

# Hand-Waving as a New Standard of Review: When Analyzing Matching Rights, has the Delaware Court of Chancery Abdicated its Review Process?

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## ABSTRACT

Deal protections have become increasingly popular in corporate merger agreements over the past decade, and they have also become increasingly more varied. One of the more popular deal protection measures is a matching right that enables an accepted bidder to match any subsequent bid that comes in. It is virtually ubiquitous in modern deals. Such ubiquity has led to potential problems. When Delaware courts review challenges to deal protection measures they are supposed to use an intermediate standard of review. Instead, however, the Delaware Court of Chancery appears to be subjecting matching rights to nothing more than a cursory glance, which stands in stark contrast to how the court treats other deal protection measures.

This Comment discusses that appearance of permissiveness. In addition, this Comment discusses the proper standard of review for deal protection measures and analyzes how courts ought to review deal protection measures. Finally, this Comment suggests a reason for the alleged permissiveness and discusses a solution that will enable Delaware courts to properly review challenges to matching rights.

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## I. INTRODUCTION

Over the past decade, corporate merger agreements have become replete with deal protections in what scholars have called “lock-up creep.”<sup>1</sup> Some defensive measures have become so prevalent that Delaware courts have “started to refer to [them] as ‘standard merger terms.’”<sup>2</sup> Not only have deal protection measures become increasingly popular, but they have also become more creative and varied.<sup>3</sup> One of the more popular new deal protection measures is a matching right that allows the holder of the right to maintain its deal by matching a third party’s higher bid.<sup>4</sup>

When deal protection measures are challenged, Delaware courts are supposed to analyze them to ensure the corporate board that used the measures did not breach any of their duties.<sup>5</sup> The analyzing court is required to use a non-deferential standard of review in its analysis of the deal protection measures.<sup>6</sup> However, at least one scholar has suggested that the Delaware Court of Chancery “ha[s] adopted a . . . permissive posture with respect to matching rights.”<sup>7</sup> In other words, the court has

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1. Steven Davidoff & Christina Sautter, *Lock-Up Creep*, 38 J. CORP. L. 681, 681 (2013) (describing lock-up creep as the phenomenon where the “number and type of merger agreement lock-ups have materially increased”).

2. J. Travis Laster, *Revlon is a Standard of Review: Why It’s True and What it Means*, 19 FORDHAM J. CORP. & FIN. L. 5, 35 (2013) (footnote omitted).

3. See Davidoff & Sautter, *supra* note 1, at 682.

4. See *id.*; see *infra* notes 37–41 and accompanying text for a description of matching rights.

5. See discussion *infra* Part II.B.

6. See discussion *infra* Part II.B.

7. Brian JM Quinn, *Re-evaluating the Emerging Standard of Review for Matching Rights in Control Transactions*, 36 DEL. J. CORP. L. 1011, 1013 (2011) [hereinafter Quinn, *Re-evaluating the Standard*].

allegedly not used the proper standard of review when dealing with challenges to matching rights.

This Comment addresses the perceived permissive posture by the Chancery Court and provides a potential solution. Part II will offer a background of deal protections,<sup>8</sup> the current scholarship surrounding their use,<sup>9</sup> and the standard of review that Delaware courts have developed to analyze challenges to deal protection measures.<sup>10</sup> Part III will analyze Delaware Court of Chancery opinions issued since Professor Quinn's 2011 article,<sup>11</sup> which incorrectly analyzed the permissiveness issue, and discuss potential reasons behind the alleged permissiveness.<sup>12</sup> Part III will then suggest that the Court of Chancery is not being overly permissive, but rather lacks a sufficient framework to analyze matching rights properly and, absent such a framework, can only look to precedent.<sup>13</sup> To solve that problem, this Comment will propose that empiricists should perform a detailed economic analysis of matching rights to assist the court in future determinations.<sup>14</sup>

## II. BACKGROUND

### A. *Deal Protection Measures*

Matching rights are a type of deal protection measure,<sup>15</sup> so to understand matching rights it is useful to first understand deal protection measures generally. Deal protection measures<sup>16</sup> can be placed into one of three categories: “voting protections, exclusivity measures, and compensatory devices.”<sup>17</sup> Deal protection measures function either as wards against third party interference in friendly deals or as defensive

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8. See discussion *infra* Part II.A.

9. See discussion *infra* Part II.A.

10. See discussion *infra* Part II.B.

11. See Quinn, *Re-evaluating the Standard*, *supra* note 7.

12. See discussion *infra* Part III.A.1.

13. See discussion *infra* Part III.A.2.

14. See discussion *infra* Part III.B.

15. See *infra* notes 37–41 and accompanying text.

16. “Lock-ups,” “deal protections,” “defensive devices,” and “deal protection measures” are all terms that are used interchangeably. See, e.g., *Revlon, Inc. v. Macandrews & Forbes Holdings, Inc.*, 506 A.2d 173, 176 (Del. 1986) (lock-ups); *Omnicare, Inc. v. NCS Healthcare, Inc.*, 818 A.2d 914, 934 (Del. 2003) (“Defensive devices . . . is a synonym for what are frequently referred to as ‘deal protection devices.’ Both terms are used interchangeably to describe any measure . . . intended to protect the [deal]”); Marcel Kahan & Michael Klausner, *Lockups and the Market for Corporate Control*, 48 STAN. L. REV. 1539, 1541–42 (1996) (lock-up); Brian JM Quinn, *Bulletproof: Mandatory Rules for Deal Protection*, 32 J. CORP. L. 865, 866 n.2 (2007) (describing different terms) [hereinafter Quinn, *Bulletproof*]. However “stock lockup” is a specific type of deal protection measure. See *infra* note 27.

