



DELAWARE CORPORATE LAW AND LITIGATION: WHAT HAPPENED IN 2016 AND WHAT IT MEANS FOR YOU IN 2017



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WHY YOU SHOULD READ THIS ANNUAL UPDATE

Delaware has long been known as the corporate capital of the world, and it is now the state of incorporation for 66 percent of the Fortune 500 and more than half of all companies whose securities trade on the NYSE, Nasdaq and other exchanges. Each year, the Delaware courts issue a number of significant opinions having tremendous importance to businesses, those who manage them and those who counsel them. Many of those recent cases are discussed in this *Annual Update*, which is intended to provide sufficient detail so as to be helpful to in-house counsel, but is also written in a way so that the often-long and complex Delaware decisions can be easily understood by directors and other fiduciaries. Takeaway observations are also provided. This *Annual Update* may help you focus on the right issues, ask the right questions and, along the way, protect yourself and your company.

Delaware's preeminence in business law starts with its corporate code (the Delaware General Corporation Law or DGCL) and alternative entity statutes, which are continuously reviewed and enhanced with innovations designed to meet the expanding needs of corporate and financial America. The Delaware Court of Chancery and the Delaware Supreme Court have helped the state maintain its preeminence by striking a balance in the application of these laws between entrepreneurial risk-taking by management and the right of investors to demand that management put the best interests of the corporation above all others.

Delaware's courts are now the most popular and preeminent venues in the United States for resolving business disputes and challenges to actions by boards of directors, such as breach of fiduciary duty claims, M&A litigation and virtually any issue implicating corporate governance and compliance with Delaware's business laws. In fact, for more than ten years, an annual assessment conducted by the United States Chamber of Commerce has ranked Delaware first among the court systems in all 50 states, noting the Delaware courts' fairness and reasonableness, competence, impartiality and timeliness in resolving disputes. Year after year, decisions from the Delaware courts demonstrate that its judges are neither stockholder nor management biased. Indeed, Delaware's guiding principles are: strict adherence to fiduciary duties; prompt enforcement of articles of incorporation, bylaws and merger agreements; and the maximization of stockholder value.

The Business Judgment Rule – a rule that prevents judges from second-guessing the decisions of directors who reasonably inform themselves of important information before making decisions, who are free of economic or other disabling conflicts of interest, and whose only agenda is that of advancing the best interests of the corporation – remains alive and well in Delaware. While the facts and legal analyses confronting directors are usually complex, so long as independent directors can articulate why, in their best judgment, they acted as they did and why they believed those actions were in the best interests of the corporation, the Delaware courts will typically respect their decisions.

The significance of Delaware's corporate law becomes strikingly clear when one considers the statistics on M&A litigation. While the 2016 information is still being compiled and analyzed, a study prepared by Ravi Sinha of Cornerstone Research showed that there has been a decline in the rate of M&A litigation since a 2016 ruling of the Court of Chancery refusing to approve a disclosure-only settlement. Even so, for the first half of 2016:

- Plaintiffs' attorneys filed lawsuits in 64 percent of M&A deals valued over \$100 million – the first time this number has dropped below 90 percent since 2009
- The average number of lawsuits per deal is down from 4.1 in 2015 to 2.9
- No deal had more than 10 lawsuits, down from six in 2015
- Only 56 percent of M&A cases were resolved before closing, down from 75 percent in 2015

In addition to an annual review of Delaware law developments, DLA Piper also publishes an easy-to-read handbook, *Avoiding Personal Liability: A Guide for Directors and Officers*, available at dlapiper.com.



Henry duPont Ridgely and John L. Reed



DELAWARE COURT OF CHANCERY ISSUES FIRST DECISION INTERPRETING DELAWARE'S LEGISLATIVE BAN ON FEE-SHIFTING FOR STOCKHOLDER LITIGATION AND DECLARES INVALID BYLAW IMPOSING ATTORNEY'S FEES ON STOCKHOLDER WHO VIOLATES EXCLUSIVE FORUM PROVISION

In *Solak v. Sarowitz*, 2016 WL 7468070 (Del. Ch. Dec. 27, 2016), the Delaware Court of Chancery issued the first decision interpreting recent amendments to Section 109(b) of the DGCL banning "loser pays" or fee-shifting provisions in connection with a stockholder's assertion of an internal corporate claim. The court held that a bylaw that required a stockholder-plaintiff

to pay damages (i.e., a company's attorneys fees and costs) if the stockholder brought, and lost, an internal corporate claim in a forum other than Delaware in violation of the company's exclusive forum bylaw violated Section 109(b)'s ban on bylaws that shift fees "in connection with" an internal corporate claim.

History of Exclusive Forum Provisions

In 2013, the Court of Chancery, in *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*, 73 A.3d 934 (Del. Ch. 2013), held that boards of directors of Delaware corporations may adopt exclusive forum bylaws that are binding on stockholders. The court addressed the validity of the bylaws under the DGCL, as well as the question of whether bylaws enacted by a board of directors without stockholder involvement can be enforced, as a contractual matter, against stockholder plaintiffs.

The court made two primary holdings. First, Section 109(b) of the DGCL permits an exclusive forum selection bylaw because it allows a corporation's bylaws to "contain any provision, not inconsistent with law or with the certificate of incorporation, relating to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors, officers, or employees." The court held that forum selection bylaws "easily meet these requirements." Second, forum selection provisions are enforceable against stockholder plaintiffs, even though the bylaws were board-enacted, because bylaws are part of a flexible contractual relationship between stockholders and a corporation. Based on the certificate of incorporation, stockholders understand whether a particular board of directors has the power to enact bylaws. If the certificate of incorporation grants a board the power to unilaterally amend the corporation's bylaws, as permitted by Section 109(a), then the board may enact bylaws and thereby unilaterally alter the flexible contract.

The *Chevron* case upheld as facially valid a bylaw that provided for exclusive jurisdiction in Delaware, but in a 2014 case involving a Delaware corporation – *City of Providence v. First Citizens Bancshares, Inc., et al.*, 99 A.3d 229 (Del. Ch. 2014) – the company's bylaw provided for exclusive jurisdiction in the United States District Court for the Eastern District of North Carolina or, if that Court lacks jurisdiction, any North Carolina state court with jurisdiction. Nonetheless, the court upheld the bylaw based on the same rationale in *Chevron* and dismissed the case.

The Delaware case law was important, but it was when the company and management faced lawsuits in other states that they really needed the exclusive forum provisions to be enforced, which required non-Delaware courts to accept their validity and enforce them. One court refused to enforce an exclusive forum provision. In *Roberts v. TriQuint Semiconductor*, 2014 WL 4147465 (Cir. Ct. Or. Aug. 14, 2014), reversed, 364 P.3d 328 (Ore. 2015) an Oregon court refused to enforce a forum selection bylaw adopted at the same time as the merger agreement being challenged by stockholders because of "the closeness of the timing of the bylaw amendment to the board's alleged wrongdoing, coupled with the fact that the board enacted the bylaw in anticipation of this exact lawsuit." Questions surrounding validity and enforcement of exclusive forum provisions led to a legislative change, discussed below.

History of Fee-Shifting Provisions

In *ATP Tour, Inc. et al. v. Deutscher Tennis Bund et al.*, 91 A.3d 554 (Del. 2014), the Delaware Supreme Court, sitting en banc, held that a Delaware corporate bylaw that requires a losing claimant to pay the legal fees and expenses of the defendants is not invalid per se, and if otherwise enforceable can be enforced against losing claimants whether or not they were already stockholders when the relevant bylaw provision was adopted.

In 2006, the board of directors of ATP Tour, Inc. a Delaware non-stock (also known as a membership) corporation adopted a bylaw providing that if any member or members brought or supported a claim against the corporation or any other member, the claimant would then be obligated (and if more than one claimant, jointly and severally obligated) to pay the legal fees and expenses of those against whom the claim was brought if the claimant "does not obtain a judgment on the merits that substantially achieves, in substance and amount, the full remedy sought..." Members of ATP Tour, Inc. filed claims against the corporation and the board. A federal district court, having found for the defendants on all counts, certified to the Delaware Supreme Court the question of the validity of the fee-shifting provision.

Citing Section 109(b) of the DGCL for the baseline rule that the bylaws may contain any provision not inconsistent with law or the corporation's certificate of incorporation, the court noted that bylaws are presumptively valid and that a bylaw that "allocated risk among parties in intra-corporate litigation would appear to satisfy the DGCL's requirement that bylaws 'must relat[e] to the business of the corporation, the conduct of its affairs, and its rights and powers or the rights and powers of its stockholders, directors, officers or employees.'" Although the corporation in that case was a non-stock corporation, the analysis is applicable to stock corporations and non-stock corporations alike, with the members of non-stock corporations being analogous to stockholders.

The Court held that no principle of common law prohibits directors from enacting fee-shifting bylaws and that because contracting parties may modify the "American Rule" under which litigants pay their own costs to provide that "loser pays," a fee-shifting bylaw (bylaws being "contracts among a corporation's shareholders") would be a permissible contractual exception to the American Rule. The court noted further that an intent to deter litigation, as a fee-shifting provision inherently does, was not invariably an improper purpose.

The Court did note, however, that the enforceability of such a bylaw provision would depend on the manner in which it was adopted and the circumstances under which it was invoked, and that "[b]ylaws that may otherwise be facially valid will not be enforced if adopted or used for an inequitable purpose."

After *ATP*, many corporations adopted fee-shifting bylaw provisions. Others adopted a wait and see approach because of legislative initiatives in Delaware.

Legislation

The 2015 Amendments to the DGCL made several changes affecting corporations' efforts to curtail shareholder litigation:

As to exclusive forum provisions, a new Section 115 was added to expressly permit a corporation to adopt a provision in its charter or bylaws that requires internal corporate claims to be brought exclusively in "any or all of the courts" in Delaware. Corporations can select another jurisdiction; however, Section 115 also prohibits a corporation from selecting a non-Delaware jurisdiction (or an arbitral forum) as the *exclusive* forum for deciding internal corporate claims.

As to fee-shifting provisions, a new Section 102(f) was added and Section 109(b) was amended to prohibit stock corporations from adopting "loser-pays" fee-shifting charter or bylaw provisions for certain types of stockholder litigation and other intra-corporate disputes. Under the new provisions, neither the charter nor the bylaws can include a provision that would impose liability on a stockholder for attorneys' fees or expenses of the corporation (or any other party) in connection with "internal corporate claims," which Section 115 defines as any claim (including a derivative claim brought in the right of the corporation): (i) that is based on a violation of a duty by any person in his or her capacity as a current or former director, officer or stockholder, or (ii) for which the DGCL vests the Delaware Court of Chancery with the jurisdiction to decide. Agreements on fee-shifting signed by individual stockholders are not prohibited. An amendment to Section 114(b) provides that the ban on fee-shifting provisions does not apply to non-stock memberships corporations.

Solak v. Sarowitz

In *Solak*, the Court of Chancery applied newly-amended Section 109(b) to a bylaw adopted by Paylocity Holding Corporation (Section 8.2) that required the stockholder plaintiff to pay damages, including attorneys' fees and costs, if she lost a lawsuit brought in violation of Paylocity's exclusive forum bylaw (Section 8.1), which cabined litigation of all internal corporate claims to Delaware.

The plaintiff, a stockholder of Paylocity, brought claims against Paylocity seeking a declaratory judgment that Section 8.2 of Paylocity's bylaws was invalid under Section 109(b), as well as under Section 102(b)(6), which states that, unless provided in the certificate of incorporation, a company cannot require stockholders to pay the debts of a company. The plaintiff also brought a claim against Paylocity's board of directors for breach

of fiduciary duty, for enacting a bylaw in violation of the DGCL. The plaintiff explained that he had no intention of violating Paylocity's exclusive forum bylaw, but nonetheless sought a declaration that Section 8.2 is facially invalid.

The court's opinion first concluded that the dispute was ripe, even absent the plaintiff's intent to violate Paylocity's exclusive forum bylaw because, in the court's view, failure to rule "would mean, as a practical matter, that its validity under the DGCL would never be subject to judicial review" because of the deterrent effect. The court also noted that, "[d]eclining review of the fee shifting bylaw also could encourage other corporate boards to adopt similar bylaws to take advantage of their potent deterrent effect on stockholders without regard to whether such provisions are legally permissible."

The court dismissed, with prejudice, all breach of fiduciary duty claims against the company's directors. In its ruling, the court held that "the Complaint contains no factual allegations calling into question the independence of any of the individual defendants, or suggesting that any of them had a personal or financial interest" or "that they acted in bad faith."

The court also rejected the plaintiff's claim that the company's bylaw was an unlawful attempt to make stockholders pay the company's legal debts in violation of Section 102(b)(6) of the DGCL. The court explained that the plaintiff had the burden of demonstrating that Section 8.2 of Paylocity's bylaws was invalid on its face, which required the plaintiff to demonstrate that it was invalid under any circumstances. With respect to Section 102(b)(6), the plaintiff failed to provide any authority as to the interpretation of the word "debts" as used in Section 102(b)(6). In addition, the plaintiff failed to demonstrate that Section 8.2 violated Section 102(b)(6) because that section contains an exception for liability "by reason of [a stockholder's] own conduct or acts." 8 Del. C. § 102(b)(6).

On the question of whether the company's bylaw violated Section 109(b), the court stated: "I do not intend to suggest that a stockholder who files an internal corporate claim outside Delaware in blatant violation of a plainly-valid forum-selection bylaw would suffer a detriment from being compelled to litigate in the mandated forum, nor should such behavior be condoned." The court continued: "To the contrary, stockholders are expected to play by the rules of the company in which they chose to invest." Nonetheless, the court concluded that it was constrained by "the plain text" of the statute passed by the Delaware Legislature to ban bylaws that shift fees "in connection with" internal corporate claims and that the language the Legislature used placed a "blanket prohibition" on any provision shifting fees, even ones to merely enforce a forum-selection bylaw.

