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***87 INTRODUCTION**

Over the last year or so, there has been significant interest in “going private transactions,” which are generally defined to be transactions in which a controlling shareholder, the executive management team, or other person seeks to “take the company private” by acquiring all outstanding public shares. This increased interest in going private transactions may be explained by a number of new burdens facing public companies.

First, public companies have always experienced higher costs than private companies due to the cost of complying with their obligations under the Securities Exchange Act of 1934, as amended (“Exchange Act”). Those compliance costs have increased significantly as a result of the substantial corporate reforms now required by the Sarbanes-Oxley Act of 2002 (“Sarbanes-Oxley” or “SOX”) and related rules of the Securities and Exchange Commission (“SEC”), the New York Stock Exchange (“NYSE”), and the National Association of Securities Dealers Automated Quotation system (“NASDAQ”). A recent study commissioned by Foley & Lardner reports that audit fees have increased 27 percent for S&P 500 issuers and 35 percent for S&P MidCap issuers between 2001 and 2002. [FN1] This same study, based upon responses of senior management, estimated that the average costs of being public--including director and officer insurance, accounting services, legal services, public relations, compensation of the board of directors (“board of directors” or “board”), financial reporting and printing, lost productivity, compliance personnel, investor relations, director search firms, transfer agent fees, and other SOX-related costs--will increase 90 percent as a result of the adoption of Sarbanes-Oxley. [FN2]

Second, with increasing disclosure obligations, especially new certification requirements under Sarbanes-Oxley, management of public companies is subject to increased liability and risk. The Department of Justice recently initiated criminal prosecutions under Sarbanes-Oxley based upon these certifications. [FN3] The SEC has announced an increased focus on directors of public companies. [FN4] Furthermore, in the first year following the adoption of Sarbanes-Oxley, researchers found a decline in the frequency of dismissals of securities lawsuits. [FN5]

Third, with the substantial market declines of the last two years, many companies are finding their valuations lower than ever. Approximately one-third of NASDAQ-traded *88 companies now have market capitalizations of less than \$100 million. [FN6] Reductions in analyst coverage have resulted, in part, from increased scrutiny by regulators of analyst activities and severe cuts in the rankings of Wall Street analysts in reaction to drastically diminished investment banking and brokerage revenues. [FN7] As of May 2003, more than 6,800 public companies had an equity capitalization of less than \$250 million, representing approximately 75 percent of all U.S. publicly traded companies. [FN8] These factors, coupled with historically low financing costs, may provide a controlling shareholder or management with the incentive to “buy back” the company at a bargain price.

There are currently over 10,000 public companies in the United States. [FN9] According to Schedule 13E-3 filings in 2003, only 79 going private transactions were attempted. [FN10] This is a decrease from 99 going private transactions attempted during 2002 (also based upon Schedule 13E-3 filings). [FN11] Therefore, despite the factors mentioned above and predictions to the contrary, the number of going private transactions did not increase in 2003. Interestingly, the same Foley & Lardner study referenced above stated that 62 percent of respondents answered “yes” when asked if their company was considering going private or selling. [FN12]

Although one can only speculate as to the reasons why a greater number of public companies have not decided to pursue a going private transaction, it is the authors' experience that the following factors are frequently cited by those with decision-making authority when explaining their decisions to remain public:

- Financing and transactional costs of effecting such a transformation are prohibitive.
- NASDAQ Bulletin Board and Pink Sheet stocks avoid much of the more onerous reform regulations.
- Many management stockholders consider themselves already private, for all practical purposes, because of lack of analyst coverage.
- Fear that regulatory and/or shareholder scrutiny may result from a going private SEC filing.
- *89 • Pride and the perception of withdrawal from the public markets would be seen as failure.
- Refusal to believe the current situation is more than temporary.
- Inertia or focus on the business by management during a difficult environment.

I. WHAT IS A GOING PRIVATE TRANSACTION?

A going private transaction has been defined differently for different purposes and by different commentators. For purposes of this paper, we will define it to be either a transaction in which all minority shareholders are eliminated or a transaction in which the number of shareholders is reduced to less than 300, thereby permitting deregistration under Section 15(d) of the Exchange Act. [FN13] For ease of reference, we will refer to the company that is to be taken private as

the “Target Company” and the shareholder(s) and/or investor(s) who will end up owning the Target Company or its assets, either directly or indirectly, collectively as the “Acquiror.”

II. HOW DO YOU TAKE A COMPANY PRIVATE?

There are several methods by which the Target Company can be taken private. Among the more common are the following:

- A cash-out merger (either long-form or short-form) in which the minority shareholders of the Target Company receive cash and the Acquiror ends up owning, directly or indirectly, all of the stock of the Target Company. [FN14]
- A tender offer (including an odd-lot tender) by the Acquiror, which is generally followed by a short-form merger. [FN15]
- A charter amendment effecting a reverse stock split that leaves the minority shareholders of the Target Company with only fractional shares, which are then cashed out. [FN16]
- The sale of all or substantially all of the assets of the Target Company to the Acquiror followed by a dissolution of the Target Company (or the dissolution of the Target Company followed by a sale of its assets in liquidation to the Acquiror). [FN17]

*90 III. HOW DO YOU CHOOSE WHICH METHOD TO USE?

There are numerous factors that should be considered in selecting the method to use, and no “one size fits all.” At times, it may feel like putting a puzzle together because the “right” solution to accomplish one goal may thwart another goal. Among the factors to consider are the following, many of which are applicable in any acquisition:

- Which method has the greatest likelihood of success?
- Which method is the most tax efficient? For instance, is a sale of assets by the Target Company more desirable to the Acquiror so it can have a step-up in basis?
- Which method is the most easily documented? For instance, will a sale of assets involve more documents to effectively transfer the assets than a cash-out merger?
- Which method best permits the Acquiror to take free of unwanted or unknown liabilities?
- Which method is more likely to receive financing?
- Which method results in the least negative consequences under the Target Company's material contracts? For instance, is there a non-assignment provision that will be violated by a sale of assets but not by a merger? Is there an acceleration of debt provision implicated upon a change of control?
- Which methods are permitted by applicable state law? For example, is there a “control share” statute that prohibits, for some period of time, certain transactions between the Target Company and the Acquiror? What percentage of share ownership is needed to permit a short-form merger? Is it permissible to cash out minority shareholders in a short-form merger?

