The Evolving Role of Special Committees in M&A Transactions: Seeking Business Judgment Rule Protection in the Context of Controlling Shareholder Transactions and Other Corporate Transactions Involving Conflicts of Interest

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Special committees of independent, disinterested directors have been widely used by corporate boards to address conflicts of interests and reinforce directors' satisfaction of their fiduciary duties in corporate transactions since the wave of increased M&A activity in the 1980s. In 1988, The Business Lawyer *published an article titled* The Emerging Role of the Special Committee *by one of this article's co-authors, examining the emerging use of special committees of independent directors in transactions involving conflicts of interest. At that time, the Delaware courts had already begun to embrace the emergent and innovative mechanism for addressing corporate conflicts. Now, after over thirty years of scrutiny by the Delaware courts, it is clear that the special committee is a judicially recognized (and encouraged) way to address director conflicts of interest and mitigate litigation risk. This article will examine the role of the special committee in the context of conflict of interest transactions, with a particular focus on transactions involving a change of control or a controlling stockholder, from a U.S. perspective (in particular, under the laws of the state of Delaware), and will briefly consider international applications of the concepts discussed. To this end, this article will examine recent case law developments, and compare the special committee processes at the heart of two high-profile Delaware decisions, and, finally, provide guidance to corporate practitioners on the successful implementation of a special committee process.*

I. Introduction

Corporate transactions often involve conflicts of interest, presenting legal and business risks that require careful management by corporate counsel and outside legal advisors. This is particularly true in the context of high-stakes public company M&A transactions, where a failure to adequately address actual or potential conflicts of interest risks potential litigation, personal liability, and the inability to successfully complete the transaction on the terms agreed between the parties. Facing these risks, and with increased frequency, U.S. corporate boards have

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sought additional legal protection through the use of special committees of independent, disinterested directors for purposes of evaluating and negotiating transactions involving a change of control (or the complete takeout of a minority by an already controlling shareholder).

In the 1980s, the Delaware courts first began to embrace the use of special committees of independent directors as an innovative mechanism for addressing corporate conflicts.[1] For more than thirty years the Delaware courts have continued to emphasize the importance of the special committee and refine the jurisprudence surrounding the benefits of a robust special committee process.

This article will examine the evolving role of the special committee in the context of conflict of interest transactions, with a particular focus on change of control and controlling stockholder transactions, from a U.S. perspective (in particular, under the laws of the State of Delaware),[2] as well as briefly consider the application and use of special committees outside the United States.

II. Legal Background and Recent Developments

Duties of Care and Loyalty

The business and affairs of a corporation are generally managed by or under the direction of its board of directors.[3] In carrying out these functions, directors owe an unyielding fiduciary duty to the company and its stockholders, which encompasses both a duty of care and a duty of loyalty.[4] The duty of care requires directors to "use that amount of care which ordinarily careful and prudent men would use in similar circumstances" and to inform themselves of "all material information reasonably available" to them in making business decisions, including with respect to potential alternatives.[5] Generally,

1. In 1988, *The Business Lawyer* published an article titled *The Emerging Role of the Special Committee* by one of this article's co-authors, examining the emerging use of special committees of independent directors in transactions involving conflicts of interest and, in particular, management leveraged buyouts. *See* Scott V. Simpson, *The Emerging Role of the Special Committee—Ensuring Business Judgment Rule Protection in the Context of Management Leveraged Buyouts and Other Corporate Transactions Involving Conflicts of Interest*, 43 Bus. Law. 665 (1988).

2. With over half of all U.S. public companies organized in Delaware, the state is generally considered to have the most well-developed body of law in this area, which provides instructive, if not necessarily controlling, precedent for many U.S. state courts. *See* Lewis S. Black, Jr., Why Corporations Choose Delaware (2007), *available at* http://corp.delaware.gov/whycorporations_web.pdf.

3. *See* Del. Code Ann. tit. 8, § 141(a) (West, Westlaw through 79 Laws 2014, ch. 283).

4. *See* Stone ex rel. AmSouth Bancorporation v. Ritter, 911 A.2d 362, 370 (Del. 2006) (noting that, although prior Delaware case law had characterized the board's fiduciary duties as a "triad" of good faith, due care, and loyalty, "the obligation to act in good faith does not establish an independent fiduciary duty that stands on the same footing as the duties of care and loyalty").

5. *In re* Walt Disney Co. Derivative Litig., 907 A.2d 693, 749 (Del. Ch. 2005) (citations omitted) (internal quotation marks omitted), *aff'd*, 906 A.2d 27 (Del. 2006); *see also In re* Fort Howard Corp. S'holders Litig., No. 9991, 1988 WL 83147, at *14 (Del. Ch. Aug. 8, 1988); Freedman v. Rest. Assocs. Indus., Inc., Civ. A. No. 9212, 1987 WL 14323, at *6 (Del. Ch. Oct. 16, 1987); UIS, Inc. v. Walbro Corp., Civ. A. No. 9323, 1987 WL 18108, at *2 (Del. Ch. Oct. 6, 1987).

directors must be sufficiently familiar with the details of a proposed transaction and its alternatives, independently examine all material information reasonably available to them, and take a sufficient amount of time to come to a decision on the matter. The greater the significance of a business decision—for example, a decision to enter into a change of control transaction—the greater the requirement for directors to examine and consider alternatives and ensure they have an informed view.[6]

The duty of loyalty addresses fiduciaries' conflicts of interests, requiring that directors privilege the corporation's interests above their own (or the interests of their superiors).[7] Violations of the duty of loyalty may include the misappropriation of corporate assets or opportunities, fraud, bad faith, or self-dealing.[8] Other acts solely or primarily for a personal or non-corporate purpose, such as to entrench oneself in office as a director, also implicate the duty of loyalty.[9]

Notably, in the context of a change of control transaction[10] or "break up" of a corporate entity, target company directors' duties of care and loyalty take on an enhanced obligation (the so-called "*Revlon* duty"), which requires directors to perform their fiduciary duties with the specific objective of maximizing value for stockholders in the near term.[11] This enhanced *Revlon* duty does not apply merely because a company is "in play," nor does it give rise to an obligation to sell the company or negotiate with an approaching acquirer. Rather "[t]he duty to seek the best available price applies only when a company embarks upon a transaction—on its own initiative or in response to an unsolicited offer—that will result in a change of control."[12]

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6. *See Fort Howard Corp.*, 1988 WL 83147, at *1.

7. *See* Hampshire Grp., Ltd. v. Kuttner, No. 3607-VCS, 2010 WL 2739995, at *12 (Del. Ch. July 12, 2010).

8. *See* Smith v. Van Gorkom, 488 A.2d 858, 872–73 (Del. 1985).

9. *See, e.g.*, Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437, 439 (Del. 1971) (finding that the board of directors acted inequitably in changing the corporation's bylaws so as to change the date of the annual meeting in order to thwart an imminent proxy contest to replace the incumbent management).

10. An acquisition transaction effectuated through a stock swap, rather than cash, in which both target and acquirer are non-controlled, widely held public companies does not constitute a sale of control to which *Revlon* duties apply. *See In re* Santa Fe Pac. Corp. S'holder Litig., 669 A.2d 59, 71 (Del. 1995) (dismissing plaintiffs' *Revlon* claim for failing to allege that post-transaction control would not remain "'in a large, fluid, changeable and changing market'" (citation omitted)). Furthermore, *Revlon* duties are not implicated by a transaction involving the cash-out of the minority shareholders by an existing controlling shareholder because the controlling shareholder is not buying corporate control. *See* Mendel v. Carroll, 651 A.2d 297, 305–06 (Del. Ch. 1994). *But see In re* Loral Space & Commc'ns Inc. Consol. Litig., Nos. 2808-VCS, 3022-VCS, 2008 Del. Ch. LEXIS 136, at *115 (Del. Ch. Sept. 19, 2008) (finding that the acquisition of a majority interest by an existing shareholder implicated the "core concerns animating the *Revlon* doctrine").

11. *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986); *see also* Lyondell Chem. Co. v. Ryan, 970 A.2d 235 (Del. 2009); Greene v. N.Y. Mercantile Exch., Inc. (*In re* NYMEX S'holder Litig.), Nos. 3621-VCN, 3835-VCN, 2009 Del. Ch. LEXIS 176 (Del. Ch. Sept. 30, 2009); Wayne Cnty. Emps.' Ret. Sys. v. Corti, No. 3534-CC, 2009 Del. Ch. LEXIS 126 (Del. Ch. July 24, 2009), *aff'd*, 996 A.2d 795 (Del. 2010).

12. *Lyondell Chem.*, 970 A.2d at 242.

The Business Judgment Rule

Under Delaware law, the standard of judicial review generally applicable for purposes of determining whether corporate directors have satisfied their duties of care and loyalty in connection with their consideration of a transaction is the so-called "business judgment rule."[13] The business judgment rule is a deferential mode of judicial review wherein directors benefit from a rebuttable presumption that their actions have been carried out in accordance with their duties. The rule presumes that boards' decisions have been made in good faith by informed, disinterested directors and, as such, should not be second-guessed by the courts.[14] Not only does the business judgment rule serve to insulate board and director action through the substantive presumption that their fiduciary duties have been satisfied, but it also places the procedural burden of proof on the party challenging the board's decision.[15] In other words, if the business judgment rule applies, the key effect is that the initial burden of proof falls on the plaintiff challenging the board decision (e.g., a target shareholder challenging a merger transaction) to prove a breach of duty, which requires a factual showing in support of the alleged breach. Unless the plaintiff is able to meet such burden, the business judgment rule requires that the court dismiss the plaintiff's claim so long as the board's decision can be "'attributed to any rational business purpose.'"[16] Accordingly, the ability to structure a board's process in connection with its consideration of a transaction such that its decisions will benefit from the protection of the business judgment rule provides significant practical comfort that its decisions will not be overturned by a court.[17]

Conflict Transactions and Heightened Judicial Review: Entire Fairness

The business judgment rule and its protections will not be available to interested directors and the court's willingness to defer to the business judgment of

13. *See* Benihana of Tokyo, Inc. v. Benihana, Inc., 906 A.2d 114, 120 (Del. 2006). There are generally four levels of judicial scrutiny applied in Delaware for the evaluation of a target board's actions in connection with corporate transactions: (i) the business judgment rule, in the absence of evidence of director misconduct or self-interest, (ii) enhanced scrutiny of the implementation of defensive measures by directors without shareholder approval, (iii) entire fairness review of actions wherein one or more directors may not be disinterested, and (iv) the requirement of compelling justification for action that interferes with the exercise of shareholders' right to vote. In addition, in the context of a change of control transaction or "break up" of a corporate entity, the Delaware courts will assess whether the target company directors have satisfied their so-called "*Revlon* duty." This article addresses the nexus between the first and third modes of review and how they relate to the use of special committees.

14. *See* Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) (holding that the business judgment rule contains the presumption that "in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company"), *overruled on other grounds by* Brehm v. Eisner, 746 A.2d 244 (Del. 2009).

