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ALERT MEMORANDUM

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Delaware Chancery Court Provides Guidance on Fulfillment of Fiduciary Duties When Evaluating Antitrust Risk

Directors of public companies are increasingly facing pressure from hedge fund and institutional stockholders to engage in accretive combinations with competitors. But they must balance this pressure against the willingness of antitrust regulators in the United States, Europe, China and beyond to delay transactions and either require significant divestitures or conduct remedies or just block these combinations outright. Against this backdrop, the Delaware Court of Chancery issued an opinion on December 19, in *In re Family Dollar Stores, Inc. Stockholders Litigation*, that provides useful guidance on how directors may fulfill their fiduciary duties to obtain the best value for stockholders while taking into account antitrust risk.

Stockholder plaintiffs had challenged the recent decisions by the board of directors of Family Dollar to enter into a cash/stock merger agreement with Dollar Tree and to refuse, based on antitrust considerations, to enter into negotiations with Dollar General in response to a competing all-cash proposal Dollar General made after the announcement of the Dollar Tree merger agreement. At the crux of the plaintiffs' claims was a second-guessing of the Family Dollar board's assessment of the antitrust risks of a Family Dollar/Dollar General combination.

The Court's denial of plaintiffs' motion for preliminary injunctive relief highlighted a number of actions by the board, derived from a preliminary record, that supported the Court's decision. Although one size does not fit all, boards should consider these action items when considering how to comply with their duty of care when navigating antitrust risk in this environment where stockholders are aggressively pushing for industry consolidation to boost returns. Among the elements of the board's conduct that supported the Court's decision were the following.

- *Serious analysis of antitrust risk early on*. The preliminary record indicated that, at the outset of the board's consideration of whether to explore strategic alternatives to the stand-alone plan, a committee of the board directly supervised and reported to the full board on the results of an assessment by antitrust counsel of the antitrust risks of different combinations identified by the board in consultation with its financial advisor. This advance work enabled the board to make critical decisions about whether and how to explore a sale of the company in a well-informed and responsible manner from the outset. It also laid the groundwork for an expeditious and thorough antitrust assessment of the interloper's bids.

- *Request antitrust discussions with potential strategic bidder as a threshold matter.* Potential bidders with a good strategic fit and rationale for paying an attractive premium may be the bidders with the greatest antitrust risk. The Court observed approvingly that, before Family Dollar entered into the merger agreement with Dollar Tree, representatives of Family Dollar, acting at the request of the board, had raised the issue of antitrust risk with Dollar General and conveyed an express request to Dollar General that the parties' respective

antitrust experts get together to explore this risk and how to address it. Dollar General declined this invitation, but the request by the board supported the Court's conclusion that plaintiffs would be unlikely to show that the board had breached its duty of care.

- *Antitrust risk of an interloper bid.* When an interloper bid is announced after the execution, but before stockholder approval, of a merger agreement, the target board must determine whether to enter into discussions with the interloper. The duty of the board is to maximize value for stockholders while operating within the confines of the no-shop covenant in the merger agreement. The Court observed that Family Dollar's merger agreement with Dollar Tree contains customary provisions to permit Family Dollar to *"negotiate with a third party who makes a proposal (1) if the Board determines in good faith after consulting with its advisors that the proposal is reasonably expected to lead to a transaction that is (a) financially more favorable than the [existing merger agreement] and (b) reasonably likely to be completed on the terms proposed and (2) if failure to engage in such negotiations would be inconsistent with the directors' fiduciary duties."* The Court reviewed favorably the following elements of the Family Dollar board's approach to determining whether to engage in discussions with the Dollar General after the announcement of its interloping acquisition proposal.

    - *Insist on and document clear and specific antitrust advice.* Family Dollar's board received and documented in its minutes clear and specific antitrust advice that Dollar General's proposal was unlikely to receive antitrust clearance on the terms proposed.