- Which method accomplishes the goal of becoming a private company in the shortest period of time?
- Which method accomplishes the goal of becoming a private company with the least amount of expense?
- Which method requires the least amount of disclosure?
- Which method generates the least amount of controversy and/or litigation?
- Which method gives rise to shareholder appraisal rights?

***91** IV. TIMELINE FOR A TYPICAL GOING PRIVATE TRANSACTION 1. The Acquiror arranges its financing.

2. The Acquiror presents the proposal (either in general or specific terms) to the board of directors of the Target Company.

3. The board of directors of the Target Company announces receipt of the proposal, appoints a special committee of independent directors to evaluate the proposal, and grants necessary authority to the special committee.

4. The special committee engages counsel and a financial advisor to assist it.

5. The financial advisor gathers information and makes a preliminary presentation to the special committee concerning the fairness of the offer.

6. The special committee negotiates with the Acquiror concerning the terms of the offer and the related transactional documents.

7. The special committee recommends an offer.

8. The financial advisor renders a fairness opinion and the transactional documents are signed.

9. The transaction is consummated.

V. CERTAIN STRUCTURES AND ISSUES OF LAW TO CONSIDER

This Article does not attempt to address all the potential permutations of a going private transaction. For ease of presentation, this Article only focuses on certain specific legal structures and issues involved in a going private transaction, including the following: (1) federal rules and regulations relating to tender offers; (2) important state corporation laws; (3) the entire fairness standard and special committees; (4) beneficial ownership reporting; (5) disclosure liability; and (6) antitrust issues.

A. Tender Offers

By effecting a tender offer that is conditioned on a specified minimum amount of the securities of the Target Company being tendered, the Acquiror may (1) assure itself of the ability to approve a subsequent merger; (2) assure itself of the ability to do a short-form merger; and (3) avoid the lock-out period under state anti-takeover statutes. [\[FN18\]](#)

***92** The term “tender offer” is not defined in the Exchange Act or any of the rules promulgated thereunder, but it has

been described as:

[A] publicly made invitation, usually announced in a newspaper advertisement, to all shareholders of a corporation, to tender their shares for sale at a specified price. To induce the shareholders to sell, the price usually includes a premium over the current market price of the target company's shares. Cash or other securities may be offered to the shareholders as consideration. An offer is made for a limited period of time only. An offeror may offer to buy all tendered shares, or it may offer to buy only a stated number. In general, the offeror also sets a minimum number of shares that must be tendered before he will buy any shares. [FN19]

The Williams Act, passed in 1968, amended the Exchange Act to regulate tender offers. [FN20] The Williams Act added Sections 13(d), 13(e), 14(d), 14(e), and 14(f) to the Exchange Act. [FN21] Sections 13(d), 14(d), and 14(f) apply only to tender offers for equity securities registered under Section 12 of the Exchange Act, while Section 14(e) applies to all tender offers, regardless of whether the Target Company securities are registered under Section 12 of the Exchange Act.

1. Section 14(d) of the Exchange Act

The primary provision of the Williams Act that deals with tender offers is Section 14(d). Under that provision, it is unlawful for a person to make a tender offer for an Exchange Act-registered equity security if, after consummation of the offer, the person would beneficially own more than 5 percent of a class of securities, unless at the time such offer is first published or given to stockholders, certain required filings are made, including a Tender Offer Statement on Schedule TO. [FN22]

a. Securities Sought

A tender offer may not only be conditioned on the receipt of a minimum number of securities, but may also place a cap on the number of securities that the offeror desires to purchase. [FN23]

b. Pre-Commencement Communications

Before commencement of a tender offer, all communications relating to the tender offer must comply with the requirements of Rule 14d-2(b) promulgated under the Exchange Act. [FN24] *93 Each pre-commencement written communication relating to the tender offer must (1) be filed with the SEC on Schedule TO no later than the day the communication is first made; (2) inform security holders how to obtain the Tender Offer Statement for free, once available; and (3) include a legend advising security holders to read such statement. [FN25]

c. Commencement of Tender Offer

Rule 14d-2(a) specifies when a tender offer is deemed to have been commenced. A tender offer commences at 12:01 a.m. on the date the bidder first publishes, sends, or gives the means to tender to security holders. [FN26] Rule 14d-2(a) clarifies that the "means to tender" is the transmittal form or a statement specifying how a security holder may obtain the transmittal form to tender its securities. [FN27]

d. Filing Schedule TO

The Acquiror may not make a tender offer for the Target Company securities unless, as soon as practicable on the date of the commencement of the tender offer, it files a Tender Offer Statement on Schedule TO with the SEC and delivers a copy to the Target Company and to any other bidder that has filed a Schedule TO with the SEC in connection with any other tender offer for the Target Company securities. [FN28] If the Target Company securities are listed on a nation-

al securities exchange such as the NYSE, telephonic notice must also be given and the Schedule TO must be mailed to that exchange. [FN29]

e. Dissemination of Tender Offer Materials

On the date of commencement of a tender offer--in addition to making the required filings with and disclosures to the SEC, the Target Company, and the relevant stock exchanges and/or markets pursuant to Rule 14d-3(a)--the Acquiror must also comply with certain dissemination and disclosure provisions. [FN30] Rule 14d-4 generally requires information to be given to the holders of the Target Company securities concerning cash tender offers or exempt securities offers by (1) "adequate" publication of a "long-form publication"; (2) "adequate" publication of a "summary" publication coupled with mailing of the tender offer materials to each security holder who requests them; or (3) mailing of the tender offer materials to the security holders using a stockholder list and securities position listing as described in Rule 14d-5, following compliance with either clause (a) or (b). [FN31] Rule 14d-4(c) provides a safe harbor by providing that "publication in all editions of a daily newspaper with a national circulation" (e.g., The Wall Street Journal) is "adequate" publication. Anything short of that is not given safe-harbor protection. [FN32]