15. *See* MM Cos. v. Liquid Audio, Inc., 813 A.2d 1118, 1127–28 (Del. 2003).

16. *See, e.g.*, *In re* Walt Disney Co. Derivative Litig., 906 A.2d 27, 74 (Del. 2006) (quoting Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971)).

17. Furthermore, even where the business judgment rule presumption is overcome and a breach of duty is found, the directors can still mitigate this by showing that the transaction was "entirely fair"—although this is a much more difficult standard to overcome, as discussed below.

the board ends where such board is predominantly interested in the transaction. In transactions with a controlling shareholder[18] or in which a majority of the board is interested or not independent[19] with respect to the transaction, the Delaware courts have generally rejected the deferential business judgment rule in favor of the more rigorous "entire fairness" standard of review.[20]

The entire fairness standard is the strictest level of judicial review of board action applied by the Delaware courts, requiring directors that sit on both sides of a transaction to demonstrate "the most scrupulous inherent fairness of the bargain."[21] Under the entire fairness standard of review, the burden of proof lies with the director defendants to demonstrate that the transaction was entirely fair—one which mirrors that of an arm's-length negotiated transaction in terms of both process and the resulting price. As articulated by the Delaware courts, the concept of entire fairness has two separate, but related, aspects: "fair dealing" and "fair price."[22] Fair dealing focuses on the process by which

18. *See* Kahn v. Lynch Commc'n Sys., Inc., 638 A.2d 1110, 1115 (Del. 1994).

19. *See* Paramount Commc'ns Inc. v. QVC Network Inc. (*In re* Paramount Commc'ns Inc. S'holders Litig.), 637 A.2d 34, 42 n.9 (Del. 1994); *see also* Cinerama, Inc. v. Technicolor, 663 A.2d 1156, 1168 (Del. 1995) (finding that the business judgment rule does not apply to a transaction in which only one director or a minority of the board is interested, if the interested director(s) controls or dominates the board as a whole).

20. Until recently, a controlling shareholder engaging in a going-private transaction and seeking to avoid entire fairness review could find something of a solution by structuring the transaction as a unilateral, non-negotiated tender offer (i.e., a going-private transaction that is the product of a tender offer made without negotiation with the target board). Under *In re Siliconix Inc. Shareholders Litigation*, Civ. A. No. 18700, 2001 WL 716787 (Del. Ch. June 19, 2001) and its progeny, such a unilateral tender offer was not subjected to entire fairness review, but rather an evolving and less onerous standard focused on whether the transaction was "coercive." *See id.* at *6–8; *see also In re* Aquila Inc. S'holders Litig., 805 A.2d 184, 190 (Del. Ch. 2002); *In re* Life Techs., Inc. S'holders Litig., C.A. No. 16513, 1998 WL 1812280, at *3–4 (Del. Ch. Nov. 24, 1998); *In re* Ocean Drilling & Exploration Co. S'holders Litig., C.A. No. 11898, 1991 WL 70028, at *5 (Del. Ch. Apr. 30, 1991); Lewis v. Charan Indus., Inc., C.A. No. 7738, 1984 WL 8257, at *4 (Del. Ch. Sept. 20, 1984). In *In re Pure Resources, Inc. Shareholders Litigation*, 808 A.2d 421 (Del. Ch. 2002), decided soon after *In re Siliconix Inc. Shareholders Litigation*, the Court of Chancery held that a unilateral tender offer by a controlling shareholder would be non-coercive only where "(1) it is subject to a non-waivable majority-of-the-minority tender condition; (2) the controlling stockholder promises to consummate a prompt [short-form] merger at the same price if it obtains more than 90% of the shares; . . . (3) the controlling stockholder has made no retributive threats," and (4) "the independent directors on the target board . . . have free rein and adequate time to react to the tender offer." *Pure Res.*, 808 A.2d at 445. However, under the so-called "unified standard" first articulated in dicta by Vice Chancellor Strine in *In re Cox Communications, Inc. Shareholders Litigation*, 879 A.2d 604 (Del. Ch. 2005), and more recently applied by Vice Chancellor Laster in *In re CNX Gas Corp. Shareholders Litigation*, 4 A.3d 397 (Del. Ch. 2010), either a unilateral tender offer or a negotiated tender offer by a controlling shareholder would be subject to the entire fairness standard described herein; however, the deferential business judgment rule would instead apply if the transaction is both (i) negotiated and recommended by a special committee of independent directors and (ii) conditioned on the affirmative vote or tender of a majority-of-the-minority shareholders. Despite the Court of Chancery's ruling in *In re CNX Gas Corp. Shareholders Litigation*, the unified standard of review has not been tested by the Delaware Supreme Court and the members of the Court of Chancery are divided as to the appropriate standard of review. *Cf. In re* MFW S'holders Litig., 67 A.3d 496 (Del. Ch. 2013), *aff'd sub nom.* Kahn v. M&F Worldwide Corp., 88 A.3d 635 (Del. 2014).

21. Weinberger v. UOP, Inc., 457 A.2d 701, 710 (Del. 1983).

22. *Id.* at 711 ("[T]he test for fairness is not a bifurcated one as between fair dealing and price. All aspects of the issue must be examined as a whole since the question is one of entire fairness.

a board conducts a transaction, scrutinizing the timing, disclosures, structure, negotiations, and approval practices in connection with the transaction.[23] Fair price, in turn, focuses on the economic and financial considerations of the transaction, including all relevant factors such as assets, market value, earnings, future prospects, and other aspects impacting the intrinsic or inherent value of a company's stock.[24]

Unlike the deferential business judgment rule where the initial burden of proof lies on the plaintiff challenging the board's action, the initial burden of proof under the more exacting entire fairness standard lies on the director defendants.[25] While this procedural shift of the evidentiary burden does not create liability for the defendant directors per se, in practice it is often outcome determinative (or in any event makes it more difficult for the defendant directors to defeat litigation at an early stage). As the Delaware Supreme Court has noted, "'[b]ecause the effect of the proper invocation of the business judgment rule is so powerful and the standard of entire fairness so exacting, the determination of the appropriate standard of judicial review frequently is determinative of the outcome of [the] litigation.'"[26] It is in this context that the effective use of a special committee may prove most valuable.[27]

Traditional Effect of a Well-Functioning Special Committee[28]

As discussed above, where a transaction subject to entire fairness review is challenged, the initial burden of proof lies on the parties defending the transac-

However, in a non-fraudulent transaction we recognize that price may be the preponderant consideration outweighing other features of the merger.").

23. *See id.*

24. *See id.*

25. *See id.* at 710 ("The requirement of fairness is unflinching in its demand that where one stands on both sides of a transaction, he has the burden of establishing its entire fairness, sufficient to pass the test of careful scrutiny by the courts.").

26. Cinerama, Inc. v. Technicolor, 663 A.2d 1156, 1163 n.8 (Del. 1994) (alterations in original) (citation omitted).

27. Judicial recognition and support of special committees of independent and disinterested directors as a means of dealing with conflicts in corporate control transactions in Delaware can be traced back at least as far as the 1983 landmark Delaware Supreme Court decision in *Weinberger v. UOP, Inc.* In ruling that a cash-out merger between UOP and its majority shareholder, Signal Companies, Inc., failed to meet the test of entire fairness, the court noted (in a particularly influential footnote) that "the result here could have been entirely different if UOP had appointed an independent negotiating committee of its outside directors to deal with Signal at arm's length." *Weinberger*, 457 A.2d at 709 n.7. Importantly, the Delaware courts have continued to embrace the construct, and an effective special committee process has become an important feature of judicial approaches to pare down the full application of the strict "entire fairness" test.

28. Even in the absence of director conflicts of interest—for example, where the entire board is independent and disinterested (or where the few directors who are conflicted or otherwise lack independence recuse themselves from the process entirely)—a special committee may be a valuable mechanism by which to demonstrate the board's compliance with its fiduciary duties in connection with the transaction. A small, active special committee can also provide day-to-day oversight of the sale process in a way that is not practical for the larger board. For example, in the context of an acquisition offer by an unaffiliated third party in which members of the target's management will participate (a so-called "management buy-out"), a special committee may serve as a useful tool for more closely overseeing management (whose interests may not be aligned with those of the other share-

tion. However, where a special committee has been appropriately established and is well functioning,[29] the burden of proof shifts back to the plaintiff to demonstrate, through a factual showing, that the transaction is *not* entirely fair.[30] Given the exacting nature of the entire fairness test, this is a potentially important procedural advantage for the target board.[31] It also has certain evidentiary benefits. This is because a finding of an effective special committee not only benefits the defendants through its burden-shifting effect, but also serves as strong evidence of "fair dealing" (the process-focused prong of the entire fairness test).[32] As such, where the parties defending a transaction are able to shift the burden through the use of a special committee, it is often outcome determinative. Although a court will still test the transaction for fairness, in practice, it becomes very difficult for the plaintiff to successfully show that the transaction was unfair. For this reason, practitioners advising both target boards and controlling shareholders (or other parties sitting on both sides of the transaction) will often turn to a special committee as a way to minimize director liability, increase deal security, and undermine the potential settlement value of litigation challenging the deal.

holders) and may even serve as a substitute for management in leading negotiations on behalf of the target company or leading arm's-length negotiations between the company and management. *See* Simpson, *supra* note 1, at 678–89 (illustrating the role of a special committee in the context of a leveraged buyout proposal in which management will participate).

29. A reviewing court will examine the effectiveness of the special committee on the pretrial record to determine whether the burden shifts to the plaintiffs. If the court is unable to make such a pretrial determination, then the burden remains with the defendants throughout the trial. *See* Ams. Mining Corp. v. Theriault, 51 A.3d 1213, 1243 (Del. 2012). Under this framework, a plaintiff may seek to avoid burden shifting by simply raising questions of fact at the summary judgment stage, which may undermine incentives to utilize a special committee (or majority-of-the-minority vote). *See In re* Orchard Enters., Inc. Stockholder Litig., 88 A.3d 1, 25 (Del. Ch. 2014) (holding that the burden of proof remains on the defendants during trial where plaintiffs raised material questions of fact regarding the independence of the special committee's chairman and negotiation process).

30. *See* Kahn v. Lynch Commc'n Sys., Inc., 638 A.2d 1110, 1117 (Del. 1994). Approval of the transaction by an informed majority of the disinterested shareholders may also have the effect of shifting the initial burden to the party challenging the transaction under the entire fairness test. *See id.* However, as a practical matter, fewer practitioners will seek to avail themselves of a disinterested shareholder vote as a mechanism to achieve burden shifting where a special committee can be properly formed, given the practical time and expense of calling a special shareholder meeting (where the transaction is not otherwise subject to shareholder approval) and the risk of non-approval. This is particularly the case in light of hedge funds and other activist shareholders that may see value in a "vote no" campaign as a way to force negotiation of a higher price. Furthermore, notwithstanding the use of either procedural protection, the Delaware courts will still scrutinize the entire fairness of the transaction—in terms of fair process and fair price—under the entire fairness standard of review. However, unlike the successful use of a well-functioning special committee, disinterested shareholder approval in and of itself will not serve as evidence of a fair process.

