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Series of Avoidable Missteps by an Activist Stockholder and the Target Board Led the Court of Chancery to Find Fiduciary Breaches and Stockholder Aiding and Abetting in Connection With the Sale of a Company--PLX Technology

Avago Technologies Wireless (USA) Manufacturing Inc. acquired PLX Technologies, Inc. for $6.50 per share in cash. After the $300 million merger closed, certain former PLX stockholders sued for damages, alleging that the PLX directors had breached their fiduciary breaches, aided and abetted by both Potomac Capital Partners II, L.P. (a hedge fund that is an activist stockholder and had three designees on the PLX board) and the PLX board's financial advisor (the "Banker"). Before trial, the claims against the Banker were settled and those against the directors were dismissed or settled; the trial thus proceeded only against Potomac.

In the post-trial decision, *In re PLX Technology Inc. Stockholders Litigation* (Oct. 16, 2018), the Delaware Court of Chancery held that Potomac had aided and abetted a breach of fiduciary duties by the PLX directors that was predicated on the board having succumbed to Potomac's pressure to effect a quick sale of PLX. (The court suggested in dicta that the Banker likely also had aided and abetted the breach.) Further, however, the court held that the plaintiffs did not prove that damages had flowed from the breach; thus, judgment was entered in favor of Potomac.

Key Points

- **Notwithstanding the court's findings of fiduciary breaches and aiding and abetting, in our view the decision does *not* change the high unlikelihood of personal liability for directors, dominant stockholders or bankers in connection with a sale process.** Even putting aside that the court found in this case that damages were not proven, duty of *care* breaches by directors are typically exculpated and duty of *loyalty* breaches are found only in the most egregious cases. Further, there is a very high bar to establishing an aiding and abetting claim (including a requirement of "knowing participation," which involves scienter). It takes an extraordinary series of missteps for a stockholder or a banker to be found to have aided and abetted a board's breaches--and generally these types of missteps can be readily avoided (see "Practice Points" below). We would suggest that *PLX* is most instructive as a guide to the errors by the board, the stockholder and the banker that led to the unusual findings in this case.

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- **The decision underscores that only a most seriously flawed sale process will constitute a fiduciary breach.** The court stated that, notwithstanding all of the problematic factors relating to the sale process, *the court still would have viewed the process as clearly "within the range of reasonableness"* but for "one additional critical fact." That fact was that "ES" (one of Potomac's director-designees on the PLX board, who was also the co-managing partner of Potomac) and the Banker withheld from the PLX board material information that the buyer had told them about its plans to make an acquisition proposal--which information (the "Avago Tip") included the buyer's intended timing and pricing. The court's discussion on this point reaffirms that, even in a flawed sale process, absent unusual and egregious factors, the potential of liability for director fiduciary breaches or for aiding and abetting is remote. The opinion also highlights the importance of the board's selection of the lead negotiator for the company and the need for the board to monitor and understand what the lead negotiator is doing (particularly if that person may have dual loyalties or be subject to actual or potential conflicts of interest). A board's identifying and addressing any conflicts of interest is critical.

- **Potomac's own statements and actions led the court to find that Potomac did not have an identity of interest with the other stockholders.** It appears that Potomac and the PLX board may not have *realized* that Potomac's agenda for a sale of PLX to Avago constituted a conflict of interest for Potomac. Potomac's sole investment thesis was to achieve a near-term sale of PLX to whomever the sole competing bidder was during the go-shop under a merger agreement between PLX and another company (IDT) that had recently been terminated due to antitrust issues. Presumably, in Potomac's view, such a sale would have benefitted all of the stockholders (and, indeed, that might have been the case). However, Potomac's *sole focus* on pressing for the near-term sale (without having considered, or being open to consider, the possibility of any other route to enhancing PLX's value), and Potomac's emphasis on its achieving a short-term profit on the PLX shares that it had acquired at very depressed prices following termination of the PLX-IDT deal, led the court to conclude that Potomac had a "divergent interest" from the other stockholders. That conflict of interest, the court stated, triggered judicial skepticism regarding the sale process that was led by ES.

