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## Delaware Chancery Court Reaffirms Standard for Classifying a Minority Stockholder as a Controlling Stockholder

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### **The Court Rejects Argument That Minority Stockholder Was a Controlling Stockholder and Dismisses Breach of Fiduciary Duty Claims**

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#### **SUMMARY**

In a December 30 decision, the Delaware Court of Chancery in *In Re Essendant, Inc. Stockholder Litigation*, No. 2018-0789 (Del. Ch. Dec. 30, 2019), held that plaintiffs, a putative class of target Essendant's stockholders, failed to plead facts sufficient to show that buyer Sycamore Partners ("Sycamore"), a private equity firm, was a controlling stockholder. In so holding, the Chancery Court dismissed plaintiffs' claims that Sycamore breached an alleged fiduciary duty to Essendant stockholders by pressuring the Essendant Board to accept Sycamore's inadequate offer and that the Board aided and abetted such a breach. In addition, the Court dismissed plaintiffs' claims that the Essendant Board breached its duty of loyalty by accepting Sycamore's offer because they failed to plead facts sufficient to show that the Board was "dominated and controlled by Sycamore"—a minority stockholder. The Court of Chancery's decision reaffirms well-established Delaware law that a minority stockholder is a controlling stockholder only if it "exercises control over the business affairs of the corporation"<sup>1</sup> such that "as a practical matter, it [is] no differently situated than if it had majority voting control."<sup>2</sup>

## BACKGROUND

In the fall of 2017, Essendant's Board considered a potential merger with a subsidiary of Genuine Parts Company ("GPC"). The proposed merger would be a stock-for-stock transaction in which Essendant stockholders would own 49% of the combined company. Essendant's investment bankers had opined that the merger would provide Essendant stockholders with value in the range of \$13.30 – \$23.90 per share. Both GPC and the Essendant Board anticipated that the proposed transaction would face serious antitrust scrutiny. The merger agreement, which was executed on April 12, 2018, contained a non-solicitation provision that prohibited Essendant from knowingly encouraging a competing acquisition proposal and required Essendant to notify GPC within twenty-four hours of receiving a competing acquisition offer so that it could consider exercising matching rights. Three days prior to the signing of the merger agreement, Sycamore called Essendant to express interest in acquiring the company. On April 17, 2018, after the GPC Merger Agreement was signed, Sycamore offered Essendant \$11.50 per share in an all-cash transaction. On April 24, 2018, the Essendant Board rejected Sycamore's proposal because "it was unlikely to lead to a superior proposal when compared with the GPC merger agreement," but the Board communicated to Sycamore that "it would 'be open to receiving a revised offer.'"<sup>3</sup> On April 29, 2018, Sycamore communicated a renewed proposal at the same \$11.50 price per share as its previous proposal. This time the Essendant Board concluded this second offer was "reasonably likely to lead to a superior acquisition proposal," even though the price of the offer was unchanged.<sup>4</sup> The Essendant Board proceeded to notify GPC of Sycamore's proposal, and GPC revised its offer to include a contingent value right in the form of a cash payment of up to \$4 per share.

While negotiating with the Essendant Board, Sycamore started acquiring Essendant's stock on the open market. Rather than execute a standstill agreement with Sycamore, Essendant adopted a stockholder rights plan. The plan served to halt Sycamore's stock purchases at a point where it had acquired 11.16% of Essendant's outstanding shares.

After further negotiations among the parties, on September 10, 2018, Essendant announced that it had accepted Sycamore's revised offer of \$12.80 per share in cash—an 11% discount to Essendant's then-current stock price of \$14.24 per share but a 51% premium to the stock's unaffected price before the GPC deal had been announced. GPC chose not to match this revised deal. Essendant's financial advisor provided an opinion that Sycamore's all-cash offer was fair from a financial perspective, even though it was lower than the value range of \$13.20 – \$23.90 per share estimated for the GPC proposal. The Essendant Board explained in its Schedule 14D-9 that it favored the cash deal because of "risk related to continued secular decline in the Company's industry."

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Following the consummation of the transaction, a putative class of Essendant stockholders brought suit against the Essendant Board alleging that the Board “breached its fiduciary duty by failing to obtain the highest value reasonably available for Essendant”; “aided and abetted Sycamore’s breach of fiduciary duties as a controlling stockholder”; and the merger with Sycamore constituted waste.<sup>5</sup> The putative class also brought suit against Sycamore alleging that Sycamore was a controlling stockholder and “use[d] its control against the interests of the non-controlling stockholders by ‘pressuring . . . the Essendant [Board] to accept its inadequate [] offer’” and “aided and abetted the Essendant Board’s breach of fiduciary duties.”<sup>6</sup>

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### THE COURT OF CHANCERY DECISION

The Court of Chancery began its analysis by noting that, because Essendant had an exculpatory charter provision pursuant to 8 Del. C. § 102(b)(7) that protected the Board from monetary liability for breaches of the duty of care, plaintiffs could only survive defendants’ motion to dismiss the claims alleging a breach of fiduciary duty by showing that the Essendant Board breached the duty of loyalty or acted in bad faith. Despite plaintiffs’ “lack of clarity” in the complaint, the Court identified two possible theories asserted by plaintiffs as to how the Board breached its duty of loyalty: (i) the Board succumbed to the “will of Sycamore as a controlling stockholder at the expense of other stockholders,” and (ii) the individual Board members “operated under some broader conflict of interest.”<sup>7</sup> The Court held that plaintiffs failed to plead facts sufficient to support either of these theories.

