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Injunction Junction, Not Our Function: Court of Chancery Grapples with Enjoining Stockholder Votes on Troubled Transactions

By Stephen B. Brauerman

While more than 90% of publicly announced mergers face lawsuits from dissatisfied stockholders, obtaining a preliminary injunction to enjoin such transactions remains a tall order. Within the span of one week in February, three different members of the Delaware Court of Chancery each considered expedited challenges to proposed mergers (*In re El Paso Corporation Shareholders Litigation*, C.A. No. 6949-CS (Feb. 29, 2012), *In re Micromet, Inc., Shareholders Litigation*, C.A. No. 7197-VCP (Feb. 29, 2012), and *In re Delphi Financial Group Shareholder Litigation*, C.A. No. 7144-VCG (Mar. 6, 2012)) and—despite facts that led the court to conclude in two cases that serious breaches of fiduciary duty may exist—declined to enjoin the contemplated transaction. Instead, in each instance, the court chose to respect the shareholder franchise and allowed the stockholders to decide for themselves whether to approve the merger. Secure that the combination of monetary damages and appraisal rights would adequately, albeit imperfectly, protect dissenting shareholders, the Court of Chancery refused to enjoin shareholder votes on transactions that offered substantial premiums over pre-announcement market price where no alternative bidders were readily apparent—even in the face of disappointing, if not defective, negotiation processes. Even when faced with troubling circumstances, the Court of Chancery's prompt denial of each of these preliminary injunction motions demonstrates its respect for the shareholder franchise and unwillingness to deprive stockholders of the ability to think for themselves.

As with most equitable remedies, the Court of Chancery has substantial discretion to enjoin a challenged merger. Nevertheless, in order to obtain a preliminary injunction (as set out in the *Micromet* decision), a plaintiff must demonstrate "(1) a reasonable probability of success on the merits at a final hearing; (2) an imminent threat of irreparable injury; and (3) a balance of the equities that tips in favor of issuance of the requested relief." While a plaintiff must prove each element, "there is no steadfast formula for the relative weight each deserves. Accordingly, a strong demonstration as to one element may serve to overcome a marginal demonstration of another." *Canter Fitzgerald, L.P. v. Cantor*, 724 A.2d 571, 579 (Del. Ch. 1998). The adequacy of money damages makes it difficult for a stockholder plaintiff to demonstrate the requisite irreparable harm.

El Paso

In considering whether to enjoin the transaction, the Court of Chancery colorfully noted several facts that made the El Paso Corporation board's otherwise "reasonably debatable choices" subject to greater skepticism. First, El Paso's chief executive officer and primary negotiator did not disclose his interest in leading a post-merger management buyout of one of El Paso's businesses from Kinder Morgan, Inc. In the court's view, "when El Paso's CEO was supposed to be getting the maximum price from Kinder Morgan, he actually had an interest in not doing that." Second, the El Paso board received conflicted advice from Goldman Sachs, Inc. (which owned 19% of Kinder Morgan and designated two of its directors), and then inadequately cabined the conflict by incentivising Morgan Stanley, "the conflict-cleansing bank," to approve the merger since Morgan Stanley would only get paid if El Paso sold to Kinder Morgan. Third, the El Paso board employed a "less than aggressive negotiating strategy" in allowing Kinder Morgan to reduce its bid after threatening a hostile takeover and failed to subject the offer even to a soft-market check. These facts convinced the court, on a preliminary record, that plaintiffs had "a reasonable likelihood of success in proving that the Merger was tainted by disloyalty."

The court next considered whether El Paso stockholders would suffer irreparable harm if the Kinder Morgan transaction were to proceed. Chancellor Strine first found that the exculpatory provisions in El Paso's charter would make it difficult to recover money damages from El Paso's independent directors, who justifiably relied on management and the company's financial advisors in making their decisions, and then concluded that El Paso's wealthy CEO could not satisfy estimated post-trial damages in excess of $500 million. In view of these facts, the court was "willing to accept that the plaintiffs have shown that there is a likelihood of irreparable injury if the merger is not enjoined."

With the first two elements necessary for a preliminary injunction satisfied, the *El Paso* court turned to the "real question"—"whether the court should intervene when the El Paso stockholders have a chance to turn down the Merger at the ballot box." Two factors weighed heavily on the court's mind. First, the Kinder Morgan transaction presented a 37% premium over El Paso's pre-announcement trading price and no rival bid for the company existed. Second (and perhaps in recognition of this fact), the stockholder plaintiffs did not seek a traditional injunction enjoining the shareholder vote. Rather they sought a quasi-injunction that would allow El Paso to shop the transaction, unburdened by any of the deal protection devices in the merger agreement (no-shop, matching rights, and a termination fee of 3.1% of equity value) while retaining the ability to force Kinder Morgan to close at the end of the injunction period if El Paso could not find a better deal. The court observed that the plaintiffs' creative remedy "illustrates that they share the concern I have, which is that an injunction could pose more harm than good" and then held that "[g]iven that the El Paso stockholders are well positioned to turn down the Kinder Morgan price if they do not like it, I am not persuaded that I should deprive them of the chance to make that decision for themselves."

