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WHAT *PRESIDIO* TEACHES US ABOUT THE MATRYOSHKA DOLL STRUCTURE OF M&A LITIGATION

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On January 29, 2021, the Court of Chancery granted in part and denied in part motions to dismiss a stockholder class action challenging the private equity buyout of Presidio.[1] The case implicates virtually all participants in a sell-side merger process, including directors, management, the sell-side financial advisor, a controlling stockholder, and the acquiror. As a result, the case puts in stark relief how their different roles in the transaction create different litigation risks.

The first part of this article summarizes and synthesizes the Court's decision.[2] The second suggests some important doctrinal implications for transaction participants and litigators alike.

Transactional Facts

Apollo acquires Presidio, monetizes some of its controlling stake, and explores a sale of the company

Led by technology entrepreneur Robert Cagnazzi, Presidio provides digital infrastructure, cloud computing, and information security services. Apollo bought Presidio from American Securities in 2015, and sold about 25% of its shares in an IPO two years later. Between late 2017 and early 2019, Apollo sold its stake down to 42% in a series of secondary offerings. Under a stockholders' agreement, Apollo would retain control over five of nine board seats until the next annual meeting, which was expected to occur late in 2019.[3]

In May 2019, Apollo began exploring a sale of the company. For financial advice, Apollo turned to LionTree, with whom Apollo had developed a thick relationship. LionTree advised Apollo on the 2015 Presidio acquisition and 2017 IPO. Outside Presidio, LionTree advised

IN THIS ISSUE:

What *Presidio* Teaches Us About the Matryoshka Doll Structure of M&A Litigation 1

Proposed Antitrust Reform Legislation: Sea Change or Nothing to See? 9

Delaware Supreme Court Resuscitates Suit Challenging Decision to Value Pending Litigation Claims at Zero in Merger 19

Germany Adopts New Competition Rules for Tech Platforms 22

From the Editor 28

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Apollo and co-invested in a $2 billion deal involving West Corporation. And at the same time Apollo was beginning to explore a sale of Presidio, LionTree was advising Apollo on two multi-billion dollar transactions.[4]

Apollo and LionTree met with two private equity firms in May and June 2019 to explore their interest in Presidio. BC Partners ("BCP") presented as a financial buyer who would partner with company management. Clayton Dubilier & Rice's ("CD&R") investment thesis involved combining Presidio with Sirius Computer Solutions, a recent addition to CD&R's portfolio. As a result, CD&R was more like a strategic acquiror, who could pay a higher price for Presidio to capture synergies, but who also had incumbent management that could run the post-merger company.[5]

With limited visibility, the board negotiates a merger agreement with BCP

About a month after LionTree's meetings with BCP and CD&R, the Presidio board ran what appeared on the surface as a benign sale process. It decided to negotiate with a single bidder pre-signing, but insist on a post-signing go-shop to test the market. On the surface, the board made reasonable strategic decisions to maximize the value of the company in a sale of control. But then litigation ensued, and "discovery disturbed the patina of normalcy surrounding the transaction."[6]

At a July 3 board meeting, Cagnazzi introduced LionTree as the company's financial advisor, and LionTree reported to its new client about its conversations with BCP and CD&R. LionTree's account of the meetings favored BCP, underselling CD&R's interest in proceeding with a near-term acquisition of Presidio. As a result, the board sensibly chose to engage with BCP, but not CD&R. Within weeks, the company and BCP had agreed to a purchase price of $16.00 per share.[7]

One week later, LionTree made its conflicts disclosures to the board for the first time. For the first time, LionTree disclosed to the board that it

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had earned about $4 million in fees from BCP and about $16 million in fees from Apollo in the two-year reporting period. The board reacted meekly to these disclosures. It asked LionTree if those fees were material to LionTree, and LionTree said they were not. Apparently satisfied with the advice of a financial advisor who had earned $20 million in fees the previous two years from the company's controlling stockholder and the would-be acquiror, the board approved the company's engagement of LionTree.[8]

On August 12, the board met to consider the merger agreement. LionTree gave a preliminary fairness opinion, and the company's CEO proposed that LionTree receive a success fee of about $31.5 million. The next day, LionTree delivered its final written fairness opinion, and the board approved the merger agreement. At the CEO's urging, the board also approved an increase in LionTree's success fee to about $33 million. BCP reached an agreement to keep the company's incumbent management, and the CEO agreed to invest two-thirds of his equity in the post-merger company at the deal price.[9]

