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Court of Chancery Amplifies the MFW *Prerequisites (and May Portend a New Approach to* MFW *and* Corwin*?)*– Dell Technologies

In re Dell Technologies Inc. Class V Stockholders Litigation (June 11, 2020) can be viewed as a routine decision analyzing the *MFW* prerequisites to post-closing review of a transaction proposed by a controlled company under the deferential business judgment standard. We would suggest, however, that–possibly–the opinion should be read more generally as indicating that going forward the court may apply a more restrictive approach to the availability of business judgment review of challenged transactions under *MFW* (and, in the *non*-controlled company context, under *Corwin*).

Dell Technologies involved a post-closing challenge to a negotiated redemption by Dell Technologies, Inc. (the "Company"), a company controlled by Michael Dell ("MD") and private equity firm Silver Lake, of its Class V shares. The redemption was approved by both a special committee and the minority stockholders. However, the Court of Chancery, at the pleading stage, found that it was reasonably conceivable that the committee and the stockholders had been subjected to "coercion" by the Company. The court also found that it was reasonably conceivable that the disclosure to the stockholders had been materially flawed; that the special committee had not been fully authorized; and that the committee members had not been independent, had not fulfilled their duties, and had acted disloyally. On these bases, the court held that the *MFW* prerequisites to business judgment review were not satisfied. Vice Chancellor Laster denied the defendants' motions to dismiss and ruled that the "entire fairness" standard of review would apply.

Key Points

- **A company's statements that it might implement unilaterally an alternative transaction that would be disadvantageous to the minority stockholders may constitute "coercion" that precludes business judgment review under *MFW*.** The Company allegedly (i) made statements that it might implement a "forced conversion" of the Class V shares (which was authorized under the Company's charter) if the redemption were not approved, (ii) publicly took steps to prepare for a forced conversion, and (iii) did not authorize the special committee evaluating the redemption to consider and say no to a forced conversion. The court observed that the coercion may have undermined the ability of the committee to negotiate the redemption on the equivalent of an arm's-length basis and may have caused the stockholders to approve the redemption based on factors other than the merits of the transaction (*i.e.*, to avoid a forced conversion).

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- **A special committee's acquiescence to direct negotiations between the minority stockholders and the company (at least if to the point of complete "abdication" of its negotiating role) may constitute non-fulfillment of the committee's duties for *MFW* purposes.** After several large minority stockholders objected to the redemption terms that the special committee had negotiated on their behalf and recommended to them, those stockholders negotiated directly with the Company and secured improved terms for the minority stockholders. The court stated that a special committee, to fulfill its duties for *MFW* purposes (*i.e.*, to be viewed as having "functioned effectively"), cannot "abdicate" its role as the "independent negotiating agent" for the minority stockholders. Even though the stockholders negotiated better terms than the committee had, the court observed that the better terms were not necessarily fair or as good as the committee could have negotiated had it fulfilled its duties (and not been subject to coercion). While the court did not state as much, we observe that its concern about the direct negotiations undoubtedly was intensified based on its view that the committee wholly abdicated the negotiating role after the stockholders expressed their objections, as well as its view that the committee members may not have been independent.

- **A special committee's "catering to" the company's controller may constitute a breach of their duty of loyalty (which would be unexculpated).** The court found, at the pleading stage, that it was reasonably conceivable that the special committee directors had acted disloyally or in bad faith by "catering to" MD and Silver Lake. The focus of this analysis appears to have been, again, on the committee members' possible lack of independence and the abdication of their negotiating role in the latter stages of the process.

- **The decision underscores the importance of (i) selecting members for a special committee who will be considered independent and (ii) providing adequate disclosure to the stockholders.** The court viewed the Company's committee members as potentially non-independent due to extensive business co-investments and connections with the controller, as well as personal associations such as belonging to the same "exclusive" golf clubs. Of note, in one case, the personal connections the court emphasized were based on membership in the same exclusive golf clubs; and, in the other case, the business and personal connections were with the best friend of the controller rather than the controller himself. The court also viewed the disclosure to stockholders as potentially materially flawed. The decision underscores that, to ensure the availability of business judgment review under *MFW* (or, in the non-controlled company context, under *Corwin*), a company should (i) consider having at least some number of directors who are clearly independent of the company's controllers, and (ii) err on the side of disclosure in the event of any close-call issues (even if the disclosure might be embarrassing).