*94 Under Rule 14d-5, the Acquiror may request the Target Company to either (1) furnish the Acquiror a mailing list of all stockholders of the Target Company and a securities position listing or (2) mail, at the Acquiror's cost, the Acquiror's tender offer materials. [FN33] The Target Company then has the right to choose which method it prefers. [FN34] If the Target Company elects to furnish the mailing list to the Acquiror, the Acquiror will use that list to mail tender offer materials directly to the security holders rather than rely on the Target Company to do so. [FN35]

f. Subsequent Offering Period

An Acquiror, under certain circumstances, may provide a subsequent offering period of between three and twenty business days (twenty-six calendar days at most) after the expiration of the initial tender offer period, if the requirements of Rule 14d-11 are met. [FN36]

g. Withdrawal Rights

The "withdrawal right" found in Rule 14d-7 generally permits tendering security holders to change their mind at any time during the tender offer. [FN37] The withdrawal right provides easy rescission for security holders, which means they do not have their securities tied up indefinitely while a bidder waits to receive its desired number of tenders. However, it is possible to deny withdrawal rights during a subsequent offering period. [FN38]

h. Pro Rata Purchase

Under Rule 14d-8, when a tender offer is for less than all the securities of a class, the Acquiror must purchase tendered securities pro rata according to the number of securities tendered by each security holder at any time during the period of the tender offer. [FN39] That requirement avoids the pressure security holders might otherwise feel to tender quickly, without giving it adequate thought.

i. Pricing and Best Price Requirement

Generally, the bid in a tender offer is at a premium over the market price. Frequently, the price offered in the tender offer is also the price subsequently offered in the back-end, short-form merger. Acquirors have occasionally offered one price in the tender offer and a lower price in the back-end merger, although this "front-end loaded" technique is likely to invite litigation. [FN40]

***95** Section 14(d) provides that the Acquiror must pay all tendering security holders the highest price and that, in general, each security holder must receive the same type of consideration. [FN41] Thus, if a bidder increases the tender offer price after some holders have tendered, the holders who tendered earlier are still entitled to the higher price.

2. Section 14(e) Rules

The Williams Act's antifraud provision is Section 14(e), which provides:

It shall be unlawful for any person to make any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer or request or invitation for tenders, or any solicitation of security holders in opposition to or in favor of any such offer, request, or invitation. [FN42]

a. Pre-Commencement Announcements

Rule 14e-8 prohibits a person from making a public announcement of an intent to make a tender offer if the person (1) does not have the intent to actually make and complete the offer; (2) intends for the announcement to manipulate the price of the Target Company securities; or (3) does not reasonably believe it has the financial resources to complete the offer. [FN43]

b. Recommendation of Target Company

Under Rule 14e-2, the Target Company is required to make a statement with respect to its position regarding the tender offer (or a statement as to why it cannot take a position). [FN44] This statement--the Tender Offer Solicitation/Recommendation Statement on Schedule 14D-9--must be filed by the Target Company within ten business days from the date the Acquiror's tender offer is first published, sent, or given to security holders. [FN45] The statement must include either the reasons for the position taken or the reason for the Target Company's inability to take a position. [FN46] The Target Company must, among other things, promptly disclose and disseminate all material changes in the information set forth in the statement in a manner reasonably designed to inform security holders of such changes. [FN47]

***96** c. Tender Offer Period

Rule 14e-1(a) requires a tender offer to remain open for a minimum of 20 business days. [FN48] Under Rule 14e-1(b), a tender offer must remain open for at least ten business days after notice is given of a material change in the percentage of securities sought, the consideration offered, or the dealer's solicitation fee. [FN49] The tender offer period may be extended if the notice requirements of Rule 14e-1(d) are met. [FN50]

d. Use of Non-Public Information

Rule 14e-3 prohibits any person in possession of material information concerning a tender offer that has either been commenced or with respect to which substantial steps have been taken toward commencement to trade in the Target Company securities while such information is not public. [FN51]

e. Limits on Transactions in Target Company Securities

Rule 14e-5 generally prevents a covered person, in the context of a tender offer for equity securities, from purchas-

ing, or arranging to purchase, securities of the Target Company or related securities, except as part of such tender offer. [FN52] A “covered person” is defined to include the offeror, the offeror’s dealer-manager, its respective affiliates, certain of its respective advisors, and any person acting in concert with any of the foregoing in connection with any purchase or arrangement to purchase any securities of the Target Company or related securities. [FN53] This prohibition period begins with the public announcement of the tender offer and ends when the offer expires. [FN54]

3. Section 14(f) Rules

Section 14(f) is a specialized provision that calls for certain disclosures to the SEC and to security holders when a majority of a corporation’s directorships are to be filled, other than at a meeting of security holders, following an acquisition of securities that is subject to the requirements of Section 14(d). [FN55] This provision is usually triggered by the filling of vacant directorships by sitting directors pursuant to an arrangement with the Acquiror.

*97 4. Issuer Going Private Transactions Under Rule 13e-3

Rule 13e-3 governs going private transactions effected by an issuer or an affiliate of the issuer. [FN56] Rule 13e-4 governs tender offers made by an issuer or affiliate that has a class of equity securities registered under Section 12 of the Exchange Act. [FN57]

Rule 13e-3 applies to any transaction in which the issuer or an affiliate takes certain actions, but only if the actions have either a reasonable likelihood or a purpose of producing certain effects. [FN58] The actions include the issuer or an affiliate of the issuer (1) purchasing securities of that issuer; (2) making a tender offer for securities of that issuer; or (3) soliciting proxies or distributing an information statement in connection with a merger or similar corporate transaction between the issuer and its affiliate, or the sale of substantially all of the assets of the issuer to its affiliate. [FN59] The effects include (1) any class of equity securities of the issuer registered under Section 12(g) or 15(d) of the Exchange Act to be held by less than 300 persons or (2) any class of equity securities listed on a national securities exchange or authorized to be quoted in an inter-dealer quotation system of a registered national securities association being neither so listed nor so authorized. [FN60]

a. Filings with the SEC

The Offeror must file a Schedule 13E-3 with the SEC, promptly amend the Schedule if there are any material changes in the information, and file a final Schedule 13E-3 to report the results of the transaction. [FN61] A filing fee must be paid at the time of filing a Schedule 13E-3. [FN62] Because of the potential for abuse and the conflicts of interest often encountered in Rule 13e-3 transactions, the SEC disclosure requirements are significant. The Schedule 13E-3 must set forth certain information pertaining to the parties to the transaction, the transaction history, the terms of the transaction, the post-transaction plans of the parties, the source of funds for the transaction, the purpose of the transaction, and a fairly extensive description of the fairness of the transaction. [FN63] It is generally the requirement to provide information with respect to fairness that creates the more difficult disclosure issues for persons involved in an issuer going private transaction.

