WEDNESDAY 13 JUNE 2012

Ellisa Opstbaum Habbart

The Delaware Counsel Group, Wilmington
ehabbart@delawarecounselgroup.com

The view from the bench

Moderators
James R Griffin *Weil, Gotshal & Manges, Silicon Valley*
James C Morphy *Sullivan & Cromwell, New York*

Speakers
Honorable Myron Steele *Chief Justice, Delaware Supreme Court*
Honorable Leo Strine Jr. *Chancellor, Delaware Court of Chancery*

The moderators began the session by acknowledging Delaware as the worldwide leader in corporate law. Leading jurists from the Delaware courts, Chief Justice Steele, the leader of the Supreme Court of Delaware, and Chancellor Strine, the leader of the Court of Chancery of the State of Delaware, were introduced to the audience.

The moderators then led a lively discussion that centered on the recent *In re Del Monte Foods Co S'holder Litig,* 25 A3d 813 (Del Ch 2011) and *In re El Paso Corp S'holder Litig,* 41 A3d 432 (Del Ch 2012) decisions rendered by the Delaware courts.

In *Del Monte,* the Delaware Court of Chancery preliminarily enjoined the consummation of a merger to allow time for a topping bid prior to a shareholder vote. The Delaware Court held that breach of fiduciary duty claims against the directors and the aiding and abetting claims against the purchaser had a reasonable probability of success on the merits of the claim. The investment bankers hired by the directors had a conflict of interest given they also advised the purchaser and were to provide buy-side financing. The Delaware Court acknowledged that while it was impossible to know the results of the merger negotiations, had they been handled by a representative that was not conflicted, the Delaware Court concluded that the burden of such uncertainty rested with the directors who created it. As a result, a preliminary injunction was appropriate.

In *El Paso,* the Delaware Court of Chancery determined that plaintiffs were reasonably likely to succeed on the merits of their claims that the Chief Executive Officer and the directors of El Paso breached their fiduciary duties when they approved an acquisition of the company by Kinder Morgan, Inc ('Kinder Morgan'). The Chief Executive Officer was also working on a plan to acquire parts of El Paso from Kinder Morgan following the acquisition. In addition, the financial advisors owned a significant amount of stock in Kinder Morgan. The Court fo Chancery was persuaded by the record that the board's less than aggressive negotiating tactics, its failure to conduct a pre-signing market check and debatable deal protection measures were related to the conflicts of El Paso's key negotiators. However, the Court declined plaintiffs' request for injunctive relief because no alternative bidder had emerged. In addition, El Paso's stockholders were well-positioned to vote against the transaction, should they decide the price was inadequate.

The Chief Justice and the Chancellor were asked whether the decisions summarised above established new Delaware law or if they were simply a continuation of existing law.

The Chief Justice noted that there is no new law established in the recent cases; the facts and context of the dispute regarding conflicts are different from prior cases. However, the concerns of the courts with respect to how the board of directors operates remain the same. Shareholders must be told of any flaws that could impact their decision making.

The Chief Justice also noted that the recent decisions do not stand for the proposition that the Delaware courts are directing how an investment banker is to perform their duties. When there is an allegation that an investment banker's opinion is tainted due to a conflict of interest, the question that must be asked – and answered – is whether or not the board of directors of a corporation has carried out its fiduciary duties. Specifically, has the board of directors fulfilled its duty of candour by providing all material information to shareholders in order for them to exercise their right to vote in their own best interest?

For example, consider a special committee member who is also a director of the investment banker retained by the corporation in connection with an auction of a corporation. As a result of the potential conflict between the two positions, the trustworthiness of both the special committee and the investment banker may be challenged. Similarly, consider a hostile takeover situation where the investment banker owns stock in the target company. The dual ownership may place the objectivity of the investment banker into question.

The best advice to follow is that all potential conflicts should be disclosed to shareholders. The board of directors should raise the issue first rather than waiting for another party to find and disclose the conflict. The fact that disclosure may be enhanced after there is a challenge to the integrity of the parties does not enhance the credibility of the parties.

If the advice is followed, a board of directors may be able to proceed with an investment banker that has a conflict as long as such conflicts are disclosed to shareholders.

The Chancellor then noted that lawyers have routinely done a better job than investment bankers with respect to the conflict issue. For example, a lawyer that is asked to represent a target company may have also represented other enterprises that are, or may become, involved in a hostile takeover. The lawyer will then disclose to clients that they regularly represent takeover parties and, as a result, securing other counsel should be considered.

The Chief Justice went on to explain that the Delaware courts are not saying that investment bankers must recuse themselves whenever a conflict exists. The conflict must be material. In addition, a board of directors may consider the circumstances of the conflict of interest and still have a good reason to proceed with such an investment banker. For example, substantial experience in a particular industry may be a reason to move forward with the investment banker notwithstanding the existence of a conflict. In such circumstances, the selection of the investment banker by the board of directors should be respected.

Chancellor Strine agreed that the recent cases do not establish new law. There is an extant conflict of interest in merger and acquisition transactions. You need the impartial investment banker to help with negotiations. However, the Delaware courts apply a reasonableness standard. As a result, Delaware courts have denied requests for temporary restraining orders when the disclosure looks wholly adequate and all conflicts of interest are addressed.

Examples of previous Delaware decisions that address similar fiduciary duty questions, albeit in a different context and based on different facts, were mentioned by the Chief Justice and the Chancellor.

In *Weinberger v UOP, Inc*, 457 A.2d 701 (Delaware 1983), two directors with conflicts provided information to shareholders and there was a finding that the duty of candour was violated.

In *Smith v Van Gorkom*, 488 A2d 858 (Delaware 1982), the quality of the information and process used to determine fair price were reviewed.

Finally, the Delaware Supreme Court decisions of *Lyondell Chem Co v Ryan*, 970 A2d 235 (Delaware 2009), *Barkan v Amsted Industries, Inc*, 567 A2d 1279 (Delaware 1989), *Paramount Communications v QVC Network, Inc*, 637 A2d 34 (Delaware 1994) and *In re Toys "R" Us, Inc, S'holder Litig*, 877 A2d 975 (Delaware 2005) were mentioned as examples of how a reasonablebness standard is used by the Delaware courts when considerations other than simply price are reviewed.

In *Lyondell,* the Delaware Supreme Court determined that the directors did not breach their duty of loyalty to the company even though they took only approximately one week to consider an offer. The Delaware Supreme Court explained that given the board met several times, permitted negotiations with other companies and were generally aware of their company's value, their actions were reasonable.

In *Barkan,* the Delaware Supreme Court concluded that a reasonableness test did not mandate the directors to conduct a market check so long as the directors had a reasonable and reliable basis for their belief that that the price being offered was the best possible price.

In *Paramount,* the Delaware Supreme Court held that a no-shop provision was unreasonable given that it impermissibly interfered with directors' ability to negotiate with another known bidder.

Finally, in *Toys "R" Us,* the Delaware Supreme Court used a reasonableness test to conclude that the directors were shielded from liability given that the directors took time to educate themselves, signalled publically their openness to strategic alternatives and situated themselves in the best position to choose merger terms that led to value maximisation for the shareholders.