entitled "The House That the Regulators Built (Revisited): An Analysis of Whether Respondents Should Litigate Against NASD," published in BNA's Securities Regulation & Litigation Report, available at http://www.sablaw.com/files/tbl_s47Details/FileUpload265/5031/BNAMay06.pdf.

M&A Perspective

Delaware Court Permits Postponement of Stockholders Meeting & Proposes New Standard of Review

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The recent M&A boom hasn't only produced more deals, it has produced a number of important Delaware court decisions. On August 14, Vice Chancellor Leo E. Strine, Jr. of the Delaware Court of Chancery added another one to the mix in *Mercier v. Inter-Tel (Delaware), Inc.*,[1] where he upheld a special committee's decision on the morning of a scheduled stockholder vote to postpone the meeting because the committee knew with "virtual certainty" that the merger would be voted down. Under the heightened scrutiny test set forth in *Blasius Industries v. Atlas Corporation*, which requires a compelling justification when a board acts with the primary purpose of interfering with a stockholder vote, the Court found that "compelling circumstances" exist where independent and disinterested directors believe that a merger is in the best interests of stockholders and that additional time is needed for stockholders to consider new information before casting their votes. The Court also suggested that the special committee's actions were more appropriately reviewed under a "legitimate objective test" based on a standard of "reasonableness." Although highly fact-dependent, the opinion is very significant for its practical and doctrinal implications.

Background

On April 26, Inter-Tel, Inc. ("Inter-Tel") entered into an all-cash merger agreement with Mitel Networks Corporation ("Mitel") and Mitel's private equity co-investor, Francisco Partners. The record date for the stockholder vote was set for May 25, and the special stockholders meeting was scheduled for June 29. Shortly after the merger was announced, several large stockholders voiced concern about the transaction, and Inter-Tel's founder and former chief executive officer proposed a competing recapitalization that was outlined in general terms. Proxy advisory firm Institutional Shareholder Services ("ISS") then recommended a vote against the merger, citing its belief that the merger consideration undervalued Inter-Tel. ISS also criticized the board's decision not to conduct an auction for the company. Although Inter-Tel tried to improve the terms of the merger, Mitel and Francisco Partners stood firm.

On the morning of the June 29 stockholders meeting date, Inter-Tel's special committee knew with "virtual certainty" that the merger was going to be defeated.[2] The special committee weighed its options and concluded that a postponement of the stockholders meeting would allow the company to disclose its second-quarter results, which fell short of earlier projections, and give stockholders additional time to consider negative developments in the M&A market. Accordingly, the special committee decided to postpone the meeting for approximately 30 days, with one special committee member voting against the decision. The company also declared a new record date, even though it recognized that a new record date would permit arbitrageurs to acquire and vote additional Inter-Tel shares and potentially influence the stockholder vote. After stockholder litigation ensued, the Court made clear that "[t]he Special Committee delayed the vote precisely so that it would have more time to convince the stockholders to support the Merger."[3]

The Court of Chancery's Decision

The Independent and Disinterested Directors Demonstrated a Compelling Justification to Postpone the Stockholders Meeting

Vice Chancellor Strine upheld the special committee's decision to postpone the stockholders meeting in order to solicit more support and avoid defeat of the merger proposal. In finding that the directors demonstrated a "compelling justification" under the stringent *Blasius* standard, he reasoned that independent and disinterested directors may reschedule a stockholders meeting where they:

> **(1) believe that the merger is in the best interests of the stockholders; (2) know that if the meeting proceeds the stockholders will vote down the merger; (3) reasonably fear that in the wake of the merger's rejection, the acquiror will walk away from the deal and the corporation's stock price will plummet; (4) want more time to communicate with and provide information to the stockholders before the stockholders vote on the merger and risk the irrevocable loss of the pending offer; and (5) reschedule the meeting within a reasonable time period and do not preclude or coerce the stockholders from freely deciding to reject the merger.[4]**

Because the 34-day postponement itself was not deemed to be preclusive or coercive, the Court's analysis centered on the special committee's justifications for delaying the vote—namely, the need to communicate additional information to stockholders. The Court recognized that the postponement allowed the company to disclose its most recent quarterly results and gave the company's founder additional time to pursue his competing recapitalization proposal, which was still being reviewed by the Securities and Exchange Commission ("SEC"). The postponement also gave stockholders the ability to evaluate new developments in the M&A market (which was about to "lose its froth") and Mitel's refusal to increase its offer.[5] Moreover, ISS and several large institutional stockholders had indicated to Inter-Tel's directors that they might change their positions on the proposed merger if given additional time.

