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Crying Revlon: Delaware Courts Dismiss Claims in Morton’s Restaurant Group Acquisition

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In *In Re Morton’s Restaurant Group, Inc. Shareholders Litigation*, Chancellor Strine dismissed all claims in an action arising out of the acquisition of Morton’s Group, Inc. (Morton’s). This case is another example of attempted misuse of the so-called *Revlon* “entire fairness” test by plaintiffs. It also is a reminder to boards and their advisors of the benefits of an extensive market check, as well as sharing the proceeds of the transaction ratably amongst all stockholders.

Morton’s owns and operates a chain of high-end steakhouses. Morton’s stock was listed on the New York Stock Exchange (NYSE) until 2012. A private equity fund called Castle Harlan, Inc. (Castle Harlan) owned 27.7 percent of Morton’s stock and placed two directors on the ten-director board, one of whom was the *de facto* board chairman. A third director was Morton’s Chief Executive Officer. The remaining seven directors qualified as independent under NYSE rules.

In January 2011, Castle Harlan suggested that Morton’s explore selling itself. The board agreed and conducted an extensive nine-month market check for a buyer. In December 2011, Morton’s entered into a merger agreement with wholly owned subsidiaries of Landry’s, Inc. (Landry’s). The merger price represented a 33 percent premium over Morton’s closing market price and a 41.9 percent premium over the weighted average price of the stock for the prior three-year period. All of the stockholders received the same consideration per share and, importantly, any control premium was shared ratably by all stockholders. The transaction was approved by 92 percent of the stockholders.

Former Morton’s stockholders sued, alleging that Castle Harlan had acted in its own self-interest and rushed Morton’s into a sale without regard to the shareholders’ long-term interests. Plaintiffs argued that the transaction should be subject to “entire fairness review” under *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc*. Specifically, plaintiffs claimed that: (1) Castle Harlan was a controlling stockholder with “unique liquidity need[s]” that forced a sale at an inadequate price and (2) the independent directors put Castle Harlan’s liquidity needs above their fiduciary duties to the stockholders. The plaintiffs also alleged that the buyer and the company’s two financial advisors aided and abetted the board’s breach of fiduciary duty by conspiring with the board to sell the company on the cheap.

Chancellor Strine held that all of these allegations failed. First, Chancellor Strine held that Castle Harlan, which owned 27.7 percent of the company’s stock and controlled only two of ten board

seats, was not a controlling shareholder. Plaintiffs failed to allege any facts demonstrating that Castle Harlan exercised actual domination or control of the board. The complaint was devoid of allegations suggesting that the seven disinterested directors were not independent.

Second, Chancellor Strine held that, even if Castle Harlan was a controlling stockholder, plaintiffs "plead no facts supporting the rational inference that it is conceivable that Castle Harlan's support for an extended market check involving an approach to over 100 bidders in a nine-month process reflected a crisis need for a fire sale." In addition, the transaction proceeds were shared ratably across all shareholders, which qualified the transaction for "safe harbor" protection that "immunizes the transaction because it allows all stockholders to share in the benefits of the transaction equally with the large blockholder."

Chancellor Strine also noted that he was "flummoxed" by the plaintiffs' attack on the private equity firm "playbook" of taking a company private, working to improve its operations and profitability, then taking the company public, retaining a large non-majority stake in the company for several years and eventually being open to selling the entire company after a "thorough, non-hurried process in which it shares the control premium ratably with the company's other investors." Chancellor Strine noted that private equity firms typically hold their stock for far longer periods than typical stockholders and are entitled to "sell at a good price for the benefit of their investors." Indeed, other shareholders should welcome "the idea that they will receive their ratable share of a control premium after a full and open sale process ... that rewards them along with the private equity firm."

Third, the complaint also failed to plead a viable damages claim. The plaintiffs argued that the board breached its fiduciary duties by allowing one of its financial advisors to provide financing for Landry's bid. However, the board's mergers and acquisitions committee allowed the financing because the buyer was having difficulty obtaining financing. The board also required the financial advisor to agree that it would: (a) recuse itself from further negotiations, (b) reduce its fee by $600,000 (to allow for a second financial advisor to render an independent opinion and run a go-shop) and (c) issue a fairness opinion on the consideration in the transaction. The company then used the fee reduction to hire a second financial advisor, who also rendered a fairness opinion and shopped the company to other bidders at a higher price.

Because Morton's has an exculpatory provision in its charter that immunizes directors for breaches of the duty of care, plaintiffs were required to plead that the directors breached their duties of loyalty or good faith. That claim failed because plaintiffs failed to plead any conflict of interest by Castle Harlan or any of its board members. "To the contrary, the complaint and the documents it incorporates illustrates that the board of Morton's took great care to test the market in a very full way." There were also no well-pleaded allegations of any collusion between the board and its financial advisors to generate an unfair price.

Based on the foregoing, Chancellor Strine dismissed all claims. The complaint was "an example of the now too common invocation of the iconic *Revlon* case in a circumstance where the key problem in *Revlon*—board resistance to a higher bidder based on a bias against that bidder—is entirely absent." A board engaged in a sale process can thus protect itself and the transaction by conducting an extensive market check and by sharing the proceeds of the sale ratably amongst all stockholders.

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