- **We note that, with only minor modification to any of a number of the steps that were taken by Potomac, the PLX board, or the Banker, the very same transaction could have been approved with essentially no vulnerability to successful challenge.** First, and most notably, if Potomac's conflict had been disclosed to the stockholders, then (so long as the other disclosure to the stockholders had been adequate), the *Corwin* business judgment standard of review (rather than the enhanced scrutiny of *Revlon* review) would have applied and the case would have been dismissed at the early pleading stage. Even under *Revlon* review, however, with any of the following changes, the court almost certainly would not have found a fiduciary breach: (i) the sale process had been run by someone other than ES (or the board had provided consistent oversight of ES); (ii) ES and the other Potomac director-designees of the PLX board had evaluated what was in the interests of all of the stockholders (rather than only Potomac's interest); (iii) the PLX board had more carefully considered what was in the interests of all of the stockholders (including by obtaining a standalone valuation for the company and an explanation of changes made in the company's projections); and/or (iv) the PLX board had formed a substantive foundation for changing its view that it was wrong time to sell the company (rather than framing its decision to sell the company in terms of a capitulation to Potomac).

- **The decision does not raise the bar for required disclosure--but highlights the importance of disclosure of the material facts.** The decision confirms that disclosure relating to a sale process does not have to include "every turn and bend" in the negotiations. However, the critical facts must be disclosed so that, for example, the stockholders can understand whether the negotiations were or

were not at arm's-length (including, as in *PLX*, whether a conflicted person was the lead negotiator, and whether he held critical "secret" meetings with the buyer or had other material information that was unknown to the board). As noted above, if the PLX board had made adequate disclosure (and thus *Corwin* had applied), the case would have been dismissed at the early pleading stage.

- **The court reviewed and criticized the financial advisor's actions (although the relevant claims had been settled before trial).** The court viewed the Banker as conflicted due to its having a contingent fee arrangement and a "longstanding and thick relationship" with the buyer. The court viewed the Banker's potential disloyalty to the target as confirmed by the Banker's withholding the Avago Tip from the board. The court also was critical of the facts that the board had not received a standalone valuation of the company nor an explanation of changes in projections relied on by the Banker (as compared to the company's ordinary course projections).

- **The decision also serves as a reminder of the following:**

  - ***Aiding and abetting liability without board liability.*** It is possible for a third party (such as a banker or dominant stockholder) to have aiding and abetting liability for a breach by directors as to which the directors themselves have no liability because they were exculpated or the claims against them were settled.

  - ***Dual loyalties.*** Directors with loyalties to both the company and a stockholder who appointed them must consider the interests of all of the stockholders, not just the appointing stockholder's interests.

  - ***Passive-only sale process.*** A passive-only sale process (*i.e.*, without any active solicitation of competing bids) can satisfy a board's *Revlon* duties.

  - ***Substantive foundation for board decisions.*** With respect to any board decision, a board should establish and document a substantive foundation for the board's belief that the decision is in the best interest of all of the stockholders. If a board changes a previous position (such as a view that it is the wrong time to sell the company), the foundation for that change in view should be established and documented. Capitulation to a stockholder to "head off" a proxy contest, or because of support the stockholder has garnered, may not itself be sufficient as a basis for a board decision to support the stockholder's agenda.

  - ***Partial disclosure.*** Partial disclosure relating to an otherwise immaterial matter may lead to an obligation for full disclosure with respect to that matter.

Background

Potomac acquired a 5.1% stake in PLX, which it ultimately increased to an over 9% stake. The shares were acquired at very depressed prices following termination (for antitrust reasons) of the PLX-IDT merger agreement, pursuant to which IDT was to acquire PLX for $7 per share (half-cash and half-stock). The proxy statement for that merger disclosed that, during the 30-day go-shop period, there had been one competing bid submitted (which PLX did not pursue). Potomac's plan was to achieve short-term profits on its PLX stake by conducting an activist campaign to press PLX to sell itself to whomever that competing bidder had been. As Potomac later learned, the competing bidder had been Avago and the bid had been for $5.75 per share (half-cash and half-stock) (which was well above the prices at which Potomac had acquired its PLX shares).

