Simpson Thacher

# Securities Law Alert

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Simpson Thacher's securities litigation team is "[a] standout choice for financial institutions, with a well-established reputation for its handling of high-value litigation."

***– Chambers USA 2015***

## Second Circuit: Dodd Frank's Whistleblower Protection Provisions Extend to Allegations Reported Internally Even If Not Reported to the SEC

On September 10, 2015, the United States Court of Appeals for the Second Circuit, deferring to the interpretation of the SEC, held that the Dodd-Frank Act's anti-retaliation provision protects employees who reported suspected wrongdoing internally, but did not similarly report it to the SEC prior to suffering retaliation.

In *Berman* v. *Neo@Ogilvy LLC*, 2015 WL 5254916 (2d Cir. Sept. 10, 2015), the Second Circuit addressed the tension between two provisions of Section 21F of the Securities Exchange Act of 1934, as amended, which was part of the Dodd-Frank Act. Subsection 21F(a)(6) defines a "whistleblower" as "any individual who provides … information relating to a violation of the securities laws to the Commission." Subsection 21F(h)(1)(A) prohibits, in relevant part, all forms of discrimination against "a whistleblower in the terms and conditions of employment because of any lawful act done by the whistleblower" in providing information regarding a securities law violation to the SEC or "in making disclosures that are required or protected under the Sarbanes-Oxley Act of 2002." (Section 806 of the Sarbanes-Oxley Act prohibits retaliation against employees of publicly traded companies who provide information concerning securities law violations to, among others, a federal regulatory or law enforcement agency, any member or committee of Congress, or "a person with supervisory authority over the employee.")

In attempting to resolve this statutory tension, the Second Circuit first consulted the legislative history of the subdivision containing the cross-reference to the Sarbanes-Oxley Act. Noting that such an inquiry "yields nothing," the court stated that the tension between subsection 21F(a)(6) and subsection 21F(h)(1)(A) "renders section 21F as a whole sufficiently ambiguous" to warrant deference to "the reasonable interpretation of the agency charged with administering the statute," which, in this matter, was the SEC. Accordingly, without "definitively constru[ing] the statute" itself, the Second Circuit adopted the SEC's position that the Dodd-Frank Act's anti-retaliation provisions extend to individuals who report suspected violations to "persons or governmental authorities other than the Commission" as well as to the SEC itself.[1]

As the Second Circuit observed, its decision in *Berman* creates a circuit split with regard to the question of the scope of Dodd Frank's anti-retaliation provisions. In 2013, the United States Court of Appeals for the Fifth Circuit, in *Asadi* v. *G.E. Energy (USA), LLC*, 720 F.3d 620 (5th Cir. 2013), held that whistleblowers who face retaliation within the meaning of Dodd-Frank are covered by Dodd-Frank's anti-retaliation provisions only if they had reported the suspected violation to the SEC.[2]

1. The Second Circuit cited "Securities Whistleblower Incentives and Protections," SEC Release No. 34-64545, 76 Fed. Reg. 34300-01 (June 13, 2011); *see also* "Interpretation of the SEC's Whistleblower Rules Under Section 21F of the Securities Exchange Act of 1934," Release No. 34-75592 (Aug. 4, 2015). For a discussion of the SEC's recent interpretive release regarding the SEC's whistleblower rules under Section 21F of the Exchange Act, *see* Simpson Thacher Memorandum, "SEC Issues Interpretation Regarding Definition of 'Whistleblower' Under the Dodd-Frank Act's Anti-Retaliation Provision" (Aug. 27, 2015).

2. Please click here to read our prior discussion of the *Asadi* decision.

# Fifth Circuit: Damages Based on a "Materialization of the Risk" Theory Cannot Be Measured on a Class-Wide Basis for Rule 23(b)(3) Purposes, as Required Under the Supreme Court's Decision in *Comcast*

On September 8, 2015, the Fifth Circuit affirmed a Southern District of Texas decision denying certification to a proposed class of plaintiffs who alleged that BP had made misrepresentations concerning the safety procedures the company had in place prior to the 2010 Deepwater Horizon oil spill (the "Pre-Spill Class"). *Ludlow v. BP, P.L.C.*, 2015 WL 5235010 (5th Cir. 2015) (Higginbotham, J.). Plaintiffs contended that BP's statements "creat[ed] an impression that the risk of catastrophic failure was lower than it actually was." Plaintiffs claimed that when the risk materialized in the form of the Deepwater spill, investors who were "defrauded into taking on that heightened risk" were entitled to recover their losses as damages. The Fifth Circuit agreed with the district court that damages based on plaintiffs' "materialization of the risk" theory could not be measured on a class-wide basis, as required under the Supreme Court's decision in *Comcast Corp. v. Behrend*, 133 S. Ct. 1426 (2013), because the model required an "individualized inquiry" into whether each investor would have purchased BP stock had that investor known of the true risk of a major spill.

