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In re John Q. Hammons Hotels, Inc.: A New Roadmap for Conflict Transactions?

In the seminal case of *Kahn v. Lynch Communication Systems, Inc.*,[1] the Delaware Supreme Court settled the debate regarding the standard of review applicable to transactions in which a controlling stockholder "stands on both sides" of a transaction, such as a minority squeeze-out transaction, holding that the entire fairness standard of review applies *ab initio* to such transactions.[2] *Lynch* and its progeny left unanswered, however, the question whether and to what extent the reasoning that animated those decisions would apply to a situation in which a controlling stockholder did not "stand on both sides" of the transaction, but instead utilized its control position (and power to veto a transaction) to negotiate with a third-party acquiror for different (and perhaps greater) consideration than that received by the minority stockholders. In a recent decision, captioned *In re John Q. Hammons Hotels, Inc. Shareholder Litigation*,[3] the Delaware Court of Chancery considered that question and determined that, absent robust procedural protections, the entire fairness standard of review would apply to such a transaction. Importantly, the Court concluded that, unlike in *Lynch*, the business judgment standard of review could be invoked as the applicable standard of review in the circumstances at issue in *Hammons* if the transaction were both (i) recommended by a disinterested and independent special committee, and (ii) conditioned on the approval by the affirmative (and non-waivable) vote of the holders of a majority of the voting power of all outstanding unaffiliated shares.

Although *Hammons* provides guidance and clarity as to situations in which Delaware courts will apply the more exacting entire fairness standard of review, as well as particular *ex ante* steps that may be taken to ensure the application of the more favorable business judgment standard, the decision also raises a number of interesting questions and considerations for M&A practitioners.

The Factual Background

Hammons arose following the merger (the "Merger") of John Q. Hammons Hotels, Inc. ("JQH"), a publicly traded Delaware corporation, with and into an acquisition vehicle indirectly owned by Jonathan Eilian ("Eilian"). John Q. Hammons ("Hammons"), who served as Chairman of the Board of Directors (the "Board") and Chief Executive Officer of JQH, controlled approximately 76% of the total

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1 638 A.2d 1110 (Del. 1994) (hereinafter, "*Lynch*").

2 *Id.* at 1115-16; *see also Kahn v. Tremont Corp.*, 694 A.2d 422, 428 (Del. 1997). The entire fairness standard may never be wholly obviated in such cases, regardless of any procedural protections deployed or utilized for the benefit of the minority stockholders. *In re Cysive, Inc. S'holders Litig.*, 836 A.2d 531, 547-48 (Del. Ch. 2003).

3 2009 WL 3165613 (Del. Ch. Oct. 2, 2009) (hereinafter, "*Hammons*").

voting power of the outstanding capital stock of JQH.[4]

In early 2004, Hammons informed the Board that he had begun discussions with third-parties regarding a potential sale of JQH or his interest in JQH. The Board thereafter formed a special committee of the Board (the "Special Committee") to evaluate and negotiate a proposed transaction on behalf of the minority stockholders and to make a recommendation to the Board regarding any such transaction. The plaintiffs conceded, and the Court appeared to accept, that the members of the Special Committee were both disinterested and independent.[5]

In early 2005, Eilian, who had "no prior relationship with Hammons or JQH,"[6] extended an offer of $24 per share for all outstanding shares of Class A common stock. Hammons informed the Board that he wanted to negotiate a transaction with Eilian,[7] and thereafter representatives of Eilian spent several months negotiating with Hammons regarding the acquisition of his holdings of Class B common stock and separately negotiating with the Special Committee concerning the acquisition of the publicly held shares of Class A common stock.[8] In June, Eilian and Hammons reached agreement and Hammons asked the Special Committee to consider the proposed transaction. After the Special Committee met to consider the proposed transaction and recommended that the Board approve the merger agreement, the Board, acting on the recommendation of the Special Committee, approved the merger agreement. Hammons recused himself from the Board vote.

