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Delaware M&A Quarterly

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Delaware Court of Chancery Refuses to Enforce Merger-Related Obligations Against Non-Consenting Stockholder

In *Cigna Health and Life Insurance Company* v. *Audax Health Solutions, Inc.*, the Delaware Court of Chancery (i) held that a broad release of claims found only in a letter of transmittal, the form of which had not been included as part of the merger agreement, and that a stockholder was required to execute to receive merger consideration was unenforceable for lack of consideration, and (ii) refused to enforce the portion of a post-closing indemnification obligation requiring direct payment from a non-consenting stockholder that was indefinite in duration and potentially required repayment of the stockholder's entire *pro rata* portion of the merger consideration. For more, click here.

Delaware Court of Chancery Declines to Enjoin Merger Despite Higher but Riskier Third-Party Offer

In *In re Family Dollar Stores Inc. S'holder Litig.*, the Delaware Court of Chancery declined to enjoin a stockholder vote on a merger between Family Dollar Stores Inc. and Dollar Tree Inc., holding that Family Dollar's board of directors acted reasonably in declining to engage a competing bidder that offered a financially superior offer, but one that was exposed to higher antitrust risk.

In 2014, Family Dollar agreed to a merger with Dollar Tree at $74.50 per Family Dollar share. The two companies, along with Dollar General, Inc., are the three major players in the small-box discount retail market. Antitrust review by the FTC was, therefore, a primary consideration in the viability of the merger. Dollar General later submitted an $80 per share bid for Family Dollar. Although the merger agreement with Dollar Tree had a fiduciary out, Family Dollar's antitrust counsel advised the Family Dollar board that a Family Dollar/Dollar General combination faced greater antitrust risk than a Family Dollar/Dollar Tree combination and that it was not prudent or appropriate to open negotiations with Dollar General.

The plaintiffs sought to enjoin the merger until Family Dollar engaged with Dollar General, but the Court of Chancery declined to do so, holding that (i) the record showed that the Family Dollar board was motivated to maximize value for the Family Dollar stockholders and (ii) the Family Dollar board acted reasonably within the constraints of the fiduciary out in the merger agreement when it decided not to engage in negotiations with Dollar General because of antitrust risks.

Delaware Court of Chancery Declines to Dismiss Breach of Fiduciary Duty Claims Against Directors who Approved an Alleged 13% Termination Payment

In *In re Comverge Inc. S'holders Litig.*, the Delaware Court of Chancery declined to dismiss a claim for breach of fiduciary duty where the plaintiffs alleged that the director defendants acted unreasonably in agreeing to potentially preclusive termination fees. In *Comverge*, the company entered into a merger agreement which provided that the stockholders would receive $1.75 per share and the acquirer would receive termination fees and expense reimbursements between 5.5% and 7% of the deal's equity value if the company entered into a superior transaction during a post-signing market check. Additionally, the acquirer provided a bridge loan with 15% of the notes convertible into the company's common stock at a price of $1.40 share.

The plaintiffs argued that if a topping bidder emerged, the topping bidder would have to offer not only more than the original $1.75 per share, but the conversion of the acquirer's bridge loan notes into equity would result in a payment of an additional $.36 per share to the acquirer in addition to the already negotiated target termination fees and expense reimbursements.

The court held that (i) it was reasonable to infer that the convertible notes could be viewed as additional termination fees, resulting in a "termination payment" equaling up to 13% of the equity value of the transaction and this termination payment could have had an unreasonable preclusive effect on other potential bidders, and (ii) the director defendants were not entitled to dismissal under an exculpation provision in the company's charter because it was "reasonably conceivable" that the board's acceptance of the total termination fees of 13% was "so far beyond the bounds of reasonable judgment that it seems essentially inexplicable on any ground other than bad faith."

Delaware Court of Chancery holds that a 17.3% Stockholder/CEO may be a Controlling Stockholder

In *In re Zhongpin Inc. S'holders Litig.*, the Delaware Court of Chancery denied motions to dismiss merger-related breach of fiduciary duty claims against an alleged controlling stockholder and members of the company's board of directors, holding that the plaintiffs had raised reasonable inferences that (i) although the stockholder held only 17.3% of the company's outstanding common stock, as CEO and Chairman of the Board, he possessed "both latent and active control" over the company, and (ii) the sales process was not entirely fair. Of particular note in *Zhongpin*, although the CEO held only 17.3% of the company's shares, the company filed a Form 10-K after the execution of the merger agreement which (1) referred to the CEO as the company's "controlling shareholder," (2) implied that the CEO possessed latent control of the company and he may have the ability to impede a potential acquirer's submission of a competing bid, (3) indicated that the CEO had active control over the company's day-to-day operations because it stated that the company heavily relied on the CEO for the management of the business and that his departure would have a material adverse effect on the Company. This decision is of further interest because the court focused on the latent control of the stockholder; other recent Court of Chancery decisions have emphasized that a stockholder must exercise actual control over the board of directors to be a controlling stockholder. For more, click here.

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M&A Markets

The following issues of M&A at a Glance, our monthly newsletter on trends in the M&A marketplace and the structural and legal issues that arise in M&A transactions, were published this quarter. Each issue can be accessed by clicking on the date of each publication below.

- October 2014
- November 2014
- December 2014
- January 2015

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