The Fifth Circuit also affirmed the district court's decision certifying a class of plaintiffs who alleged that BP had misrepresented its internal estimates of the Deepwater spill rate.

## *Comcast*: Damages Must Be Capable of Measurement on a Class-Wide Basis to Satisfy Rule 23(b)(3)'s Requirements

Rule 23(b)(3) provides, in relevant part, that "questions of law or fact common to class members [must] predominate over any questions affecting only individual members." In *Comcast*, the Supreme Court held that "a model purporting to serve as evidence of damages in [a] class action must measure only those damages attributable to that theory" and must "establish that damages are susceptible of measurement across the entire class for purposes of Rule 23(b)(3)." 133 S. Ct. 1426. The *Comcast* Court emphasized that "any model supporting a plaintiff's damages case must be consistent with its liability case, particularly with respect to the alleged … effect of the violation." The *Comcast* Court further directed that "courts must conduct a rigorous analysis" to ensure that Rule 23(b)(3)'s requirements are met prior to certifying a class.

### Fifth Circuit Finds the District Court Properly Declined to Certify the Pre-Spill Class Because the "Materialization of the Risk" Damages Model Required Individualized Inquiries as to Whether Each Plaintiff Would Have Purchased BP Stock Had It Known of the Allegedly Higher Risk of a Spill

The Pre-Spill Class sought damages based on a "materialization of the risk" theory. Plaintiffs claimed that "BP [had] allegedly misstated the efficacy of its safety procedures, creating an impression that the risk of a catastrophic failure was lower than it actually was." According to plaintiffs, "[t]hese statements resulted in an 'investor being defrauded into taking a greater risk than disclosed.'"

The Fifth Circuit found that the district court had not "abuse[d] its discretion in holding that the Pre-Spill damages theory was not capable of class-wide determination," as required under *Comcast*. The Fifth Circuit explained that plaintiffs' "materialization of the risk" "theory hinge[d] on a determination that each plaintiff would not have bought BP stock *at all* were it not for the alleged misrepresentations—a determination not derivable as a common question, but rather one requiring individualized inquiry."

The court offered the example of two hypothetical pension fund investors, one that only invests in companies with a risk of catastrophic events of less than 1%, and another that has a higher 2% threshold for such risk. The court posited that if BP's "true risk of a major spill was 2%, but BP's statements had improperly represented the risk as 0.5%," then the low-risk pension fund "would not have bought BP stock at all" but "the high-risk fund still might have purchased the stock." The court explained that "[f]or the second type of plaintiff, full materialization-of-the-risk damages would prove a windfall." Because plaintiffs' damages model had no "mechanism for separating these two classes of plaintiffs," the Fifth Circuit found that the model could not "provide an adequate measure of class-wide damages under *Comcast*."

The Fifth Circuit rejected plaintiffs' claim that under the fraud-on-the-market theory, the court had to "presume[ ] that the Pre-Spill Class relied on BP's misrepresentations in purchasing the [stock] and the misrepresentations were a cause-in-fact of their losses." The court explained that the fraud-on-the-market theory set forth in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), "does not provide any presumptions with regard to loss causation—whether the misstatement caused the loss."

Moreover, the court pointed out that "the fraud-on-the-market presumption is rebuttable," and found that "plaintiffs' own model may well have rebutted it." The court explained that the fraud-on-the-market theory "presume[s] reliance because (a) all information in an efficient market is priced into a security and (b) investors typically make investment decisions based on *price and price alone*." Here, however, "plaintiffs' own model assert[ed] that they [had] relied on something other than price: risk." The Fifth Circuit found that "[b]y claiming that class members may have divested themselves of BP stock if they had known about the true risk of an accident in the Gulf—as distinguished from that risk's impact on BP's stock *price*," plaintiffs were effectively "arguing that their investment decisions were based substantially on factors other than price." The Fifth Circuit determined that "plaintiffs' argument thus undercut[ ] one of the rationales for the *Basic* presumption of reliance."

