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Control Premium May Violate Charter Prohibition on Disparate Merger Consideration in Dual Class Stock Context

Under Delaware law, a controlling stockholder owes minimal duties to the minority stockholders. In the merger context, this means that the controller generally has the right to sell its stock to further its sole interest and need not consider the interests of the other stockholders. Further, Delaware law generally allows the payment of a premium to the controlling stockholder without any requirement to share that premium with other stockholders. See e.g., [Abraham v. Emerson Radio Corp.](#) In the recent *In re Delphi Financial Group* decision, however, Delaware Vice Chancellor Glasscock (on a motion for preliminary injunction) found that there was a reasonable likelihood that Delphi's controlling stockholder, CEO and Chairman of the Board, Robert Rosenkranz, may have violated either or both his fiduciary duties to the other stockholders and contractual obligations under Delphi's charter when he negotiated a control premium for himself alone in the sale of Delphi to Tokio Marine Holdings, Inc. Although the court declined to grant a preliminary injunction, the decision nevertheless provides insight into the Delaware courts' view of the proper interaction between controlling and other stockholders.

Delphi has a two-class common stock capital structure, consisting of Class A, largely held by the public, and Class B, held by Rosenkranz. Class B has ten votes per share to Class A's one vote per share, resulting in Rosenkranz's holding 49.9% of the vote, but only 13% of the equity, of Delphi. Importantly, when Delphi went public in 1990, its charter included, among other things, a provision mandating that both classes of stock must receive the same consideration in a merger transaction.

In 2011, Tokio Marine approached Delphi about a deal. In light of the possible conflicts between Rosenkranz and the other stockholders, the Delphi board formed an independent special committee not only to oversee negotiations with Tokio Marine, but also to negotiate with Rosenkranz over his demand for an additional premium for his shares (notwithstanding the existence of the charter prohibition against disparate consideration). Although the special committee recognized that Rosenkranz may have interests in the transaction different from those of other stockholders, special committee allowed him to continue as the lead negotiator with Tokio Marine because, among other things, it deemed that his interests were sufficiently aligned with those of the other stockholders in terms of his desire to extract the highest price from Tokio Marine. Ultimately, the parties agreed to a transaction resulting in a price of \$44.875 per share to the Class A holders (a 76% premium over the market price prior to the announcement of the transaction) and \$53.875 to Rosenkranz. The merger between Delphi and Tokio Marine was conditioned on the amendment of Delphi's charter to remove the prohibition on disparate consideration, which required majority stockholder approval. Although the special committee exhibited discomfort at the payment of an additional premium

to Rosenkranz, it finally agreed given Rosenkranz's unwavering insistence on such payment and its belief that without Rosenkranz's support of the transaction the other stockholders would be deprived of the opportunity to consider this high premium offer.

While the plaintiffs in this suit alleged a multitude of breaches of fiduciary duty and contract by the Delphi board and Rosenkranz and also disclosure violations by Delphi, the court held that most of those claims did not have a reasonable probability of success.

The one exception was the allegation that Rosenkranz obtained the additional control premium in violation of his contractual and fiduciary duties to the minority stockholders. While affirming that controlling stockholders are, with limited exceptions, permitted to negotiate a control premium and to act in their own interest in so doing, the court found that Rosenkranz had already bargained away that premium when the company went public with the aforementioned charter prohibition in exchange for what was presumably a higher offering price. To now seek a second control premium in the context of the sale would, according to the court, amount to a "wrongful transfer of merger consideration from the Class A stockholders to Rosenkranz." Even though Delphi had implemented procedural protections for the minority stockholders (including an independent special committee and the negotiation of a non-waivable condition that the merger be approved by a majority of the minority stockholders), the court still suggested that, among other things, the conditioning of the merger upon the approval of the charter amendment amounted to the coercion of the stockholders' concession of rights guaranteed by the charter and that such coercion may constitute a violation of Rosenkranz's fiduciary duties.

Further, the court noted that a charter constitutes a contract between the corporation's stockholders and carries with it an implied covenant of good faith and fair dealing between the parties. When a party takes "advantage of [its] position to control implementation of the agreement's terms" and in so doing "frustrates the 'overarching purpose' of the contract," that party (in this case, Rosenkranz) may breach that implied covenant. Because the court found that disgorgement remedies would suffice, and because the court, like the Delphi board, did not wish to deprive the stockholders of a premium-generating transaction, it denied plaintiffs' request for a preliminary injunction.

The decision is notable in that it further exemplifies the Delaware courts' willingness to protect minority stockholders against what it deems to be coercive behavior by controlling stockholders, and also its hesitancy to enjoin premium transactions where no alternative offer is on the table.

For the *Delphi* opinion, see <http://courts.delaware.gov/opinions/download.aspx?ID=169430>

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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