Morris James LLP
Lewis H. Lazarus
Albert H. Manwaring, IV
Albert J. Carroll

Delaware Corporate and Commercial Case Law Year In Review – 2018

This top ten list summarizes significant decisions of the Delaware Supreme Court and the Delaware Court of Chancery over the past calendar year. Our criteria for selection are that the decision either meaningfully changed Delaware law or provided clarity or guidance on issues relevant to corporate and commercial litigation in Delaware. We present the decisions in no particular order. The list does not include every significant decision, but provides litigants and litigators with an array of decisions on varied issues likely to affect business dealings or business litigation.

One: *City of North Miami Beach General Employees' Retirement Plan v. Dr. Pepper Snapple Group Inc.*, 189 A.3d 188 (Del. Ch. June 1, 2018) (Bouchard, Chancellor)

This decision arose out of a merger involving the Dr. Pepper and Keurig companies. In a reverse triangular merger, a parent company uses a subsidiary to acquire a target, with the target absorbing that subsidiary. That is how Dr. Pepper and Keurig structured their deal. The result was Dr. Pepper stockholders getting cash but retaining their stock, and Keurig's stockholders getting a controlling interest in Dr. Pepper. Certain Dr. Pepper stockholders sued in the Court of Chancery, asserting that they had appraisal rights to a judicially-determined fair value in connection with the deal under Section 262 of the Delaware General Corporation Law (DGCL), which were being violated.

Under Section 262 of the DGCL, Delaware law makes available appraisal rights for stockholders under certain circumstances, which means a statutory process allowing them to forgo a merger's financial consideration in favor of a judicially-determined appraisal of "fair value." The statute makes appraisal rights available to stockholders of a "constituent corporation." As this decision holds, that term means an entity actually being merged or combined, and not the parent of such an entity. Since Dr. Pepper itself did not merge or combine, its stockholders had no appraisal rights. The Court also added a second, alternative basis for finding appraisal rights were unavailable. Section 262 contemplates petitioners who have been forced to give up their shares in a proposed transaction. While they would become minority stockholders through the deal with Keurig, Dr. Pepper's stockholders were retaining their shares. So they had no appraisal rights for that additional reason.

Key Takeaway: Under *Dr. Pepper*, stockholders of a parent in a reverse triangular merger lack appraisal rights.

Two: *CBS Corp. v. National Amusements, Inc.*, 2018 WL 2263385 (Del. Ch. May 17, 2018) (Bouchard, Chancellor)

This decision was both front-page newsworthy and legally significant. It arose out of the highly-publicized dispute over a proposed transaction involving CBS and Viacom, each controlled by members of the Redstone family. CBS and Viacom used to be one entity but split. The Redstones retained voting control in each through a dual-class voting structure. Later,

the Redstones began pushing to merge the entities once again and both entities formed special committees to consider the proposal.

After CBS's special committee found the proposal was not in the company's best interests, the committee members grew concerned about how the Redstones would react. To preempt the Redstones from removing the independent directors and forcing a deal on the minority stockholders, the committee proposed a special meeting of the board to consider a dividend that would dilute and deny the Redstones' voting control over CBS, but one conditioned on the Delaware courts approving its legality. To protect this plan, the committee initiated an action in the Delaware Court of Chancery against the Redstones and sought a restraining order to hold them at bay and prevent interference in the dividend plan—an unprecedented request.

In this letter decision, the Court of Chancery declined to restrain the Redstones at the time. While plaintiffs had shown a colorable claim for breach of fiduciary duty, they failed to show threatened, imminent irreparable injury absent restraints. Rather, the Court relied on its extensive power to provide redress if the Redstones ultimately tried to take some action regarding the dividend plan inconsistent with a controlling stockholder's fiduciary obligations. Also notable is the Court's balancing of the equities and its discussion of the apparent tension in Delaware law between, on one hand, a controlling stockholder's right to protect its control position and, on the other, the right of independent directors to respond to threats posed by a controller, including through possible dilution. The parties eventually settled before trial and dismissed the action.

***Key Takeaway*:** The apparent tension in Delaware law between the rights of controlling stockholders and the rights of independent directors remains for another day.

Three: *In re Tesla Motors Inc. Stockholder Litigation*, 2018 WL 1560293 (Del. Ch. Mar. 28, 2018) (Slights, Vice Chancellor)

Under Delaware law, a controlling stockholder need not be a majority stockholder. A controlling stockholder might be a group of aligned stockholders who together hold a majority. Or, as in this case, it might be a minority but substantial stockholder who practically has and exercises board-level control with respect to the challenged transaction. The presence of a controller is a critical factor in litigation. It may result in a stricter standard of judicial review. Or, as here, it could prevent defendants from achieving a prompt dismissal of a post-closing fiduciary duty action relying on stockholder approval and the well-known decision in *Corwin v. KKR Fin. Holdings LLC,* 125 A.3d 304 (Del. 2015).