The Fifth Circuit therefore affirmed the district court's decision denying certification as to the Pre-Spill Class.

## Southern District of New York: Insurers' IBNR Reserves Are Opinions That Are Actionable Under *Omnicare* Only If (1) the Speaker Did Not Believe the Statement at the Time It Was Made, or (2) the Statement Did Not Rest on Some Meaningful Inquiry

On September 11, 2015, the Southern District of New York dismissed claims brought under Section 10(b) and Rule 10b-5 alleging that MetLife, Inc. had understated its reserves for incurred but not reported death benefit claims ("IBNR reserves"), which in turn allegedly impacted the accuracy of the company's financial statements. *City of Westland Police and Fire Ret. Sys. v MetLife, Inc.*, 2015 WL 5311196 (S.D.N.Y. 2015) (Kaplan, J.). The court determined that MetLife's representations regarding its IBNR reserves were statements of opinion that were not actionable under the Supreme Court's decision in *Omnicare, Inc. v. Laborers Dist. Council Construction Indus. Pension Fund*, 135 S. Ct. 1318 (2015).[3] The court found plaintiffs' allegations insufficient to plead either that "(1) MetLife did not actually believe its IBNR reserves were adequate but nevertheless said (or implied) they were," or that "(2) MetLife's (explicit or implicit) representations regarding the adequacy of its IBNR reserves did not rest on a meaningful inquiry, rendering them misleading to a reasonable investor reading MetLife's financial statements in context."

### Background

Plaintiffs claimed, *inter alia*, that MetLife had misrepresented the company's financial performance "because certain reserves underlying its financial statements failed adequately to take account of [IBNR] death benefit claims with respect to group life insurance policies." Specifically, plaintiffs contended that MetLife's IBNR reserves were insufficient because the company had failed to cross-check the Social Security Administration Death Master File ("SSA-DMF"), a database of recorded deaths in the United States, against its roster of group life insureds, even though a 2007 cross-check of the SSA-DMF to MetLife's roster of *individual* life insureds had "allegedly uncovered $80 million in unclaimed individual life insurance benefits."

In 2011, MetLife conducted "its *first-ever* cross-check of the SSA-DMF against its roster of group life insureds" and subsequently announced that it would take a $115-$135 million after-tax charge to adjust for increases to its IBNR reserves. Shortly thereafter, plaintiffs brought the instant securities fraud action. Defendants moved to dismiss plaintiffs' IBNR reserve-related claims based on the Supreme Court's decision in *Omnicare*.

### Court Finds MetLife's Statements Concerning Its IBNR Reserves Were (1) Statements of Opinion (2) That Were Not Actionable Under the Supreme Court's Decision in *Omnicare*

At the outset of its analysis, the court noted that "the accuracy of a company's loss reserves—that is, the degree to which the loss reserves correspond to, or vary from, the insurance obligations that ultimately will be paid out in relation to the claims, known and unknown, covered by the reserve in question—implicates the accuracy of its financial statements." The court explained that "[i]f loss reserves are too low and later must be increased," then "earnings will have been overstated in SEC filings."

The court stated that while loss reserves for known claims are "relatively easy to predict," IBNR reserves are "extremely conjectural because they are set aside to cover losses for which claims have not been reported but must be estimated." The court found that although IBNR "estimates involve some factual inputs, they necessarily require judgment and thus are statements of opinion or belief, not of fact."

The court noted that "the securities laws do not impose an absolute bar to liability for statements of opinion or belief" (citing *Virginia Bankshares v. Sandberg*, 501 U.S. 1083 (1991)). However, the court found that under the Supreme Court's decision in *Omnicare*, "it is substantially more difficult for a securities plaintiff to allege adequately (or ultimately, to prove) that [a statement of opinion] is false than it is to allege adequately