If the going private transaction includes an issuer tender offer as a component, the Schedule 13E-3 must be filed as soon as practicable after the tender offer is first published, sent, or given to security holders. [FN64] The Schedule 13E-3 must be filed at the time of filing the preliminary statements in accordance with Regulation 14C if the Rule 13e-3 transaction is in *98 connection with an information statement. [FN65] The information contained in the information statement or the Tender Offer Statement is incorporated into Schedule 13E-3 by reference, and the filed Schedule 13E-3 must contain a cross reference sheet indicating the location of the information in the other applicable document. [FN66]

b. Disclosure to Stockholders

In addition to the information otherwise required to be disclosed to stockholders in connection with a tender offer or merger, most of the information required by the Schedule 13E-3 must be included in the information disseminated to stockholders in the proxy statement, information statement, or tender offer materials. [FN67] Much of the required information may be incorporated into a Schedule 13E-3 by reference to such other disclosure documents. [FN68] It must be appropriately amended if there is any material change in the information. [FN69]

Furthermore, if the transaction requires the vote of stockholders, the disclosure must be made to the stockholders at least 20 days prior to the vote or the date of the meeting or, if the vote is to be obtained by written stockholder consent, at least 20 days before the action authorized by the consent may be taken or consummated. [FN70]

B. State Corporate Laws

State corporate laws will dictate the specific mechanics required to effect the going private transaction from a state law standpoint.

1. Short-Form Merger

A short-form merger involves a merger of a subsidiary into a parent corporation and may generally be achieved with simple board approval at the parent corporation level, and without shareholder approval, if the parent owns a supermajority of the outstanding common stock (generally, at least 90 percent). [FN71] Both the Texas Business Corporation Act (“TBCA”) [FN72] and the Delaware General Corporate Law (“DGCL”) [FN73] provide a method by which a corporation that owns at least 90 percent of the outstanding shares of each class of stock of another corporation may effect a merger of that subsidiary corporation into itself, or merge itself into that subsidiary corporation, without the approval of the subsidiary's board of directors or stockholders. Under the relevant sections of the TBCA and the DGCL, the short-form merger requires a resolution by the board of directors of the parent company, which must state, *99 assuming that the subsidiary is not wholly-owned by the parent, the terms and conditions of the merger, including the securities, cash, property, or rights to be issued, paid, delivered, or granted by the surviving corporation upon surrender of each share of the subsidiary corporation(s) not owned by the parent corporation. [FN74]

2. Anti-Takeover Statutes

There may also be anti-takeover statutes that prohibit certain transactions between the corporation and an “interested shareholder” for several years after that person first became an interested shareholder. For instance, Part 13 of the TBCA prohibits an “affiliated shareholder” from effecting a “business combination” with an “issuing public” Texas corporation for three years after that person first became an affiliated shareholder of that corporation, unless certain special approvals are obtained. [FN75] A “business combination” is broadly defined and includes any merger that could be part of a going private transaction. [FN76] An “affiliated shareholder” of a Texas corporation is a shareholder who is the beneficial owner of at least 20 percent of the voting stock of the corporation. [FN77] Similarly, Section 203 of the DGCL generally precludes an “interested stockholder” of a Delaware corporation from effecting a “business combination” with the corporation within three years after becoming an interested stockholder, unless certain conditions are met. [FN78] A “business combination” is broadly defined under the DGCL and includes any merger that could be part of a going private transaction. [FN79] An “interested stockholder” of a Delaware corporation is one who owns at least 15 percent of the common stock of the corporation. [FN80]

3. Appraisal Rights

Minority stockholders may have appraisal or dissenter's rights with respect to any merger. Those rights provide statutory protection to ensure that shareholders receive a fair value for their shares. [FN81]

C. Fiduciary Duties and Special Committees

The board of directors of the Target Company facing an offer to take the company private must carefully consider their fiduciary duties and follow the appropriate steps to ensure a successful transaction. Because a significant percentage of going private transactions trigger class action securities litigation, it is important that the board understands its responsibilities and attempts to fulfill them in a manner that will survive intense court scrutiny. [FN82]

***100** In a number of cases, stockholders who wished to remain stockholders of a corporation have sued in an attempt to do so. One of the best known such cases is *Singer v. Magnavox Co.* in which the Delaware Supreme Court ruled that a squeeze-out merger on a cash basis, done for the sole purpose of squeezing out minority stockholders, was “an abuse of the corporate process” for which the minority stockholders had a cause of action. [FN83] Under *Singer*, the legality of such a merger was tested on two bases: (1) its entire fairness to the minority stockholders (which requirement came out of earlier Delaware case law) and (2) whether there was a valid business purpose for the merger. [FN84] After *Singer*, Delaware courts issued a number of opinions honing the *Singer* doctrine. [FN85] Subsequently, the Delaware Supreme Court ruled in *Weinberger v. UOP, Inc.* that the business-purpose requirement of *Singer* would “no longer be of any force or effect.” [FN86] Therefore, directors do not breach their fiduciary duty simply by approving a transaction that squeezes out the minority, even if there is no valid business purpose for the transaction. [FN87]