31. *But see In re* Cysive, Inc. S'holders Litig., 836 A.2d 531, 548 (Del. 2003) ("The practical effect of the *Lynch* doctrine's burden shift is slight. One reason why this is so is that shifting the burden of persuasion under a preponderance standard is not a major move, if one assumes, as I do, that the outcome of very few cases hinges on what happens if . . . the evidence is in equipoise.").

32. *See Orchard Enters.*, 88 A.3d at 29 ("Evidence pertinent to the fair process aspect of the unitary entire fairness test in turn can affect the issue of fair price . . . [and] 'significantly influence' the determination of fairness and any potential remedy.").

Recent Developments: Seeking Business Judgment Rule Protection in Controlling Shareholder and Other Conflict Transactions

Notwithstanding the benefits of successful burden shifting through the use of a well-formed and functioning special committee under the entire fairness standard of review, application of this exacting standard to controlling shareholder and other conflict transactions makes it effectively impossible to dismiss stockholder challenges before trial.[33] The question then remains as to whether parties to such transactions can structure the deal in such a way as to secure the protections of the deferential business judgment rule and avoid the entire fairness inquiry altogether.

In its 1994 decision in *Kahn v. Lynch Communication Systems, Inc.*,[34] the Delaware Supreme Court expressly rejected the application of the business judgment rule to interested merger transactions, instead finding that the entire fairness standard dictated the appropriate level of judicial scrutiny irrespective of where the burden of proof rested with respect to the interested party.[35] The burden of proof could only be shifted to plaintiffs if the transaction was *either* negotiated by a well-functioning special committee *or* conditioned on the approval of a majority-of-the-minority (i.e., disinterested) shareholders. However, the courts remained unclear on whether transactions that employed *both* a special committee and approval by a majority of disinterested shareholders would benefit from the business judgment rule standard of review.

Importantly, as Delaware case law has developed over time, the courts have sought to cut back from the full application of the entire fairness standard, in favor of the business judgment rule, where adequate procedural protections are in place to sufficiently protect minority shareholders under the circumstances. In the context of transactions involving an unaffiliated third party's acquisition of a target company that has a controlling shareholder, the courts have acknowledged the influence a controlling shareholder may have even if such shareholder does not stand on "both sides" of the transaction.[36] However, the business judgment rule may nonetheless be properly invoked where a controlling shareholder supports an arm's-length transaction that results from a thorough market check and treats all shareholders equally.[37] Similarly, the courts have determined that the business judgment rule may apply in a transaction with an unaffiliated third party, even where the controlling shareholder gets treated differently than the minority shareholders in the transaction, if the trans-

33. *See In re* MFW S'holders Litig., 67 A.3d 496, 503–04 (Del. Ch. 2013), *aff'd sub nom.* Kahn v. M&F Worldwide Corp., 88 A.3d 635 (Del. 2014).

34. 638 A.2d 1110 (Del. 1994).

35. *See id.* at 1116.

36. *See In re* John Q. Hammons Hotels Inc. S'holder Litig., No. 758-CC, 2009 WL 3165613, at *12 (Del. Ch. Oct. 2, 2009).

37. *See In re* Morton's Rest. Grp., Inc. S'holder Litig., 74 A.3d 656, 666–67 (Del. Ch. 2013).

action is approved by an independent special committee and conditioned upon a non-waivable vote of the majority-of-the-minority shareholders.[38]

However, the open question after *Kahn v. Lynch*—whether the business judgment rule could ever be invoked in a negotiated transaction involving the acquisition of a controlled company by its controlling shareholder—was not squarely addressed by the Delaware courts until last year in then-Chancellor (now Chief Justice) Leo E. Strine, Jr.'s precedent-setting decision in *In re MFW Shareholders Litigation*,[39] which was subsequently upheld by the Delaware Supreme Court in *Kahn v. M&F Worldwide Corp.*[40]

In a decision with important implications for structuring going-private transactions, the Delaware Supreme Court unanimously affirmed the Court of Chancery's decision in *In re MFW Shareholders Litigation* to apply the business judgment rule—instead of the more rigorous entire fairness standard—to going-private mergers involving a controlled company and its controlling stockholder if the merger was conditioned from the outset on *both* the rigors of a properly formed and conducted special committee *and* approved through a non-waivable, fully informed, uncoerced vote of a majority-of-the-minority shareholders.[41]

In rendering its decision, the court gave due consideration to the policy incentives created by the application of the business judgment rule where both procedural devices—a special committee in tandem with a disinterested shareholder vote—are properly employed. The court determined that minority stockholders would be sufficiently protected "when these two protections are established upfront, [acting as] a potent tool to extract good value for the minority."[42] In the court's view, these procedural devices, when properly implemented, had the effect of adequately restricting and nullifying the tactical maneuvers and influence of a controlling stockholder, who must recognize from the outset the validity of

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38. *See* Se. Pa. Transp. Auth. v. Volgenau, No. 6354-VCN, 2013 WL 4009193 (Del. Ch. Aug. 5, 2013), *aff'd mem.*, 91 A.3d 562 (Del. 2014); *John Q. Hammons*, 2009 WL 3165613, at *12.

39. 67 A.3d 496 (Del. Ch. 2013).

40. 88 A.3d 635 (Del. 2014). On January 29, 2014, Chancellor Strine was confirmed as Chief Justice of the Delaware Supreme Court. Chief Justice Strine recused himself from the Delaware Supreme Court's consideration of *Kahn v. M&F Worldwide Corp.*

41. *Id.* at 645 ("To summarize our holding, in controller buyouts, the business judgment standard of review will be applied *if and only if*: (i) the controller conditions the procession of the transaction on the approval of both a Special Committee and a majority of the minority stockholders; (ii) the Special Committee is independent; (iii) the Special Committee is empowered to freely select its own advisors and to say no definitively; (iv) the Special Committee meets its duty of care in negotiating a fair price; (v) the vote of the minority is informed; and (vi) there is no coercion of the minority."). A detailed discussion of MFW's special committee process is set forth below.

Application of the business judgment rule under the standard articulated by the Delaware Supreme Court in *Kahn v. M&F Worldwide Corp.* is only available if the pretrial record establishes that both procedural protections were established and effective in accordance with the foregoing enumerated conditions. *See id.* at 645–46 ("If, after discovery, triable issues of fact remain about whether either or both of the dual procedural protections were established, or if established were effective, the case will proceed to a trial in which the court will conduct an entire fairness review.").

42. *Id.* at 644 (quoting *In re* MFW S'holders Litig., 67 A.3d 496, 528 (Del. Ch. 2013), *aff'd sub nom.* Kahn v. M&F Worldwide Corp., 88 A.3d 635 (Del. 2014)).

the special committee's paramount role.[43] "By giving controlling stockholders the opportunity to have a going private transaction reviewed under the business judgment rule, a strong incentive is created to give minority stockholders much broader access to the transactional structure that is most likely to effectively protect their interests."[44]

The evolving trend among the Delaware courts, therefore, has been in favor of shifting the burden to the plaintiff under a business judgment rule standard of review, provided that sufficient and appropriately implemented safeguards are in place. The end result, according to the courts, better protects minority investors by appropriately incentivizing controlling stockholders to privilege the minority, through procedural protections most likely to replicate the results of arm's-length bargaining by a disinterested board that would traditionally be entitled to the benefit of the business judgment rule.

III. Case Study: A Comparison of Special Committee Processes

The array of Delaware case law discussing and evaluating the performance of special committees appointed for the purpose of evaluating complex corporate transactions that present conflicts of interests serves as a valuable resource for corporate practitioners and transaction planners alike. In this part, we will examine in detail the special committee processes at the center of two recent Delaware cases (*In re MFW Shareholders Litigation* and *In re Southern Peru Copper Corp. Shareholder Derivative Litigation*) in order to illustrate the important role the special committee plays and those key factors that support or undermine a court's determination regarding the effectiveness of this important procedural protection.

In re MFW Shareholders Litigation

It should come as no surprise that the Court of Chancery's precedent-setting decision to apply business judgment rule review to a controlling shareholder transaction in *In re MFW Shareholders Litigation* (which was affirmed by the Delaware Supreme Court in March 2014) was based on a factual record that is illustrative of a particularly well-run special committee process. In this respect, the opinion serves as a useful guideline for the successful use of a special committee.

In re MFW Shareholders Litigation stems from the 2011 going-private merger pursuant to which M&F Worldwide ("MFW")[45] was acquired by its controlling

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43. *See id.*; *see also In re* Orchard Enters., Inc. Stockholder Litig., 88 A.3d 1, 24 (Del. Ch. 2014) (holding that entire fairness applied rather than the business judgment rule where the controlling shareholder failed to "agree up front, before any negotiations began, that it would not proceed with a self-dealing transaction without both (i) the affirmative recommendation of a sufficiently authorized board committee composed of independent and disinterested directors and (ii) the affirmative vote of a majority of the shares owned by stockholders who are not affiliated with the controller").

44. *M&F Worldwide Corp.*, 88 A.3d at 643 (quoting *MFW S'holders Litig.*, 67 A.3d at 528).

45. Prior to the merger giving rise to the court's opinion, MFW was a holding company incorporated in Delaware and listed on the New York Stock Exchange, with a diverse range of operations

shareholder, MacAndrews and Forbes ("MacAndrews").[46] Prior to the transaction, MacAndrews, an entity wholly owned by Ronald Perelman, owned 43.4 percent of MFW.[47] MFW's board of directors consisted of thirteen members, three of whom also held management positions with MacAndrews, including Perelman who served as both Chairman of MFW and CEO and Chairman of MacAndrews.[48]

In June 2011, MacAndrews made a proposal to the MFW board, offering to acquire the remaining 56.6 percent of MFW that MacAndrews did not own for $24 per share.[49] Notably, MacAndrews' proposal letter specifically conditioned the proposed transaction on both approval by a special committee of independent directors and approval by a majority of the shares not already owned by MacAndrews.[50] The letter further indicated that MacAndrews had no interest in selling its stake and would not expect to vote in favor of any alternative transaction.[51]

In response to the proposal, the MFW board met and, following the recusal of those directors who also held roles at MacAndrews (as well as an additional director who had previously expressed support for the offer), the independent directors resolved to form a special committee of independent and disinterested directors.[52] Over the course of the next three months, the four-member[53] special committee ultimately negotiated a $1 per share price increase to $25 per share, representing a 47 percent premium over MFW's undisturbed share price.[54] The merger was subsequently approved by 65 percent of MFW's shareholders (other than MacAndrews) and closed on the same day.[55] Meanwhile a shareholder class action suit was brought in the Delaware Court of Chancery against MFW's directors (as well as MacAndrews) seeking post-closing damages.[56]

In dismissing the breach of fiduciary duty action brought by MFW's shareholders, the Court of Chancery found MFW's special committee in combination

including check printing, technology products, services for financial companies, and the manufacture of scanning equipment and licorice flavorings. *MFW S'holders Litig.*, 67 A.3d at 505–06.