The Merger Agreement

Under the terms of the merger agreement, each share of the publicly traded Class A common stock would be converted into the right to receive $24 per share in cash upon consummation of the Merger, which price reflected a substantial premium over JQH's stock price, which had traded in the range of $4 to $7 before rumors of a possible merger began to circulate.[9]

The merger agreement further provided that Hammons, in exchange for his Class

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4 *Id*. at *2. The capital stock of JQH consisted of two classes of common stock: (i) the Class A common stock; and (ii) the Class B common stock. Hammons and his affiliates owned approximately 5% of the outstanding shares of Class A common stock and all of the outstanding shares of Class B common stock. The balance of the outstanding shares of Class A common stock was held by the public stockholders (*i.e.*, the unaffiliated or minority stockholders). The terms "minority" and "unaffiliated" stockholders are herein deployed interchangeably, and no distinction is intended through such references.

5 *Id*. at *9, *11.

6 *Id*. at *1.

7 Hammons initially favored a transaction with Barceló Crestline Corporation ("Barceló") and indicated that he would not do a deal with the ultimate acquiror, Eilian, "under any circumstances." *Id*. at *5 n.5 Indeed, Hammons went so far as to instruct JQH's general counsel not to provide due diligence materials to Eilian. *Id*. Negotiations between Hammons and Barceló ultimately proved fruitless and the Board voted (on the recommendation of the Special Committee) not to renew exclusivity with Barceló.

8 *Id*. at *11.

9 The plaintiffs alleged that the stock price had been artificially depressed by Hammons' prior self-dealing conduct. Such alleged coercion was one of the unresolved factual and legal issues that the Court cited as a basis for refusing to grant summary judgment.

B common stock and his interest in a limited partnership controlled by JQH, would receive (i) a 2% interest in the cash flow distribution; (ii) a preferred equity interest in the surviving limited partnership, which preferred interest had a total liquidation preference of approximately $335 million; (iii) a $25 million short-term line of credit and a $275 million long-term line of credit; and (iv) various other contractual rights.[10] Such deal structuring was "essential" to Hammons' personal and tax objectives.[11] The Special Committee's financial advisor opined that the $24 per share price was fair to the minority stockholders, and further advised that the value received by Hammons (calculated to be $11.95 to $14.74 per share of Class B common stock)[12] reflected a reasonable allocation of the merger consideration between Hammons and the minority stockholders.[13]

Pursuant to the terms of the merger agreement, the Merger was conditioned on a waivable requirement that the merger agreement be adopted by the affirmative vote of a majority of the shares of Class A common stock held by unaffiliated holders present and entitled to vote at the stockholders meeting.[14] At the stockholders meeting, more than 72% of the voting power of the outstanding shares of Class A common stock voted to adopt the merger agreement (reflecting more than 89% of voting power present and entitled to vote at the stockholders meeting).[15]

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10 2009 WL 3165613, at *7-8. Hammons received (i) JQH's Chateau Lake property in exchange for transferring certain assets and related liabilities; (ii) a right of first refusal to acquire hotels sold post-closing; (iii) an indemnification agreement for any tax liability from the surviving entity's sale of any of its hotels during Hammons' lifetime; (iv) an agreement whereby Hammons' management entity would continue to manage the hotels in exchange for payments of actual operating costs and expenses incurred (approximately $6.5 million); and (v) a $200,000 annual salary, plus benefits. Hammons also entered into reciprocal side agreements whereby he assumed certain additional obligations.

11 *Id*. at *4.

12 The financial advisor's fairness opinion valued the $275 million line of credit at only $20 - 30 million and failed to account for Hammons' personal tax benefits from the transaction, and was further undercut by the defendants' alleged failure to disclose the financial advisor's conflicted interest. *Id*. at *13, *16.

13 Although unclear from the decision, it is interesting to note that the financial advisor appears to have opined on the reasonableness of the allocation of the merger consideration. Although such an opinion may not have risen to the level of a fairness opinion, practitioners should take note of this precedent given the reluctance of financial advisors to provide a "relative fairness opinion" and the Delaware courts' insistence on the advisability of such an opinion in the proper context. *See Levco Alternative Fund Ltd. v. Reader's Digest Ass'n, Inc.*, 2002 WL 1859064 (Del. Aug. 13, 2002); *In re Tele-Comm'ns, Inc. S'holders Litig.*, 2005 WL 3642727 (Del. Ch. Dec. 21, 2005).

