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Did The Dell Majority-Of-The-Minority Clause Go Too Far?


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Law360, New York (July 22, 2013, 2:29 PM ET) -- The proxy contest between Dell Inc. and Carl Icahn over Michael Dell's proposal to take the company private has provided some of the most exciting moments in recent takeover history. In the hours before the Dell shareholders meeting was set to begin on Thursday, July 18, three of Dell's largest stockholders — BlackRock Inc., State Street Corp. and the Vanguard Group — reportedly switched from a no to a yes vote, but their support was not sufficient to give the board a winning margin, and the company adjourned the meeting for six days to give the board an opportunity to solicit additional votes.

Press reports blamed the board's failure on the majority-of-the-minority voting requirement, which was built into the transaction by the merger agreement the company signed with the Michael Dell group. Under this agreement, the merger would not be approved unless it received a favorable vote from a majority of the outstanding shares other than shares owned by the Michael Dell group. The type of majority-of-minority clause used in the Dell agreement, which requires approval by a majority of the outstanding unaffiliated shares, instead of a majority of those voting on the transaction, makes the failure to cast a vote the equivalent of a vote against the deal.

A widely known company like Dell typically has a significant number of retail stockholders whose turnout at stockholders meetings is typically much less than the turn out of institutional investors and hedge funds. The press reports indicated that the absence of a large number of retail stockholders from the meeting (which were treated as the equivalent of "no votes") was an important factor in Dell's failure to obtain the necessary majority by the time the meeting convened, and the company vowed to leave no stone unturned in an effort to get the votes of these stockholders by the time shareholders reassembled the following Wednesday.

One interesting facet of the drama over the majority-of-the-minority vote is that this condition, which prevented approval of the agreement at the July 18 shareholders meeting, does not seem to have been legally required. Under current Delaware case law, a transaction between a controlling shareholder and the corporation is subject to the business judgment rule rather than being reviewed for entire fairness if it is approved by a special committee of independent directors and a majority of the shares not owned by the controlling stockholder.

However, as Delaware Chancellor Leo E. Strine observed in a hearing on the Dell transaction, Michael Dell's stock ownership, at approximately 15 percent, is far below the level that would make him a controlling stockholder. Therefore, given the other procedural protections, the Dell merger should have

come under the business judgment rule, regardless of whether it was subjected to a majority-of-the minority vote.

This does not mean that the deal would escape meaningful judicial review. As a sale of control of the corporation, the Michael Dell transaction was subject to theRevlon test to determine whether the board had taken reasonable measures to obtain the highest price attainable for shareholders. However, in a Revlon case the focus is on whether the board did enough to negotiate a good deal for stockholders or to facilitate competing bids, issues that are not impacted by the presence or absence of a majority-of-the-minority vote.

Given entire fairness was never in the picture, why was a minority-of-the-minority condition included in the Dell agreement? One explanation is that, as Steven Davidoff, the New York Times "Deal Professor" said, the special committee tried to overcome the reputation that management buyouts have for bargain basement pricing by putting "every contractual mechanism ever invented to address this problem" in the agreement including a majority-of-the minority vote. Beyond any question of cosmetics, special committee members may have believed that it would be wrong to sell the company to Michael Dell if a majority of the unaffiliated shareholders opposed the transaction and Michael Dell's votes were needed to get it approved.

But if some form of majority-of-the-minority vote was appropriate, why not a majority of the unaffiliated shareholders voting on the transaction, rather than a majority of the outstanding condition, which treats a non-vote as a vote against the deal? A majority-of-the-voting-minority condition would have prevented Michael Dell from using his voting power to force through the deal, but would not have embedded the seemingly unrealistic assumption that every share not voted is a share opposed to the transaction. Looking at the numbers, there appears to be a good chance that the deal would have been approved if a majority-of-the-voting minority condition had applied.