The Court forcefully rejected plaintiffs’ claim that Sycamore—despite owning only 11.16% of Essendant stock—was a controlling stockholder because plaintiffs had failed to “plead facts that allow a reasonable inference that Sycamore exercised such formidable voting and managerial power that, as a practical matter, it was no differently situated than if it had majority voting control.”<sup>8</sup> Specifically, plaintiffs had not shown that Sycamore, a minority stockholder, was actually acting as a controlling stockholder by: “(i) nominat[ing] members of the Essendant Board, (ii) wield[ing] coercive contractual rights, (iii) maintain[ing] personal relationships with any of the Essendant Board members, (iv) maintain[ing] any commercial relationships with Essendant that would afford leverage in its negotiations, (v) threaten[ing] removal, challeng[ing] or retaliat[ing] against any of the Essendant Board members or (vi) otherwise exercis[ing] ‘outsized influence’ in Essendant’s Board room.”<sup>9</sup> The Court further noted that it would have been challenging for any of these indicators of control to apply to Sycamore because two other entities held larger voting blocks. Accordingly, because Sycamore was not a controlling stockholder, the Court dismissed plaintiffs’ claims that the Essendant Board breached its fiduciary duty by succumbing to the will of Sycamore and that Sycamore breached its fiduciary duties to Essendant stockholders.

The Court also rejected plaintiffs’ assertion that the Board “operated under a conflict of interest,” finding each of the arguments in support general and conclusory and noting that plaintiffs had failed to undertake

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a “director-by-director analysis” of each director’s “lack of independence.”<sup>10</sup> The Court found that plaintiffs’ general assertion that the merger was “highly unusual” was insufficient to overcome the “presumption of independence” applied to each member of the Board.<sup>11</sup> As for bad faith by the Board members, the Court found that Plaintiffs relied only on immaterial quibbles with the Board’s disclosure decisions and no “knowing or intentional misstatement of a material fact.”<sup>12</sup> The Court also rejected the waste claim as nothing more than a challenge to the Board’s decision making, not a claim that the Sycamore transaction had no corporate purpose as is required to justify waste.

Finally, the Court noted that, because the fiduciary duty claims against the Essendant Board were dismissed based on 102(b)(7) standards, theoretically, a claim for aiding and abetting a *Revlon* duty of care case against Sycamore could still go forward but that no proper allegations of aiding and abetting had been made as Sycamore was accused of nothing more than making the bid that the Essendant Board chose to accept.

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### IMPLICATIONS

The Chancery Court’s decision in *In re Essendant* represents another failure by plaintiff stockholders to expand the definition of a controlling stockholder under Delaware law. The more interesting case will be a situation where the minority stockholder has board representation and has taken an active role on the board in driving corporate policy. *Essendant*, however, is not that case.

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ENDNOTES

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- <sup>1</sup> *In Re Essendant, Inc. Stockholder Litig.*, No. 2018-0789, at \*22–23 (Del. Ch. Dec. 30, 2019) (emphasis in original) (quoting *In re KKR Fin. Holdings. LLC S’holder Litig.*, 101 A.3d 980, 991 (Del. Ch. 2014)).
- <sup>2</sup> *Id.* at \*23 (quoting *In re Morton’s Rest. Grp., Inc. S’holders Litig.*, 74 A.3d 656, 665 (Del. Ch. 2013)).
- <sup>3</sup> *Id.* at \*9.
- <sup>4</sup> *Id.* at \*10 (internal quotation marks omitted).
- <sup>5</sup> GPC also brought suit in a separate case against Essendant for breach of the merger agreement. See *Genuine Parts Co. v. Essendant Inc.*, 2019 WL 4257160 (Del. Ch. Sept. 9, 2019).
- <sup>6</sup> *In Re Essendant*, at 17–18 (internal quotation marks omitted) (alterations in original).
- <sup>7</sup> *Id.* at 20.
- <sup>8</sup> *Id.* at \*23 (internal quotation marks and alterations omitted) (quoting *In re Morton’s Rest. Grp., Inc. S’holders Litig.*, 74 A.3d 656, 665 (Del. Ch. 2013)).
- <sup>9</sup> *Id.* at \*24.
- <sup>10</sup> *Id.* at \*26.
- <sup>11</sup> *Id.*
- <sup>12</sup> *Id.* at 32.

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