Going-Private Transaction Results in $148 Million Fraud Charge for CEO and GC – What to Consider Going Forward

September 15, 2015

The Delaware Court of Chancery (the "Court") recently found the CEO, David Murdock ("Murdock"), and the General Counsel, C. Michael Carter ("Carter"), of Dole Foods Company (the "Company") personally liable to investors for fraud in connection with the Company's 2013 going-private transaction.[1] The decision drew headlines due to the size and nature of the $148 million damages award; however, the Court decision may be remembered as a cautionary tale to management in future going-private transactions.

Background

In short, after undergoing a strategic process to consider its alternatives, which started in May of 2012, the Company ended up going-private in a $1.6 billion tender offer in November 2013, which resulted in Murdock acquiring 100% of the Company's stock at $13.50 per share. Before the transaction, Murdock was a 40% stockholder and was serving as Chairman and CEO of the Company. Murdock's initial proposal of $12.00 per share was presented to the Board in July 2013 and, ostensibly in secure the more favorable business judgment standard of review, was conditioned upon (1) approval by a committee of the Board comprised of disinterested directors, and (2) the affirmative vote of a majority of the disinterested stockholders.[2] An independent special committee (the "Committee") was in fact formed, which negotiated the price upwards to $13.50, and the disinterested stockholders narrowly approved the transaction with a 50.9% majority.

Despite the appearance that the process was fair due to these minority safeguards and yielded a fair price, the Court found that the transaction was not in fact the product of fair dealing but was fatally tainted by fraudulent conduct of the defendants. This conduct included the cancellation of a recently approved stock repurchase plan to drive down the market price of the Company's stock in advance of the merger proposal, the provision to the Committee of "lowball" management projections and a secret meeting with Murdock's lenders and advisors that violated the procedures established by the Committee and which resulted in positive financial and cost-saving information being shared with Murdock's advisors and lenders but not the Committee. The Court found that the defendants' conduct rendered the Committee ineffective as a bargaining agent for the minority stockholders.

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1 In re Dole Food Co. Inc. Stockholder Litigation, CA 8703-VCL, Delaware Chancery Court (Wilmington).

2 In re MFW S'hareholders Litig., 67 A.3d 496 (Del. Ch. 2013), aff'd sub nom., Kahn v M&F Worldwide Corp. 88 A. 3d 635 (Del. 2014).

Damages were calculated by the Court at $2.74 per share (totaling approximately $148 million), for which Murdock and Carter were held to be jointly and severally liable. Murdock was personally liable in two capacities—as a controlling stockholder and as a director. In addition, the acquisition vehicles that he used to effectuate an unfair freeze-out merger were liable as aiders and abetters to the same extent as Murdock, as its controlling stockholder. Carter was personally liable as a director and as an officer.

The Court was quick to dispel any misinterpretations of its decision.

- This decision was not a case of financial advisors being criticized, as the Court went out of its way to praise their "thorough and balanced work product."
- This decision was not a case of the Committee engaging the wrong legal advice, as they recognized the advisors as acting with integrity.
- Even with some "triable questions of fact" regarding the Committee's independence, the Court indicated that the Committee performed its work with integrity, and in fact praised its assistance in negotiating the price up from $12.00 per share to $13.50 per share, a price range the financial advisors opined fell within a range of fairness.

Compliance with Procedural Requirements Does Not Immunize Bad Faith Conduct

The case involved significant questions as to which party bore the burden of proof, but the Court ultimately applied the entire fairness test, with the defendants bearing the burden throughout trial to demonstrate the entire fairness of the interested transaction. The Court indicated that even if the burden had been with the plaintiffs on all issues, the result would have been the same. Stockholders are not limited to a fair price, they are entitled to a "fairer price designed to eliminate the ability of the defendants to profit from their breaches of the duty of loyalty." The actions followed by management deprived the stockholders of a fair price, which even the Committee could not overcome, having successfully negotiated the price up from the original offer.

Even though the Court praised the Committee for its efforts, "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." Therefore, even if the procedural requirements of In re MFW Shareholders Litigation were properly followed, they did not adhere to these requirements in substance.

Wearing Multiple Hats Is Always Tricky

While it is always clear that a corporate officer cannot engage in fraud, this case is very much a reminder of how wearing multiple hats can be tricky. Carter, the General Counsel, also sat on the board and reported to Murdock, who at the time happened to own 40% of the Company.

The Court's decision is a reminder that a controlling stockholder must disclose fully all facts and circumstances surrounding the transaction. Even with an independent special committee in place, the duty of the officers to the stockholders is paramount. "To state what should be obvious, a controller cannot engage in fraud. Nor can a corporate officer, even if his principal loyalty is to a controller who is his boss and source of post-transaction employment. To be blunt, if a duly empowered committee asks for information, a corporate officer, employee, or agent has a duty to provide truthful and complete information." Without accurate and up-to-date financial information, the Committee was rendered ineffective. Even though the Committee was able to recreate financial projections of its own, a "no harm, no foul" argument was rejected by the Court. The Court discussed the financial projects at length, ultimately deciding that they were flawed (prepared inconsistently with prior projections, failed to include cost savings, and did not include other important information).

While many misdoings are cited in the over-100 page opinion, the cited examples generally circumvent the process, withhold information, and generally support the controlling stockholder rather than the unaffiliated stockholders in each instance.

<u>Timing and Disclosure Is Everything</u>

The Court considered the timing and the impact of the timing of the proposal and the transaction in detail in its analysis. Officers will need to be mindful, as always, that 20/20 hindsight will be applied to all disclosures (or omitted disclosures) during the course of the strategic process, and this timeline goes beyond the immediate going-private transaction (before and afterwards). Therefore, officers in a going-private transaction will need to be able to justify the timing of any information that they have (whether they share it or not) and the impact that this information would have had on a decision of price or approval of the transaction generally.

For example, in January 2013 Carter stated in a press release (notwithstanding internal estimates that were significantly higher) that cost-savings that the Company hoped to realize that year from a prior transaction were in the range of $20 million. The press release made no mention of any additional cost savings that were anticipated in later years and was followed by a large drop in the Company's stock price. The Court noted that the press release was issued just around the time that the defendants were engaging in internal discussions with its financial advisor about the potential merger. In testimony during the trial Carter testified that the cost savings ultimately achieved were $70 million, with only $5.5 million of cost savings attributed to the Company no longer being public. In considering the timing of these disclosure and omissions relative to the transaction, the Court concluded that (1) the minority was financially injured by the timing, and (2) the controlling stockholder gained from the timing of the transaction what the minority lost.

<u>Takeaways</u>

Although bad facts abound in this opinion, the Court's decision serves as a reminder to officers to be well-advised of their duty of loyalty during a going-private transaction.

1) The general counsel represents the Company during this process and not the controlling stockholder, the Committee, nor any other member of management, all of which have competing interests. The Court's decision characterizes the general counsel as representing Murdock rather than the Company.

2) In order for the process to prevail, candor must be exhibited by the officers. Without candor (i.e. proper information and disclosures), the process is rendered ineffective.

3) A proper process is still critical, and this decision does not change that, but a breach of the duty of loyalty may compromise it.

4) Even the first few pages of the Court's opinion serve as a valuable reminder of the importance of advisors, both quality and independence.

5) Having a well-run process, with good advisors, and a tone of professionalism between all parties (board, stockholders, management, and their advisors) benefits all parties.

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