University of Illinois College of Law
Examination Cover Sheet

Mergers & Acquisitions
Professor Amitai Aviram
Spring Semester 2024
Number of Pages: 5 (including this page)
Exam Date & Time: **Wednesday, May 1, 9am**.

Exam Instructions

1. **Accessing and submitting the exam**
    a. The exam form will be e-mailed to you by my administrative assistant, on the Exam Date & Time.
    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 within 6 hours of the Exam Time (i.e., before 3pm)**, by e-mailing it as an attachment to my administrative assistant Kelly Downs (kdwns@illinois.edu).
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 **Answering the exam**: Cite relevant case and statutory authority that is part of the course material, but do not cite sources that are not part of the course material. 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.

Helios Corp. ("**Helios**") is a publicly-traded Delaware corporation that creates renewable energy systems. Its founder, Maxwell Greenfield ("**Max**"), invented a new and more efficient solar panel design, and created Helios to produce these systems. Max had a talent for communicating ideas, and became a prominent voice for green energy, especially advocating that government should restrict the development of new sources of fossil fuel (coal mines and oil fields).

Helios had two classes of shares: Class A and Class B. The charter stated that Class A shares granted the holder one vote per share, and that Class B shares would have rights as designated by the board at any time before shares of that class are issued. All of Helios' shareholders owned Class A shares. No Class B shares were issued, and the board did not designate the terms of these shares. Max owned 51% of Helios' Class A shares and was Helios' Chief Executive Officer.

Helios' board consisted of three people: **Sol**, Max's daughter, an expert in energy systems engineering and the Chief Operating Officer of Helios (the #2 officer in the company, reporting to Max); **Haley**, a professor of corporate finance; and **Emil**, a retired businessman with years of experience managing publicly-traded energy companies. Emil was the Chairman of the board. Haley has no familial or financial connection to Max or Sol (other than being on the board of Helios). Emil has one connection: He owns shares (worth about $1M) in TerraFilms, a start-up controlled by Max, which creates documentaries on environment sciences.

When the government announced a large stimulus package that included billions of dollars for funding green energy infrastructure projects, Helios' board agreed that Helios needed to raise a large amount of money quickly, to finance an expansion of its production facilities ahead of expected demand for its products. Geopolitical tensions caused the stock market to be volatile, so a public offering of stock was not a good option. That left two options: selling Helios to a well-funded acquirer that can invest in it or raising money from the current shareholders in a rights offering (a sale of new shares to the existing shareholders).

Sol was opposed to both of these options, and suggested instead to borrow the needed money. Emil was not surprised that Sol would be against a sale of the company, since her father would lose control of the company, but he was surprised that she was against the rights offering, which would raise money for Helios while maintaining her father's control. After much prodding from Emil, Sol shared the reason she was against a rights offering: Her father was currently low on cash, and would not have enough to participate in the rights offering. She conceded that her father's inability to participate does not mean that the rights offering would fail: it's possible that other shareholders would want to buy Max's allotment of shares. But this might cause Max to lose control of Helios.

Emil chided Sol that her duty as director was to Helios, not to her father. But Sol replied that the rights offering would require increasing Helios' authorized shares, which in turn requires shareholder approval. If Max objected to increasing the number of authorized shares, the rights offering would not be possible, so for any sale of shares to work, the board needed to make sure Max supported it.

Haley said that even when someone does not have available cash, there are ways to finance a purchase. She suggested that the board appoint her as a special committee to negotiate and (if in the interest of Helios) sign on behalf of the company a deal with Max that would allow the rights issue to proceed. Sol and Emil agreed and the board unanimously voted to create and authorize the committee, and also authorized her to hire advisers as needed, which Haley did.

