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The Ropes Recap

Mergers & Acquisition Law News

A quarterly recap of mergers and acquisition law news from the M&A team at Ropes & Gray LLP.

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News from the Courts

Delaware Court Awards $148 Million in Damages, as Fiduciaries' Bad Faith Conduct Prevented Stockholders from Obtaining a "Fairer Price" in Take-Private Transaction

In a recent post-trial opinion, Vice Chancellor Laster of the Delaware Court of Chancery held David Murdock, the Chief Executive Officer and 40% stockholder of Dole Food Company, Inc. ("Dole"), and Michael Carter, a Dole director who also served as Dole's President, Chief Operating Officer, and General Counsel, liable for $148 million in damages for their conduct relating to the November 2013 transaction in which Murdock took Dole private for $13.50 per share. Vice Chancellor Laster found that Carter, in concert with Murdock, acted to artificially depress Dole's value and to undermine the transaction process to ensure that Murdock could acquire Dole at an artificially low price. Notably, the transaction was approved by an independent special committee of Dole's board of directors and a majority of stockholders unaffiliated with Murdock, as provided by the framework for controlling stockholder deals established by *In re MFW Shareholders Litigation* ("*MFW*"). Nevertheless, Vice Chancellor Laster held that entire fairness review, rather than the business judgment rule review provided for in *MFW*, would apply, based on his finding that Carter and Murdock had undermined the special committee's process and effectiveness. He also held that, even though the $13.50 deal price was within a range of fairness as determined by the special committee's independent financial advisor, the Dole stockholders were entitled to a "fairer price" that an effective special committee could have potentially negotiated for. Vice Chancellor Laster awarded $2.74 per share in damages, far less than the $11.77 per share that the plaintiffs had sought.

Murdock has an extensive history with Dole, having acquired control over Dole in 1985 and previously taken Dole private in 2003. Murdock initiated an IPO in 2009, which reduced his ownership stake to 40%. The Court concluded that even though Dole had become a public company, Murdock remained "an old-school, my-way-or-the-highway controller who dominated the company's operations." The Court also found that Murdock, together with his "right-hand man" Carter, opportunistically conspired to commence another take-private transaction. In order to facilitate the transaction at a favorable price, the Court found that Murdock and Carter worked to depress Dole's stock price, both by suppressing the release of favorable information and by cancelling a potential share repurchase program that the board believed would increase Dole's stock price. Murdock and Carter were able to effect these changes, the Court noted, by alternately bullying and misleading directors, all with the goal of setting conditions favorable to their planned go-private transaction.

The Court found that, while Carter was taking efforts to suppress Dole's share price, which had traded down to $10.20, Murdock proposed to acquire Dole's remaining shares that he did not already own for $12 per share. Structured to comply with *MFW*, Murdock's acquisition proposal was conditioned on approval from (a) an independent special committee of Dole's board and (b) a majority of Dole's unaffiliated stockholders, which *MFW* sets as pre-requisites to obtain business judgment review of a squeeze-out transaction involving a controlling stockholder. In

making his proposal, consistent with *MFW*, Murdock informed the board that he was not interested in selling his stake in Dole, effectively precluding any transaction not approved by Murdock.

The Court found that the special committee, as well as its advisors, performed laudably in connection with the transaction, but that their efforts were undermined by Murdock and Carter. As an initial matter, the Court found that Carter attempted to limit the committee's authority only to negotiating with Murdock, rather than a broader mandate permitting the committee to negotiate for the best transaction available to stockholders. The Court also found that Carter had then inserted himself into the negotiations of NDAs with potential bidders, thus giving him (and presumably Murdock) insight into the identity of potential competitors. The Court further found that the special committee also had to overcome resistance from Carter and Murdock to independently selecting both its Chairman and its financial advisor, as Carter initially insisted that the committee use an advisor that had a long-term relationship with Murdock and Dole. However, the Court was most troubled by its finding that Carter provided the committee with artificially low management projections while withholding the "real" projections that were provided to Dole's lenders, and which were the basis for Dole's 2015 budget. The Court found that Carter's conduct severely handicapped the committee, which was forced to create its own projections in an effort to determine Dole's actual value, but which never had access to management's best estimates of Dole's expected future performance. The Court concluded that Carter's efforts to mislead the special committee about Dole's projected performance were "fatal" to the committee's otherwise good faith process, and prevented the committee from negotiating the transaction on a fully informed basis.

