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DGCL SECTION 251(h) SHORT-FORM MERGERS: PROPOSED AMENDMENTS TO ADDRESS UNCERTAINTY

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In the two and a half years since the Delaware legislature adopted Section 251(h) of the Delaware General Corporation Law (the DGCL), the provision has had a significant impact on the M&A market. Section 251(h)[1], which facilitates short-form mergers without stockholder approval following a first-step tender or exchange offer, has reintroduced the tender offer as a viable option for efficiently consummating an acquisition. In the 12 months prior to the enactment of Section 251(h), 23 percent of all acquisitions involving public Delaware corporations utilized a two-step process, while in the 12 months following the enactment of Section 251(h), 35 percent of all acquisitions involving public Delaware corporations were structured as a two-step process utilizing Section 251(h).[2] In 2015, tender offers rose to 36 percent of all U.S. public company acquisitions with a deal size of at least $100 million, as per FactSet Mergers. However, practitioners have expressed doubt about their ability to utilize Section 251(h) in certain situations. As a result, the Corporation Law Council of the Delaware State Bar Association recently proposed amendments to Section 251(h) intended to address these and other concerns.

Perhaps the most notable concern involved the requirement in Section 251(h) that the offer be for "any and all" shares of the target corporation. Practitioners questioned whether such requirement would prohibit utilizing Section 251(h) if the tender or exchange offer includes a minimum tender condition. Another prevalent concern involves the treatment of "rollover shares" (*i.e.*, shares held by management that are contributed to the buyer (or a buyer affiliate) in exchange for equity of the buyer (or such buyer affiliate) rather than being tendered into the offer). Practitioners expressed doubt about the ability to include rollover shares in calculating whether the buyer held sufficient shares upon expiration of the offer to utilize Section 251(h). In addition, there was uncertainty as to whether Section 251(h) could be utilized when the target corporation has more than one class or series of stock entitled to vote on the merger (particularly when only one such class or series is publicly traded) and, if so, whether there can

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be separate offers consummated for separate classes or series.

Minimum Tender Conditions

Under the present language of Section 251(h), the first-step tender or exchange must be for "any and all" outstanding stock of the target corporation entitled to vote on the merger. Because Section 251(h) required that the offer be for "any and all" shares, many practitioners questioned whether offerors utilizing Section 251(h) could be conditioned on the tender of a minimum number or percentage of shares. The proposed amendments alleviate this concern.

If adopted, the proposed amendments would expressly permit a first-step tender, exchange or other offer to be "conditioned on the tender of a minimum number or percentage of shares of stock" of the target corporation (of any class or series thereof). Moreover, the amendments would further clarify Section 251(h) by providing that the offer be for "all" shares of the outstanding stock of the target, eliminating the requirement that the offer be for "any and all" shares.

Rollover Stock

Section 251(h) may be utilized to effect a short-form merger without the need for stockholder approval if, following a first-step tender or exchange offer for all outstanding shares of stock entitled to vote on the merger (and each class or series thereof), the offeror has at least the minimum percentage of shares that would otherwise be required to approve the merger under Delaware law and the target corporation's certificate of incorporation (the Statutory Minimum Test).

In order to better incentivize target management and encourage management to remain employed with the target following a change-of-control transaction, offerors often enter into rollover agreements with management, under which management stockholders agree to exchange their shares of target stock for equity in the offeror or an affiliate of the offeror, rather than tendering their target shares into the offer. Management's equity in the target "rolls over" into equity in the offeror (or its affiliates). Such arrangements also provide assurance to the offeror that there will be a smooth transition following the acquisition, since management will be incentivized to remain with the target.

Currently, it is unclear whether rollover shares may be counted in satisfying the Statutory Minimum Test under Section 251(h). Under the "best-price rule" of

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the Williams Act, the offeror is required to pay the same consideration to all holders of the same class or series of shares during the pendency of the offer. Accordingly, the common practice is to effect the rollover of management shares following consummation of the tender or exchange offer (but prior to the second-step merger), even though there is generally a binding rollover agreement in effect prior to such time. However, because Section 251(h) measures the shares owned or acquired by the offeror or in the tender or exchange offer "following" the consummation of the offer (which has been interpreted by some practitioners to mean "immediately" following consummation of the offer), it has been unclear whether an offeror could count rollover shares in determining if it has satisfied the Statutory Minimum Test. This uncertainty limits the effectiveness of Section 251(h), since the rollover shares may be needed to satisfy the test.

The proposed amendments would remedy this situation by expressly including rollover shares in determining if the offeror has satisfied the Statutory Minimum Test. The proposed amendments define "rollover stock" as shares of stock of the target corporation that are subject to a written agreement requiring such shares to be transferred, contributed or delivered to the offeror or any offeror affiliate in exchange for stock or other equity interests in the offeror or any offeror affiliate. Importantly, rollover stock ceases to be defined as such and, therefore, not included in determining whether an offeror has sufficient shares to satisfy the Statutory Minimum Test, if, immediately prior to the merger becoming effective, such shares have not been transferred, contributed or delivered to the offeror or offeror affiliates pursuant to the rollover agreement. In other words, rollover shares will be included in determining if the Statutory Minimum Test has been satisfied only if such shares actually are "rolled over" as of immediately prior to the second-step merger.