3. Please click here to read our prior discussion of the *Omnicare* decision.

(or prove) that a statement of pure fact is false." The court explained that "[t]o allege adequately that a statement of fact … [was] false within the meaning of the securities laws, a plaintiff need plead only facts that, if true, would be sufficient to show, assuming materiality, that the statement [was], in fact, false." A misstatement of fact is "'untrue' for purposes of Rule 10b-5 regardless of whether the speaker knew it was false or thought, mistakenly, that it was correct." However, "[t]o allege adequately that a statement of opinion or belief … [was] false within the meaning of the securities laws," a plaintiff must allege facts sufficient to show either that "(1) the opinion or belief 'constitute[d] a factual *misstatement*' in itself, or (2) the opinion or belief [was] 'rendered misleading by the *omission* of discrete factual representations'" (quoting *Omnicare*, 135 S. Ct. 1318). The court explained that "while there are two ways for a plaintiff who challenges a statement of opinion or belief to state a legally sufficient claim under Rule 10b-5, … each of these methods is tied to a separate and distinct provision of the Rule."

### Applying the First Prong of the *Omnicare* Test, Court Finds Plaintiffs Failed to Allege That MetLife's Statements Concerning Its IBNR Reserves Were Untrue Statements of Material Fact

Under the first provision of the *Omnicare* test, the court explained that a plaintiff alleging that a statement of opinion was itself an "*untrue statement* of a material fact" "must do more than allege that the underlying fact [was] false." The plaintiff must also "plead facts that, if true, would be sufficient to show that the speaker did not 'actually hold[ ] the stated belief'" (quoting *Omnicare*, 135 S. Ct. 1318).

Here, the court found "the fact that MetLife's IBNR reserves ultimately proved insufficient [was] not determinative" of actionability under Rule 10b-5. Rather, the court determined that the "critical question[ ]" was whether plaintiffs had adequately alleged that "MetLife did not actually believe its IBNR reserves were adequate but nevertheless said (or implied) they were."

The court held that plaintiffs had "failed to allege facts sufficient to make out a plausible claim that MetLife did not believe, in advance of the 2011 SSA-DMF cross-check, that its IBNR reserves were adequate." The court noted that plaintiffs did not allege, for example, "facts concerning the size of MetLife's IBNR reserves; the size of those reserves relative to MetLife's existing liabilities; [or] the relative sizes of MetLife's group and individual life insurance pools and how the $80 million in unpaid individual life insurance benefits revealed as a result of the 2007 SSA-DMF cross-check might have affected what estimated reserves should have been preceding the 2011 SSA-DMF cross-check." While the court found it "possible that the 2007 discovery of $80 million in unpaid benefits perhaps might have rendered MetLIfe's IBNR reserves insufficient, or at least alerted MetLife to the fact that it might be under-reserved in the future," the court determined that "it equally would be possible that the discovery had no such impact" based on the facts alleged.

### Under the Second Prong of the *Omnicare* Test, Court Finds Plaintiffs Failed to Allege That MetLife's Statements Concerning Its IBNR Reserves Did Not Rest on a Meaningful Inquiry

Pursuant to the second provision of *Omnicare* test, the court explained that a plaintiff alleging "that the speaker *omitted* to state a material fact necessary in order to make its opinion or belief not misleading cannot state a claim by alleging only that the opinion was wrong" (quoting *Omnicare*, 135 S. Ct. 1318) (internal quotation marks and alterations omitted). Rather, the plaintiff must allege that "the statement did not 'rest on some meaningful … inquiry,' rendering it 'misleading to a reasonable person reading the statement fairly and in context'" (quoting *Omnicare*, 135 S. Ct. 1318). To overcome this hurdle, a "plaintiff 'cannot just say that the issuer failed to reveal [the] basis' for the opinion," "[n]or may the plaintiff merely 'recit[e] … the statutory language' or offer bare 'conclusory allegation[s]' that the issuer 'lacked reasonable grounds for the belief it stated.'" Instead, a plaintiff "'must identify particular (and material) facts going to the basis for the issuer's opinion—facts about the inquiry the issuer did or did not conduct or the knowledge it did or did not have—whose omission makes the opinion statement at issue misleading to a reasonable person reading the statement fairly and in context.'" The court found that this was "no small task for an investor."