17. Quinn, *Bulletproof*, *supra* note 16, at 868.

measures by inducing white knight<sup>18</sup> bidders in attempts to defeat or prevent hostile tender offers.<sup>19</sup>

Voting protections deal with voting agreements that are acquired by the seller's board of directors ("board") to protect the board's preferred deal.<sup>20</sup> While it is easier for the board of a closely held corporation<sup>21</sup> to secure such voting agreements because of the limited number of shareholders, a public corporation may have a small number of shareholders that hold a large enough percentage of shares to make such protections attractive even in deals involving public corporations.<sup>22</sup> A common voting protection measure is a "'force-the-vote' provision that requires boards to call [a vote on the initial transaction] prior to terminating a merger agreement[.]"<sup>23</sup> This vote can occur regardless of whether the board recommends the transaction or not.<sup>24</sup>

Compensatory devices are measures that provide some measure of compensation to the initial successful bidder while simultaneously deterring other bidders.<sup>25</sup> Common compensatory devices include "[s]tock lockups, termination fees, and topping fees[.]"<sup>26</sup> A stock lockup is an agreement that allows a bidder to purchase the target company's

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18. Melissa J. Rhodes, *The White Knight Privilege in Litigated Takeovers: Leveling the Playing Field in Discovery*, 43 STAN. L. REV. 445, 445 n.1 (1991) (defining a "white knight" as "a bidder seen as friendlier by the management of the target company than the unsolicited outside bidder").

19. See Kahan & Klausner, *supra* note 16, at 1541–42. A tender offer is an attempt to gain a controlling interest in a corporation through an offer to purchase shares of the corporation. See Jo Hackl and Rosa Testani, *Second Generation State Takeover Statutes and Shareholder Wealth: An Empirical Study*, 97 YALE L.J. 1193, 1193 n.1 (1988). A hostile tender offer is one in which a corporation is attempting to takeover another corporation without approval from the target corporation's board of directors. See 1-5E ELEANOR FOX & BYRON FOX, CORPORATE ACQUISITIONS AND MERGERS § 5E.01 (Matthew Bender 2016).

20. See Quinn, *Bulletproof*, *supra* note 16, at 868.

21. A closely held corporation has a limited number of shareholders, no market for its shares, and significant day-to-day control exercised by majority shareholders. See *Donahue v. Rodd Electrotype Co.*, 328 N.E.2d 505, 511 (Mass. 1975). For a background on Delaware-specific aspects of closely held corporations, see generally Robert Ragazzo, *Toward a Delaware Common Law of Closely Held Corporations*, 77 WASH. U. L. Q. 1099 (1999).

22. See Quinn, *Bulletproof*, *supra* note 16, at 868–69. See generally *Omnicare, Inc. v. NCS Healthcare, Inc.*, 818 A.2d 914 (Del. 2003) (dealing with a corporation where two shareholders controlled a majority of the voting shares).

23. Quinn, *Bulletproof*, *supra* note 16, at 869.

24. See *id.* at 869 n.11; see also DEL. CODE ANN. tit. 8, § 251(c) (2017) (allowing a vote without board recommendation). This can theoretically allow the spurned buyer to close the deal anyway if it can convince enough shareholders to vote for the deal. See R. Franklin Balotti & A. Gilchrist Sparks, III, *Deal-Protection Measures and the Merger Recommendation*, 96 NW. U.L. REV. 467, 473 (2002).

25. See Quinn, *Bulletproof*, *supra* note 16, at 871.

26. *Id.*

stock after a specified event occurs, like the termination of the deal.<sup>27</sup> This is beneficial to the initial bidder because it increases the number of shares that a subsequent bidder will need to purchase by increasing the number of shares on the market,<sup>28</sup> while providing a premium to the initial bidder because the price paid is the original bid price.<sup>29</sup> By way of illustration, suppose company T had 100 outstanding shares and bidder A gave a bid of \$10. The total deal value would be \$1,000. If bidder A had a stock lockup that enabled it to purchase up to 10 shares and bidder B made a subsequent bid of \$11 that was accepted, then bidder A would purchase 10 shares for \$10. There would now be 110 shares outstanding, so the deal value would be \$1,210 ( $\$11 * 110$  shares). Without the stock lockup, the deal value would be \$1,100 ( $\$11 * 100$  shares); so the stock lockup costs bidder B an additional \$110 while bidder A would be paid \$11 per share when the deal closed (a premium of \$1 per share) for a profit of \$10 to compensate it for the lost deal. Termination fees and topping fees are cash payments made to the initial bidder based upon certain triggering events: a termination fee when the deal is terminated and a topping fee when the seller accepts a higher competing bid (i.e., accepts a topping bid).<sup>30</sup> Economically, from the perspective of later bidders, a compensatory device can be seen “as a tax on its bid.”<sup>31</sup>

An exclusivity measure is one designed to inhibit the board of the selling corporation from dealing with rival bidders.<sup>32</sup> The most common exclusivity measures are “no-shop and no-talk provisions[.]”<sup>33</sup> A no-shop provision, also known as a “no-solicitation” measure or a “window shop” provision, prevents the seller’s board from attempting to find another buyer but does not prevent the board from responding to unsolicited bids.<sup>34</sup> A no-talk provision limits the responses that the selling board can make to subsequent bidders, so that the board cannot share any information that is non-public.<sup>35</sup> The combination of a no-talk

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27. *See id.* For an example of a deal with a stock lockup option, see *Paramount Comm’ns v. QVC Network*, 637 A.2d 34, 39 (Del. 1994).

28. The shares that the holder of the lockup purchases are either “treasury shares [] or authorized but unissued shares.” Timothy Burch, *Locking out rival bidders: The use of lockup options in corporate mergers*, 60 J. FIN. ECON. 103, 108 (2001).

29. *See id.* Since a stock lockup only kicks in when a higher subsequent bid is accepted, it necessarily means that the price the initial bidder pays for the agreed upon shares is lower than the final sale price. *See id.* for more details on stock lockups.

30. *See Quinn, Bulletproof, supra* note 16, at 871.

31. *Id.*

32. *See id.* at 869.