46. *Id.* at 499.

47. *Id.*

48. *Id.* at 505–06. The thirteen-member MFW board included three members with roles at both companies: Perelman, who served as both Chairman of MFW and CEO and Chairman of MacAndrews; Barry Schwartz, who served as both President and CEO of MFW and Vice Chairman and Chief Administrative Officer of MacAndrews; and William Bevins, who was a vice president at MacAndrews. *Id.* at 505–06.

49. *Id.* at 506.

50. *Id.*

51. *Id.*

52. *Id.* at 506–07.

53. Although the MFW board originally appointed five directors to the special committee, one of its members recused himself the following day, despite qualifying as "independent" for New York Stock Exchange purposes, due to "some current relationships that could raise questions about his independence for purposes of serving on the special committee." *Id.* at 507 (quoting Defs.' ex. 28 (e-mail from Michael Schwartz to the special committee (June 15, 2011))).

54. *Id.* at 499–500.

55. *Id.*

56. *Id.* Plaintiffs initially sought to enjoin the transaction, but withdrew their injunction application after discovery to concentrate on a post-closing claim for money damages.

with the majority-of-the-minority shareholder vote procedure sufficient to qualify for "cleansing credit under the business judgment rule."[57] In doing so, the Court of Chancery placed specific focus and importance on the following features of the special committee process: (i) the breadth and strength of the special committee's mandate; (ii) the independent and disinterested nature of the special committee; and (iii) the special committee's exercise of due care in considering the proposal, including through retaining independent legal and financial advisors, studying a range of financial information, and evaluating alternatives to inform itself. We examine the facts surrounding each of these features of the committee's process in turn below.

Broad Mandate. In appointing the special committee, the MFW board empowered the committee with wide authority to not only evaluate MacAndrews' offer, but to negotiate with MacAndrews over the terms of its proposal, make such investigation of the proposal as it deemed appropriate, engage independent legal and financial advisors, and elect not to proceed with the proposal.[58] The Court of Chancery emphasized that the MFW special committee had real authority to negotiate with MacAndrews and that, "[c]ritically, this negotiating power was accompanied by the clear authority to say no definitively to MacAndrews & Forbes."[59] In affirming the Court of Chancery's decision, the Delaware Supreme Court also emphasized the lower court's finding that the special committee had the leeway to consider strategic alternatives, despite MacAndrews having announced it was not interested in selling its stake in MFW, noting that the "undisputed record shows that the Special Committee . . . did consider whether there were other buyers who might be interested in purchasing MFW."[60]

Independent and Disinterested Members. Also central to the Court of Chancery's ruling was the independent and disinterested nature of the special committee. One of the plaintiffs' key arguments was that three of the four special committee members lacked independence as a result of various business and social ties with representatives of MacAndrews and, therefore, the committee failed to function properly.[61] The Court of Chancery discussed the independence of each of these

57. *Id.* at 501. The Delaware Supreme Court subsequently upheld the Court of Chancery's decision, finding that "where the controller irrevocably and publicly disables itself from using its control to dictate the outcome of the negotiations and the shareholder vote, the controlled merger then acquires the shareholder-protective characteristics of third-party, arm's-length mergers, which are reviewed under the business judgment standard." Kahn v. M&F Worldwide Corp., 88 A.3d 635, 644 (Del. 2014).

58. *MFW S'holders Litig.*, 67 A.3d at 499–500.

59. *Id.* at 508. Importantly, the special committee possessed the ability to reject the offer definitively as a result of its broad mandate as well as MacAndrews' decision to condition its proposal, from the beginning, on the approval of an independent special committee.

60. *M&F Worldwide Corp.*, 88 A.3d at 651.

61. The plaintiffs' arguments against the independence of the special committee focused on alleged business and social ties of special committee members Martha Byorum, Viet Dinh, and Carl Webb with Perelman, MacAndrews, and their associates. With respect to Byorum, the plaintiffs pointed to former personal and business relationships she had with Perelman and certain of his associates while working at Citibank in the 1990s, her being asked to join the MFW board by MacAndrews' CEO, and an affiliate of Stephens (the investment bank where she worked as a vice president and head of the international group) receiving a $100,000 retainer fee for work Byorum initiated for

three members in turn, in each case dismissing the plaintiff's "cursory" allegations and finding that they failed to meet a requisite "materiality standard, under which the court must conclude that the director in question's material ties to the person whose proposal or actions she is evaluating are sufficiently substantial that she cannot objectively fulfill her fiduciary duties."[62] In doing so, the Court of Chancery emphasized that it is "necessary to look to the financial circumstances of the director in question to determine materiality."[63] In affirming the lower court's holding, the Delaware Supreme Court emphasized its finding that "the Appellants did 'nothing . . . to compare the actual circumstances of the [challenged directors] to the ties [they] contend affect their impartiality' and 'fail[ed] to proffer any real evidence of their economic circumstances.'"[64]

Satisfaction of the Duty of Care. Also central to the Court of Chancery's opinion is the fact that the record supported a finding that the special committee had satisfied its duty of care in connection with its consideration and approval of the transaction. In coming to this conclusion, the Court of Chancery focused closely on the significant steps taken by the special committee to exercise an informed judgment on the merits of the transaction. Empowered with a wide mandate, the special committee engaged its own independent and qualified legal counsel and financial advisors to inform itself as to whether the proposed going-private transaction was in the best interests of MFW's minority shareholders.[65] With the assistance of its advisors, the special committee actively negotiated with MacAndrews for over three months, rejecting MacAndrews' initial $24 per share offer

an entity in which Perelman had a 37.6 percent stake. With respect to Dinh, a professor at the Georgetown University Law Center and a co-founder of the Bancroft law firm, the plaintiffs pointed to the fact that Bancroft had received approximately $200,000 in legal fees from MacAndrews and another entity affiliated with Perelman over the previous three years and alleged that Dinh had a close personal relationship with Barry Schwartz (President and CEO of MFW and Vice Chairman and Chief Administrative Officer of MacAndrews), noting that Schwartz sat on the Georgetown Board of Visitors and had previously requested Dinh to join the board of another Perelman corporation, Revlon. Finally, with respect to director Webb, the plaintiffs alleged that Webb had known Perelman for over twenty years and that they had invested in thrifts together in the late 1980s, from which they both made a "significant" amount of money. *MFW S'holders Litig.*, 67 A.3d at 510–14.

62. *Id.* at 509.

63. *Id.* at 510. The court also noted that the plaintiffs failed to argue that any of the special committee members lacked independence under the requirements of the New York Stock Exchange, upon which MFW was listed. Although a director that is independent for such purposes does not necessarily qualify as independent for purposes of Delaware law, the stock exchange rules "cover many of the key factors that tend to bear on independence . . . and they are a useful source for this court to consider when assessing an argument that a director lacks independence." *Id.*; *see also M&F Worldwide Corp.*, 88 A.3d at 648 n.26 (noting that "[t]he record reflects that the Court of Chancery discussed NYSE standards on director independence for illustrative purposes . . . [, but that its] factual and legal determinations regarding the Special Committee's independence were premised on settled Delaware law").

64. *M&F Worldwide Corp.*, 88 A.3d at 649 (alterations in original) (quoting *MFW S'holders Litig.*, 67 A.3d at 510). The supreme court also rejected the appellants' assertion that the materiality of any economic relationships between the members of the special committee and Perelman should not have been decided on summary judgment, noting that "Delaware courts have often decided director independence as a matter of law at the summary judgment stage," and that "the Appellants could have, but elected not to, submit any Rule 56 affidavits, either factual or expert, in response to the Defendants' summary judgment motion." *Id.*

65. *MFW S'holders Litig.*, 67 A.3d at 507.

with a counteroffer of $30 per share, before accepting MacAndrews' "best and final" offer of $25 per share.[66] During this period, the committee met eight times, considered a range of strategic alternatives, and reviewed a "rich body of financial information relevant to whether and at what price a going private transaction was advisable."[67]

The actions of the special committee described above serve as an example of a process that ultimately played an important role in avoiding post-closing liability for the parties involved. We will now turn to a case that illustrates a markedly less robust process, and with significant adverse consequences.

In re Southern Peru Copper Corp. Shareholder Derivative Litigation

In stark contrast to the well-run process demonstrated in connection with the MFW transaction in *In re MFW Shareholders Litigation*, another recent decision by the Delaware Court of Chancery, *In re Southern Peru Copper Corp. Shareholder Derivative Litigation* (which was affirmed by the Delaware Supreme Court in 2012),[68] serves as a particularly useful example of the difficult and complex issues facing directors charged with navigating a related-party transaction and how the courts will view their actions.

The Court of Chancery's 2011 opinion in *In re Southern Peru*, which was upheld by the Delaware Supreme Court in 2012, stems from the 2004 transaction involving Southern Peru Copper Corporation ("Southern Peru") and its controlling shareholder, Grupo México, S.A.B. de C.V., which owned 63.08 percent of Southern Peru's voting capital through its wholly owned subsidiary Americas Mining Corporation (together, "Grupo Mexico").[69] Grupo Mexico was also the owner of 99.15 percent of a private Mexican mining company, Minera México,

66. *Id.* at 515.

67. *Id.* at 516. Although the special committee had MFW's projections from the outset, it requested management to review and prepare updated projections reflecting management's most current views, on which the special committee's financial advisor produced a range of valuations for MFW, using a variety of accepted methods, including a DCF model and a premiums-paid analysis. Valuations ranged from $15 to $45 per share. *Id.* at 515. As the Delaware Supreme Court noted in its decision upholding the Court of Chancery's decision, MacAndrews and any "dual" MacAndrews/MFW executives normally involved in the process of vetting MFW's projections were excluded from the preparation of the updated financial projections, "[c]onsistent with the Special Committee's determination to conduct its analysis free of any MacAndrews influence." *M&F Worldwide Corp.*, 88 A.3d at 651. Furthermore, although the special committee lacked the practical authority to market the company to other potential acquirers (given that MacAndrews was not interested in selling and possessed the practical ability to block another transaction through its large ownership interest), the special committee did, nonetheless, consider with its financial advisor whether there were other potential bidders for the company if MacAndrews were willing to sell. *See MFW S'holders Litig.*, 67 A.3d at 508. The special committee also considered whether a break-up of MFW would lead to enhanced shareholder value, and it asked its financial advisor to analyze how a possible sale of one of MFW's operational companies to a rival would affect MFW's valuation (to which its financial advisor opined that it would not), and it received a fairness opinion from its financial advisor prior to accepting MacAndrews' revised, increased offer, opining that the price offered was fair. *Id.* at 515.

68. *In re* S. Peru Copper Corp. S'holder Derivative Litig., 52 A.3d 761, 763–65 (Del. Ch. 2011), *aff'd sub nom.* Ams. Mining Corp. v. Theriault, 51 A.3d 1213 (Del. 2012).

69. *Id.* at 765 & n.2.