The PLX board's firm view following the termination of the IDT deal in December 2012 was that there should be a "pause" of at least two quarters before re-engagement by PLX in a sale process--as the PLX stock price had plummeted following the termination, the company was on an upward financial trend, and there had not been time for an important new product to have a value impact.

In January 2013, Potomac, through ES (who controlled Potomac's strategy and operations), commenced an activist campaign to cause PLX to sell itself to whomever the competing bidder had been that emerged during the go-shop. ES sent a number of public letters to the PLX board and had meetings with PLX's senior management and directors, urging an evaluation of strategic alternatives and making clear that he thought that PLX should talk to the competing bidder. The board believed that an immediate sale was not in the company's best interest. In addition, the board had had private discussions with Avago after termination of the IDT merger, in which Avago had indicated that it would be willing to pay $6 per share. The board believed that that price was too low. In February 2013, Avago, which had accumulated a 3.1% stake in PLX and was considering a hostile bid for PLX, contacted PLX and proposed an acquisition at $6 per share. Over the next several months, in a series of discussions, PLX's board tried to, but could not, obtain a higher price from Avago. It appears that Potomac was not aware of these discussions; and Potomac continued to press for PLX to engage with Avago.

In March 2013, Potomac nominated a slate of director nominees, including ES, for a majority of the PLX board seats. ES continued to send public letters with threats that Potomac would hold the board personally liable for not executing a sale process. PLX responded that it still did not think a near-term sale would be in the company's best interest. In May 2013, PLX terminated its discussions with Avago when, after a request for a final best offer, Avago would not increase its offer above $6. In August 2013, when the board reviewed the situation, the Banker advised that selling the company in the near term "could leave value on the table." However, the board decided at this time that "the Company had done enough," that it wanted to "head off" Potomac's proxy contest, and (without articulating any basis for this conclusion) that the timing was now "optimal [for] pursuing an affirmative process."

In September 2013, the board created a special committee. The committee re-engaged with Avago, which expressed a willingness to increase its offer above $6 per share. The Banker contacted fifteen other potential bidders, nine of which executed non-disclosure agreements. The Banker viewed four of the parties as having a serious level of interest; however, all four ultimately declined to bid.

In November 2013, Potomac filed a definitive proxy statement to replace three PLX directors (less than a majority of the seats). Potomac attacked the directors' long tenure and lack of significant stock ownership. Potomac acknowledged recent PLX improvements but argued that these successes should be "translated into a value-maximizing transaction." The PLX proxy materials emphasized that the board was open to selling PLX but that Potomac's plan for an *immediate* sale was "self-serving" in its focus on achieving quick liquidity for Potomac without regard to the best interests of all PLX stockholders. Other activists bought shares and voiced support for Potomac's slate. Proxy firm ISS endorsed Potomac's slate, citing concerns about the PLX directors' long tenure. After ISS issued its endorsement, PLX viewed the success of Potomac's proxy contest as assured and a sale of PLX as "a done deal." Potomac's designees were elected at the annual meeting in December 2013 and, at ES's request, the board appointed him to be the chairman of the special committee.

The Banker advising PLX was also Avago's long-time banker. A different team at the Banker was at this time advising Avago on its acquisition of another company, LSI. The day following the election of Potomac's slate to the PLX board, a senior executive of Avago ("K") contacted a managing director on the Banker's PLX team and told him that Avago had taken notice of the "transition" on the PLX board and

would, as soon as the LSI acquisition closed, propose to buy PLX for $300 million (which translated to $6.52 per share). The Banker relayed this information (the "Avago Tip") to ES--*but, critically, neither the Banker nor ES shared the information with anyone at PLX.*

ES did not push for a sale of PLX from January until April 2014 (pending closing of Avago's LSI transaction)--but he insisted on keeping the special committee in place and disclosing in PLX's Form 10-K the committee's existence and his role as chairman. In early May 2014, Avago contacted PLX to make an acquisition proposal. Discussions ensued between the respective bankers and managements, with enthusiastic support from ES. On May 21, ES and K met for dinner and K signaled that Avago would propose acquiring PLX for $6.25 per share. The next day, Avago formally proposed the $6.25 price, and, over the following nine days, led by ES, PLX counter-offered at $6.75 and then agreed to $6.50 per share--almost exactly the price that had been relayed in the Avago Tip. In June 2014, the Banker rendered a fairness opinion, and the full board approved the transaction. 80.3% of PLX's outstanding shares were tendered in the first-step tender offer. No competing bidders emerged.