The court determined that the "critical question[ ]" for purposes of *Omnicare*'s second prong was whether plaintiffs had adequately alleged that "MetLife's (explicit or implicit) representations regarding the adequacy of its IBNR reserves did not rest on a meaningful inquiry." Here, the court found that plaintiffs had "provided no indication that the stated basis for MetLife's IBNR reserve estimates—namely, 'actuarial analyses of historical patterns of claims and claims development'—ran afoul of the customs and practices of the life insurance industry." In fact, plaintiffs had "not alleged any facts suggesting that there *is* a particular custom or practice in the life insurance industry for fixing IBNR reserves." The court further found that plaintiffs had not "allege[d] adequately that either (1) it was a custom or practice among life insurers to estimate IBNR reserves by conducting a cross-check of the SSA-DMF against all life insureds, or (2) the 'foundation' upon which MetLife *did* rest its IBNR reserve estimates did not comport with what a reasonable person reading the [c]ompany's financial statements fairly and in context would have expected." Finally, the court found that plaintiffs had not alleged any facts "tending to show that MetLife's IBNR reserves did not fairly align with information it possessed *at the time*."

Given "all the circumstances," the court concluded that plaintiffs had "failed adequately to allege that MetLife [had] omitted to state a fact (or facts) necessary to prevent its representations regarding the sufficiency of its IBNR reserves from misleading reasonable investors reading the [c]ompany's financial statements fairly and in context."

The court therefore dismissed plaintiffs' Section 10(b) and Rule 10b-5 claims based on MetLife's alleged misstatements of opinion concerning its IBNR reserves.

## Delaware Chancery Court: Courts Must Carefully Scrutinize Disclosure-Only Settlements of Class Action Merger Litigation to Ensure the Settlements Are in the Best Interests of the Class

On September 17, 2015, the Delaware Chancery Court indicated that parties to disclosure-only settlements of merger litigation should no longer expect that the court will automatically approve settlements pursuant to which plaintiffs obtain marginal additional disclosures and counsel fees in exchange for a broad release of future claims. *In re Riverbed Technology Inc. S'holdrs. Litig.*, 2015 WL 5458041 (Del. Ch. 2015) (Glasscock, V.C.). The court reasoned that "[t]he interests of the individual litigants and their counsel may not be fully aligned with the class." In the typical class action merger suit, "the individual plaintiff may have little actual stake in the outcome, her counsel may rationally believe a quick settlement and modest fee is in his best financial interest, and the defendants may be happy to 'purchase,' at the bargain price of disclosures of marginal benefit to the class and payment of the plaintiffs' attorney fees, a broad release from liability." The court found that this "agency problem" "mandates [judicial] scrutiny of [disclosure-only settlements] … in [merger-related] class actions."

### Background

At issue before the court was a proposed settlement of litigation brought in connection with the acquisition of Riverbed Technology, Inc. by Thoma Bravo, LLC and Teachers' Private Capital, an affiliate of Ontario Teachers' Pension Plan. Riverbed stockholders initially sought to enjoin the merger, and also asserted disclosure claims. Plaintiffs eventually agreed to settle the suit in exchange for supplemental disclosures in an SEC filing prior to the stockholder vote, as well as attorneys' fees (the "Settlement"). As consideration, plaintiffs agreed to "forgo the substantive process claims alleged in the complaint and to release all claims arising from the merger."

Following the announcement of the merger, Professor Sean J. Griffith of Fordham Law School purchased Riverbed stock "for the specific purpose of making an objection" to the proposed settlement. The Chancery Court rejected plaintiffs' contention "that a party taking exception to a potential settlement must be a stockholder *before the underlying transaction is announced*." The court found that Professor Griffith was "clearly a member of the Class who [would] be affected by the Settlement" and was therefore "entitled to oppose the Settlement."

### Chancery Court Finds Disclosure-Only Settlements Warrant Particular Judicial Scrutiny Because the Incentives of Plaintiffs' Counsel and Individual Plaintiffs May Be at Odds with the Interests of the Class

The Chancery Court stated at the outset that when considering whether to approve a proposed settlement of class action litigation, it must "balance the policy preference for settlement against the need to ensure that the *interests of the class have been fairly represented*." Because class action litigation is "particularly fraught with questions of agency," the court found that it must "ensure that divided loyalties have not influenced the actions of the [c]lass representative and counsel, and that the settlement reached is reasonable in light of the facts alleged and the record developed, and in light of the proposed release of claims."

The court explained that "[a] plaintiff's attorney may favor a quick settlement where the additional effort required to fully develop valuable claims on behalf of the class may not generate an additional fee as lucrative to the plaintiffs' attorney as accepting a quick and moderate fee, then pursuing other interests." Defendants, on other hand, are typically focused on "the consummation of the deal and the termination of any further litigation threat." If defendants can negotiate "a broad release" in exchange for "inexpensive disclosures and a modest … fee award," defendants have "little incentive … to engage in further litigation even if the claims are weak."

