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Delaware Court of Chancery Dismisses Shareholder Complaint for Failure to Allege Conflicts of Interest Among Board, Bidders

The Court of Chancery in *In re BJ's Wholesale Club, Inc. Shareholders Litigation* dismissed all of the stockholder plaintiffs' claims, which fell across a broad spectrum of claims that are typically brought to challenge board conduct in mergers. The decision reaffirmed that boards are entitled to rely on their advisors and to favor certain bidders over others, if done in good faith, and that pressure tactics by a large stockholder or buyer will be considered permissible hard bargaining unless the plaintiffs can show the actions were purposely designed to induce a breach of fiduciary duty.

Background

On July 1, 2010, Leonard Green Partners ("LGP") instigated what led to the eventual sale of BJ's by filing a Schedule 13D disclosing a 9.5% stake in the company. Initially, the company's non-executive Chairman led the company's response and discussions with LGP, but approximately two months after the filing, BJ's board of directors formed a special committee to evaluate strategic alternatives.

The special committee ran a sale process that focused on private equity buyers. In the early stages, a competitor expressed interest at $55-$60 per share, but the special committee for several reasons determined not to share confidential information with the competitor and the competitor made no further efforts toward a transaction with the company. The company also received a proposal for recapitalizing BJ's in a transaction the party said valued BJ's between $60 and $72 and which involved paying a one-time $20 per share dividend and acquiring that party's warehouse club franchise. The board rejected this proposal two days after receiving it.

Initially, the special committee was reluctant to permit potential private equity buyers to partner with each other, but eventually permitted LGP and CVC Capital Partners ("CVC") to submit a joint proposal. After negotiations, on June 28, 2011 the parties announced an all cash transaction at $51.25 per share, valued at $2.8 billion and representing a 6.6% premium to the closing price on June 28, 2011 and a 38% premium to the closing price before LGP announced its desire to acquire BJ's. The special committee's financial advisor delivered a fairness opinion containing a discounted cash flow analysis using projections the company had recently revised downward. Stockholder suits followed the announcement of the transaction, but it closed on September 30, 2011 after the plaintiffs abandoned their request for a preliminary injunction in response to additional disclosures made in the proxy.

Allegations of Interest Are Meaningless Unless Majority Is Interested or Lack Independence

It has become commonplace for stockholder plaintiffs to allege and pursue claims that directors are interested in a merger transaction, as the plaintiffs in this case did, but the Court reminded the parties that the relevant standard for alleging that a board is conflicted is that a <u>majority</u> of the board is conflicted. It further reminded the parties that allegations that a CEO controls a board composed of a majority of independent directors are implausible under ordinary circumstances.

Reasonable Process, Free from Conflicts, Difficult to Assail

Because the plaintiffs failed to allege that a majority of the board suffered a conflict of interest, they were tasked with showing that it was reasonably conceivable that the board's decision to sell was "so far beyond the bounds of reasonable judgment that it seems essentially inexplicable on any ground other than bad faith." But the complaint alleges facts showing that the BJ's board met regularly, formed a special committee with financial and legal advisors, conducted a publicized process, met with parties making serious overtures, negotiated for a price increase and obtained a fairness opinion – all of which the Court regarded as substantial evidence of the directors' good faith. The Court also found it was reasonable for the board to mistrust an overture from a competitor, especially where regulatory risks were "self-evident." Further, the Court held that the board had no obligation under *Revlon* to pursue the fundamentally different recapitalization proposal based on speculative estimates of value.

Hard Bargaining Does Not Constitute Aiding and Abetting

Plaintiffs claimed that LGP aided and abetted a breach of fiduciary in that they pressured the board to "accept a lower price and engage in a hasty sale" when they said that they would be "extremely disappointed if, for example, there was [a] $54 bid from somebody else and the board held out for $55." As the Court noted, "[t]his . . . hardly shows that [LGP] pressured the Board" and "amounts to nothing more than hard bargaining, which in an arm's-length transaction does not constitute knowing participation in a fiduciary breach."

Reliance on Advisors

Finally, the Court found there was no evidence that the board knew of any errors in the financial advisor's fairness opinion valuation (as alleged by the plaintiffs) and that to establish bad faith, plaintiffs had to show knowledge and not merely that the board "should have known" of the alleged errors. The board was entitled rely on its carefully chosen financial advisor who was not alleged to have any conflict and not obligated to duplicate and double-check the advisor's work.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

Lewis R Clayton 212-373-3215 lclayton@paulweiss.com	Paul D. Ginsberg 212-373-3131 pginsberg@paulweiss.com	Andrew Gordon 212-373-3543 agordon@paulweiss.com
Justin G. Hamill 212-373-3189 jhamill@paulweiss.com	Stephen P. Lamb 302-655-4411 slamb@paulweiss.com	Frances Mi 212-373-3185 fmi@paulweiss.com
Robert B. Schumer 212-373-3097 rschumer@paulweiss.com		

Joseph Christensen and Laura Bower contributed to this memorandum.