14 The vote required in *Hammons* – the affirmative vote of the holders of a majority of the unaffiliated shares voting at the stockholders meeting – is distinct from, and less onerous than, the affirmative vote of a majority of all outstanding unaffiliated shares. Since the transaction occurred in 2005, the parties did not have the benefit of a later Court of Chancery decision finding that the proper vote in at least one other context was the latter vote – a majority of all outstanding unaffiliated shares. *See In re PNB Holding Co. S'holders Litig.*, 2006 WL 2403999, at *15 (Del. Ch. Aug. 18, 2006). The precondition that a merger be supported by the holders of a majority of all outstanding unaffiliated shares is herein referred to as a "majority-of-the-minority condition."

15 2009 WL 3165613, at *8. The Court's opinion does not state whether these figures include the approximately 5% of Class A common stock controlled by Hammons and his affiliates. Regardless, a majority of the outstanding unaffiliated shares were voted in favor of the Merger.

The Decision

The minority stockholder plaintiffs brought a class action suit against Hammons for allegedly breaching his fiduciary duties by negotiating an array of private benefits for himself that were not shared with the minority stockholders. The plaintiffs also contended that the JQH directors breached their fiduciary duties by voting to approve the Merger and allowing it to be negotiated through a flawed process.[16] Hammons and the JQH directors separately moved for summary judgment.

In his memorandum opinion, Chancellor Chandler confronted two critical, threshold issues: (i) whether the board's decision to approve the Merger should be subject to review under the entire fairness standard or whether business judgment should apply, and (ii) whether and to what extent procedural protections would affect the applicable standard of review.

A. The Applicability of the Entire Fairness Standard of Review

Hammons and the JQH directors argued that the Board's decision to approve the Merger should be subject to the business judgment standard of review, because (i) Hammons was not on both sides of the transaction; (ii) the minority stockholders had been represented by the disinterested and independent Special Committee; and (iii) holders of a majority of the unaffiliated shares actually voted to adopt the merger agreement. The plaintiffs argued for the applicability of the entire fairness standard of review, claiming that (i) the Special Committee was "ineffective;" (ii) the majority of the minority vote was "illusory;" and (iii) Hammons had a conflict of interest in negotiating benefits for himself that were not shared with the minority stockholders. Further, the plaintiffs characterized the Merger as a "minority squeeze-out transaction" and argued that the entire fairness standard was therefore mandated by *Lynch*.

Chancellor Chandler first determined that *Lynch* did not apply to the facts in *Hammons*, reaffirming that *Lynch* applies only where the controlling stockholder "stands on both sides" of the transaction.[17] The Court concluded that the controlling stockholder in *Hammons* did not stand on "both sides" of the transaction, as he did not extend the offer to the minority stockholders. Rather, the unaffiliated third-party acquiror had negotiated and dealt with the minority stockholders through the disinterested and independent Special Committee. Thus, the Court declined to extend *Lynch* to the present facts.[18]

Although *Lynch* did not apply, Chancellor Chandler nevertheless held that the standard of review was entire fairness. In reaching that conclusion, the Court found as follows:

> Although I have determined that Hammons did not stand 'on both sides' of this transaction, it is nonetheless true that Hammons and the minority stockholders were in a sense 'competing' for portions of the consideration Eilian was willing to pay to acquire JQH and that Hammons, as a result of his controlling

16 The plaintiffs also asserted disclosure claims based upon alleged misstatements or omissions in the proxy statement, as well as claims against the third-party acquiror for aiding and abetting the alleged breaches of fiduciary duty. This article does not address those claims and the Court's disposition thereof.

17 2009 WL 3165613, at *10, 12.

18 *Id.* at *11. The Court also rejected the plaintiffs' argument that the Special Committee was "ineffective" merely because Hammons could, as a practical matter, veto any transaction.

