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EXPERT ANALYSIS

Why Ceo Was Held Personally Liable For $148 Million in Dole Foods Buyout

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The president of Dole Foods was recently held personally liable for $148 million for breach of the duty of loyalty in connection with the controlling stockholder's freeze-out merger. Vice Chancellor J. Travis Laster's opinion *In re Dole Foods Co. Inc. Stockholder Litigation,* No. 8703 2015 WL 5052214 (Del. Ch. Aug. 27, 2015), provides a shocking tale of the "right-hand man" who put loyalty to his boss, the controlling stockholder, ahead of the corporation and its unaffiliated stockholders.

THE HISTORY

Before the transaction, David H. Murdock owned about 40 percent of the common stock of Dole, one of the world's largest producers and marketers of fresh fruit and vegetables.

Murdock served as Dole's chairman and CEO and was *de facto* in control. He testified that he was "the boss" and "the boss does what he wants to do."[1] Dole executives did not address him by name, but referred to him deferentially as "the chairman."

Criticizing Murdock was unthinkable. On those rare occasions when Murdock was challenged, he responded aggressively, giving tongue-lashings to outside directors and forcing directors off the board. Murdock was described as "extremely volatile," "very, very headstrong" and "not receptive to being pushed by anybody to do anything."

Michael Carter was Murdock's "right-hand man." Although Carter was a director, president and general counsel of Dole, his first allegiance clearly was to Murdock. Carter was Murdock's only direct report, which meant that the executive team reported to Carter. According to the vice chancellor, "His job was to carry out Murdock's plans, and he did so effectively, even ruthlessly."

Because he did not like the public company model, Murdock began orchestrating a freeze-out merger in 2012, intending to take the company private over several years. As a first step, in September 2012, Dole announced the sale of its higher-margin packaged food business for a premium valuation, saying it would use the proceeds to pay down debt.

Dole management knew that after the sale of the packaged foods business, the company could achieve cost savings of $50 million or more. Dole told stock analysts that it expected to achieve $50 million in annual savings, with $20 million to 25 million achieved in 2013 and the full $50 million per year starting in 2014.

However, in January 2013, Carter issued a press release stating that Dole's "current expectation" for adjusted 2013 EBITDA included 2013 planned cost savings in the $20 million range. The loss of $30 million in savings represented about 20 percent of Dole's forecasted EBITDA.

Vice Chancellor Laster found that Carter's purpose was to push down the stock price in preparation for the freeze-out merger. It worked. Dole's stock price dropped 13 percent after the announcement.

Murdock and management decided in February 2013 to implement a self-tender as a precursor to his plan to take Dole private. The company hired Bank of America Merrill Lynch to advise on the share repurchase.

Two outside directors opposed the self-tender. They believed open-market purchases were better for Dole and its stockholders. The bankers at BAML agreed and advised Carter to buy shares in the open market or wait for the stock price to decline. But Murdock kept pressing for a self-tender. At a board meeting May 8, 2013, the board approved open-market repurchasing.

Thwarted, Murdock and Carter made sure that the outside directors did not get their way either. Two weeks later, without board authorization, Carter issued a press release announcing the share repurchases had been "suspended indefinitely." Quoting Carter, the release gave "the approximately $165 million investment in ships and the drag on earnings due to significant losses in our strawberry business" as reasons for the suspension. After the announcement, Dole stock tumbled 10 percent.

Vice Chancellor Laster found that Carter's stated reason for canceling the buyback was pretextual. The board believed that the ship acquisition and the share repurchase programs were mutually feasible. So did BAML, which advised the board on the repurchase.

According to Vice Chancellor Laster, Carter suspended the buyback "to make Dole's stock price drop in advance of Murdock's planned merger proposal."

Murdock delivered his initial buyout proposal to the board June 10, 2013. The stock had most recently traded at $10.20 per share. Murdock's letter contemplated a transaction at $12 per share. Murdock set a deadline of July 31, 2013, for the board to respond.

Criticizing CEO David H. Murdock was unthinkable. On those rare occasions when he was challenged, he responded aggressively, giving tongue-lashings to outside directors and forcing directors off the board.

