Delaware court determines controlling stockholder has no duty of self-sacrifice for the benefit of minority stockholders

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In *In Re Synthes Inc. Shareholder Litigation*, the Delaware Court of Chancery refused to impose the more exacting entire-fairness standard of review based on the allegation that the controlling stockholder was conflicted in a merger transaction because the target company executed a merger agreement with Johnson & Johnson that consisted of 65percent stock and 35 percent cash for all of the target's outstanding shares instead of pursuing an all-cash private-equity consortium bid that would have only cashed out the minority stockholders but required the controlling stockholder to roll substantially all of his equity into equity of the surviving company. *In re Synthes Inc. S'holder Litig.*, 2012 WL 3594293 (Del. Ch. Aug. 17, 2012).

The court based its decision on the "basic understanding that when a stockholder who is also a fiduciary receives the same consideration for her shares as the rest of the shareholders, their interests are aligned," and therefore the controlling stockholder would not have "a conflicting interest in the merger in the sense that he derived a personal financial benefit 'to the exclusion of, and detriment to, the minority stockholders.'"

The court also held that the mixed-merger consideration failed to qualify as a "change of control" subject to the enhanced scrutiny of a *Revlon* analysis because the control of the corporation post-merger would remain "in a large, fluid market," and the mix of 65 percent stock and 35 percent cash was nearly equivalent consideration to binding Delaware Supreme Court precedent that held that consideration of 33 percent cash and 67percent stock did not trigger enhanced scrutiny review under *Revlon*. *Revlon Inc. v. MacAndrews & Forbes Holdings*, 506 A.2d 173 (Del. 1986).

Accordingly, the court granted the defendants' motion to dismiss on all counts.

> "Delaware law does not … impose on controlling stockholders a duty to engage in self-sacrifice for the benefit of minority shareholders," the court said.

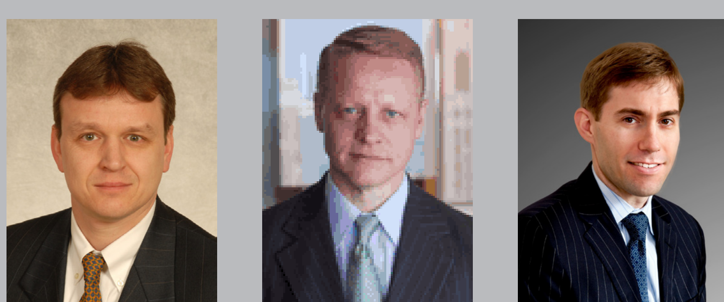
BACKGROUND

Synthes Inc. "was a global medical device company incorporated in Delaware with its headquarters in Switzerland, whose common stock traded on the SIX Swiss Exchange and, at the end of the 2010 fiscal year, had a market capitalization exceeding $15 billion.

The largest stockholder of Synthes was Swiss billionaire Hansjoerg Wyss, who directly held 38.5 percent of the Synthes' stock and, according to the plaintiffs, controlled about another 13.25 percent through his control of shares owned by family members and trusts.

In April 2010, as part of its ongoing review of strategic initiatives, the board decided, with the support of Wyss, to explore the possibility of a potential sale of the company. The board appointed an independent lead director to lead such process and hired Credit Suisse Securities (USA) LLC as its financial adviser. The company proceeded to conduct what the court characterized as "an open-ended and deliberative sales process" in which nine "logical strategic buyers with the financial capacity to acquire a company of Synthes' large size" were contacted in September 2010, followed by six private equity firms being contacted in November 2010. Of the strategic bidders, only J&J emerged, submitting an initial nonbinding offer to acquire all of Synthes at an indicative price range of CHF (Swiss Franc) 145-150 per share, with at least 60percent of the consideration to be in the form of J&J stock. Of the six private equity firms, only three firms remained through the bidding stages, with each indicating an unwillingness to independently finance the transaction.

Attentive to this concern, in January 2011 Synthes determined to permit the three remaining private equity firms to club for bidding purposes. On Feb. 9, 2011, the private equity consortium submitted an all cash bid of CHF 151 per share to acquire Synthes, but its bid was subject to Wyss converting a substantial portion of his equity into equity of the surviving company. While recognizing that the consortium's all-cash bid represented greater value certainty, the board also recognized that such bid was riskier because the ability to finance such transaction would depend on the financing



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markets and require Wyss to roll substantially all of his equity into a less liquid investment.

