University of Illinois College of Law
Examination Cover Sheet

Mergers & Acquisitions
Professor Amitai Aviram
Spring Semester 2022
Number of Pages: 5 (including this page)

Exam Instructions

1. **Accessing and submitting the exam**
    a. The exam form will be e-mailed to you by my administrative assistant, at 10am CST on Tuesday, May 3 (Reading Day).
    b. Save your exam answer as a Word (.doc or .docx) file, with the file name being your 4-digit exam number.
    c. Submit the exam by e-mailing it as an attachment to my administrative assistant Kelly Downs (kdwns@illinois.edu). **You must submit the exam before 10am CST on Monday, May 9**.
2. **Permissible material**: This is an open book exam. Subject to Instruction 3 (confidentiality), you may use any written materials you want, whether in hardcopy or electronic format.
3. **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.
4. **Anonymity**: The exams are graded anonymously. Do not put in your exam answer anything that may identify you, except for your 4-digit exam number.
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), 1 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 business entity's charter states that: the entity is a stock corporation, has limited liability and perpetual existence; the entity 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 business entity'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.

When Vivian completed her Ph.D. in biology she founded Viva, a Delaware corporation that is a biotechnology start-up. In her doctorate, Vivian developed a new technique for genetically engineering bacteria that produce medicine as their waste product. This technique offered a more efficient method of producing large amounts of medicine. Viva was created to apply Vivian's technique to create various medicines, hopefully at a much lower cost than was possible before.

Originally, Viva had a single class of shares ("Common Shares"). Vivian owned 40% of these, while a few early investors in Viva owned the remaining shares. However, Viva quickly ran out of money. It was enormously expensive and complicated to go through the approval process of the FDA (the pharmaceutical regulator), and without that approval, Viva's medicines could not be sold. Viva needed to find new investors – preferably ones with experience dealing with the FDA.

After considering various options, Vivian and the other shareholders agreed to bring in Paul, who made a lot of money founding, managing and eventually selling a start-up pharmaceutical company. Paul was in a strong bargaining position: Viva was nearly out of money and Paul was willing to invest a large amount; also, Paul had experience obtaining FDA approvals, and could provide Viva with useful guidance.

Because of his strong bargaining position, Paul negotiated good terms for his investment:

- A new class of shares is formed, called "Preferred Shares". The number of authorized shares of this class is equal to the number of outstanding Common Shares, and all authorized Preferred Shares are issued to Paul in return for his investment.
- Board: Viva's board consists of three directors, and the Preferred Shares have the right to appoint two of those directors (the Common Shares have the right to appoint the third director).
- Votes: In any shareholder vote other than electing directors, a Preferred Share has twice the voting power of a Common Share (electing directors is governed by the terms mentioned above in the bullet titled "Board").
- Liquidation: If Viva went through a "liquidation event", Preferred Shareholders would be entitled to the first $10M of Viva's assets, while any remaining assets would be split 50% to the preferred SHs, and 50% to the common shareholders. A "liquidation event" included the sale of Viva.
- Dividends: Preferred Shares are entitled to 50% of any dividends distributed, and Common Shares are entitled to the other 50%. Both classes of shares have equal priority to receive dividends.

All of these terms were written into Viva's charter. Viva issued Paul the Preferred Shares and received in return the agreed upon investment. The Common Shareholders elected Vivian as director. Paul elected as directors himself and Alanna (a law firm partner with expertise in pharmaceutical M&A and pharmaceutical patents). Alanna had no financial or familial connections to Paul and did not own any shares in Viva.

Aided by Paul's investment, Viva was able to expand its operations and work concurrently on five different products. Of these products, the one with the largest potential market appeared to be **InstaTan**, a pill that induced melanin production and (Viva's scientists hoped) could create a suntan without exposing the skin to sunlight.

It was clear that testing and getting regulatory approval for InstaTan would be an expensive and lengthy process. Paul believed that the huge potential market justified the expense and wanted to devote most of Viva's funds to that product.

Vivian, however, thought that InstaTan was a mere "cosmetic", and wanted Viva to focus on products that did more social good. Specifically, another Viva product called **LawBGone**, which suppressed activity in an area of the brain that scientists connected to the desire to become a lawyer. Regular treatment with this medicine would (Viva's scientists hoped) eliminate a patient's desire to pursue a legal career. This, Vivian believed, would solve the problem of having too many talented people become lawyers (rather than channel their talent in directions that Vivian believed are more productive, such as science). Vivian argued that in the long run, Viva would "do well by doing good": by embracing social responsibility (helping reduce the number of lawyers) Viva would develop a good reputation that would eventually translate into higher profits.

