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Delaware Supreme Court affirms BGC decision finding conflicted-controller transaction 'entirely fair' despite an 'imperfect' sale process

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The Delaware Supreme Court, in an *en banc* decision issued August 10, 2023, affirmed the Court of Chancery's dismissal of *In re BGC Partners Inc. Derivative Litigation*. The lower court's decision (issued August 19, 2022) held that, despite significant flaws in the sale process for the challenged conflicted-controller transaction, the merger met the stringent entire fairness standard of review. The Supreme Court's one-page decision, without commentary, upheld the dismissal based on the reasoning set forth in the lower court's opinion.

Key points

- *BCG* furthers the Delaware courts' recent trend in more often finding that conflicted controller transactions meet the entire fairness standard (Delaware's most exacting standard of judicial review). Although, historically, application of the entire fairness standard generally was outcome-determinative in favor of plaintiffs, over the past few years, in several cases, the court has found that the standard was satisfied. Moreover, in *BCG*, the court found entire fairness satisfied notwithstanding apparently significant flaws in the sale process. The decision also highlights the court's recent emphasis on fair *price* as the predominant consideration in the "unitary" entire fairness analysis that examines both price and process.
- *BCG* reflects the highly facts-intensive nature of the entire fairness inquiry — and, therefore, that, when entire fairness applies (and the *MFW* prerequisites for business judgment review have not been satisfied), dismissal of claims at the pleading stage is rare. *BCG* also demonstrates, however, that, although dismissal of a case subject to entire fairness review may be rejected at the pleading stage, the defendants may be able to prove entire fairness at trial. The case underscores the benefit of utilization of a *clearly* independent, well-functioning special committee in a conflicted-controller sale process — as there is then the potential for a shift of the burden of persuasion on entire fairness, and thus the potential for dismissal of the case, at the pleading stage (avoiding the significant expense and distraction of a trial).

Background. Howard Lutnick controlled Cantor Fitzgerald, which indirectly owned both Berkeley Point and BGC. Lutnick proposed that BGC acquire the financially struggling Berkeley Point. A Special Committee of BGC's board, comprised of the company's four outside directors (*i.e.*, all of the directors other than Lutnick), approved the transaction.

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BGC minority stockholders brought suit, alleging that Lutnick had caused BGC to overpay for Berkeley Point, which was in his personal interest because he owned a far larger economic stake in Berkeley Point than in BGC.

Lutnick initially had mentioned a price for Berkeley Point of about $700 million, but the price BGC ultimately paid was over $875 million (plus a side debt investment by BGC of $1 billion in a separate business of Berkeley Point's parent company). Lutnick received 42% of the alleged overpayment, which amounted to $125 million.

The plaintiffs contended, however, that Lutnick had presented the transaction to the BGC board as a *fait accompli*; had dictated the timing and terms of the transaction; had co-opted the Special Committee, rendering it ineffective; had withheld valuation information from the BGC board; and had increased the price from what he had originally suggested, in part in order to cover Cantor's large tax liability for the transaction.

The court applied the entire fairness standard to the transaction (as Lutnick stood on both sides of the transaction). At the pleading stage, Vice Chancellor Will rejected dismissal of the claims against Lutnick. After trial, however, the Vice Chancellor determined that

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the transaction was "entirely fair" and dismissed the case. That decision has now been affirmed by the Delaware Supreme Court.

Discussion

The court found the sale process significantly flawed. The transaction was approved by a Special Committee of BGC's outside directors (but was not subjected to a vote of the minority stockholders).

The Court of Chancery, in its post-trial decision, agreed with the plaintiffs that Lutnick was personally incentivized to have BGC overpay for Berkeley Point, and that his "presence loomed large" during the process and "marr[ed]" the process, including by his playing a role in the selection of the Special Committee's co-chairs and advisors, trying to control the timetable for the transaction, and having back-door discussions with the Special Committee's co-chair.

The court found that, despite the flaws, the process was fair. The Court of Chancery found that the Special Committee, which negotiated with Cantor over several months, had functioned effectively on behalf of BGC's minority stockholders.

