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Delaware Chancery Court Decisions Highlight That a "Crucial Difference" In Analyzing Director Liability For "Bad Faith" In the Context of an M&A Sales Process Is the Seriousness of the Bidder

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Two decisions earlier this year by the **Delaware Court of Chancery** in which the Court (Noble, V.C.) reached opposite conclusions on the divergent facts before it, serve to highlight that determining whether a bidder is "serious" in its pursuit of the target is a key factor in analyzing a target director's liability for "bad faith" in the context of a merger and acquisition ("M&A") sales process under Delaware law.

Revlon Duties Generally

Once a board of directors has decided to pursue a process that will result in the sale of the corporation, it is obligated to maximize stockholder value by seeking the highest purchase price reasonably available. *See Revlon, Inc. v. MacAndrews & Forbes Holdings*, 506 A.2d 173 (Del. 1986). If the target's certificate of incorporation includes the exculpatory provisions permitted by **Section 102(b)(7)** of the Delaware General Corporation Law, 8 Del. Code § 102(b)(7), a plaintiff who seeks to challenge the board's decision must demonstrate that the board acted in "bad faith" in order to succeed on a breach of the duty of care claim. Accordingly, if the corporation has in place a Section 102(b)(7) exculpatory provision, a defendant's motion to dismiss claims of breach of fiduciary duties in the M&A sales process context will be successful unless the plaintiff pleads facts supporting the conclusion that (1) directors breached their duty of loyalty (i.e., the majority of the board approving the transaction was "interested") or (2) the directors acted in bad faith.

In re Novell, Inc. Shareholder Litigation, 2013 WL 322560 (Del. Ch. Jan. 3, 2013): Motion to Dismiss Denied

In March 2010, the board of directors of Novell, Inc. ("Novell") issued a press release announcing that it was rejecting an unsolicited, non-binding offer to purchase the company for $5.75 per share and was retaining a financial advisor to "explore various alternatives to enhance stockholder value." Over the next few months, fifty potential buyers were contacted, thirty potential buyers signed non-disclosure agreements and nine potential buyers submitted preliminary non-binding proposals. Novell's board decided to pursue discussions with five of the potential buyers that had submitted non-binding proposals, including Attachmate Corporation ("Attachmate"). Subsequently, Attachmate, who, unlike the majority of bidders, had already been allowed to work with two strategic partners, indicated that it was having difficulties arranging financing and, unlike any other bidder, was allowed to seek additional financing. In August, the two remaining bidders, Attachmate and "Party C," were asked to submit "best and final offer[s]." Even though Attachmate's bid was $0.06 lower, it was granted exclusivity. During the exclusivity period, Microsoft offered to purchase certain patents and patent applications from Novell for $450,000,000, and Attachmate, unlike any other bidder, was told of the Microsoft offer and invited to submit a revised bid.

Ultimately, Novell's board of directors accepted Attachmate's revised bid, which reflected a purchase price of $6.10 per share. Upon public announcement of the transaction, certain

Novell stockholders brought suit in Delaware Chancery Court against Novell's board alleging, among other things, that the board had breached their fiduciary duties by conducting an "'improper and opaque' sales process [that] failed to maximize shareholder value" and had favored Attachmate over other bidders. Although the Court noted that the board was "not absolutely required to treat all bidders equally," he did not dismiss the case at the pleading stage because the facts pled indicated that the board "treated Party C in a way that was both adverse and materially different from the way they treated Attachmate," which supported "an inference that the Board's actions were in bad faith."

***In re BJ's Wholesale Club, Inc. Shareholders Litigation*, 2013 WL 396202 (Del. Ch. Jan. 31, 2013): Motion to Dismiss Granted**

In February 2011, the board of directors of BJ's Warehouse Club, Inc. ("BJ's") issued a press release announcing that it had hired a financial advisor to "evaluate potential strategic alternatives." Shortly thereafter, "Party A," one of two direct channel competitors, expressed interest in acquiring BJ's; however, because Party A "had no prior history of acquiring domestic companies" and BJ's board of directors was "not comfortable sharing material, non-public information with a direct competitor," Party A was rebuffed. Nonetheless, Party A submitted a conditional proposal to acquire the company in an all-cash transaction at a purchase price in the range of $55 to $60 per share. After two subsequent meetings with Party A, BJ's board of directors determined that "it would not be in the best interest of [BJ's] to pursue the expression of interest by Party A."

Ultimately, BJ's board of directors accepted a private equity offer that reflected a purchase price of $51.25 per share. Upon public announcement of the transaction, certain BJ's stockholders filed suit in Delaware Chancery Court against BJ's board of directors alleging, among other things, that the directors had breached their fiduciary duties by "shunn[ing] Party A . . . despite its superior offer of $55 to $60 per share." The Court, echoing the concerns of the BJ's board of directors, dismissed the action because, among other things, "Party A's proposal was subject to further due diligence and regulatory analysis" and the board "had no reason not to rely on its [financial advisor's] advice that strategic buyers, including Party A, would not likely be interested or that their interest would not lead to a serious offer."

The "Crucial Difference"

In the *BJ's* decision, Vice Chancellor Noble articulated the "crucial difference" between this case and *Novell*: the Novell board's actions "occurred *after* the board had determined that the bidder was a serious participant," while "the [BJ's] board was making an *initial assessment*, in its business judgment, whether pursuit of Party A's expression of interest was in the best interest of the Company and whether a transaction with Party A raised serious regulatory issues" (emphasis added). In other words, directors may have some leeway in their treatment of bidders in the initial stages of an M&A sales process; however, once a board of directors has adjudged bidders to be "serious," it is imperative that the board treat all such bidders equally.

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