The Dole board appointed a special transaction committee of independent directors to consider the proposal. Vice Chancellor Laster found that the committee, with legal counsel from Sullivan & Cromwell and Richards, Layton & Finger and transactional advice from Lazard Frères & Co., carried out its task with integrity.

4 ISSUES

From the outset of the special committee process, Murdock and Carter sought to inappropriately influence the committee's work. The first issue was whether the board or the special committee could pick the committee's chair. Because they controlled a majority of the board, the committee members prevailed, and included this power in the authorizing resolution.

The next fight was over the scope of the committee's authority. The committee wanted its mandate to include considering alternatives to Murdock's proposal, with the additional authority to continue considering alternatives even if Murdock withdrew his proposal. Carter objected.

The committee members did not force the issue because they believed that if push came to shove, they comprised a majority of the board and could have a new vote at the board level.

The third confrontation was over the committee's ability to enter into nondisclosure agreements with other potential bidders. Carter insisted on and ultimately got control over the terms of the agreements. As a result Carter, and therefore Murdock, always knew when the committee provided confidential information to an interested party.

The fourth dispute was over the committee's choice of advisers. The committee selected Lazard as its financial adviser. Carter objected. He wanted the committee to hire BAML, a bank with a long-standing relationship with Dole. The committee prevailed after agreeing to a number of changes to Lazard's engagement letter.

WAITING IN THE WINGS

Meanwhile, Murdock was preparing to launch a hostile tender offer if the committee did not accept his bid by the July 31 deadline. Carter knew that Murdock was preparing the hostile offer and consulted with Murdock and his financial adviser about it. Carter never advised the committee about these activities.

Much more disturbing than Carter's interference with the committee's work, according to Vice Chancellor Laster, was the fact that "Carter used his control over Dole's management to provide false information to the committee."

Responding to a request by Lazard for updated projections that reflected Dole management's current best views about the prospects of the business, Carter took charge of revising the company's internal projections. He called together Dole's senior management for a two-day meeting; it produced new five-year projections that were significantly lower than previous internal projections.

The committee and Lazard concluded that the projections were not an accurate representation of the value of the company and thought "management had taken a meat cleaver to the projections."

Two aspects of Carter's revised projections warranted particular focus. First, the projections contained only $20 million out of the $50 million of anticipated post-divestiture cost savings.

Second, Carter's projections did not forecast that Dole would receive any additional income from the purchase of more farms. At the time Carter prepared the projections for the committee, Dole management had identified the need to acquire farms as a strategic imperative in order to increase the scope of its vertical integration and thereby capture the grower's share of profits. In fact, the board had approved a $59 million acquisition of banana farms, which Dole estimated would generate $15 million per year in incremental income. Dole expected that further investments in new farms would similarly improve its average food-cost margins.

The judge held this was the "prototype instance in which the timing of a merger would itself likely constitute a breach of a controlling shareholder's duty" under the entire-fairness standard.

MISSING PROJECTIONS

The day after delivering his projections to the committee, Carter provided more hopeful information to the bankers providing financing for Murdock's freeze-out. Carter discussed with the lenders the projected $50 million in cost savings and the additional $15 million in EBITDA expected from farm purchases. Carter did not advise the committee about his meeting with the lenders.

The committee did learn that Murdock's financial adviser had access to the company's data room, in violation of the committee's instructions. The committee asked Carter to immediately terminate access and cease providing them with any information. Carter never complied with these instructions.

After a series of negotiations, Murdock and the committee agreed on a price of $13.50 per share. Lazard's discounted cash flow analysis, using its internal financial projections, valued Dole at between $11.40 and $14.08, and the $13.50 price fell closer to the top of the range than the midpoint. The price also exceeded the ranges of values generated by Lazard's public company and precedent transaction analysis.

The committee's advisers believed that it was a good outcome. At the time, however, the committee and its advisers did not know that the projections Lazard had used lacked material information about planned cost savings and farm purchases.

After reaching an agreement on price, the committee and its advisers negotiated the terms of the merger agreement with Murdock. Without receiving permission from the committee, Carter and other members of Dole senior management advised Murdock and his lawyers on the merger agreement, including advice about certain pro-Murdock terms and how to deal with the committee on other matters.