This action involved the highly-publicized automotive and energy company Tesla and the very public face of its organization, Elon Musk. Musk owned only about 22% of Tesla at the time of a suit challenging a deal between Tesla and SolarCity, another one of Musk's investments. The Delaware courts rarely find control when ownership is as low as 20-something percent. Nonetheless, the Court of Chancery found Musk was a controlling stockholder of Tesla

with respect to the Solar City transaction, at least at the pleadings stage. The relevant factors included: (1) Musk's history of eliminating opposition; (2) the board's lack of safeguards to prevent his control over the company's consideration and negotiation of the challenged self-interested transaction; (3) a board packed with members interested in the transaction or beholden to him; and (4) public disclosures portraying him as in control. Because there was a conflicted controller involved in the deal, defendants could not rely on stockholder approval to obtain an early dismissal under *Corwin*.

***Key Takeaway*:** As demonstrated by *Tesla*, the question of control under Delaware law is a practical one, looking to one's influence over a board, and not wed to ownership levels.

<u>Four</u>: *Sciabacucchi v. Salzburg*, 2017 WL 6719718 (Del. Ch. Dec. 19, 2018) (Laster, Vice Chancellor)

A Delaware corporation may include a forum-selection provision in its certificate of incorporation governing all "internal affairs" claims by its stockholders. That authority comes from the decision in *Boilermakers Local 154 Retirement Fund v. Chevron Corporation,* 73 A.3d 934 (Del. Ch. 2013), as well as Sections 102(b)(1) and 115 of the DGCL. There has been much national debate of late regarding including forum-selection provisions for securities claims in charters. A key question is whether a corporation can require stockholders to arbitrate such claims. This Court of Chancery decision wades into that debate by addressing several charter provisions mandating a federal forum for securities claims despite concurrent federal and state court jurisdiction. The companies involved included some familiar names—Stitch Fix, Roku, and Blue Apron.

The decision holds that Delaware law does not authorize a Delaware corporation to include a forum-selection provision in its charter governing claims under the Securities Act of 1933. According to the Court of Chancery, the State of Delaware can regulate claims relating to a Delaware corporation's internal affairs, as reasoned in *Boilermakers*. Claims under the 1933 Act, however, are external to the corporation—*i.e.*, they do not "turn on the rights, powers, or preferences of the shares, language in the corporation's charter or bylaws, a provision in the DGCL, or the equitable relationships that flow from the internal structure of the corporation." Being external, the claims are beyond the power of state corporate law to regulate. The Court accordingly held the at-issue provisions trying to regulate them invalid and ineffective.

***Key Takeaway*:** *Salzburg* likely puts a damper on the hopes of those advocating for including securities claims arbitration clauses in corporate charters.

<u>Five</u>: *Akorn Inc. v. Fresenius Kabi AG*, 2018 WL 4719347 (Del. Ch. Oct. 1, 2018), (Laster, Vice Chancellor), *aff'd* 2018 WL 6427137 (Table).

In M&A transactions, there is always the possibility of the selling company's business significantly deteriorating between signing and closing. To account for this, merger agreements

commonly contain buy-side protection in the form of a material adverse effect or material adverse change clause (an "MAE"). These often are complex provisions that permit the buyer to avoid closing under the right circumstances—usually a significant, company-specific deterioration, rather than a market-wide issue.

Historically, an MAE has been very difficult to prove under Delaware law. As this decision explains, a buyer asserting an MAE faces a heavy burden. The paramount consideration "is whether there has been an adverse change in the target's business that is consequential to the company's long-term earnings power over a commercially reasonable period, which one would expect to be measured in years rather than months." In other words, a short-term "hiccup" in the target's business will not support an MAE. No Delaware court had ever found an MAE, until this decision. *Akorn* therefore represents an important milestone in Delaware M&A jurisprudence. But the case did involve a rather extreme set of facts supporting an MAE, with a drastic and sustained business downturn, whistleblowers, and serious regulatory violations. Thus, while important, is unlikely that *Akorn* represents a shift in Delaware law or that it will open the floodgates of MAE litigation.

Key Takeaway**:** After *Akorn*, MAEs under Delaware law are no longer mythical creatures, but they remain difficult to prove.