CD&R expresses interest during the go-shop, and LionTree cuts short a competitive bidding situation

The go-shop began right away. CD&R expressed interest. On September 23, CD&R submitted a topping bid of $16.50 per share, subject to finishing diligence. CD&R's bid letter made clear that its offer was confidential and that nothing was to be disclosed to BCP beyond CD&R's identity as an "Excluded Party" as required by the merger agreement.[10]

The next day is when the process went off the rails, with LionTree at the switch instead of the board. Shortly after noon on September 24, the company gave the required notice to BCP that CD&R was an Excluded Party. But earlier that morning, LionTree called BCP and told them that CD&R had bid $16.50 per share. LionTree did not have the board's permission before making that call. Nor did it seek forgiveness after the fact: "Until this litigation, the Board did not know that LionTree spoke with BCP before the Company delivered the notice. The Proxy did not mention the conversation."[11]

BCP exploited the tip. It quickly prepared a revised bid of $16.60 per share, just $0.10 more than CD&R's bid. But in exchange, BCP proposed an increase in the termination fee and also put a short fuse on its offer, hoping to preempt another bid from CD&R.[12]

CD&R came back with an offer of at least $17.00 per share. Still, the board chose BCP's bid once again. This time, CD&R read the room and walked away.[13]

The Court of Chancery's Decision

On behalf of a putative class of Presidio's former stockholders, the plaintiff sued the members of the Presidio board for breach of fiduciary duty in connection with the merger. The plaintiff also sued Apollo for breach of its fiduciary duties as a controlling stockholder. And the plaintiff sued BCP and LionTree for aiding and abetting the alleged breaches of fiduciary duty.

The Court dismissed the claims against Presidio's directors and Apollo, but not the claims against Cagnazzi, LionTree, or BCP. The court's analysis is a casebook-ready explanation of the multi-layered analysis required by post-closing M&A litigation.

First, the court chooses one of three possible "transactional standards of review" to provide "the analytical framework for evaluating whether the transaction or decision should be respected in equity."[14] Next, the court decides whether to adjust the applicable transactional standard of review as a result of a stockholder vote. These two steps are a team sport, pitting the plaintiff against the defendants as a collective unit. Next comes the "individual liability" assessment, in which the court addresses each defendant or commonly situated group of defendants to determine whether they can be liable for damages. Although the individual liability assessment considers each defendant on their own, the court considers a common set of facts.

And as this case demonstrates, corporate directors have protections not available to other potential defendants in M&A cases that can be outcome determinative.

The Court applies enhanced scrutiny as the transactional standard of review

The Court applied enhanced scrutiny as the "analytical framework for evaluating whether the transaction or decision should be respected in equity."[15] In a straightforward application of *Revlon* and its progeny, the Court held that enhanced scrutiny supplanted the business judgment rule because challenged transaction involved the sale of the company for cash.[16]

Whether to apply entire fairness proved a closer question. The plaintiff argued that entire fairness applied because the merger provided a controlling stockholder with a unique benefit in the form of liquidity of its large position. In support of its argument that Apollo would sacrifice value to meet its liquidity needs, the plaintiff alleged that Apollo had held its Presidio investment past its expected holding period, and that Apollo had made public announcements and sold shares in secondary offerings that demonstrated its desire to liquidate the position. The plaintiff also alleged that Apollo was motivated to sell while it maintained its grip over a mathematical majority of the board, which it expected to lose in a few months.[17]

The Court held that these allegations did not rise to the level of conflict of interest. The liquidity-as-conflict theory was felled in part by those secondary offerings, which proved that Apollo could sell when it wanted to and thus negated the inference that Apollo needed to sell the company to liquidate its position.[18] The Court discounted Apollo's alleged need to sell the company before losing the ability to appoint a majority of the board because of what would ordinarily be a plaintiff-driven argument: as a 42% stockholder with the ability to appoint four of the nine board members and the CEO, Apollo would maintain effective control of the company past the 2019 annual meeting.[19]

The Court holds Corwin *inapplicable because the stockholder vote approving the merger was not fully informed*

As the Court observed, "one [disclosure] violation is sufficient to prevent application of *Corwin*" because it renders the vote less than fully informed.[20]

Here, that one violation was the proxy disclosures about LionTree's tip to BCP about CD&R's bid. The company disclosed in the merger proxy that in the fateful conversation, LionTree told BCP that CD&R's proposal "offered a substantial economic improvement over the Merger

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Consideration."[21] That may have been accurate and complete as far as the board knew when it made the disclosure.