Accordingly, beginning in February 2011, at the board's direction, the lead independent director negotiated with J&J exclusively, initially informing J&J that Synthes had received a competing bid in amounts higher than J&J's initial bid. Following several months of due diligence review, J&J increased its offer in April 2011 to CHF 159, with 65 percent being in J&J stock, which implied a 26 percent premium to Synthes' average trading price during the preceding month and an implied equity value of $21.3 billion. The merger agreement was approved by Synthes' board April 25, 2011, with Synthes' stockholders approving the transaction Dec. 15, 2011.

From making its initial bid in February 2011 through December 2011, the private equity consortium remained silent. Moreover, at no time did a third-party interloper emerge.

THE COURT'S ANALYSIS

The plaintiffs challenged the fairness of the transaction to the minority stockholders on three related grounds, alleging that the J&J transaction:

- Was a conflicted transaction subject to entire-fairness review because the controlling stockholder, based on financial motives adverse to the interests of the minority stockholders, unfairly prevented Synthes from pursuing the all-cash bid from the private equity consortium.
- Was an "end stage" transaction following which Synthes stockholders would never be able to receive a control premium for their shares and, as a result, should be subject to enhanced scrutiny under a *Revlon* analysis.
- Contained unreasonable deal protections precluding more attractive third-party bids and, as a result, should be subject to enhanced scrutiny under a Unocal analysis. *Unocal v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985).

The business judgment rule applies to a merger resulting from an open and deliberative sale process when a controlling stockholder shares the control premium ratably with the minority

The court noted that one way for a plaintiff to rebut the presumption that a board's decision is entitled to the protection of the business judgment rule is to "allege that … the controlling stockholder received materially different terms from the third party in the merger than the minority stockholders" and, as a result, the transaction should be subject to an entire-fairness review. The basis for such an argument is that the "controller used its power over the company to cause the company to enter into a transaction that was not equal to all the stockholders and unfair to the minority because the controller unfairly diverted proceeds that should have been shared ratably with all stockholders to itself."

> *Revlon* does not apply, and even if it did, the board did not breach its *Revlon* duties.

The court viewed the plaintiffs' allegations as unconvincing and "ginned up" when plaintiffs asserted that "Wyss received liquidity benefits that were not shared equally with the rest of the stockholders and colored his decision to support the merger and to supposedly improperly reject further consideration of the partial company bid."

In the court's determination, "Wyss' supposed liquidity conflict was not really a conflict at all because he and the minority stockholders wanted the same thing: liquid currency and all things being equal at the highest dollar value amount of that currency. If there is anything even more liquid than J&J stock, its cash …Wyss had little reason not to prefer an all-cash deal if the PE Club was willing to out-bid J&J on terms equally available to all shareholders."

To the court, this logically explained why Wyss supported a consortium private equity bid. Putting this all into context, the court noted a controlling stockholder, given its large financial stake, would have a "natural incentive" to obtain the best price for its shares and, therefore, as "a general matter … if one wishes to protect minority stockholders, there is a good deal of utility to making sure that when controlling stockholders afford the minority *pro rata* treatment, they know that they have docked within the safe harbor created by the business judgment rule."

CONCLUSIONS

In summation, the court stated that "Delaware law does not … impose on controlling stockholders a duty to engage in self-sacrifice for the benefit of minority shareholders. That is, the duty to put the 'best interest of the corporation and its shareholders' above 'any interest … not shared by the stockholders generally' does not mean that the controller has to subrogate his own interests so that the minority stockholders can get the deal that they want."

Revlon *does not apply, and even if it did, the board did not breach its* Revlon *duties*

The court noted that "under binding authority of our Supreme Court …, Revlon duties only apply when a corporation undertakes a transaction that results in the sale or change of control. Putting aside the reality that the plaintiffs … were moving from a company under the control of Wyss to receiving stock in company that had no controlling stockholder, and thus is already an odd case to apply *Revlon*, the mixed-consideration merger does not qualify as a change of control under our Supreme Court's precedent. A change of control 'does not occur for purposes of *Revlon* where control of the corporation remains, post-merger, in a large, fluid market. Here, the merger consideration consists of a mix of 65 percent stock and 35 percent cash, with the stock portion being stock in a company whose shares are held in large, fluid market … [The] Supreme Court held that a merger transaction involving nearly equivalent consideration of 33 percent cash and 67 percent stock did not trigger *Revlon* review when there was no basis to infer that the stock portion of that consideration was stock in a controlled company. That decision is binding precedent."

Moreover, even if *Revlon* did apply, the court cited numerous actions taken by Wyss and the board — including the duration of the sale process and its open-ended, deliberative, and nondiscriminatory nature — to suggest that Wyss and the board likely chose a reasonable course of action to achieve the highest value reasonably attainable for Synthes stockholders.