The court rejected an argument by the defendants that Section 109(b) did not speak to the question of displacing the common

law with respect to damages for violating a forum selection clause, as recognized by the Delaware Supreme Court in *El Paso Natural Gas Co. v. TransAmerican Natural Gas Corp.*, 669 A.2d 36 (Del. 1995). The court explained that *El Paso* was a case about damages for breach of a forum selection clause in a contract, not a bylaw, and because Section 109(b) carves out private contracts from its prohibition, *El Paso* was distinguishable.

The court also rejected the argument that because Section 115 was added to the DGCL at the same time Section 109(b) was

amended, that demonstrated the legislature's desire to permit enforcement of Section 115. The court explained that, because Section 109(b) did not distinguish between claims brought in Delaware or outside of Delaware, Section 109(b) prohibited "'any provision' that would shift fees 'in connection with an internal corporate claim' without regard to where such a claim is filed." The court therefore concluded that the plaintiff had met his burden of demonstrating that Section 8.2 is invalid on its face. An appeal by Paylocity to the Delaware Supreme Court is expected.

Takeaways

- Under *Solak*, the Court of Chancery gave Section 109(b) a broad reading, which eliminated not just one common law right (i.e., to have a fee-shifting bylaw that changes the "American Rule"), but a second common law right (i.e., the right to damages for breach of a forum selection clause). The court did so without looking behind the plain words of Section 109(b) to determine the legislative intent, because it felt constrained by the plain text of Section 109(b) and its use of the phrases "any" claim "in connection with an internal corporate claim." However, Section 109(b) is a statute in derogation of the common law and statutes in derogation of the common law are to be strictly, not broadly, construed. Paylocity's bylaw does not impose liability on a stockholder "in connection with" litigating and losing a corporate claim. The bylaw imposes liability in connection with a violation of the exclusive forum provision adopted pursuant to the express authority granted by Section 115 of the DGCL. Paylocity's bylaw does not deter the assertion of internal corporate claims because those claims can be brought in Delaware without fear of fee-shifting, no matter how badly the stockholder-plaintiff may lose.
- The court's decision casts a cloud over any company's ability not just to enforce a forum selection provision via a bylaw, but also to enforce a forum selection provision at common law by seeking damages. Whether the Delaware Supreme Court will agree with the Court of Chancery's view of Section 109(b) is an open question.
- While the 2015 amendments also purport to ban a Delaware corporation from selecting arbitration as an exclusive forum, mandatory arbitration for corporate governance disputes may nonetheless be the next challenge. One could argue that certain actions expressly permitted by the DGCL should be excluded – e.g., Section 211 (annual meetings), Section 220 (books and records), Section 225 (votes and elections) and Section 262 (appraisal) actions – because the DGCL authorizes them without condition, but the rationale for exempting even these actions from a validly adopted charter or bylaw provision is not clear if a charter provision explicitly states that the provision is being adopted pursuant to the Federal Arbitration Act. An argument could be made that the Delaware amendment may be preempted under such circumstances, leaving it as an issue to be resolved by federal litigation.
- While a "loser pays" system is now banned in Delaware, in 2014, Oklahoma became the first state to adopt a law mandating fee shifting in stockholder derivative suits. Of course, fee-shifting provisions were never one-sided because if the corporation loses, it pays plaintiff's counsel. That is the current state of the law. The question now is this: are there other solutions to dealing with the problem? What about charter or bylaw provisions that expressly impose the American Rule on both sides – i.e., each side bears their own costs – that eliminates *special* treatment for stockholders? What about a provision that limits the plaintiff's fees to actual time incurred or imposes a cap of no more than two times the actual time incurred? What about a financial litmus test for plaintiffs? What about no fees, or at least no premium or actual time, unless the plaintiff can demonstrate that he or she shopped around for the best deal available from counsel? The validity of charter or bylaw provisions that prohibit fee shifting at all or limit fees in some way are potential issues yet to be addressed by either the Delaware courts or the Delaware General Assembly.



DELAWARE COURTS CLAMP DOWN ON DISCLOSURE-ONLY SETTLEMENTS AND PROPOSE NEW FRAMEWORK

Throughout 2016, the Delaware Court of Chancery continued its trend of closely scrutinizing disclosure-only settlements in class action merger litigation, questioning the broad releases provided to defendants in exchange for supplemental disclosures that provide little (if any) benefit to the class.

This trend began in 2014, with the Court of Chancery rejecting disclosure-only settlements on at least three separate occasions, including one decision by then-Chancellor (now Chief Justice) Strine. See *In re Medicis Pharm. Corp. S'holders Litig.*, C.A. No. 7857-CS (Del. Ch. Feb. 26, 2014) (TRANSCRIPT); *Rubin v. Obagi Medical Products, Inc., et al.*, C.A. No. 8433-VCL (Del. Ch. Apr. 30, 2015) (TRANSCRIPT); *In re Theragenics Corp. S'holders Litig.*, C.A. No. 8790-VCL (Del. May 5, 2014) (TRANSCRIPT). In 2015, the Court rejected proposed settlements altogether. See e.g., *Acevedo v. Aeroflex Holding Corp.*, C.A. No. 7930-VCL (Del. Ch. July 8, 2015) (TRANSCRIPT); *In re Riverbed Tech., Inc. S'holders Litig.*, 2015 WL 5458041 (Del. Ch. Sept. 17, 2015); and *In re Aruba Networks,*

Inc. S'holders Litig., C.A. No. 10765-VCL (Del. Ch. Oct. 9, 2015) (TRANSCRIPT).

In the aftermath of the court's rulings in 2014 and 2015, several plaintiffs also voluntarily withdrew proposed disclosure-only settlements and/or requested the dismissal of their claims. See *Berk v. Covance Inc.*, C.A. No. 10440-VCL; *In re Advent Software, Inc. S'holders Litig.*, C.A. No. 10623-VCL; *In re Orbitz Worldwide, Inc. S'holders Litig.*, C.A. No. 10711-VCMR; and *In re Procera Networks, Inc.*, C.A. No. 10951-VCL. In the *Orbitz* case, however, plaintiffs subsequently withdrew their proposed order dismissing the case.

During the annual meeting of the ABA Business Law Section in late 2015, Vice Chancellor J. Travis Laster echoed the well-known concerns regarding the proliferation of merger litigation, noting "we are now dealing with an epidemic. When dealing with an epidemic you have to come back and look at your system." He further foreshadowed an impending change in dealing with disclosure-only settlements: "We are going in a different direction. What has been enough is no longer enough."

In re Trulia, Inc. Shareholder Litigation

This systemic change was articulated in a landmark opinion by Chancellor Andre G. Bouchard in *In re Trulia, Inc. S'holder Litig.*, 129 A.3d 884 (Del. Ch. 2016), where the court rejected a proposed settlement and set forth a new proposed framework for analyzing disclosure claims in the future (discussed further below) and warned litigants of “increasingly vigilant” scrutiny of such claims. As explained by Chancellor Bouchard, “to the extent that litigants continue to pursue disclosure-only settlements, they can expect that the Court will be increasingly vigilant in scrutinizing the ‘give’ and the ‘get’ of such settlements to ensure that they are genuinely fair and reasonable to the absent class members.”

In *Trulia*, Chancellor Bouchard refused to approve a proposed settlement arising from Zillow, Inc.’s acquisition of Trulia based solely on supplemental disclosures. More importantly for practitioners, however, the court offered its “perspective that disclosure claims arising in deal litigation optimally should be adjudicated outside of the context of a proposed settlement so that the court’s consideration of the merits of the disclosure claims can occur in an adversarial process without the defendants’ desire to obtain an often overly broad release hanging in the balance.” The Court suggested that such adjudication could occur either through a preliminary injunction motion or through plaintiffs’ counsel’s application for an award of attorneys’ fees after defendants supplement their proxy materials with additional disclosures.

The supplemental disclosures at issue in *Trulia* involved the all-too-typical complaint of plaintiff stockholders regarding the information disclosed relating to a financial advisor’s analysis. The court noted that “[t]he essence of a fair summary is not a cornucopia of financial data, but rather an accurate description of the advisor’s methodology and key assumptions. In my view, disclosures that provide extraneous details do not contribute to a fair summary and do not add value for stockholders.” After reviewing the disclosures already contained in the proxy statement, including a 10-page summary of Trulia’s financial advisor’s work, the court held that the disclosures were not “material or even helpful to Trulia’s stockholders.” The court rejected the settlement because “from the perspective of Trulia’s stockholders, the ‘get’ in the form of the Supplemental Disclosures does not provide adequate consideration to warrant the ‘give’ of providing a release of claims to defendants and their affiliates, in the form submitted or otherwise.”

The more important aspect of the opinion was the court’s suggestions of how to address the well-known concerns about deal litigation in general, including that “far too often such litigation serves no useful purpose for stockholders,” but “serves only to generate fees for certain lawyers who are regular players in the enterprise of routinely filing hastily drafted complaints on behalf of stockholders on the heels of the public announcement of a deal and settling quickly on terms that yield no monetary compensation

to the stockholders they represent.” The court acknowledged the current litigation dynamic, with “the threat of an injunction to prevent a transaction from closing” incentivizing defendants to obtain deal protection through broad releases of claims. The court noted that this system had resulted in 94.9 percent of transactions of \$100 million or more in 2014 generating lawsuits, and therefore, the system was in need of reexamination.

The court also observed that “the optimal means by which disclosure claims in deal litigation should be adjudicated is outside the context of a proposed settlement,” and offered two proposals for such adjudication. First, disclosure claims could be judicially reviewed in the context of a preliminary injunction motion, “in which case the adversarial process would remain intact and plaintiffs would have the burden to demonstrate on the merits a reasonable likelihood of proving that the alleged omission or misrepresentation is material.” Second, plaintiffs’ counsel could apply for attorneys’ fees “after defendants voluntarily decide to supplement their proxy materials by making one or more of the disclosures sought by plaintiffs, thereby mooted some or all of their claims. In that scenario, securing a release is no longer an issue, so defendants are incentivized to oppose fee requests they view as excessive.” And if defendants do not oppose an application for a mootness fee, “the Court would have some indication of the reasonableness of the fee request.” Defendants would not receive a release from a mootness dismissal, but “the filing of a stipulation of dismissal likely represents the end of fiduciary challenges over the transaction as a practical matter.”

Chancellor Bouchard further warned that “practitioners should expect that the Court will continue to be increasingly vigilant in applying its independent judgment to its case-by-case assessment of the reasonableness of the ‘give’ and the ‘get’ of such settlements in light of the concerns discussed above.” Disclosure-only settlements will not be approved unless the supplemental disclosures are truly meaningful and the proposed release of claims is sufficiently narrow:

To be more specific, practitioners should expect that disclosure settlements are likely to be met with continued disfavor in the future unless the supplemental disclosures address a plainly material misrepresentation or omission, and the subject matter of the proposed release is narrowly circumscribed to encompass nothing more than disclosure claims and fiduciary duty claims concerning the sale process, if the record shows that such claims have been investigated sufficiently. In using the term “plainly material,” I mean that it should not be a close call that the supplemental information is material as that term is defined under Delaware law.

The court also suggested that, “[w]here the supplemental information is not plainly material, it may be appropriate for

the Court to appoint an amicus curiae to assist the Court in its evaluation of the alleged benefits of the supplemental disclosures, given the challenges posed by the non-adversarial nature of the typical disclosure settlement hearing.”

With this new structure for addressing disclosure claims, the court acknowledged that plaintiffs’ counsel may be more inclined to file such claims in other forums in hopes of finding courts more likely

to sign-off on such settlements. The court noted that corporations could address this issue by enacting exclusive forum provisions in their bylaws. Moreover, the court opined that the “historical predisposition that has been shown towards approving disclosure settlements must evolve” and the court expressed “hope and trust that our sister courts will reach the same conclusion if confronted with the issue.”

Takeaways

- The Court of Chancery has made clear that the rules of the game have changed – corporations can no longer expect to obtain global releases of all claims arising out of merger transactions for disclosure-only settlements.
- The Court of Chancery’s heightened scrutiny appears to be curbing the number of meritless lawsuits. According to a recent study, in 2015, 84 percent of M&A deals valued over \$100 million had associated litigation. Plaintiffs filed lawsuits relating to a total of 174 M&A deals in that year. By contrast, in the first half of 2016, plaintiffs challenged only 47 M&A deals, and only 64 percent of M&A deals valued over \$100 million. Further, for the first three quarters of 2015, 61 percent of deal litigation was filed in Delaware. That number declined to just 26 percent for the fourth quarter of 2015 and the first half of 2016.
- Companies will continue to be creative in their quest to obtain global releases and attendant deal protection. Exclusive forum clauses can be crafted to be waivable by a company. Whether companies will waive exclusive forum clauses to achieve a global release in another forum may turn upon whether other jurisdictions agree that the historical practice of approving disclosure-only settlements must evolve. Another possible strategy is to enter into relatively cheap cash settlements with plaintiffs, of which plaintiffs’ counsel recover up to a third of fees, in exchange for the broad releases that companies’ crave. Given that most deals are in the hundreds of millions or billions, such fees amount to little more than a rounding error and a small price to pay to achieve deal certainty.
- The US Court of Appeals for the Seventh Circuit in *In re Walgreen Co. Stockholder Litigation*, 832 F. 3d 718 (7th Cir. 2016) has cited *Trulia* favorably and refused to approve a disclosure-only settlement. In *Walgreen*, Judge Posner, writing for the court, specifically deferred to Delaware’s view on disclosure-only settlements, noting Delaware’s unique experience in dealing with large public company settlements and litigation.



