customers.

Within a few months, SLyme had multi-million dollar revenue, with most of it coming from sales of slime and only a minority coming from YouTube's sharing of the channel's ad revenue. The YouTube videos focused on promoting the slime and on Sandra's never-ending quest to improve the slime.

Going Public: By the end of Sandra's third year in College, SLyme was prosperous, but Angel was worried that the slime craze may fade, and with it the fortunes of SLyme. At his urging, the board agreed to have slime conduct an IPO, selling 40% of slime's shares to the public. After the IPO, Slime would have 1M shares outstanding, Sandra would own 400,000 shares, Angel would own 200,000 shares, and many investors from the public would together own the remaining 400,000 shares. SLyme's stock would trade on NASDAQ. Its board would expand to 7 directors, with four of those being independent directors unaffiliated with Sandra or Angel, to comply with NASDAQ's listing rules.

Angel and Sandra signed a shareholder agreement in which they promised that they would agree on a slate of candidates before each shareholder election of SLyme directors, and would then vote in favor of that slate. The slate would include one candidate nominated by Angel, two candidates nominated by Sandra, and four candidates that both parties agreed on and that were independent under NASDAQ's rules.

The IPO went as planned. SLyme expanded its board of directors, which now included Sandra, Rob, Angel, Ira, Ilene, Irene and Isaac. Ira was a retired senior executive at Newell. Ilene and Isaac were mid-level executives at Hasbro, a toy/game company. Irene was a retired senior executive at Meijer, a supermarket chain. None of the four independent directors had any financial or familial connection to Sandra, Angel, or Rob.

A possible deal: Despite Angel's worries, the slime craze continued. At Sandra's suggestion, the board approved expanding SLyme's business, so that it now also sold "premium glue" that was specially designed for making slime at home.

Again, it was a success. Indeed, SLyme was so successful that it had noticeably dented the glue sales of Newell. At SLyme's next board meeting, Ira announced that he recently met his good friend Nate, who is Newell's CEO. Nate said that Newell was interested in buying SLyme, but only if Sandra would remain the public face of the SLyme brand.

At the board meeting, Sandra said that she would not rule out selling the company, but it would depend on the price Newell offered. Ira said that since he was a former Newell employee and still has many close friends there, he could be seen as conflicted in evaluating any offer Newell may make, so he was recusing himself and will not be involved in any discussions or decisions the board made on this issue.

The remaining six directors agreed to create a committee to negotiate with Newell (the "Committee"). They appointed Irene, Isaac and Rob and to the Committee, and authorized the Committee to decide whether it is in the firm's interest to be sold, and if it was, to negotiate and approve a deal with Newell or anyone else who may be interested in acquiring SLyme. To give the Committee the board's full authority, the board stated that it would not agree to any sale of the company unless the Committee first approved it.

The Committee hired an independent investment banker who conducted a valuation of SLyme. At this time SLyme's shares were trading at $10/share. The banker presented several scenarios, under which the fair value of SLyme ranged from $9/share (worst-case scenario) to $17/share (best-case scenario). The Committee members discussed the banker's analysis, and ultimately agreed that they would not accept a price below $13/share.

Sticky negotiations: The Committee then met with Nate and asked how much he was offering. To their surprise, Nate said he didn't want to waste everyone's time negotiating at this point, because Newell was only interested in an acquisition if Sandra agreed to remain an employee after the acquisition to maintain SLyme's brand. Nate said he wanted to meet with the Committee to obtain their permission to first negotiate with Sandra and see if she was amenable to a deal. If she and Nate could agree on terms for her involvement after an acquisition of SLyme, then Nate will negotiate with the Committee. The Committee gave Nate permission to negotiate first with Sandra.