The court found that "[i]n combination, the incentives of the litigants may be inimical to the class." Although "the aggregate interest of the class in pursuing litigation may be great," "the individual plaintiff may have little actual stake in the outcome." The court explained that this "well-known agency problem" "mandates [judicial] scrutiny of settlements … in class actions." Before approving a proposed settlement, a court "must scrutinize the claims being given up, the value of the settlement, and, in the case of a broad release, the potential value of unknown claims being surrendered in connection with the settlement."

### Chancery Court Approves Disclosure-Only Settlement of Riverbed Merger Litigation Based on the "Minor" But "Tangible" Nature of the Supplemental Disclosures and the Parties' "Reasonable Expectation" of Court Approval

Turning to the proposed disclosure-only settlement at hand, the court found that the additional disclosures negotiated by plaintiffs' counsel "had tangible, although minor, value to the [c]lass." The court determined that these additional disclosures were effectively "a peppercorn, a positive result of small therapeutic value to the [c]lass." Given this "rather meager benefit achieved by the Settlement for the [c]lass," the court found that Professor Griffith had raised a meritorious objection to the "broad release" of "valuable unknown claims" set forth in the proposed settlement. The court agreed with Professor Griffith that "the breadth of the release [was] troubling" and stated that "[i]n another factual scenario, it might well carry the day."

Based on "the specific facts here," however, the court concluded that the Settlement was "appropriate." The court noted that plaintiffs' counsel had "carefully considered" the federal claims and found them "not viable," and further observed that no other class member besides Professor Griffith had objected to the Settlement. The court also reasoned that "the parties [had] in good faith negotiated a remedy—additional disclosures—that [had] been consummated, with the reasonable expectation that the very broad, but hardly unprecedented, release negotiated in return would be approved by this [c]ourt." While the court found that the parties "reasonable expectation[s]" of settlement approval bore "some equitable weight" in this case, the court cautioned that "this factor … will be diminished or eliminated going forward."

Although the court approved the proposed settlement, the court reduced plaintiffs' counsel fees from $500,000 to approximately $330,000. The court found that the result plaintiffs' counsel achieved was "too modest a benefit to justify the fee sought here."

## Delaware Chancery Court: Adherence to *MFW*'s Safeguards for Controlling Stockholder Transactions Does Not Protect the Controller from Liability for Breaching the Duty of Loyalty If the Controller Engaged in Fraud in Connection with the Transaction

On August 27, 2015, the Delaware Chancery Court held that stockholders of Dole Food Company, Inc. were "not limited to a fair price" in connection with a going-private merger in which David H. Murdock, Dole's Chairman and CEO, acquired all of Dole's common stock that he did not already own (the "Merger"). *In re Dole Food Co., Inc. Stockholder Litig.*, 2015 WL 5052214 (Del. Ch. 2015) (Laster, V.C.). Prior to the transaction, "Murdock owned approximately 40% of Dole's common stock … and was its *de facto* controller." Although Murdock had ostensibly followed the safeguards for controlling stockholder transactions laid out in *MFW*,[4] the court found that Murdock had not "adhere[d] to [*MFW's*] substance." The court determined that both Murdock and C. Michael Carter, Dole's former Chief Operating Officer, had "breached their duty of loyalty" to Dole's stockholders by "driving down Dole's stock price" prior to the merger negotiations and "provid[ing] the [Special] Committee with lowball management projections," among other actions. The court held that this "fraud tainted the approval of the Merger by the [Special] Committee, as well as the stockholder vote." While the court found that the merger price "fell within a range of fairness," the court determined that Dole stockholders were "entitled to a fairer price designed to eliminate the ability of the defendants to profit from their breaches of the duty of loyalty."

4. *In re MFW S'holders Litig.*, 67 A.3d 496 (Del. Ch. 2013) (*MFW I*), *aff'd sub nom., Kahn v. M&F Worldwide Corp.*, 88 A.3d 635 (Del. 2014) (*MFW II*). Please click here to read our prior discussion of the *MFW I* decision; please click here to read our prior discussion of the *MFW II* decision

### Court Finds the Merger Was Not Entirely Fair in Light of Defendants' Fraud

At the outset of its analysis, the court explained that "[w]hen a transaction involving self-dealing by a controlling stockholder is challenged, the applicable standard of judicial review is entire fairness." The court found that in the case before it, "defendants had not made the showing necessary" under *MFW* to change the standard of review from entire fairness to the business judgment rule. The court also rejected defendants' contention that "the burden had shifted to the plaintiffs to prove unfairness."