In addition to rollover stock, the proposed amendments, if adopted, also would permit shares of target stock held by (i) direct and indirect parent entities of the offeror or (ii) direct and indirect wholly owned subsidiaries of such parent entities or of the offeror to be included in calculating whether the offeror has satisfied the Statutory Minimum Test.

Offers for Separate Classes or Series of Shares of Stock

Currently, Section 251(h) may be utilized when the target corporation has shares of stock "listed" on a national securities exchange or held of record by more than 2,000 holders immediately prior to the execution of the agreement of merger. However, it has been unclear whether Section 251(h) could be utilized for a target corporation with more than one outstanding class or series of stock, particularly if only one such class or series of stock is publicly listed, and, if so, whether the offer must include shares of all such classes or series.

The proposed amendments alleviate these concerns. If adopted, Section 251(h), as amended, would expressly provide that a tender, exchange or other offer may be made for any target that has "a" class or series listed on a national securities exchange or held of record by more than 2,000 holders, even if not all classes or series of stock of such corporation are so listed or held. The proposed amendments also clarify that, if the target corporation has more than one class or series of stock entitled to vote on the merger, there may be separate tender, exchange or other offers consummated for separate classes or series listed.

Conclusion

The proposed amendments to the DGCL, if adopted, would further enhance the efficacy of Section 251(h) in consummating two-step acquisitions. If approved by the Executive Committee of the Delaware State Bar Association, the proposed amendments to Section 251(h) will be introduced in the General Assembly for consideration and, if adopted, become effective for merger agreements entered into after August 1, 2016.

ENDNOTES:

[1]Edward P. Welch, Allison L. Land, Cliff C. Gardner and Christopher M. DiVirgilio, "Legislative Solutions to Practitioner Problems: Important Amendments to the Delaware General Corporation Law," *The M&A Lawyer,* July/August 2013, Vol. 17, Issue 7.

[2]"Mergers & Acquisitions 2016: Trends & Developments," *Corporate Law & Practice* (2016).

IT'S TIME TO STREAMLINE THE NDA PROCESS

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Each year companies and private equity firms waste thousands of hours and millions of dollars negotiating detailed terms of non-disclosure agreements ("NDAs") principally intended to provide customary protection of a selling company's confidential business information. It is time for a change: sellers should start with a middle-of-the-road form intended to avoid negotiating cycles while providing adequate protections for both sides to an NDA.

The drill is all too familiar: a selling company's legal counsel drafts a "standard" but decidedly "seller-friendly" NDA to be signed by prospective bidders for the selling company or certain of its assets; legal counsel for each prospective bidder marks up the NDA to make it more "buyer-favorable" or at least "seller neutral"; legal counsel and principals of the selling company and each bidder have one or more rounds of exchanging and/or discussing comments until they settle on a final form of NDA. Multiply the effort expended in this process by the number of potential bidders looking at each company sale opportunity, and then again by the number of companies sold each year. The end result in most situations is similar—a fairly balanced, "neutral" form of NDA that follows a fairly well-established market norm.

Many private equity firms and large corporate buyers look at more than 1,000 sell-side opportunities per year, and each requires the prospective buyer to sign an NDA with the selling company—just to get access to initial materials about a specific opportunity (that may contain very little information that is highly proprietary). Sometimes the selling company will serve up a form of NDA that can be accepted and signed as presented. The far more common occurrence, though, is a form of NDA that is too seller-friendly and requires negotiation. Private equity firms and some large corporate buyers have responded to the mountain of work on NDAs in different ways—ranging from hiring internal counsel dedicated to negotiating NDAs, outsourcing the review of NDAs to highly-specialized but low-cost NDA counsel, or relying on traditional deal counsel. There is no question that the cost is high.

The cost to selling companies likewise is high because selling companies also have to expend time and resources negotiating NDAs with a potentially long list of suitors. Starting with a form NDA that is too seller-friendly substantially increases the chance that individual suitors will comment on and negotiate the NDA each is asked to sign. Spending time negotiating nice-to-have points on an NDA also adds friction to the sales process and may result in fewer bidders looking at a sell-side opportunity and/or set a caustic tone to a process that makes bidders more reluctant to proceed. (In this regard, selling a company is not different than retail sales—you need to get shoppers in the store and interacting with your products, and shoppers move on quickly if you make it too difficult for them to get a good look at the goods.)

As noted above, most fully-negotiated NDAs today end up in substantially the same place from a substantive perspective. There certainly used to be much more variance in NDAs used among different parties, but with increasing numbers of repeat buyers actively engaged in M&A and greater availability of form NDAs and commentary accessible via the internet and law firm publications, parties and legal counsel have evolved to greater conformity of terms. Most sell-side NDAs for privately-held companies today end up (after negotiation) providing:

