Memorandum
To Our Friends and Clients

Delaware Chancery Court Reduces Fee Award and Urges Rationalization of Delaware Law on Going Private Transactions

In the context of slashing a class action fee request by 75%, Vice Chancellor Leo E. Strine of the Delaware Court of Chancery took occasion to suggest reforming the Delaware law governing the standard of review for going private transactions with controlling stockholders. Describing the class action suit as “premature, hastily drafted and makeweight,” the Court nevertheless determined that the suit could not be dismissed, and thus had settlement value, because of what the Vice Chancellor regards as the anomalous state of Delaware law.

Vice Chancellor Strine made these observations in a case relating to the acquisition by the Cox family of the minority interest held by the public in Cox Communications. The Cox family initially proposed a price of $32 per share, representing a 14% premium over the previous 30-day average market price. After vigorous negotiations, the Cox family and a special committee of disinterested directors agreed upon a price of $34.75 per share, subject to approval by a majority of the minority stockholders, settlement of the outstanding lawsuits and the receipt of a fairness opinion.

The plaintiffs settled their class action lawsuit with the Cox family, with the Cox family acknowledging that the pendency of the litigation had contributed to their decision to increase the offer price and to agree to the majority-of-the-minority condition. The family also agreed not to oppose an application for fees of up to $4.95 million, and that any fees awarded would be paid by the family. The Vice Chancellor approved the settlement even though it is clear he believed the case to be without merit.

Vice Chancellor Strine urges that the standard of review for a going private merger with a controlling stockholder should be the business judgment rule if the merger was
effected using a process that mirrored both elements of an arm’s length merger: approval by the disinterested directors and by a majority of the disinterested stockholders. Under present law, the entire fairness standard of review applies to any going private merger with a controlling stockholder. Because this standard requires a factual inquiry into the fairness of the transaction, it is impossible to dismiss any complaint challenging the transaction at the pleading stage on motion, and therefore any such complaint has “settlement value,” even where the complaint was filed prematurely and without any substantive basis.

On the other hand, Vice Chancellor Strine noted that the entire fairness standard of review does not apply under present law if controlling stockholders acquire the minority interest in a tender offer which is structured to be non-coercive and provides full disclosure to stockholders - even if the disinterested directors recommended that stockholders reject the tender offer. Vice Chancellor Strine believes that the entire fairness standard should apply if the disinterested directors recommend that stockholders not tender. Under the approach suggested by Vice Chancellor Strine, the deliberation process (both negotiation and review) and not the form of the transaction would govern whether the applicable standard of review is the business judgment rule or the entire fairness standard. Vice Chancellor Strine’s approach would require the Delaware Supreme Court to abandon the strict construction of the doctrine of independent legal significance in this area--where form trumps substance---and adopt a substantive approach that encourages the use of two complementary means of achieving results comparable to an arms'-length negotiation.

In light of the Vice Chancellor’s views about the merits of the plaintiff’s complaint, he approved legal fees of $1.275 million instead of the requested fee of $4.95 million. The Court concluded that the plaintiffs should not be entitled to any “risk” premium since the plaintiff had “at best” contributed pennies to the $2.75 per share increase in share price resulting from the negotiations of the special committee. In the Court’s view, the plaintiff was, at most, a stand-by monitor for the special committee in the event something went wrong – and, in the Court’s view, nothing did go wrong.