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SABRE/FARELOGIX: INNOVATION, TWO-SIDED PLATFORMS, AND THE RISKS OF MULTIJURISDICTIONAL MERGER REVIEWS

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Over the past several years, competition enforcers around the world, including in the United States and Europe, have expressed increasing levels of concern about protecting nascent and potential competition, especially in technology markets. These enforcers question whether dominant firms are harming competition by acquiring nascent rivals in an effort to preempt a growing or potential threat to their incumbent positions. Setting aside government investigations of consummated transactions (which may provide evidence of actual anticompetitive effects), most merger analysis is predictive. Enforcers must assess the evidence in a legally defensible antitrust market and demonstrate that the proposed transaction is likely to harm competition by increasing prices, reducing output, or diminishing quality or innovation.

Enforcers have relatively more experience—and success—challenging transactions between head-to-head competitors in a market with few rivals and high barriers to entry. The sands can shift dramatically, however, when enforcers seek to challenge transactions between potential competitors, firms that are in a vertical relationship, or firms that supply complementary products or services. Further, the transaction may be subject to review by enforcers in multiple jurisdictions that have different enforcement policies, legal standards, and precedent. These dynamics are front and center in a pending transaction involving technologies used in the airline industry.

In April 2020, over the course of three days, Sabre Corporation and Farelogix,

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Inc. received directly opposing reactions in two jurisdictions to the likely competitive effects of their proposed transaction. In the United States, the DOJ lost its attempt to block the transaction when the U.S. District Court for the District of Delaware held that the government failed to meet its burden of proof.[1] The court concluded that Sabre and Farelogix did not compete as a matter of antitrust law because Sabre is a two-sided platform and Farelogix is not. The parties' victory, however, was short-lived. Days later, the United Kingdom's Competition and Markets Authority ("CMA") blocked the transaction. The CMA focused on competitive effects in two markets (rather than one, two-sided market) and concluded that the transaction would result in harm in each.

Although the DOJ indicated it would appeal the district court decision, the parties abandoned the transaction on April 30 when their merger agreement expired. In a press release, Sabre cited the CMA's decision, noting that it believes the CMA was "acting outside the bounds of its jurisdictional authority." According to public reports, Sabre intends to appeal the CMA's exercise of jurisdiction. The transaction provides a number of important lessons for companies considering a merger with a competitor or potential competitor. Following a short discussion of the industry and the decisions in the U.S. and UK, we discuss five key takeaways.

Airline Travel Booking Industry

Sabre and Farelogix both provide technology that facilitates airline bookings made through travel agencies. Airlines sell tickets through two kinds of travel agencies: online travel agencies, such as Expedia and Priceline, and traditional travel agencies. Sabre operates a Global Distribution System ("GDS"), which allows travel agencies to search for and book flights across multiple airlines. Sabre's GDS is a two-sided platform facilitating transactions between airlines and travel agencies. Sabre's GDS is the largest in the United States, with around 50% of the airline bookings made through travel agents. Sabre competes with other GDSs, Amadeus and Travelport, as well as the airlines' direct distribution channels (*i.e.*, their own websites and

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[15]CMA Final Report at 382 (quoting the Parties as stating that "it would be inappropriate for the CMA to continue its investigation, including consideration of remedies, without taking into account the implications of the Delaware Court judgment and ensuring that the outcomes of the US and UK processes are appropriately aligned" before explaining that "it is not incumbent on the CMA (and nor in some cases swill it be legally or practically possible, or desirable from a policy perspective) to come to the same substantive outcome as other jurisdictions, or vice versa.").

[16]*United States v. AT&T, Inc.*, 916 F.3d 1029, 1032, 2019-1 Trade Cas. (CCH) ¶ 80685 (D.C. Cir. 2019).

[17]*Amex* at 2286.

[18]*Id.*

[19]*Sabre* Decision at 70-71.

[20]*Id.* at 31.

[21]*Id.* at 87-88 (citing *U.S. v. Baker Hughes Inc.*, 908 F.2d 981, 988, 991 1990-1 Trade Cas. (CCH) ¶ 69084 (D.C. Cir. 1990)).

[22] *Id.* at 63-64.