- **The opinion, possibly, may portend a more restrictive approach by the court in applying business judgment review under *MFW* (and *Corwin*).** Having ruled at the outset that the alleged threats by the Company conceivably constituted coercion and therefore rendered *MFW* business judgment review unavailable, the Vice Chancellor nonetheless went on to evaluate each of the plaintiffs' other claims–and found that almost all of them also, standing alone, would render *MFW* inapplicable. In addition, the Vice Chancellor appeared to go out of his way, throughout the opinion, to emphasize the low standard of review at the pleading stage (which is the stage at which *MFW* or *Corwin* applicability is determined). The Vice Chancellor pointedly articulated that, at the pleading stage, plaintiffs are entitled not to the "only inference," or even the "most persuasive inference," but to any "possible inference" in their favor that can be drawn from the alleged facts, assuming the truth of the alleged facts. It remains to be seen whether the Vice Chancellor simply viewed this case as, for whatever reason, meriting an unusually thorough explication of the *MFW* prerequisites–or whether the opinion signals that, going forward, the court may apply a more searching lens than previously when determining whether the "cleansing"

effects of *MFW* (or *Corwin*) is available. We note that some commentators have expressed the view that *MFW* and *Corwin* represented *over*-corrections to the problem they were intended to address (namely, the prevalence of litigation challenging M&A transactions), and that they have, inappropriately, provided "cleansing" for some transactions that involved egregious fact situations.

Background. In 2013, MD (the founder and CEO of Dell, Inc,) and Silver Lake took Dell, Inc. private through a leveraged buyout (with the Company being the resulting company). In 2016, the Company acquired EMC Corporation for $67 billion, using a combination of cash and newly issued Class V common stock of the Company. The Class V shares were designed to track the performance of VMware Inc. (a public company that was 81.9% owned by EMC and was one of its most valuable assets). The Class V shares were listed on the New York Stock Exchange and were subject to a conversion right (the "Conversion Right") such that, if the Company listed its Class C shares on a national exchange, it could then forcibly covert the Class V shares into Class C shares pursuant to a specified pricing formula (a "Forced Conversion"). The Class V shares represented 4%, and MD's holdings represented over 73%, of the Company's outstanding voting power. The Class V shares traded at a discount of about 30% as compared to the publicly traded shares of VMware (commonly referred to as the "Dell Discount"), due to a public perception that MD and Silver Lake could exploit the Conversion Right to their advantage or take other actions that would disadvantage the public stockholders.

After acquiring EMC, the Company considered how "to consolidate its ownership of VMware." The three logical paths were: (i) a negotiated acquisition of VMware, (ii) a negotiated redemption of the Class V shares, or (iii) a Forced Conversion. The board formed a special committee (the "Special Committee"); authorized it to evaluate and negotiate (or "say no" to) a redemption or any similar transaction; and conditioned a redemption or other transaction on approval by the Special Committee and the holders of a majority of the Class V shares. The board did not authorize the Special Committee to evaluate (or say no to), and reserved the right to implement, a Forced Conversion.

For three months, the Special Committee, on behalf of the minority stockholders, negotiated the terms of a redemption with the Company. During that time, according to the plaintiffs, the Company's representatives and the Special Committee's advisors repeatedly told the Special Committee that, if a negotiated redemption were not approved, the Company would proceed unilaterally with a Forced Conversion, which, they stressed, would be the least attractive option for the Class V stockholders. The Special Committee ultimately agreed to a redemption (the "Committee-Sponsored Redemption") that valued the Class V shares at $21.7 billion. Several large Class V stockholders objected to the Committee-Sponsored Redemption. The Company (rather than the Committee) then negotiated directly with these stockholders over a period of four months, and ultimately acceded to a redemption that valued the Class V shares at an amount that was $2 billion higher (the "Stockholder-Negotiated Redemption"). The Company informed the Committee of the terms of the Stockholder-Negotiated Redemption; the Committee met and approved it; and the Class V stockholders approved it with 61% of the unaffiliated Class V shares outstanding voting in favor.