33. *Id.*

34. *See id.*

35. *See id.* at 869–70.

and no-shop provision effectively “starv[es] a subsequent bidder of the information required to generate a competitive bid.”<sup>36</sup>

Another exclusivity measure used to limit subsequent bids, which is the focus of this Comment, is a matching right.<sup>37</sup> A matching right grants the holder the right to match any new bid that comes in, which could cause a subsequent bidder to incur the cost of the bid<sup>38</sup> without the benefit of its superior bid being accepted.<sup>39</sup> Matching rights are “intended to [] deter second bidders” or to make sure that “the initial bidder [is] advantageously positioned to succeed in completing the acquisition.”<sup>40</sup> The importance and perceived utility of matching rights is underscored by the fact that they are “ubiquitous terms in merger agreements.”<sup>41</sup>

Theoretically, deal protections work because it costs money to make a bid,<sup>42</sup> and deal protection measures increase those costs only for subsequent bidders without foreclosing substantially better bids.<sup>43</sup> The increased cost caused by deal protection measures can impact the amount that a subsequent bidder is willing to pay for the target corporation.<sup>44</sup> While deal protections are useful, there is a potential pitfall. If the boards of selling organizations are tasked with finding the highest bidder, then a deal protection that deters multiple bidders is problematic.<sup>45</sup> It is therefore of critical importance that the courts properly review deal protections to promote wealth maximization.

## B. *Proper Standard of Review*

### 1. *From Unocal to Revlon*

As a general rule, Delaware courts give broad deference to actions taken by corporate boards through the business judgment rule.<sup>46</sup> It is

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36. *Id.* at 870.

37. *See id.*

38. For a discussion of bid costs, see *infra* note 42.

39. *See infra* note 42.

40. Quinn, *Re-evaluating the Standard*, *supra* note 7, at 1012.

41. *Id.* at 1015.

42. *See* Kahan & Klausner, *supra* note 16, at 1547. Costs are significant enough that failing bids can lead to significant stock declines for the failing bidder. *Id.* at 1547 n.25.

43. *See id.* at 1544.

44. *See* Quinn, *Bulletproof*, *supra* note 16, at 867. Because of the cost of making a bid, the bidder will only bid if after-acquisition profit is enough to justify the cost of the bid. For a more detailed economic analysis of how deal protection measures can impact acquisitions, see Kahan & Klausner, *supra* note 16, at 1547–48.

45. *See infra* notes 53–62 and accompanying text.

46. *See* Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984), *overruled on other grounds* by Brehm v. Eisner, 746 A.2d 244 (2000) (defining the business judgment rule as “a presumption that in making a business decision the directors of a corporation acted

important to note that the business judgment rule does not mean that judicial deference to corporate board action is absolute.<sup>47</sup> When a board adopts deal protection measures, the measures “must be reasonable in relation to the threat posed” in order to qualify for judicial deference under the business judgment rule.<sup>48</sup> The Supreme Court of Delaware adopted a reasonableness rule in *Unocal Corporation v. Mesa Petroleum Co.*<sup>49</sup> when dealing with a novel deal protection measure involving a board’s attempt to block a hostile tender offer.<sup>50</sup> The court noted that the board had presumptive power to act because of the “fundamental duty and obligation” of a corporate board “to protect the corporate enterprise, which includes stockholders, from harm reasonably perceived.”<sup>51</sup>

The *Unocal* decision formed the foundation for subsequent reviews of defensive measures used by corporate boards.<sup>52</sup> At first glance it would not appear that *Unocal*, which focused upon defensive measures, is relevant to a discussion of matching rights (or deal protections in general). However, deal protections can also be used as defensive measures.<sup>53</sup>

Following *Unocal*, the court in *Revlon, Inc. v. Macandrews & Forbes Holdings, Inc.*<sup>54</sup> dealt with the defensive use of deal protections. The underlying dispute in *Revlon* was simple: the board of Revlon defensively used various measures to deal with a hostile takeover threat by Pantry Pride.<sup>55</sup> In *Revlon*, the court made it explicit that the Revlon board’s defensive use of deal protections to induce a “white knight”

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on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company”).

47. See *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954 (Del. 1985) (allowing for a judicial review of board actions taken during takeover negotiations “[b]ecause of the omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders” before the business judgment rule protections cover the board).

48. *Id.* at 955.

49. *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985).

50. In *Unocal*, the board attempted to block a hostile tender offer by Mesa by making a self-tender of its own shares, but excluding Mesa from the self-tender offer. See *id.* at 951.

51. *Id.* at 954.

52. See *Unitrin, Inc. v. Am. Gen. Corp. (In re Unitrin, Inc.)*, 651 A.2d 1361, 1373 (Del. 1995) (“The common law pronouncement in *Unocal* of enhanced judicial scrutiny, as a threshold or condition precedent to an application of the traditional business judgment rule, is now well known.”).

53. See, e.g., *Revlon, Inc. v. Macandrews & Forbes Holdings, Inc.*, 506 A.2d 173, 177 (Del. 1986) (dealing with a company using deal protections to induce a third party to bid in order to overcome a hostile takeover bid). For a general background on the defensive use of deal protections, see Kahan & Klausner, *supra* note 16, at 1551–64.

54. *Revlon, Inc. v. Macandrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986).

55. See *id.* at 176–79.

bidder was “a recognition that the company was for sale.”<sup>56</sup> Once a company is for sale, the board’s sole focus and goal should be to “sell [the corporation] to the highest bidder”<sup>57</sup> which at that point was Pantry Pride.

The Revlon directors initially used two different defensive measures to protect against the hostile offer by Pantry Pride: a poison-pill rights plan<sup>58</sup> and a self-tender offer similar to that employed in *Unocal*.<sup>59</sup> With respect to both defensive measures, the court used “the fiduciary standards outlined in *Unocal*” to analyze the board’s actions and found that “the [Revlon] board acted in good faith, and on an informed basis.”<sup>60</sup> After Pantry Pride increased its offer, the board gave authorization to the management to try to negotiate a deal with a third party (i.e. to find a “white knight” bidder).<sup>61</sup> The court asserted that it was at this point that the board had put the company up for sale because the board’s focus had shifted from blocking the takeover to selling to a preferred party.<sup>62</sup> As a result, the board’s duty shifted to one of bid maximization.<sup>63</sup>

Bid maximization does not entirely preclude attempts to induce third party bidders, as the court acknowledged the economic reality that some “white knight” bidders may only be induced to bid by “some form of compensation to cover the risks and costs involved.”<sup>64</sup> In fact, Revlon’s board was successful in inducing a third party bid through the offering of several deal protections including a no-shop provision and the right to purchase certain assets at \$100–175 million below market value if another bidder acquired more than 40 percent of Revlon’s shares.<sup>65</sup> The court held that while deal protection measures are not *per se* illegal in Delaware, they are not allowed when motivated by something other than bid maximization and result in “the ultimate detriment of [a corporation’s] shareholders.”<sup>66</sup>

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56. *Id.* at 182.