S.A. de C.V. ("Minera"), which was "emerging from—if not still mired in—a period of financial difficulties" at the time of the transaction at issue.[70]

In February 2004, Grupo Mexico approached the independent directors of Southern Peru, proposing that Southern Peru purchase its stake in Minera in exchange for newly issued Southern Peru shares with a market value of $3.05 billion.[71] At this time, Grupo Mexico representatives held seven out of thirteen seats on the Southern Peru board.[72] Grupo Mexico was controlled by the Larrea family, and Germán Larrea served as both Chairman and CEO of Grupo Mexico and Southern Peru.[73]

Given Grupo Mexico's interest in the transaction, the Southern Peru board of directors established a special committee of disinterested directors to evaluate the proposed transaction.[74] The special committee consisted of four members—three of whom had been nominated to the Southern Peru board by Grupo Mexico and the fourth of whom was a representative of Cerro, an entity that owned 14.2 percent of Southern Peru's outstanding common stock.[75]

After eight months of "awkward back and forth with Grupo Mexico,"[76] the Southern Peru special committee approved the transaction in October 2004, at which time the market value of the Southern Peru shares to be issued to Grupo Mexico had risen to $3.1 billion.[77] On March 28, 2005, the merger was approved by 90 percent of Southern Peru's shareholders and was subsequently completed on April 1, 2005, at which time the market value of the Southern Peru shares issued to Grupo Mexico equaled $3.75 billion.[78] Southern Peru's shareholders subsequently brought a derivative action before the Delaware Court of Chancery alleging that the transaction was entirely unfair to the company and its minority shareholders.[79] The parties agreed that entire fairness was the appropriate standard of review.[80]

70. *Id.* at 765–68 & n.2.

71. *Id.* at 765.

72. *Id.* at 768.

73. *Id.*

74. *Id.* at 765.

75. *Id.* at 768–69. With the exception of the member representing Cerro, the independence of the special committee was not challenged by the plaintiffs. With respect to the Cerro nominee, the court was particularly critical of his role in the special committee process. Rather than serve as an aggressive negotiator on behalf of Southern Peru's minority shareholders, the court concluded that the Cerro nominee was engaged in negotiations of his own with Grupo Mexico, seeking registration rights for the Southern Peru shares held by Cerro (which wanted "to get out" of its investment in Southern Peru). The negotiations over the registration rights were held in tandem with the Minera transaction negotiations, culminating in Grupo Mexico agreeing to Cerro's registration rights on the same day that the Minera merger was approved, and in exchange for Cerro agreeing to vote in favor of the Minera transaction unless the special committee changed its recommendation in favor of the deal. Although the Cerro nominee recused himself from the special committee's final vote approving the transaction, the court was highly critical of his heavy role in negotiating the Minera transaction in light of his distinct interests in securing registration rights from Grupo Mexico on behalf of Cerro. *See id.* at 778–81.

76. *Id.* at 765.

77. *Id.* at 765–66.

78. *Id.* at 785.

79. *Id.* at 766.

80. *Id.*

The Court of Chancery ultimately ruled for the plaintiffs, finding that the merger was entirely unfair and that the defendants had breached their duty of loyalty, and issued a substantial award of approximately $2 billion in damages and interest.[81] In coming to its decision, the court first undertook a factual review of the special committee's process, finding that it was "not 'well functioning'"[82] and, accordingly, found the burden of proof remained with the defendants to show the entire fairness of the transaction, which they were unable to do.[83]

In reviewing the fairness of the transaction and ruling that the special committee's process failed to function effectively, the Court of Chancery focused on the following factors, which are examined in more detail below: (i) the special committee fell victim to its narrow mandate and "a controlled mindset,"[84] taking "strenuous efforts to justify a transaction at the level originally demanded" by Grupo Mexico and failing to consider available alternatives;[85] (ii) the special committee's failure to justify the transaction based on standalone valuations of Minera and the use of unconventional "relative" valuation metrics that ignored the true market value of Southern Peru's stock and enhanced the value of Minera's equity;[86] and (iii) the special committee's failure to reconsider its recommendation of the transaction prior to the shareholder vote, despite having negotiated the ability to do so and strong evidence that the basis for its initial approval of the transaction had changed.[87] Together, these factors indicated to the Court of Chancery that the special committee failed to simulate the role of an independent third-party negotiator on behalf of Southern Peru's minority shareholders.[88] Instead, the committee tried to find a way for the Minera merger to "make sense rather than aggressively testing the assumption that the Merger was a good idea in the first place."[89]

Narrow Mandate and "Controlled Mindset." The resolution appointing the special committee provided that its "duty and sole purpose" was to evaluate the transaction in such manner as it deemed desirable and in the best interests of Southern Peru's shareholders.[90] Notably, the special committee's mandate did

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81. *Id.* at 819.
82. *Id.* at 793.
83. As discussed above, under *Kahn v. Lynch Communication Systems, Inc.*, 638 A.2d 1110 (Del. 1994), the burden of proof may be shifted to the plaintiffs to prove that the transaction was entirely unfair, through the use of a well-functioning special committee or, under certain circumstances, a fully informed vote of a majority of the disinterested shareholders. *Id.* at 1117. Although the transaction was approved by 90 percent of Southern Peru's shareholders, the court refused to shift the burden to the plaintiffs on this latter basis because the transaction was not conditioned from the outset on a majority vote of disinterested shareholders and the defendants failed to meet their burden of proof to show that the shareholder vote was fully informed, given that the proxy statement in respect of the shareholders' meeting left out material aspects of the special committee's negotiation process. *S. Peru Copper Corp.*, 52 A.3d at 793–97.
84. *S. Peru Copper Corp.*, 52 A.3d at 798.
85. *Id.* at 764.
86. *Id.* at 763.
87. *Id.* at 810–11.
88. *See id.* at 773–74.
89. *Id.* at 801.
90. *Id.* at 769.

not grant it authority to negotiate a transaction with Grupo Mexico or consider alternative transactions and, as the Court of Chancery critically noted, the committee members failed to push for more expansive authority.[91] Although the special committee did, nonetheless, proceed to negotiate with Southern Peru, "its approach to negotiations was stilted and influenced by its uncertainty about whether it was actually empowered to negotiate."[92] Apparently insecure about its own purpose, the special committee perceived Grupo Mexico's proposal to have been the only one on the table. At no point did the special committee consider alternative transactions that may have been available to Southern Peru. Rather, it functioned in a way that indicated that Grupo Mexico dictated the terms of the transaction.

Relative Valuation and Other Economic Contortions. This "controlled" mindset was further evidenced by the special committee's response to its own financial advisor's initial valuation analyses and its approach to analyzing the economic terms of the transaction going forward. At the outset of the special committee process, the committee's financial advisor performed a number of customary valuation analyses on the standalone equity value of Minera, the outcome of which was presented to the special committee in an "'Illustrative Give/Get Analysis.'"[93] The analysis made clear the stark disparity between Grupo Mexico's asking price and the financial advisors' own valuation of Minera: "Southern Peru would 'give' stock with a market price of $3.1 billion to Grupo Mexico and would 'get' in return an asset worth no more than $1.7 billion."[94] In other words, the financial advisors' valuations indicated that Southern Peru would be overpaying by a full $1.4 billion. But rather than confront Grupo Mexico with its valuation and seek to negotiate a significant drop in the asking price, the special committee "embarked on a 'relative valuation' approach," devaluing Southern Peru to make Minera look closer in value to the $3.1 billion of Southern Peru shares that Grupo Mexico was demanding.[95] In fact, the financial advisor's initial presentation was the only time that it ever included a "give-get analysis." Thereafter, the special committee and its financial advisor took the view that the market was overvaluing Southern Peru's stock and that, "although Southern Peru had an actual cash value of $3.19 billion, its 'real,' 'intrinsic,' or 'fundamental' value was only $2.06 billion, and giving $2.06 billion in fundamental value for [Minera's] $1.7 billion in fundamental value was something more reasonable to consider."[96]

91. Moreover, the Southern Peru special committee lacked the mandate or practical ability to definitively "say no" to Grupo Mexico, which did not condition its proposal on the approval of an independent special committee. *Cf. In re* MFW S'holders Litig., 67 A.3d 496, 508 (Del. Ch. 2013) (noting that the special committee "was fully empowered to say no and make that decision stick"), *aff'd sub nom.* Kahn v. M&F Worldwide Corp., 88 A.3d 635 (Del. 2014).

92. *S. Peru Copper Corp.*, 52 A.3d at 797.

93. *Id.* at 772.

94. *Id.* at 771–72.

95. *Id.* at 763–64.

96. *Id.* at 773 (footnote omitted). Strikingly, the defendants' testimony indicated that the special committee's members were somewhat "comforted" by these revised values—which, as the court noted, is "an odd word in this context" and that the members thereafter embraced the idea that Southern Peru and Minera should be valued on a "relative basis." *Id.* at 773–74.

The Court of Chancery was highly critical of the special committee's approach to considering the economics of Grupo Mexico's proposal and in particular its decision to abandon the real-world market value of Southern Peru's shares. In its own words,

> [a]lthough directors are free in some situations to act on the belief that the market is wrong, they are not free to believe that they can in fact get $3.1 billion in cash for their own stock but then use that stock to acquire something that they know is worth far less than $3.1 billion in cash or in 'fundamental' or 'intrinsic' value terms because they believe the market is overvaluing their own stock and that on real 'fundamental' or 'intrinsic' terms the deal is therefore fair. In plain terms, the special committee turned the 'gold' it was holding in trust into 'silver' and did an exchange with 'silver' on that basis, ignoring that in the real world the gold they held had a much higher market price in cash than silver.[97]

Failure to Reconsider Fairness of the Transaction Before the Shareholder Vote. Under the terms of the merger agreement, the special committee was contractually entitled to change or withdraw its recommendation of the merger if required by its fiduciary duties, although it did not have the right to terminate the merger agreement or halt the shareholder vote under such circumstances.[98] The special committee's right to make a change of recommendation was a particularly important provision. Once the merger agreement was signed, Southern Peru had no way out of the transaction, even if the board no longer thought the merger was advisable, other than to publicly change its recommendation for the transaction in an effort to convince the minority shareholders to vote against it.[99] "The only utility therefore of the recommendation provision was if the Special Committee seriously considered the events between the time of signing and the stockholder vote and made a renewed determination of whether the deal was fair."[100] The Court of Chancery, however, determined that the special committee had not done this.[101]

Despite having the ability to rescind their recommendation, the special committee failed to do so. Nor did it ask for an updated fairness opinion from its financial advisor prior to the shareholder vote. The Court of Chancery was critical of this, noting that "an adroit Special Committee would have recognized the need to re-evaluate the Merger" under the circumstances.[102] Instead, there was

97. *Id.* at 764–65.

98. *Id.* at 780 & n.53.

99. Moreover, so long as the special committee continued to recommend the deal, Cerro (an entity which owned 14.2 percent of Southern Peru's outstanding common stock) was contractually required to vote in favor of the merger pursuant to a support agreement it had entered into with Grupo Mexico—making the shareholder vote (and the merger) a *fait accompli* given that Grupo Mexico and Cerro together held over two-thirds of the voting power. *Id.* at 778.