However, the fairness of the transaction is still relevant. In general, if the Acquiror or its affiliates do not have any significant stock ownership of the Target Company and do not serve as officers or directors of the Target Company, the business judgment rule should apply. [FN88] The business judgment rule requires the plaintiff to bear the burden of proving a breach of fiduciary duty and provides great deference to decisions by disinterested directors of a company who are informed and act in good faith. [FN89] If, on the other hand, the Acquiror is somehow affiliated with the Target Company, the directors who approve such a transaction will, at least initially, have the burden of proving that the transaction was approved in a manner consistent with their duties of loyalty and care and in a manner that negates undue influence of the Acquiror. [FN90] If the Acquiror is affiliated with the Target Company but is not a “controlling” shareholder, approval by disinterested and independent directors or shareholders will generally be protected by the business judgment rule. [FN91] If the Acquiror is a controlling shareholder, the directors will have to prove the “entire fairness” of the transaction. [FN92]

1. Entire Fairness Standard

The entire fairness test is composed of two separate components: “fair price” and “fair dealing.” [FN93] Under the entire fairness review used in *Weinberger*, the court will consider the process that the board followed, the quality of the result it achieved, and the quality of the ***101** disclosures made to the stockholders to allow them to exercise such choices as the circumstances present. [FN94] The *Weinberger* court held that:

The concept of fairness has two basic aspects: fair dealing and fair price. The former embraces questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained. The latter aspect of fairness relates to the economic and financial considerations of the proposed merger, including all relevant factors: assets, market value, earnings,

future prospects, and any other elements that affect the intrinsic or inherent value of a company's stock. . . . However, the test for fairness is not a bifurcated one as between fair dealing and price. All aspects of the issue must be examined as a whole since the question is one of entire fairness. [FN95]

A fair price is a price that a reasonable seller, under all the circumstances, would regard as within a range of fair values--one that such a seller could reasonably accept. [FN96] It is not unusual to obtain an independent appraisal in order to determine the fairness of a price in this context. [FN97]

If a transaction has been approved by an informed majority of the minority stockholders or by a special committee of the board of directors composed solely of disinterested and independent directors, the burden of proof on the issue of fairness may shift from the controlling stockholder to the challenging stockholders. [FN98]

A recent decision by the Delaware Court of Chancery emphasizes the importance of creating the right factual record in connection with a transaction that is subject to review under the entire fairness standard. [FN99] In *In re Cysive, Inc. Shareholders Litigation*, the court ruled in favor of the defendants in finding that the management buy-out transaction proposed by its controlling stockholder satisfied the entire fairness standard. [FN100] Without giving weight to any particular factor over another, the court stressed the following factors that supported a finding of entire fairness: (1) the special committee of independent directors of Cysive used "diligent efforts" and "acted as an effective proxy for arms-length bargaining" with the controlling stockholder; (2) the "absence of any bad faith conduct by [the controlling stockholder] and his willingness to permit the special committee to do its job without pressure from him"; (3) the "extensive market check that preceded and followed the signing of the [acquisition] agreement," which the court found to be "material evidence of the fairness of the deal price"; (4) the "premium that the deal price [represented] to the pre-affected market trading price of Cysive shares and to [Cysive's] liquidation value"; and (5) the presence of an independent *102 board majority. [FN101] The Cysive decision provides helpful guidance with respect to some of the key factors that will support a determination that a buy-out transaction by a controlling shareholder satisfies the Delaware entire fairness standard of review. It also reaffirms a judicial cognizance of the fact that no sale process is perfect, and that flaws need not be fatal if the overall process is carried out in good faith by disinterested and independent directors with an understanding of their duties.

2. Special Committees

The "fair dealing" component of the entire fairness standard refers to the process used to approve the transaction, and not to the ultimate terms reached as a result of that process. [FN102] A special committee of disinterested, independent directors is frequently recognized by courts as a means of satisfying the fair dealing prong of the entire fairness review. [FN103]

Statutory authority also indicates that the primary protective measure a Target Company board should take in a going private transaction is to form a special committee consisting solely of disinterested, independent directors to negotiate the transaction. [FN104] To be disinterested, a director must not be an affiliate or designee of the controlling shareholder or the acquiring management team, or otherwise be "related" to the proposed buyer. [FN105] To be independent, a director must not be " beholden " to the controlling shareholder. [FN106] This committee must have real bargaining and negotiating power on an arm's-length basis. [FN107] The committee also has the duty to approve transactions only if it finds the transactions to be in the best interests of the minority shareholders. [FN108] The use of a special committee of disinterested, independent directors will not be conclusive that the transaction is fair, but courts will view it as strong evidence of fairness. [FN109]

*103 In the event the interested party buyer forgoes negotiation with the Target Company board and simply pursues a

tender offer of the shares it does not already own, courts may not apply the entire fairness standard because the Target Company is not directly involved in the transaction. [FN110] However, the Target Company board still has an affirmative duty to protect the best interests of the company and minority shareholders by acting diligently to hire its own advisors, to provide shareholders with an informed recommendation, and to disclose adequate information for shareholders to make an informed judgment. [FN111] Under these circumstances, it is still strongly recommended that a board form a special committee composed entirely of independent, disinterested directors.

D. Beneficial Ownership Reporting

Section 13(d) of the Exchange Act requires a person who beneficially owns more than 5 percent of a class of equity securities registered under the Exchange Act to disclose certain information via a Schedule 13D to the issuer, to the SEC, and to each exchange on which the security is traded. [FN112]

For purposes of Section 13(d), a person has “beneficial ownership” of a security if the person “directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise, has or shares: (1) [v]oting power which includes the power to vote, or to direct the voting of, such security; and/or (2) [i]nvestment power which includes the power to dispose, or to direct the disposition of, such security.” [FN113]

Also, if a person has a right to acquire beneficial ownership of a security within 60 days after the date of a determination of beneficial ownership is made, that person is deemed to already have beneficial ownership of that security. [FN114]

Schedule 13D is designed to give management of the issuer information concerning potential tender offerors. That information includes (1) the number of shares beneficially owned by the reporting person; (2) the source of funds used to purchase the shares; and (3) any plans of the reporting person to liquidate the issuer, to sell its assets, to engage it in a merger, or to effect any other major change in its structure, if the purpose of the purchase of shares is to acquire control of the issuer. [FN115]

