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Delaware Court of Chancery Discusses the Application of Entire Fairness Review and *Revlon* in a Controlling Stockholder Context

The Delaware Court of Chancery in its most recent *Frank v. Elgamal* decision has further clarified the application of the entire fairness and *Revlon* standards of review in the context of a transaction involving a possible control group. In a nuanced decision the true impact of which will only be known after further fact finding at trial, the court focused in particular on whether there was a control group during different periods of the sale process.

Background:

The case centers on the sale of American Surgical Holdings, Inc. to an affiliate of Great Point Partners. The basic facts are the same as was summarized in our [memo](#) on the first *Frank v. Elgamal* decision, but we note the following facts as being particularly important to the court's findings in *Frank v. Elgamal II*: (i) four key employees of American Surgical (the "shareholder group") together owned approximately 68% of the company's stock, although no individual held over 50% of the company's stock; (ii) within weeks of receiving a call about a possible transaction from a potential buyer, GPP, the board had decided to sell the company, ultimately forming a special committee of two independent directors to oversee the process, with a mandate to maximize shareholder value, in particular for the minority shareholders; (iii) there was no evidence that the shareholder group exerted any control over the sale process or the terms of the initial GPP offer accepted by American Surgical (which included an partial equity rollover by the shareholder group); (iv) GPP proposed three decreased offers as a result of certain diligence findings, with the general trade-off being that the less stock rolled over the more net cash for the shareholder group but less for the minority shareholders; (v) the special committee, with relatively little debate noted in the record, accepted one of the three revised offers; and (vi) the special committee considered but declined to use a majority-of-the-minority condition because of concerns that imposing such a condition would endanger the deal with GPP.

Decision in *Frank v. Elgamal I*:

In *Frank v. Elgamal I*, the court denied several of the defendants' motions to dismiss, in each case based on the limited evidence available at that time.

Among other findings, the court held that plaintiff had sufficiently alleged that the shareholder group acted as a control group because each member had agreed to vote his common stock in favor of the merger, participated in the equity rollover and accepted employment in the post-merger entity. As such, the merger would be subject to entire fairness under *In re John Q. Hammons* and *In re LNR Property Corp.* unless conditioned on "robust procedural protections," including both (i) a recommendation by a disinterested and independent special committee and (ii) approval by a non-waivable vote of a majority of the minority stockholders.

Decision in *Frank v. Elgamal II*:

In *Frank v. Elgamal II*, we note the key holdings as follows:

- Whether a control group exists is central to whether the entire fairness standard applies in this context, and whether such a group existed is fact specific and can change throughout the course of a transaction as facts shift.
- Mere “parallel interests” among individuals are insufficient to establish a control group; rather the individuals must be “connected in some legally significant way – *e.g.*, by contract, common ownership, agreement or other arrangement – to work together toward a shared goal” to be considered a control group.
 - Here the court finds two distinct periods that are relevant to its analysis, (i) the time beginning when the board decided to put American Surgical up for sale and ending when it initially accepted the GPP offer and (ii) the time during the renegotiation of the GPP offer and acceptance of the final, revised terms.
 - As to the first period, the court concludes as a matter of law that the shareholder group was not a control group because no evidence suggested that the group exerted any control during that time. That a potential acquirer may need to structure its proposal to make it more palatable to the shareholder group does not automatically give the group control status.
 - As to the second period, however, the court found that a reasonable inference could be drawn that the shareholder group became united in their interests in favoring one of the three GPP options and may have exerted control over the selection of one of the options by the special committee. Thus, the court could not find as a matter of law that no control group existed during this later period.
- The court noted two nuances to the application of *Revlon* when there is a controlling shareholder: (i) if the company is not up for sale generally, *Revlon* may not be implicated if a controlling stockholder proposes a cash-out merger between it and the company, and (ii) if the company is for sale to a third party, the board’s goal is to determine if the sale would result in a “maximization of value for the *minority* shareholders” (emphasis added).
 - Here the court found that American Surgical entered *Revlon* mode when the board agreed to put the company up for sale after the initial GPP expression of interest. Because no evidence pointed to the existence of a control group at that time, *Revlon* dictated that the board seek the best price reasonably available to all stockholders. After the shareholder group may have become a control group, however, the board’s decisions as to which of the later GPP options to select would have been governed by *Revlon*’s requirement that the board obtain the best price reasonably available for American Surgical’s minority stockholders.
 - Notwithstanding that *Revlon* applied, however, the court found for the defendants’ on plaintiff’s breach of fiduciary claims against the special committee and its designated director-negotiator because plaintiff failed to demonstrate the interest, non-independence or bad faith

necessary to sustain a *Revlon* claim in light of American Surgical's exculpatory provisions under Section 102(b)(7) of the Delaware General Corporation Law.

- Plaintiff's *Revlon* claims against two other directors who were part of the shareholder group survived, however, because there is a reasonable inference that they may have acted in their own interests and influenced the special committee's decision in selecting one of the three GPP options.
- The court found for the defendants on plaintiff's breach of fiduciary duty claim against the two other employees that were part of the shareholder group. In each case, the court held that the employees did not owe any fiduciary duties to the company and its stockholders because they were not officers of the company.

For a copy of the opinion, click [here](#).

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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:

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