THE RECORDER

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Lessons in M&A From the 'Dole' Decision

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The Delaware Court of Chancery is seen by most corporate lawyers as management-friendly, predictable and highly skeptical of outsized shareholder claims. For the most part, Chancery Court opinions support this perception—except when they don't.

The Court of Chancery recently handed down an award of nearly $150 million to shareholders challenging the actions of senior executives of the fresh fruit and vegetable producer Dole Food Co. Inc. in connection with the 2013 $1.2 billion management buyout of the firm. The size of the award, which is reported to be the second largest award ever by a Delaware court in connection with an M&A transaction, is attention-grabbing enough. But what has surprised many observers was that even though the transaction was negotiated and approved by a special committee of independent directors, a majority of the shareholders voted in favor of the transaction, and the price received by shareholders was found to be within the "range of fairness," the court ultimately determined that shareholders were "entitled to a fairer price."

Delaware Court of Chancery opinions arguably have more impact on San Francisco and Silicon Valley companies than even our own state and federal courts. This is because Delaware has long been and remains the preferred state of incorporation for California-based companies, from startups to established *Fortune* 500 firms. Especially in Silicon Valley, where technology companies compete for investments and attention from venture capital and private equity firms, being incorporated in Delaware is almost a prerequisite to getting funded. And, being incorporated in Delaware and governed by Delaware corporate law, corporate governance disputes involving California-based companies are likely to end up before the Delaware Court of Chancery.

So, when the Chancery Court conducts a trial, writes a 100+ page opinion with a painstaking review of the evidence and thorough legal analysis, and holds senior executives of a major corporation personally liable for a deal that was admittedly fair, but could have been fairer, California business lawyers should pay attention.

Here are the basic facts: Dole's CEO and chairman David Murdock, 92, owned 40 percent of Dole in 2013, and decided, with the support of the company's chief operating officer, president and general counsel Michael Carter, to buy all the company's shares he did not already own. The Dole board of directors formed a special committee to negotiate the transaction on behalf of shareholders, which negotiated the share price up from Murdock's original offer of $12 per share to $13.50 per share, then recommended the full board approve the transaction, which it did. The transaction was then put to a shareholder vote, and won approval by a "majority of the minority," admittedly with a thin margin (50.9 percent).

Unsurprisingly for such transactions, shareholders (represented by pension funds) brought a class action claiming that Murdock and Carter breached their fiduciary duties in connection with the transaction, and that the share price should have been higher. What is surprising, though, is that the shareholder class claims did not result in a quick settlement, as is typical in such cases, but rather went to trial over nine days in February 2015 before Vice Chancellor Travis Laster. On Aug. 27, 2015, Laster issued his opinion, excoriating both Murdock's and Carter's conduct, and concluding that the steps taken to protect minority shareholders were form without substance: "[W]hat the Committee could not overcome, what the stockholder vote could not cleanse, and what even an arguably fair price does not immunize, is fraud." The fraudulent conduct included, among other things, efforts by Murdock and Carter to limit the special committee's authority, to influence its selection of a financial advisor, making public announcements to driving down the trading price of the stock prior to the announcement of the offer, and providing false financial projections to the Special Committee.

As a result, Laster ordered Murdock and Carter to pay shareholders $2.74 per share, or a 20.4 percent increase in the original transaction price. Notably, the other defendants on trial, including the other non-independent director and Murdock's financial advisor and lender, were not held liable.

With the caveat that cases involving blatant fraud are not always the most instructive for companies and executives looking for guidelines and best practices, they are still several critical and broadly applicable takeaways from the *Dole* decision.

1. A Fair Price Will Not Overcome Unfair Dealing

Delaware law has long required that judicial analysis of corporate transactions with a controlling shareholder, such as the management buy-out in *Dole*, are subject to the "entire fairness" standard of review. This concept has two aspects: fair dealing (timing, structure, negotiations, disclosures, approvals, votes), and fair price (economic and financial considerations, including the inherent value of the company). Although Laster acknowledged that fair price is the "predominant" consideration in the entire fairness test, he goes on to conclude that Murdock's and Carter's fundamentally unfair dealing was so abhorrent here—"the antithesis of a fair process"—that it fatally infected the entire deal, and that the price, although within the range of fairness, was less than what shareholders were entitled to. The lesson is that process matters, and that under the entire

fairness standard even if the ultimate terms of a transaction are objectively fair, that will not prevent close scrutiny into the intricacies of the events preceding and culminating in the transaction.

2. Pre-merger Conduct and Transaction Timing are Relevant to Fairness

One might assume that the court's analysis of the fairness of the negotiation and approval of a merger would focus solely on the time period between initial proposal of the deal and the closing. Laster's analysis, however, examined evidence that Murdock has been planning to take Dole private since 2012, had pushed for a self-tender offer, and had taken steps to intentionally drive down the price of Dole's stock in anticipation of the buy-out, including suspending a stock buy-back program and lowering earnings estimates. The court pointed to each of these actions in concluding that the merger process was fundamentally unfair.

3. Projections and Post-Merger Performance Are Relevant to Fairness

In seeking to neutralize their failure to provide to the special committee the internal projections they had presented to their lenders, Murdock and Carter argued to the court that they were not required to turn over optimistic projections of post-merger performance. The court disagreed, ruling that the plans and projections should have been disclosed, as they were "part of Dole's operative reality on the date of the merger." Moreover, the court looked to the post-merger realization of management's undisclosed projections as further evidence that the merger price was not fair. Interestingly, this case may have had a different outcome had the company's post-merger strategy been less effective.

Although the *Dole* decision applies most obviously to management-led buyouts, the court's broad and probing use of the "entire fairness" test is relevant to a broad range of transactions where a conflict of interest may exist. Lawyers advising California businesses or executives who find themselves on both sides of a transaction—which is not all that rare a circumstance in today's economy—would do well to internalize *Dole*'s lessons.

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