GODFREY KAHN S.C.

Litigation Focus

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Wisconsin Supreme Court strengthens hand of corporate directors defending challenges to their exercise of business judgment

It is a fact of modern corporate life: over 90 percent of mergers and acquisitions draw one or more lawsuits, often within 24 hours of the first public announcement.[1] Typically, such lawsuits accuse the directors of the target corporate of various breaches of fiduciary duty that allegedly have caused them to obtain an "inadequate" price and/or have prevented the shareholders from making a fully informed decision.[2] And, because most deals are time-sensitive, more often than not the corporate defendants will settle no matter how baseless the claim.[3] Such settlements rarely put money into the hands of the shareholders, instead calling only for the issuance of perfunctory "curative" disclosures[4] and the payment of the plaintiff's attorneys fees—a payment some commentators refer to as the "merger tax."

In *Data Key Partners v. Permira Advisers LLC, et al.*,[6] the Wisconsin Supreme Court gave corporate directors a new tool for avoiding the "merger tax" by allowing directors to raise certain protective doctrines at an early stage of the proceedings, even before any discovery has taken place.

Data Key Partners arose out of the acquisition via merger of Wisconsin Rapids-based Renaissance Learning, Inc. On August 16, 2011, Renaissance announced that it had entered into an agreement to be acquired by affiliates of Permira Advisers LLC, an advisor to global equity funds, for a substantial premium over the price at which its stock had been trading before the announcement. Within a few weeks another interested party submitted a competing offer, triggering a bidding war. Eventually, the majority shareholders of Renaissance advised the Directors that they would not support the second bidder's final offer even though it was ostensibly higher because of the increased risk of non-consummation it presented. However, the majority voluntarily agreed to take millions less for their own shares so that the minority would not be prejudiced by their preference. Since no merger could take place without the support of the majority shareholders and because the price of the two offers—by this time, a 40 percent premium over market—was effectively identical from the standpoint of the minority shareholders, the Directors voted to go forward with a sale to the original bidder.

Predictably, even before the bidding was over a lawsuit had been filed in the name of Data Key Partners (allegedly "small, typical shareholders") alleging breach of fiduciary duty and failure to make adequate disclosures. However, Data Key's motion to enjoin the merger was quickly denied and the deal between Renaissance and Permira was consummated, leaving Data Key with a claim against the directors for money damages.

It already was well-established in Wisconsin that corporate directors may not be held liable for actions taken in the exercise of their business judgment unless their actions are tantamount to willful misconduct; this rule is embodied in both the court-made Business Judgment Rule and the legislatively-created Director Immunity Statute. The directors moved to dismiss the complaint, arguing that the facts alleged showed nothing worse than a good faith exercise of judgment on a debatable choice. The trial court agreed, dismissing plaintiff's complaint.

The Wisconsin court of appeals, however, concluded the Rule and the Statute were mere affirmative defenses that could not be considered on motion to dismiss and so remanded for further proceedings. Defendants then sought discretionary review by the Wisconsin Supreme Court.

Ultimately, the Supreme Court granted review, reversed the decision of the court of appeals, and reinstated the trial court's judgment of dismissal. In so doing, the Court enunciated a number of principles that will be important to any director accused of breaching his or her fiduciary duty:

First, the Court held that the Business Judgment Rule and the Director Immunity Statute are rules of substantive law whose standards may and should be taken into account in evaluating the sufficiency of the complaint on motion to dismiss. Any other rule would give plaintiffs "a powerful and perverse incentive to 'dummy-up' [the complaint] about the obvious implications of the business judgment rule."

Second, the Court rejected the contention that the majority's abstract power to vote the directors off the board created a conflict of interest that would preclude the directors from taking advantage of the Rule (as Data Key had argued). If this were so, reasoned the Court, "no director would be protected by the business judgment rule."

Third, the Court likewise rejected the notion that the directors' stock and stock rights in the company created a conflict of interest (as Data Key also had asserted). To the contrary, the Court concluded, such rights "create powerful incentives to get the best deal in the sale of the company."