Discussion

The court ruled that *Revlon* was the applicable standard of judicial review. When a transaction not subject to the entire fairness standard of judicial review (*i.e.*, not involving a conflicted controller) is approved by stockholders in a fully-informed, uncoerced vote, then, under *Corwin*, business judgment is the applicable standard of review. The very deferential business judgment standard requires only that the transaction did not constitute "corporate waste." Thus, when *Corwin* applies, claims challenging a transaction are dismissed at the early pleading stage of litigation. In *PLX*, however, the court found that the disclosure to stockholders in connection with their approval of the transaction was inadequate; therefore, *Corwin* was inapplicable and the court applied the enhanced scrutiny of *Revlon*. *Revlon* requires that a board seek to obtain the best transaction that is reasonably available.

The court found that Potomac had a "divergent interest" from the other stockholders based on its single focus on achieving a quick sale of the company to Avago so that Potomac could obtain a short-term profit on its PLX shares. The court wrote: "What typically drives a finding of unreasonableness [by a board under the *Revlon* standard] is evidence of self-interest…or a similar non-stockholder-motivated influence that calls into question the integrity of the process." In this case, the court concluded, "[t]he divergent interest that led to the predicate breach of duty…was [ES]'s interest in achieving a near-term sale." The court observed that ordinarily ownership of a large block of stock "is helpful…[in] undermin[ing] any concern about divergent interest--that is, the large stockholder's interest is aligned with the interest of the other stockholders in considering the trade-offs for the company between a sale and remaining independent and, if a decision is made to sell, in obtaining the best price reasonably available." However, there are times when a large stockholder's interest in liquidity or short-term profit can create a divergence of interest. This may occur in the case of "activist hedge funds [who] are impatient shareholders, who look for value and want it realized in the near or intermediate term."

The court acknowledged that it is not enough for a plaintiff merely to generally assert that a director has a conflict of interest "because she is affiliated with a particular type of institution that has particular incentives or pursues a particular strategy." The court acknowledged (in a footnote) a line of cases that has established that a general desire for liquidity does not represent a divergent interest from other stockholders unless it is based on a *critical need* for liquidity (such as to avoid imminent bankruptcy). In this case, however, there was a preponderance of evidence that "[ES] and Potomac had a divergent interest in achieving quick profits by orchestrating a near-term sale." First, in their activist campaign and proxy contest, they argued vehemently that PLX should be sold quickly. Their *only* investment thesis was

a quick sale to the other bidder who emerged during the go-shop for the IDT transaction. They "never prepared any valuation or other analysis of the fundamental value of PLX." They lacked "any ideas for generating value at PLX other than to sell it." Second, the PLX board made clear that it understood that ES and Potomac's intent was to effect a quick sale only for their own short-term profit motives. Third, once ES was on the PLX board, he "consistently acted with that intent" and "orchestrated" a process to "engineer" a deal on Avago's preferred terms.