CHANGING PROJECTIONS

After the merger agreement was signed, Carter made presentations to the ratings agencies in September 2013 and to Dole's lenders in October 2013; in both cases, he provided forecasts significantly higher than the projections given to Lazard in July. The presentations noted the anticipated farm purchases and the projected cost savings.

After the merger closed, Dole bought almost exactly the amount of farms that Carter had predicted at the lender meeting. Dole ultimately achieved about $70 million in annual cost reductions, with only $5.5 million attributed to shedding the expenses of operating as a public company.

In an action for breach of fiduciary duty and a transaction involving self-dealing by a controlling stockholder, the applicable legal standard of judicial review is entire fairness, with the defendants bearing the burden of persuasion.[2] The Dole freeze-out merger was an interested transaction, so entire fairness provided the baseline standard of review.

"The concept of fairness has two basic aspects: fair dealing and fair price."[3] Fair dealing embraces questions of the timing of the transaction; how it was initiated, structured, negotiated and disclosed to the directors; and how the approvals of the directors and stockholders were obtained.

Fair price relates to the economic and financial considerations of the proposed merger, including all relevant factors: assets, market value, earnings, future prospects and any other element of the intrinsic or inherent value of company stock. Although the two aspects may be examined separately, "the test for fairness is not a bifurcated one as between fair dealing and fair price. All aspects of the issue must be examined as a whole since the question is one of entire fairness."

Vice Chancellor Laster found that "Carter engaged in fraud," which "rendered useless and ineffective the highly commendable efforts of the committee and its advisers to negotiate a fair transaction that they subjectively believed was in the best interest of Dole's stockholders."

The concept of fair dealing encompasses an evaluation of how the transaction was timed and initiated. Vice Chancellor Laster found that Carter primed the market by pushing down the stock in advance of the announcement.

"A calculated effort to depress the market price of a stock until the minority of stockholders are eliminated by merger or some other form of acquisition constitutes unfair dealing." Vice Chancellor Laster held this was the "prototype instance in which the timing of a merger would itself likely constitute a breach of a controlling shareholder's duty" under the entire-fairness standard.

FULL DISCLOSURE

Fair dealing also encompasses questions of how the transaction was negotiated. Vice Chancellor Laster noted that "an important element in an effective special committee is that it be fully informed in making its determination." To make a special committee structure effective it is necessary that the controlling stockholder disclose fully all the material facts and circumstances surrounding the transaction. As Vice Chancellor Laster explained, "if a duly empowered committee asks for information, the corporate officer, employee, or agent has a duty to provide truthful and complete information."

Withholding the company's latest projections and knowledge of their existence from the committee and its advisers rendered the committee ineffective as a bargaining agent for the minority stockholders. Vice Chancellor Laster found "the projections Carter provided were knowingly false. Carter intentionally tried to mislead the committee for Murdock's benefit."

Vice Chancellor Laster also noted that Carter interfered with and obstructed the committee's efforts to manage the process and negotiate with Murdock. "The negotiation of the merger was the antithesis of a fair process. Through his actions, Carter rendered the special committee ineffective as a bargaining agent for the minority stockholders, notwithstanding the committee's valiant efforts."

The second aspect of the entire-fairness inquiry is fair price. Carter's actions tainted both the negotiation process and Lazard's work. "Methods of valuation are only as good as the inputs to the model," Vice Chancellor Laster wrote.

CONCLUSIONS

Vice Chancellor Laster determined that the probable adjustments to Lazard's valuation analysis, accounting for the cost savings and income that were concealed from the committee, would have added $2.74 per share to Lazard's DCF valuation range. Because the defendants engaged in fraud, and in light of the Delaware Supreme Court's guidance regarding damage calculations by loyalty breaches, Vice Chancellor Laster found the plaintiffs are entitled to the full incremental $2.74 per share in damages.

Murdock and Carter were held jointly and severally liable for breaches of their duty of loyalty in the amount of $148 million.

NOTES

[1] *In re Dole Foods Co. S'holder Litig.,* 2015 WL 5052214 at *5 (Del. Ch. Aug. 27, 2015).

[2] *Americas Mining Corp. v. Theriault,* 51 A.3d 1213, 1239 (Del. 2012).

[3] *Weinberger v. UOP Inc.,* 457 A.2d 701, 711 (Del. 1983).

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