100. *Id.* at 785.

101. *Id.*

102. *Id.* at 783. The Court of Chancery found the special committee's failure to reconsider the fairness of the merger prior to the shareholder vote curious for two reasons. First, Southern Peru's stock price had risen substantially since the time that the transaction was announced, and the committee had agreed to a fixed exchange rate without a collar or termination right. *Id.* Despite having dropped nearly 5 percent upon announcement of the transaction in October 2004, Southern Peru's stock price

no evidence that the special committee gave a serious second thought to the fairness of the transaction after the signing of the merger agreement.

IV. Lessons Learned: Hallmarks of a Well-Designed and Well-Functioning Special Committee

The full benefits of a special committee require that it be both well-formed and well-functioning. In other words, both the formation and composition of the committee as well as its demonstrable effectiveness are of paramount importance. While the independent and disinterested nature of its members is a defining feature of a special committee, it is not enough. Rather the special committee must "function in a manner which indicates that . . . the committee exercised real bargaining power 'at an arms-length.'"[103] Below are some of the key features that should be considered, early in the process and with the assistance of legal counsel, when implementing (or considering implementing) a special committee in connection with a corporate transaction that presents actual, perceived, or potential conflicts of interest.

Composition—Disinterested and Independent Members

Determining "the composition of the special committee is of central importance" and should be approached conscientiously and with a view to minimizing risk.[104] The most fundamental feature of a special committee formed for purposes of considering a corporate transaction is that its members be both disinterested and independent—and this should be formally tested from the outset (e.g., through the use of a questionnaire or in-person/telephonic interviews) and continuously monitored.[105] A director is generally considered to be disinterested if he or she lacks an interest in the particular transaction at issue. But even where a director is disinterested (i.e., lacks an interest in the transaction that is distinct to that of other shareholders generally), one must still consider whether such director is independent.[106] "Independence means that a director's decision is based on the corporate merits of the subject before the board rather than extraneous considerations or influences."[107] A director lacks independence if he or she is "'beholden'" to the interested party or interested director(s), or is so under such party's or person's

had risen by over 20 percent by the time of the shareholder vote on March 28, 2005, with shares trading at an average price of $58.60 per share. *Id.* at 782–83. Second, Southern Peru's actual 2004 EBITDA numbers had become available and they "smashed through" the projections used by the special committee and its financial advisor, which "should have given the Special Committee serious pause." *Id.* at 783–84.

103. Kahn v. Tremont Corp., 694 A.2d 422, 429 (Del. 1997) (citation omitted).

104. Gesoff v. IIC Indus., Inc., 902 A.2d 1130, 1145–46 (Del. Ch. 2006).

105. To optimize the benefit of the special committee, it should be formed and functioning as early in the transaction process as possible. A delay may provide a basis for those challenging the transaction to claim that the special committee's process was irrevocably tainted, particularly if interested or non-independent members of the board were participating in the transaction process for some time.

106. *See* Aronson v. Lewis, 473 A.2d 805 (Del. 1984).

107. *Id.* at 816.

influence that the director's "discretion would be sterilized."[108] Independence also focuses on independence from corporate management.[109] Similarly, the payment of significant consulting or other fees by the company or a party connected to the transaction to a director may undermine such director's independence.[110] A thorough inquiry into each proposed committee member's independence should focus on both the more obvious conflicts as well as the more subtle relationships that a director may have, including among others:

- any material financial interest the director may have in the transaction or the counterparty;
- any board or management positions the director may hold at the counterparty or its affiliates, resulting in conflicting duties or perhaps dependence on financial benefits;
- any long-term or close business or personal relationships the director may have with senior persons on the other side of the transaction that may be perceived to constrain hard bargaining; and
- any historical or current relationship the director may have with a person related to the other side that constitutes domination or control of or undue influence over such director (e.g., that would likely make the director feel beholden to such person) in the context of his or her representation of the target in connection with the transaction.

That said, not all relationships should disqualify a director from serving on an independent special committee. Mere personal relationships between an interested and disinterested director, without more, are generally insufficient to taint a disinterested director's independence.[111] Notably, the mere fact that a director was nominated or elected to the board by an interested party to the transaction is not enough to undermine his or her independence in and of itself.[112]

108. Rales v. Blasband, 634 A.2d 927, 936 (Del. 1993) (citing *Aronson*, 473 A.2d at 815).

109. Although not binding, the Delaware courts will consider the stock exchange rules. *See In re* MFW S'holders Litig., 67 A.3d 496, 510 (Del. Ch. 2013). The stock exchange rules reflect experience in Delaware.

> Although the fact that directors qualify as independent under the NYSE rules does not mean that they are necessarily independent under our law in particular circumstances, the NYSE rules governing director independence were influenced by experience in Delaware and other states and were the subject of intensive study by expert parties. They cover many of the key factors that tend to bear on independence, including whether things like consulting fees rise to a level where they compromise a director's independence and they are a useful source for this court to consider when assessing an argument that a director lacks independence.

Id. (citations omitted); *see also* Kahn v. M&F Worldwide Corp., 88 A.3d 635, 648 n.26 (Del. 2014) (describing NYSE standards as "illustrative").

110. *See, e.g.*, *MFW S'holders Litig.*, 67 A.3d at 510; *see also Rales*, 634 A.2d at 937.

111. *See* Beam v. Stewart, 845 A.2d 1040, 1051 (Del. 2004) (holding that "[a]llegations that Stewart and the other directors moved in the same social circles, attended the same weddings, developed business relationships before joining the board, and described each other as 'friends,' even when coupled with Stewart's 94% voting power, are insufficient, without more, to rebut the presumption of independence").

112. *See* Aronson v. Lewis, 473 A.2d 805, 816 (Del. 1984) ("[I]t is not enough to charge that a director was nominated by or elected at the behest of those controlling the outcome of a corporate

Moreover, the fact that a director is expected to serve on an acquirer's board post-transaction, or that a director is also a shareholder in the target, would not generally disqualify him or her from serving on the special committee in the absence of other problematic facts.[113]

Finally, it is worth noting that the special committee members should, ideally, be selected by the disinterested members of the board and not by directors who are interested in the transaction under consideration.[114]

Composition—Other Considerations

In considering potential members, it is also important to consider the personalities, availability, and expertise of the particular members of a board, as well as the optimum size for an efficient, decisive, and attendant committee. It is often helpful to have at least one member of the special committee who has financial or transactional experience or expertise to assist with evaluating the valuation of the offer and take a leading role in negotiations.

Determining the appropriate size of a special committee involves the consideration of many factors, including the number of independent and disinterested directors on the board, overall time availability, real time accessibility, desired experience, leadership skills, and board attitude. With respect to legal guidance on the matter, the Delaware courts have disfavored the use of a single-member special committee, and a two-member committee is similarly problematic.[115] Where there are simply too few potential candidates for the special committee, it is permissible to bring additional directors onto the board for the specific purpose of serving as a member of the committee. On the other hand, boards should be aware that a special committee that is too large can become unwieldy

election. That is the usual way a person becomes a corporate director. It is the care, attention and sense of individual responsibility to the performance of one's duties, not the method of election, that generally touches on independence."); S. Muoio & Co. v. Hallmark Entm't Invs. Co., No. 4729-CC, 2011 WL 863007, at *10 (Del. Ch. Mar. 9, 2011) ("The mere nomination of a director by a majority stockholder, however, is insufficient to demonstrate lack of independence."), *aff'd mem.*, 35 A.3d 419 (Del. 2011).

113. *See, e.g.*, Cal. Pub. Emps.' Ret. Sys. v. Coulter, Civ. A. No. 19191, 2002 WL 31888343, at *9 (Del. Ch. Dec. 18, 2002) ("Our cases have determined that personal friendships, without more; outside business relationships, without more; and approving of or acquiescing in the challenged transactions, without more, are each insufficient to raise a reasonable doubt of a director's ability to exercise independent business judgment.").

114. *See In re* Fort Howard Corp. S'holders Litig., No. 9991, 1988 WL 83147, at *12 (Del. Ch. Aug. 8, 1988) (stating, in the context of a leveraged buyout in which the target's CEO and other members of management participated, that, "[i]t cannot, for example, be the best practice to have the interested CEO in effect handpick the members of the Special Committee as was, I am satisfied, done here. . . . A suspicious mind is made uneasy contemplating the possibilities when the interested CEO is so active in choosing his adversary.").

115. *See* Kahn v. Dairy Mart Convenience Stores, Inc., No. 12489, 1996 Del. Ch. LEXIS 38, at *19–20 (Del. Ch. Mar. 29, 1996); Lewis v. Faqua, 502 A.2d 962, 967 (Del. Ch. 1985) ("'[I]f a single member committee is to be used, the member should, like Caesar's wife, be above reproach.'" (citation omitted)). In practice, a two-member committee is also problematic because action requires unanimous agreement, there is a potential for deadlock, and if one committee member becomes unavailable or non-independent through the course of the transaction, the committee is left with a single member, which the courts are particularly skeptical of.

and counterproductive, as it may become difficult for a larger group to actively manage the process. Of course, creating a special committee comprised of only a subset of the disinterested directors on the board may present political or relationship issues that deserve recognition and should be taken into account.

Committee Mandate

An effective special committee must be formed with a clear mandate that is sufficiently broad so as to serve the duties of directors and to provide them with real bargaining power and "authority comparable to what a board would possess in a third-party transaction."[116] As courts and practitioners have previously noted, "in the context of a conflict transaction, the importance of the committee's charter cannot be overstated."[117] To this end, a special committee should be formed through the use of a clear, well-drafted resolution that will serve as the special committee's guiding charter throughout the transaction process. Among other things, the resolution should authorize the special committee to not only evaluate the proposed transaction, but also, if appropriate in the view of the special committee, to negotiate aggressively, consider alternatives, and have the "'critical power' to say 'no' to the transaction."[118] Furthermore, well-drafted resolutions should require that the company give the special committee its full cooperation, including by answering questions and providing all information requested, and should allow the special committee to retain its own independent legal, financial, and other advisors at the company's cost. In certain circumstances it may be appropriate to specifically empower the special committee with authority to file litigation (e.g., against a controlling shareholder) or to adopt takeover defensive measures (e.g., a "poison pill").[119]

Empowered, Educated, and Active Members

Even with an appropriate mandate, in order to perform effectively, special committee members must be advised of, and understand, their legal duties and mandate (under applicable law and the committee's adopting resolution). They also must be kept abreast of transaction developments as they unfold and in real time—particularly with respect to central economic and other business issues. This requires members to be active participants in the process and key decisions,

116. *In re* CNX Gas Corp. S'holders Litig., 4 A.3d 397, 414 (Del. Ch. 2010).

117. Gregory Varallo, Srinivas Raju & Michael Allen, Special Committees: Law and Practice 41 (2011).

118. Gesoff v. IIC Indus., Inc., 902 A.2d 1130, 1146 (Del. Ch. 2006) (citation omitted); *see also In re* MFW S'holders Litig., 67 A.3d 496, 506 (Del. Ch. 2013) (citing the proposal letter whereby the special committee was created and empowered with a broad mandate), *aff'd sub nom.* Kahn v. M&F Worldwide Corp., 88 A.3d 635 (Del. 2014).