- A broad definition of "Confidential Information" to pick up all types of confidential information of the seller however conveyed (and without the requirement to mark all written materials "confidential" in order to be covered).
- The bidder and its associates or representatives have the right to use Confidential Information solely to evaluate, negotiate and consummate a possible transaction between the parties and an obligation to not disclose Confidential Information to third parties, with the bidder being responsible for breaches by its associates or representatives.
- Neither party shall disclose the fact they are discussing a possible transaction or existence of the NDA, except for disclosures legal counsel advises are required by law or stock exchange rules.
- The seller makes no express or implied representations as to the accuracy or completeness of Confidential Information provided, and the NDA creates no agreement to negotiate or consummate a potential transaction.
- If the bidder or its associates or representatives are required by law to disclose Confidential Information to a third party, such disclosure can be made pursuant to an agreed process that allows the seller to seek to minimize the required disclosure or obtain a protective order.
- An agreed-upon process in which the bidder will return or destroy the Confidential Information if the seller requests, with the bidder providing certification as to destruction (subject to the bidder and its associates and representatives being permitted to retain copies of Confidential Information for regulatory compliance reasons and not have to purge routine electronic backup systems).
- Non-solicitation and non-hire restrictions for 12-24 months, with customary exceptions.
- A term of 24 months, possibly with an ongoing obligation to maintain confidentiality of any Confidential Information retained by the bidder and any of its associates or representatives.
- Other routine boilerplate typical for M&A transaction agreements.

With practice evolving to greater conformity of NDA terms across deals, sellers and bidders would benefit from changing the overall approach of using a bespoke NDA for each sell-side opportunity in favor of using a model form of NDA. The model form NDA would reflect customary market terms for a typical fully-negotiated NDA and allow easy customization on an exhibit to the NDA. Use of a model form NDA would allow selling companies and bidders to save substantial time and cost while providing a selling company adequate protection of its confidential business information. Alternative provisions could be available for selling companies that have publicly traded securities, as these companies typically have certain additional concerns (but again within a fairly narrow range of outcomes).

A proposed Model Non-Disclosure Agreement for Sale of a Privately-Held Business can be viewed at: http://www.paulhastings.com/docs/default-source/PDFs/85067502__2.pdf. Others are invited to propose comments to improve the form, and hopefully lawyers and principals can coalesce around the idea of using this or a similar simplified form—in the interest of expediency and efficiency.

KEY ISSUES IN U.S. GOING PRIVATE TRANSACTIONS

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From time to time, a private equity firm or other financial sponsor (directly or through a fund that it manages) may find itself owning a significant stake, perhaps even a controlling stake, in a publicly-traded company. For instance, the sponsor might have bought shares of the company in the open market, invested privately in a "PIPE" transaction, or simply retained shares in a portfolio company that it has taken public.

A sponsor that wishes to acquire the outstanding public float of a company in which it already owns a meaningful stake is said to engage in a "going-private" transaction. A U.S. going-private transaction is accomplished through a one-step merger or a tender offer followed by a back-end merger, just like any other public deal. However, two bodies of law—the U.S. federal securities laws and state fiduciary duty law—create additional layers of process, disclosure and timing challenges. A sponsor engaging in a going-private transaction should carefully consider its tactics and approach, weigh the risk of premature disclosure, prepare for the likelihood of a drawn-out process and steel itself against probable litigation. If the sponsor is a *controlling* stockholder, the going-private process presents additional challenges.

Premature Disclosure

In most cases, a financial sponsor that holds more than 5% of the shares of a public company will have already filed a Schedule 13D describing any "plans or proposals [the firm] may have which relate to or would result in. . . an extraordinary corporate transaction, such as a merger. . ..." Any material changes to the disclosure in the Schedule 13D require the "prompt" filing of an amendment.

When must a sponsor amend its Schedule 13D disclosure to tell the world of its plans to take the target private? Ideally, not until the parties are ready to announce the deal. Premature disclosure may put the target "in play" or cause the stock price to rise, putting pressure on the deal negotiations.

The general practice has been to include generic disclosure in the Schedule 13D, indicating that the sponsor may in the future consider a going-private transaction. Then, when the sponsor actually makes a proposal to the target, it would amend its disclosure to provide more detail about the sponsor's plan. Steps taken prior to the formal submission of an offer typically did not trigger an amendment. Some buyers have taken the position that they have not formulated a plan or proposal until they have become comfortable with diligence and are prepared to enter into definitive agreements—until then, they are simply exploring the possibility of taking the target private.

The SEC may be less likely these days to accept this latter position. In March 2015, the SEC announced three settlements in which various insiders, including a major stockholder, were charged with 13D violations, became subject to cease and desist orders, and agreed to pay civil penalties to the SEC. The steps taken by those shareholders that the SEC viewed as indications that they planned to effect going-private transactions (and thus should have promptly amended their 13Ds) included:

- informing target company management of their intention to take the company private;
- forming a consortium of shareholders to participate in the going-private;
- determining the structure of the transaction to take the company private; and

- obtaining waivers from preferred shareholders to facilitate the going-private.

The SEC's position in these cases seems to be not only that buyers may have formulated plans that require a 13D amendment *before* any proposal is made to the target, but also that a shareholder that has taken significant steps toward effecting a going-private has an obligation to amend its 13D *even before* it has formulated a going-private plan, let alone made a formal proposal to a target. There is no bright line test. Sponsors should carefully consider with counsel the implications of *(1)* discussing potential terms with financing sources, bankers or consortium partners, *(2)* undertaking feasibility studies and *(3)* other steps taken in advance of a formal offer. Sponsors must be sensitive to the 13D rules and the SEC's views on disclosure, and should recognize before embarking on a going-private transaction that they may be required to disclose their plans before any transaction is actually announced.