57. *Id.*; see also *Mills Acquisition Co. v. MacMillan, Inc.*, 559 A.2d 1261, 1288 (Del. 1989) (“We stated in *Revlon*, and again here, that in a sale of corporate control the responsibility of the directors is to get the highest value reasonably attainable for the shareholders.”).

58. A poison pill, or shareholder rights plan, “dilute[s] a hostile bidder’s stake massively if the bidder acquires more than a specific percentage of target stock.” Albert Saulsbury, *The Availability of Takeover Defenses and Deal Protection Devices for Anglo-American Target Companies*, 37 DEL. J. CORP. L. 115, 137 n.152 (2012).

59. See *Revlon*, 506 A.2d at 180–81.

60. *Id.* at 181.

61. See *id.* at 182.

62. See *id.*

63. See *id.*

64. *Id.* at 183.

65. See *id.* at 178.

66. *Id.* at 185.

The underlying concern behind both the *Unocal* and *Revlon* decisions is that a corporate board might have different motivations and interests than that of the stockholders.<sup>67</sup> The Delaware courts made a conscious decision to “adopt[] a middle ground”<sup>68</sup> between the business judgment rule<sup>69</sup> (representing extreme deference to the board’s actions) and entire fairness review<sup>70</sup> (representing extreme skepticism of the board’s actions). The middle ground is the enhanced scrutiny test where “the extent of judicial deference . . . narrows from rationality to range-of-reasonableness.”<sup>71</sup>

## 2. Evolution of the Enhanced Scrutiny Test and the Application in Non-matching Rights Contexts

The Supreme Court of Delaware had a chance to apply the *Unocal-Revlon* enhanced scrutiny<sup>72</sup> standard in *Paramount Communications v. QVC Network*.<sup>73</sup> In doing so, the Court created a two-step test for future courts:

- (a) a judicial determination regarding the adequacy of the decisionmaking process employed by the directors, including the information on which the directors based their decision; and
- (b) a judicial examination of the reasonableness of the directors’ action in light of the circumstances then existing. The directors have the burden of proving that they were adequately informed and acted reasonably.<sup>74</sup>

The court has to decide whether the directors’ actions were reasonable, as opposed to perfect, and courts are not to “substitute their business judgment for that of the directors,” but rather to discern whether the board’s “decision was, on balance, within a range of

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67. See *In re Dollar Thrifty S’holder Litig.*, 14 A.3d 573, 597 (Del. Ch. 2010).

68. *Id.*; see also *id.* at 598 n.175 (providing more background on the adoption of a middle ground test).

69. See *supra* note 46 and accompanying text.

70. See *In re Dollar Thrifty*, 14 A.3d at 597 (“[E]ntire fairness review reflect[s] a policy of extreme skepticism toward self-dealing decisions”); see also *Weinberger v. UOP*, 457 A.2d 701, 711 (Del. 1983) (describing entire fairness review and its application).

71. Laster, *supra* note 2, at 6.

72. While the Delaware courts refer to this as enhanced scrutiny, some scholars refer to this as an intermediate standard of review. See, e.g., Quinn, *Re-evaluating the Standard*, *supra* note 7, at 1012.

73. *Paramount Commc’ns v. QVC Network*, 637 A.2d 34, 36 (Del. 1994) (“[W]e hold that the sale of control in this case . . . implicates enhanced judicial scrutiny of the conduct of the Paramount Board under *Unocal* . . . and *Revlon*”).

74. *Id.* at 45.

reasonableness.”<sup>75</sup> This suggests that residual vestiges of the business judgment rule are lurking in the enhanced scrutiny test, which raises the question of whether *Paramount*, despite the actual claim of enhanced scrutiny, actually stands for the idea that the business judgment rule protects boards who lock up a friendly deal against subsequent bidders.<sup>76</sup> In other words, the actual standard applied might be less strict than the enhanced scrutiny test would require.

The *Paramount* court, in determining whether the Paramount board breached its *Revlon* duties,<sup>77</sup> based its analysis upon the framework laid out in an earlier case: *Unitrin, Inc. v. American General Corporation*.<sup>78</sup> The court in *Unitrin* noted that the enhanced scrutiny test should not “lead to a structured, mechanistic, mathematical exercise.”<sup>79</sup> To emphasize that point, the *Unitrin* court pointed out the fallacy behind attempts to turn the “inherently qualitative proportionality test” into “a quantitative formula.”<sup>80</sup> Instead, the test “is a flexible paradigm”<sup>81</sup> that can be applied to the wide range of situations that a corporate board faces.

In applying the flexible paradigm, the *Paramount* court laid out the requirements for the board:<sup>82</sup> the Paramount board needed to critically evaluate “all material aspects of the . . . transaction (separately and in the aggregate)” to determine if they “were reasonable and in the best interests of the Paramount stockholders[.]”<sup>83</sup> Further, the board was obliged to determine whether the deal provisions both individually and together among other things “adversely affected the value provided to the Paramount stockholders[.]”<sup>84</sup> or either prevented or encouraged other bids. The court then determined that the deal protections, including a

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75. *Id.*

76. See Quinn, *Bulletproof*, *supra* note 16, at 873 n.28. However, the fact that the Delaware Supreme Court ruled against the Paramount board suggests that this might be a faulty reading. See *Paramount*, 637 A.2d at 51 (describing the board’s process as “deficient”)

77. See *supra* note 62 and accompanying text. But see Laster, *supra* note 2 at 6–7 for a discussion on why “*Revlon* duties” may not be an accurate phrase and *Revlon* is better understood to be a standard of review only.

78. *Unitrin, Inc. v. Am. Gen. Corp. (In re Unitrin, Inc.)*, 651 A.2d 1361 (Del. 1995).