119. *See* La. Mun. Police Emps.' Ret. Sys. v. Fertitta, No. 4339-VCL, 2009 Del. Ch. LEXIS 144, at *31 (Del. Ch. July 28, 2009) (holding that "the board's failure to employ a poison pill . . . in the face of an obvious threat to the corporation and the minority shareholders . . . supports a reasonable inference that the board breached its duty of loyalty").

including whether to pursue alternatives and how to approach negotiations. In the context of a transaction involving a substantial or controlling shareholder, the special committee should effectively replicate arm's-length bargaining on behalf of the minority shareholders. Frequent and well-documented committee meetings should be part of the process. Members of the special committee should keep in mind that they are creating a record with each meeting and discussion. All special committee meetings should be conducted with an eye toward potential litigation. In particular, we recommend that detailed minutes are kept of each special committee meeting as the meetings occur.

Qualified Independent and Disinterested Advisors

Early in the process, the special committee should engage its own legal and financial advisors (and potentially other relevant advisors) that are appropriately experienced and capable and carefully screened for conflicts and significant relationships with the target company, potential acquirers, large shareholders, and other interested parties. These advisors should serve as qualified resources upon which the special committee's members may rely, and they further reinforce the committee's role as an independent body. If the committee's financial advisor delivers a fairness opinion, the special committee should request one or more presentations, with materials provided in advance, regarding the diligence, methodologies, and procedures applied and the outcome reached. When engaging advisors, care should be taken to ensure that compensation is not structured in a way that drives a specific result with respect to a particular transaction.

Because of the significant role that financial advisors play in exploring and evaluating strategic alternatives, the special committee should be particularly focused on ensuring that its financial advisor is, and remains during the course of the transaction, independent and free of conflicts. A number of recent Delaware cases have indicated that the courts are prepared to scrutinize banker conflicts and enjoin transactions where the financial advisor's activities have tainted the process.[120]

Compensation

It is common for members of special committees to be compensated for their membership and work on the committee and the courts generally support the idea that "[d]irectors serving on a special committee are entitled to reasonable

120. *See In re* Del Monte Foods Co. S'holders Litig., 25 A.3d 813, 835 (Del. Ch. 2011) (granting a preliminary injunction postponing the vote on a merger where the financial advisor (Barclays) had, without the board's knowledge, manipulated the sale process in order to engineer a transaction that would allow it to obtain lucrative buy-side financing fees). The court in *Del Monte Foods* noted that, "[a]lthough the blame for what took place appears at this preliminary stage to lie with Barclays, the buck stops with the Board," and concluded that the plaintiffs established a reasonable likelihood of success on the merits of their claim that the directors had breached their fiduciary duties by failing to seriously oversee Barclays. *Id.* at 835–36.

compensation for their efforts."[121] The amount and form of such additional remuneration varies widely, though we would emphasize that care should be taken to ensure that the compensation structure and amount are readily defensible as reasonable.[122] In this regard, it can be useful for the board to consider precedents in setting appropriate compensation terms. Practitioners should be careful not to structure compensation in a way that undermines the committee members' status as independent and disinterested directors. For example, payment of a significant bonus to a committee member upon closing a successful transaction—especially if structured before the special committee process has concluded—could be seen to undermine the independence of that member and the entire committee in the eyes of a court.[123]

V. The Use of Special Committees Outside the United States

In recent years, conflict of interest transactions involving public companies have garnered substantial attention by institutional investors, shareholder advocacy groups, and regulators in many countries outside the United States. As boards and regulators outside the United States grapple with this increased scrutiny, there has been increased emphasis on the role of outside and independent directors in many jurisdictions, in particular in Europe,[124] and non-U.S. boards are increasingly turning to U.S.-style special committee practices to validate important corporate transactions.[125]

In the United Kingdom, the role of independent directors and the use of special committees to address conflicts have taken on particular importance among the corporate governance community. Historically, potential conflicts in a related-party transaction had been dealt with on an ad hoc basis, with

121. Se. Pa. Transp. Auth. v. Volgenau, No. 6354-VCN, 2013 WL 4009193, at *14 (Del. Ch. Aug. 5, 2013), *aff'd mem.*, 91 A.3d 562 (Del. 2014).

122. *See* Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1156, 1169 (Del. 1995); *see also* Orman v. Cullman, 794 A.2d 5, 29 n.62 (Del. Ch. 2002) (noting that directors' fees do not generally establish a material interest, but that the "Court's view of the disqualifying effect of such fees might be different if the fees were shown to exceed materially what is commonly understood and accepted to be a usual and customary director's fee").

123. In *Volgenau*, the chairman of a special committee requested, after the signing of a merger agreement, a $1.3 million bonus payable to charities he was affiliated with (in addition to his compensation of $75,000 and a $150,000 charitable contribution on his behalf for serving on the committee). Although the court ultimately ruled that the bonus request did not strip the chairman of his independence, the court noted that "[t]his type of request or expectation raises serious concerns about the objectivity of a special committee member. One can easily imagine how this practice, if adopted, could be fraught with potential abuse." 2013 WL 4009193, at *16 n.135.

124. There have also been a number of recent China-based M&A transactions (often involving China-based companies incorporated or listed in the United States) utilizing a special committee process to address conflicts of interest at the board level. Two recent examples include the 2013 acquisition of Focus Media Holdings Ltd. by a consortium led by the company's Chairman and Chief Executive Officer and the 2012 acquisition of Shanda Interactive Entertainment Ltd. by Premium Lead Company Ltd., an entity jointly owned by the Chairman, Chief Executive Officer, and President of Shanda, his wife, a non-executive director of Shanda, and his brother, the Chief Operating Officer and a director of Shanda.

125. *See generally* Paul Davies et al., Corporate Boards in Law and Practice: A Comparative Analysis in Europe (2013).

interested directors simply not taking part in board discussions. In recent years, however, as conflict transactions are increasingly subjected to public scrutiny, non-executive and disinterested directors have been forced to take on a more active role, either via special committees or by taking a harder line on potential conflicts.[126] Where a conflict transaction is contemplated, such as a management buy-out or similar transaction with a controller or group of controllers, it is now considered best practice for public companies in the United Kingdom to form a committee of disinterested directors to consider the transaction and communicate its views to shareholders where their approval is required.[127]

A number of prominent organizations in the United Kingdom have recently refocused their attention to corporate governance and, in particular, the role of independent directors.[128] At the forefront of this movement is the Association of British Insurers ("ABI"),[129] which issued an influential and well-received report in July 2013 titled *Improving Corporate Governance and Shareholder Engagement*.[130] Among the other corporate governance issues addressed in its report, the ABI recommends the use of special committees to address potential conflicts of interest and further advocates that, in the context of a management buy-out or transaction involving a controller or group of controllers, "a special committee comprising only unconflicted directors should *always* be formed to consider

126. For example, Essar Energy plc, listed on the London Stock Exchange, recently utilized a special committee process in connection with a £910 million takeover bid by its 78 percent shareholder, Essar Global Fund Ltd. Following the receipt of an indicative offer on February 17, 2014, a five-member special committee of independent directors was formed to consider the bid's terms and, in particular, to protect the interests of the company's minority shareholders. The independent committee appointed its own independent financial and legal advisors, sought feedback from a number of stakeholders, and unanimously concluded that the indicative bid would undervalue the company and its long-term growth prospects. Despite the committee's initial recommendation against the offer, the offer was ultimately successful. Following the bidders' announcement on May 9, 2014, that all conditions to the offer had been waived, making the offer wholly unconditional, the committee decided to "[r]eluctantly" recommend that Essar shareholders "seriously consider accepting" or be faced with the risks and uncertainties of remaining investors in a delisted stock. London Stock Exch., Offers for Essar Energy plc: Publication of a Further Circular to Shareholders and Convertible Bondholders and Change of Recommendations by the Independent Committee of the Board of Essar Energy plc, RNS No. 9089(G) (May 13, 2014), *available at* http://goo.gl/DccZxq.

127. *See, e.g.*, Ass'n of British Insurers, Improving Corporate Governance and Shareholder Engagement (2013) [hereinafter Improving Corporate Governance].

128. *See generally id.* Furthermore, several major U.K. companies have been trying to reassess their corporate governance and standards of operations following the financial crisis of 2008. In July 2012, for example, the board of Barclays plc commissioned an independent review of its business practices, the result of which was made available to the public in April 2013 and is generally referred to as the Salz Review. The Salz Review sets out recommendations on a number of issues, including corporate governance. According to the Salz Review, board committees play a crucial role in the effectiveness of board governance, as committees allow non-executive directors to examine issues in more depth and with greater efficiency than at the full board level. *See* Anthony Salz, An Independent Review of Barclays' Business Practices 13 (2013).

129. *See* Improving Corporate Governance, *supra* note 127. The ABI represents approximately 90 percent of the British insurance market and has been highly influential in promoting corporate governance "best practices," transparency, and high standards within the U.K. insurance and investment industry.

130. *Id.*

the transaction."[131] The ABI's report also sets forth certain recommendations with respect to the functioning of a special committee formed to consider a conflict transaction, which in many ways mirror U.S.-style best practices. For example, the ABI report recommends that a special committee have a clear and broad mandate, which allows it to consider not only the terms of the proposed transaction, but also whether the transaction itself (as opposed to other courses of action) is in the best interest of the company and its shareholders, and that such mandate should be disclosed to the company's shareholders.[132] Similarly, the ABI recommends that special committees always take independent financial and legal advice.[133] However, unlike common market practice in the United States (at least with respect to financial advisors), the ABI's report includes a recommendation that advisors should be paid on a fixed fee, rather than on a "success" or "incentive," basis.[134] A similar emphasis on good governance and the role of independent directors in conflict transactions has arisen in continental Europe in recent years, though to a lesser extent than in the United Kingdom.[135] Unlike as in the United States, many publicly listed companies in continental Europe have a dominant shareholder who either owns a majority of the shares or exercises control of the company.[136] As a result of this concentrated ownership structure, controlling shareholder transactions (or change of control transactions supported by a controlling shareholder) involving continental European companies have historically been relatively commonplace and subjected to less public scrutiny or oversight than U.S. practitioners may be accustomed to.

Nevertheless, it appears that the roles of independent directors and special committees of independent and disinterested directors have become increasingly important in Europe, as numerous corporate governance scandals (such as those involving Parmalat and Cirio in the early 2000s)[137] have been the focus of public attention.[138]

131. *Id.* at 4 (emphasis added).

132. *Id.*

133. *Id.*

134. *Id.*

135. *See generally* OECD, RELATED PARTY TRANSACTIONS AND MINORITY SHAREHOLDERS RIGHTS (2012).

136. *See* Joseph A. McCahery & Erik P.M. Vermeulen, *Corporate Governance Crises and Related Party Transactions: A Post-Parmalat Agenda*, *in* CORPORATE GOVERNANCE IN CONTEXT: CORPORATIONS, STATES, AND MARKETS IN EUROPE, JAPAN, AND THE U.S. 215, 220 (Klaus J. Hopt et al. eds., 2005).