Some sponsors who are truly passive investors or who acquired their shares prior to the initial public offering of the company may have filed the simpler Schedule 13G in lieu of a Schedule 13D. Nevertheless, except in the case of a Schedule 13G filed upon an IPO, the same facts and circumstances that would trigger the filing of an amendment to a Schedule13D would also cause the Schedule 13G filer to convert its Schedule 13G to a Schedule 13D, creating the same premature disclosure issue. The sponsor who acquired shares before an IPO has an advantage in that it will not need to convert or promptly amend its 13G to reflect the formulation of a going-private plan.

Even a sponsor who is not a current 13D or 13G filer with respect to the target company should be mindful of these considerations, as taking significant steps with an existing 13D filer of a company could trigger the same premature disclosure concerns on the part of that shareholder, if, for instance, it is a member of management holding a 5% or more stake or a large shareholder. It is worth noting in this regard that the Brokaw Act, recently introduced in Congress, would, if passed, expand the definition of "persons" who must file a 13D, making coordinated behavior more likely to result in a required filing.

Standard of Care

The law of the state in which the target company is organized governs the standard of fiduciary care to which the board or a controlling stockholder will be held. In Delaware, as in most states, courts will generally defer to the business judgment of directors, and there is a (rebuttable) presumption that directors acted in good faith and in the best interests of the corporation. In the context of a change of control, including a going-private transaction, instead of the business judgment rule, Delaware courts will apply the higher *Revlon* standard, which requires that directors seek the best price reasonably available for the company. A court applying the *Revlon* standard will examine the reasonableness of the directors' conduct, an inquiry that necessarily involves a certain amount of discovery and, thus, means that litigation will survive a motion to dismiss.

If the sponsor controls the target, a very high standard called *entire fairness* will apply, on the theory that in these sorts of transactions the minority stockholders require special protection. The "entire fairness" standard permits a court to examine both the fairness of the price and of the process. Delaware courts have, however, recently decided that even in these circumstances the business judgment rule can apply, *provided* that:

- the transaction is negotiated by an independent and disinterested special committee of the board, authorized to retain its own advisors, negotiate and reject or recommend a deal; and
- the transaction is conditioned on a non-waivable condition that it be approved by a majority of the minority stockholders or, in the case of a ten-

der offer, that a majority of the minority stockholders tender into the offer (the so-called "MoM" condition).

To be effective, these conditions should be included in the buyer's initial going-private proposal. They should not be first discussed midway through negotiations or traded out during a price negotiation. A sponsor that controls a Delaware target should be thoughtful about its initial approaches to the portfolio company's board, as it is easy to omit or misstate these critical conditions at the outset, providing disgruntled stockholders and others a basis for complaining that the transaction was not entirely fair. A controlling sponsor should also avoid involvement in the establishment of the special committee and the selection of its advisors. Finally, if a sponsor is a buyer only (and clearly not a seller), it should make this position clear in its initial overture to the target company board.

For these purposes, a "controlling" stockholder either holds a majority of the target's shares or actually *controls* the target, through some combination of equity ownership, participation on the board, and management or contractual governance rights. Sponsors are likely to have some of these non-equity influences on their portfolio companies, so it is always good to check with counsel to determine whether the sponsor should consider itself a controlling stockholder for these purposes.

Disclosure Issues

Going-private transactions may implicate the enhanced disclosure requirements under Rule 13e-3 of the federal securities laws. The rule applies when an "affiliate" of the issuer engages in an acquisition transaction that has a reasonable likelihood or purpose of taking the issuer private. An "affiliate" of the issuer includes a sponsor that controls the issuer, but control under the securities laws is based on a lower threshold than under Delaware law: a common rule of thumb is that a party that owns 10% of a company and has a seat on the board is presumed to control the company.

If Rule 13e-3 applies, the sponsor must file a Schedule 13E-3 together with the normal proxy statement or tender offer documents. Preparing the disclosure can be somewhat time-consuming, but is generally not difficult to do. The most challenging task is to explain why the buyer believes that the transaction is fair to the *minority stockholders*. This somewhat counterintuitive disclosure requirement is often addressed by focusing on process rather than valuation.

In addition, a copy of every report, opinion or appraisal must be filed (typically without confidentiality protection) with the SEC as an exhibit to the Schedule 13E-3. The SEC takes an especially broad view of what this obligation encompasses and, for instance, often expects every board book, including preliminary decks, presentations and other materials relating to valuation—whether or not prepared specifically for the transaction—to be filed. It is possible that this could pick up materials (including projections) prepared by or for the sponsor. Sponsors should talk with counsel in advance about what they plan to prepare or have prepared.

Projections and Access to Management

A sponsor preparing for a going-private should also be aware that any projections prepared in connection with the transaction may not only be disclosed but may also be examined for their conformity to past forecasting practices of the target company. In the Delaware litigation arising out of the Dole Food Company going private, the court was highly critical of the attempt by the controlling shareholder to change the manner in which updated forecasts were prepared for the special committee, which the court found resulted in misleading and artificially depressed projections.