Under Section 13(d), amendments to a Schedule 13D must be filed promptly upon the occurrence of any material change in the disclosed information. [FN116]

*104 E. Disclosure Liability

Because a going private transaction typically involves the purchase and sale of a security, the disclosure made in connection with a going private transaction must be accurate in all material respects and must not omit any material information. [FN117]

In the past, some plaintiffs have alleged, and courts have agreed, that Rule 10b-5 provisions cover not only misstatements and omissions, but also breaches of fiduciary duty, even if there was full and fair disclosure of the transaction. [FN118] However, in the landmark decision of *Green v. Santa Fe Industries, Inc.*, the Supreme Court clarified that Rule 10b-5 requires deception, misrepresentation, or non-disclosure in order to constitute a breach of fiduciary duty by the majority shareholders. [FN119] Further, the Court refused to extend Rule 10b-5 in cases where the minority shareholders have adequate remedies under state law. [FN120]

Nevertheless, distinguishing *Santa Fe*, some courts have found a Rule 10b-5 violation if there was an omission of a fact that would be relevant to a decision by a shareholder whether to sue under state law, regardless of whether the omis-

sion would have affected the investment decision of the shareholder. [FN121] Under this line of cases, the shareholders of a Target Company are entitled to know all the facts that could justify the filing of a state law suit for breach of fiduciary duty. [FN122] In essence, any breach of fiduciary duty is not a violation of Rule 10b-5 per se, but the failure to disclose the breach (or any other action that could give rise to litigation) is a violation of Rule 10b-5. [FN123] Therefore, it is important to be as forthcoming as possible in the disclosure documents. In fact, many of the disclosures that were sought by this line of cases are now mandated by Rule 13e-3. [FN124]

However, in *Virginia Bankshares, Inc v. Sandberg*, the Supreme Court ruled that there is no remedy under the federal securities laws for misleading information given in connection with a transaction if the vote of the minority is not necessary to effect the transaction, unless the misleading information causes the minority to forego their state law rights. [FN125]

*105 F. Antitrust Issues

An advance notification may be required under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, before an acquisition may be consummated. [FN126] A filing is required for any acquisition that involves either the acquisition of (1) at least \$200 million of voting securities and assets or (2) at least \$50 million of voting securities and assets if one party to the transaction is at least a “\$10 million person” and the other is at least a “\$100 million person.” [FN127] There are a number of extremely complicated rules for determining the size of a person, the size of an acquisition, and whether or not a filing is required. [FN128] A fee must be paid upon filing the form of notification. [FN129] The fee is (1) \$45,000 for transactions less than \$100 million; (2) \$125,000 for transactions between \$100 million but less than \$500 million; and (3) \$280,000 for transactions \$500 million or more. [FN130] If a filing is required, the tender offer may not be consummated until the appropriate notifications are filed and 15 days have passed, or 30 days after the Federal Trade Commission and Attorney General receive the receipt of the notification. [FN131]

CONCLUSION

Although enormous benefits can be obtained by going private, the process is extremely complex. Effecting a going private transaction is much like putting a puzzle together. The numerous federal and state laws must be considered and carefully pieced together with the overriding business goals in order to assure that the final product is worth the cost and expense.

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[FN1]. Steven Vazquez & Lance Jon Kimmel, *Increased Financial Costs of Corporate Governance After Sarbanes-Oxley for Florida Public Companies*, Foley & Lardner Study, Sept. 23, 2003, at 10, available at <http://www.foley.com>.

[FN2]. *Id.*

[FN3]. See, e.g., [SEC v. HealthSouth Corp.](#), 261 F. Supp. 2d 1298 (N.D. Ala. 2003).

[FN4]. Bloomberg Press, SEC Vows to Target Directors over Fraud (Aug. 21, 2003), available at http://www.boston.com/business/globe/articles/2003/08/21/sec_vows_to_target_directors_over_fraud (last visited Apr. 7, 2004).

[FN5]. Elaine Buckberg et al., Recent Trends in Securities Class Action Litigation: Will Enron and Sarbanes-Oxley Change the Tides?, NERA Economic Consulting, June 2003, at 5, available at <http://www.nera.com/wwt/publications/6143.pdf>.

[FN6]. Companies Face Mounting Costs as Implementation of Sarbanes-Oxley Provisions Begins, On Board, Aug. 2003, at 1, available at <http://www.hlh.com> (Houlihan Lokey Howard & Zukin's Board Advisory Service).

[FN7]. Securities Analyst Coverage of Small-cap Stocks, The Napeague Letter, Oct. 23, 2002, available at <http://www.napeague.com>.

[FN8]. David A. Stockton et al., Going Private: The Best Option?, Nat'l L.J., June 23, 2003, at 19 (citing statistics compiled by FactSet Research Systems).

[FN9]. Accounting and Investor Protection Issues Raised by Enron and Other Public Companies: Oversight Hearing Before the Senate Comm. on Banking, Hous. & Urban Affairs, 107th Cong. (2002) (statement of The Honorable Roderick M. Hills, Chairman, Securities and Exchange Commission, 1975-77).

[FN10]. 10k Wizard, Global Securities, Inc. Online, at <http://www.tenkwizard.com/files.php?repo=tenk&sdate=20030101&edate=20031231&fg=0&stype=97&ind=-1&&st=1> (last visited Apr. 7, 2004).

[FN11]. 10k Wizard, Global Securities, Inc. Online, at <http://www.tenkwizard.com/files.php?repo=tenk&sdate=20020101&edate=20021231&fg=0&stype=97&ind=-1&&st=1> (last visited Apr. 7, 2004).

[FN12]. Vazquez & Kimmel, *supra* note 1, at 9.

[FN13]. 15 U.S.C. § 78 (2000).

[FN14]. Arthur M. Borden & Joel A. Yunis, *Going Private* §§ 1.02, 3.02 (2003); F. Hodge O'Neal & Robert B. Thompson, *O'Neal's Oppression of Minority Shareholders* §§ 5:04-5:09 (2d ed. 1985 & rev. ch. 1997).

