

Monolithic Systems abandoned its suit against Synopsys after three days of trial, allowing the defendant to walk from a merger agreement

## Synopsys wins in a walkover

LAWYERS HOPING FOR MORE CASE LAW from Delaware about the interpretation of material adverse effects clauses must still wait. Three days into a trial before Vice Chancellor Stephen Lamb in Wilmington, Monolithic System Technology Inc. settled its suit against Synopsys Inc., ending its quest to enforce the companies' merger agreement.

The deal offered Monolithic shareholders the possibility of \$13.50 a share when the stock hadn't traded above \$8 since Synopsys announced it was terminating the deal April 16. But there seemed little doubt from Lamb's comments from the bench that he was set to rule against Sunnyvale, Calif.-based Monolithic, whose unorthodox decision to end the case before getting a decision was apropos of its baffling legal maneuvers in other aspects of the situation.

### THE AGREEMENT ITSELF

Monolithic and Synopsys announced their deal Feb. 23, with the Mountain View, Calif.-based semiconductor designer agreeing to acquire Monolithic for \$432 million in cash and stock, or \$13.50 a share. (See "MAE Synopsys snap Monolithic deal?" June.) The price came at a 93% premium to Monolithic's Feb. 23 closing price, a premium that caused Synopsys' stock price to fall 16%, from an opening price of \$35.77 a share Feb. 23 to a close the next day of \$29.88.

The price may have been too high, but Synopsys had negotiated a very favorable agreement. Like most merger contracts, it included an MAE clause, in this case very favorable to Synopsys. The clause allowed Synopsys to define an MAE as one "that is or that reasonably could be expected to be or to become materially adverse" to Monolithic. If Synopsys determined that Monolithic had suffered an MAE, it could abandon the deal by paying a \$10 million fee.

That broad standard meant Synopsys could rely on its own judgment of what might constitute an MAE rather than a more objective standard that a court would apply after Synopsys made a decision to walk. Richard Climan, a partner at Cooley Godward LLP in Palo Alto, Calif., represented Synopsys, while Monolithic tapped Alan Kalin at Bingham McCutchen LLP in East Palo Alto.

The contract also included two conditions that proved highly favorable to Synopsys. Under one of them, Monolithic's two founders, Fu-Chieh Hsu and Wingyu Leung, the company's CEO and chief technology officer, respectively, were to be employed by Monolithic at the close of the deal and thereafter to work for Synopsys.

Neither "shall have communicated to an officer of [Monolithic] or [Synopsys] any intention to terminate his employment or to decline to accept employment" with either of the two companies.

Despite including this condition, Monolithic did not insist that Synopsys sign Hsu and Leung to employment agreements that would survive the close of the deal—an oversight that would make Hsu and Leung's employment status an important issue at trial.

The second offer condition relevant in the litigation required that there be no pending litigation that "if adversely determined, could reasonably be expected to have a company material adverse effect [and] that could materially and adversely affect the right of [Synopsys] or [Monolithic] to own the assets or operate the business of [Monolithic]."

Because the condition was related to the definition of MAE, it gave Synopsys broad leeway in determining the potential severity of a lawsuit against Monolithic.

### SYNOPSIS' CHANCE TO FLEE

In its suit, Monolithic argued that Synopsys regretted the price it had agreed to pay and was looking for a way out of the deal. If so, a perfect opportunity emerged March 31, 2-1/2 weeks before the deal was set to close, when UniRAM Technology Inc. brought a patent infringement suit against Monolithic in federal court in San Jose, Calif.

UniRAM alleged that MoSys acquired trade secrets from a UniRAM predecessor in 1997 and 1998 to develop 1T-SRAM semiconductor memory technology, Monolithic's key product line. Synopsys wanted to buy MoSys to gain that technology, which reduces the number of transistors per cell from six to one, yielding chips that are smaller, use less power and maintain or increase speed.

Synopsys didn't point specifically to the infringement suit in its April 17 release announcing it had ended the Monolithic agreement and paid the target a \$10 million fee for terminating the deal.

But Synopsys in its June 21 pretrial brief focused on two reasons for walk-

ing from the deal: the UniRAM litigation and Leung's uncertain employment status.

### MONOLITHIC'S MATERIAL

Monolithic's litigators faced a stiff challenge in the trial before Lamb, which was scheduled to last six days. He's not a judge inclined to read beyond the language of a contract, which in this case was very unfavorable to Monolithic.

In analyzing Synopsys' decision to walk, Lamb seemed more likely to focus on the rectitude of the company's process than on the substance of its decision, as he had in his 2002 ruling *In re NCS Healthcare Inc. Shareholders Litigation*, the ruling the Delaware Supreme Court reversed in *Omnicare Inc. v. NCS Healthcare Inc.*

In NCS, Lamb focused on the process by which the NCS board approved an offer from Genesis Health Ventures Inc. rather than on the board's rejection of what turned out to be a much more valuable offer from Omnicare. Similarly, Lamb seemed likely to bless Synopsys' decision to terminate the Monolithic deal as long as the defendant could show that its board had thoroughly considered the action.

