CANADIAN Lawyer
WWW.CANADIANLAWYERMAG.COM
REPRINT CREATED WITH PERMISSION FROM THE CL44.02 ISSUE. © KEY MEDIA

COLUMN: BANKING ON CORPORATE

Bad facts, better reading

Decisions such as BGC describe the breadth of relationships that may affect director independence or the perception of impartiality

THERE IS AN old expression that bad facts make bad law. Whether or not that is so, it's difficult to dispute that bad facts usually make for better reading.

Though the regulatory framework for related party transactions is different in the United States, and fiduciary duties aren't always interpreted and applied in the same manner, decisions by the prolific Delaware courts dealing with conflicts can be instructive, and the decision of the Court of Chancery in *Re BGC Partners, Inc.* falls firmly into the category of interesting reading.

In the late 1950s, the U.S. was gripped by what's been dubbed the Sputnik crisis, when that first man-made satellite, launched by the Soviet Union, was circling the globe and triggering fear across America.

The *BGC Partners* case involved a different kind of space oddity: the intersecting orbits of two companies controlled by Howard Lutnick. Specifically, the case concerned the acquisition by BGC Partners, Inc., a publicly traded company over which Lutnick had voting control, of Berkeley Point Financial LLC, a private company he also controlled. Two shareholders of BGC argued that Lutnick was motivated to have BGC overpay because his financial interest in Berkeley Point (60 per cent) far exceeded that in BGC (13.8 per cent).

Lutnick first advised the BGC audit committee of the proposed acquisition, noting that the deal would be in the low US$700-million range and that agreements had been reached with some of the vendors. A special committee of the BGC board was struck, which authorized Lutnick, the conflicted party, to proceed with the negotiations. The committee acknowledged that Lutnick was not required to share information about the target with BGC but did not restrict him from sharing BGC information with the target.

Through the course of the discussions, the price moved from the initial range to US$875 million, although elements of the transaction terms themselves implied a target value of approximately US$570 million. The committee did not consider any alternatives. Its financial advisor provided eight reasons why the proposed price overvalued the target. The advisor also expressed concern about the structure of the deal and certain risks in the target's business, and they recommended a significant price decrease.

Following a negotiation, after which the committee met "for no more than 75 minutes," the parties settled on US$875 million and without the additional protections recommended by the committee's advisor. A subsequent IPO of an affiliate implied a value for the target of US$563 million.

The plaintiffs' derivative action was permitted in the circumstances to proceed because the facts and the apparent flaws in the process created a reasonable doubt about the impartiality of the board. In analyzing the committee members' positions, the court noted that conflicts are not exclusively about money but about other human motivations "such as love, friendship or collegiality," and further that the court can make inferences based on details of the individuals' relationships.

In the *BGC* case, one of the directors had served with Lutnick on four boards of Lutnick-controlled companies and had attended and co-ordinated several social engagements with him. Two others had also served on Lutnick-controlled boards, for compensation very material to them relative to their incomes and wealth, and both had served as managers or directors of a school to which Lutnick had donated US$65 million.

The court concluded there was reasonable doubt about the directors' impartiality and, on that basis, found that any demand by the plaintiffs that BGC itself initiate the claim against the board would have been futile and that there was a reasonably conceivable claim for breach of fiduciary duty. The court reached this conclusion by referencing the "constellation of facts" — an expression somehow chosen by the court without express reference to the fact that Lutnick rhymes with Sputnik.

Canadian related partner transaction rules include a number of provisions deeming directors to be non-independent, but they more generally provide that independence is a question of fact, similar to the general governance standard that turns on the existence or non-existence of any material relationship. Decisions such as *BGC* help inform that standard by describing the breadth of relationships that may affect independence or the perception of impartiality.

> "The court concluded there was reasonable doubt about the directors' impartiality . . ."

This approach can be particularly challenging in a country as relatively "small" as Canada, no matter how geographically large it appears to Sputnik and its descendants. CL

Neill May *is a partner at Goodmans LLP in Toronto focusing on securities law. He can be reached at nmay@goodmans.ca. The opinions expressed in this article are his alone.*