The court stated that "[o]nce entire fairness applies, the defendants must establish to the *court's* satisfaction that the transaction was the product of both fair dealing and fair price." Under the Delaware Supreme Court's decision in *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983), the concept of "[f]air dealing 'embraces questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained'" (quoting *Weinberger*, 457 A.2d 701). "Fair price 'relates to the economic and financial considerations of the proposed merger, including all relevant factors: assets, market value, earnings, future prospects, and any other elements that affect the intrinsic or inherent value of a company's stock.'"

#### Court Finds the Merger Was Not a Product of Fair Dealing

The court first considered "how the [Dole going-private] transaction was timed and initiated." The court found that Carter had "primed the market" for Murdock's going-private merger "by pushing down the stock" price. Specifically, the court determined that Carter had "intentionally given the market a subterranean estimate of Dole's anticipated cost savings" in connection with ITOCHU

Corporation of Japan's acquisition of Dole Asia (the "ITOCHU Transaction"). The court also found that Carter had canceled Dole's stock repurchase program for no legitimate business reason (other than to drive down Dole's stock price). The court explained that "a calculated effort to depress the [market] price of a stock until the minority stockholders are eliminated by merger or some other form of acquisition constitutes unfair dealing." (internal quotations and alterations omitted).

The court then addressed the merger negotiation process. The court explained that "in order to make a special committee structure work it is necessary that a controlling stockholder … disclose fully all the material facts and circumstances surrounding the transaction." Specifically, a controller must disclose (1) "all of the material terms of the proposed transaction;" (2) "all material facts relating to the use or value of the assets in question to the beneficiary itself"; and (3) "all material facts which it knows relating to the market value of the subject matter of the proposed transaction." The court stated that "[t]hese categories are intended to encompass *all material information known to the fiduciary except that information that relates only to its consideration of the price at which it will buy or sell and how it would finance a purchase or invest the proceeds of a sale*." The court underscored that "[i]mplicit in the expectation that the controller disclose this information is the requirement that the controller disclose it accurately and completely."

Here, however, the court found that Carter had provided the Committee with "a set of projections that contained falsely low numbers." The court determined that these "knowingly false" projections were designed "to mislead the Committee for Murdock's benefit." The court concluded "[b]y providing the Committee with false information, Carter ensured that the process could not be fair." The court further found that Carter had also "interfered with and obstructed the Committee's efforts to manage the process and negotiate with Murdock in other ways as well." For example, Carter had restricted the Committee's "ability to consider and explore the viability of potentially superior alternatives" to Murdock's offer. The court concluded that "[g]iven Carter's activities, the negotiation of the Merger was the antithesis of a fair process."

Finally, the court determined that "Carter's fraud tainted the approval of the Merger by the Committee, as well as the stockholder vote" because neither the Committee nor the stockholders had "the benefit of full information" regarding the Merger.

The court concluded that "[t]he evidence at trial established that the Merger was not a product of fair dealing." The court emphasized that "fraud vitiates everything." Here, the court found that the fraud "rendered useless and ineffective the highly commendable efforts of the Committee and its advisors to negotiate a fair transaction that they subjectively believed was in the best interests of Dole's stockholders."

### Court Finds the Merger Price May Not Have Been Fair

The court then turned to "[t]he second aspect of the entire fairness inquiry": fair price. The court found the evidence at trial "indicate[d] that without accounting for Carter's fraud, the $13.50 per share [Merger] price fell within a range of fairness." The court explained that "[i]f the Committee and [its financial advisor, Lazard] had not been misled, then the Committee's negotiations and Lazard's analysis would have provided powerful evidence of fairness." Here, however, the court determined that "Carter's actions tainted both the negotiation process and Lazard's work product."