Fourth, in applying the presumption of good faith required by the Rule and implicit in the Statute, the Court took a common sense view of the actions of the directors. Not only would it have been impossible for any sale to go forward without the consent of the majority but, because of the "significant risks" presented by the second offer, the directors "could in good faith conclude that a bird in the hand was worth two in the bush." That being so, the Court concluded, there was "nothing improper" in the directors' decision.

Finally, in evaluating the allegations of the complaint the Court for the first time explicitly adopted the so-called *Twombly/Iqbal* "plausibility" pleading standard now followed in federal courts.

Taken together, these rulings place squarely on any plaintiff asking a Wisconsin court to second-guess the decisions of corporate directors the burden of alleging concrete facts that give rise to a plausible inference of willful misconduct. In the absence of such allegations, directors should now be positioned to obtain early dismissal of baseless but potentially disruptive challenges to mergers, acquisitions, and other corporate actions.

At all stages of the legal proceedings Renaissance Learning and its directors were represented by Howard Pollack and Michael Apfeld from the Corporate Governance and Securities group of Godfrey & Kahn's litigation team.

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[1]Robert M. Daines & Olga Koumrian, "Recent Developments in Shareholder Litigation Involving Mergers and Acquisitions" (March 2012 update), *available at* www.cornerstone.com/getattachment/03dcde90-ce88-4452-a58a-b9efcc32ed71/Recent-Developments-in-Shareholder-Litigation-Invo.aspx and (February 2013 update), available at http://www.cornerstone.com/getattachment/9d8fd78f-7807-485a-a8fc-4ec4182dedd6/Shareholder-Litigation-Involving-Mergers-and-Acqui.aspx. *See also* Boris Feldman, "Litigating Post-Close Merger Cases" (Harvard Law School Forum on Corporate Governance and Financial Regulation) (November 9, 2012) ("It doesn't matter how high the premium or how clean the deal: someone (usually, one of the same someones) will sue"), found at http://blogs.law.harvard.edu/corpgov/2012/11/09/litigating-post-close-merger-cases/.

[2]For a description of the commencement, progress, and resolution of a typical challenge to an announced merger, see Clark & Mayer, *Anatomy of a Merger Litigation*, LXXXIII No. 6 Corporation (Aspen Publishers March 15, 2012) at 1-6.

[3]*See* Dionne Searcey & Ashby Jones, *Deals and Dealmakers: First, the Merger; Then the Lawsuit* (Wall Street Journal, January 10, 2011).

[4]The authors of the Cornerstone Research analyses, *supra* n.1, have noted that they "have not encountered a case in which shareholders rejected the deal after the additional disclosures were provided." See John Gould, Olga Koumrian and Robert Daines, "Developments in M&A Shareholder Litigation" (Harvard Law School Forum on Corporate Governance and Financial Regulation) (posted March 4, 2012), found at http://blogs.law.harvard.edu/corpgov/2012/03/04/developments-in-ma-shareholder-litigation.

[5]See, e.g., U.S. Chamber Institute for Legal Reform, "The Trial Lawyers' New Merger Tax: Corporate Mergers and the Mega Million-Dollar Litigation Toll on Our Economy" (Oct. 24, 2012) at 2, found at http://www.instituteforlegalreform.com/resource/the-trial-lawyers-new-merger-tax-corporate-mergers-and-the-mega-instituteforlegalreform.com/resource/the-trial-lawyers-new-merger-tax-corporate-mergers-and-the-mega-million-dollar-litigation-toll-on-our-economy/;

Daniel Fisher, "*Lawyers Extract 'Merger Tax' from Shareholders, Study Says*" (Forbes.com, Oct. 24, 2012), found at http://www.forbes.com/sites/danielfisher/2012/10/24/lawyers-extract-merger-tax-from-shareholders-study-says/.

[6]2014 WI 86 (July 23, 2014).

[7]WIS. STAT. § 180.0828.

[8]*Data Key Partners* ¶¶ 32-42.

[9]*Id*. ¶ 45.

[10]*Id*. ¶¶ 46, 51-52.

[11]*Id*. ¶¶ 49-50.

[12]*Id*. ¶¶ 19-31. The rule is named after a pair of U.S. Supreme Court cases, *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007) and *Ashcroft v. Iqbal*, 556 U.S. 662 (2009).

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