

Delaware Court of Chancery Denies Injunctive Relief, Instructs on Deal Protection Provisions and Disclosure of Projections

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In re: Orchid Cellmark Inc. Shareholder Litigation, May 12, 2011

In a letter opinion issued on May 12, 2011, the Delaware Court of Chancery declined to extend preliminary injunctive relief to plaintiff shareholders objecting to Laboratory Corporation of America Holdings, Inc.'s (LabCorp) acquisition of Orchid Cellmark Inc. (Orchid). In denying the plaintiffs' request for injunctive relief, the Court reviewed two important areas of corporate M & A law and practice: the permissibility of deal protection mechanisms and the adequacy of projection disclosures made to shareholders in connection with a tender offer.

The plaintiffs sought to enjoin the \$85.4 million transaction on two general grounds: (1) claims that the approval of the transaction by Orchid's Board of Directors (the Board) was based on a flawed and inadequate decision-making process that failed to reasonably maximize shareholder value, and (2) claims that Orchid's shareholders were provided with materially misleading and incomplete disclosures in connection with the transaction.

The Court determined that the plaintiffs failed to demonstrate a reasonable probability of success on the merits under each claim. In rejecting the plaintiffs' first claim, the Court concluded the information relied upon by the Board in the decision-making process was adequate, and the Board's decisions to approve the merger agreement and the deal protection measures the agreement included were reasonable. Similarly, the Court concluded the plaintiffs fell short of their burden with respect to the disclosure claim because the information disclosed to shareholders by the Board was accurate and sufficient.

Facts

In November 2010, LabCorp submitted a non-binding proposal to acquire Orchid for \$2.55 per share. The Board formed a Special Committee of three independent directors to evaluate the proposed transaction.

Shortly thereafter, the Board approved the Special Committee's recommendation to retain Oppenheimer & Co. (Oppenheimer) as Orchid's financial advisor on the deal. In December 2010, Orchid simultaneously countered LabCorp's offer with \$3.00 per share and, through Oppenheimer, began discussions with other entities interested in acquiring Orchid. LabCorp rejected Orchid's counteroffer of \$3.00 per share but expressed a willingness to increase its \$2.55 offer by 5 to 10 cents per share. Pursuant to the advice of the Special Committee and Oppenheimer, Orchid's Board proposed a transaction at \$2.80 per share. LabCorp agreed to \$2.80 per share conditioned on exclusivity.

Internal deliberations at Orchid ensued through January of 2011 as Oppenheimer continued to procure higher bids. Although Oppenheimer identified private equity firms interested in acquiring only Orchid's United Kingdom operations, Oppenheimer "advised the Board that it did not believe the interest shown as of that point in time would materialize into a financially superior proposal than the \$2.80 per share offer of LabCorp."

Orchid's Board approved LabCorp's written indication of interest to acquire Orchid and authorized a binding 30-day exclusivity period in February 2011. On April 5, 2011, the Board approved the merger agreement and recommended that Orchid's shareholders tender. Subsequently, the plaintiff shareholders filed suit seeking to enjoin the transaction.

Deal Protection Provisions

The plaintiffs offered five allegations to establish a reasonable probability of success on their claim that the Board's approval was based on a flawed and inadequate process that failed to reasonably maximize shareholder value. The Court rejected all five, including the allegation that Orchid's Board "agreed to deal protection measures that cut short the market check and ... were not reasonably calculated to increase shareholder value."

Specifically, the plaintiffs relied upon the following deal protection measures as being sufficient to support the conclusion that the process was flawed:

- a top-up option,
- a no-shop clause,
- matching and informational rights provisions,
- a termination fee, and

- a provision preventing the Company from pulling its poison pill for other bidders unless Orchid terminated the merger agreement.

The Court concluded that the deal protection measures, both individually and cumulatively, were reasonable under the circumstances. The Court explained that, despite the plaintiffs' concerns over the poison pill carve out, the provision had little deterrent effect on other bidders because the termination fee provision would apply if Orchid terminated the merger agreement with LabCorp regardless of whether Orchid had the ability to redeem its poison pill with respect to other bidders. Once the merger agreement was terminated, the poison pill carve out would no longer apply. Moreover, the Court held the termination fee, as measured according to Orchid's equity value, represented less than 3 percent of the deal price - a fee that "is generally deemed reasonable under Delaware law." The Court further held that none of the remaining protection measures were so burdensome as to deter other bidders. Although the Court explained that "at some point, aggressive deal protection devices - amalgamated as they are - run the risk of being deemed so burdensome and costly as to render the 'fiduciary out' illusory," the Court concluded that "the line [was] not crossed here."

Projection Disclosures

The plaintiffs asserted that there was a reasonable probability of success on a claim of breach of fiduciary duty because certain disclosures made by Orchid's Board regarding bidder interest in acquiring only Orchid's UK operations were either inadequate or misleading, and that Oppenheimer's engagement biased it towards LabCorp's tender offer. The Court, however, disagreed. Although the Court admitted that the determination of whether the Board's failure to disclose bidder interest in the UK operations and the price believed to be obtainable in such a transaction was a "close one," the Court determined that this information was "not necessarily incompatible with the existing disclosures" and the Board "could reasonably have judged that leaving shareholders with a somewhat riskier chance to end up with \$2.93 per share plus an asset with negative value" was not a better result than LabCorp's offer at \$2.80 per share for all of Orchid's operations.

The plaintiffs also claimed Orchid should have disclosed the financial projections prepared by Orchid's management on Orchid's prospects in the event it continued to operate as an independent entity. The Court disagreed and explained that the Board, as the body with "the ultimate responsibility for managing the affairs of a Delaware corporation," was under no obligation to disclose financial projections that it did



not consider reliable. The opinion suggests that only Board-endorsed projections must be disclosed to shareholders.

After concluding that the plaintiffs failed to establish a reasonable probability of success on the merits of their claims, the Court also determined that no irreparable harm was likely. The Court also determined that the balancing of the equities counseled against injunctive relief because the LabCorp offer represented a 40 percent premium to Orchid's trading price before the tender offer became public and that appropriately informed shareholders were entitled to decide whether that premium is acceptable.

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