Six: *Flood v. Synutra Int'l, Inc.*, 195 A.3d 754 (Del. Oct. 9, 2018) (Strine, Chief Justice)

Transactions between a Delaware company and its controlling stockholder usually are subject to rigorous entire fairness review. But even a merger involving a conflicted controller may gain the benefit of deferential business judgment review. Under *Kahn v. M&F Worldwide Corp.,* 88 A.3d 635 (Del. 2014), commonly referred to as *MFW*, a controller may gain the benefit of business judgment review when it conditions a transaction—from the outset (*i.e.*, *ab initio*)—on two procedural protections. Those involve approval by (i) an independent special committee and (ii) a majority of the minority stockholders. The point of the timing requirement is that the controller disables its influence from the beginning, instead of using the protections as a bargaining chip when negotiating economic terms.

This decision makes clear what from the beginning means. It is not necessarily at the first expression of interest. Rather, according to the Delaware Supreme Court, it can be later, as long as it is before any economic negotiations occur. Thus, even when the controller's initial offer does not include the *MFW* protections, it may add them before actual negotiations start. This flexible approach is consistent with the policy of increasing real-time protections for minority stockholders in conflict transaction scenarios. But, as the dissenting opinion points out, it does leave more room for dispute in litigation than would a more bright-line rule.

Key Takeaway**:** The Delaware courts do not use a bright-line rule for *MFW*'s *ab initio* requirement. Still, a controller is best advised to invoke *MFW* as soon as possible to avoid any argument that the protections came too late.

Seven: *Morrison v. Berry*, 191 A.3d 268 (Del. July 9, 2018, *revised* July 27, 2018) (Valihura, Justice)

Under *Corwin v. KKR Financial Holdings LLC,* 125 A.3d 304 (Del. 2015), approval of a transaction by a fully-informed, uncoerced majority of the disinterested stockholders invokes the deferential business judgment standard of review for a post-closing damages action. A qualifying transaction becomes nearly immune from further judicial scrutiny. This decision is important for its discussion of *Corwin*'s "informed" approval prerequisite. This aspect of *Corwin* turns on thoroughly-developed standards under Delaware law regarding what is or is not material to the stockholders' decision-making. In that way, the decision is not novel. Still, because a disclosure violation may prevent what would otherwise be an early dismissal of a breach of fiduciary duty action against directors for damages, the issue is of heightened importance post-*Corwin*.

In the Delaware Supreme Court's words, this case "offers a cautionary reminder to directors and the attorneys who help them craft their disclosures: 'partial and elliptical disclosures' cannot facilitate the protection of the business judgment rule under the *Corwin* doctrine." Here, the material undisclosed facts concerned a founder's early dealings with the private equity buyer, pressure on the board, and the degree that this influence may have affected the sale process structure. Aiding the stockholder plaintiffs' arguments were documents obtained in connection with a pre-suit books and records demand under Section 220 of the DGCL. That is another area of increased importance post-*Corwin*. A *Corwin* defense is not available in a books and records action and thus a stockholder can get documents critical to pleading around a *Corwin* defense in a subsequent plenary action..

***Key Takeaway*:** Even with injunctions harder to come by in M&A litigation before the Delaware courts, disclosure violations remain consequential. As here, they may be the difference between a prompt dismissal and facing discovery and a potential trial on the merits.

Eight: *California State Teachers Retirement System v. Alvarez*, 179 A.3d 824 (Del. Jan. 25, 2018) (Valihura, Justice)

This is an important decision clarifying the rules regarding the preclusive effect the dismissal of a derivative suit outside of Delaware might have on a similar action in Delaware. The litigation saga of this case involving a bribery scandal at Wal-Mart took some interesting turns, ping-ponging between the Delaware Court of Chancery and the Delaware Supreme Court.

Relevant here, the Court of Chancery had dismissed a derivative action in Delaware based on the preclusive effect of an earlier dismissal in a similar suit in Arkansas federal court. In doing so, the Court applied the accepted preclusion approach. That involves applying the other jurisdiction's law examining the "adequacy of representation" provided by the plaintiffs in the dismissed action. So long as the representation was adequate, *i.e.*, not "grossly deficient," and there were no conflicts of interest, then dismissal was likely in the second suit. But, on

appeal, the Delaware Supreme Court remanded the matter back to the Court of Chancery to consider federal due process concerns in that rule's application.

On remand, considering the issue afresh, the Court of Chancery found no due process concerns but advocated a new test governing preclusion in derivative litigation. According to this new test, just because one derivative litigation was dismissed for failure to overcome the requirement of a pre-suit demand on the board, it does not mean a similar derivative action must be dismissed on the same grounds. Instead, an earlier dismissal should only affect the second suit if the first suit was dismissed *after* (i) the plaintiff survived a demand futility motion or (ii) the board conceded that demand is excused. Only at one of those points would the plaintiff in the first suit be acting on the company's behalf, with its actions capable of binding other derivative plaintiffs who are trying to act on the same company's behalf. Originally stated as dicta in *In re EZCORP, Inc. Consulting Agreement Derivative Litigation*, 130 A.3d 934 (Del. Ch. 2016), this rule, among other things, would prevent ill-prepared and typically rushed derivative complaints from cutting off better-prepared complaints.