The Court found that, despite Carter's efforts, the special committee was ultimately able to obtain price concessions from Murdock, who increased his offer from $12 to $13.50, a price that the committee's financial advisor found to be within its range of fairness. The committee also obtained a relatively low termination fee and a go-shop provision, although the Court stated that the go-shop's efficacy was undermined by Murdock's unwillingness to sell his 40% equity stake to any other bidder. The transaction ultimately closed, with a slender majority (50.9% of the unaffiliated shares) approving the transaction, and holders of 17,287,284 shares seeking appraisal.

In arguing that their conduct was proper and entitled to judicial deference, Murdock and Carter relied heavily on their adoption of the *MFW* process, and pointed to the special committee's effectiveness in negotiating an increased, premium offer. But the Court held that the transaction process did not adhere to the substance of the *MFW* process, and that the special committee's "heroic" efforts were effectively undermined. The Court's review looked beyond the form of the technical adherence to the *MFW* mechanics and concluded that here the structure failed in practice to protect minority stockholders.

With respect to damages, the opinion acknowledged that an entire fairness "fair price" analysis should involve an assessment of whether the transaction fell within a "range of fairness." However, because the Court had also concluded that the negotiation was effectively undermined

by Murdock and Carter, the Court found that the negotiated transaction price was insufficient, holding that it is not "sufficient to obtain a fair price if that price is not the best alternative available for the corporation and its stockholders."

While the facts of Dole found by Vice Chancellor Laster were relatively extreme, the Dole opinion can be read as a warning to corporate officers – including senior in-house attorneys – that they retain a paramount fiduciary duty to stockholders and cannot act solely for the benefit of a controller, and may be held personally liable for bad faith conduct detrimental to the stockholders. Here, Vice Chancellor Laster expressly held that Carter had committed fraud, which prevents exculpation under Dole's 102(b)(7) provision and could make it difficult for him to obtain indemnification or insurance coverage for the Court's judgment. On December 7, 2015, both parties agreed to drop any potential appeal of the Court of Chancery's decision, and Murdock and Carter agreed to pay stockholders $101 million in damages and $12.5 million in interest to settle the litigation.

In contrast, Vice Chancellor Laster found that Mr. Murdock's financial adviser and lead financing bank was not liable to Dole's shareholders for aiding and abetting the breaches of duty found by the Court. In an important victory for investment banks, Vice Chancellor Laster found that Deutsche Bank "did not know about or participate in th[e] acts" which gave rise to liability, and that it "was not directly involved, nor even secondarily involved in the critical breaches of duty." Cabining the nature of claims against banks acting as financial advisors, Vice Chancellor Laster held that actions purportedly giving rise to aiding and abetting liability must "resul[t] in harm" to shareholders as "casually related damages."

In re Dole Food Co., Inc. S'holder Litig., C.A. No. 8703-VCL, 2015 Del. Ch. LEXIS 223 (Del. Ch. Aug. 27, 2015).

Delaware Court Denies Claims for Advancement in Two Recent Cases on the Basis of "By Reason of the Fact" Standard

Section 145 of the Delaware General Corporation Law (the "DGCL") permits corporations to indemnify any person for legal expenses "by reason of the fact" that they are a current or former director, officer, employee or agent of the corporation. Under Section 145, such persons may also make claims for litigation expenses in advance of the final disposition of litigation. While such advancement claims have often been broadly permitted by the Delaware Court of Chancery, in two cases decided in August and September 2015 the Court denied a former corporate officer's claim for advancement of litigation expenses, establishing limits on advancement claims.

