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# Delaware Chancery Holds Early Committee Appointment Necessary to Cleanse Conflict from Corporate Transactions

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In *Salladay v. Lev*, the Delaware Chancery Court elaborated on how early a corporate board must take protective measures to shield a conflicted transaction from entire fairness review.

*Salladay* involved a motion to dismiss a challenge to a merger agreement based on alleged director conflicts at the target company. The defendants argued that the transaction was approved by an independent committee of directors and a shareholder vote, warranting deferential business judgment review and, in turn, dismissal. The court held that business judgment review was inappropriate because the independent committee only became involved in negotiations after they had begun—too late to "replicate the value-enhancing structure of an arms-length transaction"—and the shareholder vote was not fully informed. Instead, the much stricter standard of entire fairness applied, rather than the more lenient business judgment rule, and therefore dismissal was inappropriate.

**The Facts**

Intersections, Inc. ("Intersections"), a credit management and identity-protection software company, sought financing as it attempted to get a flagship product to market. The Intersections board consisted of six directors, three of which together controlled the majority of company stock and had significant ties to private equity firm Loeb Holding Corp. ("Loeb"), which was a co-founder and major investor in Intersections. Early in 2018, the board formed a special committee consisting of the three independent directors to explore financing options, though the committee was later abandoned.

In September 2018, iSubscribed Investor Group ("iSubscribed") approached Intersections and Loeb about a potential transaction. iSubscribed communicated with non-independent Intersections directors to discuss a possible acquisition. In late September, one of the conflicted directors allegedly proposed a share price range to iSubscribed representatives. The conflicted directors also allegedly expressed a desire to roll over "the substantial majority" of their Intersections stock.

On October 5, the Intersections board reconstituted the committee. iSubscribed made an offer to acquire Intersections at the bottom end of the previously provided share-price range in a deal that would allow the conflicted directors to roll over their Intersections equity. Less than a week later, iSubscribed increased its offer to just under the middle of the range.

On October 11, the Committee retained a new financial advisor, which terminated the engagement mere days later. The Committee found another new advisor, giving it eight days to provide a fairness opinion on the transaction. On October 29, the board adopted the committee's approval of the transaction. Intersections filed its proxy and, in January 2019, the companies announced completion of their merger.

**The Case**

Plaintiff, an Intersections shareholder, brought suit challenging the merger. At the outset, the court found that the three non-committee directors—comprising half of the board that approved the transaction—were conflicted because of the roll over and other benefits they (and Loeb) received from the merger. A board can potentially cleanse a conflicted transaction, however, through the use of procedural safeguards, as stated in the seminal decision, *Kahn v. M&F Worldwide Corp.*. There, the Chancery Court held that business judgment review could apply to a merger proposed by a controlling shareholder if it was conditioned "ab initio" on two procedural protections: (1) the approval of an independent special committee, and (2) the fully informed and uncoerced vote of a majority of minority stockholders. The question before the Chancery Court in this case was whether the Intersections board adequately carried out these safeguards to restore business judgment deference. The court concluded that it had not.

The court emphasized that an independent committee must be in charge of negotiations from the beginning, in line with recent Delaware Supreme Court case *Olenik v. Lodzinski*. "The acquirer—as well as any interested directors—must know from the transaction's inception that they cannot bypass the special committee." The committee must therefore be constituted "before any substantive negotiations begin," so that preliminary communications do not allow conflicted board members to shape the transaction.

Conflicted Intersections board members had given a range of acceptable share prices, creating a "price collar" that "set the field of play for the economic negotiations to come," similar to the defendants in *Olenik*. The Intersections defendants argued that *Olenik* involved interested-party involvement over the course of months, not weeks. Vice Chancellor Glasscock reasoned, however, that the test was not time of involvement, but rather whether the involvement was sufficient to shape the economic terms of subsequent committee negotiations.

The Chancery Court additionally found that the complaint had adequately alleged that the proxy statement did not fully inform voting stockholders of all material facts. The statement failed to, among other things, explain why a previous financial advisor had not been rehired, and why the new one had suddenly cut its engagement short. Though the court reasoned that such details were not always material, it held that "[t]he compressed timing of this transaction and the fairness opinion associated with it . . . create a context in which information regarding a hired financial advisor that walks away becomes plausibly material."

Concluding that the plaintiff adequately pled that the board's procedural safeguards failed to ensure fairness, the court held that dismissal would be inappropriate.

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