Sarbanes-Oxley

I. New Rules for Directors and Officers
   a. CEO/CFO certifications
      i. Section 906
      ii. Section 302
   b. Internal Controls
   c. No loans to directors/officers
   d. Insider trading
   e. CEO/CFO disgorgement penalty
   f. Code of ethics

II. New Requirements SEC reports
    a. 10-K, 10-Q
       i. auditor identified adjustments
       ii. off-balance sheet transactions
       iii. internal control report, etc.
    b. faster 8-K disclosure

III. New Section 16 Reporting Requirements
     a. Directors, officers and 10% shareholders must report stock transactions within 2 business days

IV. New Rules for Audit Committees and Auditors

V. New Sanctions against Corporate Fraud
   a. Prohibitions against destruction of documents
   b. Protections for whistleblowers
   c. Changes in penalties
   d. Enforcement changes

VI. SEC rules on earnings releases and non-GAAP disclosures
Legal Liability of Managers and Board Members

I. Power of the Board of Target to Block Takeovers

a. Friendly vs hostile takeovers

b. Hostile Takeover defenses

i. Defenses requiring shareholder ratification

1. shareholder vote required
   a. take time
   b. not flexible

2. shark repellent certificate amendments – used to prevent someone with newly acquired voting power from taking over BOD
   a. staggered BODs
   b. eliminating shareholder votes through written consent procedure – forces shareholder meetings
   c. etc. pg. 234-7
   d. supermajority vote for combination of target and acquiring firm if hostile
   e. time-phased voting plans – changes voting rights of outstanding common stock

ii. Defenses put in place by BOD through general authority contained in certificates or articles of incorporation

1. if power not in articles, shareholders have to vote to amend articles
   a. faster
   b. don’t have to justify in proxy statements

2. poison pill plans
   a. dividend distribution to existing shareholders of stock, stock rights or other securities that have special redemption or conversion provisions.
   b. Conversion options triggered by hostile acquisition
   c. Effect – target too expensive to buy without BOD approval
   d. Leveraged recapitalization – target exhausts debt capacity and free cash – can’t be acquired using own assets to pay for acquisition
iii. **Defenses of BOD based on state corporate code**
   1. shareholders do not vote
   2. sale of assets – crown jewel defense

iv. Shareholders can vote to remove defenses from ii and iii

c. **State anti-takeover statutes – pg. 240-246**

d. **Court review of BOD decisions to block hostile takeovers**

   i. **Void defenses**

   ii. **Unocal standard**
      1. reasonable – perception of threat real
      2. proportional – action merited by level of threat

II. **Decision of the Board of Target to Sell the Company**

a. **Court tests for judging the actions of a selling firm’s board:**

   i. **Business judgment rule**
      1. basic standard for court review of BOD decision to sell a firm to a single suitor
      2. if applies, BOD protected from second guessing by courts
      3. to lose protection of business judgment rule, board members need to be:
         a. grossly negligent
         b. reckless
      4. BJR doesn’t apply if
         a. Duty-of-loyaltiy cases - Proof of fraud, bad faith, self-dealing
         b. Duty-of-care cases - Uninformed decision making
            i. Protections –
               1. fairness opinion
               2. documented in-house comparables valuation
               3. documented board deliberation

      5. If BJR doesn’t apply, courts evaluate deal under **Entire or Intrinsic Fairness Test** - Deal must be entirely fair to shareholders

   ii. **Enhanced scrutiny test (Unocal test)** –
      1. applied to auctions when BOD favors one bidder over another

   iii. **Intrinsic fairness test** -
      1. when BOD operating under conflicts of interest
b. **Deal Protection Measures**

i. **Purpose**
   1. economic compensation for jilted purchaser in event target chooses not to close
   2. obstructs disruption of deal by another purchaser

ii. **Types of covenants**
   1. no-talk clause – blocks sharing of confidential info by target with other suitors
   2. no-shop clause – limit on target’s soliciting other bids
   3. requirement that target managers use best efforts to close merger
   4. goodbye kiss - termination fee
   5. lock-up option – option granted to purchaser to acquire stock or assets of target if deal does not close

iii. **Fiduciary Out clause** – provide target company with escape hatch
    1. directors are excused from actions that would constitute violation of fiduciary duty – would allow target BOD to negotiate with third party despite no shop clause

c. **Court Review of Cases of Multiple Bidders**

i. **Issues**
   1. Has company put itself up for sale? Yes if:
      a. Initiates auction
      b. Initiates transaction resulting in change of control –
         i. Change of control occurs if majority of stock ends up under control of single individual/small group of individuals
         ii. Does not occur if stock transfers to diffuse group of shareholders
      c. Initiates bust up of company’s divisions
      d. Any of the above constitute the Revlon Zone –
         i. courts will use enhanced scrutiny in these cases (far beyond business judgment rule)
         ii. focus – did BOD get best deal for shareholders?

   2. If put itself up for sale, BOD decision has to satisfy entire fairness test
      a. Must sell to highest bidder
      b. Unless BOD actions can satisfy modified Unocal standard – 2 part test:
         i. Reasonableness
            1. ex. One bidder unlikely to be able to finance acquisition
         ii. Proportionality
d. **Deal structure matched to court evaluation**
   
   i. **Business Judgment rule**
      
      1. Stock for stock merger
   
   ii. **enhanced Revlon duties**
      
      1. Cash acquisition
      2. Target shareholders given choice of cash or shares in Acquirer
      3. Deal protection clauses –
         
         a. currently unclear how whether Revlon or BJR applies
         b. safest to include fiduciary out clauses
         c. less stringent application of enhanced scrutiny in case of strategic mergers – deal protection clauses may be viewed as appropriate by courts


e. **Court review of Management Buyout Offer**
   
   i. Conflict of interest exists (management both sellers and buyers), therefore:
      
      1. business judgment rule unavailable
      2. board’s decision must meet entire/intrinsic fairness test
   
   ii. If plaintiff alleges conflict of interest, burden of proof on BOD. Need to prove:
      
      1. fully informed shareholders ratified board decision or
      2. subcommittee of disinterested board members (Special Committee) acted independently and with sufficient information
      3. if either 1 or 2 shown, burden of proof shifts to plaintiff to prove fails test of entire fairness