A sponsor will often have enjoyed a close relationship with company management during the period of its investment. Indeed, such close relations and the "hands on" approach taken by sponsors is often cited as a hallmark of the added value that sponsors bring to their investments. What a sponsor may rightly view as conscientious monitoring of an investment during the ordinary course operations of a company can be characterized as preferential access in the context of a going-private transaction. After the *Dole* decision, a sponsor should also expect that the special committee will seek to exert some measure of control over the sponsor's access to management, not to prevent such access but rather to ensure that it occurs with the knowledge and participation of the special committee and its advisors.

Timing

Sponsors seeking to engage in going-private transactions should steel themselves for a potentially frustrating timetable. The company's special committee will take particular care to create a record demonstrating how hard it has negotiated on behalf of the unaffiliated stockholders and the tangible improvements in the transaction terms it has obtained. One negotiating technique is delay itself. Moreover, *both* the company's and the special committee's advisors often participate in the process, generating further holdups.

Moreover, the SEC intensely scrutinizes transactions subject to Rule 13e-3 and often comments heavily on the disclosure, which can prolong the process, sometimes for several weeks. A sponsor should also realize that if it owns a significant equity stake in the target but concludes that it is nevertheless not an affiliate and that Rule 13e-3 does not apply, it is almost certain to get a comment from the SEC asking it to defend its position. This could result in back and forth that could take some time to resolve.

Finally, of course, there is litigation. The inherent conflicts perceived in going-private transactions ensure that they are likely to attract shareholder litigation. Litigation takes time and can interfere with the closing schedule for the transaction.

Conclusion

Going-private transactions can be challenging, complicated and frustrating. But they are eminently doable. The trick is to understand the pitfalls and prepare for them in advance. Take nothing for granted; actions taken early on could well have consequences as the process unfolds and will always be viewed by courts and the SEC with the benefit of hindsight. Having experienced counsel on board from the beginning is the right call.

EMBRACING E-DISCOVERY IN ANTITRUST MATTERS: SLOW BUT STEADY PROGRESS TOWARD CONVERGENCE BETWEEN THE U.S. AND THE U.K.?

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Lawyers are sometimes risk adverse and slow to change. Although this tends to lead to a more cautious approach to embracing new technologies, including the use of artificial intelligence, the increasing burden of e-discovery has forced the issue. Lawyers on both sides of matters increasingly are embracing the rise of a technology known as "predictive coding" to identify responsive and nonresponsive documents in private litigation and government investigations. While the United States is on the leading edge of this trend, other jurisdictions, including the United Kingdom, have been slower to follow suit, particularly in antitrust matters.

This is a timely and important issue. Recent research shows that nearly half of the cases requiring U.K. electronic corporate data to be processed were either in preparation for, or in response to, U.K. or foreign antitrust and regulatory matters. This dynamic has led to predictions that lawyers in the U.K. (and elsewhere) are expected to make greater use of artificial intelligence in the near future.

The U.S. experience is illustrative. The two federal antitrust agencies—the U.S. Department of Justice ("DOJ") and Federal Trade Commission ("FTC")—have agreed with parties that predictive coding is useful to cull large volumes of electronically stored information in antitrust investigations. By contrast, there has not been any clear statement on this subject from the U.K.'s Competition and Markets Authority ("CMA"), the U.K. sector regulators, or the courts. That changed in February 2016, when the High Court of England and Wales for the first time endorsed the use of predictive coding in the U.K., relying in large part on judicial acceptance of the technology in the U.S.[1]

This article discusses the latest trends in the use of predictive coding in U.S. and U.K. antitrust matters, and how *Pyrrho* is likely to spur slow but steady progress toward greater acceptance in the U.K.

What Is Predictive Coding?

Use of e-discovery tools to alleviate the burdens associated with document-intensive matters is not new. Since the mid-1980s, private litigants have agreed to use keyword searches, "concept-based" searches, and most recently predictive coding as alternatives to manual document-by-document ("linear") review. Generally speaking, predictive coding is a form of artificial intelligence that uses human reviewers' examination of a subset of documents (so-called "seed documents") to "train" computer algorithms to review and "predict" what other documents are responsive. Nowadays, the term "predictive coding" is used interchangeably with "technology-assisted review" ("TAR"), "computer-assisted review," or simply "assisted review."

How Does It Work in Practice?

There are a number of different software platforms capable of performing the necessary analytics for predictive coding. Lawyers work with e-discovery vendors to understand the capabilities of the predictive coding software to ensure that the document population is handled appropriately. For example, some predictive coding models cannot categorize certain file types, which would need to undergo a linear review. However, other predictive coding software platforms do not have the same limitations. In terms of training protocols, there are two broad categories of how predictive coding models can be trained. In "passive learning" protocols, the model is trained by evaluating multiple sets of random samples of documents coded by attorney reviewers. In "active learning" protocols, the computer helps select certain "borderline" documents for attorneys to review to further refine the model more efficiently than entirely random document sets would.

While the various software platforms may employ assorted processes and have varied limitations, a key objective across all of them is the ultimate "recall rate"— *i.e.*, the percentage of relevant documents ultimately discovered—that is validated by the nonresponsive sample results. An agreed-upon recall rate allows litigants, merging parties, and government agencies to vet the effectiveness of the predictive coding platform regardless of the software used.