Certain Class V stockholders brought a post-closing action for damages against MD, Silver Lake, and the Special Committee directors, claiming they had breached their fiduciary duties in connection with the negotiation and approval of the redemption. The defendants responded that *MFW* applied and therefore fiduciary breaches would be cleansed under the business judgment standard of review. The court held that the alleged facts supported a reasonable inference that the *MFW* prerequisites had *not* been satisfied and therefore entire fairness review would apply.

***MFW*.** "In order to invoke *MFW* and receive the benefit of the irrebuttable business judgment rule," the court wrote, "the controller must irrevocably and publicly disable itself from using its control to dictate the outcome of the negotiations and the shareholder vote, thereby allowing the conflicted transaction to

acquire the shareholder-protective characteristics of third party, arm's-length mergers." The prerequisites to applicability of *MFW* are: (i) from the outset of the process, the transaction was irrevocably conditioned on approval by both a special committee and a majority of the minority stockholders; (ii) the committee was comprised of directors who were independent and disinterested with respect to the proposed transaction; (iii) the committee was fully authorized (*i.e.*, empowered freely to select its own advisors and to "say no" definitively to the proposed transaction); (iv) the committee satisfied its duty of care in negotiating a fair price (*i.e.*, functioned effectively); and (v) the minority stockholders' vote was "fully informed" (*i.e.*, the disclosure was not materially flawed) and "uncoerced."

Coercion of the Special Committee: The court found it reasonably conceivable that the Company and its advisors made "threats" that coerced the Special Committee and undermined its ability to negotiate effectively. The court found that it was reasonably conceivable that "the Special Committee was deprived of the ability to negotiate a redemption, free of the sword of Damocles that the Conversion Right represented." The Committee thus may have been "unable to bargain at arm's length" and may have agreed to the redemption "not because it was fair, but because it was better for the Company's stockholders than a Forced Conversion." The court cited the following as part of "a steady drumbeat" of actions that "signaled the Company's intent to exercise the Conversion Right in the absence of a negotiated redemption": the Company reserved the right to implement the Forced Conversion unilaterally when it authorized the Special Committee to consider transactions; the Company disclosed that it was considering a range of potential transactions, including a Forced Conversion; the Company's investment banker emphasized to the Committee the possibility of a Forced Conversion and said that it would be for a small number of shares ("to capitalize on nervousness about [it]"); the managing partner of Silver Lake met with the Committee's financial advisor "to stress the downsides of a Forced Conversion for Class V stockholders"; and the Company disclosed in an SEC filing that the Company met with an investment bank to explore a potential IPO of its Class C stock as a "contingency plan" in case the redemption were not consummated. The court also cited examples of statements by the Committee members and the Committee's advisors that evidenced that they "were mindful at all times of the Company's ability to implement a Forced Conversion." The court noted that the Company "did not simply make truthful disclosures about a necessary consequence of a failure to approve a transaction"–rather, given that the Company "was never obligated to exercise the Conversion Right," its statements "signaled to the Class V stockholders that if they rejected a negotiated redemption, then the Company would choose to exercise the Conversion Right."

Coercion of the Stockholders: The court found it reasonably conceivable that the Company subjected the minority stockholder vote to "fiduciary breach coercion" and "situational coercion." ***Fiduciary breach coercion*** occurs when a fiduciary threatens, or structures a transaction to create, a negative consequence if the transaction is not approved–as a result of which the stockholders' approval may be "for reasons other than the merits of that transaction." The court concluded that the Company's threats of a Forced Conversion may have induced the stockholders to approve the redemption to avoid the worse alternative of the Forced Conversion. ***Situational coercion*** occurs when the stockholders are presented with "an impossible choice between an unappealing status quo and an alternative which, although unfair, [is] better than their existing situation." (This type of coercion does not necessarily involve wrongful conduct or a breach by the fiduciary defendants, but "simply means that the stockholder vote does not have a cleansing effect.") The court observed that maintenance of the status quo was unappealing for the Class V stockholders because it meant "no prospect of escaping the Dell Discount, which had depressed the value of the Class V shares from the time of their issuance." The court concluded that the stockholders may have approved the redemption to avoid the worse alternative of a continuation of the Dell Discount.