In *Lieberman v. Electrolytic Ozone, Inc.*, two former officers of Electrolytic Ozone, Inc. ("EOI") brought a claim against EOI for advancement of legal expenses. Both of the plaintiffs had entered into employment agreements with EOI containing restrictive covenants regarding confidential information, non-competition and non-solicitation. In December 2013, EOI

discontinued operations and terminated the employment of the plaintiffs. In February 2014, the plaintiffs began working for a former customer of EOI, which had commenced an arbitration against EOI alleging breach of contract. In June 2014, EOI brought counterclaims against the former customer and the plaintiffs, alleging the plaintiffs had breached the terms of the restrictive covenants in their employment agreements by failing to return property and proprietary information to EOI and by breaching the non-solicitation and non-competition covenants in their employment agreements.

The plaintiffs, in turn, brought suit against EOI for advancement of their legal expenses in connection with EOI's claims against them, claiming that such advancement was required under EOI's corporate documents, which provided for indemnification and advancement to the full extent allowed by Delaware law, and indemnity agreements that the Plaintiffs had previously entered into with EOI.

Vice Chancellor Noble rejected the plaintiffs' claims for advancement. The analysis relied on the Court's interpretation of Section 145 of the DGCL, which permits corporations to indemnify current and former corporate officials for legal expenses incurred "by reason of the fact that the person is or was a director, officer, employee or agent of the corporation." Vice Chancellor Noble explained that the "by reason of the fact" standard requires a "nexus or causal connection" between the underlying proceedings and the corporate officer's official corporate capacities, and this connection is established if the person's corporate powers "were used or necessary for the commission of the alleged misconduct." Applying this standard, Vice Chancellor Noble found that the claims brought against the plaintiffs were contractual claims that arose out of actions plaintiffs took after they were terminated by EOI, meaning that no corporate power was used in connection with the alleged misconduct, and the "by reason of the fact" standard was not met. Accordingly, Vice Chancellor Noble found that advancement of expenses to the plaintiffs, whether by means of EOI's corporate documents or its indemnification agreements with the plaintiffs, was not permitted by the DGCL.

In *Charney v. American Apparel, Inc.*, Dov Charney, the founder and former Chairman and Chief Executive Officer of American Apparel, Inc. ("American Apparel"), brought suit against American Apparel, seeking advancement of legal expenses in connection with a breach of contract claim that American Apparel had brought against Charney. In June 2014, American Apparel's board of directors suspended Charney as Chief Executive Officer of American Apparel and revoked his authority to act on the company's behalf. A few days later, Charney, who owned over 40% of American Apparel's stock, entered into an agreement with an investment firm to provide financing for a potential transaction whereby Charney and the investment firm would acquire additional stock of American Apparel. Three weeks after Charney's suspension, Charney, American Apparel, and the investment firm, entered into a standstill agreement that restricted Charney from acting to replace American Apparel's directors and from disparaging the company.

In May 2015, American Apparel filed a suit against Charney alleging several violations of the standstill agreement, including discussions between Charney and a private equity firm regarding a potential takeover of the company, and several instances of Charney allegedly disparaging the company in discussions with its employees and in public statements. In June 2015, Charney filed a complaint seeking advancement of his legal fees from American Apparel in connection with American Apparel's suit against him under the terms of his indemnification agreement with American Apparel and under the company's corporate documents.

Chancellor Bouchard denied Charney's claim for advancement. Chancellor Bouchard found that American Apparel's corporate documents did not afford Charney a right to advancement, as the documents did not expressly impose advancement obligations on American Apparel with respect to former directors and officers, and Charney was no longer a director or officer of the company at the time that the May 2015 suit was filed.

The Court also found that the "related to the fact" language in Charney's indemnification agreement was properly interpreted as having the same scope of the "by reason of the fact" standard that appears in Section 145 of the DGCL. Chancellor Bouchard noted that, as a policy matter, there is no justification for interpreting advancement provisions in a manner that would negate the requirement of a causal connection to the use or abuse of corporate power that is imposed by the DGCL. Applying these conclusions to the facts of the case, the Court found that none of the allegations made by American Apparel against Charney was eligible for advancement under the "related to the fact" standard, because all of the alleged actions occurred after Charney had been suspended as an officer of American Apparel and none, therefore, involved an alleged misuse of corporate power.