After a week of negotiations, Nate and Sandra signed a contingent employment agreement that stated that if Newell acquired SLyme, Sandra would serve as Newell's "Chief Slime Officer" and would produce at least two slime videos per week. Copyrights and income from her videos would belong to Newell. In return, Sandra would receive a salary of $500,000 a year. The salary was guaranteed for 5 years (i.e., Sandra was entitled to the entire 5 years of salary even if she was fired).

Nate then met again with the Committee, and offered to acquire SLyme for $12.50/share, paid in cash. The Committee told him that this was too low and refused to negotiate further unless he raised his offer.

Nate returned with an offer of $13.50/share, but payment would be in Newell shares (based on the price for which Newell shares traded on the day the agreement was signed) rather than in cash. The Committee said that still seemed low, but they were willing to negotiate the other details of the deal while Newell considered raising its offer. After a week of intense negotiations, the parties ironed out all the details, but Nate did not raise the offer price, claiming Newell could not pay any more. When the Committee seemed willing to walk away from the deal, Nate suggested a compromise: Newell would still pay in Newell shares a value of $13.50 for each SLyme share, but before the acquisition took place SLyme would borrow $1M and announce a dividend of $1/share in cash. This would give shareholders one extra dollar per share, and Newell agreed not to reduce the price it paid for SLyme even though SLyme incurred $1M in debt.

Newell presented to the Committee a draft acquisition agreement that included all the details they negotiated, including the new concession about the $1M dividend. The agreement stated that it was contingent on approval by a majority of SLyme's

outstanding shares. SLyme was allowed to "shop" itself, and if it received a better offer it could terminate the agreement by paying a termination fee of $300,000.

After thorough investigation and deliberation, the Committee approved the acquisition agreement ("the Deal").

Wrapping it up: SLyme's board then approved the Deal and called a special shareholder meeting that had as its only agenda item the approval of the Deal. The board fully disclosed to shareholders all details of the negotiations (both with the Committee and with Sandra) that were described in this fact pattern.

At the special shareholder meeting (the "Meeting"), the vote tally was as follows:

- 790,000 shares voted in favor of the deal (including 400,000 shares owned by Sandra; 200,000 shares owned by Angel; 50,000 shares owned by Rob; 50,000 shares owned by Ilene).
- 120,000 shares voted against the deal
- 90,000 shares were not present or represented (their owners did not attend the Meeting nor signed a proxy)

The board announced that shareholders have approved the Deal. It then had SLyme borrow $1M from a bank, and announced a $1/share dividend. All shareholders cashed their dividend checks.

After the Meeting, SLyme shopped itself but did not find a better offer. Newell and SLyme obtained the required antitrust approval. Then, they closed the Deal, and each SLyme shareholder received Newell shares worth $13.50 per SLyme share they owned, and SLyme merged into Newell.

Lawsuits: Paul, who owned 20,000 SLyme shares but failed to vote his shares at the Meeting, notified SLyme right after the Meeting that he intended to seek appraisal. When the merger closed, Paul refused to receive the Newell shares, and petitioned the court for an appraisal, without alleging wrongdoing by any relevant party. Newell (which succeeded the merged SLyme as the defendant in the appraisal proceeding) claimed that Paul was not entitled to an appraisal.

Patty, who also owned 20,000 SLyme shares and also didn't vote at the Meeting, sued Sandra, alleging that Sandra violated her fiduciary duty as a controller by diverting to herself (through her employment agreement with Newell) some of the value Newell would otherwise have paid all shareholders. Specifically, Patty alleges that Newell was willing to pay a total of $16M for SLyme, but only paid the shareholders $13.5M ($13.50/share for 1M shares) because it paid the remaining $2.5M to Sandra in the form of a "salary" ($500K/year for 5 years). **Discuss both Paul's and Patty's suits**.