DELAWARE COURTS PRECLUDE LITIGATION OF DERIVATIVE CLAIMS BASED ON PRIOR DISMISSAL BY OTHER COURTS FOR FAILURE TO ADEQUATELY PLEAD “DEMAND FUTILITY”

In two cases in 2016, the Delaware Court of Chancery dismissed stockholder derivative actions on preclusion grounds because a derivative action in another state, challenging the same conduct, had been dismissed for failure to plead demand futility.

In re Wal-Mart Stores, Inc. Delaware Derivative Litigation

In *In re Wal-Mart Stores, Inc. Delaware Derivative Litigation*, 2016 WL 2908344 (Del. Ch. May 13, 2016) (Chancellor Andre G. Bouchard), the Delaware Court of Chancery dismissed a stockholder derivative suit brought in response to the “Wal-Mex” bribery scandal, holding that a prior dismissal of a similar stockholder suit in Arkansas precluded the Delaware case from going forward.

Background

Following an April 2012 *New York Times* exposé reporting on the alleged bribery scheme at Wal-Mart’s Mexican subsidiary (Wal-Mart de Mexico), and its cover-up, Wal-Mart stockholders filed 15 derivative lawsuits in Arkansas and Delaware. As multi-forum litigation often goes, the Delaware and Arkansas plaintiffs pursued different litigation strategies. Specifically, after their cases were consolidated, the Delaware plaintiffs separately brought a books and records action under Section 220 of the DGCL, seeking documents supporting their claims of mismanagement. After several years of litigation, in May 2015, the Delaware plaintiffs filed an amended complaint with information obtained in the Section 220 action. The Arkansas plaintiffs, for their part, neither sought records from Wal-Mart nor waited for the

conclusion of the Delaware books-and-records litigation, and in March 2015, the district court in Arkansas dismissed plaintiffs' claims against Wal-Mart, concluding that the plaintiffs had failed to adequately allege demand futility under Delaware law, and specifically under *Rales v. Blasband*, 634 A.2d 927 (Del. 1993). In June 2015, Wal-Mart moved to dismiss the Delaware action on the basis that the Arkansas court's dismissal precluded the Delaware plaintiffs from further litigating the issue of demand futility in Delaware.

The Court of Chancery's Decision

Applying Arkansas law, which the parties agreed applied in deciding the motion to dismiss in Delaware, the Court of Chancery concluded that the Delaware plaintiffs were precluded from litigating the issue of demand futility. As an initial matter, the parties also agreed that the demand futility issue was determined by a valid and final judgment in Arkansas, and that the Arkansas court's determination was essential to its judgment. Thus, the Court of Chancery focused only on the remaining elements in determining whether issue preclusion applied: that is, whether the issue sought to be precluded was the same as the issue in the prior litigation, whether the issue was actually litigated, and that the parties to be precluded must have been parties in the prior litigation, or in privity with them, and must have been adequately represented in the prior suit. In assessing these elements, the Court of Chancery determined the following:

1. The issue to be precluded was the same. Although the Arkansas and Delaware complaints raise differing factual details, because they both focused on whether the board of directors could exercise valid business judgment in determining whether to initiate litigation against the director defendants for their involvement in the bribery scheme, the inclusion of additional factual details did not affect whether an underlying issue was identical.
2. The demand futility issue was actually litigated. The Delaware plaintiffs contended that the issue was not actually litigated because certain deficiencies in the Arkansas complaint led the court to apply the *Rales* demand futility test when it should have applied *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984). The Court of Chancery rejected this argument, as the Arkansas court fully addressed, and the Arkansas plaintiffs had the opportunity to be heard as to, which demand futility test should apply. In addition, because the inquiries of the two tests are so similar, the Court of Chancery concluded that the Arkansas court's decision to apply *Rales* instead of *Aronson* was of no "substantive consequence."
3. The Delaware and Arkansas plaintiffs were in privity. Noting that although the Arkansas courts had not decided the issue

of whether privity existed between different stockholder plaintiffs, the Court of Chancery concluded that the Arkansas courts likely would find privity element was satisfied. The court's conclusion was based on the fact that a majority of decisions in other jurisdictions have found privity between different stockholder plaintiffs on the basis that the corporation is the real party in interest in both actions, which the Arkansas Supreme Court has recognized in other contexts, and the fact that other authorities (such as the *Restatement*) and public policy are inconclusive on the issue.

4. The Arkansas plaintiffs were adequate representatives. The Delaware plaintiffs attacked the adequacy of the Arkansas plaintiffs' representation primarily on the basis that the Arkansas plaintiffs were "fast-filers," that is, they pursued the Arkansas litigation without first obtaining Wal-Mart's books and records, a litigation strategy often admonished in Delaware. The court rejected this argument, because taken to its "logical extreme," the court noted, would render inadequate any plaintiff stockholder who did not first seek books and records, a presumption expressly rejected by the Delaware Supreme Court in *Pyott v. Louisiana Municipal Police Employees' Retirement System*, 74 A.3d 612 (Del. 2013). The court noted it had no reason to think that Arkansas courts would reach a different conclusion. Substantively, after reviewing the allegations in the Arkansas complaint, the court concluded that plaintiff's failure to first seek books and record, although ill-advised, was not "so grossly deficient as to render them inadequate representatives."

Delaware Supreme Court Remand

On January 18, 2017, the Delaware Supreme Court (C.A. No. 295, 2016) remanded the case for the Court of Chancery to consider closely the question of whether the Delaware plaintiff's due process rights were violated by concluding that they were collaterally estopped by the Arkansas court's dismissal. The Delaware Supreme Court explained that the Delaware plaintiffs made a more "refined argument as to Due Process" on appeal than they did before the Court of Chancery. In doing so, the Delaware plaintiffs relied heavily on Vice Chancellor Laster's opinion in *In re EZCORP Inc. Consulting Agreement Deriv. Litig.*, 130 A.3d 934 (Del. Ch. 2016), which was decided during the pendency of motion to dismiss. In *EZCORP*, Vice Chancellor Laster relied on the United States Supreme Court case of *Smith v. Bayer Corp.*, 564 U.S. 299 (2011) to hold that in a derivative case, as a matter of due process, "privity does not attach unless and until a derivative plaintiff survives a motion to dismiss."

The Delaware Supreme Court instructed the parties and the Court of Chancery to answer the following question: "In a situation where dismissal by the federal court in Arkansas of

a stockholder plaintiff's derivative action for failure to plead demand futility is held by the Delaware Court of Chancery to preclude subsequent stockholders from pursuing derivative litigation, have the subsequent stockholders' Due Process rights been violated? See *Smith v. Bayer Corp.*, 564 U.S. 299 (2011)." (Order at 18.) The Delaware Supreme Court was clearly troubled by the outcome for the Delaware plaintiffs who had followed the Court's advice to use the "tools at hand" and requested the company's books and records before filing in Delaware. The closer due process analysis, and a ruling consistent with *EZCORP*, would likely reverse the outcome for the Delaware plaintiffs and avoid an incentive for plaintiffs not to follow the court's advice regarding pre-suit books and records requests.

Laborers' District Council Construction Industry Pension Fund v. Bensoussan

Shortly after issuing the *Wal-Mart* opinion, Chancellor Bouchard issued his decision in *Laborers' District Council Construction Industry Pension Fund v. Bensoussan*, 2016 WL 3407708 (Del. Ch. June 14, 2016), in which the court dismissed claims against lululemon athletica inc. and several of its directors and officers, as a result of a prior dismissal of similar claims by a federal district court in New York.

In short, applying New York issue preclusion law, the Chancellor concluded that the Delaware plaintiffs' claims were barred because they had asserted theories of liability underlying their demand futility arguments that were similar to the positions maintained in the New York action, and thus the New York court adjudicated the same issues being litigated in the Court of Chancery. It was of no moment, the court concluded, that the New York plaintiffs had asserted additional claims not also being asserted in the Delaware action and that the New York plaintiffs included in their complaint many pages of allegations not being advanced in Delaware.

The Chancellor additionally noted that the Delaware plaintiffs had a full and fair opportunity to litigate in the New York action, as they had attempted to intervene there in order to curb the New York litigation until the Delaware plaintiffs could obtain books and records from lululemon. Finally, invoking the *Pyott* decision (discussed above), the court declined to find that the varying plaintiffs lacked privity solely on the basis that the New York plaintiffs were inadequate representatives because they failed to obtain books and records before bringing their derivative claims: "Although *Pyott* was not decided as a matter of New York law, plaintiffs have not cited any authority suggesting that a New York court would conduct a different analysis, and I have no reason to think otherwise."

Takeaways

- The overarching posture of these cases emphasizes the importance (for both defendants and plaintiffs) of adopting exclusive forum bylaws or charter provisions. Here, both *Wal-Mart* and *lululemon athletica* were forced to litigate the same issues in separate forums, exposing the companies to increased costs and potentially varying outcomes. In addition, the stockholders who pursued the more prudential approach of first seeking books and records were stuck with non-coordinating stockholders' litigation decisions.
- As required by the Delaware Supreme Court in *Pyott*, the Court of Chancery will adhere strictly to the law of the forum state in determining whether a Delaware stockholder plaintiff should be precluded from proceeding following the dismissal of a similar action in another state.
- Unless the forum state's courts reject the Delaware Supreme Court's decision in *Pyott*, and in particular the high court's rejection of the fast-filer presumption, Delaware courts likely will continue to reject the proposition that a stockholder plaintiff per se inadequately represents the interests of the company solely by failing to seek books and records before advancing derivative claims.



IN RARE REVERSAL, THE DELAWARE SUPREME COURT OVERTURNS DISMISSAL BASED ON FAILURE TO PLEAD DEMAND FUTILITY

In *Sandys v. Pincus*, 2016 WL 7094027 (Del. Dec. 5, 2016), the Delaware Supreme Court reversed the Court of Chancery's dismissal of a stockholder derivative suit, concluding that the Court of Chancery erred in finding that the plaintiff failed to adequately plead demand futility.

Background

The complaint alleged that Zynga's CEO, chairman, and controlling stockholder Mark Pincus, as well as other managers and directors at Zynga, were provided an exemption from Zynga's own company rule regarding insider sales of stock. That rule only permitted such sales to commence starting three days following an earnings announcement. Pincus and others used the exemption to sell 20.3 million shares of stock at \$12/share for \$236 million. After the earnings announcement, the market price of Zynga dropped to \$8.52. The market price subsequently dropped to \$3.18 three months later after further negative news.

The complaint alleged two derivative claims. First, the insiders who sold their shares breached their fiduciary duties for misusing confidential information. Second, the directors who approved the exemption for the sale of those shares breached their duty of loyalty. The defendants moved to dismiss the complaint under Court of Chancery Rule 23.1 for failure to make a pre-suit demand and for failure to adequately plead demand futility under *Rales v. Blasband*, 634 A.2d 927 (Del. 1993).

The Court of Chancery's Decision

There were nine directors on the board of Zynga (Mark Pincus, Reid Hoffman, Jeffrey Katzenberg, Stanley J. Meresman, William Gordon, John Doerr, Ellen Siminoff, Sunil Paul and Don Mattrick), and the Court of Chancery concluded that only two of those directors, Pincus and Hoffman, who both participated in the sale of securities, were interested and therefore could not impartially consider a demand. The Court of Chancery then considered

the independence of five other directors and concluded that all were independent. The Court of Chancery did not analyze the independence of the other two directors, one of which, Mattrick, had replaced Pincus as CEO at the time the complaint was filed.

The Delaware Supreme Court's Decision

A majority of the Delaware Supreme Court agreed that Pincus and Hoffman were interested. The Supreme Court also concluded that Mattrick was interested, as CEO, because Zynga's controlling stockholder Pincus was interested in the transaction. The Supreme Court disagreed with the Court of Chancery regarding the independence of Siminoff, Doerr, and Gordon.

With respect to Siminoff, the Supreme Court focused on his co-ownership of a private plane with the Pincuses. This, the Supreme Court explained, was evidence of an "extremely close" relationship and that the Pincuses and Siminoffs are "among each other's most important and intimate friends." This suggestion of such a close relationship resulted in a "reasonable doubt" as to Siminoff's impartiality.

With respect to Gordon and Doerr, the Supreme Court focused on several factors. To start with, both were partners at Kleiner Perkins Caufield & Byers, which controlled about 9.2 percent of Zynga's equity. That same firm was also an investor in a company Pincus's wife co-founded. There was also a connection to Hoffman, as Kleiner had an investment in a company where Hoffman served on the board. Lastly, the Supreme Court found persuasive the fact that the Zynga board itself determined that Gordon and Doerr were not independent directors under the NASDAQ Listing Rules. Although there were no facts adduced as to why the Zynga board concluded Gordon and Doerr were not independent, the Supreme Court nonetheless concluded that, even though there is a presumption of independence of directors, dismissing a derivative suit on demand excusal grounds when a company's own board does not believe certain directors are independent "creates cognitive dissonance that our jurisprudence should not ignore." The Supreme Court also rejected the argument that Pincus was actually beholden to Kleiner, not the other way around, because it was Kleiner that invested in Zynga. It stated that "the reality is that firms like Kleiner Perkins compete with others to finance talented entrepreneurs like Pincus, and networks arise of repeat players who cut each other into beneficial roles in various situations."

As to the lack of facts as to why the Zynga board concluded Gordon and Doerr were not independent, the Supreme Court was critical of the plaintiff's lack of diligence to gather those facts. Although the plaintiff did utilize a books and records request to gather information relating to the underlying transactions, it failed to request any information regarding the board's independence.

Having concluded that Mattrick, Siminoff, Doerr, and Gordon were not independent, the Supreme Court concluded that the plaintiff had satisfied his burden under *Rules* to demonstrate a reasonable doubt that a majority of the board was independent, and the Supreme Court reversed the Court of Chancery's dismissal.

