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California Legal Issues Affecting Mergers and Acquisitions

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Many California lawyers are not as familiar as they should be with provisions of California law applicable to mergers and acquisitions (M&A) transactions. This is due in part to the fact that many corporate lawyers in California are more familiar with general principles of Delaware corporate law and federal securities laws than analogous California laws, and in part to the confusing nature and the traps for the unwary found in California corporate and securities laws. This article highlights key issues of California law that bear on M&A transactions, whether involving a California corporation or a non-California corporation with a substantial presence and/or shareholders in California. This article focuses on (1) corporate approvals of a sale of a corporation; (2) application of California corporate law to non-California corporations; (3) California securities law issues in M&A transactions; (4) utilizing California "fairness hearings;" and (5) special issues when contracting under California law.

I. Corporate Approvals of a Sale of a Corporation

Corporate acquisitions can be accomplished by merger, purchase of assets or stock, or other less common means, and the California Corporations Code (the "Code") contains detailed provisions governing the requirements for each. A merger and a sale of assets each involves corporate action both by the corporation's board of directors and in most cases, its shareholders. For example, effecting a merger involving a target California corporation requires (i) approval of the target corporation's board; (ii) a written merger agreement; (iii) approval of the target corporation's shareholders; and (iv) filing of articles of merger with the California Secretary of State. The Code and case law dictate the nature of the board and shareholder approvals required, which are different than in other states.

A. Board Approval

A merger involving a California corporation must be approved by the corporation's board of directors, and the board's decision should be guided by the duty of care it owes to the corporation's shareholders.[1] The Code defines this duty as the duty "to act with such care, including reasonable inquiry, as an ordinary prudent person in a like position would use under similar circumstances."[2] Case law supplements the statute to make clear that directors enjoy the benefit of the business judgment rule, under which courts largely defer to the judgment of the board on business matters.[3]

The Expedited Jury Trials Act: An Alternative to Form Arbitration Clauses

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There would be no need for contracts if parties always reached a true and complete meeting of the minds, remembered what they agreed to do, and then did what they said they were going to do. But from the perspective of the business trial lawyer, that seldom happens. This truism heightens the importance of dispute resolution clauses in contracts. Yet little time is spent considering or drafting these clauses. After disputes have arisen, transactional lawyers all too often admit that they used the arbitration clause contained in the contract at issue because it was part of a template.

Fortunately, the California Legislature recently adopted an alternative to traditional civil litigation and arbitration that, for the right kinds of disputes, provides a roadmap to a new form of dispute resolution that is more efficient and economical for the right kinds of controversies. Although still in its infancy, the Expedited Jury Trials Act[1] offers a menu of ways for seasoned transactional lawyers and trial lawyers to consider what kinds of disputes are likely to arise and craft a dispute resolution provision that is well-suited to those disputes. The Act became effective on January 1, 2011 and codifies a set of procedures to try cases to a jury in about a day. The procedures themselves are not new, or anything that lawyers could not have agreed to before. But, adopting (and following) the Act's procedures could allow parties to secure a short trial at a substantially reduced cost that, looking backward from trial, would also contain the costs of the litigation.

The Good the Bad and the Ugly of Litigation and Arbitration

Civil litigation is, like democracy, the worst form of dispute resolution except all those other forms that have been tried from time to time.[2] And that's the "Good." Civil litigation is also often expensive and time consuming. And, worst of all from the client's perspective, it is commonly unpredictable in both its process and result.

Arbitration is often no better. Sometimes it is made much worse by the obligation to pay someone to referee the squabble. The arbitrator has little incentive (other than the potential for repeat business) to lower the temperature in the dispute. And often, it seems most would rather mediate the dispute than arbitrate it anyway. Despite the best of intentions to expeditiously resolve a dispute, parties commonly alter the procedures in arbitration once they realize what they've agreed to. This results in a litigation-like arbitration that sidesteps its contemplated benefits. And, there are numerous perils in blindly selecting an arbitration clause that should be well known.[3]

The Expedited Jury Trial Act Compared

Although it has not been marketed to lawyers in this way, the Expedited Jury Trial Act's greatest benefits may be realized if transactional attorneys begin incorporating its procedures into contracts as the method by which disputes are resolved. It must be noted that at present, "[a]ny agreement to participate in an expedited jury trial under this chapter may be entered into only after a dispute has arisen and an action has been filed."[4] However, with careful consideration in drafting an agreement and after consultation with a trial attorney, the Act's provisions can guide parties toward striking a novel balance that avoids many of the criticisms of litigation and arbitration. It does so by creating a menu of options to intelligently craft a dispute resolution process suited to the disputes that are likely to arise under a contract.

The benefits of the Act are perhaps best considered in the reverse order they are presented in the Rules of Court -- that is, from the final decision backward in time. Like arbitration (except under those agreements that preserve appellate rights[5]), the grounds upon which to bring post-trial motions and appeal and an expedited jury trial are extremely limited: judicial misconduct, jury misconduct, and "Corruption, fraud, or other undue means … that prevented a party from having a fair trial."[6] "Parties to an expedited jury trial may not appeal on any other ground."[7] The court will, however, modify a verdict to conform to a high/low agreement between the parties.[8] Such an agreement is a natural consequence of bilateral provisions limiting liability and imposing liquidated damages, even if only for specified types of disputes.