The court emphasized that, notwithstanding the flaws in the process, the Special Committee and its advisors were independent of Lutnick, Lutnick ultimately separated himself from the process, the Special Committee "bargained hard" for BGC's minority stockholders, and the Special Committee successfully "pushed back" against Lutnick on important points and ultimately achieved a structure and price that were fair to the minority stockholders.

The court also observed that the agreed price of $875 million for Berkeley Point "was forged in the crucible of objective market reality," coming after "months of arm's length negotiations."

The court found that the price was fair. Importantly, in addition to finding that the Special Committee functioned effectively, the court found that Berkeley Point was "a unique asset particularly appealing to BGC," and that the merger price was "in line with what [BCG's] financial advisor determined to be appropriate" in "a detailed fairness opinion" that was delivered "after more than a month of additional due diligence" by the banker.

Further, the price was toward the lower end of what the court determined to be the range of fairness based on the analyses conducted by the parties' respective experts that the court found reliable as evidence of fair value. The court also observed that the agreed price of $875 million for Berkeley Point "was forged in the crucible of objective market reality," coming after "months of arm's length negotiations."

The court reaffirmed the recent Delaware trend emphasizing price over process under the entire fairness standard. The court wrote: "A fair process paired with an unfair price may ... cause the court to conclude that defendants have breached their fiduciary duties. Price, however, is often the paramount consideration because procedural aspects of the deal are circumstantial evidence of whether the price is fair."

At the same time, we would emphasize that a board should not underestimate the critical importance of the process prong of entire fairness. In some cases (*e.g., Trados*), the court has found that a conflicted controller transaction did *not* meet the entire fairness standard where the price was fair but the process was not.

A special committee should be prepared to "say no" to a transaction advocated by a controller, and should "push back" against the controller in negotiating the transaction on behalf of the minority stockholders.

We would stress that an entire fairness inquiry will be fact-intensive, the overall factual context will be important, and a grossly inadequate price *or* process may result in the court determining that entire fairness was not met.

Practice points

- **A controller should not seek to influence a special committee's work**. Rather, a controller should, to the extent practicable, remove himself from the deliberation process. Such removal generally should include not only abstaining from voting on the transaction at issue, but also not attending board or special committee meetings at which the transaction is discussed, and not participating in the process of selecting advisors to or chairs of the committee.
- **Advisors to a special committee should be independent of the controller**. If the controller played a role in selecting or recommending the committee's advisors, then the committee, once fully empowered, should itself reconsider the selection of advisors and choose for itself (and, if it reaffirms the controller's selection or recommendation, the reasons for the committee's judgment should be documented). BGC also highlights the benefits of a "detailed" fairness inquiry and opinion by the financial advisor.
- **A special committee should "negotiate hard" on behalf of the minority stockholders**. Committee members should be actively engaged — asking questions, requesting information, keeping abreast of developments, and so on; and these efforts should be documented (for example, in the committee's meeting minutes, which can also reflect information provided or actions taken outside of the committee's meetings). Most importantly, a special committee should be prepared to "say no" to a transaction advocated by a controller, and

should "push back" against the controller in negotiating the transaction on behalf of the minority stockholders.

- **Special committee members should be independent of the controller**. In selecting members of a special committee, the board should be mindful that even outside directors may be viewed by the court as non-independent if they are "beholden" to, or otherwise subject to the influence of, the controller. A controller should consider having at least one or more unquestionably independent directors on the board so that a special committee, if needed, can be formed that will be clearly independent. We would note that, in *BGC*, although there were issues about the independence of some of the outside directors, the court ultimately may have been influenced in part (at least in resolving close calls) by the directors' particularly distinguished credentials (which the court detailed in its opinion). Efforts should be made, where possible, to document the independence of outside directors so that an appropriate determination can be made at the pleading stage of litigation. For example, consideration should be given to reflecting in board and committee minutes that directors (especially those as to whom there could be some question about independence) were deeply engaged, asked questions, sought information, and at times "pushed back" against the controller's interests or requests. *BGC* also serves as a reminder that a controller should not try to dictate the timetable for a transaction in a way that would disadvantage the minority stockholders; and should not engage in back-door discussions with members of the special committee (and, if such discussions occur, they should be reported to the full committee).

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