

Corporate Finance/M&A - USA

Chancery court considers reasonableness of deal protection measures

Contributed by **Ropes & Gray LLP**

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In *In re Comverge, Inc Shareholders Litigation*⁽¹⁾ Vice Chancellor Parsons declined to dismiss a claim that a target company's board breached its fiduciary duties when it agreed to deal protection measures that stockholder plaintiffs claimed were unduly burdensome and restrictive to a potential alternative bidder.

Facts

In late 2011 Comverge, Inc, at the time facing severe capital constraints, received a take-private offer from HIG Capital for \$1.75 per share. As part of the offer, HIG proposed to extend a \$12 million bridge loan to Comverge. Following negotiations, HIG raised its offer to \$2.15 per share and the board granted HIG a 19-day exclusivity period. Two days after the start of the exclusivity period, Comverge received an offer from another bidder to buy the company for up to between \$4 and \$6 per share. The board pushed HIG to increase its offer, but the parties were unable to agree on an increased price during the exclusivity period. After exclusivity expired, the board commenced negotiations with the other bidder. Less than two weeks after the exclusivity period expired, HIG notified Comverge that an affiliate of HIG had purchased 51% of a convertible note that Comverge had issued to Partners for Growth III. The note afforded its holder blocking rights over any sale of Comverge. In the following days, HIG notified Comverge that it was in default under the note for failing to deliver certain compliance certifications and for failing to meet the required minimum revenue. The board disputed both points.

On March 5 2012 HIG made a reduced offer of \$1.50 per share, with the \$12 million bridge loan that would involve notes convertible into Comverge common stock at \$1.40 per share. After weeks of negotiations, HIG ultimately offered a \$1.75 per share price (for a purchase price of \$48 million), which represented a negative premium because Comverge's stock was trading at \$1.88 per share. HIG also told the board that if the proposed merger agreement was not signed within two days, it would accelerate the debt under the note and declare the entire principal and outstanding interest due and payable. The board accepted HIG's offer and the parties executed the merger agreement and entered into the bridge loan agreement simultaneously.

Comverge stockholder plaintiffs challenged, among other things, the deal protection measures included in the merger agreement, including:

- the termination fee;
- Comverge's agreement to reimburse up to \$1.5 million of HIG's expenses if it entered into a superior transaction; and
- the convertible notes issued to HIG, which the plaintiffs alleged could result in at least a \$3 million payment to HIG if Comverge entered into a superior transaction and should be considered in the analysis of the deal protection measures.

Decision

The Delaware Court of Chancery denied the board's motion to dismiss the claims that the board had breached its fiduciary duties by agreeing to these deal protection measures. The court noted that even if the lesser fee in the tiered termination fee structure was used and the convertible notes were excluded from the calculation, the combined termination fee and expense reimbursement would be equal to 5.55% of the transaction's equity value, which was near the upper limit of what the Delaware courts have considered a reasonable range for termination fees, even allowing for additional flexibility in the context of a micro-cap acquisition.

The court also considered whether the convertible notes should be included in the termination fee analysis. The plaintiffs argued that the conversion privileges of these notes could amount to an additional termination fee of at least \$3 million (ie, the additional amount an alternative bidder would

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need to pay for Converge if HIG elected to convert its notes). If this amount were taken into account, the total termination fee would amount to 13% of the transaction's equity value, an amount which the court indicated was well above the accepted range of reasonableness. The court found that it was reasonably conceivable that the convertible notes may have been viewed by potential bidders as additional termination fees, noting communications from an activist investor describing the notes as a second termination fee. Thus, at the motion to dismiss stage it was appropriate to consider them as a component of the deal protection measures. The court also noted that its concerns over the protection measures in the case were heightened by the fact that the deal was at a negative premium to the market price, and because HIG's control of the note gave HIG superior bargaining power in the transaction.

Comment

Stockholder plaintiffs almost always assert that the deal protection measures agreed to by the parties in a transaction are improperly preclusive, and this is a rare case in which that claim resonated with the court. Accordingly, practitioners should note the court's guidance on the upper boundaries of 'reasonableness' for termination fees and other ancillary factors (eg, bargaining power and the premium on the deal that is being protected) that Delaware courts will look at when evaluating the preclusive effect of deal protection measures.

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Endnotes

(1) CA No 7368-VCP (Del Ch November 25 2014).

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