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## Deals With Controlling Stockholders: 5 Tips for Boards

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Dealing with controlling stockholder transactions? There are a number of steps directors can take to make the process go smoothly and help avoid costly judgments.

In a number of recent Delaware Chancery Court cases, the court has applied the stricter "entire fairness" standard of review to M&A deals involving a company and its controlling stockholder. The most recent decision in this line of cases, *In re Southern Peru Copper Corp. Shareholder Derivative Litig.*, C.A. No. 961-CS., found that the controlling stockholder defendants had breached their fiduciary duty of loyalty and awarded damages to the plaintiffs in excess of \$1.2 billion. When participating in M&A deals involving controlling stockholders, it is important to note that if properly structured and managed, such a costly judgment may be avoided. The deal could be subject to review under the more director-friendly "business judgment rule" or the burden of proof could be shifted to the plaintiffs under the "entire fairness" standard.

Below are five tips for directors who are dealing with controlling stockholder transactions.

1. Form a special committee of independent and disinterested directors. The board should form a special committee made up of directors who are free from personal and business relationships that would affect their ability to exercise independent judgment regarding the deal. The director(s) should be disinterested in the transaction in the sense that they would not receive, directly or indirectly, benefits that are above and beyond those received by the minority stockholders. A director who owns stock in the company wouldn't be automatically disqualified. However, the interests of the directors on the special committee and interests of the minority stockholders must be aligned.
2. Give the special committee proper authority. The board should grant the special committee the authority to critically review, negotiate at arm's length, and evaluate the deal as well as to explore alternatives. It should have sufficient time to conduct a thorough analysis of the deal and make an appropriate recommendation to the minority stockholders. The special committee should also hire counsel, investment bankers, and other appropriate advisers to assist in performing its obligations. The special committee should endeavor to ensure that its advisers do not have conflicts relating to the controlling shareholder, the company, or the transaction that might impact the special committee's ability to rely on the adviser's judgment.

3. Does the special committee approve of the deal? Once the special committee has, in conjunction with its advisers, reviewed the deal and explored all alternatives, it should vote on the transaction and make a recommendation to the board and the stockholders based on that vote. The benefits of a lower judicial standard of review will not be available unless the deal is approved by the special committee and by a majority of the minority stockholders (see below for more details on the minority stockholder approval). However, the special committee approval cannot be illusory.

4. Keep the minority stockholders informed. The special committee should make sure that all relevant facts relating to the deal, including any relationships, conflicts, available projections, and financials and relevant history, are disclosed to the minority stockholders so that they can make an informed decision about whether to approve the transaction.

5. Approval of a majority of the minority stockholders. In order to ensure that the minority stockholders have sufficient bargaining power, the deal must be conditioned on the approval of a majority of the minority stockholders. No party, including the special committee, should have the right to waive this condition. This vote is a key way for the minority stockholders to validate the special committee. Only if approval is ultimately obtained from the minority stockholders in a manner that is consistent with all of the tips in this article, can the special committee hope to rely on the "business judgment rule" under Delaware law.

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