> position, could effectively veto any transaction. In such a case it is paramount – indeed, necessary in order to invoke business judgment review – that there be robust procedural protections in place to ensure that the minority stockholders have sufficient bargaining power and the ability to make an informed choice of whether to accept the third-party's offer for their shares.[19]

As a result, the Court concluded that the entire fairness standard of review would apply to the circumstances at issue in *Hammons*.[20]

B. The Need for Robust Procedural Protections

Although the entire fairness standard of review applied in *Hammons*, the Court found that the business judgment standard of review could be invoked through the implementation of robust procedural protections. The Court determined that the procedural protections that would be necessary to invoke the business judgment standard of review in *Hammons* were (i) a fully-functioning and effective special committee comprised of disinterested and independent directors recommending the transaction, and (ii) approval by the holders of a majority of all outstanding unaffiliated stock in a non-waivable vote. The Court found that these procedural protections must be preconditions to the transaction,[21] and must be clearly explained and disclosed to the minority stockholders.

Turning to the facts in *Hammons*, the Court refused to find that the procedural protections were sufficient to warrant invocation of the business judgment standard of review. Glossing over the effectiveness of the Special Committee,[22] the Court raised concerns with respect to the minority stockholder vote condition and determined that it was flawed for two reasons. First, the condition was waivable by the Special Committee. The Court found that such a condition must be non-waivable to be effective in this case because it "serves as a complement to, and a check on, the special committee" in that it "provides the stockholders an important opportunity to approve or disapprove of the work of the special committee and to stop a transaction they believe is not in their best interests."[23] Second, the condition in the merger agreement did not require the affirmative vote of a majority of all outstanding unaffiliated shares. Requiring an

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19 *Id.* at *12.

20 *Id.* at *12-13. Applying the entire fairness standard, the Court rejected Hammons' alternative argument that, regardless of the applicable standard, he would be entitled to summary judgment because he received less than $24 per share for his Class B common stock and therefore received no consideration at the minority's expense. The Court found that lingering factual and legal disputes regarding the persuasive value of the financial advisor's opinion precluded entry of summary judgment in the defendants' favor on the issue of fair price. The Court also denied cross motions for summary judgment on the issue of fair dealing.

21 With respect to the involvement of a special committee, the Court noted that it is not sufficient for the special committee merely to be disinterested and independent. The special committee also must have sufficient "authority and opportunity" to bargain on behalf of the minority stockholders. *Id.* at *12 n.38. Such authority to effectively bargain includes, but is not limited to, the ability to hire independent legal and financial advisors.

22 Although the Court did not analyze the effectiveness of the Special Committee, the Court may have been skeptical of its effectiveness due to, among other things, the appearance of certain conflicts of the Special Committee's legal and financial advisors.

23 2009 WL 3165613, at *12.

affirmative vote by a majority of all *outstanding* shares held by minority stockholders, rather than those *voting*, ensures that there is not "passive dissent" amongst the minority stockholders.[24] Because the minority stockholders' affirmative "self-interested decision to approve" provides the requisite proof of fairness to obviate a judicial examination of that question, the Court concluded that the minority vote condition was ineffective.[25]

Chancellor Chandler therefore held that, although the holders of a majority of all of the unaffiliated shares in fact voted to adopt the merger agreement, such approval was ineffective because it was subject to waiver by the Special Committee and the transaction was not conditioned on the requisite majority-of-the-minority condition. Accordingly, the procedural protections "were not sufficient to invoke business judgment review." [26]

Lessons and Implications of Hammons

The *Hammons* decision provides practitioners with valuable guidance concerning the procedural protections that may be utilized in transactions between a third-party acquiror and a corporation with a controlling stockholder in order to ensure the applicability of business judgment review. However, the decision raises a number of interesting questions regarding the applicable standard of review and the potential ramifications of agreeing to a non-waivable majority-of-the-minority condition.

A. Discerning the Applicability of the Entire Fairness Standard of Review and the Import of Procedural Protections

Perhaps the most notable lesson from *Hammons* is the Court of Chancery's eagerness to narrow the reach of *Lynch*. Although the Court's decision may not be a surprise to practitioners, the decision can be viewed as welcome precedent confirming that *Lynch* will be limited to its facts and that there will be an opportunity in certain situations, and with proper structuring, to invoke business judgment protection in transactions in which a controlling stockholder does not "stand on both sides" of the transaction.