137. Parmalat S.p.A. is a multinational dairy and food corporation incorporated in Italy. The company collapsed in 2003 with debts found to total nearly $20 billion in what remains Europe's largest bankruptcy. Parmalat's founder and controlling shareholder was convicted of market-rigging, false accounting, and obstructing market oversight. *See* Claudio Storelli, *Corporate Governance Failures—Is Parmalat Europe's Enron?*, 2005 COLUM. BUS. L. REV. 765, 766–67; John Hooper, *Parmalat Founder Gets 10 Years' Prison for Market Rigging*, GUARDIAN (Lon.), Dec. 18, 2008, at 40. Cirio, which is best known for canned tomatoes and canned fruit under the Del Monte name, defaulted on its bonds in 2002 and later collapsed. The default resulted in approximately $1 billion of losses to a plethora of small investors, and Cirio's former chief executive, whose family owned 80 percent of the Cirio group, received a nine-year jail term. *See* Alessandra Galloni, *Financial Services Brief—Capitalia S.p.A.: Police Search Officials' Homes as Part of Cirio Investigation*, WALL ST. J., Dec. 8, 2003, at B10; Rachel Sanderson, *Geronzi Handed Four-year Sentence*, FIN. TIMES (Lon.), July 6, 2011, at 17.

138. In Italy, for example, the debate on the use of special committees to address conflicts has become a topic of interest after the 2013 arrest of certain controlling shareholders of the insurance

As institutional investors increasingly focus on corporate governance and conflicts of interests in corporate transactions, many countries are introducing additional requirements or procedures to address conflicts in the board approval process. For example, Italy has recently passed new legislation governing conflict transactions that requires Italian public companies to adopt internal codes providing for stricter procedural and disclosure requirements.[139] These requirements differ depending on the size and materiality of a particular transaction. For conflicted transactions under a prescribed materiality threshold, companies are required to obtain a non-binding opinion from a special committee of independent and disinterested directors as to why the proposed transaction is in the company's interests and as to the transaction's substantial fairness.[140] For conflicted transactions above the relevant threshold, the special committee must take an active role in all negotiations, and enjoys a veto right over the completion of a conflict transaction.[141]

In other European jurisdictions, the idea of using a special committee to address conflicts of interests also is emerging, even where not required under applicable law.[142] In France, for example, increased focus on governance and conflicts of interests has led to the issuance of various "soft law" recommendations from prominent working groups and organizations advocating the use of special committees[143] in conflict transactions, although the use of such committees remains

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group Fondiaria-SAI. *See* Ilaria Polleschi & Gianni Montani, *Italy's Ligrestis Arrested in Fondiaria Probe*, REUTERS (July 17, 2013), http://goo.gl/U5oxjF.

139. Commissione Nazionale per le Società e la Borsa, Regulation no. 17221 on Related Party Transactions (Mar. 12, 2010), amended by Regulation no. 17389 (June 23, 2010), *available at* http://www.consob.it/mainen/documenti/english/laws/reg17221e.htm.

140. *Id.* §7.

141. *Id.*

142. Two recent examples include the formation of special committees by Sweden's Scania A.B. and France's Vivendi S.A. In February 2014, Scania announced the formation of a special committee of disinterested and independent directors, advised by its own legal and financial advisors, to "evaluate the offer and to take such resolutions . . . as are necessary" in relation to a takeover offer by its largest shareholder, Volkswagen AG. Despite the committee's recommendation that Scania's shareholders not tender into the offer, the €6.7 billion offer was successful, with Volkswagen obtaining over 90 percent of Scania's shares. *See* Press Release, Scania, Information from Scania in Relation to the Offer by Volkswagen to the Shareholders in Scania (Feb. 21, 2014); Press Release, Scania, Independent Committee in Scania Evaluates the Offer by Volkswagen (Feb. 23, 2014); Press Release, Scania, Recommendation from the Independent Committee of the Scania Board of Directors (Mar. 18, 2014); Andreas Cremer, *VW's Scania Bid Succeeds, Clears Way for Truck Alliance*, REUTERS (May 13, 2014), http://goo.gl/CpwFbr. In connection with Vivendi's decision to sell its SFR mobile phone unit, it formed a special committee, comprised of four independent directors and assisted by its own advisors, to examine bids made by Altice/Numericable and Bouygues. In April 2014, Vivendi's supervisory board followed the special committee's recommendation and accepted Altice/Numericable's €17 billion offer. *See* Press Release, Vivendi, Vivendi Selects the Altice/Numericable Offer for SFR (Apr. 5, 2014).

143. Under French law, board committees have no decision-making power. Their authority is limited to the examination of board decisions and the issuance of advice or opinions to the board. *See* Loi 67-236 du 23 mars 1967 du conseil d'administration et de la direction générale [Decree 67-236 of March 23, 1967 of Board and Executive Management], JOURNAL OFFICIEL DE LA RÉPUBLIQUE FRANÇAIS [J.O.] [OFFICIAL GAZETTE OF FRANCE], Mar. 24, 1967, p. 2850 art. 90; CODE DE COMMERCE [C. COM.] art. R225–29 (Fr.). Therefore, it would be difficult to replicate in France the U.S. practice of giving the special committee the power to veto a contemplated transaction with a third-party acquirer.

unusual in practice and is not reflected in either the French Commercial Code (*Code de commerce*) or the Code of Corporate Governance for Listed Companies (the so-called AFEP/MEDEF Code) to which most of the SBF 120 French listed issuers refer. For example, in April 2011, the MEDEF (*Mouvement des Entreprises de France*), the largest union of employers in France, published guidelines intended to complement the AFEP/MEDEF Code, containing a recommendation to "put in place structures and means to be used to manage any conflicts, in particular by setting up an ad hoc committee."[144] Similarly, the French National Association for Joint Stock Companies ("ANSA"), an organization tasked with analyzing and interpreting French and European regulations and proposing practical solutions for commercial entities, has recommended the use of special committees on conflicts of interests (or alternatively the use of an existing audit committee) for "reviewing, negotiating [and] making recommendations to the board of directors in relation to transactions comprising a conflict of interests between the executives and the company or the board of directors."[145]

The utility of a special committee of independent and disinterested directors to evaluate and negotiate transactions has also been recognized by the corporate community in the Netherlands, where a number of public takeover targets have set up special committees in recent years.[146] Although the establishment of a special committee is not strictly required under Dutch law, recent case law has confirmed the legal principle that conflicted directors (including, in certain cases, those appointed or nominated by large or controlling shareholders) must abstain from the overall decision-making process and has suggested that a special committee may be appropriate in certain high-stakes public M&A situations.[147] For example, in the 2007 case involving Stork N.V.'s decision to trigger certain defensive measures[148] in response to a proxy contest led by two activist hedge funds (Centaurus and Paulson), the Enterprise Chamber of the Amster-

144. *See* MEDEF, PRÉVENIR ET GÉRER LES CONFLITS D'INTÉRÊTS DANS VOTRE ENTREPRISE 19 (2011) (translation from the original French).

145. Handout, Association Nationale des Sociétés par Actions, Les comités "spéciaux" sur les conflits d'intérêts ["Special" Committees in Conflicts of Interest] (Jan. 8, 1999) (translation from the original French). At its informational meetings on corporate governance within listed companies, the ANSA has recommended that special committees addressing conflicts of interests (i) consist of three to five disinterested members, with at least one independent director, and no representatives of senior management or common directors with an acquirer, (ii) provide for potential recourse to the services of external consultants, and (iii) pro-actively ask questions in order to be fully informed, particularly on any proposals made by consultants. *See id.*

146. *See, e.g.*, AI Avocado B.V., Recommended Cash Offer to UNIT4 N.V. § 6.6 (Dec. 20, 2013) (discussing the appointment of a special committee in connection with Advent International Corporation's 2013–2014 takeover offer for UNIT4 N.V.); Koninklijke KPN N.V., KPN INTEGRATED ANNUAL REPORT 2013, at 84 (2014) (referring to the special committee formed to "assist and support" the management board in connection with América Móvil's 2013 announced, and subsequently withdrawn, intended takeover offer for Royal KPM N.V.).

147. *See* Martijn van Empel, Decision of the Enterprise Chamber of the Amsterdam Court of Appeals of 17 January 2007 Stork 4 (Feb. 17, 2007), *available at* http://static.luiss.it/siti/media/5/20070503-Memo19Feb.pdf.

148. On December 19, 2006, Stork made use of its "anti-raider" powers and issued shares equal to 50 percent less one share of its share capital to a Dutch foundation (Stichting) expected to share the same policy views as Stork's incumbent management. *Id.* at 2.

dam Court of Appeals appointed three new members to Stork's supervisory board, arguably a de facto special committee, with a casting vote on issues opposing management or the activist shareholders.[149]

It is clear that special committees are being used with more frequency outside the United States. Moreover, with the significant rise of shareholder activism since the start of the financial crisis in 2008, and shareholder activism becoming an increasingly regular feature of European markets, there will be additional pressure to adopt corporate governance best practices. Therefore, we expect that the use of special committees in jurisdictions outside the United States will continue to increase.[150]

VI. Conclusion

Thirty years ago it was clear that special committees had the potential to assist directors of Delaware companies in fulfilling their fiduciary duties and thereby limit the liability of directors. Since that time, corporate boards and the corporate governance community in the United States have embraced fully the use of properly functioning special committees as an effective mechanism for mitigating the risks associated with conflicts of interest in corporate transactions. Moreover, the courts in Delaware have provided substantial guidance on what constitutes a well-run special committee. As a result, the special committee has evolved into, among other things, a procedural device capable of serving as an effective proxy for a third-party negotiator on behalf of disinterested or minority shareholders.

We expect boards and transactional planners to continue to implement special committee processes in transactions presenting potential and actual conflicts of interest. Not only do we expect the use of special committees to be the predominant trend in any transaction where there is an actual or potential conflict of interest, but we expect that the role and input of independent directors on boards of directors will become more and more important. Finally, it is clear that there will continue to be a convergence across jurisdictions in the area of best practice corporate governance; as a result, the use of special committees and the enhanced role of strong and empowered independent directors in the boardroom (a trend that is already underway) will be more commonplace outside the United States.

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149. *See id.* at 4.

150. *See, e.g.*, *The New Barbarians—Shareholder Activists Have Europe in Their Sights*, Skadden Insights (Skadden, Arps, Slate, Meagher & Flom LLP, New York, N.Y.), Jan. 16, 2014, http://www.skadden.com/insights/new-barbarians-shareholder-activists-have-europe-their-sights; Sam Jones, *Shareholder Campaigns More than Double in Three Years*, Fin. Times, Nov. 11, 2013, at 20; Ajay Khorana et al., Opinion, *Rising Tide of Global Shareholder Activism*, Citi GPS (Nov. 12, 2013), https://www.citivelocity.com/citigps/OpArticleDetail.action?recordId=300.