The Court's commentary on the role of directors in seeking stockholder approval is particularly noteworthy:

> **Here's a news flash:** ***directors are not supposed to be neutral with regard to matters they propose for stockholder action*****. As a matter of fiduciary duty, directors should not be advising stockholders to vote for transactions or charter changes unless the directors believe those measures are in the stockholders' best interests. And when directors believe that measures are in the stockholders' best interests, they have a fiduciary duty to pursue the implementation of those measures in an efficient fashion.[6]**

Notwithstanding this seemingly broad empowerment, the Court's decision must be read carefully in light of the material supplemental disclosures supporting the special committee's actions. *Inter-Tel* does not necessarily give directors authority to postpone a stockholder vote to drum up more support for an otherwise doomed proposal in the absence of new developments. Also central to the decision was the fact that the special committee members were going to lose their board seats and would not be employed by Mitel following the merger. In addition, the Court noted that the directors acted properly in responding to all other expressions of interest from third parties. Thus, the only motivation presented to the Court for the directors' actions was that they believed the Mitel merger was in the best interests of the stockholders.

A New Standard of Review?

Inter-Tel is only the second Delaware decision to find a compelling justification under the *Blasius* standard.[7] Vice Chancellor Strine took this opportunity, however, to criticize the *Blasius* doctrine as a "crude" and "bizarre" after-the-fact label used by courts.[8] Building on an article that he co-authored with former Chancellor William T. Allen and Justice Jack B. Jacobs (sometimes affectionately referred to as "Delaware's Three Tenors"), Vice Chancellor Strine proposed a more relaxed "legitimate objective" test. Under that approach, the special committee's actions would be judged on a "reasonableness" standard akin to a *Unocal* review in which the directors would have to demonstrate that their actions were "reasonable in relation" to a "legitimate corporate objective." Heightened scrutiny under *Blasius*, he continued, should be limited to actions taken in connection with director elections and other votes "touching on matters of corporate control."[9]

A reasonableness test would certainly give boards more flexibility and provide practitioners with more certainty vis-à-vis heightened scrutiny under *Blasius*. Vice Chancellor Strine's proposal, however, should not be confused with the rationality standard associated with the business judgment rule. His proposal would also place the burden on the directors to identify their legitimate objective and demonstrate that their actions were reasonable in relation thereto. Moreover, practitioners will still have to tread carefully until the Delaware Supreme Court addresses the issue. As Vice Chancellor Strine recognized, *Inter-Tel's* reasonableness standard cannot be squared with several previous *Blasius* cases.

Postponements, Adjournments, and Notice

Inter-Tel validated the board's power to postpone a stockholders meeting. The Delaware General Corporation Law ("DGCL") speaks only of adjournment, but practitioners have long believed that a stockholders meeting can also be postponed before being convened. It bears noting, however, that *Inter-Tel* did not address the issue of notice for a postponed meeting. Section 251(c) of the DGCL requires at least 20 days prior notice for a meeting to vote on a merger, while Section 222(c) states that new notice is not required for an adjourned meeting unless the adjournment is for more than 30 days or a new record date is set. Due to concerns over statutory compliance, Inter-Tel decided to issue a new notice and set a new record date for the postponed meeting.[10] Thus, the issue of whether a postponed meeting must be treated as a new one for purposes of notice under the DGCL became moot. Without further guidance, it remains unclear whether practitioners must follow Section 251(c)'s 20-day notice requirement for postponements.

Inter-Tel's proxy statement also contained a proposal, at the insistence of the SEC, seeking specific authorization to "adjourn or postpone the special meeting" in order to solicit additional proxies in favor of the merger agreement proposal.[11] Prior to postponing the meeting, Inter-Tel's proxy solicitor advised the special committee that the proposal to postpone or adjourn was going to be defeated along with the merger. Vice Chancellor Strine did not seem troubled, however, by the special committee's unilateral decision to postpone the meeting, although he noted that the special committee's "legal authority" to do so was not challenged by the plaintiff.[12] He also observed in a footnote that, had the meeting been convened, Inter-Tel's bylaws required the stockholders' consent for an adjournment.[13] Inter-Tel's bylaws did not confer upon the meeting chair the ability to adjourn. Thus, the Court implicitly validated the prevailing view among practitioners that the chair of a meeting has the power to adjourn the meeting as long as such authority is set forth in the bylaws and not used in an inequitable manner.