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24 *Id.* (*citing In re PNB Holding Co.*, 2006 WL 2403999, at *15). The Court in PNB Holding explained that a stockholder's failure to return a proxy in the merger context does not mean necessarily that the stockholder is a member of "a 'silent affirmative majority of the minority.'" *In re PNB Holding Co.*, 2006 WL 2403999, at *15. Rather, a stockholder's informed refusal to return a proxy in the merger context is more likely a "passive dissent" because of the Delaware law requirement that mergers be approved by the holders of a majority of the outstanding stock entitled to vote (*i.e.*, the failure to return the proxy is a "*de facto* no vote"). *Id.*

25 *Id.* The presumption of "passive dissent" comports with the fact that minority stockholder claims are often coupled with allegations of inadequate pre-vote disclosures.

26 2009 WL 3165613, at *2. Although the business judgment standard of review is unobtainable where a controlling stockholder stands on both sides of the transaction, the use of *either* a disinterested and independent special committee *or* a majority-of-the-minority condition will shift the burden of proving entire fairness to the plaintiff. *Cysive*, 836 A.2d at 553. As the Court of Chancery has acknowledged, the "modest procedural benefit" of such a burden shift is "slight," as the defendant's conduct will still be intensely scrutinized to determine whether it was, in fact, entirely fair. *In re Cox Comm'ns, Inc. S'holders Litig.*, 879 A.2d 604, 616-17 (Del. Ch. 2005) (hereinafter, "*Cox Communications*"); *Cysive*, 836 A.2d at 548. In *Hammons*, the Court noted that the protections employed, while insufficient to invoke business judgment protection, might be sufficient to shift the burden of demonstrating entire fairness to the plaintiffs. 2009 WL 3165613, at *14. The Court reached no determination with respect to any such burden shift in light of the remaining unresolved material issues of fact.

Although *Hammons* may be viewed as a positive development in that regard, it also raises a number of doctrinal questions. As an initial matter, it is interesting to consider why the Court concluded that entire fairness applied *as a threshold matter* to the facts at issue in *Hammons*. Given the fact that the Court determined that *Lynch* did not apply, one might ask why entire fairness would apply automatically where the stockholder was not on "both sides" of the transaction and the interests of the minority stockholders were being protected by an independent and disinterested special committee (and potentially a majority independent and disinterested board of directors). Should the Court have at least required well-pled allegations that a majority of the members of the board of directors or special committee were interested and/or not independent with respect to the particular transaction or that the decision was otherwise the result of a breach of the directors' fiduciary duties?[27] Is the mere existence of the controlling stockholder and the competition for the consideration enough to warrant invocation of the entire fairness standard from the outset (albeit with the ability to invoke business judgment with robust procedural protections)? With respect to the particular factual situation at issue in *Hammons*, such questions are answered and the mere fact that a controlling stockholder with the power to veto the transaction is competing for the same consideration is enough for entire fairness to apply absent robust procedural protections.

The Court clearly finds that robust procedural protections are necessary to invoke the business judgment standard of review in the particular circumstances at issue in *Hammons*. One might ask, however, why the Court determined that the procedural protections necessary to invoke the business judgment standard of review include *both* a special committee and a majority-of-the-minority condition. Certain current and former members of the Court of Chancery have suggested, in prior decisions and other writings,[28] that there may be intellectual and practical justifications for a paradigm in which the business judgment standard of review could be invoked even in situations in which the controlling stockholder was on "both sides" of a transaction so long as arms' length bargaining was replicated through the use both a special committee and a majority-of-the-minority condition. Indeed, the Chancellor noted in *Hammons* his recognition of the