79. *Id.* at 1373.

80. *Id.* at 1373 n.13 (laying out a sample mathematical formula with many different terms and then noting that only one of the terms is “precisely known[.]” whereas the other terms “may only be approximated”).

81. *Id.* at 1373.

82. This guidance is useful for future boards to the extent that they look to the courts for dealing with potential deals. See *Saulsbury*, *supra* note 58, at 120; see also *infra* note 106 and accompanying text.

83. *Paramount Commc’ns v. QVC Network*, 637 A.2d 34, 48 (Del. 1994).

84. *Id.*

stock option agreement, termination fees, and no-shop provisions, were unreasonable and a breach of the board's *Revlon* duties.<sup>85</sup>

Almost a decade later the Delaware Supreme Court had the opportunity to explore a situation where the deal protections were severe enough to constitute a bulletproof deal.<sup>86</sup> In *Omnicare, Inc. v. NCS Healthcare, Inc.*,<sup>87</sup> the court dealt with a merger agreement between NCS, the seller, and Genesis, the buyer, which had two agreements: a "call the vote" agreement and a voting agreement.<sup>88</sup> The voting agreement required that the two largest NCS shareholders, who controlled a majority of the voting shares, agree to vote in favor of the merger.<sup>89</sup> The *Omnicare* court reiterated the fact that deal protection measures are reviewed under enhanced scrutiny.<sup>90</sup> The court further explained the range of reasonableness from *Paramount*, noting that a board needs "latitude in discharging its fiduciary duties to the corporation and its shareholders when defending against perceived threats. The concomitant requirement is for judicial restraint."<sup>91</sup> The court noted that the reason Genesis insisted upon the deal protections was that "it feared that Omnicare would make a superior merger proposal."<sup>92</sup>

Genesis' motive reveals the tension in how the law handles deal protections. On the one hand, a bidder might not make a proposal unless it can be guaranteed the deal will go through;<sup>93</sup> on the other hand, a board is required to get the best deal possible.<sup>94</sup> This interplay appears to be at the heart of how the Delaware courts treat deal protections and the standard they use to review them. The *Omnicare* court applied the two-prong test from *Paramount*,<sup>95</sup> and when addressing the first prong noted that the board needed to have "acted in good faith after conducting a reasonable investigation"<sup>96</sup> into a potential threat, which the board

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85. *See id.* at 49.

86. *See generally* Quinn, *Bulletproof*, *supra* note 16, for a discussion on bulletproof deals.

87. *Omnicare, Inc. v. NCS Healthcare, Inc.*, 818 A.2d 914 (Del. 2003).

88. *See id.* at 918.

89. *See id.*

90. *See id.* at 930–31.

91. *Id.* at 931 (quoting *Unitrin, Inc. v. Am. Gen. Corp. (In re Unitrin, Inc.)*, 651 A.2d 1361, 1388 (Del. 1995)).

92. *Id.* at 934.

93. *See id.*; *see also* Quinn, *Re-Evaluating the Standard*, *supra* note 7, at 1012, and accompanying text; *supra* notes 42–44 and accompanying text.

94. *See supra* note 57 and accompanying text.

95. *Paramount Commc'ns v. QVC Network*, 637 A.2d 34, 45 (Del. 1994).

96. *Omnicare*, 818 A.2d at 935 ("The threat identified by the NCS board was the possibility of losing the Genesis offer and being left with no comparable alternative transaction.").

satisfied. The next prong, the proportionality test, required that the board act reasonably relative to the threat.<sup>97</sup> The court then added a new critical twist to the *Unocal-Revlon* test: courts are required to determine whether deal protections are “preclusive or coercive *before* its focus shifts to the range of reasonableness.”<sup>98</sup> This leads to a two-step process in analyzing prong two: first determine whether the deal protections are preclusive or coercive, and then determine whether it fits within the range of reasonableness.<sup>99</sup>

The preclusive-coercive test comes from *Unitrin*, where a coercive measure forced “a management-sponsored alternative to a hostile offer”<sup>100</sup> upon stockholders, and a preclusive measure would have either “deprive[d] stockholders of the right to receive all tender offers or preclude[d] a bidder from seeking control by fundamentally restricting proxy contests or otherwise.”<sup>101</sup> The *Omnicare* court applied the preclusive-coercive test to the facts of the case and determined that the deal protections failed the first prong of the test because the deal protections “made it ‘mathematically impossible’ and ‘realistically unattainable’ for”<sup>102</sup> anything other than the initial Genesis deal to succeed regardless of the superiority of any subsequent bid.

### 3. Enhanced Scrutiny or Passivity?

In all of the foregoing cases, the courts engaged in a factual analysis to determine whether the deal protections were valid. In examining such fact-centered holdings, a question arises: have the courts been equally consistent in dealing with matching rights in particular? In 2011, Professor Brian Quinn, a professor at Boston College Law School, wrote an article suggesting that the Delaware courts have been *overly permissive* in dealing with matching rights.<sup>103</sup> Professor Quinn argued that courts accord great deference to a board’s decision to grant matching rights when compared to decisions regarding other deal protection devices.<sup>104</sup> Professor Quinn also argued that matching rights are

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97. *See id.*

98. *Id.* at 932 (internal quotation marks removed, emphasis in original).

99. *See id.*

100. *Id.* at 935 (citing *Unitrin, Inc. v. Am. Gen. Corp. (In re Unitrin, Inc.)*, 651 A.2d 1361, 1387 (Del. 1995); *Paramount Commc’ns, Inc. v. Time Inc.*, 571 A.2d 1140, 1154 (Del. 1989)).

101. *Id.*

102. *Id.* at 936 (quoting *Unitrin*, 651 A.2d at 1388–89).

103. *See generally* Quinn, *Re-Evaluating the Standard*, *supra* note 7.