But LawBGone, also, required significant funding over a lengthy period for testing and approval. Vivian and Paul would routinely clash in board meetings over allocating funds to develop these two products. Eventually the directors agreed to a compromise, funding both projects, but at a slower development pace than Vivian and Paul each wanted for the product they favored.

In early 2022, Viva's cash was about to run out, and neither product was yet approved. Viva's financial situation was too fragile to borrow money. Vivian wanted Viva to raise money by issuing new shares to a new investor, but Viva's fragile financial situation meant that they needed to raise a large amount of money at a low share price, so the new investor would likely own over 50% of Viva's control rights (and Paul's control rights, currently at 66.67%, would diminish to about 30%). Paul said he would never agree to this, and his proposed solution to the lack of funds was to sell the company.

Paul's objection effectively vetoed the option of issuing stock to a new investor, since issuing so many new shares would require amending the charter to increase authorized shares, and Paul's 66.67% control rights could block the required shareholder approval. Therefore, Vivian agreed to explore the sale of Viva. She hoped she could organize financing and buy the company, which would get rid of Paul and allow her to focus Viva on LawBGone.

The board unanimously decided to create a committee composed solely of Alanna, to solve Viva's cash crisis. The committee was authorized to hire advisors as necessary, and was instructed to explore any viable solution to the cash crisis (including, but not limited to, selling the company or some of the company's assets). The committee was authorized to sign, on behalf of the board, agreements to sell Viva or any of Viva's assets.

Alanna hired investment bankers and lawyers as advisors (these advisors had no financial or familiar connections to any of Viva's shareholders or directors). One group of advisors was tasked with finding potential acquirers, while another group did a valuation of Viva and explored other possible ways for Viva to raise money.

The latter group reported that their valuation of Viva was between \$10M and \$12M. The group also confirmed the board's initial assessment, that Viva could not raise the necessary money through borrowing, and could not raise the necessary money through issuing shares as long as Paul objected. Thus, Viva could either sell itself now, or cut spending sharply and stay independent a little longer, but if it stayed independent, it would not have the funds to proceed with FDA approvals. Based on this, Alanna proceeded with exploring the sale of Viva, and announced a deadline for potential acquirers to submit offers.

While Alanna was exploring the sale of Viva, Vivian was working on her plans to buy it. Vivian raised cash by selling most of her shares in Viva to Bashir, a wealthy retiree. She also had some savings, but it wasn't enough to buy Viva, so she lined up potential buyers for InstaTan and Viva's three minor products. Vivian planned to take a short-term loan which, together with her money, would be enough to make a competitive offer for Viva. If her offer was accepted, she would then sell all of Viva's products other than LawBGone, and use the proceeds from these sales to pay back the loan. Viva would then be completely focused on LawBGone, and would be owned solely by Vivian.

One other potential acquirer had emerged: Krook & Krook, Inc. ("K&K"), a consumer goods and pharmaceuticals company that was about 100 times as large as Viva. K&K was publicly-traded, and no shareholder owned more than 1% of its shares.

On the deadline set by Alanna, Vivian submitted an offer to pay $12M in cash for Viva. Of these $12M, $9M would need to be borrowed. K&K submitted an offer of $11M, paid in K&K's publicly-traded shares (not in cash). Since K&K was about 100 times larger than Viva, all of these shares together would amount to about 1% of its shares.

Alanna preferred K&K's offer for two reasons. First, she was concerned that Vivian would not be able to secure the $9M loan. Second, she believed that K&K's size, reputation and marketing reach would provide great synergies with Viva's products (improving future profits). Vivian had no other businesses that could provide synergies.

Alanna met with Vivian and told her why she believed K&K's offer was better. Vivian asked for a week to secure financing so she could dispel Alanna's first concern, and Alanna agreed. Vivian also said that Alanna should prefer her offer over K&K for two reasons. First, it was $1M higher, and second, it was paid in cash, which has a secure value, while K&K paid with their shares, which could decline in value after the acquisition agreement was signed.

Within a week, Vivian submitted to Alanna documents showing that a certain bank committed to providing the $9M loan. Alanna had her advisors study the documents, and they concluded that the financing for Vivian's offer was secure. Alanna still preferred K&K's offer because of the future synergies. However, as Vivian pointed out, her offer was $1M higher, and in cash. Alanna urged K&K to improve their offer.

After some negotiating, K&K was willing to raise their offer to $12M. K&K was reluctant to pay in cash, but eventually compromised as follows: They would pay entirely in K&K shares to Viva's preferred shareholders (since Paul was OK with that); but they would pay Viva's common shareholders 75% in K&K shares, and 25% in cash. Alanna prepared an agreement to sell Viva to K&K based on this improved offer ("the Acquisition Agreement").