The Role of Arbitragers and ISS

In challenging the postponement, the stockholder-plaintiff also argued that the delay gave time for arbitragers to acquire additional Inter-Tel stock and approve the merger for a quick-flip profit—in particular, because Inter-Tel's stock was trading at a discount to the merger consideration. The evidence at trial established that the board was well aware of this possibility. The Court refused to issue an injunction, however, "on the notion that some stockholders are 'good' and others are 'bad short-terms.'"[14] It also questioned whether investors would give "irrational weight to the chance to receive an immediate premium when a superior return might be attained by a stand-alone strategy" or from a third-party proposal readily obtainable in the near future.[15] Nevertheless, the Court ultimately concluded that arbitragers did not influence the outcome of the merger:

> **the reason why the vote came out differently… was not because the stockholders eligible to vote were different, but because stockholder sentiment regarding the advisability of the Merger had changed.[16]**

Thus, the Court left room for a future challenge where a change in record date has a material effect on the outcome of a vote.

The Court was also mindful, if not skeptical, of ISS's role in the proposed merger. It characterized ISS's recommendation against the merger as a "*philosophical stance* toward the appropriate method of value maximization that ISS seeks to advance through voting recommendations."[17] In addition, the Court seemed concerned with ISS's possible attempt to elicit additional merger consideration from the buyer without being a party at the negotiating table. ISS's "'no' recommendation," the Court observed, "had started a high-stakes game of chicken" where the buyer "had not blinked."[18] Accordingly, when market conditions worsened and Mitel held firm on its offer, ISS indicated that it might change its recommendation if given more time to consider additional information. Although Vice Chancellor Strine refrained from further scrutinizing ISS's actions, his observations are consistent with other comments that he has made about the increasingly powerful and high-profile role of proxy voting advisory services.[19]

Disclosure of the Reasons for the Postponement

Although the Court upheld the special committee's decision to postpone the stockholders meeting, it was troubled by the "coy nature" of the committee's disclosures at the time of the postponement. Specifically, the committee did not disclose that the merger was going to be voted down or that the postponement and new record date could affect the stockholder base eligible to vote on the transaction. These omissions, the Court observed, were less than "ideal" but were not motivated by bad faith.[20] Ultimately, the Court reasoned that these facts were either obvious or common sense to reasonable investors. Going forward, however, the decision counsels toward greater disclosure of the facts and motivations surrounding postponements and adjournments.

Conclusion

Inter-Tel provides boards with greater flexibility to control the voting process and seek stockholder support for an acquisition proposal. The facts in *Inter-Tel* were fairly extreme: the special committee postponed the stockholders meeting on the morning of the meeting date with full knowledge that the stockholders would vote down the merger and the proposal seeking specific authorization to adjourn to solicit more proxies. The directors also knew that the postponement would give arbitrageurs the opportunity to acquire additional shares that could be voted at the meeting—most likely in favor of the merger. Nevertheless, the Court found that compelling circumstances existed to support the postponement.

> ***Notwithstanding this seemingly broad empowerment, the Court's decision must be read carefully in light of the material supplemental disclosures supporting the special committee's actions.*** *Inter-Tel* ***does not necessarily give directors authority to postpone a stockholder vote to drum up more support for an otherwise doomed proposal in the absence of new developments.***

The key to *Inter-Tel* lies in the important facts justifying the actions of disinterested and independent directors. The special committee pointed to several supplemental disclosures and changed circumstances warranting additional time for stockholders in deciding how to vote—and their actions were arguably validated when ISS changed its recommendation and the merger was approved. Left unanswered is the extent to which the Court was swayed by those various factors. It is unclear, for example, whether directors who are acting in good faith could postpone a meeting to avoid defeat on a proposal that they believe to be in the stockholders' best interest without additional justification. One also has to consider the relatively short postponement period. As the Court observed, "[b]eing required to wait a month or so before making a final decision hardly subjects stockholders to a loss of free will," nor did it "force Inter-Tel stockholders to change their vote."[21] Thus, *Inter-Tel* provides a helpful roadmap but, like many important decisions, can be readily distinguished by its facts.

In challenging the postponement, the stockholder-plaintiff also argued that the delay gave time for arbitragers to acquire additional Inter-Tel stock and approve the merger for a quick-flip profit—in particular, because Inter-Tel's stock was trading at a discount to the merger consideration.