104. *See id.* at 1014 (“[C]ourts should subject board decisions to grant matching rights the same highly contextualized analysis that courts bring to bear when analyzing other deal protection measures.”).

ubiquitous and their ubiquity is due in large part to that deference.<sup>105</sup> Further, and more importantly, he pointed out that “a board reading recent court rulings might not be faulted if, in good faith, it misinterprets the court’s permissive approach to matching rights as admitting a per se validity of such provisions.”<sup>106</sup>

As an example of the type of factual analysis courts use to determine the validity of other deal protections, one need only look to how the chancellor in *In re Dollar Thrifty Shareholder Litigation*<sup>107</sup> treated a termination fee. The chancellor’s analysis of the first prong of the *Unitrin* preclusive-coercive test, the preclusiveness prong, was detailed, analytical, and extensive.<sup>108</sup> The chancellor’s treatment of the reasonableness prong was equally detailed and fact-intensive.<sup>109</sup>

The standard of review for deal protection measure challenges is thus clearly defined, so where does Professor Quinn’s charge come from? To answer this question, it is worth looking at how the Delaware Court of Chancery has handled the standard of review.

### III. ANALYSIS

#### A. *The Emerging Trend: The Court of Chancery Opinions Coalesce*

On its face it might appear that the Delaware Court of Chancery has been overly permissive, as an analysis of challenges to matching rights since Professor Quinn’s article have shown that the court appears to hand wave the challenges away.<sup>110</sup> Not all is as it appears, however, for a slightly deeper look reveals poor pleading as a potential source of the problem.<sup>111</sup> Although plaintiffs may be pleading poorly in general, the root cause of the poor pleading with respect to matching rights is the lack of proper data and the difficulty in acquiring proper data on the economic effects of matching rights and other deal protection measures.<sup>112</sup> Without adequate data, plaintiffs face two problems. First, plaintiffs cannot plead with specificity the alleged preclusive effects of the matching rights, and second, the court cannot properly review or analyze the preclusiveness of matching rights. Further economic research is necessary to provide plaintiffs and the court (as well as boards who seek to make wise choices

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105. *See id.* at 1019.

106. *Id.*

107. *In re Dollar Thrifty S’holder Litig.*, 14 A.3d 573 (Del. Ch. 2010).

108. *See id.* at 613–14 (providing economic analysis, theoretical analysis, and a detailed look at the facts of the specific controversy).

109. *See id.* at 614–15 (analyzing the deal negotiations that led to the fee, calculating the economic impact of the fee, and discussing the board’s motivations behind the fee).

110. *See infra* notes 114–30 and accompanying text.

111. *See* discussion *infra* Section III.A.1 for more details on poor pleading.

112. *See* discussion *infra* Section III.A.2.

and avoid costly litigation) with the economic data necessary to properly analyze the effects of matching rights on deals.<sup>113</sup>

### 1. Permissiveness or Poor Pleading Punishing Plaintiffs?

A casual look at Chancery decisions suggests that challenges to matching rights are not properly evaluated by courts, but a deeper look reveals that plaintiffs making challenges often fail to include enough facts in their pleadings to enable challenges to move forward. In a 2011 case, the chancellor noted that “[p]laintiffs have not shown that any alternative bidder was precluded by the challenged provisions”<sup>114</sup> and that “[t]he challenged provisions are relatively standard in form and have not been shown to be preclusive or coercive, whether they are considered separately or collectively.”<sup>115</sup>

Then, in late 2012, Novell, Inc. shareholders challenged a deal that contained no-shop provisions, matching rights, and a termination fee.<sup>116</sup> The court first noted that the deal protection measures were “customary and well within the range permitted under Delaware law.”<sup>117</sup> The chancellor then asserted that “[t]he [p]laintiffs plead no facts suggesting that the no-solicitation and matching rights provisions were unreasonable.”<sup>118</sup> In a 2014 case,<sup>119</sup> the court also pointed out deficiencies in pleading by asserting that the plaintiff “[made] no effort to explain how the devices at issue work in such a harmful manner.”<sup>120</sup> Without any such details in the pleading, the court relied upon precedent and found that “there [wa]s ample precedent for the proposition that the . . . matching rights . . . were reasonable.”<sup>121</sup> This pattern of plaintiffs being unable to articulate sufficient facts repeated itself in *In Re Triquint Semiconductor, Inc.*,<sup>122</sup> where the chancellor noted that the plaintiff did “not sufficiently articulate[] how [the] familiar and generally permissible merger agreement provisions”<sup>123</sup> were coercive or preclusive.

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113. See discussion *infra* Sections III.A.2, III.B.

114. *In re Smurfit-Stone Container Corp. S’holder Litig.*, 2011 Del. Ch. LEXIS 79, at \*79 (Del. Ch. May 20, 2011).

115. *Id.*

116. See *In re Novell, Inc. S’holder Litig.*, 2013 Del. Ch. LEXIS 1, at \*11–12 (Del. Ch. Jan. 3, 2013).

117. *Id.* at \*34.

118. *Id.* at \*35.

119. See *Dent v. Ramtron Int’l Corp.*, 2014 Del. Ch. LEXIS 110 (Del. Ch. June 30, 2014).

120. *Id.* at \*22.

121. *Id.* at \*24.

122. *In re Triquint*, 2014 Del. Ch. LEXIS 102 (Del. Ch. Jun. 13, 2014).

123. *Id.* at \*11.

Sometimes a chancellor will dismiss a matching right challenge without any analysis at all. In a 2013 case, the chancellor stated that “the only things stopping [a potential topping] bidder would be the matching rights and the . . . termination fee” and then proceeded to discuss the termination fee amount before concluding that the “deal protections would not deter a serious suitor.”<sup>124</sup>

The prior examples stand in stark contrast to how the courts have analyzed other deal protection measures.<sup>125</sup> This raises a potential question: Is poor pleading really the problem or are matching rights so ubiquitous that a new pleading standard has been born? Alternatively, was the court overly permissive in the past, as Professor Quinn suggested, and now precedent is so firmly in favor of finding no preclusion for matching rights that the court cannot easily find them preclusive? Courts have found that challenges to deal protection measures are “garden-variety challenges”<sup>126</sup> and that matching rights are “unremarkable and customary,”<sup>127</sup> “generally permissible,”<sup>128</sup> “relatively standard,”<sup>129</sup> and “have not been shown to be preclusive.”<sup>130</sup>

This suggests that challenges to matching rights must overcome several obstacles. On the preclusiveness side, plaintiffs must overcome the obstacle that courts are loath to find matching rights preclusive because of past precedent.<sup>131</sup> On the reasonableness side, they must overcome the obstacle of their ubiquity.<sup>132</sup> This seemingly impossible set of hurdles grows ever harder with each challenge. Each time a chancellor finds that a matching right provision is not preclusive, he<sup>133</sup>

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124. *Koehler v. NetSpend Holdings, Inc.*, 2013 Del. Ch. LEXIS 131, \*64–65 (Del. Ch. May 21, 2013).