After a few days of intense negotiations, Haley (on behalf of Helios) and Max signed an agreement (the "**Mine Agreement**") under which Max would sell to Helios a very profitable coal mine that he owned for $100M, which was the amount of money he needed to participate in the rights offering. Haley hired an investment banker with expertise in the coal industry, who investigated the mine and concluded that its fair market value was $100M (this was why they picked that particular asset; its value was exactly the amount of cash Max needed for the rights offering). Under the terms of the Mine Agreement, Helios was not allowed to sell the mine to anyone for 5 years, and for that same duration Max had the right to repurchase the mine for $100M (the same price he was selling the mine). The entire agreement was conditioned on Helios executing a rights offering within the next 6 months (so if Helios didn't go ahead with the rights offering, the Mine Agreement would not take effect).

Emil hated the Mine Agreement. He was worried that the company's reputation would suffer when it was known that Max – a champion of clean energy and the public face of Helios – owned coal mines. Worse, Helios itself now owned a coal mine, and could not get rid of it for 5 years. Emil feared that with such a sizable investment in coal, the company would no longer be considered by investors as a "clean energy" company.

Nonetheless, what was done was done. The board announced to its shareholders that Helios intended to execute a rights offering. The disclosure included the details of the Mine Agreement, since Helios' lawyers said that an agreement to finance a large SH's participation in the offering was material to each shareholder's decision whether to participate in the offering.

As Emil feared, the media picked up on the fact that Max, and now Helios, were investing in "dirty energy". Some shareholders were very upset about this. One Helios shareholder, **Sid**, sued Haley and Max for signing the Mine Agreement. Sid conceded that Haley had authority to bind Helios in the Mine Agreement (so you should not discuss that issue).

The media embarrassment and the backlash from some shareholders convinced Emil that Helios should not own a coal mine. He also felt that Max's tarnished reputation turned him into a public relations liability for Helios. Emil sold his investment in TerraFilms. At Helios' next board meeting, Emil recommended that Helios cancel the planned rights offering, and instead sell itself to a well-funded company. That way Helios could lawfully terminate the Mine Agreement, and distance itself from the now disgraced Max.

Sol strongly disagreed. A sale to a third party would open up the argument that the price was too low, she said. This was the advantage of a rights offering: since the buyers are the existing shareholders, no one is exploited even if the shares are not valued correctly. Sol also objected to what she viewed as "stealing the company" from her father. "You can't get rid of a shareholder just because you don't like what the media is saying about them."

Emil responded that his duty was to protect the company and its reputation, "if necessary, protect it even from our largest shareholder."

The board then voted 2-1 to hire investment bankers who would seek a buyer to acquire Helios. Preference would be given to buyers with a strong reputation in clean energy, and with financial means to invest in Helios after the acquisition, so that Helios could make the most of the upcoming government stimulus package.

After a few weeks of thorough searching, the bankers presented to the board five offers from potential acquirers. The highest bid came from **TerraVerde**, a large green energy company that had an excellent reputation as well as the funds to help Helios grow after the acquisition. The board voted 2-1 (again, with Sol voting against) to authorize Haley to negotiate with TerraVerde, try to get them to raise their offer, and if in the interest of Helios, reach agreement on a sale of Helios to TerraVerde, which would be brought to the board for approval. Again, Haley was authorized to hire legal and financial advisors, and she did.

TerraVerde offered to buy Helios for $15 (in cash) per share. Helios' bankers conducted a valuation of Helios and concluded that the fair value was between $14 and $19 per share. It was disappointing that TerraVerde's offer was on the low end of the price range, but it was the only offer of the five that was within the fair value range. Haley negotiated with TerraVerde to try to raise their offer, but TerraVerde was adamant that $15 was its "best and final" offer. They said they could not offer any more because they need to keep some resources to invest in the company after the acquisition. TerraVerde said they believed they were offering a fair price, and Helios was welcome to accept a better offer if they had one.

During the negotiations, Sol interjected with an e-mail to TerraVerde (copying Emil and Haley) that said that the takeover negotiations were merely theoretical, because her father Max owned 51% of the shares, and would not tender his shares or vote in favor of a sale of the company. Haley replied that the board's duties were to the company, not to the founder, and that Helios' lawyers assure her that they can find a way to get this deal done despite Max's objection.