[FN15]. Borden & Yunis, *supra* note 14, at §§ 1.02, 3.02; O'Neal & Thompson, *supra* note 14, at §§ 5:26-5:27.

[FN16]. Borden & Yunis, *supra* note 14, at §§ 1.02, 3.02; O'Neal & Thompson, *supra* note 14, at §§ 5:10-5:11.

[FN17]. Borden & Yunis, *supra* note 14, at §§ 1.02, 3.02; O'Neal & Thompson, *supra* note 14, at §§ 5:15-5:21.

[FN18]. Harvey L. Pitt et al., Tender Offers: Offensive and Defensive Tactics and the Business Judgment Rule, in 1 *Contests for Corporate Control* 7, 590-91 (Co-Chairman Dennis J. Block & Harvey L. Pitt, PLI Corp. Law Practice Course, Handbook Series No. 730, 1991).

[FN19]. [Great W. United Corp. v. Kidwell](#), 577 F.2d 1256, 1261 n.2 (5th Cir. 1978).

[FN20]. 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (2000); see [Kidwell](#), 577 F.2d at 1276-77 (stating that the primary purpose

is to ensure shareholders receive sufficient information so that they can make an informed decision).

[FN21]. 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (2000); see also *Kidwell*, 577 F.2d at 1261 n.3.

[FN22]. 15 U.S.C. § 78n(d)(1) (2000).

[FN23]. 17 C.F.R. § 240.14d-1 (2003).

[FN24]. *Id.* § 240.14d-2(b)(2).

[FN25]. *Id.*

[FN26]. *Id.* § 240.14d-2(a).

[FN27]. *Id.*

[FN28]. *Id.* § 240.14d-4.

[FN29]. 17 C.F.R. § 240.14d-4(a)(3)(i) (2003).

[FN30]. *Id.* § 240.14d-3.

[FN31]. *Id.* § 240.14d-4.

[FN32]. *Id.* § 240.14d-4(c).

[FN33]. *Id.* § 240.14d-5.

[FN34]. *Id.* § 240.14d-5(a)(3).

[FN35]. 17 C.F.R. § 240.14d-5(c) (2003).

[FN36]. *Id.* § 240.14d-11.

[FN37]. *Id.* § 240.14d-7.

[FN38]. *Id.* § 240.14d-7(a)(2).

[FN39]. *Id.* § 240.14d-8.

[FN40]. 1 Martin Lipton & Erica H. Steinberger, *Takeovers and Freezeouts* § 1.08 (Law Journal Press 2003) (1978).

[FN41]. 15 U.S.C. § 78n(d)(7) (2000).

[FN42]. *Id.* § 78n(e).

[FN43]. 17 C.F.R. § 240.14e-8 (2003).

[FN44]. *Id.* § 240.14e-2.

[FN45]. *Id.* § 240.14e-2(a).

[FN46]. Id. § 240.14e-2(a)(1)-(3).

[FN47]. Id. § 240.14e-2(b).

[FN48]. Id. § 240.14e-1(a).

[FN49]. 17 C.F.R. § 240.14e-1(b) (2003).

[FN50]. Id. § 240.14e-1(d).

[FN51]. Id. § 240.14e-3(a).

[FN52]. Id. § 240.14e-5.

[FN53]. Id. § 240.14e-5(c)(3).

[FN54]. Id. § 240.14e-5(a).

[FN55]. 17 C.F.R. § 240.14f-1 (2003).

[FN56]. Id. § 240.13e-3.

[FN57]. Id. § 240.13e-4.

[FN58]. Id. § 240.13e-3.

[FN59]. Id.

[FN60]. Id.

[FN61]. 17 C.F.R. § 240.13e-3(d) (2003).

[FN62]. Id. § 240.13e-100.

[FN63]. Id.

[FN64]. Id. § 240.13e-3.

[FN65]. Id. § 240.13e-3(c)(2).

[FN66]. Id. § 240.13e-3(e)(5).

[FN67]. 17 C.F.R. § 240.13e-3 (2003).

[FN68]. Id. § 240.13e-3(e).

[FN69]. Id. § 240.13e-3(d)(2).

[FN70]. Id. § 240.13e-3(f).

[FN71]. 19 Am. Jur. 2d Corporations § 2613 (2003).

[FN72]. Tex. Bus. Corp. Act Ann. art. 5.16 (Vernon Supp. 2004).

[FN73]. Del. Code Ann. tit. 8, § 253 (2003).

[FN74]. Tex. Bus. Corp. Act Ann. art. 5.16 (Vernon Supp. 2004); Del. Code Ann. tit. 8, § 253 (2003).

[FN75]. Tex. Bus. Corp. Act Ann. art. 13.03 (Vernon 2003).

[FN76]. Id.

[FN77]. Id.

[FN78]. Del. Code Ann. tit. 8, § 203(a) (2003).

[FN79]. Id.

[FN80]. Id.

[FN81]. Id. § 262.

[FN82]. *Temple v. Combined Props. Corp.*, 410 A.2d 1375, 1379 (Del. Ch. 1979).

[FN83]. *Singer v. Magnavox Co.*, 380 A.2d 969, 980 (Del. 1977).

[FN84]. Id. at 975-76.

[FN85]. See, e.g., *Tanzer v. Int'l Gen. Indus., Inc.*, 379 A.2d 1121 (Del. 1977); *Roland Int'l Corp. v. Najjar*, 407 A.2d 1032 (Del. 1979).

[FN86]. *Weinberger v. UOP, Inc.*, 457 A.2d 701, 715 (Del. 1983).

[FN87]. Id.

[FN88]. *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984).

[FN89]. Id.

[FN90]. Id. at 812-13; *In re Cysive, Inc. S'holders Litig.*, 836 A.2d 531, 548-49 (Del. Ch. 2003).

[FN91]. *Solomon v. Armstrong*, 747 A.2d 1098, 1117 (Del. Ch. 1999).

[FN92]. *Kahn v. Lynch Communications Sys., Inc.*, 638 A.2d 1110, 1115 (Del. 1994).