VOIGT V. METCALF: DELAWARE COURT OF CHANCERY ADOPTS INNOVATIVE APPROACH TO ASSESSING ALLEGATIONS OF EFFECTIVE CONTROL

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In February, just before the M&A markets paused, the Delaware Court of Chancery left dealmakers and their lawyers with reading material. In *Voigt v. Metcalf*,[1] Vice Chancellor Laster described a sale process that would make a good issue-spotting law school exam, addressing issues of control, director independence, special committee process, recusal, exculpation, disclosure, standards of review, and the incorporation of books and records on a Rule 12(b)(6) motion.

Some of the Court's rulings offer a helpful review of core M&A doctrine. The Court's ruling that a 35% stockholder with certain governance rights under a Stockholders Agreement had effective control of the corporation deserves more careful study. The quantitative analysis of block size and its relationship to effective control, and the nuanced way in which the Court addressed various levers that a stockholder might use to exert power, may foreshadow an important trend. This article discusses those issues.[2]

Transactional Facts

CD&R acquires control of NCI, then separates its ownership from its control. Clayton, Dubilier & Rice ("CD&R") acquired a controlling stake in NCI Building Systems in 2009 and entered into a Stockholders Agreement in connection with that investment.[3] The Stockholders Agreement overlaid a contractual governance scheme on top of the default governance structures supplied by the company's charter, bylaws, and the DGCL.[4] In some respects, the Stockholders Agreement supplemented the default rules of board-centric, representative corporate democracy by giving CD&R the power to participate directly as a stockholder in corporate decisions.[5] As a majority stockholder, CD&R controlled all board and stockholder-level decisions.

As a result, CD&R did not need the Stockholders Agreement to exert power. But vesting some of its power into contractual form allowed CD&R to sell equity without automatically surrendering control. Beginning in 2016, CD&R did just that, selling its nearly 70% stake down to about 42%.[6] One year and one secondary offering later, CD&R's stake stood just shy of 35%.[7] Yet the Stockholders Agreement remained and with it, CD&R maintained a measure of its now-synthetic stockholder control.

CD&R acquires control of Ply Gem and adds on Atrium. In 2017, as CD&R was selling down its NCI position, it won an auction to acquire another building industry supplier called Ply Gem.[8] At the same time, CD&R combined Ply Gem with another industry player, Atrium Windows and Doors.[9] When the pair of transactions closed in April 2018, revealing a market-tested value of $638 million for Ply Gem's equity,[10] CD&R held the majority stake.[11]

NCI acquires Ply Gem. Less than two weeks later, NCI management met with CD&R to discuss merging NCI with Ply Gem.[12] A week after that, the NCI board met, including its four CD&R representatives, and concluded that "a merger with Ply Gem was the most promising potential opportunity" for NCI.[13] That potential opportunity put CD&R in a pivot point between its controlling position at Ply Gem and its large-minority-stake-plus-contractual-control-rights position at NCI.

NCI formed a special committee of the board to consider the potential transaction, but it took half-measures.[14] It gave the committee with the authority to veto a potential transaction, but not to consider alternatives.[15] And it gave the committee the power to hire legal and financial advisors, but pushed the committee toward management's contacts,[16] including a financial advisor who was separately advising another CD&R portfolio company.[17]

Two weeks into the committee's assignment, its financial advisor gave its "initial impression" that any transaction should use Ply Gem's market-tested equity value of $638 million from the Atrium transaction that had just closed.[18] Those initial impressions wilted on contact with CD&R, however, who proposed that Ply Gem's equity value should be about $600 million higher than the Ply Gem-Atrium deal could support.[19] The committee's financial advisor dissembled, and began presenting ways the committee could support the CD&R valuation.[20]

Two weeks later, the NCI committee and CD&R had agreed to the economics of a stock-for-stock transaction that valued Ply Gem's equity at more than $1.15 billion.[21] That May 31 agreement reflected an 80% premium to Ply Gem's equity value from a transaction announced on January 31 that closed on April 12.[22]

Over the next six weeks, the market moved in Ply Gem's favor. The ownership split now reflected an equity value for Ply Gem of $1.236 billion, or nearly a 95% premium over the three-month-old precedent transaction.[23] Still, the committee's financial advisor gave a fairness opinion, the committee recommended the transaction, and the board approved it.[24]

NCI stockholders file suit; defendants move to dismiss. Shortly after the deal closed, plaintiff Gary Voigt sued on behalf of a putative class of NCI's stockholders unaffiliated with CD&R.[25] The plaintiff asserted claims against CD&R for breaching its fiduciary duties as a controlling stockholder, and against the NCI directors for breaching their fiduciary duties.