Takeaways

- This was a rare case in which the Delaware Supreme Court reversed a dismissal for demand futility reasons. In doing so, the Supreme Court repeatedly explained that it was a close case. Indeed, the reversal garnered a rare dissent from Justice Valihura, which focused much more on the pure allegations in the complaint, rather than on the inferences that can be drawn from those allegations, which the Supreme Court clearly focused on.
- This was yet another case where the Supreme Court chastised a plaintiff for not using a books and records request properly to plead demand futility. The Supreme Court repeatedly stated that the plaintiff could have done a much better job pleading demand futility, and the Supreme Court would thus not have had to focus on the inferences from the pleaded facts.

DELAWARE SUPREME COURT FURTHER CLARIFIES THE *TOOLEY* DOCTRINE AND REVERSES \$171 MILLION JUDGEMENT

In *El Paso GP Co. L.L.C. v. Brinkerhoff*, ___ A.3d ___, 2016 WL 7380418 (Del. Dec. 20, 2016) the Delaware Supreme Court reversed a \$171 million verdict by the Court of Chancery, concluding that an intervening merger extinguished the plaintiff's standing to continue to pursue his claim that the company overpaid for certain assets.

Background

The lawsuit, which spanned five years, began when the plaintiff, a limited partner in El Paso Pipeline Partners, L.P., a publicly traded Delaware master limited partnership (MLP), filed two derivative complaints challenging a special committee's approval of two "dropdown" transactions based on breach of express and implied duties, tortious interference, unjust enrichment, and aiding and abetting. So-called dropdown transactions occur when a corporation "sponsors" an MLP with assets, which in turn issues public securities to maximize market value, and then the corporate sponsor sells additional assets to the MLP in "dropdowns." After summary judgment proceedings in the Court of Chancery, the only remaining claim was against the MLP's general partner for breach of the limited partnership agreement (LPA) when the general partner caused the MLP to overpay for assets in one of the dropdowns. The Court of Chancery held a trial on plaintiff's remaining claim, but shortly thereafter the MLP merged with Kinder Morgan, Inc., and defendants moved to dismiss, arguing the merger extinguished plaintiff's derivative standing.

The Court of Chancery Decisions

In two separate decisions, the Court of Chancery held that: (1) the special committee breached the LPA when it approved one of the dropdowns because in doing so it "went through the motions" and "did not subjectively believe that approving the [transaction] was in the best interests of the [MLP]" — the standard required in the LPA — causing the MLP to suffer \$171 million damages; and (2) the merger did not extinguish plaintiff's derivative standing (and thus plaintiff could enforce the liability award) because the claim was not exclusively derivative.

As to the standing issue, the Court of Chancery concluded that plaintiff's claim was actually a direct claim because the direct/derivative test enunciated under *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031 (Del. 2004), does not apply to contract rights, and limited partners can sue directly to enforce contractual constraints in the LPA. The Court of Chancery also concluded that, in any event, under *Tooley* the plaintiff's

claim was "duel-natured." That is, under *Tooley*'s first prong (i.e., who suffered the harm alleged) both the MLP and the limited partners suffered from the overpayment: the MLP was harmed by overpaying and the limited partners suffered in the "reallocation" from the limited partners to the general partner (i.e., ultimately the sponsoring entity). In addition, the Court of Chancery concluded that under *Tooley*'s second prong (i.e., to whom recovery must flow), any recovery could go to either the MLP or the limited partnership, and allowed the limited partners a pro rata recovery.

The Delaware Supreme Court Reverses

In reversing the Court of Chancery's standing decision, the Delaware Supreme Court made several principal holdings. It first observed that the claim pursued by plaintiff was the MLP's claim: the LPA required only that the general partner (and special committee) to approve a transaction it believed was in the best interests of the MLP, not the limited partners. Next, the court concluded that in stating that *Tooley* does not apply where the alleged harm involves contract rights, the Court of Chancery read too broadly the decision in *NAF Holdings, LLC v. Li & Fung (Trading) Ltd.*, 118 A.3d 175 (Del. 2015), which merely held that a suit involving a party seeking to enforce its own rights under a commercial contract is not a derivative action in Delaware. Thus, the Court of Chancery improperly treated the LPA as a "separate commercial contract" instead of the "constitutive contract" of the MLP under the Delaware Revised Uniform Limited Partnership Act. The Supreme Court observed that treating the LPA as a separate commercial contract, and thus not subject to *Tooley*, would abrogate *Tooley* altogether as to alternative entities, as they are creatures of contract.

The Tooley Analysis

The Supreme Court held that under *Tooley*'s first prong, the MLP suffered the harm alleged. The court noted that plaintiff's "core" theory was that the MLP was injured when the defendants caused it to pay too much in the dropdown. Such overpayment claims, the court explained, "naturally assert that the corporation's funds have been wrongfully depleted, which, though harming the corporation directly, harms the stockholders only derivatively so far as their stock loses value." Indeed, at trial the plaintiff sought to prove how the MLP was harmed, and never presented evidence as to the limited partners' individual injury. And, after trial, the Court of Chancery concluded the overpayment left the MLP "\$171 million poorer." This, the Supreme Court noted, was a "classically derivative injury."

The court paused to note that in some unique circumstances claims may be recognized as “dual-natured” — having both direct and derivative characteristics. For example, the court previously held under *Gentile v. Rossette*, 906 A.2d 91 (Del. 2006), that claims challenging transactions can be dual-natured where a controlling stockholder causes the company to issue “excessive” shares in exchange for assets of lesser value from the controller, and the exchange causes an increase in the controller’s equity position and a corresponding decrease in the minority’s.

In *El Paso*, the Supreme Court explained that the plaintiff’s claims did not implicate *Gentile*: there was no transaction resulting in an “improper transfer of both economic value and voting power from the minority stockholders to the controller. Instead, the plaintiff claimed only that the MLP overpaid for certain assets and that sponsoring entity was unjustly enriched. The plaintiff argued that the fact that the economic expropriation was not coupled with a voting rights dilution was immaterial, but the court declined the “invitation to further expand the universe of claims that can be asserted ‘dually,’” as to do so on these facts would “largely swallow the rule that claims of corporate overpayment are derivative.”

As to the second prong under *Tooley*, the court concluded that any recovery by plaintiff was destined for the MLP. Not only did plaintiff seek full repayment to the MLP, but the “necessity of a *pro rata* recovery to remedy the alleged harm indicates that his claim is derivative” as well.

Chief Justice Strine’s Concurring Opinion

Chief Justice Strine joined the majority’s decision but wrote separately to express his view that *Gentile* was improperly decided and should be reversed, instead of simply cabined, as in the majority’s decision. In *Gentile*, court permitted stockholders to pursue their dilution claim directly on the theory that the diminution in their voting power gave rise to a direct injury. The Chief Justice noted that because the stockholders in that case were already in the minority (i.e., the company already was controlled), *Gentile* could be read to suggest that any time investors have less voting power after a dilutive transaction, a direct claim exists, turning traditional doctrine (that a claim alleging the company received too little value in exchange for shares is derivative in nature) on its head. Under *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986), Delaware law currently provides stockholders with the ability to assert a direct claim when a transaction shifts control from a diversified stockholder base to a single controller. The Chief Justice counseled that *Gentile* should be reversed at least “to the extent it allows for a direct claim in the dilution context when the issuance of stock does not involve subjecting an entity whose voting power was held by a diversified group of public equity holders to the control of a particular interests.”

Takeaways

- *El Paso* confirms both *Tooley* and the continuous ownership rule, borrowed from the corporation context, will continue to apply in the alternative entity context, including in instances where the plaintiff asserts a breach of duty claim under the operative governing instrument.
- The *Gentile* decision will not apply to overpayment claims not coupled with a corresponding decrease in the minority’s voting power. Further, given the Court’s and the Chief Justice’s concurring opinion, a more narrow reading of *Gentile* by the Court of Chancery should be expected.



“BENEFICIAL” HOLDER CANNOT PURSUE APPRAISAL RIGHTS IF “RECORD” HOLDER VOTES IN FAVOR OF MERGER

Section 262 of the DGCL requires that, for a stockholder to be entitled to appraisal rights, the stockholder of record must have “neither voted in favor of the merger or consolidation nor consented thereto in writing.” 8 Del. C. § 262(a). In *In re Appraisal of Dell Inc.*, 143 A.3d 20 (Del. Ch. 2016), the Delaware Court of Chancery concluded that fourteen mutual funds that were sponsored by T. Rowe Price & Associates Inc. were not entitled to appraisal of their shares because, unbeknownst to T. Rowe Price, those shares were voted in favor of the merger.

Background

The record holder of the shares at issue, Cede & Co., voted the shares in favor of the merger, therefore failing to satisfy Section 262(a)'s requirement. T. Rowe Price did not intend for the shares to be voted in favor of the merger, and had publicly opposed the

merger. At the actual meeting that approved the merger, Cede voted in favor as a result of a voting system implemented by Institutional Shareholder Services (ISS), which, absent instructions to the contrary, generates a default vote in favor of a merger if it is supported by the target's management such as Dell's merger.

The vote in favor was despite the fact that T. Rowe Price's instructions were, at one point, to override the default rule and vote against the merger. The vote on the merger was originally scheduled for July 18, 2013. The meeting was adjourned on July 18, 2013, and then adjourned several times thereafter. The special meeting was finally held on September 12, 2013. Before that meeting, the voting system used by ISS generated entirely new meeting records, which ignored prior instructions from T. Rowe Price and resulted in the default vote being used. As a result, T. Rowe Price's shares were voted by Cede in favor of the merger.

The Court's Decision

The court explained that Section 262 could be read as “all-or-nothing propositions” such that if a record holder of stock votes one share in favor of the merger, that means the record holder cannot exercise any appraisal rights, even as to shares that were not voted in favor of the merger. Nonetheless, the court noted that the Delaware Supreme Court recognized the reality that institutional investors and brokers may hold shares of record for many clients, and, accordingly, it has permitted record holders to split their vote and seek appraisal rights for the shares of beneficial holders whose shares were not voted in favor of the merger. Because there was evidence that Cede had voted T. Rowe Price's shares in favor of the merger, those shares were not entitled to appraisal.

In reaching that conclusion, the court distinguished several recent Court of Chancery cases involving “appraisal arbitrage.” The court began by outlining the basic requirements under Delaware law for appraisal:

Delaware cases uniformly place the burden of proof on the petitioner to demonstrate compliance with the requirements of the appraisal statute. The Dissenter Requirement is one of those requirements. It therefore might seem intuitive that to satisfy the Dissenter Requirement, a petitioner would bear the burden of proving that Cede, as record holder, had not voted the shares for which appraisal was sought in favor of the merger giving rise to appraisal rights. Two Delaware Supreme Court cases support that conclusion. See *Olivetti Underwood Corp. v. Jacques Coe & Co. (Olivetti II)*, 217 A.2d 683 (Del. 1966); *Reynolds Metals Co. v. Colonial Realty Corp. (Reynolds II)*, 190 A.2d 752 (Del. 1963).

In re Appraisal of Dell Inc., 143 A.3d 20, 36 (Del. Ch. 2016).

In more recent cases, however, and in seeming contradiction to the situation in *Dell*, the Court of Chancery declined to require a petitioner to make this showing, which the decisions helpfully labeled a “share-tracing requirement.” Those cases, labeled by the court as “Appraisal Arbitrage Decisions,” *In re Appraisal of Ancestry.com, Inc.*, 2015 WL 66825 (Del. Ch. Jan. 5, 2015); *Merion Capital LP v. BMC Software, Inc.*, 2015 WL 67586 (Del. Ch. Jan. 5, 2015); and *In re Appraisal of Transkaryotic Therapies, Inc.*, 2007 WL 1378345 (Del. Ch. May 2, 2007), all “involved situations where investors purchased shares in the open market after the record date for a merger for the purpose of pursuing appraisal.”

The *Dell* court described those cases as follows:

In none of the three cases was there evidence showing how the record holder voted the shares for which

appraisal was sought. To the contrary, in each case, the parties agreed that it was impossible for either side – the investors or the corporation – to show how Cede voted particular shares. Imposing a share-tracing requirement therefore implied that no stockholder who held through Cede could seek appraisal. Investors who bought after the record date would not be able to trace their shares to a prior beneficial owner with the legal authority to direct how the shares were voted. More broadly, investors who held on the record date would not be able to prove how Cede voted the shares for which appraisal was sought. As the parties presented it, a share-tracing requirement would foreclose street-name holders from seeking appraisal.

In re Appraisal of Dell Inc., 143 A.3d at 36–37. The court then distinguished those cases based on the fact that, in none of the Appraisal Arbitrage Decisions was there any evidence of how any of the shares demanding appraisal had actually been voted. It then provided a way to harmonize those cases with *Dell*:

The holdings of the Appraisal Arbitrage Decisions mean that a petitioner can establish a *prima facie* case that the Dissenter Requirement was met by showing that Cede held a sufficient number of shares that were not voted in favor of a merger to cover the appraisal class. At that point, the burden shifts to the respondent corporation to adduce evidence showing how Cede actually voted the shares for which appraisal was sought. If the corporation can rebut the petitioner's *prima facie* case and demonstrate that Cede actually voted the particular shares in favor of the merger, then the appraisal petitioner cannot satisfy the Dissenter Requirement for those shares.

Id. The court then concluded that because there was evidence submitted, in the form of public filings, that Cede had actually voted the T. Rowe Price shares in favor of the merger, those shares were not entitled to appraisal.

Takeaway

- Litigants in appraisal proceedings, including in those involving appraisal arbitrage, should now seek as much discovery as possible to determine how any record holder, including brokers like Cede, voted the shares at issue. Competent evidence to rebut the *prima facie* case can include public filings as well as evidence from voting services, such as voting records and internal control numbers.