Model answer for the Spring 2018 M&A exam

1. Paul's suit:

a. Paul claims an appraisal right (DGCL §262), which doesn't require evidence of wrongdoing. It's a direct claim because it's a right that belongs to him as a SH, so he has standing.

b. Is the dividend part of the merger consideration? The idea of the dividend came up in merger negotiations, as a way to add to what SHs received without making Newell pay more. It was announced only after shareholders approved the merger. However, it was executed while SLyme was shopping for better offers, leaving the possibility that SLyme would terminate the Deal (but the dividend would be paid anyway), making dividends unrelated to the Deal. Close call, but probably dividend is part of merger consideration.

c. If the dividend is part of the merger consideration, Paul lost his appraisal rights by cashing the dividend check. Also, Paul didn't perfect his appraisal rights because he must notify the firm in writing before the SH vote, whereas he notified after.

d. If the dividend is not part of the merger consideration, Paul is not entitled to appraisal rights because of the "market out" (DGCL §262(b)(1)-(2)): he was giving up shares in a public company (SLyme) and receiving in return only shares in another public company (Newell).

Either way, Paul doesn't have an appraisal right.[1]

2. Patty's suit:

a. **Standing**: Patty's suit is direct, so she has standing without having to make a demand. Under the *Tooley* test: (i) mSHs, not SLyme, suffered the harm: Newell would pay $16M for SLyme either way; the harm is not from underpaying but from diverting the payment from all SHs to Sandra exclusively. (ii) mSHs, not SLyme, will receive the benefit of recovery – If Patty is correct, Sandra would need to share with all SHs them the $2.5M she received personally from Newell. Applying *Agostino*, Patty can win without having to show harm to SLyme (underpayment for the company as a whole).

b. **Duty**: Sandra owes a FD as controller only if she controls the firm. This requires either owning a majority interest or exercising control over the company (*Ivanhoe*). Sandra owns only 40%, but under *Frank* she is part of a control group with Angel because they are connected in a legally meaningful way (the shareholder agreement, which coordinates their voting). Therefore, we count both her shares and Angel's, which together amount to 60% - a majority interest. Therefore, Sandra (and Angel) owe FD as controllers.[2]

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[1] It was not appropriate to analyze whether Paul could have a case for an appraisal remedy other than through appraisal right, since the fact pattern specifically states that Paul did not allege any wrongdoing.

[2] There isn't a strong case for Sandra being the controller by virtue of exercising control over SLyme (as opposed to being controller by virtue of being part of a control group that owns a majority interest). The main test for exercising control is counting directors, and four of SLyme's directors are independent.

c. **SoR** is BJR unless Sandra is self-dealing. Sandra is only on one side of the transaction (she is not acquiring SLyme), so *MFW*'s rule applying entire fairness when the controller is on both sides of the deal is irrelevant. However, under *Hammons*/*Frank*, entire fairness also applies when controller is only on one side but receives a different consideration than mSHs. If the employment agreement was part of the merger consideration, then Sandra received different consideration and entire fairness SoR applies. But if the employment agreement isn't part of the merger consideration but solely payment for her future employment, then she received same consideration as mSHs so SoR is BJR (*Sinclair*).
There's a business justification for Newell to employ Sandra to maintain SLyme's brand value, so the employment agreement doesn't exist solely to divert merger compensation from mSHs to Sandra. But salary is 12.5 times what Sandra received under the previous employment agreement and is guaranteed for five years, suggesting that employment agreement may be more generous than the true value of Sandra's employment, and may include consideration for her consent to the merger. Close call; I lean towards seeing the employment agreement as containing some merger consideration, and thus Sandra was self-dealing and entire fairness applies.

d. SoR could change to BJR if SLyme applied "robust procedural protections" in negotiating the Deal (*MFW*, applies to one-sided controller deals under *Hammons*/*Frank*).

e. Committee approval: The Committee had independent advisors, authority to consider all options, and satisfied its DoC. One member of the Committee – Rob – is conflicted because the interested person (Sandra) is his boss. Presumably Irene and Isaac know about the conflict (they know who the CEO and COO are), so no constructive conflict. Since only one-third of the Committee is conflicted, likely the Committee will be seen as independent.

f. mSH approval: The vote was informed. Shares owned by Sandra & Angel don't count because they are the control group, and shares owned by Rob don't count because he is controlled by Sandra (who's his boss). Deducting these, there are 350,000 minority shares, so a majority of all minority shares is 175,000. Only 140,000 voted in favor (790K-650K), so no approval.