The namesake of the Act, however, is codified in California Rule of Court, rule 3.1550. It provides:

> Excluding jury selection [which is also limited], each side will be allowed three hours to present its case, including opening statements and closing arguments, unless the court, upon a finding of good cause, allows additional time. The amount of time allotted for each side includes the time that the side spends on cross-examination. The parties are encouraged to streamline the trial process by limiting the number of live witnesses. The goal is to complete an expedited jury trial within one full trial day.

The provisions implementing Rule 3.1550 provide a roadmap for provisions of a dispute resolution agreement. The parties must "have been informed of the rules and procedures for an expedited jury trial and provided with a Judicial Council information sheet regarding expedited jury trials, have agreed to take part in or, in the case of a responsible insurance carrier, not object to, the expedited jury trial process, and have agreed to all the specific provisions set forth in the consent order."[9] In addition to the consent to the other provisions of the Act that may be agreed to, California Code of Civil Procedure section 630.03(e)(2) in turn provides that the parties must agree to all of the following:

> (B) That each side shall have up to three hours in which to present its case. (C) That the jury shall be composed of eight or fewer jurors with no alternates. (D) That each side shall be limited to three peremptory challenges, unless the court permits an additional challenge in cases with more than two sides as provided in section 630.04.[10]

In an expedited trial, like arbitration, the parties can agree to use relaxed rules of evidence, except for those relating to privilege, confidentiality, and privacy.[11] And, they retain the right to "issue subpoenas and notices to appear to secure the attendance of witnesses or the production of documents at trial."[12]

In addition to these requirements of section 630.03, California Rule of Court, rule 3.1547 provides optional content to include in the consent order for an expedited trial. These procedures too should be considered in drafting a dispute resolution clause, most notably in regard to the evidence that will be permitted to prove a particular point at issue in a dispute.

For example, despite the presence of integration clauses, parties commonly argue that the "plain meaning" of an agreement should be assessed in light of extrinsic evidence that demonstrates the existence of an ambiguity. Regardless of the degree of success (or the lack of success) in doing so, the exercise always makes the litigation more time consuming and expensive than necessary when the plain meaning is upheld. California Code of Civil Procedure section 630.03(c), subsections (5)-(7) suggest a way to prevent the presentation of extrinsic evidence to open up the plain meaning of the contract. They permit binding agreements about:

> (5) Any evidentiary matters agreed to by the parties, including any stipulations or admissions regarding factual matters; (6) Any agreements about what constitutes necessary or relevant evidence for a particular factual determination; [and] (7) Agreements about admissibility of particular exhibits or demonstrative evidence that are presented without the legally required authentication or foundation….

Unlike matters relating to the preservation of a right to a jury trial, such provisions can be included in the original transactional document. The agreement may provide that only certain evidence may be offered to prove a particular matter, e.g., a change order to prove the amount agreed to be paid for a particular item; an invoice to prove the amount to be supplied; an acceptance specification to provide the criteria upon which goods are deemed to be conforming; or a certificate to establish fulfillment of a technological milestone or passage of a test criterion.

The likelihood for such an agreement being enforced can also be enhanced by an agreement "concerning the timeframe for filing and serving motions in limine."[13] Such an agreement would allow the trial court, well in advance of the actual trial, to determine what evidence can be admitted at trial. Often, when certain evidence is determined to be inadmissible, the jury's conclusion becomes a fait *accompli*.

The other possible provisions in the consent to an expedited trial are more difficult to put in terms of contract, but should nevertheless be encouraged in the small or relatively simple case. And their (un)enforceability once a dispute arises should not be viewed as a reason not to include them in the original agreement. Aside from the court's incremental bias in favor of enforcing the agreement to an expedited jury trial because of the parties' original agreement to it, the inclusion of the concept in an agreement would also tend to create inertia in parties' acceptance of the idea after a dispute arises. These other possible provisions include such things as limiting the number of witnesses (including expert witnesses) to be presented by each side, changing the rules for expert disclosures, and agreements about the use of video and written depositions.[14]

The provisions relating to pretrial submissions in an expe-

dited jury trial can also be dovetailed with pre-suit mediation requirements. While pre-suit mediation is most often effective when it requires the presence of top-ranking principals of a company to attend, the likelihood of success could be enhanced if the claimant were required to exchange all of the documents showing its claimed damages and the identity of any witnesses it would call at trial at or before that mediation. Such a provision could then be folded into the requirements for an expedited trial. California Rule of Court, rule 3.1548 imposes obligations for pretrial submissions and exchanges that include "Copies of any documentary evidence that the party intends to introduce at trial (except for documentary evidence to be used solely for impeachment or rebuttal)…" and "A list of all witnesses whom the party intends to call at trial, except for witnesses to be used solely for impeachment or rebuttal."[15] Like the agreement can do, the Rule provides that "Unless good cause is shown for any omission, failure to serve documentary evidence as required under this rule will be grounds for preclusion of the evidence at the time of trial."[16]