DELAWARE COURTS CONTINUE TO VIEW A TRANSACTION PRICE NEGOTIATED AT ARM'S LENGTH AS THE BEST INDICATION OF “FAIR VALUE” IN STOCKHOLDER APPRAISAL ACTIONS

In cases brought pursuant to Delaware's stockholder appraisal statute, 8 Del. C. § 262, the Court of Chancery continues to emphasize the importance of the sale process and a reliable discounted cash flow (DCF) valuation in reaching a “fair value” determination. Under Section 262, stockholders who do not vote in favor of a merger and make a proper demand on the corporation may petition the Court of Chancery to determine the “fair value” of their stock.

“Fair value” means “the value to a stockholder of the firm as a going concern, as opposed to the firm's value in the context of an acquisition or other transaction.” To determine fair value, the court independently evaluates the evidence and may consider techniques or methods that are generally considered acceptable to the financial community and otherwise admissible in court. Depending on the case, the court may rely upon a DCF analysis, a

comparable transactions analysis, a comparable companies analysis, or the transaction price itself. Delaware courts tend to favor a DCF model over other available methodologies in an appraisal proceeding. However, the Delaware Courts now observe that a DCF analysis has “much less utility” in cases where the transaction price was determined by an arm's-length negotiation.

Historical Background

The acceptable method of valuing companies in appraisal actions is well established. The court determines the value of the corporation as a going concern “based upon the ‘operative reality’ of the company at the time of the merger[.]” *M.G. Bancorp, Inc. v. LeBeau*, 737 A.2d 513, 524 (Del. 1999), regardless of synergies obtained from the consummation of the merger,

M.P.M. Enters., Inc. v. Gilbert, 731 A.2d 790, 797 (Del. 1999), and the valuation cannot include speculative elements of value arising from the merger's "accomplishment or expectation." 8 Del. C. § 262(h). See also *Global GT LP v. Golden Telecom, Inc.*, 993 A.2d 497, 507 (Del. Ch. 2010) ("The entity must be valued as a going concern based on its business plan at the time of the merger, and any synergies or other value expected from the merger giving rise to the appraisal proceeding itself must be disregarded") (emphasis added), *aff'd*, 11 A.3d 214 (Del. 2010). Valuation "requires an examination of 'all factors and elements which reasonably might enter into the fixing of value,' including market value, asset value, earning prospects, and the nature of the enterprise, which are 'known or susceptible of proof as of the date of the merger.'" *Id.* (quoting *Weinberger v. UOP, Inc.*, 457 A.2d 701, 713 (Del. 1983)).

The principle that a transaction price provides the best evidence of value has its origins in an observation made in a fiduciary duty case:

The most persuasive evidence of the fairness of the ... price is that it was the result of arm's-length negotiations between two independent parties, where the seller ... was motivated to seek the highest available price, and a diligent and extensive canvass of the market had confirmed that no better price was available.

The fact that a transaction price was forged in the crucible of objective market reality (as distinguished from the unavoidably subjective process of a valuation expert) is viewed as strong evidence that the price is fair.

Van de Walle v. Unimation, Inc., 1991 WL 29303, at *17 (Del. Ch. Mar. 7, 1991). A law review article later suggested extending this approach to appraisal cases. See Jay W. Eisenhofer & John L. Reed, *Valuation Litigation*, 22 DEL. J. CORP. L. 37, 140 (1997).

Several years later, the Court of Chancery began considering the outcome of auctions and arm's-length processes involving independent third-party buyers as providing the best indication of value in appraisal cases. In *Union Ill. 1995 Inv. Ltd. P'Ship v. Union Financial Group, Ltd.*, 847 A.2d 340 (Del. Ch. 2004), then-Vice Chancellor (now Chief Justice) Strine used the merger price as reliable evidence of fair value because there was a fair, open, and competitive auction, a large number of prospective buyers were contacted, and the merger consideration was material for a debt-ridden company trying to avoid insolvency. *Id.* at 357-358. The facts in *Union Ill.* fell squarely within the language of *Van de Walle*. Thereafter, the court in *Highfields Capital, Ltd v. AXA Fin., Inc.*, 939 A.2d 34, 42 (Del. Ch. 2007) deferred to the merger price where there was a non-insider buyer, an arm's-length negotiation with no structural impediments to a superior offer, no one came along during the period between announcement and closing, and the subject company had an unprofitable future.

This approach survived scrutiny by the Delaware Supreme Court in *Golden Telecom, Inc. v. Global GT LP*, 11 A.3d 214 (Del. 2010), where the issue was materially different. In *Golden Telecom*, the defendant corporation appealed the Court of Chancery's appraisal valuation and asked the Supreme Court, unsuccessfully, to declare a rule requiring the Court of Chancery to defer to the merger price in an appraisal proceeding: "Therefore, we reject Golden's contention that the Vice Chancellor erred by insufficiently deferring to the merger price, and we reject its call to establish a rule requiring the Court of Chancery to defer to the merger price in any appraisal proceeding." The *Golden Telecom* appellants argued that in an appraisal proceeding the Court of Chancery should be constrained by the merger price. In other words, after *Golden Telecom*, the Court of Chancery is not required to rely exclusively on the merger price if there was a strong process, but *Golden Telecom* did not declare the merger price irrelevant to a determination of "fair value" under Section 262 of the DGCL. To the contrary, *Golden Telecom* instructed the Court of Chancery to obey the statutory mandate "that the court 'shall take into account all relevant factors.'"

Thus, the Court of Chancery remains free to embrace the transaction price not only as some evidence of value, but even in the appropriate case as the best evidence of value. This is consistent with the "all factors and elements which reasonably might enter into the fixing of value" standard laid down in *Weinberger*. This latitude was recognized by the Court of Chancery right after *Golden Telecom*. See *Olson v. ev3, Inc.*, 2011 WL 704409, at *10 (Del. Ch. Feb. 21, 2011) ("Although *no presumption* attaches to the deal price for purposes of appraisal, the ability of target fiduciaries to obtain a premium to market implies that they successfully extracted a portion of the value that the acquirer planned to create and that the merger consideration therefore exceeds the fair value of the stand-alone entity as a going concern.") (emphasis added) (citations omitted).

The 2015 Decisions

Three decisions from the Court of Chancery in 2015 followed the principle that the transaction price can be the best evidence of value.

In *In re Appraisal of Ancestry.com*, 2015 WL 399726 (Del. Ch. Jan. 30, 2015), the Court of Chancery determined that the merger price of \$32.00 per share represented the fair value of the company after considering that Ancestry did not prepare management projections in the ordinary course of business and finding that experts valuations based upon a discounted cash flow analysis were "imperfect." After noting a "robust" sales process, the Court found that fair value was "best represented by the market price."

In *Merlin Partners LP v. AutoInfo, Inc.*, 2015 WL 2069417 (Del. Ch. Apr. 30, 2015), the Court of Chancery concluded that the merger price of \$1.05 per share was the best indication of fair value at the time of the merger because there was a conflicts-free sale and negotiation process and there were no reliable cash flow projections from which to conduct a DCF analysis or other appropriate valuation. The plaintiff had used the company's projections for its proposed valuation but the court found that AutoInfo's projections were a first attempt and were specifically prepared to "paint the most optimistic and bright current and future condition of the company" as possible for purposes of a sale. AutoInfo's expert relied on the merger price and the court found that it could place "heavy weight" on a merger price in the absence of any other reliable valuation analysis. In concluding that the deal price represented fair value, the court noted that the merger was the result of a competitive and fair auction because AutoInfo: (1) retained an investment bank experienced in the transportation industry using an incentive-based fee structure; (2) contacted numerous companies in the sales process; (3) formed a special committee; (4) was sold at a premium to market; and (5) had no other topping bid emerge between announcement and closing of the merger.

In *In re LongPath Capital, LLC v. Ramtron International Corporation*, 2015 WL 4540443 (Del. Ch. June 30, 2015), the company ran a sales process that involved its advisor contacting twenty-four potential buyers and executing nondisclosure agreements with six of those potential buyers before agreeing on a final deal price of \$3.10 per share. The plaintiffs demanded appraisal and argued that fair value was \$4.96 per share. The Court of Chancery concluded that there were no reliable means of conducting a meaningful valuation and thus looked to the merger price as a starting point before deducting synergies and finding that the fair value at the time of the merger was \$0.03 below the deal price of \$3.10 per share. The court determined that plaintiffs' DCF analysis was not appropriate because it relied on management projections prepared by newer employees who were creating multi-year projections for the first time. The court also noted that the projections were created in anticipation of litigation and/or a hostile takeover bid. Instead, the court found it could give "one-hundred percent weight" to the merger price as evidence of fair value because the merger resulted from a fair process. The court determined that it was appropriate to subtract the deal's net synergies of \$0.03 per share (which was reached by netting negative revenue synergies and transaction costs from Ramtron's estimate of positive synergies) from the merger price to reach a fair value determination of \$3.07 per share.

The 2016 Decisions

In 2016, the Court of Chancery reiterated that, when certain conditions are followed, merger price is the best evidence of value.

Merion Capital LP v Lender Processing Services, Inc.

In *Merion Capital LP v Lender Processing Services, Inc.*, 2016 WL 7324170 (Del. Ch. Dec. 16, 2016), the Court of Chancery adopted the merger price in determining the "fair value" of the company's common stock. In aid of its determination, the court concluded that the merger consideration provided reliable evidence of fair value at the time of the merger, as the company conducted an objective, competitive sale process involving multiple strategic and financial buyers, to which the board provided adequate and reliable information about the company.

Background

After receiving numerous indications of interest in acquiring Lender Processing Services, Inc. (LPS), and conducting a thorough review of LPS's business and prospects (with the aid of prominent consultants and financial advisors), the LPS board decided to explore the market to sell part of or all of the business. Management reached out to Fidelity National Financial (Fidelity), which previously had expressed interest, and LPS's financial advisors reached out to a series of other potential bidders, including strategic and financial buyers. Three companies submitted proposals, although only Fidelity offered to actually acquire LPS. After some negotiation, LPS and Fidelity signed a merger agreement contemplating \$33.25 per share, 50 percent cash and 50 percent Fidelity stock. The agreement gave Fidelity the right to increase the cash component, and the formula for the stock component built in a one-way collar to protect against decline of more than 5 percent in the value of Fidelity's common stock and established a floor for the stock component at \$15.794 per share. The agreement also called for a 40-day go-shop, a five-day initial match right that fell back to a two-day unlimited match right, and a \$37 million termination fee for a deal arising from the go-shop and, otherwise, a \$74 million termination fee.

LPS's bankers reached out to 25 potential strategic buyers and 17 potential financial buyers. Three companies signed NDAs, but the bankers gained traction with only one, Altisource Portfolio Solutions S.A. (Altisource). Altisource and LPS engaged in extensive due diligence, but ultimately Altisource withdrew without explanation (although LPS's advisors believed Altisource backed out for fear that the acquisition would result in dis-synergies stemming from existing clients). When the go-shop ended, no potential bidder had submitted a formal indication of interest or a bid.

Ultimately, 78.6 percent of the outstanding shares voted in favor of the LPS-Fidelity deal (with 98.4 percent of the voting shares voting in favor). The aggregate merger consideration LPS's stockholders received was \$37.14 per share (as LPS's trading price had declined), which represented a 28 percent premium over

LPS's unaffected market price on the last trading day before the *Wall Street Journal* reported on the merger discussions.

In addition, the court noted that there was record evidence that the merger consideration included a portion of the value that Fidelity expected to generate from synergies, amounting to some \$100 million.

The Court's Fair Value Analysis

A "fair value" determination by the Court of Chancery under DGCL 262 is largely the result of judge-made law, rather than a formula provided in the statute. Moreover, there is no firm rule on how to reach a "fair value" determination. The inquiry is flexible, fact-intensive, and often, "freighted" with policy considerations. As one court noted, "[t]he value of a corporation is not a point on a line, but a range of reasonable values, and the judge's task is to assign one particular value within this range as the most reasonable value in light of all the relevant evidence and based on considerations of fairness." *Cede & Co. v. Technicolor, Inc.*, 2003 WL 23700218, at *2 (Del. Ch. July 9, 2004).

Although not conclusive, the court noted that recent appraisal jurisprudence has emphasized the Court of Chancery's willingness to consider market price data generated by the market for the company as a whole. And, if the merger "resulted from an arm's-length process between two independent parties, and if no structural impediments existed that might materially distort the 'crucible of objective market reality,'" then "a reviewing court should give substantial evidentiary weight to the merger price as an indicator of fair value." But, the "dependability of a transaction price is only as strong as the process by which it was negotiated."

Here, the court found that the merger consideration provided a reliable indicator of LPS's fair value. Several factors contributed to this finding:

1. After receiving multiple indications of interest and methodically completing its due diligence, LPS generated "meaningful competition" pre-signing by approaching multiple, "heterogeneous" potential bidders and ensuring that they perceived the sale process to be open, thereby maintaining a "credible threat" of competition. In addition, the board developed a track record of saying no (even to Fidelity), which gave Fidelity reason to believe the board would not agree to a price below its internal reserve.
2. LPS provided adequate and reliable information, and equally, to all participants pre-signing.
3. There was no explicit or implicit collusion, whether among bidders or between the seller and a particular bidder or bidders, including Fidelity. Indeed, LPS's management team believed Fidelity would not retain them. Petitioners did complain regarding, among other things, a phone call between

the two CEOs, who had a prior professional relationship, wherein they negotiated price of \$33.25 per share. The court discounted that phone call, though, as LPS's CEO lacked authority to lock-in a price and the board later had its bankers push back further on price.

4. Fair value did not exceed the final merger consideration, factoring in the expected synergies built into the initial merger consideration and LPS's subsequent stock price decline.
5. The court did conclude that the value of the go-shop was inconclusive, as most of the bidders contacted already either had been ruled out by the board or had demonstrated they were not interested. Only Altisource emerged, but even that company stood no chance given Fidelity's unlimited match right and expected synergies.