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27 Although decided before *Lynch* and its progeny and thus of uncertain utility, it is interesting to consider the Court of Chancery's decision in *Van de Walle v. Unimation, Inc.*, 1991 WL 29303 (Del. Ch. Mar. 7, 1991). In that case, a majority stockholder did not "stand on both sides" of the transaction and allegedly negotiated for and received benefits from the third-party acquiror that were not shared by the minority stockholders, including a preferred equity interest in the post-merger entity and benefits from certain side agreements with the acquiror. The Court of Chancery found no colorable evidence that the controlling stockholder had benefited at the minority's expense, and therefore held that "[b]ecause in substance and in form the merger was a bona fide arm's-length transaction negotiated with a third party, *the business judgment rule is the appropriate standard for evaluating its legality and the claims against the defendants.*" *Id.* at *11 (emphasis added). Moreover, the *Van de Walle* court held that, even if entire fairness was the applicable standard of review, the majority stockholder had acted with entire fairness in receiving less per share than minority. *Id.* at *13.

28 Vice Chancellor Leo E. Strine, Jr., has advocated, in *dicta*, that the *Lynch* line of authority be adapted to provide business judgment protection to interested mergers that are negotiated by a special committee *and* subject to a vote of unaffiliated shares. *In re Pure Resources, Inc. S'holders Litig.*, 808 A.2d 421, 444 n.43 (Del. Ch. 2002); *see also Cox Comm'ns*, 879 A.2d at 643-44. *Cf.* William T. Allen, Jack B. Jacobs and Leo E. Strine, Jr., *Function Over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 56 Bus. Law. 1287, 1306-09 (Aug. 2001) (suggesting the reexamination of *Lynch* and the application of business judgment review to interested transactions approved by "one or both" of a disinterested and independent special committee and a majority-of-the-minority condition).

recent suggestions to harmonize the standards of review applicable to different forms of transactions that have the effect of cashing out minority stockholders.[29]

Since the Court concluded that *Lynch* did not apply to the facts at issue in *Hammons*, the question arises as to why the Court believed it necessary to require both procedural protections to invoke the business judgment standard of review in a circumstance in which less judicial scrutiny would appear to be warranted. Should the business judgment standard of review be available if only a special committee is employed in a situation in which *Lynch* does not apply? The answer would seem to be that the Court was driven by the same concerns underlying *Lynch* (*i.e.*, the potential coercive effects of the "proverbial 800 pound gorilla").[30] As a result, the Court required the same procedural protections that may also be sufficient, if the Delaware Supreme Court were to revisit *Lynch* and adopt the approach suggested in *dicta*, to invoke the business judgment review even where the controlling stockholder is on "both sides" of the transaction. It remains an open question whether the operation of an effective special committee alone may be sufficient procedural protection to warrant business judgment review *ab initio* in a situation with different facts than *Hammons*.

Finally, practitioners should remain mindful that, although the entire fairness standard of review applied to the facts of *Hammons*, each transaction will be considered on a case-by-case basis. Indeed, the Court's decision in *Hammons* may be limited to the particular fact of that case. Those facts include the presence of a controlling stockholder who (i) could effectively veto any transaction;[31] (ii) negotiated directly with the third-party acquiror on its own behalf; and (iii) received distinct and potentially greater consideration than that received by the minority stockholders. In other situations in which one or more of those facts are absent or the context otherwise is different, the Court's decision as to the applicable standard of review may be different.

B. The Non-waivable Majority-of-the-Minority Condition

The Court's decision is clear that for a majority-of-the-minority condition to be a sufficiently robust procedural protection in the circumstances at issue in *Hammons* it must be non-waivable, even by a special committee. That conclusion raises several important and practical questions. First and foremost, how might such a non-waivable majority-of-the-minority condition impact *ex ante* bargaining? Will a rational third-party buyer, asserting the lack of closing certainty, discount the target company's value when the target insists on such a condition?[32] Will a target's insistence on such a condition

29 2009 WL 3165613, at *12 n.37.

30 *Cox Comm'ns*, 879 A.2d at 617.

31 A controlling stockholder will, by its nature, be able to directly or practically effectuate or veto the relevant corporate transaction. *See generally In re Western Nat'l Corp. S'holders Litig.*, 2000 WL 710192 (Del. Ch. May 22, 2000).

32 A non-waivable condition may also provide additional leverage to hedge funds and others who may use derivatives or actual holdings.

preclude the target from getting the best price reasonably available?[33] Will a special committee of a target be prepared to trade a majority-of-the-minority condition for a higher transactional price?