125. *See, e.g., supra* notes 107–09 and accompanying text.

126. *In re BioClinica S’holder Litig.*, 2013 Del. Ch. LEXIS 52, \*4 (Del. Ch. Feb. 25, 2013).

127. *Dent v. Ramtron Int’l Corp.*, 2014 Del. Ch. LEXIS 110, at \*23 (Del. Ch. June 30, 2014).

128. *In re Triquint*, 2014 Del. Ch. LEXIS 102, at \*9.

129. *In re Smurfit-Stone Container Corp. S’holder Litig.*, 2011 Del. Ch. LEXIS 79, at \*79 (Del. Ch. May 20, 2011).

130. *Id.*

131. *See supra* notes 127–30 and accompanying text.

132. *See supra* note 41 and accompanying text. Given their ubiquity, it is hardly surprising that chancellors are reticent to find matching rights unreasonable as that would require a finding that virtually all corporate boards are unreasonable.

133. The male pronoun is used because, unfortunately, no woman served as chancellor from 1994 until November 2015. *See* Maureen Milford, *Historic advance for women lawyers*, NEWS J. (Oct. 1, 2015, 11:47 PM), <http://delonline.us/1NwLfdy> (reporting that Tamika Montgomery-Reeves, if confirmed, would be the first woman on the Court of Chancery since 1994); GLOBAL DEL., *Tamika Montgomery-Reeves confirmed to Delaware Court of Chancery*, GLOBAL DEL. BLOG (Nov. 2, 2015), <http://1.usa.gov/1kViLmD> (reporting that Ms. Montgomery-Reeves was confirmed to serve as vice chancellor).

naturally relies upon past precedent.<sup>134</sup> By itself that does not properly explain the seeming permissiveness, but when added to the emphasis on pleading the problem begins to take shape.

There is one more piece to the puzzle. If a plaintiff claims that a termination fee of, for example, 3.5 percent is preclusive, the chancellor is capable of analyzing that number in the context of the deal and applying enhanced scrutiny to it.<sup>135</sup> Put another way, a plaintiff might not be challenging the existence of a termination fee but merely the extent of the fee. Matching rights do not easily lend themselves to that type of challenge,<sup>136</sup> and further, they do not easily lend themselves to that type of analysis.<sup>137</sup>

When applying the enhanced scrutiny test, the chancellor is to determine only whether the board made a reasonable decision and not whether the board made a perfect decision.<sup>138</sup> If no past case has found matching rights to be preclusive and they are ubiquitous in deals, it would be hard for a chancellor, absent any other details, to find that they are unreasonable.<sup>139</sup>

The Court of Chancery made this hesitancy to deem matching rights unreasonable somewhat clear in *In re Synthes, Inc. Shareholder Litigation*.<sup>140</sup> The court first pointed out that the plaintiffs had “made no attempt to show” how the deal protection measures were preclusive or would prevent “a genuine topping bidder willing to make a materially higher bid.”<sup>141</sup> It then said that the court was “particularly reluctant” to find a board’s decision unreasonable in part because “courts are ill-equipped to second guess [the decisions] as unreasonable.”<sup>142</sup> This strongly suggests that because of the combination of poor pleading and lack of empirical data the courts are unable to properly analyze challenges to matching rights.

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134. See *supra* notes 126–31 and accompanying text.

135. See, e.g., *supra* notes 107–09 and accompanying text.

136. While termination rights come in ranges (mathematically there is a difference between 2.0 percent and 2.5 percent), matching rights are either present or not.

137. For a detailed explanation of why that is, see Quinn, *Re-evaluating the Standard*, *supra* note 7, at 1035–36.

138. *C&J Energy Servs. v. City of Miami Gen. Emps’ & Sanitation Emps’ Ret. Trust*, 107 A.3d 1049, 1067 (Del. 2014) (“a court applying *Revlon’s* enhanced scrutiny must decide ‘whether the directors made a *reasonable* decision, not a *perfect* decision’”) (emphasis in original) (quoting *Unitrin, Inc. v. Am. Gen. Corp. (In re Unitrin, Inc.)*, 651 A.2d 1361, 1385–86 (Del. 1995)).

139. It is true that a chancellor’s mother might retort “If everyone jumped off a bridge, would you?” when applying this type of reasoning, but the principle of *stare decisis* trumps a mother’s intuition.

140. *In re Synthes, Inc. S’holder Litig.*, 50 A.3d 1022 (Del. Ch. 2012).

141. *Id.* at 1048.

142. *Id.* at 1049.

That brings the problem full circle. A plaintiff can plead that the termination fee is excessive and a chancellor can easily analyze that. But because the court does not have any other source to draw from for analyzing matching rights, a plaintiff cannot simply plead that the matching rights are preclusive and have the chancellor analyze it.<sup>143</sup> This is a critical problem and is one that Professor Quinn acknowledged.<sup>144</sup> Professor Quinn's solution was that "[c]ourts should apply the same highly-contextualized facts and circumstances analysis that is used when reviewing . . . other deal protection measures."<sup>145</sup> This solution is not a reasonable one, because it begs the question. The solution assumes that courts are choosing to improperly analyze challenges to matching rights.

