"Harbinger" of Courtroom Remedies in Deal-Jumping Situations

A recent decision in the Delaware courts includes important information for dealmakers in two key areas that are often in play in competitive bidding situations.

The normally quiet holiday period in the Delaware courts was interrupted by an important decision from VC Laster ruling on a Motion to Dismiss damages claims by NACCO arising from a failed merger with Applica in 2006, following a topping bid from funds affiliated with Harbinger. The decision has garnered immediate press attention because of fairly salacious allegations of the passing of inside information by Applica management (who were thought to favor a deal with a financial buyer over a strategic buyer where their jobs were in jeopardy) to Harbinger through a Harbinger consultant. However, the ruling also includes important guidance for the conduct of sellers and buyers, including topping bidders, in a competitive deal environment that may prove both significant and relevant. It is important to note that, as the court emphasized, the present decision was only at the pleadings stages and therefore facts alleged by NACCO were assumed to be true for purposes of this decision.

VC Laster refused to dismiss damages claims by NACCO against both Applica and Harbinger based on claims of:

- *breach of contract* (Applica's alleged breach of its "no shop" covenants in the original NACCO merger agreement by virtue of alleged furtive proactive contact with Harbinger seeking a competing bid);
- *tortious interference with contract* (Harbinger's alleged surreptitious engagement with Applica despite its knowledge of Applica's being bound by the "no shop" covenants for the benefit of NACCO);
- *common law fraud* (Harbinger's alleged faulty and misleading disclosures in its SEC filings as it accumulated a large position in Applica stock prior to and following the announcement of the NACCO merger); and
- *civil conspiracy* (Applica's alleged wrongfully conspiring with Harbinger to breach the NACCO merger agreement).

Of particular note to dealmakers are a few of the court's findings in two key areas that are often in play in competitive bidding situations:

Misleading Schedule 13D Disclosure

1. The court refused to cede exclusive jurisdiction to the Federal courts over claims of fraudulent disclosure in SEC documents, including Schedule 13D beneficial ownership documents. While VC Laster noted that Delaware courts would not enforce compliance claims based on faulty line item disclosure in response to SEC regulations, he adopted prior Delaware Supreme Court and Federal case law precedent to clearly state that Delaware courts had an interest and willingness to adjudicate claims that disclosure included in an SEC filing was false and misleading. Moreover, the court indicated that mere compliance with the line-item SEC requirements is not decisive of a Delaware inquiry of whether disclosure is in fact false and misleading.
2. The court took a very dim view of allegedly boilerplate and outdated generic disclosure by Harbinger regarding its intentions and purposes as required by Item 4 of Schedule 13D for acquirers of more than five percent of a company's shares. In particular, the court, noting consistency with the recent *CSX* decision, lent no credence to Harbinger's assertion that it was accepted practice in the hedge fund community that an acquirer need not disclose anything other than "investment intent" until the acquirer actually makes a bid for the issuer in question. The court was also unimpressed by minor wording changes (i.e., an amended filing dropping the word "only" after "for investment purposes" as Harbinger's plans to make a bid for Applica advanced), describing such revisions as a "fig leaf" and "a minimalist revision contrived to provide an argument if a future dispute arose."

3. These cautionary notes about ensuring that Schedule 13D disclosure is accurate and current are reinforced by recent SEC guidance (in both an enforcement action against *Tracinda* and a recent Compliance and Disclosure Interpretation) in which it noted that the popular "smorgasbord" approach to Schedule 13D intent disclosure (in which acquirers disclose that they "might" take many actions that could involve a change of control) must be updated when the acquirer in fact later forms such an intention.
4. The court noted that, especially in a competitive bidding situation, parties were entitled to reasonably rely on the accuracy of other parties' public disclosures in formulating their strategies and that NACCO arguably was denied the opportunity to pursue defensive measures to protect its deal because of Harbinger's failure to disclose its true intentions.
5. VC Laster held that Harbinger's alleged misleading statements in its SEC filings about its intention took it outside the "legitimate vehicles of competition" and exposed it to a claim for tortious interference with NACCO's merger agreement being that Harbinger had knowledge of the "no shop" restrictions in the agreement.

Compliance with Merger Agreement Non-Solicitation Covenants

1. The court held that NACCO was permitted to pursue expectancy damages claims notwithstanding that it participated in and ultimately lost the bidding war with Harbinger and was paid a break-up fee. The court noted that the merger agreement provision allowing Applica to terminate the NACCO deal to pursue a superior proposal and to limit its damages to the bargained-for break-up fee was predicated on Applica complying with the "no shop" covenants and not being in "willful and material breach" (see recent *Hexion* decision) of the agreement.
2. In finding a basis for pursuing breach of contract claims, the court was also unimpressed with Applica's half-hearted attempts to comply with its obligations under the NACCO merger agreement to use "commercially reasonable efforts" to update NACCO on the status and terms of discussions with a potential topping bidder. The court noted that NACCO "could reasonably expect Applica to have regularly picked up the phone" to update it on the status of its discussions with Harbinger and that, in the fast-paced world of hostile M&A activity, "days matter."

Key Take-Aways

While a trial on the merits of the claims will probably take another year and the scope of damages may vary widely, this preliminary decision offers a few key take-aways for dealmakers:

- The popular perception that Schedule 13D violations are "minor" and generally subject to cure with corrective disclosure is in question with the Delaware court, under appropriate circumstances, appearing willing to allow such violations to form the basis of a damages claim based on fraud; and
- Following on the findings in the *Hexion* case, Delaware courts are delivering a consistent message that hyper-technical compliance often will not be sufficient (i.e., "Don't be cute"):
  - Given the broad writing and reading of "no shop" restrictions, sellers should ensure that their representatives engage in thoughtful and meaningful compliance with the restrictions; particularly in hindsight, careless social contacts or a "quiet" inquiry by a banker could blossom into violations of the covenants;
  - Similar to VC Laster's recent decision on letters of intent, as discussed in a recent *M&A Update*, parties should expect to be held to good faith compliance with the terms of their agreement; for example, "radio silence," even if strategic, does not satisfy the obligation of a seller to keep the first buyer informed of discussions with a potential topping bidder; and
  - Boilerplate or contrived language or minimalist compliance in public disclosures, including SEC filings, will not preclude a finding that the disclosures are false and misleading.

If you have any questions about the matters addressed in this *M&A Update*, please contact the following Kirkland authors or your regular Kirkland contact.

David Fox
Kirkland & Ellis LLP
601 Lexington Avenue
New York, NY 10022
http://www.kirkland.com/dfox
+1 212-446-4994

Kirk A. Radke
Kirkland & Ellis LLP
601 Lexington Avenue
New York, NY 10022
http://www.kirkland.com/kradke
+1 212-446-4940

Daniel E. Wolf
Kirkland & Ellis LLP
601 Lexington Avenue
New York, NY 10022
http://www.kirkland.com/dwolf
+1 212-446-4884