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## *Stockholders May Be Third-Party Beneficiaries of Agreement That “Replicates” Standstill of Section 203 of the Delaware General Corporation Law*

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On June 28, 2019, the Delaware Court of Chancery allowed several claims to proceed past motions to dismiss in *Arkansas Teacher Retirement System v. Alon USA Energy, Inc.*, C.A. No. 2017-0453-KSJM (Del. Ch. June 28, 2019). In so doing, the case provides rare guidance regarding the intersection of Section 203 of the Delaware General Corporation Law and stockholder agreements containing standstill provisions. The case underscores the need to ensure that independent directors make the critical decisions for a company in negotiating a buyout with an interested stockholder, and to ensure that any interested stockholder and the company adhere to statutory and contractual requirements intended to protect the company’s stockholders.

### **Background**

The case arises out of the July 2017 stock-for-stock acquisition of Alon USA Energy, Inc. (“Alon”) by Delek US Holdings, Inc. (“Delek”).

In 2015, Delek acquired 48% of the common stock of Alon from Alon’s largest stockholder. That acquisition, however, would have triggered the protections of Section 203. In order to protect against “abusive takeover practices,” Section 203 prohibits interested stockholders (i.e., holders of 15% or more of a corporation’s outstanding voting stock) from acquiring the company through a merger or other acquisition for three-years after becoming an interested stockholder. The bar of Section 203 is not absolute, as excluded from this statutory standstill are situations where, among other things, (1) the company’s board pre-approved the stock acquisition resulting in the acquirer becoming an interested stockholder or (2) an interested stockholder merger is approved by the board and two-thirds of stockholders unaffiliated with the interested stockholder.

To avoid the three-year standstill of Section 203, Delek requested the Alon board of directors (the “Alon Board”) approve the 2015 purchase. While it granted Section 203 approval, the Alon Board conditioned that approval on Delek entering into a stockholder agreement (the “Stockholder Agreement”). The Stockholder Agreement established anti-takeover protections like those imposed by Section 203, but only for one year. The Stockholder Agreement also prevented Delek and its affiliates from both acquiring and “seek[ing] to” acquire over 49.99% of Alon’s total equity.



The Stockholder Agreement further permitted an “Independent Director Committee,” comprised of independent directors unaffiliated with Delek, to authorize Delek to negotiate a merger or take other actions prohibited by the agreement. It was undisputed that Alon never formed an Independent Director Committee, as defined in the Stockholder Agreement, to address the matters at issue in the litigation.

Nevertheless, with the tacit acceptance of the Alon Board, Delek allegedly took several problematic actions during the one-year standstill period, including:

- Delek’s CEO publicly indicated that Delek intended to acquire Alon.
- Delek and Alon entered into a confidentiality agreement to permit the exchange of non-public information.
- Delek negotiated the merger with a special committee of the Alon Board during the one-year standstill, including negotiating substantive terms, meeting with the chairperson of the special committee six times, and proposing deal structures reflecting a discount to then-current market prices of Alon stock.

After the end of the one-year standstill, the special committee finalized negotiations and Alon stockholders later approved the merger. The merger closed on July 1, 2017.

In its post-closing damages complaint plaintiff claimed, among other things, that Delek breached the Stockholder Agreement through its efforts to acquire Alon during the one-year standstill. Plaintiff also claimed that the breach of the Stockholder Agreement restored the protections of Section 203, resulting in the merger violating Section 203.

## **As an Alon Stockholder, Plaintiff Has Standing to Sue for a Breach of Delek’s Stockholder Agreement**

Defendants’ primary argument for dismissal of the breach of contract claim was that plaintiff, like all other Alon stockholders, was not a party to the Stockholder Agreement and thus had no standing to enforce the agreement in the event of a breach. The Court rejected defendants’ argument.

The Court held that the Delek stockholders met all three elements under Delaware law for being treated as third-party beneficiaries of the Stockholder Agreement, namely: (i) the contracting parties must have intended that the third party beneficiary benefit from the contract, (ii) the benefit must have been intended as a gift or in satisfaction of a pre-existing obligation to that person, and (iii) the intent to benefit the third-party must be a material part of the parties’ purpose in entering into the contract.

Critical to the Court’s analysis was that, by replicating the protections of Section 203, the Stockholder Agreement was intended to directly benefit Alon stockholders. The Court noted that “[l]ike all provisions of the Delaware General Corporation Law, Section 203 is part of a contract between Delaware corporations and their stockholders and thus provides enforceable benefits to those stockholders.” Turning to the statute’s legislative history, the Court noted that Section 203 was intended to confer a benefit on stockholders by striking a balance between an “unfettered market for corporate shares and the well documented and judicially recognized need to limit abusive takeover tactics” and to “encourage a full and fair offer.” The Stockholder Agreement replicated these aspects of Section 203 by preventing a “creeping takeover deleterious to stockholder value.” Accordingly, the



Court held the Stockholder Agreement was “clearly intended” to confer a direct benefit on Alon stockholders in lieu of the protections of Section 203, and they thus had standing to enforce the agreement as third-party beneficiaries. Turning to the merits of plaintiff’s breach of contract claim, the Court further held the claim was well-pled because of the alleged efforts by Delek to pursue and negotiate a merger during the one-year standstill.

## **Breach of the Stockholder Agreement Potentially Restored the Protection of Section 203**

Turning to plaintiff’s argument that a breach of the Stockholder Agreement would vitiate the Alon Board’s Section 203 approval and would restore the protections of the statute, the Court described this argument as “creative.” While acknowledging that it required “many logical leaps, which might not ultimately land,” the Court credited plaintiff’s theory at the pleading stage.

The Court further rejected defendants’ attempt to rely on a “silver bullet” that 79% of unaffiliated Alon stockholders approved the merger, thereby falling within the exception for stockholder approval in Section 203(a)(3). The Court held that the stockholder vote failed to satisfy Section 203 because Alon’s proxy materials allegedly did not disclose material facts related to the merger (including certain provisions of the Stockholder Agreement, the special committee’s financial advisor increasing its position in Delek by 60% while it was advising the committee, details related to the formation of the special committee, and details on the post-closing positions of two directors on the Alon Board).

## **Conclusions**

The ultimate weight of the Court’s holding remains to be seen due to the early procedural posture. While bound to accept plaintiff’s factual allegations on the motions to dismiss, the Court may adjust its analysis with the benefit of a more developed record. Nonetheless, the Court’s opinion is worthy of attention given the relatively underdeveloped nature of Section 203 jurisprudence.

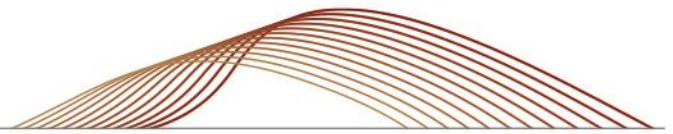
When drafting an agreement between a company and another party, counsel should take care to consider whether any provisions mimic the protections afforded to the company’s stockholders by the Delaware General Corporation Law. Such provisions could trigger the ability of a stockholder to sue to enforce an alleged breach even if the stockholders are not a party to the agreement. In particular, practitioners should take special care around invoking contractual rights that mimic Section 203, which the Court could read as being for the benefit of stockholders as third-party beneficiaries.

The Court’s opinion also demonstrates the need for a company and interested stockholders to assess their respective statutory *and* contractual obligations before engaging in merger discussions. It is critically important to consult skilled counsel in an interested stockholder buyout scenario to ensure that all appropriate steps, including a fully empowered and independent committee of directors, are established early in the process.

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*If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:*

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