The court viewed the Banker as also having conflicts of interest which led it to favor a sale of the company. As noted, the Banker settled the claims against it before trial; however, the court nonetheless focused on the issues relating to the Banker's actions because, the court stated, they "influenced the boardroom dynamic and therefore deserve mention." First, the court cited the Banker's contingent fee arrangement, which, the court stated (without further discussion), "gave [the Banker] a powerful incentive to favor a sale over having PLX remain independent." (Contingent fee arrangements, of course, are quite customary with financial advisors.) Second, the court noted the Banker's "longstanding and thick relationship" with Avago. As the Banker had been advising Avago on its acquisition of LSI, it was advising both PLX and Avago at the same time (albeit on different transactions and with different teams) during PLX's market check in Fall 2013 and when it received the Avago Tip in December 2013. The ongoing relationship with Avago "gave [the Banker] a powerful incentive to maintain good will and not push too hard during the negotiations." The court acknowledged that the Banker did not advise the buyer and the seller simultaneously on the same deal, "but when dealing with an industry that values relationships, and recognizing that bankers frequently provide advisory services first and document the engagement later, a reviewing court cannot ignore the situation that [the Banker] created." The court concluded: "As with [ES]'s conflict, [the Banker]'s position on both sides of the deal necessarily colors the court's assessment of the decisions that the directors made."

In finding that the board breached its fiduciary duties, the court emphasized the "critical fact" that ES and the Banker had withheld the Avago Tip from the board. The court stated: "Taken as a whole, [the] evidence suggests that Potomac and [ES] undermined the Board's process and led the Board into a deal that it otherwise would not have approved…. Yet, in spite of this evidence, I could not conclude that the Board's decisions fell outside the range of reasonableness without one other critical fact: [K]'s secret tip to [the Banker] in December 2013 about Avago's plans for PLX." By withholding the Avago Tip from the rest of the board, "[ES] breached his fiduciary duty and induced the other directors to breach theirs…, fatally undermin[ing] the sale process." The court stated that, if the board had known the withheld information, it "might well have proceeded differently." Knowing that Avago planned to "return to the table" once it completed the LSI acquisition and expected to pay $300 million, "the Board could have been more vigorous in its pre-signing market canvas…[,] could have negotiated more effectively for a higher price…[, and,] [m]ost important, the Board could have taken more time to consider the Company's alternatives in depth, rather than agreeing in principle to a deal at Avago's preferred price after nine busy days in May" without sufficient information. "Viewing the record as a whole, and with particular emphasis on [ES] and [the Banker]'s failure to disclose [the Avago Tip], the plaintiffs proved that the adequacy of the decisionmaking process employed by the directors, including the information on which the directors based their decision, fell outside the range of reasonableness."

The court concluded that the PLX board "lacked essential information" at the time it made its decision on the sale. At the time the board approved the $6.75 counter-offer and granted authority to reach a deal at $6.50, "the directors lacked essential information," the court stated. Specifically, the directors had not received a valuation of the company on a standalone basis (as had been true also in the *Rural Metro* case, the court noted). The Banker had only "pulled together some market information at

[ES]'s request to support a counter-offer at $6.75 per share, but that was it," the court wrote. Also, with respect to the projections that management was ordered to prepare, and the Banker relied on in preparing its fairness opinion, the board had asked for but had never received an explanation of the changes from the earlier projections that had been prepared in the ordinary course of business.

The court seemed to suggest that a board may have some affirmative obligation to seek to determine whether any director or the banker has material information that should be shared with the board. The court stated that directors must disclose to stockholders "all facts that are material to the stockholders' consideration of the transaction or matter and that are or can reasonably be obtained through their position as directors." In this case, the court concluded, the directors "breached their fiduciary duties by engaging in a sale process without knowing critical information about Avago's communications with [the Banker]." The court wrote: "The directors other than [ES] should not be blamed for this oversight in any morally culpable sense; [ES] and [the Banker] withheld the information from them. In terms of fulfilling their fiduciary duties to stockholders, however, the directors fell short." It is not clear whether the court was referring to the *other* ways in which the board fell short, or was suggesting that the directors should have done something to try to obtain information that was being withheld from them. We note that previous decisions have established that a board has an obligation to be proactive in determining whether directors or bankers have conflicts of interest. As we read the opinion, at least where the board knows that a director or banker may have a conflict, the board should consider seeking to determine whether the conflicted party has any information (such as past contacts with a potential buyer) that would be relevant to the sale process.