The New York Times reported a day after the meeting was adjourned that 23 percent of the shares had not been voted. This 23 percent total presumably includes shares whose owners were opposed to the transaction and would have voted against the deal if there had been a majority-of-the-voting minority condition in which a non-vote does not count as a vote against. But it seems highly unlikely that the full 23 percent would have been voted against the deal in these circumstances. Some of these shares would not have voted regardless of the type of majority-of-the-minority clause included in the agreement.

In one of his Airgas opinions, Chancellor William Chandler observed that 12 percent of the Airgas shares had not voted in the hotly contested election of directors at the 2010 Airgas annual meeting at which nonvoted shares did not affect the outcome of the race and said that this is fairly typical even in contested elections. Assuming that this is the approximate number that would not have voted one way or the other on the Dell merger agreement, if it had included a majority-of-the-voting-minority clause, the Michael Dell transaction would then have needed favorable votes from unaffiliated stockholders owning 36.5 percent of the outstanding shares (50 percent of the voting shares not owned by Michael Dell), which according to press reports is slightly less than the number of these shares that had submitted yes votes at the time the July 18 meeting was convened.

One reason the Dell special committee may have opted for the onerous majority-of-the outstanding minority condition is that Delaware courts have not shown a high regard for majority-of-the-voting-minority conditions. In his 2009 Hammons Hotels opinion, Chancellor Chandler found that a majority-of-the-voting-minority was not adequate to take a transaction out of entire fairness, saying that "requiring approval of a majority of all minority stockholders assures that a majority of the minority stockholders

truly support the transaction, and there is not actually 'passive dissent' of a majority of the minority stockholders."

The phrase "passive dissent" comes from a Chancellor Strine opinion in a case in which the majority-of-the-minority vote was not a condition of the transaction. When there is such a condition, it is hard to see why dissenting shareholders who believed their vote could have an impact would not vote against the deal.

The reality may be that in a hotly contested election like Dell the nonvoters are largely small retail stockholders who do not vote in proxy contests for the same reason that many people do not vote in political elections: either they have no preference or they believe it is not worth the bother to send in a proxy because there is only an infinitesimal chance that their vote will influence the outcome of the election. These small retail stockholders probably form the core of the irreducible 10 percent to 15 percent of the shareholder population who do not vote in proxy contests regardless of the situation. Absent a scientific study of the mentality of these stockholders, there is no reason to believe that they are consistently on one side or the other of merger votes.

Given the views that have been expressed by the Delaware courts, there is little chance that majority-of-the-voting-minority clauses will become an acceptable way to bring transactions with controlling stockholders under the business judgment rule, but they may be a useful tool in situations like the Dell buyout, where there is no entire fairness requirement, but the board or special committee wants to deny the purchaser the ability to use his voting power to force through the transaction, without giving the opponents of the transaction an unfair advantage.

The majority-of-the-minority clause in the Dell merger agreement left Michael Dell fighting Carl Icahn with one hand tied behind his back. Besides treating shares that weren't voted as votes against the transaction, the agreement created an asymmetrical relationship between the two contestants. Dell had his shares neutralized, while Icahn, who had proposed a competing transaction, was free to vote against the Dell offer. Icahn made the most of his tactical advantages.

For example, he dangled before Dell stockholders the possibility that if the deal was approved, Dell would offer a premium to shareholders who didn't vote for the transaction and exercised appraisal rights, saying in an open letter to stockholders: "Even if you want the Michael Dell/Silver Lake offer to be accepted, unless you believe your shares will tip the balance, why vote for it? Why not seek appraisal and have the benefit of the 'free 60 day period [during which shareholders can back out of their exercise of appraisal rights]? Dell may well pay a premium over $13.65 to settle with those seeking appraisal." Presumably, some of the nonvoting shares were held by stockholders who supported the transaction, but wanted the Icahn free look at appraisal rights.

A majority-of-the-voting-minority version of the majority-of-the-minority clause would help remedy the asymmetry that exists when a large stockholder like Icahn opposes a deal with an insider in order to open the door to a competing transaction in which the stockholder has an interest. This type of majority-of-the-minority clause would still prevent insiders from using their voting power to tip the balance on their own proposal, but it would help reduce the tactical advantage of the large shareholder opponents.

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