Use of Predictive Coding in U.S. Antitrust Merger Investigations

In the U.S., the use of predictive coding is becoming standard practice in response to the significant compulsory document requests ("Second Requests") issued by the federal antitrust agencies to parties in antitrust merger investigations. Increasingly, law firms are engaging with the DOJ and FTC on behalf of their clients to use predictive coding to identify responsive documents. Employing this type of technology is becoming necessary to handle the growing volume of emails and other electronically stored information that companies generate and to comply with often stringent time limits dictated either by the merger review process or the deal timetable (or both).

Take, for example, the DOJ and FTC processes. The DOJ has amended its "Model Second Request" to require merging parties to disclose and discuss any "software or technology used to identify or eliminate potentially responsive documents and information produced in response to this Request, including . . . predictive coding." If a merging party chooses to use predictive coding, the DOJ and the party typically will agree to a certain recall rate and the opportunity for the DOJ to review statistically significant samples of (non-privileged) nonresponsive documents to verify the agreed-upon recall rate. The DOJ has generally accepted a 75 percent recall rate with at least a 90 percent confidence level, which acknowledges that no review will be perfect and that approximately 25 percent of the responsive documents will not be produced.

The FTC's position is largely the same. Citing the widespread use of electronic materials and the need to improve the efficiency of its investigations when proposing changes to its rules of procedures, the FTC has stated, "Document discovery today is markedly different than it was only a decade ago. . .. Searches, identification, and collection all require special skills and, if done properly, may utilize one or more search tools such as advanced key word searches, Boolean connectors, Bayesian logic, concept searches, predictive coding, and other advanced analytics." Accordingly, in August 2015, the FTC also amended its Second Request Model to include instructions on the use of predictive coding.

This embrace of new technology by the DOJ and FTC is encouraging, as a growing body of evidence has demonstrated that linear reviews, in which attorneys review each document one-by-one for responsiveness, are less accurate and generate recall rates well below 75 percent.

Although the U.S. antitrust agencies are leading the way in accepting the use of predictive coding in antitrust matters, the agencies' electronic discovery negotiations are not internally consistent, and the path can sometimes be challenging, depending on the agency staff assigned to the matter. If not reasonably managed (on both sides), discussions about the e-discovery process can last weeks, elevating process over substance, delaying forward progress on the merits of the investigation. Some agency staff may attempt to evaluate how the software is performing before the model is fully trained and to set detailed parameters for the process that are not always or obviously consistent with best practices. As one of the leading U.S. judicial voices in e-discovery, Magistrate Judge Peck, cautioned, "one point must be stressed—it is inappropriate to hold TAR to a higher standard than keywords or manual review. Doing so discourages parties from using TAR for fear of spending more in motion practice than the savings from TAR for review."

The U.S. merger review process puts the burden on the merging parties to certify that they "substantially complied" with a Second Request, and, in such a context, the merging parties should retain broad discretion to use the method they reasonably believe to be appropriate, proportionate, and effective in order to satisfy their duty to comply. The agency staff can evaluate the sufficiency of the documentary response by verifying the agreed-upon recall rate through the review of samples of nonresponsive documents. As Judge Peck explained, "requesting parties can insure that training and review was done appropriately by other means, such as statistical estimation of recall at the conclusion of the review as well as by whether there are gaps in the production, and quality control review of samples from the documents categorized as nonresponsive."

U.K. Comparison

In the U.K., predictive coding has been used in litigation and antitrust matters, but not as often as in the U.S. For example, in a high-profile alleged price-fixing conspiracy investigation some years ago, the CMA's predecessor—the Office of Fair Trading—agreed to the Jones Day antitrust team's request to use predictive coding to identify a few thousand responsive documents from an original collection dataset of several million documents, with a return rate and confidence level similar to those accepted by the DOJ in "Second Request" merger investigations. Despite some experience with the technology, there continues to be no formal statement or guidance from the CMA or other U.K. sector regulators. This can perhaps be attributed to two reasons: U.K. antitrust matters, particularly merger reviews, have tended to be less document-intensive than U.S.-style "Second Requests," and there has been a historic reluctance by the English courts (and consequently, lawyers and government agencies) to endorse the use of predictive coding. But things are changing.

First, since April 2014, the CMA's investigatory powers have been strengthened, in particular through a wider power to require parties to produce documents at all stages of an investigation, including during first-phase merger reviews and market studies, and the ability to impose significant financial penalties on parties that fail to comply with an information request notice without a reasonable excuse. U.K. sector regulators have similar powers.

Second, and crucially, in February 2016, the High Court of England and Wales officially approved the use of predictive coding for the first time in the U.K. in *Pyrrho*.

