DE Court of Chancery Denies Challenge to Going-private Merger Based on Business Judgment Rule

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In *Harcum v. Lovoi, et al.*, C.A. No. 2020-0398-PAF (Del. Ch. Jan. 3, 2022), the Delaware Court of Chancery dismissed a purported shareholder class's fiduciary duty claims arising out of a going-private merger. The complaint failed to allege facts capable of establishing a conflict to support an entire fairness review, and thus, the court analyzed the merger under the deferential business judgment. *Harcum* provides valuable commentary concerning potential conflicts of interest capable of invoking a higher level of scrutiny that may call a transaction into question.

In this matter, Citizen Energy Operating, LLC, acquired Roan Resources, Inc., in an all-cash transaction. Roan accepted the offer amid a significant decline in its share value and despite the existence of other interested purchasers. Financial analysts concluded that the purchase price was fair, and 88 percent of Roan common shareholders approved the deal. Defendant John Lovoi purportedly possessed a majority interest in Roan through his control of defendants Roan Holdings, LLC, and JVL Advisors, LLC, and his ownership of additional Roan common stock. The plaintiff alleged that the Roan directors, who approved the merger, breached their fiduciary duties to the company.

In ruling on defendants' motion to dismiss, the Court of Chancery rejected the plaintiff's request to review the merger under an entire fairness standard. The entire fairness standard applies when the board of directors possesses an actual conflict of interest or, in the alternative, if the transaction involved a conflicted controller. In this case, plaintiff argued that certain defendants were conflicted controllers. Typically, a controller owns more than a 50 percent voting interest in a company. If a defendant owns less than a majority voting interest, it may still qualify as a controller if the plaintiff shows that the controller exercised control over the business affairs of the company. The court concluded that only three of the five defendants—Lovoi, JVL, and Roan Holdings—were controllers. The mere existence of a controller is not sufficient; the controller must be conflicted. A controller is conflicted if it stands on both sides of a transaction or competes with common shareholders for consideration. A controller competes with common shareholders for consideration when the controller receives greater monetary consideration, a different form of consideration, or a unique benefit. The plaintiff argued that the controllers were conflicted because they stood on both sides of the transaction and received a unique benefit.

The Court of Chancery did not find that the alleged controllers stood on both sides of the transaction. The plaintiff's theory was based on the premise that three members of Roan Holdings were affiliated with the purchaser. The allegations in the complaint undercut the plaintiff's argument, in which the plaintiff contended that Lovoi and JVL controlled Roan Holdings, and thus, the three other members' purported affiliation with the purchaser could not have put Roan Holdings on both sides of the transaction. The court also rejected the plaintiff's argument that JVL managed funds that had an unspecified interest in the purchaser's affiliate. The mere allegation was not sufficient to show that the alleged controllers had a controlling interest in the buyer or that they possessed a buy-side interest in the merger.

The Court of Chancery also did not find that the alleged controllers received a unique benefit from the transaction. The plaintiff alleged that the dismissal of separate litigation following the merger constituted unique consideration. The allegations of the complaint failed to show that the controllers were motivated to sell the company as a result of the litigation. First, Roan received sale offers prior to the commencement of the other litigation. Second, the litigation concerned the arbitrability of a dispute as opposed to the merits of a particular claim. Third, the litigation did not pose a threat to control over Roan. Alternatively, the plaintiff alleged that the repayment of a term loan prevented Roan from pursuing a more valuable transaction. The plaintiff failed to show the existence of an alternative transaction, let alone a transaction that did not trigger a change of control provision in the loan documents. Accordingly, the mere existence of the term loan did not constitute an improper incentive.

Having failed to show that the merger was subject to an entire fairness standard, the court reviewed the transaction under *Corwin*, in which a fully informed, uncoerced vote of disinterested shareholders warranted the application of the business judgment rule. The plaintiff bore the burden of showing that the disclosures were deficient. A disclosure is deficient if there is an omission of information that is substantially likely to be considered by a reasonable shareholder as important to the vote. Much of the omitted information stemmed from the defendants' purported conflicts of interest, which the court previously rejected. The court found that the information omitted from the disclosure was confusing, and thus, the plaintiff failed to establish a material deficiency.

The Court of Chancery's decision in *Harcum* represents another failed challenge to a transaction based on the application of the business judgment rule. The plaintiff unsuccessfully sought to establish a conflict of interest to trigger a more rigorous analysis. In the absence of a conflict or other circumstance giving rise to an enhanced or intermediate level of scrutiny, the court will review a transaction under the business judgment rule. In this instance, the Court of Chancery deferred to rational decision-making and dismissed the complaint.