Both parties submitted expert valuation reports. Each using a DCF analysis, petitioner's expert opined that LPS's fair value at closing was \$50.46 per share, and LPS's expert opined that fair value was \$33.57 per share. After selecting the most credible DCF inputs provided by both experts, the court determined that fair value based on DCF was \$38.67 per share, or 4 percent higher than the final merger consideration of \$37.14 per share.

The court then reviewed a handful of recent decisions split over when the Court of Chancery will rely exclusively on merger price. The decisions relying only on merger price have done so where the merger price was particularly reliable but DCF analysis would not be. In the decisions *not* relying on merger price, the sale process was either not reliable or was otherwise not emphasized at trial. Here, the court noted, merger price should predominate, as LPS ran a sale process that generated reliable evidence of fair value, and in any event, the DCF analysis, which depended heavily on assumptions, resulted in a per share price within a few points of the actual merger price.

Finally, LPS argued that the court should have backed out the value of expected synergies in arriving at fair value (thus "fair value" would have been well less than the merger price), but the court declined this invitation, as at trial LPS pursued the theory that the final merger price represented maximum fair value and then its experts failed to opine on a specific quantum of synergies.

Takeaways

- This decision emphasizes that the adequacy and reliability of the underlying deal process will affect the court's comfort level in relying on the final deal price in setting "fair value" under DGCL 262.
- Relatedly, *Merion Capital* indicates that pre-signing/pre-closing market checks will be seen to have provided "meaningful competition" if they create the "threat" of potential competition, even if ultimately there is only one bidder.

- Although the Court of Chancery previously has relied on the transaction price to determine “fair value,” this is the first decision to do so when it has determined both the merger price *and* inputs available for valuation were reliable indicators of fair value. Other courts relying on the transaction price have done so only where the transaction price was particularly reliable but an independent valuation would not be.

In re Appraisal of Dell Inc. – Bucking the Trend

In *In re Appraisal of Dell Inc.*, 2016 WL 3186538 (Del. Ch. May 31, 2016), Vice Chancellor Laster bucked the trend of using the merger price as strong evidence of fair value. Relying upon the recent Delaware appraisal cases, Dell argued that the transaction price was the strongest evidence of fair value of the transaction. Although the court noted that recent Delaware decisions had held as much, it nonetheless rejected that argument. The court differentiated those cases for a handful of reasons. First, it concluded that the transaction was not a true arms-length transaction because it was a management buyout. Second, the court considered the fact that the bidder was a financial bidder, not a strategic buyer. Therefore, according to the court, the price offered by the bidder was more focused on short term return, rather than fair value. Third, there was evidence of a “valuation gap between the market’s perception and the Company’s operative reality,” with investors focusing on Dell’s “short-term, quarter-by-quarter results.” Fourth, the merger price did not reflect fair value because there was little interest in Dell from other buyers both pre- and post-signing. Lastly, the special committee that negotiated the deal focused on the market price of Dell’s stock and “negotiated without determining the value of its best alternative to a negotiated acquisition. In the end, the Court concluded that the fair value for Dell’s stock was \$17.62 per share, almost a third higher than the \$13.75 deal price.

Takeaways

- These decisions show the importance of a robust, conflicts-free sale process. The Delaware courts may well “tend to favor a DCF model in appraisal proceedings,” but they will generally rely entirely upon or give substantial weight to the transaction price to determine fair value where there is a comfortable record for doing so.
- The *Dell* case identifies an outlier situation where specific factors were present to compel the court to conclude that the merger price did not reflect fair value. It is likely to be limited to situations where the *Dell* factors are present. But it should remind parties to conduct pre-signing market checks and to ensure that any bidders that are financial entities are focused not only on short term returns, but also long term value. Indeed, parties should be sure to focus on, and document, analysis of the company’s intrinsic value.

Other Recent Appraisal Decisions

In *In re Appraisal of DFC Glob. Corp.*, 2016 WL 3753123 (Del. Ch. July 8, 2016), the Court of Chancery concluded that the merger price should not be solely relied upon in determining “fair value” under DGCL 262, as the respondent company was sold during a period of company turmoil and regulatory and market uncertainty, undermining projections. In addition, the financial sponsor that bought the respondent company had focused on achieving a certain rate of return and closing the deal within its constraints, which circumstances could result in an outcome different from fair value. Ultimately, the court accorded equal weight to deal price, the court’s DCF valuation, and the comparable company’s analysis submitted by the respondent company’s expert. The court determined that fair value was \$10.21/share, which was a 7.5 percent premium over merger price. This decision is currently on appeal to the Delaware Supreme Court.

In *Dunmire v. Farmers & Merchants Bancorp of Western Pennsylvania, Inc.*, 2016 WL 6651411 (Del. Ch. Nov. 10, 2016), the Court of Chancery again declined to rely on merger price in determining fair value. There, the controlling stockholder set the exchange rate for the stock-for-stock transaction between the respondent company and another entity which was controlled by the same family. The court observed several specific factors contributing to its refusal to rely on merger price: (1) the merger was not the product of an auction; (2) the respondent company solicited no third parties; (3) the controller stood on both sides of the deal; (4) the record did “not inspire confidence that the negotiations [between the special committee and the controller] were truly arms-length”; and (5) the merger was not conditioned on a majority-of-the-minority vote.

In *In re United Capital Corp. Stockholders Litigation*, 2017 WL 56890 (Del. Ch. Jan. 4, 2017), the Court of Chancery declined a stockholder’s request for “quasi-appraisal” remedy in connection with a short-form merger under DGCL 253 between the company and its controlling stockholder. The plaintiff contended that the stockholder notice was inadequate and thus the stockholders lacked certain material information in deciding whether to seek full appraisal. Specifically, the plaintiff pointed out the notice omitted information used by the special committee in setting the merger price, the controller’s rationale for the initial offer, certain financial information such as projections, the extent of the company’s working capital, information regarding conflicts of 2/3 of the special committee members, and the identities of directors and a director’s spouse who jointly owned an \$8 million note with the respondent company. The court explained that in a DGCL 253 short-form merger, the parent company is not required to establish “entire fairness,” and, “absent fraud or illegality, the only recourse for a minority stockholder who is dissatisfied with the merger consideration is appraisal.” In such instances, the

corporation is required to (i) notify the minority stockholders only of the availability of the appraisal remedy, (ii) provide a copy of the appraisal statute, and (iii) disclose information that is material to a stockholder's decision whether to seek appraisal post-merger. The court concluded that the respondent company's 80-page stockholder notice was sufficient, observing that the plaintiff used the financial statements attached to the notice in estimating that the merger price's \$186.6 million implied total equity value seriously undervalued the respondent company, especially because of the company's total assets of \$342.4 million. Thus, the court held that the notice provided the plaintiff with "the minimum information necessary to determine whether he could 'trust that the price offered is good enough,' or whether the price undervalued the company 'so significantly that appraisal is a worthwhile endeavor.'" As the additional information plaintiff claimed it required was immaterial, the only remedy available to plaintiff and the minority holders was appraisal.

amount in cash, in which case interest shall accrue thereafter as provided herein only upon the sum of (1) the difference, if any, between the amount so paid and the fair value of the shares as determined by the court and (2) interest theretofore accrued, unless paid at that time." Under this amendment, a company can thus make a calculated decision to pay a certain amount of the merger consideration, and any difference between that share price and the share price determined by the court in the proceeding will not be subject to interest. Such pre-payment does have risks, however. If a company's chosen share price to pre-pay is above the share price ultimately determined as fair value by the Court, the statute does not provide for a clawback, so that is something to address by agreement.

2016 Amendments To Delaware's Stockholder Appraisal Statute

Recent amendments to Section 262 of the DGCL, which went into effect on August 1, 2016, seek to curb *de minimis* appraisal cases. Specifically, Section 262 was amended to state that, for shares of stock that, before the merger, were traded on a national securities exchange, the Court of Chancery of the State of Delaware shall dismiss an appraisal proceeding as to all stockholders otherwise entitled to appraisal rights, unless: (1) the total number of shares entitled to appraisal exceeds 1 percent of the outstanding shares of the class or series eligible for appraisal, (2) the value of the consideration provided in the merger or consolidation for such total number of shares exceeds \$1 million, or (3) the merger was approved, pursuant to Sections 253 or 267 as a short-form merger. This amendment was designed to curb what are perceived to be low-value appraisal proceedings which plaintiffs use only to gain an advantage in settlement negotiations.

It is notable that the amendment is written in the negative and disjunctive, such that if one of the three elements is present, then the appraisal rights will apply. Put another way, even if the total number of shares does not exceed 1 percent, if the total value for those shares is greater than \$1 million, the statute does not require an automatic dismissal. Similarly, stockholders in short-form mergers are still eligible for appraisal rights.

The amendments also allow a company to limit potential liability for interest relating to an appraisal proceeding, which can be significant, accruing at 5 percent over the Federal Reserve discount rate until the case has been decided. Specifically the 2016 amendments to Section 262(h) state that "[a]t any time before the entry of judgment in the [appraisal] proceedings, the surviving corporation may pay to each stockholder entitled to appraisal an



DELAWARE COURTS CONTINUE TO CLARIFY DIRECTORS' DUTIES WHEN MANAGING THE SALE OF THE COMPANY

A Primer on Revlon

The so-called *Revlon* standard of review derives from *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986), a seminal decision in 1986 by the Delaware Supreme Court. In that case, the Revlon board decided to sell the company, and what followed was a bidding competition. The *Revlon* court held that a selling board is charged with maximizing the company's value for the benefit of the stockholders when the company's sale is inevitable. However, there is "no single blueprint" that must be adhered to in order to satisfy *Revlon*. It may come as a surprise, but the *Revlon* doctrine does not necessitate, among other things, that a selling board maintain the right to terminate an agreement in favor of a superior offer that later arises, engage in an active market check, or even accept the deal with the highest monetary value. Rather, once *Revlon* is triggered, the court reviewing the sales process will apply a heightened standard of review, reflecting narrowed judicial deference to the business decisions of the board. *Revlon*, accordingly, once triggered, requires only that the selling board act within a range-of-reasonableness under

the circumstances, effectively obligating the board to perform its fiduciary duties of care and loyalty with the objective of attaining the best sale price for the company realistically attainable through a wholesome sales process.

The *Revlon* standard of review has been continuously expanded upon. In 2009, the Supreme Court decided *Lyondell Chemical Co. v. Ryan*, 970 A.2d 235 (Del. 2009), which reinforced the principle that *Revlon* does not create new fiduciary duties for directors, but merely requires the board to perform its fiduciary responsibilities with the objective of maximizing the sale price of the enterprise once a sale is inevitable.

In late 2014, the Delaware Supreme Court, in *C&J Energy Services, Inc. v. City of Miami General Employees' and Sanitation Employees' Retirement Trust*, 107 A.3d 1049 (Del. 2014), reviewed what it labeled as an "unusual preliminary injunction" and reversed an order of the Court of Chancery enjoining a business combination between C&J Energy Services and a division of Nabors Industries Ltd. In an earlier bench ruling, the Court of Chancery (i) enjoined the C&J Energy stockholder vote to approve the merger for 30

days; (ii) mandated that C&J Energy shop itself during the 30-day period in contravention of the Merger Agreement between the parties; and (iii) declared, at the outset, that the solicitation of proposals pursuant to the imposed go-shop period would not constitute a breach of the no-shop clause and similar deal protection mechanisms in the merger agreement. The Supreme Court, in an *en banc* panel that included Justice Ridgely, used the case as an opportunity to further clarify *Revlon* and its progeny. The Court explained that a target company and its board of directors may be subjected to narrower judicial deference in at least five scenarios:

1. *First*, as seen in *Paramount Communications, Inc. v. QVC Network, Inc.*, 637 A.2d 34 (Del. 1994), the doctrine applies where a company commences an “active bidding process” with the goal of selling itself or reorganizing the business with a “clear break-up of the company.”
2. *Second*, when a target company “abandons its long-term strategy and seeks an alternative transaction involving the break-up of the company” as a response to a bidder’s advance.
3. *Third*, where control of the company is transferred from unrelated stockholders to a controlling stockholder.
4. *Fourth*, as in *Revlon* itself, a complete cashout of the target company’s stockholders, given that the stockholders will no longer maintain an interest in the target company, suggesting that their primary interest is maximized value.
5. *Fifth*, when a board considers even a single offer, calling for the directorship to be adequately informed as to the deal price and the value of the company, while simultaneously engaging in an “effective” market check. However, only the board can put the company in play. As the Supreme Court articulated in *Lyondell*, the selling company and its board, in order to trigger *Revlon*, must “embark[] on a transaction – on its own initiative or in response to an unsolicited offer – that will result in a change of control.”

The Court of Chancery, in entering a preliminary injunction, determined that the C&J Energy board did not suffer from a conflict of interest and was fully informed as to the company’s value. Nonetheless, because the board failed to engage in an “active” market check and affirmatively shop C&J Energy pre- or post-signing, the court concluded that there was a “plausible” violation of the board’s *Revlon* duties, concurrently implying that *Revlon* required the C&J Energy board to possess an “impeccable knowledge of the value of the company that it is selling.”

The Court of Chancery decision was reversed on multiple grounds, but with respect to *Revlon*, the Supreme Court noted that there is “no specific route that a board must follow when fulfilling its fiduciary duties” upon entering *Revlon*-land. To the extent that the Court of Chancery mandated that the C&J

Energy board “actively” shop the company in order to satisfy *Revlon*, the Supreme Court said it did so incorrectly. *C&J Energy* thus reiterates that a board may “pursue the transaction that it reasonably views as most valuable to stockholders, so long as the transaction is subject to an effective market check under circumstances in which any bidder interested in paying more has a reasonable opportunity to do so.” Importantly, though, such market check merely needs to be “effective,” as opposed to “active.” In essence, an effective market check is one whereby “interested bidders have a fair opportunity to present a higher-value alternative, and the board has the flexibility to eschew the original transaction and accept the higher-value deal.” Of course, the latitude and freedom of stockholders to accept or reject their board’s preferences must also be considered in determining the effectiveness and propriety of a market check.