[FN93]. *Weinberger v. UOP, Inc.*, 457 A.2d 701, 711 (Del. 1983).

[FN94]. Id.

[FN95]. Id.

[FN96]. *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1134, 1143 (Del. Ch. 1994).

[FN97]. *Id.*

[FN98]. See, e.g., *Kahn v. Lynch Communications Sys., Inc.*, 638 A.2d 1110, 1116-17 (Del. 1994).

[FN99]. *In re Cysive, Inc. S'holders Litig.*, 836 A.2d 531, 553 (Del. Ch. 2003).

[FN100]. *Id.*

[FN101]. *Id.* at 534.

[FN102]. *Solomon v. Armstrong*, 747 A.2d 1098, 1112 (Del. Ch. 1999).

[FN103]. See, e.g., *Orman v. Cullman*, 794 A.2d 5 (Del. Ch. 2002); *Clements v. Rogers*, 790 A.2d 1222 (Del. Ch. 2001); *Chaffin v. GNI Group, Inc.*, No. CIV.A.16211-NC, 1999 WL 721569 (Del. Ch. Sept. 3, 1999); *In re Resorts Int'l S'holders Litig. Appeals*, 570 A.2d 259 (Del. 1990); *In re RJR Nabisco, Inc. S'holders Litig.*, No. CIV.A.10389, 1989 WL 7036 (Del. Ch. Jan. 31, 1989).

[FN104]. Del. Code Ann. tit. 8, § 144(a)(1)-(2) (2003) (stating that a merger is not voidable if approved either by a majority of disinterested directors or a majority of disinterested stockholders).

[FN105]. *Seminaris v. Landa*, 662 A.2d 1350, 1354 (Del. Ch. 1995) (“A director is interested if he will be materially affected, either to his benefit or detriment, by a decision of the board, in a manner not shared by the corporation and the stockholders. The ‘mere threat’ of personal liability in the derivative action does not render a director interested; however, a ‘substantial likelihood’ of personal liability prevents a director from impartially considering a demand.”); see also *Pogostin v. Rice*, 480 A.2d 619, 624 (Del. 1984) (“Directorial interest exists whenever divided loyalties are present, or a director either has received, or is entitled to receive, a personal financial benefit from the challenged transaction which is not equally shared by the stockholders.”).

[FN106]. *In re Cysive*, 836 A.2d at 535; see also *Aronson v. Lewis*, 473 A.2d 805, 816 (Del. Ch. 1984) (“Independence means that a director’s decision is based on the corporate merits of the subject before the board rather than extraneous considerations or influences.”).

[FN107]. *Kahn v. Lynch Communications Sys., Inc.*, 638 A.2d 1110, 1115 (Del. 1994).

[FN108]. Although the fiduciary duty is owed to all shareholders, the controlling shareholder, as the typical advocate of the transaction, is unlikely to believe the transaction to be unfair. *In re Cysive*, 836 A.2d at 548-49.

[FN109]. *Rabkin v. Philip A. Hunt Chem. Corp.*, 498 A.2d 1099, 1106 (Del. 1985).

[FN110]. *In re Pure Res., Inc. S'holders Litig.*, 808 A.2d 421, 443-44 (Del. Ch. 2002).

[FN111]. *Sealy Mattress Co. of N.J., Inc. v. Sealy, Inc.*, 532 A.2d 1324, 1338 (Del. Ch. 1987) (holding that, in the event of a proposed merger, directors have a fiduciary obligation to disclose to shareholders all material facts in an atmosphere of complete candor); see also *Smith v. Van Gorkom*, 488 A.2d 858, 872 (Del. 1985) (holding that directors must proceed with a critical eye in assessing information related to a proposed merger).

[FN112]. 15 U.S.C. § 78m(d)(1) (2000).

[FN113]. 17 C.F.R. § 240.13d-3(a) (2003).

[FN114]. *Id.* § 240.13d-3(d).

[FN115]. 15 U.S.C. § 78m(d)(1) (2000).

[FN116]. *Id.* § 78m(d)(2).

[FN117]. *Id.* § 78(j); 17 C.F.R. § 240.10b-5 (2003).

[FN118]. See, e.g., *Green v. Santa Fe Indus., Inc.*, 533 F.2d 1283 (2d Cir. 1976), rev'd, 430 U.S. 462 (1977); *Schoenbaum v. Firstbrook*, 405 F.2d 215 (2d Cir. 1968), cert. denied sub nom., *Manley v. Schoenbaum*, 395 U.S. 906 (1969).

[FN119]. *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 476 (1977).

[FN120]. *Id.* at 478-80.

[FN121]. See, e.g., *SEC v. Parklane Hosiery Co.*, 558 F.2d 1083, 1086, 1088 (2d Cir. 1977) (affirming liability where principal shareholder failed to disclose to minority shareholder purpose of proposed merger--which was found to be to repay his personal debts--and this information could have been used by minority shareholders to attempt to enjoin proposed merger under state law).

[FN122]. *Id.* at 1088.

[FN123]. *SEC v. Zandford*, 535 U.S. 813, 825 n.4 (2002).

[FN124]. 15 U.S.C. § 78m(e)(1) (2000); 17 C.F.R. § 240.13e-3 (2003).

[FN125]. *Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1107-08 (1991) (declining to address whether minority shareholders still have a state law remedy if they voted for the merger in reliance on misleading statements).

[FN126]. *Wilson v. Great Am. Indus., Inc.*, 979 F.2d 924, 931 (2d Cir. 1992) (holding that minority shareholders who lacked sufficient voting power could maintain a claim of misrepresentation due to loss of state rights).

[FN127]. 15 U.S.C. § 18a(a)(2) (2000).

[FN128]. 16 C.F.R. §§ 801-03 (2003).

[FN129]. 15 U.S.C. § 18a(a) (2000); 16 C.F.R. § 803.9 (2003).

[FN130]. 15 U.S.C. § 18a(a) (2000); 16 C.F.R. § 803.9 (2003).

[FN131]. 15 U.S.C. § 18a(b)(1) (2000).

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