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Thicker Than Water: Families, Fiduciary Duties and Controlling Stockholders

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When is an extended family a control block? In *Buttonwood Tree Value Partners v. R.L. Polk & Co.*, C.A. No. 9250-VCG (Del. Ch. Ct. July 24), the Delaware Court of Chancery acknowledged that while familial relations among a group of stockholders are not per se sufficient to establish a controlling stockholder block, a family that regularly refers to itself as a single unit may constitute a controlling stockholder block.

Courtesy photos

Benyamin Ross, left, and Taylor Hathaway-Zepeda, right, of Gibson, Dunn & Crutcher.

Background

R.L. Polk & Co., Inc. (the company) was a Delaware corporation owned and controlled by the Polk family since 1870. By 2010, the family had grown in size over multiple generations and collectively owned 90.5 percent of the company among 51 family members, with the remaining 9.5 percent owned by unaffiliated stockholders. Three of the seven directors on the company's board were Polk family members.

In late 2010, the board appointed a special committee to explore conversion of the company to Subchapter S status. After some initial valuation and structural analysis, Stephen Polk, the company's chairman and CEO, advised the board on March 9, 2011, that the Polk family was not interested in pursuing a restructuring short form merger. The board chose to instead pursue a share buyback from all stockholders who wished to tender shares, and the company engaged Stout Risius Ross, Inc. (SRR) to provide a fairness opinion.

Prior to the self-tender, the company's stock had traded in the $600–$650 per share range. On March 28, 2011, SRR determined that the proposed price of $810 per share (valuing the company at $434.5 million) was fair to the tendering stockholders. The board approved but did not recommend the self-tender, with the Polk family directors abstaining from voting.

On March 31, 2011, the company initiated the self-tender at the $810 per share price. The offering materials stated that neither the company nor the Polk family had any plans to explore a sale of the company, although they would continue to evaluate opportunities. The materials did not recommend that stockholders tender, but did disclose SRR's opinion that the offered price was fair. The company purchased 34,825 of its 536,397 outstanding shares in the self-tender, including shares held by the Buttonwood plaintiffs and certain members of the Polk family.

In October 2012, the company began exploring a sale process. The company was sold in June 2013 via short form merger to IHS, Inc. for $1.4 billion, or $2,675 per share—over three times the $810 self-tender price. Additionally, in the months prior to the sale, the board declared three dividends totaling $290 per share.

On December 19, 2016, plaintiffs Buttonwood Tree Value Partners and Mitchell Partners brought a class action suit on behalf of the unaffiliated stockholders who sold in the 2011 self-tender. The complaint included,

among other claims, claims against the directors and the Polk family for breach of fiduciary duties. Defendants moved to dismiss all counts.

Controlling Stockholder

The court acknowledged that family relations are not themselves sufficient to establish a controlling stockholder block (applying *In re PNB Holding Shareholders Litigation*, C.A. 28-N (Del. Ch. Aug. 18, 2006)). Nonetheless, the court determined that the plaintiffs pleaded sufficient facts for the court to find it reasonably conceivable that the Polk family—comprised of 51 members—collectively constituted a controlling block.

The court highlighted references throughout the record to the Polk family as a unified "entity or block." For example, the 2011 self-tender materials described the Polk family's ownership as an aggregated 90.5 percent interest. Additionally, the Polk family sought to maintain at least 90 percent ownership following the self-tender—suggesting the family expected to act as a unified block, including to possibly effect a short form merger (as it did in the sale to IHS in 2013). Significantly, Stephen Polk also referred to the Polk family as a unified block when he told the board that the Polk family no longer wished to pursue a short form merger in 2011.

The court took care to note, however, that without knowing the specific ownership structure of the Polk family, it is not clear that all members of the Polk family are part of the control block.

Entire Fairness Applies

The plaintiffs alleged that the Polk family engineered a self-tender to maintain structural control (i.e., a 90-percent block) while achieving some liquidity for Polk family members, and that the transaction was part of an overall scheme to later sell the company for more than three times the self-tender valuation. The court found it reasonably conceivable that the Polk family "engineered—and stood on both sides of" the self-tender, and therefore applied an entire fairness standard. The court concluded that plaintiffs adequately alleged that the self-tender was not entirely fair based upon the magnitude and timing of the dividends and merger consideration.

We note that in later stages of the case, the court may be asked to further scrutinize the application of entire fairness and the alleged self-dealing by a control block in a self-tender offered to all stockholders, in which some members of the family group participated and some did not.

Independent Directors

The court also addressed claims that the company's independent directors, protected by an exculpatory provision in the company charter, violated their fiduciary duties by "rubber stamping" the Polk family's alleged breaches. The court dismissed these claims on the basis that plaintiffs had not pleaded sufficient facts to show that the independent directors acted in bad faith. Specifically, the court reasoned, a finding of bad faith would require that the independent directors *knew* of the alleged scheme to later sell the company for a "blowout premium"—and the plaintiffs failed to plead such knowledge.

Takeaways

Buttonwood reaffirms the principle that extended families do not constitute a control block solely by virtue of their familial status. At the same time, however, descriptors matter. While prior Delaware cases have required the existence of a "legally significant" agreement to be deemed a control block (e.g., *In re Crimson Exploration Inc. Shareholder Litigation*, C.A. No. 8541-VCP (Del. Ch. Oct. 24, 2014)), *Buttonwood* suggests that family members (or any other stockholders) that commonly refer to themselves as a group or block may constitute a control block even in the absence of such an agreement.

Practitioners—particularly those advising family-owned businesses—should carefully describe stockholders in corporate materials and guide discussion in the boardroom to avoid implying collective control where it may not exist. *Buttonwood*'s comparative treatment of claims against independent directors (which were dismissed) versus Polk family directors (which were allowed to proceed) illustrates just how determinative the controlling stockholder analysis can be.

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