In 2015, the Delaware Supreme Court in *Corwin v. KKR Fin. Holdings LLC*, 125 A.3d 304 (Del. 2015), held that the approval of a merger by a fully informed, disinterested stockholder majority invoked the business judgment rule standard of review.

The appeal arose out of a purported class action by stockholders of KKR Financial Holdings LLC challenging a stock-for-stock acquisition of the company by KKR & Co. L.P. (KKR). The stockholder plaintiffs asserted that the entire fairness standard of review applied to the transaction as KKR was a controlling stockholder and because the company’s primary business was financing KKR’s leveraged buyout activities and the company was managed by an affiliate of KKR under a management agreement.

In granting the defendants’ motion to dismiss pursuant to Rule 12(b)(6), the Court of Chancery held that plaintiffs’ allegations did not support a reasonable inference that KKR was a controlling stockholder of the company. The Court of Chancery reasoned that KKR did not control the company’s board of directors such that those directors could not freely exercise their judgment in determining whether to approve and recommend to the stockholders a merger with KKR. The Court also found that KKR owned less than one percent of the shares of the company, had no right to appoint any directors, and had no contractual right to veto any board action. The Court of Chancery also held that, even if the majority of the company’s board was not disinterested or independent, business judgment review still applied because the merger was approved by a majority of disinterested company stockholders in a fully informed vote.

On appeal, the plaintiffs contended that the Court of Chancery erred in holding that KKR was not a controlling stockholder of the company. The plaintiffs also contended that, even if the Court of Chancery were correct in determining that KKR was not a controlling stockholder, the court should not have dismissed the complaint because they had adequately pled a claim under *Revlon v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986). In response, the defendants argued that plaintiffs’ *Revlon*

argument had not been fairly raised in the Court of Chancery and that, in any event, the transaction was subject to the business judgment rule because it had been approved by a fully informed, uncoerced stockholder vote. The Supreme Court agreed with the defendants and affirmed the Court of Chancery's dismissal of the complaint in its entirety.

The Supreme Court also explained that the *Unocal* and *Revlon* standards were not designed for application in post-closing money damages cases and instead were "designed to give stockholders and the Court of Chancery the tool of injunctive relief to address important M&A decisions in real time, before closing." The court emphasized that *Unocal* and *Revlon* "were not tools designed with post-closing money damages claims in mind, the standards they articulate do not match the gross negligence standard for director due care liability." Moreover, the doctrine articulated by the Court of Chancery is limited to situations involving fully informed, uncoerced stockholder votes, and it will not apply if material, troubling facts regarding director behavior are not disclosed to stockholders. When a transaction is not subject to the entire fairness standard of review, the "long-standing policy" of Delaware law "has been to avoid the uncertainties and costs of judicial second-guessing when the disinterested stockholders have had the free and informed chance to decide on the economic merits of a transaction for themselves."

Finally, the court rejected the plaintiffs' contention that *Gantler v. Stephens*, 965 A.2d 695 (Del. 2009), required the Court of Chancery to give the informed stockholder vote no effect in determining the standard of review. The court instead agreed with the Court of Chancery's narrow interpretation of *Gantler* as a decision solely intended to clarify the meaning of the term "ratification" and not, as plaintiffs argued, on the question of what standard of review applies if a transaction not subject to the entire fairness standard is approved by a fully informed and voluntary vote of disinterested stockholders.

The 2016 Cases

The Delaware Supreme Court followed up the *Corwin* decision with *Singh v. Attenborough*, 137 A.3d 151 (Del. 2016), which involved stockholder claims arising out of the *Zale-Signet* merger. The plaintiff in that case alleged, *inter alia*, that the director defendants had breached their fiduciary duties by failing to satisfy the standards for a change of control transaction, which thus warranted review under *Revlon*'s enhanced scrutiny. However, the change of control transaction in *Singh* was approved by a majority of the minority of disinterested stockholders. Accordingly, the court concluded, consistent with *Corwin*, that the appropriate standard of review was the business judgment rule. Under that standard, the plaintiff's complaint failed to state a claim.

Corwin continues to support dismissal in recent Chancery cases as well. For example, Vice Chancellor Montgomery-Reeves, in *In re Volcano Corporation Stockholder Litigation*, 143 A.3d 727 (Del. Ch. 2016), followed *Corwin* in a suit by former stockholders after a tender offer. The Court concluded that, in a fully informed, disinterested, and uncoerced tender offer, if a majority of the target's shares are tendered, that has the same effect as a stockholder vote on the transaction such that it irrebutably renders review of the transaction under the business judgment rule. The merger utilized a fairly new statute, Section 251(h) of the DGCL, adopted in 2013, which "permit[s] a merger agreement to include a provision eliminating the requirement of a stockholder vote to approve certain merger" if the acquirer conducts a tender offer in which the acquirer then owns "at least such percentage of the shares of stock of [the target] corporation . . . that, absent [Section 251(h)], would be required to adopt the agreement of merger by [the DGCL] and by the certificate of incorporation of [the target] corporation." In other words, if the percentage of the tendered shares is the same as the percentage required to vote to approve the merger, then a stockholder vote is not needed. Given Section 251(h), the court concluded that *Corwin* was equally applicable to mergers consummated pursuant to Section 251(h). Shortly after *In re Volcano*, Vice Chancellor Slight also concluded that *Corwin* applied in a Section 251(h) merger in *Larkin v. Shah*, 2016 WL 4485447 (Del. Ch. Aug. 25, 2016). The court noted, however, that *Corwin* will not always apply when a majority of stockholders votes or tenders their shares, such as when there is a conflicted controlling stockholder.

Finally, in what was left of the *C&J Energy* case following the Delaware Supreme Court's reversal in 2014, Chancellor Bouchard in *City of Miami General Employees' and Sanitation Employees' Retirement Trust v. Comstock*, 2016 WL 4464156 (Del. Ch. Aug. 24, 2016), relied upon *Corwin* to dismiss the plaintiff's claim alleging breaches of fiduciary duties during the merger of C&J Energy and Nabors Industries, Inc. Before dismissing the breach of fiduciary duty claims, however, the Court first considered the plaintiff's disclosure claims because the question of whether the "stockholder base was fully informed" was not only relevant to the disclosures claims but also had bearing on the defendants' "arguments concerning the applicable standard of review" for the fiduciary duty claims. The court concluded that the plaintiff's disclosure-related allegations failed to state a claim, which meant that the stockholder vote approving the merger was fully informed. The plaintiff also failed to adequately allege that a majority of the board was interested in the transaction or that the board's process was tainted by a board member's deceit or self-interest. Without pleading either board interestedness or deception, and because a majority of the disinterested stockholders were fully informed and voted to approve the merger, the board was entitled to review under the business judgment rule.

Takeaways

- The *C&J Energy* case is a clarification, if not a reiteration, of what *Revlon* requires of boards when selling companies, namely: (a) *Revlon* created no fiduciary duties in excess of the duties of loyalty and care, but simply requires that such fiduciary obligations be performed with the objective of maximizing the sale price of the enterprise when the company is put up for sale; (b) there is no judicially prescribed set of actions required to satisfy the heightened standard of review; and (c) *Revlon* is triggered only in a narrow set of circumstances and not merely because the target company is involved in a change of control transaction. Consequently, passive, yet effective, post-signing market checks may be sufficient to satisfy *Revlon*, provided that stockholders are free to participate in an uncoerced vote on the transaction, the board is adequately informed as to both the deal and the company's intrinsic value, and third-party bidders are posed only with reasonable obstacles in making a superior offer for the target company.
- While *Revlon*, and cases like *QVC* and *Lyondell*, shed light on some of the ways a selling board may trigger a heightened standard of review, directors of target companies must take care to conscientiously consider whether the sales process of their company requires that they exercise their fiduciary duties with the goal of maximizing the sale price of the enterprise, even if a conventional change of control transaction is not involved. Despite the holding in *C&J Energy*, the borders of *Revlon*-land remain movable and arguably unclear. Indeed, the Delaware Supreme Court did not engage in a *Revlon* review of the *C&J Energy-Nabors* transaction, but assumed "for the sake of analysis" that the doctrine was "invoked," leaving largely unanswered the question of whether a deal departs from *Revlon*-land when contractual provisions dilute majority stockholder authority and grant the minority a right to share pro rata in any future sale of the company.
- *C&J Energy* also addresses the Court of Chancery's role as a court of equity with broad discretion. Notwithstanding such latitude, it is inappropriate for the court to "blue-pencil" a contract and alter the rights of the parties to the merger agreement. There, the Delaware Supreme Court noted that the Court of Chancery's mandate that *C&J Energy* engage in a 30-day go-shop period and determination that such shopping would not constitute a breach of the merger agreement was not an appropriate exercise of equitable authority.
- The Delaware Supreme Court's decision in *Corwin* may continue to insulate boards of directors from fiduciary duty challenges involving transactions requiring stockholder votes. It is as important as ever for boards of directors to seek stockholder approval of transactions that would otherwise be subject to enhanced scrutiny, such as change of control transactions.

DELAWARE SUPREME COURT CLARIFIES LAW ON JURISDICTION OVER NON-RESIDENT DIRECTORS AND OFFICERS OF DELAWARE CORPORATIONS AND FOREIGN CORPORATIONS

In two recent opinions, the Delaware Supreme Court clarified the extent of the power of the state's trial courts to exercise jurisdiction over foreign corporations and non-resident officers of Delaware corporations. First, in *Hazout v. Tsang*, 134 A.3d 274 (Del. 2016) (Chief Justice Strine), the state's high court held that under Delaware's director and officer consent-to-service statute, 10 Del. C. § 3114, Delaware courts can exercise personal jurisdiction over non-resident officers and directors of Delaware corporations in a civil action in which the corporation and the officer or director is a "necessary or proper party." Next, in *Genuine Parts Co. v. Cepec*, 137 A.3d 123 (Del. 2016) (Chief Justice Strine), the court held that foreign corporations cannot be deemed to have consented to general jurisdiction in Delaware solely by virtue of having registered to do business there.

The Hazout Decision

Defendant Marc Hazout, a Canadian resident, was sued for acts taken in his official capacity as an officer and director of Silver Dragon Resources, Inc., a Delaware corporation. Hazout led Silver Dragon's negotiations for a capital investment from Tsang Mun Ting and an investor group from Hong Kong. The Hong Kong parties agreed to invest \$3.4 million in Silver Dragon on the condition that the directors of Silver Dragon execute a series of agreements, essentially handing control over to the investors. After Tsang sent the first \$1 million to Silver Dragon, only three of Silver Dragon's four directors signed the required agreements. Thereafter, Hazout refused to return the \$1 million payment, and indeed caused \$750,000 of it to be sent to Travelers International, Inc., a corporation that Hazout controlled.

Tsang brought suit in Delaware against Hazout, Silver Dragon and Travellers, asserting claims for unjust enrichment, fraud and fraudulent transfer. Hazout moved to dismiss, arguing that the Delaware courts could exercise no personal jurisdiction over him because Tsang was not suing Hazout for breach of fiduciary or other duty owed to Silver Dragon or to Tsang as a stockholder. Hazout based his argument on *Hana Ranch, Inc. v. Lent*, 424 A.2d 28 (Del. Ch. 1980), in which the Court of Chancery held that Delaware courts could exercise personal jurisdiction over a

non-resident officer or director under 10 Del. C. § 3114 only if the individual was being sued for breach of fiduciary duty. Applicable here, 10 Del. C. § 3114(b) states, in relevant part, that by virtue of holding office, an officer has consented to personal jurisdiction in Delaware in two cases: (i) "all civil actions or proceedings brought in this State, by or on behalf of, or against such corporation, in which such officer is a necessary or proper party"; or (ii) "any action or proceeding against such officer for violation of a duty in such capacity." Thus, the *Hana Ranch* decision, without a finding of facial constitutional invalidity, effectively read-out of 10 Del. C. § 3114(b) the statute's "necessary or proper party" clause. The Delaware Superior Court disagreed, and Hazout moved for interlocutory appeal. The Delaware Supreme Court granted Hazout's motion to hear this matter of first impression.

The Supreme Court affirmed the trial court's decision to exercise personal jurisdiction over Hazout and, in so doing, the court overturned *Hana Ranch*. Specifically, the Supreme Court held that the *Hana Ranch* court erroneously had excised the "necessary or proper party" clause from 10 Del. C. § 3114. Under well-settled principles of statutory construction, the judicial branch is constrained to apply the plain language adopted by the legislature and it cannot read-out provisions unless there is some constitutional justification. Thus, reading out of 10 Del. C. § 3114 the statute's "necessary or proper party" clause was improper. The court also concluded that the due process requirements described in *International Shoe Co. v. Wash., Office of Unemployment Comp. & Placement*, 326 U.S. 310 (1945), and that line of cases, were easily satisfied in this case: although Hazout was located outside Delaware, the agreements invoked Delaware as providing the governing law, and indeed had as their subject the change in control of a Delaware corporation. Additionally, the court determined that the precise "necessary or proper party" clause of 8 Del. C. § 3114 provided further safeguard to non-resident directors and officers by requiring a nexus between the claims against the corporation and those against the officer or director. Put another way, 8 Del. C. § 3114 only applies to a non-resident officer or director when that individual faces claims arising out of an exercise of corporate powers.