However, in return for their concessions K&K demanded that Viva sign an additional agreement (the “LawBGone Agreement”) that, if the Acquisition Agreement was terminated for any reason, Viva would sell its LawBGone product to K&K for $3M (which was the fair value of LawBGone according to an independent expert hired by Alanna).

Alanna, acting as the board Committee, signed the Acquisition Agreement and the LawBGone Agreement. Viva’s full board then convened, and on a vote of 2-1 (with Vivian voting against) it called a special shareholder meeting to approve the Acquisition Agreement. After providing all required disclosure (including on the LawBGone Agreement), the shareholders voted. All of the Preferred Shares voted in favor, as did 52% of the Common Shares. Vivian didn’t even bother to vote, since it was clear that the Acquisition Agreement would be approved through Paul’s voting of his Preferred Shares.

Before the deal closed, Vivian sued Alanna and Paul for breach of fiduciary duty, asking for an injunction against the Acquisition Agreement and the LawBGone Agreement. Alanna and Paul conceded that Vivian had standing in her suit. Vivian didn’t claim negligence or insufficient investigation.

While Vivian’s suit was pending, a newspaper published an article about Viva, which focused on the development of LawBGone. The article described the board clashes between Paul and Vivian over whether to fund LawBGone. The journalist wondered why Paul would need to compromise with Vivian and fund LawBGone at the expense of more funding for InstaTan – after all, Paul had two-thirds of the shareholder control rights and two-thirds of the seats on the board. The journalist reported that he received an anonymous voice mail claiming that the American Bar Association (“ABA”) paid Paul an “honorarium” of $100,000 in 2020, in order to secure Paul’s consent to let Viva continue developing LawBGone. According to the voice mail, the ABA was interested in LawBGone’s success in order to reduce the number of lawyers and thus reduce competition between lawyers. The ABA denied these allegations.

Bashir sent Viva a written shareholder inspection demand (providing evidence that he was a shareholder) and asked to receive from Paul information on any payments he received from the ABA in 2020: date of payment, amount, and reason for the payment. Bashir provided the newspaper article as the basis for his demand, and stated that his purpose was to consider suing Paul to make him disgorge to Viva any money Paul received from the ABA in breach of his fiduciary duty. Viva rejected the inspection demand, and Bashir sued Viva to compel compliance with his demand.

Discuss Bashir’s suit against Viva, and Vivian’s suit against Alanna and Paul.

Model answer for the Spring 2022 M&A exam

1. Bashir v. Viva:

(a) Bashir's inspection demand is in writing. He provided proof of shareholding. The newspaper article provides credible basis for investigating Paul's alleged self-dealing (information raising a reasonable suspicion is sufficient; caselaw doesn't require conclusive proof). The requested information is necessary & essential for the stated purpose.

(b) However, DGCL §220 only allows inspection of documents the firm has possession of, and Bashir is asking for documents that Paul (not Viva) has.

(c) Furthermore, Bashir lacks proper purpose. His potential suit is derivative under *Tooley*, since Viva (not Bashir) was harmed by Paul's acceptance of unauthorized benefit from his director position, and the remedy would be disgorgement to Viva (not Bashir). Bashir can't sue derivatively because he fails the contemporaneous ownership requirement: the wrongdoing occurred in 2020/21, but he only owned shares in 2022. Bashir loses.[1]

2. Vivian v. Alanna:

An injunction requires showing that Alanna breached FD in approving the agreements.

(a) Duty: Alanna owes FD as Viva's director.

(b) SoR: Alanna wasn't self-dealing, so Entire Fairness doesn't apply. Enhanced scrutiny under *Revlon* does not apply, despite Alanna embarking on a transaction with K&K, because it doesn't lead to change of control (*Paramount*): Compensation is in shares, and following the deal no one controls J&J. Common SHs get 25% of compensation in cash, but *Santa Fe* ruled that even 33% cash wasn't enough to trigger *Revlon*.[2] Enhanced Scrutiny does apply under *Unocal*, because the LawBGone Agreement is a "crown jewels" deal protection that restricts SHs' right to sell to Vivian: Vivian isn't interested in acquiring Viva without LawBGone, but if she buys Viva, LawBGone would be sold to K&K.