Pyrrho Ruling

This case concerned compensation claims from the shareholders of a company on various grounds, including breach of fiduciary duties. The court ordered the disclosure of all relevant documents. Initially, the total number of electronic files was "more than 17.6 million." After de-duplication, the total was narrowed to 3.1 million documents, which the court observed was "still a large and costly number to search." The parties turned to predictive coding to expedite the review and asked the court to approve this approach. The court noted that "there is not a great deal by way of guidance, and nothing by way of authority, on the use of such software as part of the disclosure process." Such a lack of authority prompted the court to analyze other jurisdictions and to draw comparisons with the well-known U.S. district court decision of *Da Silva Moore* in which Judge Peck endorsed predictive coding for the first time in judicial proceedings.[2]

In approving the use of predictive coding in *Pyrrho*, Master Matthews listed the following 10 reasons in favor of the use of predictive coding and found "no factors of any weight pointing in the opposite direction":

- Other jurisdictions have found that predictive coding software is useful in appropriate cases, notably the U.S. (*Da Silva Moore*).
- There is no evidence that predictive coding is less accurate than linear review (and indeed, there is evidence that it is more accurate).
- There is greater consistency in using predictive coding over "dozens, perhaps hundreds, of lower-grade fee-earners, each seeking independently to apply the relevant criteria."
- There are no prohibitions on the use of predictive coding in the applicable rules of procedure.
- The number of electronic documents to be reviewed in this case was "huge, over 3 million."
- The cost of manually searching these documents would be "enormous, amounting to several mil-

lion pounds at least." The court even goes further to describe a manual review of each document as "unreasonable" where a "suitable automated alternative exists at lower cost."

- The costs of using predictive coding would be a fraction of the cost of manual review.
- The value of the claims made in the litigation are in the tens of millions, making the estimated cost of predictive coding proportionate.
- If the predictive coding is unsatisfactory, there will still be time to consider alternative methods.
- The parties have agreed on the use of the software and a protocol.

In his closing remarks, Master Matthews noted that the agreed protocol was case specific: "Whether it would be right for approval to be given in other cases will, of course, depend upon the particular circumstances obtaining in them."

Implications

Pyrrho was not an antitrust case, but it is nonetheless instructive for the use of predictive coding in U.K. antitrust matters in at least two respects:

First, *Pyrrho* has been hailed as a victory for proportionality: The use of predictive coding may be appropriate in circumstances where it is effective in ensuring that disclosure exercises remain proportionate. This is particularly important for U.K. antitrust matters, where the CMA and the other U.K. sector regulators are under a duty to make sure that each request for information is justified and proportionate and enables companies to balance their duty to cooperate with the exercise of their rights of defense. The principle that document disclosure requests must be proportionate has recently been reaffirmed in Cases C-247-268/14P, *Italmobilare and Others*—in which the Court of Justice of the EU found that the European Commission's requests for information directed at cement manufacturers in an EU antitrust probe were "extremely numerous" and excessive, and thus annulled such requests. Although these cases relate to European Commission investigations under EU competition law, they are also relevant in principle for the application of U.K. antitrust rules.

Second, in *Pyrrho*, the court was satisfied that *training and review were done appropriately without the need for the disclosure of the "seed" set of documents to the other side*. This is particularly relevant for antitrust investigations. Like U.S. Second Requests, it is for the parties that are subject to a disclosure request from the CMA or other U.K. sector regulators to certify compliance with such a disclosure request. Therefore, *there is a strong argument that parties should remain free to use other reasonable means for vetting the accuracy of their disclosure, such as the statistical estimation of recall at the conclusion of the review based on the quality control review of samples from the documents categorized as nonresponsive and nonprivileged.*

Toward Convergence between the U.S. and the U.K.

Lawyers in the U.K. are likely to rely on the *Pyrrho* judgment in the future in support of the use of predictive coding in response to a large document disclosure requests, including in antitrust investigations.

Given that e-discovery is one area where the U.S. is leading the way (as recognized by *Pyrrho* itself), some guidance could usefully be drawn from DOJ and FTC experience, with a view to achieving a consistent approach to the use of predictive coding in U.S. and U.K. antitrust matters. Accordingly, in deciding whether it may be appropriate to propose the use of predictive coding in an antitrust investigation, the parties and their lawyers should take into account the following considerations:

Volume, Timing, and Collection Logistics. Consider whether predictive coding is the most efficient solution after evaluation of the document volume and collection logistics. Predictive coding may not save time and money if the volume of documents is low or if documents have to be collected and processed in small, incremental batches.

Experience. Consider whether the investigating agency staff has experience with predictive coding. The CMA and some of the U.K. sector regulators are increasingly using predictive coding for the prioritization and review of documents disclosed to them in response to information requests. A less-experienced agency staff may be less likely to agree to predictive coding or, alternatively, more inclined to challenge or delay accepting a certification of completeness where predictive coding has been used without advance acceptance by agency staff. In the absence of formal guidance or additional precedent in antitrust investigations in the U.K., the conditions set out in *Pyrrho* for accepting predictive coding provide a useful precedent.

Recall Rate. Make sure that you are comfortable with the *recall rates*. Even if the agency staff has agreed to the use of predictive coding, you will still be required to certify the efficacy of the methodology and substantial compliance with the document disclosure request.

Methodology and Protocol. Consider what aspects of the methodology and protocol will require prior agreement with the agency. A highly transparent protocol could complicate the review and open the door for an expanded and time-consuming inquiry, especially if the agency staff does not have a good understanding of the technology or visibility of what information is contained in the documents at the outset. The goal of any review process is to return a satisfactory volume of responsive documents, and ultimately the burden rests on the party deploying the technology to use it appropriately to reach the desired recall rate—which the agency can validate through nonresponsive samples. Agreement on the recall rate and verification of that rate through the review of nonresponsive samples should instead be sufficient to endorse any review process without the unnecessary distraction of prolonged discussions regarding the specific software and work flows.