Micromet

Decided on the same day as *El Paso*, Vice Chancellor Parson's decision in *Micromet* exemplifies the court's reluctance to enjoin a shareholder vote and (notwithstanding *El Paso* and *Delphi*) demonstrates that showing a likelihood of success on the merits is a tall order. Micromet, Inc. is an early stage pharmaceutical research and development company that partners with larger pharmaceutical companies to commercialize and distribute the drugs in its pipeline. To develop one of its products, Micromet entered into a confidentiality agreement with Amgen, Inc., the largest independent biotechnology medicines company in the world. As a result of this partnership, Amgen expressed an interest in acquiring Micromet and, in July, 2011, offered to acquire Micromet for $9 per share. Micromet's board rejected the offer as inadequate and continued its efforts to partner with pharmaceutical companies to develop its products. In September 2011, Amgen reiterated its $9 offer, which Micromet again rebutted as inadequate. Amgen raised its offer at the end of October to $9 per share plus contingent payouts that could net an additional $3 per share. The Micromet board also rejected this offer as inadequate. On December 21, 2011, Amgen increased its offer to $10.75 per share. Micromet negotiated this offer and the parties ultimately agreed on a price of $11 per share—a 37% premium over the one-month volume weighted average stock price for the company. Before signing the merger agreement, Micromet conducted a market check with several pharmaceutical companies, but none of those companies expressed interest in an acquisition.

With the market check complete, Micromet and Amgen entered into a merger agreement that contained several protection devices including a no-solicitation provision, information and matching rights, a termination fee of 4.9% of enterprise value and an amendment to Micromet's rights agreement to exclude Amgen from the company's poison pill, but otherwise leaving the pill in place. Following the merger announcement, six different plaintiffs groups sought to enjoin the transaction. Specifically, plaintiffs' claim that the Micromet board breached its fiduciary duties by favoring Amgen as a bidder, waiting too long to complete any meaningful market check, and agreeing to deal protections that unreasonably shortened the tender offer period and precluded competing bids. The Court of Chancery found that plaintiffs were not likely to succeed on the merits because the scope of the market check was "adequate and consistent with the Board's well-informed understanding of the industry and Micromet's needs," and the deal protections were not, "at least collectively," preclusive.

Since the stockholder plaintiffs were not likely to succeed on the merits, the court also found that they were not likely to suffer irreparable harm. With the first two preliminary injunction factors absent, the court could have ended its inquiry, but it proceeded to balance the equities, finding they weighed against enjoining the Amgen merger. The court emphasized that the "proposed transaction offers Micromet's shareholders a significant premium over the pre-announcement price of Micromet's stock . . . [and b]ecause no other bidder has emerged during what I have found to be a reasonable sales process, the proposed transaction may represent the shareholders' only and best opportunity to receive a substantial premium for their shares." As a result, the court allowed the stockholders to decide for themselves whether to tender their shares to Amgen.

Delphi

Six days later, Vice Chancellor Glasscock considered a motion to enjoin Tokio Marine Holdings, Inc.'s (THM) acquisition of Delphi Financial Group, Inc. Following its initial public offering, Delphi had two classes of stock: Class A, entitled to one vote per share and held by public stockholders and Class B, entitled to 10 votes per share and held by the company's founder and chief executive officer, Robert Rosencrantz and his affiliates. Although Rosenkranz owned less than 13% of the company's outstanding equity, he controlled approximately 49.9% of the voting power of the company. In connection with the IPO, Rosencrantz agreed to amend the company's charter to require the conversion, upon a sale of the company, of Class B stock to Class A stock, so that Rosencranz's Class B stock would receive the same consideration upon a merger as would the company's Class A stock. This essentially gave Rosencrantz a non-transferable veto right over any action requiring stockholder approval. Prior to the IPO and during the entire course of its existence, Delphi purchased investment advisory services from certain entities owned by Rosencrantz (the Management Contracts). The Management Contracts were terminable by either party upon 30-days notice and were fully disclosed at all relevant times.

TMH, through its investment banker, approached Rosenkranz about acquiring Delphi. Although Rosenkranz expressed his belief that Delphi was not for sale, he agreed to report TMH's interest to Delphi's board. The board discussed TMH's interest and Rosencrantz suggested that a deal at $45 to $60 per share might be attractive to stockholders. Notwithstanding the charter's prohibition of disparate consideration for Class B stockholders, Rosencrantz began discussing with Delphi management how he could maneuver around the charter provision and obtain a control premium for his Class B stock. Rosenkranz did not advise the board of these discussions until the middle of September.

