M&A Update

Delaware Court Finds Dole Executives Personally Liable for Millions in Damages for Defrauding Stockholders in Buy-Out and Undermining Special Committee Process

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In its August 27th post-trial opinion, *In re Dole Food Co., Inc. Stockholder Litigation,* the Delaware Chancery Court held Dole executives David Murdock and Michael Carter personally liable for $148 million in damages for undermining and interfering with the special committee's efforts to obtain a fair price for Dole's minority stockholders following Murdock's decision to take the Company private in 2013. The decision emphasizes that transactions with a controlling stockholder that employ the dual procedural protections of independent director and "majority of the minority" approval must actually adhere to the substance and purpose of those protections.

Background

Murdock, Dole's CEO and Chairman, owned 40% of Dole in 2013, when he decided to take the Company private with the help of Carter – his "right-hand man" and the Company's Chief Operating Officer, President and General Counsel.

The Dole board formed a special committee to evaluate the transaction. The special committee negotiated the buy-out price up from $12 to $13.50 a share and approved the transaction with the advice of its independent financial advisor. A very narrow majority of Dole shareholders (50.9%) then approved the transaction.

Several Dole stockholders sought appraisal, while others sued for breach of fiduciary duty claiming that Murdock and Carter engaged in egregious wrong-doing in connection with the transaction, leaving stockholders with less than a fair price for their shares. In addressing these claims, the Court noted that if a merger gives rise to both an appraisal proceeding and a plenary action for breach of fiduciary duty, the plenary action should be handled first because "a finding of liability and the resultant remedy could moot the appraisal proceeding." Ultimately, the Chancery Court found that the entire fairness standard applied, lambasting the actions of Murdock and Carter and making several key points on Delaware law.

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Takeaways

1. The Dual Protections Under the *MFW* Case to Justify Application of the Business Judgment Rule Will Not Protect a Controlling Stockholder Transaction from Entire Fairness Review in the Presence of Fraud. Murdock structured the buy-out pursuant to the guidelines set out in the Chancery Court's 2013 *In re MFW* decision. Specifically, Murdock conditioned the transaction, from the start, on (i) approval from an independent special committee and (ii) approval from a fully informed, majority of the minority stockholders. Even though the transaction had these procedural stockholder protections technically in place, the Court found that, in actuality, neither the special committee nor the stockholders were fully informed and therefore subjected the transaction to entire fairness review. Carter and Murdock – very purposefully – cancelled a previously announced stock repurchase for pre-textual reasons and made false disclosures minimizing potential cost savings in an effort to drive Dole's stock price down before Murdock's purchase. These actions the Court found undermined the validity of Dole's stock price as a measure of value. The executives then prepared "knowingly false" financial projections that undervalued the company and supported the $13.50 buy-out price. At the same time, the executives provided more accurate and positive projections to the banks who financed Murdock's buy-out. As the Court explained, "what the Committee could not overcome, what the stockholder vote could not cleanse, and what even an arguably fair price does not immunize, is fraud."

2. Controlling Stockholders and Executives Who Create an Informational Deficit for the Committee and Minority Stockholders and Otherwise Interfere with a Special Committee Risk Personal Liability. The actions of Murdock and Carter deprived the special committee and stockholders of their ability to consider the transaction on a fully informed basis and potentially say "no" to the merger. From the beginning of the special committee process, Carter interfered and failed to disclose fully all material facts relating to the value of Dole. Significantly, Carter directed Dole management to prepare different and more positive financial projections that were provided to Murdock's lenders but not to the committee. As the Court noted, "accurate and up-to-date information about the Company's financial performance is particularly important to the committee's work" and withholding this information is enough to render the committee ineffective.

   Carter also interfered and obstructed the committee's efforts to manage the process and negotiate effectively with Murdock. He challenged the committee's mandate, attempted to influence its selection of financial advisors, insisted on controlling the confidentiality agreements with potential bidders, held up data room access for the committee's financial advisor, arranged a due diligence session with company management for Murdock's lending group without the knowledge of the committee, advised Murdock during negotiations of the merger agreement and overtly disregarded

the committee's process instructions and directions from committee counsel. Given these actions, the Court found that the "negotiation of the Merger was the antithesis of a fair process."