The case then went back up to the Delaware Supreme Court on appeal. And in the instant decision, the Supreme Court rejected the new test the Court of Chancery proposed. It defaulted to the old approach instead, with thorough reasoning for doing so. In these circumstances, the State's interest in governing the internal affairs of Delaware corporations yielded to the national interests among courts to respect each other's judgments.

***Key Takeaway*:** In derivative actions, a court's disposition of a first-filed complaint may prevent a different stockholder plaintiff from proceeding even if its second-filed action arguably reflects a more diligent effort to obtain relevant documents and a more comprehensive legal analysis. Stated differently, who wins the race to the courthouse may affect who may proceed with a derivative action.

Nine: *A&J Capital, Inc. v. Law Office of Krug*, 2018 WL 3471562 (Del. Ch. July 18, 2018) (Slights, Vice Chancellor)

Corporate principles extend to the alternative entity context with some frequency. But alternative entities are creatures of contract. And, in the LLC context, the parties' rights, or lack thereof, usually derive exclusively from their agreement's plain terms. The potential extension of corporate principles turns on several things. Among them is the parties' structuring of their own affairs, such as whether the parties' operating agreement embraces corporate elements.

The law governing when a corporate director can be dismissed "for cause" may require notice and an opportunity for the director to contest the allegations. This decision declines to extend those principles to the LLC context, at least considering the operating agreement at issue. Specifically, the Court of Chancery held that, absent contrary language in the LLC's operating agreement, members do not need to provide notice and an opportunity to respond before dismissing a manager "for cause." Notably, even without such rights, a dismissed LLC manager need not go quietly into the night. The manager can still sue to contest the discharge.

***Key Takeaway*:** Not all corporate principles extend to the LLC context, at least not under all circumstances. If parties wish to ensure managers have the right to pre-removal notice and an opportunity to respond to a "for cause" removal, then they should spell that out in their operating agreement.

Ten: *Verition Partners Master Fund Ltd. v. Aruba Networks, Inc.*, 2018 WL 922139 (Del. Ch. Feb. 18, 2018) and *Verition Partners Master Fund Ltd. v. Aruba Networks Inc*., 2018 WL 922139 (Del. Ch. May 21, 2018) (Laster, Vice Chancellor)

Again, Delaware law makes available appraisal rights in certain merger transactions, meaning a statutory process allowing stockholders to forgo a merger's financial consideration in favor of a judicially-determined appraisal of "fair value." Delaware courts have long made clear that the deal price for a company, while a relevant factor, does not necessarily equate to the "fair value" petitioners are entitled to receive in an appraisal proceeding.

This opinion arises out of the appraisal proceeding relating to Hewlett-Packard's purchase of Aruba Networks. The case led to two notable opinions, so far. The first notable opinion was the Court of Chancery's original post-trial decision released in February 2018, *Verition Partners Master Fund Ltd. v. Aruba Networks, Inc*., 2018 WL 922139 (Del. Ch. Feb. 18, 2018) (Laster, Vice Chancellor). That decision came on the heels of the Delaware Supreme Court's reversals in *DFC Global Corporation v. Muirfield Value Partners, L.P.*, 172 A.3d 346 (Del. 2017) (Strine, Chief Justice) and *Dell, Inc. v. Magnetar Global Event Driven Master Fund Ltd.*, 177 A.3d 1 (Del. 2017) (Valihura, Justice). *DFC* and *Dell* reaffirmed that the deal price for an arm's-length transaction achieved after a thorough sale process likely will be the best evidence of fair value in an appraisal proceeding. In the first *Aruba Networks* decision, the Court of Chancery chose not to defer to the merger price. Rather, discounting for synergies, the Court determined Aruba Networks' fair value using the thirty-day average unaffected market price, a price well below the deal price. It was a significant loss for the appraisal petitioners in this action with potential far-reaching consequences for other petitioners. The decision has been widely-reported and hotly-debated since.

The second notable opinion in *Aruba Networks* is from May 2018. In it, the Court of Chancery denied the petitioners' motion for reargument. What makes the reargument denial significant is the Court's thorough defense of its reasoning in the original decision, with enhanced discussion of *DFC* and *Dell*. The Court takes on many contentions, including that "[the Vice Chancellor] misapprehended the law due to [his] 'frustration with many of the Supreme Court's pronouncements.'"

***Key Takeaway*:** *Aruba Networks* lowers the potential floor recovery for appraisal petitioners, creating significant risk. Practitioners are closely watching the appeal.