The court viewed the PLX board as having capitulated to Potomac without trying to obtain the best transaction for the stockholders (which could have been remaining independent). The board had held a firm view that it was the wrong time to sell the company immediately after termination of the PLX-IDT deal. The board formed a special committee to investigate a sale only after Potomac launched its proxy contest to obtain seats on the PLX board. A number of directors testified at trial that the committee was formed due to "Potomac's intervention," and that the situation with Potomac "caused [the directors] to view things a little differently." The court wrote: "This was a Board that was susceptible to activist pressure." The court observed that, after Potomac won the proxy contest and ES and the other Potomac designees joined the board, the other directors "found a new willingness to support a sale at prices below the values that they had previously rejected"--even though PLX's business had grown stronger. We note that there was apparently no evidence of any other foundation for the directors' change of view. The court also observed that the incumbent directors "deferred to [ES] when he sought to position himself to best achieve a sale," by agreeing to his request to become chairman of the special committee, and "permitted [ES] to take control of the sale process when it mattered most" (*i.e.*, when Avago "resurfaced" after it had completed its LSI transaction). Finally, and perhaps most critically, the directors testified that, given the situation with Potomac, they were "engaging in the art of the possible" when they supported the Avago deal. "This testimony was direct evidence of breach," the court wrote. In the court's view, the "art of the possible" meant seeking the "*next best* deal" rather than, as required under *Revlon*, the best deal. The court did not address whether, in the face of strong stockholder and proxy firm support for an activist, a sale championed by an activist (what the court called a "next best deal") could be, in a board's reasonable judgment, the best deal *reasonably available*. We note that, in any event, in *PLX*, as the activist held a minority of the board seats, the board could have resisted the activist's agenda.

The court reaffirmed that a passive-only market check can satisfy *Revlon* duties. Citing *C&J Energy,* the court reaffirmed that a market check "does not have to involve an active solicitation so long

as interested bidders have a fair opportunity to present a higher-value alternative, and the board has the flexibility to eschew the original transaction and accept the higher-value alternative." The court attached as an "Appendix" to the opinion a chart listing fifteen decisions in which the court has approved a passive market check (*Fort Howard* in 1988 to *C&J Energy* in 2014). In *PLX*, the court observed, the merger agreement did not unreasonably impede competing bids and there were 49 days from announcement until closing during which competing suitors could have expressed interest. The merger agreement included a no-shop clause subject to a fiduciary-out, a termination fee equal to 3.5% of the equity value (3.7% of the enterprise value), and a matching right. Significant stockholders and the directors had executed tender and support agreements governing 14.7% of the outstanding shares. In addition, PLX had done a pre-signing "market outreach" (albeit a "narrow" one), which had been preceded by a broader non-public market check several months earlier (in response to Potomac's activist campaign and the first threats of a proxy contest). There would be "no debate" about whether the directors fulfilled their duties based on this process, the court wrote--however, "where undisclosed conflicts of interest exist, even reasonable choices must be viewed more skeptically."

The court found that the activist stockholder "knowingly participated" in the directors' breach of duty as it had "created a critical informational gap" that "contributed" to the breach. The knowing participation by ES was based on the court's imputing ES's "knowledge and actions" to Potomac. Although the actions of the director-representative of a stockholder cannot always be attributed to a stockholder, the court noted, in this case, "the combination of [ES]'s position with, ties to, and actions on behalf of Potomac" (including "his role in directing and implementing Potomac's strategy" as the co-managing partner), according to the court, "support[ed] a different result."

The court found that the plaintiffs did not prove damages from the board's breach and emphasized the reliability of an arm's-length negotiated merger price in determining standalone value. The court observed that, where a board's breach of fiduciary duties involves accepting one bid instead of another, higher bid, the causally related damages are readily calculable as the difference between the two deal prices. In this case, however, the board's breach led to the board accepting a bid in lieu of remaining independent; therefore, the causally related damages would be the difference between the deal price and the company's standalone value. The court acknowledged that a DCF analysis is "the best tool" for valuing a company when there is not "credible market information" or a "market check"--however, the court concluded, in this case, the plaintiffs' DCF analysis was not "sufficiently persuasive to undergird a damages award exceeding half of the deal price." The court cited the inherent uncertainties in the DCF methodology in general, certain factors that rendered the projections less than fully reliable, and the fact that the company had a history of missing its projections. The court's emphasis, though, was on the general reliability of a deal price in an arm's-length transaction as reflecting the value of the company. Although the sale process in this case was flawed, the court observed, it was "sufficiently reliable to exclude the plaintiffs' damages contention"--given the pre-signing market checks and, in particular, that no topping bid had emerged post-signing. Moreover, the court stated, as the target and the buyer were in the same industry, the deal likely was synergistic and the deal price therefore likely exceeded the standalone value of the company. The court did not address to what extent a flawed sale process could resulted in a depressed merger price that conceivably could be below a company's standalone value.

