Client Alert

July 2013

Olshan Client, Landry's, Inc., Involved in Favorable Delaware Chancery Court Decision for Private Equity Mergers

The Delaware Chancery Court recently dismissed the stockholder lawsuit captioned *In re Morton's Restaurant Group, Inc. Shareholders Litigation*, in a decision that is highly favorable for private equity sponsors seeking the sale of a public portfolio company. Chancellor Strine's opinion also offers clear guidance for the conduct of a sale process by a public company board of directors.

The Facts

Morton's Restaurant Group, an operator of upscale steakhouse restaurants, was a public company whose private equity sponsor, Castle Harlan, owned 27.7% of Morton's stock. Morton's 10-member board of directors consisted of two Castle Harlan representatives, Morton's CEO and seven independent directors. After a nine-month search process involving a thorough market check for a buyer, Morton's entered into a merger agreement with Fertitta Morton's Restaurants, Inc. and Fertitta Morton's Acquisition, Inc. (collectively, "Fertitta"), subsidiaries of Landry's, Inc. The merger agreement provided for Morton's stockholders to receive $6.90 per share for their Morton's shares, representing a 33% premium over Morton's closing price on the trading day prior to the announcement of the transaction. All stockholders of Morton's, including Castle Harlan, received the same per share consideration.

Transaction Not Subject to "Entire Fairness" Review

The plaintiffs claimed that the Court should scrutinize the transaction under the enhanced "entire fairness" standard rather than the more deferential business judgment rule. The plaintiffs contended that entire fairness review was triggered by (1) the mere presence of a "controlling stockholder," regardless of whether the alleged controlling stockholder received any different or additional consideration from other stockholders, and (2) Castle Harlan's purported conflict of interest in pursuing the transaction.

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The Delaware Chancery Court, in a strongly worded opinion, rejected the plaintiffs' arguments. First, the Court stated that when a stockholder owns less than 50% of a corporation, the plaintiffs must show that the stockholder exercised "actual domination and control" over the board of directors for it to be considered a controlling stockholder. Here, the plaintiffs' allegations failed to create a rational inference that Castle Harlan, with only a 27.7% ownership stake and two out of 10 board members, had effective control of Morton's.

Second, the plaintiffs failed to show that Castle Harlan had a conflict of interest with other stockholders that led it to push for a sale to satisfy its liquidity needs. These allegations were wholly unsupported by the facts of the case, including the fact that Morton's contacted over 100 potential buyers during the course of a nine-month sale process. The suggestion of a change of control transaction by a large stockholder does not automatically subject the transaction to a heightened level of scrutiny. The Court noted:

> Delaware law presumes that large shareholders have strong incentives to maximize the value of their shares in a change of control transaction. When a large stockholder supports an arm's-length transaction resulting from a thorough market check that spreads the transactional consideration ratably across all stockholders, Delaware law does not regard that as a conflict transaction.

To the contrary, the Court continued, equal treatment of all stockholders is a strong indication of fairness and creates a presumptive safe harbor for the transaction, rebutted only by unusual circumstances indicating a "fire sale" has occurred.

Court Sanctions Financing Provided to Buyer by Seller's Financial Advisor

The plaintiffs also contended that Morton's board of directors breached its fiduciary duties by allowing Jefferies, Morton's financial advisor, to provide financing for Fertitta's bid. Once again, the facts refute these allegations. Within two months prior to the conclusion of the sale process, Jefferies reported to Morton's M&A Committee that Fertitta, after having approached a number of potential lenders, had contacted Jefferies about financing the acquisition. Following careful deliberation, the M&A Committee determined to recommend that the board allow Jefferies to finance Fertitta's bid if Jefferies would (1) recuse itself from further negotiations for the transaction, (2) reduce its fee by $600,000, and (3) still issue its opinion as to the fairness of the transaction. Morton's board then used the fee savings to hire another financial advisor, KeyBanc. Rather than rubber stamp the deal, KeyBanc proceeded to further shop the

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company in an effort to secure a competing bid above $6.90. Chancellor Strine stated, "The decision to let Jefferies finance Fertitta's deal while hiring KeyBanc to provide unconflicting advice, rather than risk losing a bid at a high premium to market, does not create an inference of bad faith."

Conclusion

The Court discussed the presence of a number of factors clearly demonstrating that the Morton's board of directors had used reasonable efforts to obtain the highest price available for its stockholders, thus satisfying its *Revlon* duties and immunizing the transaction from the plaintiffs' claims. Notably, the Morton's transaction included all of the following elements: (1) an initial press release announcing the company's exploration of strategic alternatives; (2) an extensive market check conducted with the assistance of its financial advisors over the course of nine months, during which virtually all potential buyers were contacted; (3) the conduct of due diligence with all interested parties; (4) the evaluation and negotiation of multiple bids; (5) the evenhanded treatment of all bidders and the board's acceptance of the highest binding offer;[1] (6) the lack of any relationship between the winning bidder, on the one hand, and Morton's or Castle Harlan, on the other; (7) the approval of the transaction by the independent directors, who constituted a clear majority of the board; and (8) the equal treatment of all stockholders in the transaction.

As the Morton's sale process appears to have been conducted in textbook fashion, the plaintiffs' claims could not survive even a motion to dismiss, despite a standard for dismissal the Court acknowledged to be "plaintiff-friendly." All participants in the sale process of a public company, including the target company's board of directors, would be well-advised to heed the lessons that may be gleaned from this transaction and the resulting Delaware Chancery Court decision.

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Please contact the Olshan attorney with whom you regularly work or one of the attorneys listed below if you have any questions regarding this decision or its potential impact.

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[1] The Court specifically noted that a key *Revlon* concern — board resistance to the highest bidder based on a bias against the bidder — was entirely absent in this case.

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