After exhaustive negotiations, the parties reached an agreement (the "**Takeover Agreement**"), under which TerraVerde would acquire Helios for $15 in cash per share. The agreement was structured as a two-tier triangular tender offer, with a tweak to allow the deal to proceed despite Max's objections.

In the front end, TerraVerde would execute a tender offer for Helios' shares (at $15 per share). If less than a majority of the minority shareholders (all SHs other than Max) have tendered their shares (i.e., no more than 24.5% of the shares were tendered), then the deal is deemed rejected by the shareholders and the Takeover Agreement is terminated without a termination fee. However, if more than 24.5% of shares are tendered, then the board would issue a certificate of designation for Class B shares, giving them the same rights as Class A shares, and would then sell enough class B shares to TerraVerde, at $15 per share, so that together with the shares that were tendered, TerraVerde would have over 50% of the votes. Helios' lawyers confirmed that there was a sufficient number of authorized Class B shares to do this, and also confirmed that issuing these shares did not require a shareholder vote under the stock exchange listing rules.

In the back end of the transaction, there would be a long-form merger between Helios and a wholly-owned TerraVerde subsidiary, cashing out the remaining Helios shareholders for $15 per share. There would be a Helios shareholder vote on the long-form merger, but it was sure to pass if the transaction got to this stage, because with the combination of the Class A shares tendered to it and the Class B shares sold to it by Helios' board, TerraVerde will own over 50% of the votes.

The Takeover Agreement was approved by Helios' board in a vote of 2-1 (yet again, with Sol voting against). Max immediately sued Haley and Emil for breaching their fiduciary duties by approving the Takeover Agreement.

Discuss Sid's suit (regarding the Mine Agreement), and Max's suit (regarding the Takeover Agreement).

Model answer for the Spring 2024 M&A exam[1]

1. Sid v. Max:

(a) Standing: Sid's suit is derivative under *Tooley* because the harm from the Mine Agreement (allegedly over-generous loan of $100M by Helios to Max) is suffered by Helios, not Sid individually, and the remedy would be enjoining the agreement, which will allow Helios to keep the $100M.
Sid didn't make a demand, so he lacks standing unless demand was futile under *Zuckerberg*. Sol & Emil fail the third prong because they aren't independent of Max, who received a material personal benefit from the allegedly wrongful Mine Agreement: Sol is Max's daughter and (as COO) Max's subordinate employee; Emil has a material ($1M) joint economic interest with Max (TerraFilms).[2] Haley likely doesn't fail the second prong of *Zuckerberg*, despite being sued, because the facts don't establish that she faces substantial likelihood of liability (see 2). Since 2/3 of the board failed, demand is futile and excused. Sid has standing.[3]

(b) Duty: Max is presumed controller because he owns >50% of control rights. He therefore owes a FD (*Ivanhoe*).

(c) SoR: Max is self-dealing because he is on both sides of the transaction: he controls the mine buyer (Helios) and is the seller. Under *MFW*, Entire Fairness SoR applies unless "robust procedural protections" applied.

(d) SoR - Procedural protections: The deal was negotiated by an independent committee (Haley is independent of Max), which was properly authorized and advised. However, there was no mSH approval (let alone conditioning the deal on mSH approval), so Entire Fairness applies. Under *Lynch*, since one of the two protections was properly implemented, burden shifts to Sid to prove unfairness.

(e) Application: Under *Weinberger*, Entire Fairness requires fair process and fair price. The process was mostly fair: negotiated by an informed, independent director, but no mSH approval. The price was deemed fair by an advisor. But given the repurchase terms, the transaction isn't really a sale, but a loan of $100M for 5 years, with interest equal to the annual profits of the coal mine. So this "interest rate", not the sale price, needs to be fair (similar to the rate Max would be charged by an unaffiliated creditor). Helios takes a reputational hit for investing in "dirty energy", but financing Max appears necessary so Max doesn't block the rights offering. Probably fair; no FD breach.