## 2. Lack of Scholarship Masquerades as Permissiveness

The problem is not that the Chancery Court is overly permissive or fails to use contextualized facts, but that the chancellors lack an adequate framework to analyze challenges to matching rights. As recently as 2000 there was only a single paper that attempted to provide an empirical study of deal protection measures: a paper by Timothy Burch.<sup>146</sup> Although that paper discussed only stock lockups,<sup>147</sup> Burch's analysis was extremely detailed, looking at over 2,000 deals from 1988 to 1995<sup>148</sup> to conclude that while stock lockups "discourage competition for a target"<sup>149</sup> the lockups caused higher returns for shareholders when compared to deals that did not have stock lockups. Slightly complicating the issue, however, is that "deals with lockup options are much more likely to be completed" which might lead to "biased returns for lockup deals."<sup>150</sup> That finding is a testament to the fact that the researcher engaged in such rigorous empirical analysis.<sup>151</sup> While the 2000 paper did not look at matching rights or any other deal protection measures, it does provide a useful example of rigorous empirical analysis.

Some additional research has been done since 2000 and "the literature on this issue is thick and varies in its conclusions."<sup>152</sup> As late

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143. See Quinn, *Re-evaluating the Standard*, *supra* note 7, at 1035–36.

144. *Id.* at 1035–1038.

145. *Id.* at 1038.

146. See John C. Coates IV & Guhan Subramanian, *A Buy-Side Model of M&A Lockups: Theory and Evidence*, 53 STAN. L. REV. 307, 311 (2000).

147. See Burch, *supra* note 28, at 104.

148. See *id.* at 106.

149. *Id.* at 139.

150. *Id.* at 125.

151. The researcher not only looked at several thousand deals and returns on those deals, but also engaged in robust regression analysis to control for different variables. See *id.* at 127–31.

152. Davidoff & Sautter, *supra* note 1, at 682 n.1.

as 2013, scholars noted that it is hard to “make definitive empirical conclusions at this time” about the effects of combinations of deal protection measures because of the difficulty in isolating and identifying “individual lock-ups and their effect on bidding.”<sup>153</sup> The difficulty with analyzing the use of deal protection measures today when compared to the study performed by Timothy Burch<sup>154</sup> is the number and variety of deal protection measures in use today, which significantly increases the variables in any study.<sup>155</sup> It is difficult to “assess the wealth effects” of the increasing use of deal protection measures without “more econometric analysis.”<sup>156</sup>

There are two potential solutions to the difficulty courts face when addressing challenges to matching rights—plaintiffs can plead with more specificity or scholars can produce better data for the court to use. This Comment proposes that the latter solution is the more reasonable solution. Simple logic dictates that if there is no body of empirical data that the court can use then it is unlikely plaintiffs can plead sufficient data to overcome the precedential hurdles<sup>157</sup> facing them. Further, one court noted that the quick turnaround time for merger challenges can “provide[] little opportunity for elegant pleading.”<sup>158</sup> If data are required for better pleading it stands to reason that better scholarship is the proper option as it would not only enable more elegant pleading, but it would also greatly improve the court’s ability to analyze the economic effects (if any) that matching rights have on deals.

#### *B. Challenge to Empiricists to Produce a Framework*

Given the lack of empirical data (and the admitted difficulty in producing the data)<sup>159</sup> it is critical that empiricists step up to the challenge by engaging in robust research and data generation. The solution proposed in this Comment is for research to be done on the economic realities of deal protection measures as they exist today. Because of the increasing variety and prevalence in deal protection measure use,<sup>160</sup> it is critical that the courts have an adequate foundation from which to analyze challenges to their use. Without adequate data,

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153. *Id.* at 700.

154. *See supra* notes 142–46 and accompanying text.

155. *See* Davidoff & Sautter, *supra* note 1, at 700.

156. *Id.* at 700–01.

157. *See* discussion *supra* Section III.A.

158. *In re BioClinica S’holder Litig.*, 2013 Del. Ch. LEXIS 52, at \*2 (Del. Ch. Feb. 25, 2013).

159. *See id.*

160. *See supra* notes 1–3 and accompanying text.

courts will have no choice but to resort to precedent, which makes it almost impossible for a challenge to matching rights to succeed.<sup>161</sup>

A forthcoming article by Fernan Restrepo and Guhan Subramanian<sup>162</sup> provides a great example of the type of analysis that this Comment is calling for. Restrepo and Subramanian used “basic game theory”<sup>163</sup> to ascertain the deterrent effects of matching rights. The authors also suggest that Delaware courts “apply basic game theory to identify the deterrent effect of match rights.”<sup>164</sup> It stands to reason that if courts are to engage in game theory analysis (or any other advanced economic analysis) then researchers need to continue to provide academic guidance to the judiciary. The paper notes that matching rights “amplify other deal protection measures” while also providing analysis that “provides greater precision on the magnitude of the deterrence effect”<sup>165</sup> of matching rights.

The Restrepo and Subramanian article is a great step forward in providing the type of information the courts need to correctly analyze matching rights. It even suggests a framework: game theory.<sup>166</sup> A single modern study is not enough, but it does highlight the importance of research. It was the authors’ use of game theory and empirical analysis that enabled them to draw conclusions about the deterrent effect of matching rights. Without such analysis, how are courts expected to draw the same conclusions? Further research is needed, but the forthcoming article by Restrepo and Subramanian is an excellent start.

#### IV. CONCLUSION

The Delaware Court of Chancery is in an unenviable position. It must adhere to precedent while also analyzing deal protection measures using enhanced scrutiny without simply deferring to a board’s decision. Without a proper empirical framework, a court will be unable to adequately analyze the preclusiveness of a challenged measure. If a plaintiff also lacks the ability to plead with specificity the court will merely defer to precedent, as is expected, and challenges to matching rights will invariably fail. That opens the court up to criticism, albeit unfair, that they are being overly permissive and failing to use the proper standard of review. Scholars can solve that problem by engaging in the

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161. See discussion *supra* Section III.A.1.

162. See Fernan Restrepo and Guhan Subramanian, *The New Look of Deal Protection*, 69 STAN. L. REV. (forthcoming 2017), <https://ssrn.com/abstract=2820431>.

163. *Id.* (manuscript at 4).

164. *Id.*

165. *Id.* (manuscript at 37).

166. See *id.*

empirical research necessary to enable the court to more fully analyze challenges alleging that matching rights are preclusive.