But the board learned much more about LionTree's tip during the litigation. And the Court held that "[a] reasonable stockholder would view as important the fact that LionTree provided BCP with CD&R's specific price, enabling BCP to bid just above CD&R's offer rather than having to make a large move because of uncertainty about CD&R's bid."[22] And again, LionTree's failure to own up to its tip magnified the problem: "A reasonable stockholder would view it as important that the Board did not know about LionTree's tip and therefore could not have taken that information into account when negotiating with BCP and CD&R."[23]

The sale process fails enhanced scrutiny at the pleadings stage

LionTree's tip did more than undercut the defendants' *Corwin* argument; it caused the sale process to fail enhanced scrutiny at the pleadings stage.

Applying enhanced scrutiny, the Court looked for, and found, alleged facts supporting a reasonable inference that the sale process fell outside the range of reasonableness. For starters, the allegations of the complaint supported an inference that LionTree and Cagnazzi steered the process to BCP. For Cagnazzi, the motivation was straightforward: As existing management, he stood to gain more from the acquiror seeking to retain existing management than from one who wasn't. For LionTree, it had two objectives other than maximizing the value of Presidio for its stockholders: (1) close the deal and collect its contingent compensation, and (2) maintain its lucrative relationships with Apollo and BCP. "It is reasonably conceivable that for LionTree, steering the deal to BCP was the winning solution."

The plaintiff alleged facts showing that those conflicted motivations infected the sale process. "The principal defect in the sale process was LionTree's undisclosed tip to BCP." In a live bidding situation, LionTree gave BCP a competitive advantage. And BCP used it, pricing its topping bid at just $0.10 per share higher than it knew CD&R had bid. And by not disclosing the conversation candidly to its client, "LionTree prevented the Board from taking action to neutralize the effect of the tip and facilitate an active bidding contest."

The importance of this undisclosed tip to the Court's conclusions cannot be overstated; it was outcome determinative: "Without the tip, the sale process as a whole would fall within a range of reasonableness. With the tip, the sale process must be viewed in a different light. Taken as a whole, the complaint's allegations support an inference that the Board's tactical decisions did not rest on an informational base that allowed the directors to make a principled evaluation of the risks and benefits to the Company's stockholders, but rather rested on an informational base shaped by LionTree and Cagnazzi's consideration of their own financial and personal interests."

As a result of its finding that the transaction failed enhanced scrutiny at the pleadings stage, the Court could "apply enhanced scrutiny after trial to determine whether to issue a mandatory injunction, a permanent prohibitive injunction, or similar equitable relief that operates on a transactional basis."[24]

The Court holds that Apollo and the Presidio directors cannot be liable for damages, but Cagnazzi, LionTree, and BCP can

Just because the complaint states a claim that the transaction cannot satisfy enhanced scrutiny doesn't mean that all the defendants' motions to dismiss were denied. Instead, the Court next moved to the next layer of analysis: whether each defendant may be liable for money damages. Though each defendant is analyzed on their own, the Court's analysis breaks down into groups.

The Outside Directors: The directors who are not affiliated with Apollo and not Cagnazzi present perhaps the strongest grounds for dismissal.

Despite the Court's conclusion that the complaint alleges facts sufficient to defeat enhanced scrutiny, the Court reasoned that a fiduciary cannot be personally liable for damages unless the fiduciary breached the fiduciary duty of loyalty or care. But because the Presidio directors are protected by an exculpation clause in the company's charter, the only path to damages from the directors is a breach of the duty of loyalty.[25] That requires "facts supporting a rational inference that the director harbored self-interest adverse to the stockholders' interests, acted to advance the interest of an interested party from whom they could not be presumed to act independently, or acted in bad faith."[26]

The plaintiff did not allege that the outside directors faced any conflict of interest or lacked independence. As for bad faith, the best the plaintiff could do against the outside directors was an allegation that they did not sufficiently supervise LionTree, and an allegation that they chose BCP's bid over waiting and developing CD&R's higher-priced indication of interest.[27]

Those allegations added up, at most, to exculpated breaches of the duty of care. As a result, the Court dismissed the claims against the outside directors.[28]

The Apollo Directors: The Apollo directors stood one step closer to the crosshairs because of their affiliation with Apollo. But because the Court held that Apollo did not face a conflict of interest, that affiliation became legally insignificant. As a result, the Court dismissed the claims against the Apollo directors for the same reasons as the outside directors.[29]