The defendants moved to dismiss the complaint. In the main, the defendants argued that CD&R was not a controlling stockholder of NCI, and that as a result, the transaction is subject to the business judgment rule. In addition, some of the individual defendants made a *Cornerstone*[26] argument—that the claims against them should be dismissed because the exculpation clause in NCI's charter protects them. Finally, some of the individual defendants argued for their dismissal because they recused themselves from the board's vote to approve the challenged transaction.

The Court of Chancery's Decision

The Court of Chancery largely denied the Defendants' motions to dismiss. In addressing control, the Court deployed a pragmatic, fact-based analysis of CD&R's various degrees of control of NCI that prioritizes the after-the-fact litigation value of doing case-specific equity over the transaction-planning value of certainty.

With a 35% stake plus contract rights, the Court found that CD&R is NCI's controlling stockholder at the pleadings stage. The Court began its analysis of control with the sheer size of CD&R's ownership stake, measured in terms of voting power. At nearly 35%, CD&R held a significant block, but not enough to be a majority stockholder with "hard control."[27]

Next, the Court analyzed whether CD&R "as a practical matter" was "no differently situated than if [it] had majority voting control."[28] The Court explained that a stockholder may have effective control as a general matter, or for a specific transaction.[29]

In analyzing CD&R's degree of effective control, the Court then methodically assessed the plaintiff's allegations along several dimensions.

Board Composition: The Court explained that relationships between an alleged controller and members of the company's board can be "an obvious source of influence that lead to an inference of actual control."[30] Here, despite its minority stake, CD&R retained the contractual right to designate four directors on NCI's 12-member board.[31] The Court observed that there were two other directors with "longstanding ties" to CD&R. Although they were "nominally independent," these two directors had been appointed to the NCI board by CD&R when it had hard control.[32] And most significantly, NCI had publicly disclosed that "subject to their fiduciary duties," the two directors "were subject to CD&R's control for purposes of [b]oard-level decisions."[33] Finally, the Court observed that CD&R's relationships with two more directors—NCI's current CEO, and the director tapped to become the combined company's chairman and CEO—also "contribute[] to a reasonable inference that CD&R exercised actual control over the [c]ompany."[34]

Block Size: The Court surveyed its precedents and described its research as "unsatisfying, because the interaction of block size with other factors prevents clear patterns from emerging."[35] Even so, the Court observed that "a relatively larger block size *should* make an inference of actual control more likely, even though the interplay with factors makes the correspondence difficult to perceive."[36] In an innovative, quantitative assessment of the practical effects of block size, the Court assessed CD&R's 35% stake in the context of a stockholder meeting in which, on average, only 80% of stockholders participate.[37] In this light, the Court held that CD&R's 34.8% stake "contributes to a reasonably conceivable inference that CD&R exercised actual control" over NCI.

The Stockholders Agreement: The Court naturally analyzed CD&R's ability to control NCI as a stockholder in the context of its rights under the Stockholders Agreement, but noted that "[t]he provisions in that agreement cut in both directions."[38] Adding to CD&R's control were the consent rights provided by the Stockholders Agreement that "encompassed both significant corporate and financial transactions, as well as more basic corporate governance issues like increasing the size of the [b]oard or amending the bylaws."[39] These rights amplified CD&R's stockholder-level control of NCI because they addressed some items that otherwise would not require stockholder-level input, thus replacing general principles of representative corporate democracy with issue-specific veto rights wielded by a stockholder whose actions in that capacity would not be subject to board-level fiduciary duties.[40] The Stockholders Agreement also included some control-limiting provisions, including limitations on CD&R's ability to take retributive actions against independent directors who act against CD&R's wishes.[41] Still, the Court held that it remained "reasonably conceivable at the pleading stage that CD&R controlled [NCI] through a combination of levers."[42]

Board Committees: Adding to the pleadings-stage inference of CD&R's control, although to a lesser extent, the Court noted CD&R's right to proportionate representation on board committees. That right, combined with its other board-level relationships, gave CD&R significant influence on the nominating committee, which in turn "gave CD&R significant influence over the composition of the [b]oard."[43]

Company Management and Advisors: The Court also said that an alleged controller's relationships with company management and advisors could bolster an inference of actual control. But here, the Court found the pled relationships to be "relatively weak," and that on their own, they "would not support a reasonable inference of control."[44]

What Does This Mean Going Forward?

A pleadings-stage determination about whether a stockholder is controlling is among the most significant decisions that the Delaware Courts make in terms of allocating litigation exposure.