The court found that the PLX board breached its duty of disclosure. The court found that the board, in connection with the stockholder vote on the sale, (i) did not disclose to stockholders the Avago Tip, (ii) "downplayed" ES's role in the negotiations, and (iii) misleadingly characterized the projections used by the Banker to evaluate the fairness of the deal price as having been prepared in the ordinary course of business. In addition, the court stated that it was a "close call" whether an earlier set of projections (that

were not relied on by the Banker) would have had to be disclosed, but as there was "partial disclosure" that the board had reviewed them, the board also had to disclose that the values indicated all were above the price initially proposed by Avago, PLX's counter-offer, and the ultimate deal price.

Practice Points

- **A board should proactively identify and address conflicts of interest.** A director should identify to the board any actual or potential conflict that he or she has. These obligations apply throughout the sale process. The board may determine that there is not actually a conflict. If there is a conflict, the board should decide what role, if any, the conflicted person should play in the sale process. The board may decide to establish a special committee that excludes conflicted persons or to establish procedures for monitoring and oversight of conflicted persons.

- **Where a stockholder's agenda is based on a desire for liquidity, the board should determine whether that desire represents a conflict of interest.** The board should seek to distinguish between (a) a general desire for liquidity--which should not represent a divergent interest from the other stockholders, and (b) a desire that reflects a *critical need* for liquidity (such as to avoid imminent bankruptcy) or a *single focus* on achieving liquidity motivated by the particular stockholder's situation (such as in *PLX*, wanting to obtain a quick profit on shares recently bought at depressed prices, without regard to the interests of the other stockholders)--which could represent a divergent interest.

- **A board should consider seeking to determine whether a director or banker (especially if conflicted) has material information relating to the sale process that has not been shared with the board.** In addition, a director or banker should disclose any such information to the board.

- **Given the very significant benefit that arises from review under *Corwin* rather than the heightened scrutiny of *Revlon*, in the case of "close calls," a company may wish to err on the side of more disclosure to stockholders rather than less.** "Every bend and turn" of negotiations does not have to be disclosed; however, a company should disclose the material elements so that stockholders can determine, for example, whether the negotiations were actually arm's-length or not. A board should not "downplay" the role of a possibly conflicted person who was a key negotiator; should accurately characterize projections as to whether they were prepared in the ordinary course; and should be mindful that partial disclosure of otherwise immaterial facts may create an obligation for full disclosure.

- **An activist or sponsor stockholder, when formulating a plan for the company that it intends to press, should consider the advantages and disadvantages of a single-focused approach.** The stockholder may well be advantaged if, although it has a *preferred* plan, it has considered or at least is open to considering alternative routes to enhancing the company's value.

- **A board obviously should have a rational basis for its decisions, including for supporting a stockholder's agenda.** If a majority of the board seats are not held by the stockholder, the board can and should resist the stockholder's plan unless it has determined that the plan is in the best interests of all of the stockholders--and, when *Revlon* applies, that the deal is the best deal reasonably obtainable. (When, as in *PLX*, a majority of the board has not been designated by the stockholder who is pressing an agenda, it is unlikely that the stockholder's plan could be the *only* deal reasonably obtainable.) Capitulation to a stockholder because it has gained significant support, or to avoid a proxy contest or public embarrassment, may not in and of itself provide a sufficient basis for a board

decision. Also, if a board changes a previously held view (such as that it is not the right time to sell the company), the board should establish (and document) a substantive foundation for the change.