The deal protections were not unreasonable and not preclusive

The court characterized the plaintiffs' allegations in this context as "half-hearted," noting that the plaintiffs failed to make any colorable argument as to why the J&J deal protections would have unreasonably precluded a third-party interloper from making a higher bid. Although Wyss had entered into a voting agreement, and there was a "force the vote" provision that required Synthes' board to submit the merger proposal to its stockholders despite the Synthes board having changed its recommendation with respect to the J&J merger, the court noted that if "a better topping bid was available, Synthes' stockholders could have voted down the merger and opened the door to that better bid … [B]ecause the board had deliberately searched the market and was seeking to close a favorable deal with the last remaining bidder, it had a firm market basis to make the decision about how likely a later emerging bid was and to judge what concessions in terms of deal protections were necessary in order to land the one huge fish it actually had on the hook. This court should be particularly reluctant to deem unreasonable a board's decision to use deal protections as part of the negotiating strategy to pull the best bid from the final bidder or bidders who emerge from an open process on the theory that some party that has already had a chance to make a real bid without having to hurdle any deal-protection barrier at all will somehow come to a different realization of the company's value, or that some unexpected bidder will emerge from an unexplored and overlooked dusty corner of our well-scoured capital markets."

CONCLUSION

The court's rejection of the various alleged fiduciary breaches suggested by plaintiff stockholders, including the controlling stockholders' and the board's decision to deal exclusively with an attractive, strategic bidder and to agree to typical deal-protection measures demonstrates, even under a *Revlon* and *Unocal* analysis, the continued deference shown to independent boards who diligently supervise a sale process and do not discriminate against any particular buyer or buyer class. The *Synthes* decision is also useful in that it reinforces the bounds of when *Revlon* scrutiny would not apply in mixed-consideration mergers.

NEWS IN BRIEF

DELTA PETROLEUM CONSUMMATES CHAPTER 11 PLAN

Denver-based Delta Petroleum Corp., now known as Par Petroleum Corp., has consummated its third amended plan of reorganization, the company said in an Aug. 31 statement. The plan is sponsored by Laramie Energy II LLC. Par said implementation of the plan, confirmed by the U.S. Bankruptcy Court for the District of Delaware Aug. 16, marks the conclusion of its financial restructuring and emergence from Chapter 11. Delta's outstanding common stock has been canceled and will no longer be traded, and $265 million in unsecured notes were converted into equity, the company said. As part of the plan, Par and Laramie formed a joint venture called Piceance Energy LLC, which is made up of the companies' assets in Colorado's Mesa and Garfield counties. Piceance distributed about $74.1 million to Par Petroleum, which said it intends to use the funds to pay bankruptcy expenses, secured-debt and priority claims, and to fund two litigation trusts.

In re Delta Petroleum Corp., No. 11-14006, plan confirmation (Bankr. D. Del. Aug. 16,

FEE APPLICANT MUST SHOW LACK OF SELF-INTEREST, 3RD CIR. RULES

A group of senior noteholders that succeeded in negotiating the removal of a board member of Tropicana Entertainment LLC during its Chapter 11 case has failed to convince a federal appeals panel that it should be paid more than $2 million in fees for its efforts. Tropicana and related entities filed for bankruptcy protection in May 2008 in U.S. Bankruptcy Court for the District of Delaware after the New Jersey Casino Control Commission revoked their gaming license in Atlantic City. According to the 3rd Circuit's opinion, the revocation resulted from "the gross mismanagement of board member William J. Yung III." After Yung refused requests to step down, the Ad Hoc consortium filed an emergency motion in Bankruptcy Court for the appointment of a trustee. The parties settled in a deal that called for Yung to resign from his management position. The agreement also acknowledging that expenses the consortium incurred in prosecuting the motion "represent a substantial contribution to the debtors' estate," the opinion said.

In re Tropicana Entertainment LLC, No. 10-3970, 2012 WL 3776531 (3d Cir. Aug. 31, 2012).

Related Court Document:
Opinion: 2012 WL 3776531

DBSI TRUSTEE CAN SEEK AVOIDANCE IN DELAWARE

More than a hundred defendants in an avoidance action brought by the liquidating trustee for DBSI Inc. have failed to convince a Delaware Bankruptcy Court judge that the case should be litigated on the company's home turf in Idaho. Judge Peter J. Walsh of the U.S. Bankruptcy Court for the District of Delaware found that Idaho, as the location of DBSI's primary operations, has a significant interest in the outcome of the DBSI bankruptcies and associated litigation. But he denied the defendants' motion to exchange venue, saying they failed to carry their burden to overcome the presumption favoring the trustee's choice of forum. As the forum for the bankruptcy cases, Delaware has an interest in ensuring that the aim of the Bankruptcy Code (the orderly and equitable distribution of the estate to creditors) is met," Judge Walsh said.