In *Voigt*, the Court held that the plaintiff adequately pled facts showing that CD&R controlled NCI. As a result, CD&R remains a deep-pocketed defendant staring down the barrel of an expensive entire fairness case, driven by a valuation disparity that is powerful evidence of unfairness, at least on the surface. And CD&R sits in those crosshairs on its own, without the four-sided shield of Section 141(e), exculpation, indemnification, and insurance protections that corporate directors typically carry with them. Now consider the result if CD&R were merely a 25% stockholder with no contract rights and no compromising relationships with the company's independent directors, advisors, or management. CD&R likely would not be considered a controller, and likely would not be a defendant at all, even with the same valuation disparity. The consequences of a pleadings-stage finding of control can be massive.

And because the pleadings-stage analysis of control is binary—a toggle rather than a dimmer switch—transaction planners must put themselves in the Court's shoes and try to identify and understand the facts that the Court will consider when it assesses control. To that end, the Court's decision in *Voigt* raises at least two important questions.

Is 35 the New 50? If the Court of Chancery will be assessing arguments about effective control in the context of the assumption set forth in *Voigt* that only 80% of stockholders participate in stockholder meetings, then the minimum threshold of what constitutes an effectively invincible position for plurality votes becomes something close to 35%.[45] So will 35% become an automatic pass to pleading control?

It shouldn't. And not because there is anything wrong with the Court of Chancery's math or its pragmatic use of the same kinds of background assumptions that have long been used in the courts' poison pill jurisprudence. A "pure" 35% stockholder with no special contract rights or compromising relationships should be treated as having skin in the game, aligned with the company and the unaffiliated common in ways that do not suggest any abuse of control. But where, as in *Voigt*, the blockholder has misaligned levers of control, including contract rights as well as relationships with directors, officers, or advisors, then *Voigt* would support a downward shift in how the block size will be viewed by the Court.

Is the Stockholder Control Analysis Blurring Together with the Director Independence Analysis? *Voigt* is among the most detailed, nuanced, pragmatic analysis of control that appears in Court of Chancery decisions, particularly at the pleadings stage. If deployed widely in future cases, this type of analysis promotes case-specific justice, but produces fewer black-letter rules.

In this way, it resembles the analytical shift that the Delaware Supreme Court has made, particularly in the *Sanchez* and *Zynga* derivative cases, in the area of director independence.[46] Those decisions drive a gut-level sense of fairness, but do not offer boards and their lawyers a paint-by-number approach to determining independence.

So too in *Voigt*. The alleged facts, if true, suggest that if CD&R wanted at all costs to drive NCI into the Ply Gem transaction, it likely could have done so. But they leave transaction planners a mosaic of factors to consider in determining whether a large blockholder may be considered controlling, instead of a formula.

That puts those blockholders to a difficult question in assessing the tradeoff between deal risk and litigation risk. If a 30% stockholder wants to acquire the company, should it treat itself as a controller and self-disable, to mitigate its litigation risk? Or should it vote its shares as it is entitled to, recognizing that its litigation risk will turn on the multi-factor control analysis? The answers to these questions will be deal-specific, but how the Court applies *Voigt* going forward will help shape the analysis.

ENDNOTES:

[1]2020 WL 614999 (Del. Ch. Feb. 10, 2020) (the "Opinion").

[2]These facts are taken from the Court of Chancery's motion to dismiss decision, which are

themselves taken from the facts alleged in and reasonably inferable from the Plaintiff's complaint. Accordingly, they are presented here as allegations only. No representation is made regarding their truth.

[3]Opinion at *2.

[4]Opinion at *3.

[5]*Id.* ("The Stockholders Agreement also granted CD&R contractual consent rights over a wide range of significant corporate and finance matters, including decisions that the Board otherwise would be able to take without needing any stockholder-level approvals.").

[6]Opinion at *4.

[7]*Id.*

[8]Opinion at *5.

[9]*Id.*

[10]*Id.*

[11]*Id.*

[12]*Id.*

[13]*Id.*

[14]*Id.*

[15]*Id.*

[16]*Id.*

[17]*Id.*

[18]*Id.*

[19]*Id.*

[20]Opinion at *6.

[21]Opinion at *7.

[22]*Id.*

[23]*Id.*

[24]*Id.*

[25]Opinion at *8.

[26]*In re Cornerstone Therapeutics Inc, Stockholder Litigation*, 115 A.3d 1173 (Del. 2015).