Direct Negotiation by the Stockholders: **The court found it reasonably conceivable that, because the Class V stockholders negotiated directly with the Company to finalize the terms of the**

redemption, the Special Committee did not fulfill its duties. The court observed that *MFW* "contemplates that the special committee will act as an independent negotiating agent whose work is subject to stockholder approval." The committee's and the stockholders' respective roles "are complements, not substitutes," and stockholders "cannot take over for the committee and serve both roles." If a committee's initial result is rejected by the stockholders, "it does not mean that its work is over or that it can pass the baton to a handful of stockholder volunteers to negotiate for themselves." When the Class V stockholders objected to the redemption terms negotiated by the committee, the Committee should not have acquiesced to their negotiating directly with the Company, but should have "return[ed] to the bargaining table, continue[d] to act in its fiduciary capacity, and [sought] to extract the best transaction possible." Although the stockholders negotiated more favorable terms than the Committee had achieved, the court noted that the shares were valued $3 billion lower than the price that the Committee (just before it abdicated its negotiating role) had told the board it believed would have to be paid to obtain stockholder approval. The court noted that the shareholders' negotiations would be part of the evidence the court would consider when making a determination whether the price and process for the redemption were entirely fair.

Non-independence of the Committee: The court found it reasonably conceivable that neither of the two Special Committee members were independent of the controllers. As described by the court, based on the facts alleged: (i) "***D***": D is a partner of a private equity firm ("PE") that has "longstanding relationships with [MD] and Silver Lake," including having advised them on their leveraged buyout of Dell, Inc. and the Company's acquisition of EMC, and having invested in six companies associated with MD and Silver Lake (for one of which he serves as a director). D also has "close social ties" to the managing partner of Silver Lake, based on both of them belonging to two "selective" golf clubs (known for the "like-mindedness" of, and "trust" among, the members) and having played together in "numerous" amateur golf tournaments. According to the court, "[f]or purposes of this case, the social connections are reinforced by the fact that [D] turned to a third member of [these golf clubs] to serve as the lead banker to the Special Committee and the retention happened only days after [that person] played in a golf tournament with [D] and in a foursome with [D]'s wife." Both D and the managing partner of Silver Lake also are "platinum" donors (donating over $25,000 per year) to the University of Georgia. These relationships, "taken as whole," make it reasonably conceivable that D's ability "to engage in hard-nosed bargaining as a member of the Special Committee" was compromised. "As a principal of [PE], [D] had reason to remain on good terms with both [MD] and Silver Lake, given their outsized influence in the financial world and the history of beneficial transactions that these relationships have generated for [D]'s firm"; and D's social connections with the managing partner of PE "underscore and reinforce his financial and economic relationships with…Silver Lake."

(ii) "***G***": G has a 30-year "important and long-standing…friendship and business association" with "T"–the decades-long best friend and a frequent business partner of MD. (The court noted that the plaintiffs had not "cited any authority that requires a director to have a compromising relationship with the controller himself as opposed to a close advisor or other associate [of the controller].") T acted as the Company's "senior advisor" with respect to the Stockholder-Negotiated Redemption; and was the former CEO of EMC (on whose board G served). G and T "worked closely together" on the acquisition of EMC, after which G joined the Company's board and T acted as MD's senior advisor. During the same period, G and T jointly founded and were co-CEOs of a company focusing on "a field in which [MD] and Silver Lake have significant influence." G and T "traded on their relationship with [MD] to attract investors." G was appointed to the board of a company after T's private equity company bought a majority stake in it. The court concluded that, in this case, "[G] was supposed to be representing the Class V stockholders as their independent bargaining agent in a transaction where T, his co-CEO and long-time close friend, was advising the Company and [MD] on the other side of the negotiating table." Furthermore, while serving on the Committee, G also served as a director of Pivotal, a Company subsidiary that "was dependent on the

Company and VMware" and was being advised in its IPO by the same major investment bank that was advising the Company with respect to the redemption. "Taken as a whole,…[G]'s relationship with [T] and his role as a Pivotal director compromised his ability to negotiate vigorously and independently against [T] and the Company as a member of the Special Committee."

