More Guidance from Delaware on Controlling Shareholder Take-Private Transactions

The Delaware Chancery Court has found two individuals jointly and severally liable for more than $148 million in damages for fiduciary breaches committed in connection with a controlling shareholder take-private transaction.

Dole Food Company was taken private by David Murdock in 2013. When Murdock initiated the transaction he owned 40% of Dole's common stock and served as its Chairman and CEO, giving him effective control over Dole. Murdock conditioned his proposal from the outset on two approvals -- by a committee of disinterested and independent directors and by the holders of a majority of the unaffiliated shares. Presumably he did that in order to avoid the entire fairness standard of review that generally applies when a controlling shareholder takes a Delaware corporation private. Under the doctrinal approach adopted in 2013 by the Delaware Chancery Court in *In re MFW Shareholders Litigation* (discussed here and affirmed by the Delaware Supreme Court here), for a transaction that from the outset is expressly subject to this dual approval condition, the presumptive standard of review is business judgment instead of entire fairness.

In a post-trial opinion handed down at the end of last month, the Delaware Chancery Court found that Murdock had been unsuccessful in his attempt to avoid adverse judicial scrutiny of his buyout of Dole's public shareholders, finding that "[d]espite mimicking *MFW*'s form, Murdock did not adhere to its substance." Instead, the Court held that the take-private was not entirely fair, both as a result of a failure in process and an unfair price, and found Murdock and his COO/president/general counsel, Michael Carter, jointly and severally liable for damages of $148 million plus interest based on their conduct in the take-private.

Murdock and Carter did a lot of things they shouldn't have in connection with the take-private. In the end though, only a subset of their misbehavior landed them in trouble. Murdock bullied the independent directors, before and after he made his take-private proposal. Carter rejected the special committee's requests that it be given a broader mandate and tried to prevent the committee from selecting its own chairperson. He attempted to dictate the committee's choice of financial adviser, and refused to allow the committee's adviser access to Dole diligence materials until the terms of the adviser's engagement had been changed to his satisfaction. Carter also orchestrated meetings between members of Dole management and Murdock's advisers and funding sources that contravened process instructions previously given by the committee, and refused to comply with instructions from the committee to terminate unauthorized access by Murdock's lenders to Dole's electronic data room. The Court noted it had expected before trial that this behavior would implicate the "fair dealing" component of the entire fairness analysis (that analysis has two components, the other being "fair price"). But the Court found after considering the trial testimony that, because the special committee and its advisers had behaved in an exemplary manner, and had succeeded in simulating an arms'-length negotiation despite the bullying and attempts at interference, these actions by Murdock and Carter, while improper, had not caused damage. It seems that if this had been the entirety of their misconduct, Murdock and Carter could have escaped liability despite the egregious nature of their conduct.

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The subset of misbehavior that the Court found ***did*** give rise to liability involved conduct that the special committee and its advisers had been unaware of, and therefore were unable to address. This conduct involved, first, actions intended to depress Dole's share price in advance of Murdock's take-private offer (to make the offer appear more attractive) and, second, providing the special committee and its advisers with financial projections doctored to make Dole's prospects appear more gloomy than they actually were. Murdock had been planning the take-private since at least 2012 and in 2013, Carter departed from Dole's previous practice of providing earnings guidance, changed estimates on potential cost savings, and lowered the valuations of certain assets. Carter also cancelled Dole's stock repurchase program for what the Court found to be "pretextual reasons." The Court found this behavior was intended to, and did, cause Dole's shares to trade down before Murdock made his buyout offer. The Court found the projections Carter provided to the committee contained "falsely low numbers," and were inconsistent with other projections given previously to the board of directors as well as with others given to Dole's lenders. Commendably, the committee and its financial adviser had recognized that the projections supplied by Dole's management at Carter's direction were unreliable and had created a revised set of projections. Those revisions did not however address all the shortcomings in the projections furnished by Carter because they did not reflect certain cost saving and revenue opportunities that Carter knew of but had not disclosed. According to the Court, this behavior (especially providing inaccurate projections) made it impossible for the special committee to function properly. This necessarily resulted in a finding of liability.

In assessing the amount of damages to be awarded, the Court noted that the price of $13.50 per share paid by Murdock in the Dole take-private conceivably might be at the bottom end of a range of fairness, even after adjusting the range calculated by the special committee's financial adviser to address the cost saving and revenue opportunities that had been concealed from it. Nonetheless, said the Court, even if the price received by Dole's cashed-out shareholders had been (barely) "fair," the shareholders were entitled to "a fairer price designed to eliminate the ability of the defendants to profit from their breaches of the duty of loyalty." The fairer price set by the Court reflected an increase of $2.74 per share, or approximately 20%. That increase resulted in a damages award of $148 million (plus pre- and post-judgment interest).

Murdock's financial adviser was found by the Court to have improperly helped him to prepare his take-private proposal at a time it was working for Dole, but escaped liability because there was no showing that the adviser had participated in the manipulation of financial information on which liability was premised.

Take-aways

- First and most obviously, if you're a controlling shareholder and you're serious about invoking *MFW* and benefitting from business judgment review, you have to refrain from interfering with the special committee's work, ensure it gets access to accurate and complete information, and ensure the target company's officers take direction from the special committee. (We kind of knew that already, but apparently it bears repeating.)
- Even when the transaction is subject to entire fairness review, a well-performing special committee can save the day for the controlling shareholder. Even if the controller improperly attempts to interfere with the committee (imperilling the "fair dealing" component of entire fairness), if the committee is resilient and fully informed, behaves with an appropriate degree of independence and extracts terms approximating arms'-length terms from the controller, that record can defeat an entire fairness claim (but that result likely will come only after a trial). Here, the Court found the committee's work "indisputably excellent," which allowed it to overcome "most of Murdock's and Carter's machinations."
- The Court praised the special committee's bankers and declined to impose liability on Murdock's bankers, but nobody should take those findings as an indication that the Chancery Court is becoming more forgiving of banker conduct. Murdock's bankers barely escaped liability, and other similarly situated banks will be well-advised to avoid the kind of conflicted situation that the Court identified here. Bankers also will do well to be more alert to the perils their controller clients face in take-private transactions, and to counsel those clients to behave much better than Murdock and Carter did. Failure to do that risks aiding and abetting liability.

- After the class action plaintiffs' bar digests the opinion, shareholders challenging take-private transactions are likely to increase their focus on the quality of financial information provided to the special committee -- both to defeat motions to dismiss that invoke *MFW* and at the later stages of any such litigation. Participants in controlling shareholder take-private transactions should plan accordingly.
- General counsel taking on multiple roles assume special risks that they will become enmeshed in conflict situations and their conduct challenged. Here, Carter was not only Dole's general counsel, he was also its COO and a board member. He lost sight of who his client was and, instead, did the bidding of his boss, a 40% shareholder.

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