[27]Opinion at *11; *see also OTK Associates, LLC v. Friedman*, 85 A.3d 696, 707 (Del. Ch. 2014) (equating majority ownership with "hard control").

[28]Opinion at *11 (quoting *In re PNB Holding Co. Shareholders Litigation*, 32 Del. J. Corp. L. 654, 2006 WL 2403999 (Del. Ch. 2006).

[29]Opinion at *11-12.

[30]Opinion at *13.

[31]Opinion at *14.

[32]Opinion at *15.

[33]*Id.*

[34]Opinion at *17.

[35]*Id.*

[36]*Id.* Part of the reason there isn't a linear relationship between block size and an inference of control is that litigants and the court should, in theory, not simply identify situations of control, but situations in which there is a greater potential for abuse of control. The potential abuse of control is negatively correlated with block size. *See Kalisman v. Friedman*, C.A. No. 8447-VCL (Del. Ch. May 14, 2013) (TRANSCRIPT) ("The equity ownership is a mitigating factor in terms of the potential misuse of control because it aligns the controller's economic incentives with those of the company as a whole. It's actually more problematic, then, for someone to have control without the underlying equity stake than it is for somebody to have control with the underlying equity stake.").

[37]Opinion at *18-19. This analysis tracks conceptually the Delaware Supreme Court's analysis of whether a takeover defense is preclusive under *Unocal*, which asks whether the target board has made a hostile bidder's success "realistically unattainable." *Versata Enterprises, Inc. v. Selectica, Inc.*, 5 A.3d 586, 601 (Del. 2010).

[38]Opinion at *19.

[39]*Id.*

[40]*Id.*

[41]Opinion at *20.

[42]Opinion at *21.

[43]*Id.*

[44]Opinion at *22.

[45]Opinion at *19.

[46] *See Sandys v. Pincus*, 152 A.3d 124 (Del. 2016); *Delaware County Employees Retirement Fund v. Sanchez*, 124 A.3d 1017 (Del. 2015).

COVID-19 PANDEMIC IMPACTS PREVIOUSLY ANNOUNCED M&A TRANSACTIONS

By Frank Aquila, George Sampas, Matthew Goodman, Donna Kim and Elan Spanjer

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Bed Bath & Beyond Sues 1-800-Flowers for Refusing to Close

On April 1, 2020, Bed Bath & Beyond Inc. ("BB&B") filed a complaint in Delaware Chancery Court, Case No. 2020-0245, alleging that defendant 1-800-Flowers.com, Inc. ("1-800-Flowers") unilaterally refused to close its pending $252 million acquisition of BB&B's PersonalizationMall.com, LLC ("PMall") business on the scheduled March 30, 2020 closing date due to the uncertainty and negative impacts of the COVID-19 pandemic.[1]

According to the complaint, on March 24, 2020, 1-800-Flowers communicated to BB&B that the scheduled March 30, 2020 closing was not feasible and that it would be postponing the closing to April 30, 2020. 1-800-Flowers cited a number of COVID-19-related impacts, including the "stay-at-home" orders issued in various states and the negative effects on both parties' businesses, including the shut-down of PMall's facilities until at least April 7, 2020. BB&B rejected any postponement of the closing, claiming that 1-800-Flowers' failure to close the transaction would constitute a breach of the purchase agreement.[2] In correspondence that followed, despite BB&B's attempts to facilitate the closing and make accommodations to ease the post-closing transition,[3] 1-800-Flowers continued to insist a March 30, 2020 closing was commercially impracticable and that closing must be postponed until April 30, 2020. After 1-800-Flowers failed to pay the purchase price on March 30, 2020, BB&B filed the complaint, requesting specific performance.[4]

In its correspondence with BB&B, 1-800-Flowers did not invoke the "material adverse effect" clause, or MAE, the absence of which was a condition to 1-800-Flowers' obligations to close,[5] or any other provisions of the purchase agreement. 1-800-Flowers instead claimed that neither party was in a position to assess whether PMall had been, or might be reasonably expected to be, materially adversely affected by the COVID-19 pandemic and any necessary government response.[6] According to BB&B's complaint, at the time of signing, which occurred on February 14, 2020, the COVID-19 outbreak "in other countries was universally public knowledge, as was its potential to impact the economy."[7] BB&B also argued that "PMall is in the same situation as millions of businesses worldwide facing the impact of COVID-19, and 1-800-Flowers cannot refuse to [c]lose the [t]ransaction on that basis."[8]

1-800-Flowers' decision to not invoke an MAE