Delaware law generally interprets the indemnification and advancement provisions of the DGCL quite broadly. However, the *Lieberman* and *Charney* cases show that the Court of Chancery will apply the "by reason of the fact" statutory test to advancement cases as a limit on permissible advancement. In each case, the Court of Chancery held that the "by reason of the fact" standard requires more than a mere "but-for" causal connection between alleged misconduct and the person's corporate officer status; instead, the alleged misconduct must be tied to an alleged misuse of corporate power, a standard which can be difficult to meet in cases where the alleged misconduct occurred after the termination of the officer in question.

These two cases also show that the "by reason of the fact" analysis is applicable to advancement claims arising out of both corporate governance documents and indemnification contracts between the corporation and its officer, as the Court of Chancery has shown it will interpret such contracts to be consistent with the statutory standard wherever possible, and may view contracts that clearly go beyond the statutory standard as being invalid under Delaware law.

Lieberman v. Electrolytic Ozone, Inc., C.A. No. 10152-VCN (Del. Ch. Aug. 31, 2015), and
Dov Charney v. American Apparel, Inc., C.A. No. 11098-CB (Del. Ch. Sept. 11, 2015).

Delaware Court Continues to Scrutinize Disclosure-Only Settlement Cases

In *In re Riverbed Technology, Inc. Stockholders Litigation*, one of a number of cases in recent months scrutinizing disclosure-only settlements, Vice Chancellor Glasscock gave further voice to the Delaware Court of Chancery's views on the merits of such settlements, which the Court has described as resulting in "intergalactic" releases by stockholders in exchange for supplemental disclosures providing little value in return (and at the same time resulting in the award of sizable legal fees to class counsel). Two other recent decisions (*Acevedo v. Aeroflex Holding Corp,. et al.* and *In Re InterMune Inc. Stockholder Litigation*) voiced similar criticisms, signaling a marked reduction of the Court's willingness to approve disclosure-only settlements in the future.

In re Riverbed arose from Thoma Bravo's $3.5 billion acquisition of Riverbed Technology, Inc. ("Riverbed") and involved typical post-announcement stockholder litigation claims of insufficient disclosure and breach of fiduciary duties. Fordham Professor Sean Griffith, a critic of disclosure-only settlements and a nominal stockholder of Riverbed, filed a formal objection to the proposed settlement, arguing that the supplemental disclosures provided were without value and that the release provided to Riverbed in exchange was too broad, foreclosing potentially valuable future claims by stockholders.

While Vice Chancellor Glasscock ultimately approved the settlement, finding that the supplemental disclosures did in fact have some tangible value (however small) and citing a respect for the parties' reasonable expectation that the accompanying release (while overbroad) would be approved by the Court, given the numerous other disclosure-only settlements that had been approved by the Court in the past, he went on to note that future plaintiffs and defendants would be on notice that similar reliance-based arguments would be given far less weight in the future. Despite approving the settlement, Vice Chancellor Glasscock was unwilling to award plaintiff's counsel the full $500,000 in requested attorneys' fees and reduced the requested attorneys' fees by approximately $200,000.

In re Riverbed, together with other recent Chancery Court settlement discussions, highlights a pattern in the Court's shifting analysis of disclosure-only settlements that could alter the landscape of stockholder litigation in public company deals. Over time, the Court's increasing skepticism of disclosure-only settlements (and the attorneys' fees associated with such settlements) may well discourage the filing of merger stockholder strike suits.

In re Riverbed Technology, Inc. Stockholders Litigation, C.A. No. 10484-VCG (consol.), memo. op. (Del. Ch. Sept. 17, 2015).

Technicalities Disqualify Dell Stockholders' Appraisal Rights under "Continuous Holder" Requirements

On July 13, 2015, the Delaware Court of Chancery in *In re Appraisal of Dell Inc.* granted summary judgment in favor of Dell, Inc. ("Dell") denying appraisal rights to three funds and two retirement plans (collectively, the "Funds") that had acquired Dell shares after the announcement of a going-private transaction because the Funds had not met the statutory "Continuous Holder" requirement.