Thus Monolithic had to show that Synopsys acted in bad faith. The plaintiffs did have some good facts to work with. Synopsys CFO Steve Shevick admitted on the stand that Aart de Geus, the company's chairman and CEO, wanted to explore terminating the agreement to buy Monolithic in mid-March. UniRAM had offered to settle its suit against Monolithic for \$15 million and 4% of the annual revenue from the patents at issue in the suit, which would have added about \$1 million a year to the proposed settlement.

Synopsys may have taken advantage of Leung's and Hsu's not having employment contracts with it to foment an excuse to walk from the deal. Both men offered to put their proceeds from the sale of the company

in escrow to assuage the buyer's concerns that they would leave the company less than two years after the close of the merger, but Synopsys kept putting them off.

The defendant also didn't walk away from the deal as cleanly as it might have. When it terminated the merger agreement April 16, Synopsys also offered to buy Monolithic for \$10 a share, down from \$13.50 a share, suggesting that whatever adverse effect Monolithic had suffered was not material enough for Synopsys to lose all interest in the target. Monolithic executives rejected the offer without taking it to their board.

### THE TRIAL

Despite Lamb's judicial inclinations, Monolithic would have been in a much better position before the vice chancellor had it not had to confront the UniRAM suit. Instead, Hsu viewed the suit as an insult and an attack on

Quoting the e-mail, Tinsley said Hsu had agreed to the suggestion, writing: "The concept is to make the breakup easy. There is no need to explicitly quantify the material adverse effect." Hsu's lawyers did not contradict that testimony.

But William Bates III, a Bingham partner and Monolithic's lead lawyer at trial, was stuck with both his client and the UniRAM suit. Bates made the validity of the suit central to the first two days of the trial, which did nothing but strengthen Synopsys' case. Though Bates needed to address the patent suit in the trial, his decision to start his case by doing so was probably a mistake. Instead, the lawyer should have begun by depicting Synopsys as a company desperate to find a pretext to walk.

Instead, Bates' effort to prove that UniRAM's patent suit was groundless strengthened Synopsys' case. Monolithic designs software for the manu-

**"The concept is to make the breakup easy. There is no need to explicitly quantify the material adverse effect."**

*Fu-Chieh Hsu in an e-mail about the merger agreement*

his character and refused to settle.

The response proved short-sighted. Randolph Tinsley, Synopsys' vice president for corporate development, testified on the first day of trial about an e-mail exchange he had Feb. 21 with Hsu. Tinsley, one of the lead negotiators at Synopsys, said the parties had stalled in negotiations over the amount of due diligence his company would be allowed to conduct on the prospective target.

Tinsley testified that he proposed "putting the burden on Synopsys. We would determine the severity" of an event that might have a significantly negative effect on the target and determine whether that event allowed MoSys to walk from the deal if it paid Synopsys a \$10 million breakup fee.

facture of semiconductors, and the technology involved is so complex as to be all but impossible for a lay person to understand. Given that complexity, Synopsys' contention that the mere existence of the suit constituted an MAE under the contract was easily defensible.

As Stephen Neal, a Cooley partner who was Synopsys' lead trial lawyer, pointedly noted in his July 7 cross-examination of Joseph McAlexander, an expert witness for Monolithic, "One of the realities of patent litigation is that opinions honestly held by the witnesses are rejected by courts or rejected by the jury." Neal also cited an academic study that found that juries find a patent has been infringed in 75% of such cases that have come to

trial in the Northern District of California, the federal court where UniRAM has brought its suit. McAlexander agreed with that figure. Synopsys' decision to walk seemed a rational response to such uncertainty.

#### **THE MAE IMPLICATIONS**

Lamb did not issue a ruling in the case, which will have no precedential value. But lawyers can still extract some lessons from the situation, especially since Monolithic's abandonment of its litigation was an admission that it had no chance to win.

Most obviously, the resolution of the case shows that Delaware courts are extremely unlikely to read a contract creatively to save a party from unfavorable wording. Lamb may be more conservative in this regard than his fellow judges on the Court of

Chancery, but the outcome would not have been different had another judge heard the case.

The outcome of Monolithic's case also suggests the very unusual nature of Vice Chancellor Leo E. Strine Jr.'s decision to order Tyson Foods Inc. to complete its purchase of IBP Inc. in 2001 after Tyson tried to walk from the deal. Not only did IBP have a reasonably favorable contract, excellent lawyers and a receptive judge, it was also able to tell an exceptionally favorable story. And while Synopsys involved its outside lawyers in crafting a way out of the deal, Tyson froze them out of the process.

CEO John Tyson was not pleased that his father, controlling shareholder Donald Tyson, decided to kill the deal, a sentiment quite apparent at trial. The son, surly at times on the stand,

even told Strine that he thought the deal still made strategic sense, which had to affect the judge's view of the case. If those Oedipal dynamics were not enough, IBP uncovered an e-mail in which Tyson's head of investor relations informed the company's CFO that he would communicate with Wall Street analysts in a way that would "keep the pressure on [IBP's] stock price." Few plaintiffs in MAE cases will have such material.

On the other hand, few plaintiffs will have to overcome a contract as unfavorable as the one Monolithic negotiated with Synopsys. In an MAE case, as in any other case involving contract interpretation, when the contract is against you, nothing else matters. ■

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