- **A board should not ignore the issues actually raised by a stockholder in a proxy contest--** which may be different from the issues the stockholder had raised previously in discussions with the company. In *PLX*, while Potomac had focused on pressing a sale of the company, in its proxy contest it focused on board tenure and stock ownership. PLX's proxy materials focused on its willingness to sell the company and its disagreement with Potomac just as to timing. ISS supported Potomac based on the board tenure issue. We note also that PLX could have considered eliminating the tenure issue by itself replacing or adding directors.

- **A board should ensure that it has all material information reasonably obtainable by it that it needs to evaluate the banker's financial analyses and advice.** Generally, a board should evaluate the alternative of the company remaining independent (including by obtaining from the banker a standalone valuation of the company). Generally, a board should obtain identification and explanation of any changes made to company projections that were prepared in the ordinary course of business. If the board is told that changes were made to "update" the projections for "new information," the board should seek to understand whether there actually was new information that was reflected. A board should obviously follow up to determine why it has not received information that it has requested. A banker engaged in negotiations with a potential buyer should keep the target apprised of all key developments in the negotiations and should not hold "secret" meetings.

- **Defendants in fiduciary breach cases should take the position that, even in the case of a flawed sale process, there are no damages in the context of an arm's-length negotiated merger price.** Where there is a reasonable period of time for, and no significant contractual impediments to, a topping bid emerging, and no topping bid emerges, the court is likely to view the merger price as the best evidence of the company's standalone value--particularly in the case of a strategic buyer or other indication of synergistic value being included in the merger price.

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Fried Frank M&A/PE Group:

Andrew J. Colosimo	Randi Lally	Peter L. Simmons
Warren S. de Wied	Mark H. Lucas	Matthew V. Soran
Steven Epstein	Scott B. Luftglass	Steven J. Steinman
Christopher Ewan	Brian T. Mangino	Gail Weinstein
Arthur Fleischer, Jr.	Philip Richter	Maxwell Yim
Andrea Gede-Lange	Robert C. Schwenkel	
David J. Greenwald	David L. Shaw	

This Briefing is not intended to provide legal advice, and no legal or business decision should be based on its contents. If you have any questions about the contents of this Briefing, please call your regular Fried Frank contact or an attorney listed below:

Contacts:

New York

Andrew J. Colosimo	+1.212.859.8868	andrew.colosimo@friedfrank.com
Warren S. de Wied	+1.212.859.8296	warren.dewied@friedfrank.com
Steven Epstein	+1.212.859.8964	steven.epstein@friedfrank.com
Christopher Ewan	+1.212.859.8875	christopher.ewan@friedfrank.com
Arthur Fleischer, Jr.*	+1.212.859.8120	arthur.fleischer@friedfrank.com
Andrea Gede-Lange	+1.212.859.8862	andrea.gede-lange@friedfrank.com
David J. Greenwald	+1.212.859.8209	david.greenwald@friedfrank.com
Randi Lally	+1.212.859.8570	randi.lally@friedfrank.com
Mark H. Lucas	+1.212.859.8268	mark.lucas@friedfrank.com
Scott B. Luftglass	+1.212.859.8968	scott.luftglass@friedfrank.com
Philip Richter	+1.212.859.8763	philip.richter@friedfrank.com
Steven G. Scheinfeld	+1.212.859.8475	steven.scheinfeld@friedfrank.com
Robert C. Schwenkel	+1.212.859.8167	robert.schwenkel@friedfrank.com
David L. Shaw	+1.212.859.8803	david.shaw@friedfrank.com
Peter L. Simmons	+1.212.859.8455	peter.simmons@friedfrank.com
Matthew V. Soran	+1.212.859.8462	matthew.soran@friedfrank.com
Steven J. Steinman	+1.212.859.8092	steven.steinman@friedfrank.com
Gail Weinstein*	+1.212.859.8031	gail.weinstein@friedfrank.com
Maxwell Yim	+1.212.859.8214	maxwell.yim@friedfrank.com

Washington, D.C.

Brian T. Mangino	+1.202.639.7258	brian.mangino@friedfrank.com

*Senior Counsel