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# Delaware Court of Chancery Applies Business Judgment Rule to Going-Private Transaction based on *M&F Worldwide*

In *In re Books-A-Million, Inc. Stockholders Litigation*, the Delaware Court of Chancery dismissed the fiduciary duty claims of former minority stockholders following a going-private, squeeze-out merger because the transaction satisfied the framework to invoke business judgment review as approved by the Delaware Supreme Court in *Kahn* v. *M&F Worldwide Corp*.

## Background

The plaintiffs brought fiduciary duty claims challenging the transaction pursuant to which the controlling stockholders of Books-A-Million, Inc. took the company private. The agreed price offered a premium to market, but was nevertheless lower than a competing offer from a third party to whom the controlling stockholders refused to sell. In addition, the controlling stockholders' offer contained an appraisal condition pursuant to which the controllers could back out of the transaction if more than 10% of the minority stockholders sought appraisal. The transaction was designed to follow the framework of *M&F Worldwide* (discussed here). Under that framework, Delaware courts will apply the business judgment standard of review to a controlling stockholder transaction (instead of entire fairness review) if the following six elements are satisfied: (i) the controller conditions the transaction on the approval of both a special committee and a majority of the minority stockholders; (ii) the special committee is independent; (iii) the special committee is empowered to freely select its own advisors and to say no definitely; (iv) the special committee meets its duty of care in negotiating a fair price; (v) the vote of the minority is informed; and (vi) there is no coercion of the minority. Once business judgement review is invoked, the only claims that a court will entertain are those constituting waste and thereby bad faith.

## Analysis

The Court, expressly noting that the *M&F Worldwide* framework can be applied on a motion to dismiss, found that the transaction satisfied each element of the framework. In applying the framework, the Court focused on the requirement for special committee independence and the plaintiffs' claims that the Books-A-Million special committee was not independent and had acted in bad faith.

- *The special committee did not act in bad faith when it approved the lower-priced offer from the controlling stockholder in the face of a competing, higher-priced offer from a third party.*



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- The plaintiffs argued that the special committee had acted in bad faith because it was irrational for the committee to approve the lower-priced, controlling-stockholder offer over a higher, third-party offer.

- The Court disagreed that the special committee's action necessarily amounted to bad faith for several reasons.

  - First, the Court noted that "[i]f the independent directors facilitated a grossly inadequate offer," or accepted a price with an "extreme" minority discount, then it might be possible to infer that independent directors sought to serve the interests of the controllers and acted in bad faith. Here, however, the Court found that the price offered by the controlling stockholders, which applied a minority discount of approximately 23% to the offer by the third party, fell "within a rational range of discounts and premiums" when compared to the third party offer, and the difference between the two prices was "not so facially large as to suggest that the [special committee] was attempting to facilitate a sweetheart deal" for the controlling stockholders.

  - Second, the Court found that appraisal was a "further check on expropriation" by the controllers, as a court would not apply a minority discount in any appraisal proceeding. If a sufficient number of minority stockholders felt aggrieved by the controllers' price (that applied a minority discount), they could exercise their appraisal rights and the controlling stockholders could use the appraisal condition to terminate the transaction. Thus, a minority of the minority stockholders could influence the outcome of the transaction.

  - Third, the special committee could have rationally believed that the stockholders preferred liquidity at a premium to market. The controllers' offer represented a substantial premium to the market (93% higher than the trading price the day before the controller proposed the merger and 23% higher than the trading price the day before the merger was announced) and a 20% premium to the controllers' initial offer.

- The Court also found support for its analysis in the seminal case of *Mendel* v. *Carroll*.

  - *Mendel* involved a company entertaining an offer from controlling stockholders (who also refused to sell to a third party) and a higher offer from a third party. *Mendel* stated that it was "quite possible" that the lower controlling-stockholder offer was fair, and even generous, and that the higher third-party offer was inadequate because of the "fundamental difference" between the two deals: the third party had to buy control whereas the controlling stockholder already held it. According to *Mendel*, a board in these situations must act as a "protective guardian of the rightful interests of the public shareholders," including using "extraordinary steps to protect the minority from plain overreaching." A board is not authorized, however, to

"deploy corporate power against the majority stockholders, in the absence of a threatened serious breach of fiduciary duty" by the stockholder. The board must respect the rights of the controllers (which include the right not to sell their shares), while assuring that the terms are also fair to the public stockholders and were the best available.

- Applying the principles of *Mendel* to the case at hand, the Court found that there was no overreaching by the controlling stockholders and, in fact, effort was made to comply with the *M&F Worldwide* framework (including its protections for the minority stockholders). The Court stated that the Books-A-Million special committee could not have acted loyally if it had deployed corporate power against the controlling stockholders to facilitate a third-party deal. Instead, the special committee could use third-party offers to test the controllers' buyer-only stance or to assess the value of the controllers' bid, which is what the special committee did.

- *The prompt resignation of an interested director from the special committee and his presence at the fairness presentation to the committee did not taint the special committee's independence.*

  - Initially, the special committee was comprised of three directors, but one director resigned prior to the commencement of any negotiations due to his "social and civic relationships" with the controlling stockholders. Although this director resigned at an early stage and did not participate in negotiations, to avoid the need for the special committee's financial advisor to make multiple fairness presentations, the resigning director was present for the fairness presentation to the special committee, which took place after negotiations had finished.

  - The plaintiffs argued that this director's initial membership on the special committee and his presence during the presentation tainted the committee's independence. The Court disagreed, noting that the director's resignation was "commendable," as it was prompt and occurred before negotiations commenced. Also, the Court found that the director's mere presence at the fairness presentation, after which he was excused and did not participate in deliberations, did not affect the committee's independence.

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Scott A. Barshay
Partner
New York Office
212-373-3040
Email

Ariel J. Deckelbaum
Partner
New York Office
212-373-3546
Email

Ross A. Fieldston
Partner
New York Office
212-373-3075
Email

Justin G. Hamill
Partner
New York Office
212-373-3189
Email

Stephen P. Lamb
Partner
Wilmington Office
302-655-4411
Email

Jeffrey D. Marell
Partner
New York Office
212-373-3105
Email


*Partner Richard A. Rosen, Counsel Frances Mi and Legal Consultant Cara Grisin Fay contributed to this alert.*

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