In February 2013, Dell agreed to a merger in which each publicly held share of Dell common stock would be converted into the right to receive $13.75 in cash, subject to the statutory appraisal rights of stockholders. After the transaction was announced, the Funds engaged in "appraisal arbitrage" by acquiring shares of Dell stock and subsequently exercising appraisal rights with respect to 922,975 shares. The Funds held their shares through custodial banks which deposited the shares with the Depository Trust Company ("DTC"), and the record holder of the shares was DTC's nominee, Cede & Co. ("Cede"). After the Funds exercised their appraisal rights, in order to avoid inadvertently surrendering the shares in exchange for the merger consideration, DTC had the transfer agent issue physical stock certificates for the Funds' shares and then transferred them to the custodial banks.

The custodial banks' policies required that shares held by them be issued to their own nominees, so the transfer agent reissued the stock certificates in the names of the custodial banks' nominees. The Funds were not aware (nor had they specifically approved) of the transfers. Because of the transfer, Dell filed a motion seeking summary judgment denying appraisal rights to the Funds on the basis that Section 262 of the DGCL requires a stockholder seeking appraisal to "continuously hold such shares through the effective date of the merger" and any change in the stockholder of record of the shares from the date of the appraisal petition through the effective date of the merger would cause the stockholder to lose its appraisal rights.

In his opinion, Vice Chancellor Laster granted summary judgment for Dell, citing Delaware Supreme Court precedent that required him to strictly interpret the "Continuous Holder" statutory requirement, irrespective of the fact that the beneficial owners of the stock in question never changed. It is notable that a significant part of the opinion was devoted to advocating for an approach similar to the one used by the SEC, where beneficial owners are considered owners for securities law purposes, even though Vice Chancellor Laster's decision ultimately found that prior rulings of the Delaware Supreme Court required him to find that a technical transfer of a record holder (even without any beneficial change in ownership) nullified any appraisal rights. Vice Chancellor Laster noted that his 2010 *Kurz v. Holbrook* decision advocated for the Supreme Court to change its approach, but that the Court declined and stated that "a legislative cure [was] preferable" to the Court's interpreting who is a record holder.

In re Appraisal of Dell Inc., Consol. C.A. No. 9322-VCL (Del. Ch. July 13, 2015).

Delaware Supreme Court Confirms Effect of Majority Vote of Disinterested, Informed Stockholders

In the Fourth Quarter 2014 edition of the *Ropes Recap*, we reported on the Delaware Court of Chancery's holding in *In re KKR Financial Holdings LLC Shareholder Litigation*. In that decision, the Chancery Court found that a management entity with operational control of a target company, but holding only 1% of its stock and without control of the board of directors, was not a controlling stockholder. The Chancery Court further held that, because there was no controlling stockholder, a fully-informed vote of the disinterested stockholders approving the transaction would subject the transaction to business judgment review, rather than the more demanding standard of entire fairness review.

On October 2, 2015, the Delaware Supreme Court upheld the Chancery Court's decision. In his opinion for the Court, Chief Justice Strine focused on the principle that a fully-informed majority vote by disinterested stockholders will lead to business judgment review of a transaction, even if a company is required to hold a stockholder vote by statute rather than holding a vote voluntarily.

The Court clarified its previous decisions on this point. While the plaintiffs argued that the Supreme Court's 2009 decision in *Gantler v. Stephens* distinguished between voluntary votes of the disinterested stockholders (which would lead to business judgment review) and statutorily required votes (which could lead to entire fairness review), the Court explained that the true significance of *Gantler* was the materially misleading disclosure to stockholders in that case and not whether the stockholder vote was required by statute. The Court cited an extensive list of Supreme and Chancery Court precedents for the principle that as long as there is no controller, a majority of fully-informed, disinterested stockholders "can easily protect themselves at the ballot box by simply voting no" and do not need the protection of entire fairness review in post-deal litigation. This decision confirms a bright-line rule and should be welcome news to companies that wish to structure transactions to avoid litigation challenges.