On September 7, 2011, TMH offered to acquire Delphi at a price between $33 and $35 per share (then a 50% to 59% premium over Delphi's market price). Rosenkranz expressed disappointment with this range and suggested a range of $45 to $60 per share might work, even though Rosenkranz was unwilling to sell his Class B stock for $45 per share. In response, TMH raised its offer to $45 per share (a 106% premium). Rosenkranz presented this offer to the board, advising that as a controlling stockholder he viewed it as inadequate and was unlikely to approve it. Rosenkranz suggested that the board form a special committee to evaluate the TMH proposal and direct negotiations. The special committee retained its own legal and financial advisors and created a sub-special committee to discuss Rosenkranz's demand for disparate consideration to approve the merger.

After determining that Rosenkranz would torpedo the deal if he did not receive a control premium for his Class B stock, the sub-special committee negotiated vigorously to obtain the best deal on disparate consideration. Ultimately, the sub-special committee succeeded in convincing Rosenkranz to accept $53.875 for each share of Class B stock (down from $59 per share) and $44.875 for each share of Class A stock. During these negotiations, Delphi continued to negotiate with TMH, ultimately extracting a one dollar pre-closing dividend, which effectively raised the merger consideration to $46 per share. To avoid disrupting the momentum with TMH, the special committee decided to leave Rosenkranz as the company's primary negotiator, albeit with close supervision from the special committee's financial advisor. With the price set, the parties agreed to condition the merger on stockholder approval of a charter amendment that would allow Rosenkranz to receive the disparate consideration.

In an effort to extract more value from the deal, Rosenkranz attempted to sell to TMH the entities providing services under the Management Contracts for $57 million. In the end, he convinced TMH to agree to keep the Management Contracts in place for five years. Upon learning of this side-deal the sub-special committee convinced TMH and Rosenkranz to repudiate their side-deal and obtained representations that no other agreements between Rosenkranz and TMH existed, other than those set forth in the transaction documents.

In spite of the more than 100% premium offered by the transaction, plaintiffs sought to enjoin the stockholder vote on the merger because the board and Rosenkranz breached their fiduciary duties in approving differential consideration for the Class B stockholders, allowing Rosenkranz to dominate the negotiation process, and allowing Rosenkranz to funnel money to himself through the Management Contracts, which depressed Delphi's stock. The plaintiffs also challenged the process that the special committee and sub-special committee used to reach the disparate merger price with Rosenkranz.

Although the court recognized troubling aspects of Rosenkranz's conflicting roles and the side agreement with TMH, it found plaintiffs would not likely succeed in their challenge to the process by or price at which the TMH transaction would occur or to the side deal relating to the Management Contracts on the basis of disparate consideration for Rosenkranz. The court was, however, persuaded that plaintiffs would succeed on their claim that "despite a contrary provision in the Delphi Charter, Rosenkranz in breach of his contractual and fiduciary duties, sought and obtained a control premium for his shares, an effort that was facilitated by the Executive and Director Defendants." The court observed that "though Rosenkranz retained voting control [following the IPO], he sold his right to a control premium to the Class A stockholders via the Charter. The Charter provision, which prevents disparate consideration, exists so that if a merger is proposed, Rosenkranz cannot extract a *second* control premium for himself at the expense of the Class A stockholders." (Emphasis in original.)

The court next considered whether these breaches would expose plaintiffs to irreparable injury, concluding that Rosenkranz's breaches of fiduciary and contractual duties could easily be remedied by an award of money damages, enforceable through disgorgement of proceeds received from the transaction. The court also found that the balance of the equities counseled against an injunction. Citing *El Paso*, Vice-Chancellor Glasscock concluded that the opportunity to obtain a substantial premium through a single-bidder merger was too great to deprive the stockholders of a vote, notwithstanding Rosenkranz's questionable behavior. As the court explained, "[t]he price offered by TMH for the Class A shares, even though less than what Rosenkranz will receive in the Merger, is 76% above Delphi's stock price on the day before the Merger was announced. No party has suggested that another suitor is in the wings or is likely to be developed at a greater, or even equal price."

Conclusion

The *El Paso*, *Mircomet*, and *Delphi* decisions each demonstrate the Court of Chancery's reluctance to deprive stockholders of the chance to vote themselves on a cash-out transaction that represents a substantial premium to each company's pre-transaction trading price—even where the court has serious concerns (at least in *El Paso* and *Delphi*) about the process that led to the transaction. The court expressed confidence in the availability of money damages and the appraisal statute to adequately protect stockholders, making injunctive relief unnecessary. Most importantly, these cases demonstrate the court's reluctance to deprive stockholders, even at their own request, of the opportunity to sell at a substantial premium where no alternative transactions or even competing bidders appeared likely to emerge. Stockholders (and not the court) should decide at the ballot box whether to approve an economically intriguing, but procedurally flawed transaction, that but for fiduciary misconduct (potentially remedied by a post-merger award of money damages), might have yielded an even higher return for stockholders.

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