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LESSONS FROM CARL ICAHN'S FAILED BID TO TAKE LEAR PRIVATE: NAKED NO-VOTE TERMINATION FEES CAN PROPERLY PROTECT BUYERS FROM BROKEN DEALS WITHOUT EXPOSING TARGET BOARDS TO LIABILITY

Recent litigation (*Re Lear Corporation Shareholder Litigation*, No. 2728-VCS (September 2, 2008)) surrounding Carl Icahn's failed bid to take Lear Corporation private offers valuable insights into risk sharing for broken deals and fiduciary duties of boards of directors of target companies.

The story behind the *Lear* litigation, in very simple terms, can be sketched as follows. As a manufacturer of interior systems for automobiles, Lear has been exposed to the "health" of the auto industry. Lear engaged in merger discussions with an affiliate of Carl Icahn, Lear's largest shareholder. Lear shareholders appeared ready to vote down the deal, thereby increasing the risk to Mr. Icahn of proceeding with a transaction that will not be consummated. In part to accommodate this increased deal risk, Mr. Icahn agreed to increase the deal consideration in exchange for Lear agreeing to pay Mr. Icahn a \$25 million naked no-vote termination fee (0.9% of the proposed deal value). "Naked no-vote termination fees" are termination fees payable where the target's stockholders vote to decline a merger agreement absent the target's acceptance of an alternative transaction. The plaintiff shareholders alleged that Lear's directors breached their duty of loyalty because they voted to approve the deal (with the naked no-vote termination fee), despite knowing that the merger was not likely to be approved. The plaintiffs also claimed that the buyout proposal undervalued the company.

In granting the defendants' motion to dismiss, Vice Chancellor Leo Strine noted that the complaint only contained cursory allegations that the board had acted in bad faith and made "clear that the board received advice from JPMorgan and Evercore that the Revised Merger Agreement was fair to the Lear stockholders in view of the future earnings potential of the firm as of the time the board approved the Revised Merger Agreement." This, VC Strine noted, did not satisfy the stringent standard of gross negligence required to establish a violation of the good faith component of the duty of loyalty. The court found that, in approving the merger agreement, the board was comprised of independent directors, used a thorough process in agreeing to the merger agreement, and had competently concluded that the per share price was attractive for the shareholders. As a result, the plaintiffs could not successfully argue that the board breached its fiduciary duty of loyalty absent facts supporting an inference of bad faith.

This decision reaffirms that, in the appropriate circumstances, naked no-vote termination fees can (1) duly allow buyers to shift broken deal risk to the target; and (2) be a useful tool for a target board seeking to increase a proposed purchase price. For the seller, a board using sound decision-making processes cannot be found liable for a breach of fiduciary duty solely because the shareholders disagreed with its recommendation. The long-standing business judgment rule continues to apply to a board's decision to enter into a merger agreement regardless of whether shareholder approval is likely.

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