In *Hammons*, for example, Chancellor Chandler noted without comment that another third-party, Barceló, offered $21 per share for JQH's Class A common stock if a potential transaction was subject to approval by a simple majority of shares (including those owned by Hammons), but would only pay $20 per share if a majority-of-the-minority condition was required.[34] With respect to that transaction, at least, the potential buyer had concluded that a majority-of-the-minority condition justified a five-percent discount to the value of JQH's shares. Moreover, the potential gain from ceding such a condition may increase dramatically where the risk or consequences of transactional failure are heightened, as an offeror facing such risks might pay a substantial premium to obtain increased transactional certainty. In such circumstances, how will a target board conclude that its insistence upon (or even willingness to accept) a non-waivable majority-of-the-minority condition is consistent with its duties?[35]

In *Cox Communications*, Vice Chancellor Strine acknowledged the distinct possibility that an independent, well-motivated special committee could "drive a better deal for stockholders" by trading a majority-of-the-minority condition for a higher transactional price in a traditional freeze-out merger context, but concluded that the possibility of obtaining a better deal by forgoing the condition is "outweighed by the general utility of ensuring that controllers and special committees both know that the transactions they agree upon will be subject to approval by the disinterested minority."[36] In short, in the *Lynch* context, Delaware law generally does not regard the maximization of transactional price as a valid basis for trading procedural safeguards to protect the interests of minority stockholders, even where such a trade may appear economically rational under the circumstances.[37] However, in a transaction such as the one in *Hammons*, where the controlling stockholder is not on "both sides," it is less clear that there is a "general utility" to precluding a target from trading a majority-of-the-minority condition for an increase in the transaction price.

Beyond the possible impact upon the transaction price, widespread insistence upon a majority-of-the-minority condition that is non-waivable may cause the risk of deal failure to increase, particularly in light of the inherent and unavoidable baseline rate

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33 In a change of control transaction, a target board of directors has the singular responsibility to maximize immediate stockholder value by securing the highest price available. *See generally Revlon, Inc. v. MacAndrews and Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986) (hereinafter, "*Revlon*"). While the plaintiff in *Hammons* conceded that the transaction was not subject to a *Revlon* review, 2009 WL 3165613, at *9, there are circumstances (for example, where the controlling stockholder is not asserting its right to a control premium) in which the transaction will be reviewed under *Revlon*. *See, e.g., McMullin v. Beran*, 765 A.2d 910 (Del. 2000). In any event, a board of directors always has a fiduciary duty to get the best deal available under the circumstances. *See Mendel v. Carroll*, 651 A.2d 297 (Del. Ch. 1994).

34 2009 WL 3165613, at *5.

35 The authors can posit at least one scenario – where a special committee is concerned that potential plaintiffs may raise a litigable question concerning the committee's effectiveness – in which the committee may be unwilling to trade the majority-of-the-minority condition, for fear of losing an advantageous burden shift.

36 879 A.2d at 644 n.82.

37 Cf. *Ryan v. Tad's Enterprises, Inc.*, 709 A.2d 682, 693 (Del. Ch. 1996).

of nonparticipation in stockholder voting, or "dead vote."[38] In nearly every transaction, some percentage of the shares are unlikely to be voted without regard to the transaction being considered.[39] As the size of the majority's control position increases, the anticipated "dead vote" imposes an increasingly larger supermajority vote requirement and becomes an increasingly greater obstacle to minority approval – a consequence unaccounted for in the decisions to date that have addressed the value of a non-waivable majority-of-the-minority condition.[40]

In *Hammons*, for example, the holders of more than 18% of the Class A common stock did not vote on the adoption of the merger agreement, and therefore more than 61% of the participating voting power would had to have supported the transaction to obtain a simple majority of outstanding unaffiliated shares.[41] Where a desired transaction has the support of a substantial supermajority of minority stockholders, but fails to garner a majority of all outstanding minority votes due to the "dead vote," should the special committee have the capacity to draw its own conclusions as to the differences between the "dead vote" and possible "passive dissent" and waive the majority-of-the-minority condition? As the special committee makes so many critical decisions regarding an interested transaction, why should it be restrained or discouraged from deciding, under such circumstances, that it is in the best interests of the stockholders to waive the majority-of-the-minority condition?[42]