Inter-Tel may also have broader implications. It addressed cutting-edge issues involving arbitrageurs and the role of proxy advisory services. While it left room to challenge board action that permits arbitragers to affect the outcome of a vote, the Court expressed its faith in rational investors and efficient markets. From a doctrinal perspective, clear authority that limits the *Blasius* doctrine to director elections would be a major development in Delaware law. Vice Chancellor Strine's "reasonableness" test, which would place the burden on directors to demonstrate a "legitimate corporate objective," would give directors greater latitude in seeking support at stockholder meetings not only for M&A transactions, but also for a wide variety of proposals other than the election of directors. It remains to be seen, however, whether the Delaware Supreme Court will agree.

NOTES

1 Mercier v. Inter-Tel (Delaware), Inc., C.A. No. 2226-VCS, mem. op. (Del. Ch. Aug. 14, 2007).
2 *Id.* at 19.
3 *Id.* at 21.
4 *Id.* at 1.
5 *Id.* at 18.
6 *Id.* at 42 (emphasis added).
7 *See Hollinger* Int'l, Inc. v. Black, C.A. No. 183-N, mem. op. at 124 (Del. Ch. Feb. 26, 2004) ("[E]ven if *Blasius* did apply to the Rights Plan, a sufficiently compelling justification exists for any incidental burden on Inc.'s voting rights."). *Inter-Tel* did not cite to *Hollinger*, which, like *Inter-Tel*, initially applied a more relaxed standard of review before applying the *Blasius* standard in the alternative.
8 *Inter-Tel*, mem. op., at 37.
9 *Id.* at 46.
10 *See id.* at 25.
11 As a mechanical matter, it is not clear how stockholders could vote to "postpone" the meeting since conducting the vote would require calling the meeting to order, thus presumably transforming the proposal into one for adjournment rather than postponement.
12 *Id.* at 35.
13 *Id.* at 35 n.38.
14 *Id.* at 52.
15 *Id.* at 53.
16 *Id.* at 32–33.
17 *Id.* at 12 (emphasis added).
18 *Id.* at 17.

19 See Leo E. Strine, Jr., Toward Common Sense and Common Ground? Reflections On the Shared Interests of Managers and Labor in a More Rational System of Corporate Governance, J. Corp. L. (forthcoming).
20 *Inter-Tel*, mem. op. at 50–51.
21 *Id.* at 57.

M&A Perspective

Designing Stock Plans That Work in Corporate Transactions

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Because corporate transactions (such as mergers, acquisitions and divestitures) are not everyday occurrences in the lives of most companies, they are often overlooked when companies and practitioners are designing stock plans. With private equity fueling today's frenetic M&A environment, inattention to the issues raised by corporate transactions can lead to unpleasant surprises down the road when a company actually engages in a deal. In addition, recent changes in accounting, tax and disclosure rules, as well as market practice in compensation arrangements and M&A, may necessitate design changes even for companies that had previously thought through all of the issues. This article discusses the issues that should be addressed in designing the provisions of stock plans implicated by corporate transactions. Specifically, this article addresses provisions relating to: (1) change-of-control vesting of stock-based awards (including change-of-control definitions and single- versus double-trigger provisions), (2) design of change-of-control vesting provisions for performance-based awards, (3) design of change-of-control vesting provisions for awards subject to the deferred compensation tax rules, (4) extended post-termination exercise periods following changes of control, (5) adjustments to awards in the deal context, (6) adjustments to awards in connection with equity restructurings, including spin-offs and recapitalizations and (7) definitions of termination of employment in the context of spin-offs and divestitures.

Does Your Stock Plan Parachute Know When to Open?

The first question for a company seeking to design a stock plan that works in a corporate transaction is: do the parachute provisions of the plan know when to open? While change-of-control definitions are often technical in nature, and practice in drafting these definitions has become increasingly sophisticated, many companies continue to rely upon outdated change-of-control definitions that do not adequately address the increasingly complex forms in which business combinations are structured today. Many definitions trigger the vesting of substantial benefits upon transactions that do not represent a true transfer of ownership or control of the company. Conversely, some definitions fail to trigger upon a true change in ownership or control.

Getting the definition right is critical to the practical operation of change-of-control provisions in stock plans. Take, for example, the proposed merger between US Airways and UAL, in which US Airways shareholder approval was obtained but the deal was never consummated. Because the US Airways stock plans defined a change of control as shareholder approval of the merger, rather than as consummation of the merger, the stock awards for many key executives of US Airways accelerated or became payable even though the deal was never actually consummated. A similar event occurred at Sprint because shareholder ap-