The Continued Need for Some Linear Review. Linear reviews of predicted responsive documents that contain potentially privileged communications, as identified by "privilege" search terms, are still common as parties seek to identify 100 percent of privileged communications. But as technology and legal standards advance, parties to an investigation and their lawyers should keep an open mind and be prepared for further change and development in this area.

ENDNOTES:

[1]Case No: HC-2014-000038, *Pyrrho Investments Limited and another v. MWB Property Limited*, [2016] EWHC 256 (Ch).

[2]See the March 2012 Jones Day Client Alert, "Will Recent Court Approval of Computer-Assisted Document Review Spur Acceptance in Antitrust Investigations?" (http://www.jonesday.com/will-recent-court-approval-of-computer-assisted-document-review-spur-acceptance-in-antitrust-investigations-03-14-2012/).

FROM THE EDITOR

A Temporary Lull; Changes in Delaware

It already seemed a touch unlikely that 2016 would match the previous year in terms of deal volume: after all, it's always hard to top a record-breaker. But there have been signs of a short-term slowdown in deals this spring, which has some analysts wondering whether this could portend a sluggish summer and overall year.

In March, there were only 88 completed deals posted, compared to March 2015's 147 deals; the figure was also down from February 2016's 107 deals, according to Thomson Reuters data. The number of letters of intent was down, as were leads for potential new offerings.

What's going on? There's a lot on the plate at the moment in the political scene: see China's continual economic sluggishness and its growing military adventurism in the South China Sea. Or Europe, currently reeling from terrorist attacks in Belgium and the ongoing refugee crisis and facing a possible U.K. pullout of the European Union this summer. There's also been some credit tightening among lenders and there's some wariness about the ongoing strength of the U.S. economy, given the global situation.

Our lead article takes a look at a more regionally-specific issue. Since the Delaware legislature adopted Section 251(h) of the Delaware General Corporation Law in 2013, the provision has been having a significant impact on M&A. Skadden Arps' Allison Land and Lisa Ogust note that "Section 251(h), which facilitates short-form mergers without stockholder approval following a first-step tender or exchange offer, has reintroduced the tender offer as a viable option for efficiently consummating an acquisition." The evidence is pretty substantial. "In the 12 months prior to the enactment of Section 251(h), 23 percent of all acquisitions involving public Delaware corporations utilized a two-step process, while in the 12 months following the enactment of Section 251(h), 35 percent of all acquisitions involving public Delaware corporations were structured as a two-step process utilizing Section 251(h)."

However, "some practitioners have expressed doubt about their ability to utilize Section 251(h) in certain situations." For instance, one concern "involved the requirement in Section 251(h) that the offer be for "any and all" shares of the target corporation. Practitioners questioned whether such requirement would prohibit utilizing Section 251(h) if the tender or exchange offer includes a minimum tender condition. Another prevalent concern involves the treatment of "rollover shares" (*i.e.*, shares held by management that are contributed to the buyer (or a buyer affiliate) in exchange for equity of the buyer (or such buyer affiliate) rather than being tendered into the offer)."

As a result, the Corporation Law Council of the Delaware State Bar Association recently proposed amendments to Section 251(h). These amendments were being considered as *The M&A Lawyer* was going to press.

Chris O'Leary

Managing Editor

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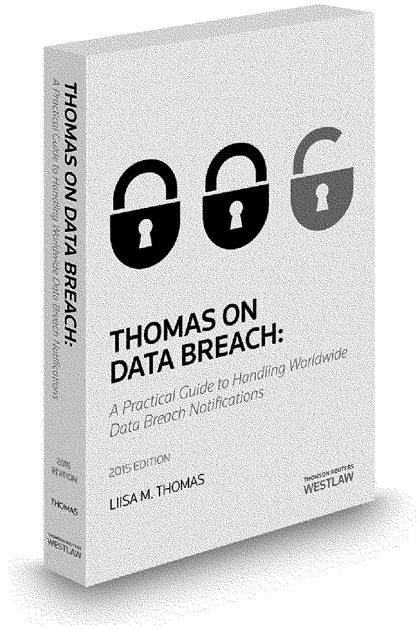

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THOMAS ON DATA BREACH

A Practical Guide to Handling Worldwide Data Breach Notifications

Liisa M. Thomas

Thomas On Data Breach: A Practical Guide To Handling Data Breach Notifications Worldwide is intended to serve as a helpful tool in navigating a data breach. The book will help you understand breach notification requirements so you can have a clear plan in place before the breach occurs.

As the nation – and the world – debate issues about data breach laws, this guide gives you a comprehensive overview of where we are right now, and how to best prepare for the future. It will also aid you in assessing specific data breach questions, such as What are our legal obligations? Do we have to notify under various data breach notification laws? Whom do we notify? How quickly? What should be included in the notice? What is our potential exposure after the notice goes out? And finally Did we do all that we could have to prevent the attack?

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