Corwin v. KKR Financial Holdings LLC, No. 629, 2014 (Del. Oct. 2, 2015).

Accounting Standards Update

The End of Extraordinary Items

The Financial Accounting Standards Board's January 2015 Accounting Standards Update (ASU) 2015-01 eliminated the concept of extraordinary items. Extraordinary items were required to be separately reported below the line (i.e., net-of-tax and after income from continuing operations) on the face of the income statement. Under ASU 2015-01, companies are required to report material items that are either unusual in nature or infrequently occurring, or both, above the line (i.e., as a separate component of income from continuing operations). The nature and amount of

each item should be reported either as a separate line item on the income statement or in notes to the financial statements and should not be grouped with other similar items as "Extraordinary items." The amendments in ASU 2015-01 are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015.

FASB Proposes "Materiality" Guidance

FASB recently issued two exposure drafts that address the use of materiality to help companies eliminate unnecessary disclosures in their financials. In addition, the exposure drafts attempt to better align the FASB's conceptual framework with the legal concept of materiality. One of the exposure drafts proposes amendments to Chapter 3 of FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting*, and is intended to clarify the concept of materiality. The other exposure draft, Proposed Accounting Standards Update, *Notes to Financial Statements (Topic 235): Assessing Whether Disclosures Are Material*, promotes the appropriate use of discretion when deciding the materiality of disclosures.

The exposure drafts are part of the FASB's disclosure framework project, which seeks to improve the effectiveness of disclosures in the notes to the financial statements by clearly communicating the most important information. The FASB's proposals would make clear that FASB does not define materiality and would refer to materiality as a legal concept. In addition, the proposed changes would clarify that the omission of an immaterial disclosure is not an accounting error, and thereby help reduce the number of potentially immaterial items entities and their auditors are required to report to the audit committee. Under the FASB's proposals, footnote disclosures (or the omission thereof) could increasingly become subject to legal review.

At a recent meeting of the SEC's Investor Advisory Committee, members raised concerns regarding FASB's proposed changes to the definition of "materiality," asking whether the proposed changes would result in a "less sensitive standard that would allow for less disclosure". Comments on the exposure drafts were due on December 8, 2015.

Contributors

Partners:	**Associates:**
C. Thomas Brown (New York) thomas.brown@ropesgray.com	James Davis (Chicago) james.davis@ropesgray.com
Jason Freedman (San Francisco) jason.freedman@ropesgray.com	Tara Fisher (Boston) tara.fisher@ropesgray.com
Jane Goldstein (Boston/New York) (co-head of M&A) jane.goldstein@ropesgray.com	Jeffrey Koh (Chicago) jeffrey.koh@ropesgray.com
Howard Glazer (San Francisco) howard.glazer@ropesgray.com	Natalie Logan (San Francisco) natalie.logan@ropesgray.com
David Hennes (New York) David.Hennes@ropesgray.com	Marc Migliazzo (Boston) marc.migliazzo@ropesgray.com
James Lidbury (Hong Kong) (co-head of M&A) james.lidbury@ropesgray.com	Larissa Smith (New York) larissa.smith@ropesgray.com
Carl Marcellino (New York) (co-head of M&A) carl.marcellino@ropesgray.com	Justin Voeks (Chicago) justin.voeks@ropesgray.com
Philip Sanderson (London) philip.sanderson@ropesgray.com	Christian Westra (Boston) christian.westra@ropesgray.com
John Sorkin (New York) John.Sorkin@ropesgray.com	**Professional Support and KM Lawyers:** Fay Anthony (London) fay.anthony@ropesgray.com
Peter Welsh (Boston) peter.welsh@ropesgray.com	Marc Feldhamer (New York) marc.feldhamer@ropesgray.com
Marko Zatylny (Boston) marko.zatylny@ropesgray.com	Marvin Tagaban (New York) marvin.tagaban@ropesgray.com
Counsel: Martin Crisp (New York) martin.crisp@ropesgray.com	
Chief of Legal Knowledge Management: Patrick Diaz (Boston) patrick.diaz@ropesgray.com	