   Also, approval was coerced because the Deal was conditioned on approval by majority of outstanding shares, not majority of mSHs.

Under *Beam*, the mere fact that a person was nominated to be director by a shareholder (or that the shareholder voted in favor of making that person director) does not make the person dominated by the shareholder. The "counting shares" test would indicate influence (largest SH, twice as many shares as next largest SH), but that isn't the preferred test, and actually understates Sandra's control, since she is allied with the second largest SH (via the SH agreement). As for evidence of direct influence on SLyme, one cannot consider Sandra's influence that is attributable to her position as an agent of the firm (i.e., as SLyme's CEO), because such influence is legally controlled by the board (i.e., it is natural for a CEO to suggest things to the board and to act for the firm, but this is not evidence of controlling the firm since the CEO must abide by the board's instructions, not the other way around).

g. Application: Because both conditions were not satisfied, entire fairness SoR applies. However, because one of the conditions (Committee approval) was likely satisfied, BoP shifts to Patty to show unfairness (*Kahn1994*).

Fairness is assessed under the *Weinberger* test: fair process and fair price. Process was somewhat flawed (see 2e/2f): one committee member was conflicted, mSHs didn't approve the Deal, and Deal wasn't conditioned on mSH approval.[3]

Fair price depends on whether Sandra's employment agreement payments exceeded the value of her services – if it did, the remaining compensation is disguised merger compensation that should have been shared with mSHs. If Sandra's previous employment agreement is a fair benchmark, then of the $2.5M she received, only $200,000 ($40,000 x 5 years) is employment consideration, and the remaining $2.3M must be shared with mSHs. But her prior employment agreement may have undervalued her services, since as a SH she also collected 40% of SLyme's profits resulting from her efforts, whereas now she only collects her salary. Court would likely consider compensation of comparable employees.[4]

Even if Sandra's employment compensation didn't exceeded that benchmark (so price is fair), court may find FD breached (and order plaintiff expenses paid) if the process is severely flawed (*Nine Systems*).

[3] There was no process flaw in the Committee allowing Nate to negotiate Sandra's employment agreement before Nate negotiated with them. Negotiating first didn't enable Sandra to force SLyme to accept the Deal. Rather, the Deal couldn't be executed unless the Committee supported it. Sandra did have the power to thwart the deal if she refused to be employed by Newell, but this was not a result of her power as a controller, but of her skills as an employee. She would have had the same ability to kill the deal even if she didn't own any SLyme shares.

[4] Many exams considered, in assessing fair price, the price Newell paid to SHs. This is the most appropriate fact to analyze when plaintiff alleges that the board didn't get the best price for the firm, but it is not the best evidence in this case. The harm Patty claimed was diverting of some of the money Newell paid, from payments to SHs to Sandra's salary. Patty did not claim that the board could have extracted more money from Newell (or another acquirer). Therefore, it is more appropriate to consider the fairness of Sandra's salary (to identify excesses that represent value transferred from SHs to Sandra), than to consider the fairness of the price paid to SHs. The fairness of price paid to SHs is relevant (finding that the price paid to SHs was lower than appraised value could indicate that some value was transferred to Sandra's employment agreement), but it could also be caused by other reasons that were not alleged by Patty (such as SLyme's board not driving a hard enough bargain). Also, given the wide range in which SLyme was valued, a significant amount of value could be diverted to Sandra's employment agreement while payment to SHs would still be in fair price range. Thus, "fair price" in Patty's suit is assessed best by examining Newell's payment in Sandra's employment agreement, not Newell's payment to the SHs.