3. The Court Will Review Whether Projections Reflected Management's Actual View of the Company and Business Performance After the Merger Can Be Relevant. Members of management and the controlling stockholder can be held liable if they present the committee and its advisors with projections that do not accurately encompass their full understanding and view of the business at the time, which includes potential performance in the future. Here, Murdock and Carter argued that the Court "cannot consider anything that happened after the Merger closed and must ignore both the cost savings that Dole actually achieved, as well as its farm purchases." The Court, however, vehemently disagreed, explaining that "the plans to cut costs and buy farms to improve profits were part of Dole's operative reality on the date of the Merger," and thus, they could not be ignored by Carter and Murdock for their own self-interest. Indeed, the court looked to Dole's post-merger performance to find that a reasonable assessment of Dole's business should have attributed value to the cost savings and farm purchases at the time management prepared the projections provided to the committee. Thus, while members of management and the controlling stockholder of course cannot predict with certainty the financials of the company in the future, this in no way insulates them from the requirement to present a fair and complete understanding of the company's situation to the best of their abilities.

4. Entire Fairness Review Will Cover Not Just the Transaction From the Time it is Proposed But Will Also Take Into Account Transactions That Occurred Leading up to the Transaction at Issue. The evidence before the Court showed that Murdock had been planning to take Dole private at least since 2012 and caused Dole to engage in several transactions, including a split-off of its higher margin businesses at a premium valuation and using the proceeds to pay down debt, in order to create the opportunity to take the company private. Murdock had also pushed for a self-tender offer which would have reduced the number of shares outstanding and facilitated his buyout. Then, Carter primed the market by pushing down the price of Dole stock. Thus, the timing of a merger itself can constitute a breach of the controlling stockholders duty under the entire fairness standard.

5. Financial Advisors Should Work to Identify and Counteract Flaws in a Controlling Stockholder's Financial Presentations. As the Court noted, several financial advisors have been heavily criticized by the Court over the past few years for their conflicts of interest and "outcome-driven analyses" in connection with challenged mergers and acquisitions (*Rural/Metro, Del Monte, El Paso*, etc.). In stark contrast with those opinions, the Court praised the special committee's financial advisor, Lazard, here for

"act[ing] with integrity" and providing "thorough and balanced work product." In the face of being presented with "lowball" projections from Carter, Lazard still made every effort to determine a fair price, including working with the committee to come up with projections of their own, upon recognizing the flaws in the numbers it was receiving.

6. <u>A Financial Advisor's Liability for Aiding and Abetting Requires Both Knowledge and a Duty to the Selling Stockholders or the Board Committee Representing Them</u>. The Court found that while Murdock's financial advisor, Deutsche Bank, might have favored him, it was not liable for aiding and abetting his breaches of fiduciary duty. Deutsche Bank did not know of the major areas of Murdock's fraud – and thus did not knowingly participate in the breach. Furthermore, the Court went on to explain that while the financial advisor "might have had some reason to be concerned that something might be amiss," as Murdock's advisor, it was "not Deutsche Bank's job to call the committee, its counsel, or Lazard to make sure everything was OK." In other words, where a financial advisor's duty runs to the wrong-doers and not the committee or the stockholders, it should not be open to liability – even if it suspects some wrong-doing. The court's decision with respect to Deutsche Bank should provide an important limitation on potential "gatekeeper" liability where a bank does not represent the selling company, its stockholders or the board committee charged with negotiating on their behalf.

7. <u>The Fairness of the Transaction May Hinge on Fair Dealing Alone</u>. Several recent Delaware decisions have also addressed the meaning of entire fairness, with some finding that fair price is enough absent fair dealing (*In re Trados*), while others have not (*In re Nine Systems Corp.*), depending on the context. The decision sheds further clarity on what it takes for a transaction to be entirely fair. Here, the Court found that even though $13.50 might fall within the range of reasonableness, the transaction was not entirely fair because the behavior and disclosure was egregiously not fair. Furthermore, a still fairer price could have been obtained. The decision underscores that though there is no one formula for creating an entirely fair transaction, it is clear from the case and *In re Nine* (where the transaction was found not entirely fair based on the lack of fair dealing, and even though no damages were awarded because the price was technically fair, the plaintiffs were allowed to go after attorney's fees) that a fair price will not save egregious conduct from liability.

8. <u>Fair Price or Not, Wrong-Doers Will Not be Able to Profit Off Their Misconduct</u>. Ultimately, the Chancery Court found that the value per share was closer to $16.24, and that Murdock and Carter were legally responsible for paying the stockholders the difference – equating to the $148 million. The court emphasized that Murdock and Carter's actions were "intentional and in bad faith," and that even though the price Murdock paid may have fallen with the range of reasonableness, Murdock and Carter

should not be allowed to profit off of their bad deeds. As the Court stated, "although facially large, the award is conservative relative to what the evidence could support."

For a full copy of the opinion, click here.

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