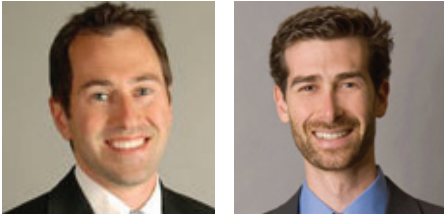


## Equity Repurchase Provisions, Good Faith and Fiduciary Duties



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Disputes between a former employee of a limited liability company and its board of managers can implicate both the LLC's operating agreement and other ancillary agreements between the employee and LLC. These agreements generally differ in at least one significant respect: While an LLC's board of managers may be subject to default fiduciary duties or to contractually explicit fiduciary duties in the operating agreement, ancillary documents typically do not contemplate or impose fiduciary duties.

In *Stewart v. BF Bolthouse Holdco LLC*, 2013 Del. Ch. LEXIS 215, the Court of Chancery examined contractually-mandated fiduciary duties in an operating agreement alongside an ancillary document that did not explicitly mandate fiduciary duties, but instead prescribed a standard of good faith for purposes of determining the fair market value of repurchased equity. The court's analysis of the contractual standard of good faith demonstrates the evidence a court might find persuasive of potential bad faith, while the court's conclusion that fiduciary duties described in an operating agreement could apply to conduct already governed by an ancillary agreement's good-faith standard provides additional considerations for drafting equity repurchase provisions.

### **Background**

In December 2005, Madison Dear-

born Partners acquired a controlling interest in BF Bolthouse Holdco LLC, a family-owned food and beverage producer. From 2005 through 2008, certain employees, including the plaintiffs, purchased Class B common units of Bolthouse for approximately \$25 per unit, pursuant to an executive unit purchase agreement.

Pursuant to the purchase agreement, in the event that an employee was terminated, Bolthouse could repurchase, within 210 days of the date of termination, all or part of such employee's units. Bolthouse could exercise the repurchase option for vested units at their fair market value, and could repurchase nonvested units at the lesser of their fair market value and the price paid for the units.

According to the terms of the purchase agreement, the fair market value was: (1) decided as of the date employment terminated and (2) to be determined in good faith by the Bolthouse board in its sole discretion after taking into account all factors determinative of value, including the lack of a readily available market to sell such units, but without regard to minority discounts.

In connection with the execution of the purchase agreement, each plaintiff also executed counterparts to the company's limited liability company agreement. Under the LLC agreement, the board owed the com-

pany and its members the same fiduciary duties that a director of a Delaware corporation owes a corporation and its stockholders.

In September 2008, the Campbell Soup Co. expressed interest in acquiring Bolthouse for \$1.4 billion to \$1.6 billion, translating to approximately \$1,000 per Class B common unit, but failed to reach an agreement with Madison Dearborn.

On Feb. 25, 2010, the plaintiffs voluntarily terminated their employment. Within the 210-day repurchase period, Bolthouse gave notice of its repurchase of the plaintiffs' units. The notice stated that the fair market value of such units was \$0, and such units were consequently canceled.

In August 2012, after renewed negotiations, Campbell acquired Bolthouse from Madison Dearborn for approximately \$1.55 billion, translating to approximately \$1,200 per Class B common unit.

### **Good-Faith Analysis**

In considering a motion to dismiss the plaintiffs' claims for various breaches of contract, fiduciary duties and the implied covenant of good faith and fair dealing, the court primarily examined whether the board breached the purchase agreement's requirement to determine fair market value in good faith when the board determined that the fair market value was \$0.

The court determined that to allege a breach of a contractual duty to act in good faith, the plaintiff must only allege facts related to the alleged act taken in bad faith, and a plausible motivation for it (applying similar logic to that applied by the Delaware Supreme Court in *DV Realty Advisors LLC v. Policemen's Annuity and Benefit Fund of Chicago*, 2013 Del. LEXIS 430 (Del. August 26, 2013).)

The court found that sufficient facts were alleged, including: (1) the \$25 price originally paid per unit; (2) the absence of material change to Bolthouse's financial position from 2008 to 2010; and (3) a February 2010 email from the Bolthouse CEO to the plaintiffs describing Bolthouse's bright prospects and a \$200 per unit valuation, based on then-current earnings before interest, taxes, depreciation and amortization (EBITDA) levels and multiples.

### **Contractual Fiduciary Duty Analysis**

With respect to the claim that the defendants breached their contractually-mandated fiduciary duties, the court first examined whether the LLC agreement's fiduciary duty provisions applied to the purchase agreement and the repurchase option. The court acknowledged that evidence presented at a later stage of trial could demonstrate that the purchase agreement's good-faith requirement was intended to override the LLC agreement's more general fiduciary duties. Nonetheless, based on the close relationship between the LLC agreement and the purchase agreement, and absent clear contractual language to the contrary, the court found it reasonably conceivable that the board was bound by the contractual fiduciary duties of the LLC agreement when exercising the repurchase option under the purchase agreement, in addition to the good-faith obligation imposed by the purchase agreement.

After establishing that the contractually-mandated fiduciary duties

of the LLC agreement could apply to the repurchase option, the court restated the well-established principle that the duty of loyalty encompasses more than interested transactions and also covers director actions taken in bad faith. Looking to the alleged bad-faith conduct described above, the court found a sustainable claim that the defendants' bad-faith conduct was also a breach of the defendants' contractual duty of loyalty under the LLC agreement.

Below are a number of key considerations practitioners should consider in light of the *Bolthouse* decision and other earlier but related Court of Chancery decisions:

### **Standard Of Conduct**

In designating a standard of conduct, note:

- Fiduciary duties included in one agreement may unintentionally be applied to a second agreement, particularly if the first agreement (e.g., an LLC operating agreement) bears a strong relationship to the second (e.g., a purchase agreement allowing for equity repurchases). Consider expressly describing whether such fiduciary duties are meant to apply.

- If fiduciary duties are expressly disclaimed but the parties explicitly apply a good-faith standard, they should consider further specifying whether such good faith should be subjective or objective. At least in LLCs and partnerships, a good-faith standard without any further modification likely means subjective good faith, described in *Policemen's Annuity* as an action so far beyond the bounds of reasonable judgment that it seems essentially inexplicable on any ground other than bad faith. If a more stringent standard is desired, then "reasonable good faith" may be more appropriate.

- On the flip side, if fiduciary duties are not expressly disclaimed but the parties agree that a decision may be made in the "sole and absolute discretion" of the board, such language

might only mean that the board need not consult with any other party before deciding the matter, but would not override any pre-existing fiduciary duties, as in *Paige Capital Management v. Lerner Master Fund*, 2011 Del. Ch. LEXIS 116, \*110. Consequently, consider specifying that "sole and absolute discretion" means that the company need not consider any other interests, like those of the employee member.

### **Timeframe And Valuation Date**

Though not a central focus of *Bolthouse*, ambiguity surrounded the target date of valuation. In addition to specifying the timeframe during which a repurchase might be exercised, consider clearly specifying the target date—typically the date of the precipitating event, an earlier or later date (e.g., as of the previous or next financial close), or the date of delivery of notice.

### **Discounts And Adjustments**

Consider whether and how marketability, liquidity and minority discounts should apply. Further consider what effect will be given to the precipitating event (i.e., the departure of key employees), or any other consequential events.

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