For the foregoing reasons, it is unclear whether *Hammons*, which will incentivize boards and special committees in certain contexts to insist upon a non-waivable majority-of-the-minority condition, will drive a change in deal practice, particularly if the imposition of a such a condition actually decreases deal certainty or reduces merger prices.[43]

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38 *See generally* Lucian Arye Bebchuk and Assaf Hamdani, *Optimal Defaults for Corporate Law Evolution*, 96 Nw. U. L. Rev. 489, 512 (2002) (noting "the substantial incidence of nonparticipation in corporate votes").

39 In the authors' experience, a "dead vote" for a merger proposal in the 5-10% range is not surprising.

40 As described in Table A (set forth at the end of this article), the larger the expected dead vote, the higher the percentage of disinterested shares that must be voted in favor of the transaction to obtain a majority of all disinterested shares.

41 2009 WL 3165613, at *8. Only 4,293,264 (or fewer) of the 5,253,262 issued and outstanding Class A shares participated in the Merger vote, reflecting a combined "dead vote" and "passive dissent" vote of at least 18.274%.

42 One response is that the procedural protections afforded by minority approval stand upon a higher theoretical footing, relative to the use of a special committee, "because by definition minority stockholders are not conflicted and their approval of an interested merger could not be challenged on that ground." William T. Allen, Jack B. Jacobs and Leo E. Strine, Jr., *Function Over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 56 Bus. Law. 1287, 1308 (Aug. 2001); *cf.* Donald J. Wolfe, Jr., *The Odd Couple: Majority of Minority Approval and the Tender Offer*, The M&A Lawyer, Vol. 6, No. 6 (Nov/Dec. 2002) (suggesting that a majority-of-the-minority condition presents an "all or nothing" dilemma, and that a special committee may, by reason of its flexibility and capacity to adapt and forge compromise, prove to be a superior mechanism for protecting the interests of minority stockholders).

43 To the extent either of these concerns is merited or becomes manifest, perhaps Delaware courts, while maintaining a strong preference for non-waivable conditions, will allow for the possibility that a special committee may wish to either forego a majority-of-the-minority condition (for example, to secure a greater deal price) or waive such condition (for example, because of the impact of the expected "dead vote"). This approach would be consistent with the Delaware courts' preference to favor context-specific inquiries over the imposition of bright-line rules. *See In re Toys "R" Us, Inc. S'holder Litig.*, 877 A.2d 975, 1016 (Del. Ch. 2005).

Conclusion

In *Hammons*, Chancellor Chandler applied the entire fairness standard of review to a merger between a third-party acquiror and a corporation with a controlling stockholder that did not stand on "both sides" of the transaction but competed for merger consideration with the minority stockholders. Although raising interesting doctrinal questions, *Hammons* should be a helpful precedent for transactional planners as it limits the reach of *Lynch* and simultaneously provides a roadmap for the robust procedural protections – a disinterested and independent special committee and a non-waivable majority-of-the-minority condition – that will invoke business judgment protection in at least one unique context. Whether practitioners will implement such procedural protections *ex ante* in future deal structuring, however, in order to ensure the application of a more favorable standard of judicial review remains, for the moment, an open question. At a minimum, target counsel in such circumstances should consider the practical, legal and business impacts of insisting upon the inclusion of the full panoply of procedural protections.

Table A:

Percentage of Disinterested Shares That Must Be Voted In Favor of the Transaction To Obtain A Majority of All Outstanding Unaffiliated Shares:

	Percentage of Presumed "Dead Vote"			
Percentage Held by the Controlling Stockholder and its Affiliates	4%	6%	8%	10%
40%	>53.5%	>55.5%	>57.6%	
50%	>54.3%	>56.8%	>59.5%	
60%	>55.5%	>58.8%	>62.5%	
70%	>57.6%	>62.5%	>68.1%	
80%	>62.5	>71.4%	>83.3%	