    - *Understand feedback from the antitrust regulator.* When evaluating whether an interloper bid is *"reasonably likely to be completed on the terms proposed,"* the target company will likely already be before antitrust regulators in connection with obtaining clearance of the original merger agreement. If the original merger agreement is with a strategic operating company, as was the case with Family Dollar's agreement with Dollar Tree, then the initial feedback from the antitrust regulator on the original merger may provide valuable information as to how the regulator will approach review of the interloper bid. Moreover, if and when the interloper starts the process of trying to obtain antitrust clearance, the target company should obtain visibility from the regulator on this process as well. It is critical for the board to have antitrust counsel update and expand upon its earlier antitrust analyses and guidance by taking into account all intelligence and feedback from the regulator in connection with these processes. This may require multiple board sessions at which nuanced explanations and updates are conveyed. The Court's decision that the Family Dollar board had fulfilled its duty of care was supported by its review of the minutes of the meetings of the Family Dollar board that reflected the board's understanding and taking into account of the implications of the feedback from the FTC's ongoing clearance process.

    - *Cognizance of the interloper's stance*. When determining whether the interloper proposal *"is reasonably expected to lead to a transaction"* that satisfies the *"reasonably likely to be completed on the terms proposed"* standard, the board should consider not only whether the *current* terms of

the interloper's bid satisfy this standard, but also whether discussions would be *"reasonably expected to lead"* to a proposal that would satisfy this standard. The board should be aware of and take into account the interloper's posture on the allocation of antitrust risk. The board should consider whether the interloper "seem[s] open to reducing the antitrust risk associated with its proposal" to the extent that, after such a reduction, the proposal would be able to satisfy the *"reasonably likely to be completed on the terms proposed"* standard. The Court praised the board of Family Dollar for attention to this nuance.

- *Tactical shrewdness.* The other variable that the board should consider is whether, from the perspective of maximizing stockholder value, *"it would be prudent and appropriate to engage"* with the interloper. The Court observed that, when a target board makes a determination to engage in discussions with an interloper, the board is arguably sending a message to the interloper that, even if its proposal's commitments to mitigate antitrust risk do not yet render the proposal *"reasonably likely to be completed on the terms proposed,"* the proposal's terms are still *"within the zone"* of being able to satisfy this standard. The Court endorsed the legitimacy of a conclusion by the Family Dollar board, after receiving advice on what terms would be *"within the zone,"* that entrance into discussions would be contrary to the objective of maximizing stockholder value – i.e., the objective of obtaining a financially superior proposal that had terms that reduced antitrust risk to a point where the transaction was *"reasonably likely to be completed on the terms proposed."* A well-informed and well-reasoned view of the tactical downsides of engaging in discussions with the interloper can be central to the target board's fulfillment of the duty of care when responding to an interloper that brings antitrust risk to the table along with its competing takeover proposal.

- *Disclosure to stockholders of the board's antitrust risk assessment.* When a board asks its stockholders to vote in favor of a merger agreement and reject an interloper's competing offer on the basis of antitrust risk, the board should inform the stockholders of the basis for this conclusion. The Court reviewed how Family Dollar's disclosure has "outlined in considerable detail the Board's antitrust review," including the feedback from the antitrust regulator and its implications for understanding the substantive analyses that the regulator would apply to the Dollar General proposal and the Dollar Tree merger and the significance of these implications for the two transactions' respective timelines to closing and likelihoods of completion on the terms proposed. Against this background, the Court found no support for plaintiffs' claims that the disclosure by Family Dollar about the basis for the board's conclusions about antitrust risk fail to satisfy the directors' duty of disclosure. Practitioners and the SEC staff, prompted by decisions of the Chancery Court over the last several years, have paid a lot of attention to the adequacy of disclosure about internal financial forecasts and financial analyses underlying a board's decisions on change in control transactions, but boards, as well as interlopers, should similarly remember to pay attention to the adequacy of their disclosure of their internal analyses of antitrust risks and their implications for the timing and likelihood of consummation of the competing proposal on the terms proposed.

An important take-away from *In re Family Dollar Stores, Inc. Stockholders Litigation* is the value for boards of integrated corporate, litigation and global antirust advice. When considering whether to sell a company in an era of heightened antitrust review of business combinations, antitrust support has to be about much more than presenting persuasive advocacy before the regulator, while corporate law and litigation guidance must include assurance that the board is acting in a well-informed and well-reasoned manner in response to antitrust risks at every step of what frequently turns out to be a tumultuous M&A process.

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In connection with these topics, please do not hesitate to reach out to your regular contacts at Cleary Gottlieb or any of the partners on the firm's website listed under "Antitrust and Competition", "Litigation and Arbitration," and "Mergers, Acquisitions and Joint Ventures".

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