Cagnazzi: Cagnazzi did not fare as well as his fellow directors, in part because of his dual role as officer and director, and in part because of the allegations that he personally helped steer the company to BCP in service of his own self-interest. As the Court reasoned, Cagnazzi favored BCP because BCP wanted to partner with existing management. The prospect of a continuing role as CEO of the post-merger company combined with the chance to roll his personal investment made BCP far more attractive financially for Cagnazzi than a deal with CD&R, which would have meant the end of the line for him.[30] The Court found that Cagnazzi acted consistent with that self-interest and worked with LionTree to steer the process toward BCP by being less than candid with the board about CD&R's interest in a transaction at the start of the process.[31]

The Court found those allegations sufficient to state a non-exculpated claim for breach of Cagnazzi's duty of loyalty. And making matters worse, Cagnazzi's role as an officer gave the plaintiff another path to money damages from Cagnazzi, as a 102(b)(7) provision can only protect directors, not officers.[32]

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Apollo: As for Apollo itself, the Court held that because Apollo had no conflicts of interest, there could be no claim for breach of the duty of loyalty. But unlike its affiliated directors, Apollo does not enjoy 102(b)(7) protection, so the Court addressed whether Apollo could be liable for breaching its duty of care.[33]

After questioning whether controlling stockholders owe a duty of care, the Court reasoned that the plaintiff could only state a claim for breach of that duty of alleging facts supporting an inference that Apollo acted with gross negligence. Gross negligence in the corporate context requires "a devil-may-care attitude or indifference to duty amounting to recklessness," and the Court determined it was absent here. As a result, it dismissed the damages claim against Apollo.[34]

BCP: As a third-party acquiror, BCP enjoyed the protected space of arm's-length negotiation. And yet here, the Court held that the plaintiff stated an actionable claim for damages against BCP because BCP knew it was not entitled to the information it received from LionTree in the form of a tip. Having received the information, BCP "immediately sought to capitalize on it" in the form of an exploding offer with a small bidding increment and an increased termination fee. This, the Court reasoned, was enough to "foreclose a pleading-stage dismissal of BCP."[35]

LionTree: As the conflicted party most responsible for the decisions that caused the transaction to stray outside the range of reasonableness, the Court held that the plaintiff stated a viable damages claim against LionTree under two theories. Under the traditional aiding and abetting framework, the Court held that LionTree's conduct amounted to "knowing participation" in a fiduciary breach because LionTree "sought to achieve an outcome that would please Cagnazzi and BCP while providing Apollo with a satisfactory price." In particular, LionTree's tip to BCP (a) helped ensure BCP would win the auction, (b) pleased Cagnazzi, who preferred a deal with BCP, (c) met Apollo's desire to sell the company, and (d) brought a swift and sure end to the auction that increased the certainty that LionTree would receive its contingent compensation.[36] Alternatively, the Court endorsed an alternative theory of liability—the so-called fraud on the board theory—and held that the claim against LionTree easily met its elements.[37]

Lessons and Takeaways

Apart from being a good teaching tool for learning and reinforcing the multi-layered analysis in M&A litigation, the Opinion's treatment of differently situated defendants provides meaningful guidance for participants in transactions and subsequent litigation.

Financial Advisors: The lessons for financial advisors are important, but not new. Financial advisors often have a leading role in communicating on behalf of the sell-side board in a sale process, and almost always have compensation contingent on executing a transaction. Moreover, successful financial advisors will have personal and firm-level relationships with industry players and financial sponsors. Together, these are benign facts, yet they can be the active ingredients for litigation explosion if not handled with care.

Any advisor should aim to provide meaningful relationship disclosures to a client or prospec-

tive client early in the process. The longer a process goes before disclosure is made, the easier it will be for a plaintiff to allege that the advisor held back for self-interested or tactical reasons, and to allege that the sell-side board could not meaningfully assess and address the relationships before the process reaches a point of no return (as in *Presidio*, when the disclosure came after the agreement on price with BCP).

And any advisor should aim to provide real-time disclosure of any information in its possession throughout a sale process. The Court's decision in *Presidio* would read much differently had there been an outside director present for the "tipping" conversation, or even if LionTree promptly told the board about its conversation. An independent, non-conflicted board could act to cure any misstep in a sale process and restore competitive bidding on a level playing field, but only if they are aware of the facts on the ground in real time.