Disclosure Flaws: The court found it reasonably conceivable that the Company: (i) should have disclosed the redemption price that the Special Committee told the Company it thought the Company would have to pay to obtain the minority stockholders' approval (after the minority stockholders objected to the price the Committee had negotiated); (ii) should not have implied that the Committee achieved the increase in the redemption price when the increase was attributable to the stockholders' negotiations with the Company after "ignoring" the Committee; (iii) should not have characterized an advisor to the Committee (that had been engaged to evaluate the Company's projections) as an "independent industry expert," and should have disclosed the advisor's compensation arrangement, given that the advisor was "a one-man shop" run by a friend of the lead investment banker for the Company, had never consulted for a public company before, and had predecessor entities that "had run into financial difficulties"; and (iv) should have disclosed a valuation by Deloitte of the Class V shares, which was conducted three months before the Committee approved the Committee-Sponsored Redemption (and opined that the Class C stock was worth far less that the value implied in the Redemption), as it was "possible that the information had not become stale" although it was prepared eight months before the stockholder vote.

Duty of Loyalty: The court found that, "viewed as a whole," it was reasonably conceivable that the Special Committee members acted disloyally or in bad faith "in catering to the wishes" of MD and Silver Lake–by: (i) retaining as the Committee's lead banker an individual (at a major investment bank) who had close ties to MD and Silver Lake, without interviewing any other advisors (after Silver Lake apparently "brokered the engagement"); (ii) retaining an advisor to review the Company's projections that apparently "lacked the qualifications necessary" and whose "principal qualification appears to have been a close friendship with [the lead banker for the Committee]"; (iii) failing to use the Deloitte valuation "to push back against the Company's inflated valuation for its Core Business"; (iv) endorsing the Committee-Sponsored Redemption and "then abandon[ing] the field and bec[oming] a passive instrumentality, content to wait while the [Class V Stockholders] negotiated a superior transaction"; (v) rubber-stamping the Stockholder-Negotiated Redemption in a "late-night, one hour meeting"; and (vi) approving a proxy statement "that contained a seemingly false and misleading depiction" of the Committee's price proposal.

Practice Points

- **Board actions.** If a company or its controller seeks to structure a proposed transaction to be *MFW*-compliant, it should seek to ensure that: (i) the special committee is authorized to evaluate and "say no to" not only the proposed transaction but also all alternative transactions the company may be considering (including those that could be implemented unilaterally by the board); (ii) the board, special committee, company, and advisors do not make statements about options to implement alternative transactions that may be construed as coercive threats; and (iii) the special committee is kept informed of, and afforded the opportunity to participate actively in, any direct discussions that may take place between the stockholders and the company.

- **Low pleading-stage standard.** Clearly, the likelihood of liability for directors, or even the non-dismissal of claims against them at the pleading stage, even when a controller is involved, remains low in connection with transactions approved by a special committee and the minority stockholders. However, deal participants should be aware of the potential for non-applicability of *MFW* (or, in the non-controller context, *Corwin*), and thus the non-dismissal of claims at the pleading stage, based on judicial conclusions that it is "reasonably conceivable" that fiduciary duties were breached, stockholders or special committee members were coerced, a special

committee was not independent, the disclosure to stockholders was materially flawed, or the *MFW* conditions were not imposed "at the outset" of the process.

- **Potential inapplicability of *MFW* and *Corwin.*** *Dell Technologies* underscores the trend that in our view has been developing of expanded circumstances under which the courts may find these doctrines inapplicable. It will be important to monitor developments based on future Court of Chancery or Delaware Supreme Court decisions.

- **Disclosure.** It bears constant emphasis that, on any close calls relating to disclosure, companies should err on the side of disclosure (even if the disclosure may be potentially embarrassing)– given the severe consequences (including inapplicability of *MFW* or *Corwin*) if a court determines it is reasonably conceivable that the disclosure was materially flawed.

- **Committee advisors.** Advisors to a special committee should be selected by the committee, without participation by the company's controller. The committee should inform itself as to, consider, and appropriately address, any potential conflicts that the advisor may have. The committee should select advisors that it believes offer appropriate capabilities, experience, judgment, and reputation. A company should be careful about characterizing an advisor as an "industry expert" if it does not have appropriate experience or reputation or has had financial or other difficulties.

- **Independent directors.** A company should consider including on the board at least some number of directors who clearly would be deemed to be independent (*i.e.*, have no, or limited, business and personal connections with the company's controller). A company should avoid, if possible, committee directors or their advisors being in a situation where they are negotiating in some capacity for the company's controller while at the same time negotiating on behalf of the minority stockholders against the controller.

- **Section 220.** This case is another reminder that companies should be mindful of the potential for stockholders to obtain, under Section 200 requests, corporate books and records which can be used to frame allegations challenging the company's transactions

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