The court found that "[m]odifying Lazard's discounted cash flow ('DCF') analysis to take into account the information that Carter misrepresented or withheld suggest[ed] that the $13.50 per share price may have been below the range of fairness." The court determined that "the first issue [was] cost-cutting" in connection with the ITOCHU Transaction. The court found that "Murdock and Carter [had] delayed Dole's cost-cutting program until after the [Merger], then achieved more than $30 million in incremental savings." The second issue was the additional income that Dole would later receive from purchasing farms as part of a vertical integration initiative. While the court found that some adjustment to fair value was necessary to account for both issues, the court explained that there was "uncertainty" at the time of the Merger as to "how much Dole actually could achieve in cost savings, as well as the number of farms that Dole could buy and the value they would generate." The court determined that "it would [have] overvalue[d] the incremental cash flows available from these sources to treat them for valuation purposes as being just as certain as the cash generated by Dole's core operations."

Notably, the court rejected defendants' contention that it could not "consider anything that happened after the Merger closed and must ignore both the cost savings that Dole actually achieved, as well as its farm purchases." The court found Delaware law "clear" that when "the company's business plan as of the merger included specific expansion plans or changes in strategy, those are corporate opportunities that must be considered part of the firm's value."

Based on the court's own modified DCF analysis, which took into account Dole's cost-saving plans and its expected farm acquisitions, the court found that the merger price was not necessarily fair. However, the court acknowledged that even if it had the benefit of complete information concerning Dole, Lazard "may have concluded that the price was still fair, albeit at towards the lower end of fairness."

### Court Finds Fraud Rendered the Merger Unfair, and Entitled Dole Stockholders to a "Fairer" Price

The court concluded that "Carter's conduct rendered the Merger unfair" in its entirety. Even if the Merger price "fell within a range of fairness," the court held that Dole stockholders were "entitled under the circumstances to a 'fairer' price." The court reasoned that "by engaging in fraud, Carter [had] deprived the Committee of its ability to obtain a better result on behalf of the stockholders, prevented the Committee from having the knowledge it needed to potentially say 'no,' and foreclosed the ability of the stockholders to protect themselves by voting down the deal."

## Court Awards Damages to Prevent Defendants from Profiting from Their Breaches of Fiduciary Duty

The court found that both Murdock and Carter had breached their duty of loyalty to the Dole corporation and its shareholders, and were consequently "personally liable for damages resulting from the Merger." The court explained that "[o]nce disloyalty has been established," then Delaware law "require[s] that a fiduciary not profit personally from his conduct."

Based on "modest estimates," the court calculated a fair value for Dole of $16.24 per share. The court stated that "[t]he $2.74 [additional] per share figure suggest[ed] that Murdock and Carter's pre-proposal efforts to drive down the market price and their fraud during the negotiations reduced the ultimate deal price by 16.9%." The court awarded damages based on this difference in fair value, amounting to a total of $148,190,590.18.

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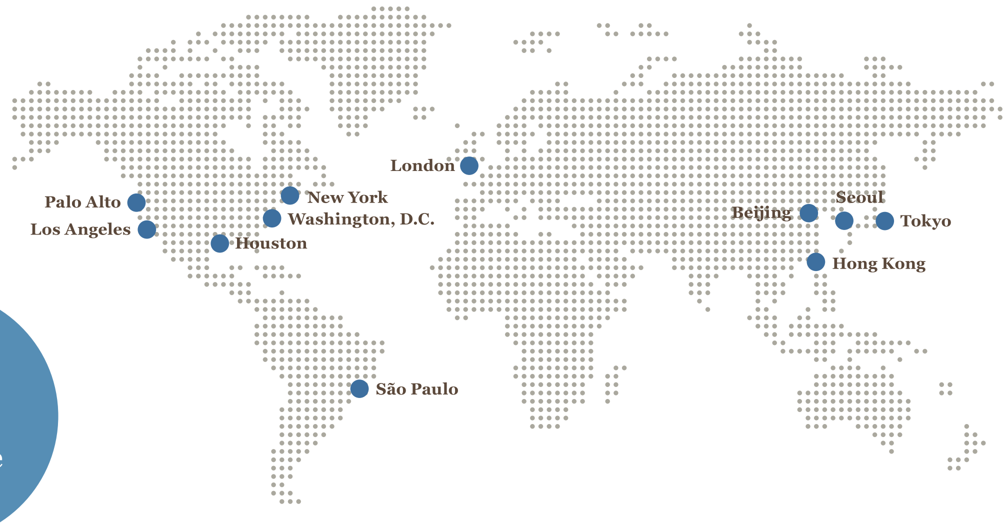


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