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Selling a Technology Company – Why You Can't Stand Still in Changing Times

By John Yates, Special To LTW

Editor's note: John C. Yates Chairs the Technology Group of the law firm Morris, Manning & Martin, LLP.

ATLANTA - For the technology entrepreneur, a sale of your company is the only viable strategy to achieve liquidity in the current market. The days of the IPO are over – at least for the foreseeable future. Solid tech businesses will be juicy targets for cash-rich financial acquirors or strategic buyers.

As a result, many tech companies will be presented with letters of intent to acquire their businesses. The terms in these letters must undergo significant change as a result of court decisions and increasing fiduciary obligations of directors.

The major case of *Omnicare, Inc. vs. NCS Healthcare, Inc.* decided in Delaware is one reason for a new set of rules with respect to acquisitions of tech companies.

In the *Omnicare* decision, the Delaware Supreme Court invalidated a series of popular measures designed to lock-up a merger transaction. These provisions basically prevent a target (selling) company from rejecting an offer after an acquiror has submitted an acceptable bid.

The court in the *Omnicare* case examined these provisions in detail. The court then nullified certain provisions of the negotiated merger transaction, including:

- The irrevocable agreement among the stockholders of the target's outstanding stock to vote in favor of the merger.
- The agreement to put the merger to the target stockholders for a vote, even if the Board of Directors withdrew its recommendation of the deal.

These provisions were held to be unenforceable as over-reaching efforts by the acquiring company to gain control of a target business.

As a result of this decision, Directors who are considering a merger or acquisition must exercise greater caution. These various lock-ups or protective provisions that *irrevocably* tie up stockholders of the target (selling) company may be held invalid. More importantly, the Board of Directors of these companies may be subject to liability if they support such measures.

The fallout

What does this mean for the technology company that is considering a sale to another business?

First, the documentation relating to the proposed sale should include an acceptable fiduciary "out" provision. This provision generally allows the Board of Directors to withdraw from closing a deal if a better set of terms is proposed by another party. These fiduciary "out" provisions will become more important and will be more complex in the way they are drafted in letters of intent.

Second, break up fees will become more prevalent. These fees will be payable where a target (selling) company decides it must back out of a deal, thereby leaving behind a jilted acquiror. Even the smallest deals may now include these types of fees. After all, a prospective acquiring company does not want to incur significant fees in negotiating a deal only to find that the fees have been wasted when the target company ejects itself from the deal.

Third, the M&A negotiating process may be elongated. There will be fewer reasons for an acquiring company to want to move too quickly - especially if the target company will have more reasons to jump from one deal to a better one.

Fourth, purchase prices may be adversely impacted. For example, some acquirors may be reluctant to begin the bidding at a high level fearing that their efforts will be undercut at the last minutes. Acquisition-hungry companies may simply let others play the bidding game and then swoop in at the last minute as the best offer. Only time will tell if this approach is more beneficial to the selling company and will result in increased shareholder values.

Fifth, some states may choose not to follow the edict of the Delaware Supreme Court in the *Omnicare* case. For businesses incorporated in Delaware, the Delaware Court decision is binding. For companies incorporated in other states, this court decision may be influential but a court is not required to adhere to the holding.

As a practical matter, target companies will need to be very careful in drafting these fiduciary "out" provisions. Also, Directors must exercise greater care and scrutiny in considering and analyzing offers to sell their company to third parties.

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