2. Sid v. Haley:

(a) Standing: Same as 1a.

(b) Duty: Haley owes FD as a director.

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[1] The average raw score was higher on this exam than in past years (either this exam was easier, or students knew the material better). Since grading is done on a curve, this meant that any given grade required a higher raw score than usual.

[2] Some students analyzed the TerraFilms investment under the *Beam* test and concluded that it wouldn't be material (i.e., that Emil would care more about his reputation as director than about risking his investment by alienating Max). This is a reasonable application of the facts and was treated as correct.

[3] Some students wrongly applied the *Zuckerberg* test only to Haley. This is wrong because what is evaluated is the independence of the board that would have evaluated the plaintiff's demand, not the independence to the alleged wrongdoers.

(c) SoR: No self-dealing, since Haley had "no familial or financial connection to Max". Haley's committee didn't embark on a transfer of control, nor deployed corporate power against shareholders, so no Enhanced Scrutiny. BJR applies.

(d) Application: No FD breach.
- No bad faith: The Mine Agreement wasn't illegal. It wasn't corporate waste: as a sale, it was at fair market value; as a loan, the interest was the mine's annual profit.
- No self-dealing: Haley was independent of Max (see 2b).
- No negligence: The agreement involved "days of intense negotiations" and Haley had advisors and an expert assessment of the fair value of the mine.

<u>3. Max v. Haley & Emil</u>:

(a) Standing: Max has standing because his suit is direct under *Tooley*: the Takeover Agreement directly harms him by thwarting his ability to vote down TerraVerde's acquisition. Recovery would either be damages (paid directly to him) for lost control, or an injunction to block the "top up" of Class B shares (preventing direct harm to Max).

(b) Duty: Haley & Emil owe FD as directors.

(c) SoR: Haley & Emil aren't self-dealing in selling Helios to TerraVerde, so no Entire Fairness. The Takeover Agreement doesn't infringe on SHs' ability to sell so *Unocal* doesn't apply, but it does infringe on Max's voting rights by bypassing his ability to vote down the TerraVerde acquisition, so Enhanced Scrutiny under *Blasius*. Also, Enhanced Scrutiny under *Revlon*, since the sale to TerraVerde will change control of Helios.

(d) Application
- Legitimate purpose: Helios' board is thwarting Max's control so they can dissociate the company from Max's tarnished reputation, and so Helios' controller has resources to invest in Helios post-acquisition. Both purposes aren't illegal nor corporate waste, so they could be legitimate under *Blasius* if reasonable/compelling, but they are illegitimate under *Revlon*, since they don't maximize current SHs' short-term benefit (future investments and reputation won't benefit current SHs, who are cashed out).[4]
- Good faith: No self-dealing (see 3b).
- Reasonable investigation: Yes. The board conducted "thorough searching" that yielded five offers and calculated Helios' fair value.
- Reasonableness: An action is unreasonable if it's coercive, preclusive, or otherwise unreasonable (*Unitrin*). The Takeover Agreement isn't preclusive since SHs can reject the acquisition if ≤24.5% tender their shares. It's not coercive in the typical sense of forcing SHs to vote against their wishes. Possibly, expelling a shareholder because the board finds them undesirable is inherently unreasonable even under *Blasius* (otherwise, what stops a board from expelling any shareholder who disagreed with them on matters requiring shareholder approval?). It must be unreasonable under *Revlon* since the board's purpose, in itself, violated *Revlon* duties.
- The purposes were illegitimate under *Revlon*, so FD breached.

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[4] Even though most students identified that *Revlon* applied, many missed the issue that the board violated their *Revlon* duties by choosing a sale over a rights offering, for reasons that benefit the sale's buyer rather than the current shareholders.