Acquirors: BCP is perhaps the edge case for liability in this scenario, and probably holds the most hope for winning on liability at a later stage of the case. Simply put, what was BCP to do when it received competitively advantageous information it never asked for? The answer is unclear, but immediately preparing a preemptive bid, based on not delivery of value to stockholders but on deal terms that made competitive bidding harder, helped seal its fate, at least at the pleadings stage.

Controlling Stockholders: *Presidio* is the rare case in which a controlling stockholder is not conflicted and gets dismissed at the pleadings stage. As a result, it serves to remind stockholders that being a controlling stockholder is not a status crime or strict liability regime, and that the Delaware Courts will address thoughtfully allegations of conflicts of interest.

The Opinion also raised an important question that remains unresolved: Do controlling stockholders owe a fiduciary duty of care? If so, what is a controlling stockholder to do? In my view, the Delaware Courts should decide that controlling stockholders have no duty of care. The fiduciary duty of care is a process-oriented duty. It requires that fiduciaries inform themselves of all material information reasonably available when making corporate decisions. As a result, the duty of care pairs well with corporate directors and officers—the human fiduciaries who have the statutory power to make corporate decisions. It is incongruous with a controlling stockholder who, on her best behavior, may be best advised from a corporate governance perspective to stay out of the boardroom as much as possible to give directors and officers space and comfort to do their work.

Moreover, removing a controlling stockholder's duty of care would also solve another of the Opinion's doctrinal puzzles, the cases addressing exculpation in the context of claims against controlling stockholders. As the Opinion observed, the Court of Chancery has held "that a controlling stockholder could not be held liable for a breach of the duty of care if its board representatives would be exculpated."[38] If the cases instead recognized that controlling stockholders don't owe a duty of care, they would not need to stretch the concept of exculpation to accomplish the same result.

ENDNOTES:

[1]*See generally Firefighters' Pension System*

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of Kansas City v. Presidio, Inc., 2021 WL 298141 (Del. Ch. Jan. 29, 2021) (the "Opinion").

[2]These facts are taken as true from the Opinion, and are therefore the facts alleged in and reasonably inferable from the plaintiff's complaint. They should be understood here as allegations only.

[3]Opinion at *2-3.

[4]Opinion at *3.

[5]Opinion at *4.

[6]*In re Del Monte Foods Co. S'holders Litig.*, 25 A.3d 813, 817 (Del. Ch. 2011).

[7]Opinion at *5-6.

[8]Opinion at *7.

[9]Opinion at *7.

[10]Opinion at *9-10.

[11]Opinion at *11.

[12]Opinion at *12-13.

[13]Opinion at *13-14.

[14]Opinion at *18.

[15]Opinion at *18.

[16]Opinion at *21.

[17]Opinion at *22.

[18]Opinion at *23-24.

[19]Opinion at *25.

[20]Opinion at *29.

[21]Opinion at *27.

[22]Opinion at *27-28.

[23]Opinion at *28.

[24]Opinion at *18-19.

[25]Opinion at *47.

[26]Opinion at *47 (citing *In re Cornerstone Therapeutics Inc, Stockholder Litigation*, 115 A.3d 1173, 1179-80 (Del. 2015)).

[27]Opinion at *47.

[28]Opinion at *48.

[29]Opinion at *48.

[30]Opinion at *46.

[31]Opinion at *46.

[32]Opinion at *47.

[33]Opinion at *48.

[34]Opinion at *48-50.

[35]Opinion at *44-46.

[36]Opinion at *39-43.

[37]Opinion at *37 n.15 (citing Joel Edan Friedlander, *Confronting the Problem of Fraud on the Board*, 75 Bus. Law. 1441 (2020)).

[38]Opinion at *49 (citing *Shandler v. DLJ Merchant Banking, Inc.*, 2010 WL 2929654, at *16 (Del. Ch. July 26, 2010)).

PROPOSED ANTITRUST REFORM LEGISLATION: SEA CHANGE OR NOTHING TO SEE?

By Tiffany Lipscomb-Jackson, Aimee DeFilippo, Debra Belott, and Larissa Bergin

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Antitrust reform has become a popular topic in the halls of Congress, academia, and even some (socially distant) gatherings. The topic has slowly picked up pace over the years as lawmakers and academics have decried the growth and conduct of large technology companies and pointed to consolidation across a wide range of industries as a source of concern for consumers