The Act also provides parties with the post-dispute ability to modify an attorneys' fees provision in the agreement at issue. California Code of Civil Procedure section 630.10 provides that "[a]ll statutes and rules governing costs and attorneys' fees shall apply in expedited jury trials, unless the parties agree otherwise in the consent order."[17] The consent order procedure thus allows the parties to cut short the possibility that litigation will continue because attorneys' fees are incurred that dwarf the damages resulting from the breach of contract. Again, while the Act provides an opportunity to modify the allocation of attorneys' fees, forethought about the disputes that are likely to arise might warrant attorneys' fees only in certain circumstances or certain types of disputes under the agreement.

While the Act will, in all likelihood, be renewed upon its expiration, it should be noted that the Act is currently only valid until January 1, 2016.[18] Contracts with performance periods extending beyond that date should account for this sunset provision.

The Contractual Road Ahead

While the existence of the Expedited Jury Trial Act will not prevent disputes from occurring in the future, its provisions offer intelligent ways to think about how to draft agreements to avoid many of the expensive features of litigation and arbitration. With careful drafting, the Act provides a roadmap to ensure that contract disputes stay focused on the parties and their conduct, and that the parties' interests are not overwhelmed by a quest for recovering exorbitant attorneys' fees. ■

Endnotes

1 *See* Cal. Rules of Court, rule 3.1545-3.1552, *available at* http://www.courtinfo.ca.gov/rules/documents/pdfFiles/title_3.pdf; and Cal. Civ. Proc. Code § 630.01 et seq., *available at* http://www.leginfo.ca.gov/cgi-bin/displaycode?section=ccp&group=00001-01000&file=630.01-630.12.

2 Churchill, Speech in the House of Commons, The Official Report, House of Commons (5th Series) (Nov. 11, 1947), vol. 444, at 206–07.

3 *See, e.g.,* Geibelson and Conn, *Clause and Effect: Parties agreeing to standard arbitration clauses may unwittingly alter their rights,* Los Angeles Lawyer (Oct. 2006), *available at* http://www.lacba.org/Files/LAL/Vol29No8/2294.pdf.

4 Cal. Civ. Proc. Code § 630.03(c). This limitation is a codification of the prohibition on advance jury trial waivers. However, with encouragement from transactional lawyers, this provision could be amended in the same manner that arbitration allows the circumvention of full-blown litigation and jury trials, perhaps based upon amounts in controversy.

5 In March 2008, the United States Supreme Court in *Hall Street Associates, L.L.C. v. Mattel, Inc.*, 552 U.S. __, 128 S. Ct. 1396, 1404-1405 (2008) ruled that contracting parties may not by their agreement obtain expanded judicial review of an arbitration award under section 9, 10 and 11 of the Federal Arbitration Act, 9 U.S.C. §§ 1 et seq. ("FAA"). However, the Court left the door open to parties agreeing to more expansive judicial review of arbitration awards under other circumstances and other laws. Following *Hall*'s lead, the California Supreme Court in *Cable Connection, Inc. v. DIRECTV, Inc.*, 44 Cal. 4th 1334 (2008) confirmed contracting parties' right to use California contract law to create a right to judicial review of arbitration awards, thereby allowing courts to review arbitration awards for errors in law.

6 Cal. Civ. Proc. Code § 630.09.

7 Cal. Civ. Proc. Code § 630.09(d). *See also id.* § 630.08 (setting forth waiver of motions of directed verdict, motions to set aside verdict or judgment, and motions for a new trial based upon inadequate or excessive damages).

8 Cal. Civ. Proc. Code § 630.07. California Code of Civil Procedure section 630.01(b) defines a "High/low agreement" as "a written agreement entered into by the parties that specifies a minimum amount of damages that a plaintiff is guaranteed to receive from the defendant, and a maximum amount of damages that the defendant will be liable for, regardless of the ultimate

verdict returned by the jury." It also provides that "Neither the existence of, nor the amounts contained in any high/low agreements, may be disclosed to the jury."

9 Cal. Civ. Proc. Code § 630.03(e)(1).

10 As above, these provisions for an expedited jury trial are ordinarily agreed to once litigation has already begun in a form entitled "Consent to Expedited Jury Trial."

11 Cal. Civ. Proc. Code § 630.06.

12 Cal. Civ. Proc. Code § 630.06(c).

13 Cal. Rules of Court, rule 3.1547(b)(11).

14 *See* Cal. Rules of Court, rule 3.1547(b).

15 Cal. Rules of Court, rule 3.1548(b)(1) and (2).

16 Cal. Rules of Court, rule 3.1548(e).

17 The reference necessarily includes California Code of Civil Procedure sections 1021 et seq. (relating to the award of fees and costs in litigation) and California Civil Code section 1717 (relating to contractual allocation of fees).

18 Cal. Civ. Proc. Code § 630.12.