(c) Application: Alanna's purpose for preferring K&K over Vivian was creating future synergies. Absent *Revlon* duties, this is legitimate since it isn't illegal nor corporate waste. Alanna acted in good faith (no self-dealing) and Vivian conceded reasonable investigation. Reasonableness: An action is unreasonable if it's coercive, preclusive, or otherwise unreasonable (*Unitrin*). The LawBGone Agreement doesn't coerce SHs through loss of value (unlike termination fees and underpriced 'crown jewel' sales)

[1] The fact that Bashir's potential lawsuit is derivative doesn't, in itself, eliminate the proper purpose. Bashir has a proper purpose in requesting information for either a direct lawsuit (vindicating a right he has as a shareholder), or a derivative lawsuit (vindicating the corporation's right by exercising a right he has as a shareholder – the qualified right to sue derivatively). What eliminates Bashir's proper purpose is that he lacks standing to bring the potential lawsuit that he presents as his purpose.

[2] Note that for the *Paramount* exception to *Revlon* to not apply, one needs to satisfy two conditions: (a) that following the deal Acquirer has no controller **and** (b) that Target's shareholders received most of the compensation in the Acquirer's shares. If only the first condition occurred, Target's SHs would be immediately cashed out, so long-term increases in value would not accrue to them. If only the second condition occurred, Acquirer's controller would have acquired control in Target, so longer-term increases in value would accrue to the controller and would not need to be paid to Target's original shareholders. Some exam answers wrongly stated that ***either*** of the two conditions was sufficient for *Revlon* not to apply.

since K&K would pay the product's fair value. If SHs think K&K's offer is unattractive, they do not lose value by rejecting it.[3] It's possibly preclusive: while there's a path to selling Viva to Vivian (if SHs vote against the K&K sale), without LawBGone Vivian wouldn't be interested in buying. Unlike a poison pill, the LawBGone Agreement cannot be dismantled once implemented. Even if it doesn't rise to preclusion, it may be otherwise unreasonable, since it is designed to eliminate the only other bidder for Viva (similar to *Revlon*) and (unlike a poison pill) cannot be undone even if Vivian tops K&K's offer.

(d) Under *Corwin*, informed, uncoerced SH approval ratifies directors' FD breach. Here, the SH vote was informed and uncoerced (the LawBGone Agreement doesn't coerce, see 2c). Vivian loses.

3. Vivian v. Paul:

(a) Duty: Paul owes FD as a controller. He has 66.67% of SH control rights and appoints ⅔ of directors. Controller FD applies under *Frank*/*Hammons* because Paul receives something different from the mSHs: he receives all compensation in K&K shares, while mSHs receive 25% cash and 75% shares.[4]

(b) SoR: BJR applies only if "robust procedural protections" were in place. The deal was negotiated and approved by a committee (Alanna) that was independent, satisfied its DoC, was authorized to select independent advisors, and had the board's full bargaining power and discretion (including considering alternatives to selling Viva). The transaction was approved by a majority of mSHs in an informed vote, but the vote was coerced in the sense that mSH approval was not an unwaivable condition to the transaction (indeed, mSH vote seemed so futile that Vivian didn't bother to vote). Thus, the second protection is imperfect, and Entire Fairness, not BJR, applies. However, because one of the two protections was completely applied, burden of proof of fairness shifts to Vivian (*Lynch*).

(c) Application: Under *Weinberger*, court examines fair process & fair price. The only evidence for price is Viva's valuation by Alanna's advisors, at $10M to $12M. K&K is paying $12M, so price is fair. The process was nearly perfect (see 3(b)) except for not conditioning the deal on mSH approval. So, probably fair process, and overall fair deal. Vivian loses.

[3] A common mistake on the exam was to call the LawBGone Agreement a termination fee, to consider its value as being lost to shareholders if they vote against the K&K deal, and since that value amounted to 25% of Viva's value, to find that it was coercive. This is wrong because Viva is being paid the fair value of the product it is selling. No value is lost: Viva is replacing an asset with cash equal to the asset's fair value. Therefore, there is no coercion. The effect of the LawBGone Agreement is not on the voting of Viva's shareholders, but on the likelihood that Vivian would bid for Viva, which is addressed under preclusion. Note that "crown jewels" clauses can operate like termination fees, if the value for which the assets are sold is below the fair value. For example, if the price in the LawBGone Agreement was $2.4M ($600,000 below the fair value), then it would have (in addition to its preclusive effects in deterring Vivian's bid) a coercive effect equal to 5% of the value of the deal, and a coercive effect of that magnitude would likely make it unreasonable (even without considering the preclusive effect).

[4] *Hammons* applies when the controller is treated differently from the mSHs. There is no need, in applying *Hammons*, to show that this different treatment is a better treatment; i.e., that the controller received a better deal than the mSHs (though this latter question – whether controller was treated better than mSHs – becomes relevant when applying the fairness test, in assessing fair price/terms).