The Cepec Decision

In *Cepec*, the defendant, Genuine Parts Co., a Georgia corporation, perhaps epitomized the “foreign corporation”: it maintained no corporate office in Delaware, conducted no stockholder meetings in Delaware, and had no officers or directors in Delaware. Additionally, fewer than 1 percent of its employees work in Delaware, fewer than 1 percent of its stores are located in Delaware and less than 1 percent of its revenue is derived from the state. In the underlying case, Genuine Parts was sued over claims having nothing to do with its activities in Delaware. Nevertheless, the Delaware Superior Court had concluded it could exercise jurisdiction over Genuine Parts because the company had appointed a registered agent to accept service of process, in accordance with 8 Del. C. § 376, and therefore it had consented to the general jurisdiction of the Delaware courts. The trial court conducted no due process analysis; instead, it cited to the Delaware Supreme Court’s previous decision in *Sternberg v. O’Neil*, 550 A.2d 1105 (Del. 1988), which had interpreted 8 Del. C. § 376 as conferring general jurisdiction over a registered foreign corporation via express consent.

Writing for a majority, Chief Justice Strine wrote that at least two decisions issued by the United States Supreme Court credibly called into question *Sternberg*’s viability. For example, in *Goodyear Dunlop Tires Operations, S.A. v. Brown*, 564 U.S. 915 (2011), the nation’s high court explained that “[a] court may assert general jurisdiction over foreign . . . corporations . . . when their affiliations with the State are so ‘continuous and systematic’ as to render them essentially at home in the forum State.” *Id.* at 919. Following the *Goodyear* case, the court further clarified in *Daimler AG v. Bauman*, 571 U.S. 20 (2014), that “only a limited set of affiliations with a forum will render a defendant amenable to all-purpose jurisdiction there.” 134 S. Ct. at 760. Noting that “we no longer live in a time where foreign corporations cannot operate in states unless they somehow become a resident; nor do we live in a time when states have no effective bases to hold foreign corporations accountable for their activities within their borders,” the majority in *Cepec* held that Delaware courts, in most instances, cannot exercise general jurisdiction over foreign corporations unless that corporation has its principal place of business within Delaware. 137 A.3d at 123, 137. Importantly, the United States Supreme Court has not yet extended its holdings to mean that state courts can exercise general jurisdiction over foreign corporations only if the corporation has its principal place of business within the forum state.

A Rare Dissent

Dissenting opinions are relatively rare in the Delaware Supreme Court. The *Cepec* decision, however, reveals a deeper divide on this important jurisdictional issue and perhaps other constitutional issues. Justice Vaughn issued a lone dissenting opinion. As explained by the Justice, his dissent is based on the fact that the United States Supreme Court has not actually ruled that state courts can exercise general jurisdiction over foreign corporations only if the corporation has its principal place of business within the forum state: “It may be that the United States Supreme Court will go in the same direction as the Majority. But we won’t know until it gets there. I would not divest the trial courts of this state of significant jurisdiction unless I was sure I was right, and I am not sure the Majority is right.” 137 A.3d at 149.

Takeaways

- Under *Hazout*, Delaware courts can exercise personal jurisdiction over non-resident officers and directors of Delaware corporations in a civil action in which the corporation and the officer or director is a “necessary or proper party.”
- Under *Cepec*, Delaware courts can exercise general jurisdiction over foreign corporations only if the corporation has its principal place of business within Delaware.



RISKS TO FINANCIAL ADVISORS FOR AIDING AND ABETTING BREACHES OF FIDUCIARY DUTY IN M&A TRANSACTIONS CONTINUE TO EVOLVE

Historical Background

Attempts by stockholders to hold financial advisors liable first gained traction in 2011 in *In re Del Monte Foods Company Shareholders Litigation*, 25 A.3d 813 (Del. Ch. 2011), when the Court of Chancery temporarily enjoined a premium merger transaction, finding a reasonable probability that the directors of Del Monte Foods Company breached their fiduciary duties in the course of selling the company. The decision was driven, in large part, by conflicts of interest suffered by Del Monte's financial advisor who, unbeknownst to Del Monte, approached its private equity clients to stir up interest in the company. The financial advisor was then engaged to advise on the offers but never disclosed that it stirred up the interest and that it planned to provide buy-side financing. The bidders all signed a "no teaming" provision, but ultimately Del Monte did not accept any bids. Later, the financial advisor approached two bidders and advocated a joint effort, which violated the "no teaming" provision. This time, a deal was reached.

The court found that the board's decision to allow the joint bid was "unreasonable" because it eliminated Del Monte's "best prospect for price competition." The court also found that it was "unreasonable" for the board to permit its financial advisor to provide buy-side financing at a time when no price had been agreed to and there was a "go-shop" process to run. The case settled for \$89.4 million, and the court approved the settlement in December 2011, with Del Monte paying \$65.7 million and the financial advisor paying \$23.7 million. The court awarded \$23.3 million in attorney's fees.

In 2012, the Court of Chancery, in *In re El Paso Corporation Shareholder Litigation*, 41 A.3d 432 (Del. Ch. 2012), denied a motion to enjoin a merger between El Paso Corporation and Kinder Morgan, Inc. However, the court severely criticized the actions of El Paso's management and its financial advisor. El Paso's financial advisor owned approximately 19 percent of Kinder Morgan (valued at \$4 billion) and controlled two board seats. The

conflicts were fully disclosed and a second financial advisor was brought in to handle the sale. Nonetheless, first advisor continued as the lead advisor on a spinoff option and helped El Paso craft the second advisor's engagement letter in a way that provided for a fee only if the company was sold as a whole.

While the court ultimately concluded that, in the absence of a competing bid, the El Paso stockholders should have the opportunity to decide whether or not they like the price notwithstanding the conflicts, the court went on to state that "[a]lthough an after-the-fact monetary damages claim against the defendants is not a perfect tool, it has some value as a remedial instrument, and the likely prospect of a damages trial is no doubt unpleasant ...". The case settled for \$110 million.

The outcomes in 2013 were different because the Court of Chancery's opinion in *In re Morton's Restaurant Group Shareholders Litigation*, 74 A.3d 656 (Del. Ch. 2013), demonstrated that a second financial adviser, when properly engaged and actively involved, can help to overcome a merger challenge based upon a primary financial adviser's alleged lack of independence. The complaint alleged that Morton's board of directors breached its fiduciary duties by acting in bad faith when it allowed the investment bank that ran the sales process to provide financing for the buyer after learning that the high bidder could not otherwise secure financing. The court found this process did not create an inference of bad faith: "The decision to let [the financial advisor] finance [the high bidder's] deal while hiring [a second advisor] to provide unconflicting advice, rather than risk losing a bid at a high premium to market, does not create an inference of bad faith."

Also in 2013, the Court of Chancery, in *Miramar Firefighters Pension Fund v. AboveNet, Inc.*, 2013 WL 3995257 (Del. Ch. July 31, 2013), granted defendants' motion to dismiss where the plaintiff failed to allege facts supporting an inference that the board knew of alleged deficiencies in the financial advisor's analysis and where the board refused to allow the financial advisor to provide staple financing to a potential acquiror and, in *SEPTA v. Volgenau*, 2013 WL 4009193 (Del. Ch. Aug. 5, 2013), aff'd, 91 A.3d 562 (Del.) dismissed a claim of advisor conflict based upon the allegation that a \$8.4 million fee paid only upon the completion of the deal. All things considered, bankers appeared to be turning things around in 2013, but then came 2014.

On March 7, 2014, the Court of Chancery issued its decision in *In re Rural Metro Corporation Stockholders Litigation*, 88 A.3d 54 (Del. Ch. 2014), holding RBC Capital Markets, LLC liable for aiding and abetting breaches of fiduciary duty by the board of directors of Rural/Metro Corporation in connection with Warburg Pincus LLC's acquisition of Rural. The case proceeded to trial against RBC even though Rural's directors, as well as a financial advisor serving in a secondary role, settled before trial. The court's 91-page opinion makes clear that when financial advisors step outside their roles as advisors, and take active steps to

manipulate a company's sale for their own self-interests, they risk incurring liability for aiding and abetting a breach of fiduciary duty.

Rural was a public corporation that provided ambulance and fire protection services. Rural had one national competitor, American Medical Response (AMR), a subsidiary of Emergency Medical Services Corporation (EMS). During the summer of 2010, Rural began looking at potential strategic alternatives and formed a special committee in August 2010, which considered three potential options: (1) continue to pursue the standalone business plan; (2) pursue a sale of the company; or (3) pursue a business combination to take advantage of synergies available.

In December 2010, rumors circulated that EMS was pursuing strategic alternatives. RBC gave certain directors of Rural an overview of the EMS process and suggested Rural as a potential partner in the process. At the same time, RBC recognized that if Rural engaged in a sales process led by RBC, then RBC could use its position as sell-side advisor to secure buy-side roles with private equity firms bidding for EMS. In making its pitch to the special committee, however, RBC did not disclose that it planned to use its engagement as Rural's financial advisor to secure financing work from the bidders for EMS. Counsel for the special committee advised of the potential conflict and, if RBC was selected, to be particularly vigilant about the integrity of the process and to consider appointing a second independent firm.

RBC was selected but ran a process that the court found favored its own interest in gaining financing work by prioritizing bidders involved in the EMS process over those who were not. In addition to an M&A advisory fee of \$5.1 million, RBC hoped for staple financing fees of \$14-20 million for the Rural deal and \$14-35 million by financing a portion of any EMS deal.

When RBC began soliciting bids, it discovered that most larger firms were conflicted out of due to non-disclosure agreements signed during the EMS process. Nevertheless, RBC pressed on, and received six indications of interest. The special committee, but not the full Board, met to discuss these results in February 2011. RBC gave a presentation that included no valuation metrics. One director asked for and was given an analysis of potential LBO returns, showing that at \$18 per share, an LBO would result in five-year internal rates of return exceeding 20 percent. This information was not shared with the other directors.

It was not until March 15, 2011 that Rural held another meeting of its full Board. RBC's presentation again included no valuation metrics. The board adopted a resolution granting the special committee authority to seek a purchase of RBC. At the same time, RBC internally worked on securing a \$590 million staple financing package for Warburg, anticipating \$8-16 million in fees from this work.

Only Warburg offered a formal bid for Rural, at \$17.00 per share on March 22, 2011. After some negotiation, Warburg offered

\$17.25 per share on March 25, saying that it was Warburg's "best and final offer," and that it expired on March 28. RBC spent March 26 attempting to get a piece of the financing for Warburg's bid. RBC then submitted valuation materials to its internal fairness committee, but later tweaked the valuations in ways that made the offer more appealing. On March 27, 2011, the board accepted Warburg's \$17.25 per share offer. At 9:42 pm, the board received Warburg's valuation information – the first valuation information the Board ever received during this process. At 11:00 pm, the meeting began, and the board approved the merger after midnight.

The plaintiff alleged that RBC aided and abetted breaches of duty both during the sales process and by inducing disclosure violations. With a fiduciary relationship between Rural's board and its stockholders readily established, the court turned to whether there was a breach of fiduciary duty by Rural's board. The court noted the *Revlon* standard of review applied, whereby directors must have "act[ed] reasonably to seek the transaction offering best value reasonably available to stockholders." The court therefore asked "whether the defendant directors employed a reasonable decision-making process and reached a reasonable result."

Before turning to the merits of the sale process, the court considered whether Rural Metro's exculpatory charter provision – modeled after Section 102(b)(7) of the DGCL, which exculpates directors from liability for breaches of the fiduciary duty of care – precludes liability for aiding and abetting a breach of fiduciary duty. The court held that the statute only covers directors for breach of fiduciary duty, not aiders and abettors. Because Section 141(e) of the DGCL encourages directors to rely on advice from experts, the court held there are "sound reasons" why the legislature might wish to exculpate directors, but not experts advising the board.

The court then considered whether several decisions of the board fell outside the range of reasonableness. First, the court held that the decision to run the sales process in parallel with the EMS auction fell outside the range of reasonableness because RBC did not disclose that a parallel process advanced RBC's self-interest in gaining a role in the financing of bidders for EMC. RBC favored those bidders over others. Second, the court held that the decision to continue the sales process fell within the range of reasonableness, despite the fact that the special committee received six indications of interests at substantial premiums, because multiple private equity sources recommended deferring sale. Third, the court held that the board decision to accept Warburg's bid of \$17.25 per share fell outside the range of reasonableness because the Board failed to provide active and direct oversight of RBC: "When it approved the merger, the Board was unaware of RBC's last minute efforts to solicit a buy-side financing role from Warburg, had not received any valuation information until three hours before the meeting to approve the deal, and did not know about RBC's manipulation of its valuation metrics."

Having established that certain decisions of the board fell outside the range of reasonableness, thereby establishing a breach of fiduciary duty, the court determined that RBC knowingly participated when it, for improper motives of its own, misled the directors into breaching their duty of care. The court gave short shrift to RBC's argument that its engagement letter with Rural, which contained a generalized acknowledgment that the financial advisors might extend acquisition financing to other firms, somehow insulated RBC from liability because the actual conflict was not disclosed. The court held that RBC proximately caused the breach of fiduciary duty and harm to Rural "by causing the company to be sold at a price below its fair value" and that "RBC's self-interested manipulations caused the Rural process to unfold differently than it otherwise would have."

For similar reasons, the court held that RBC aided and abetted the board's breach of its fiduciary duty of disclosure by causing the board to include inaccurate valuation materials in its proxy statement, and causing the board to provide false and misleading statements about RBC's incentives in the proxy statement.

In October 2014, the court issued its opinion on damages in *In re Rural/Metro Stockholders Litigation*, 102 A.3d 205 (Del. Ch. 2014). The court: (i) determined that Rural's stockholders suffered \$91.3 million in damages from both director and financial advisor misconduct; (ii) allocated 83 percent of the damages (\$78.5 million) to RBC; and (iii) held that RBC's liability could not be reduced to account for damages attributable to directors who settled prior to trial but who would have otherwise qualified for protection under Rural's exculpatory provision. The opinion provides an extensive analysis of allocation of liability between directors and officers and those who may aid and abet a breach of fiduciary duty (like financial or other advisors) under Delaware's Uniform Contribution Among Tortfeasors Law (DUCATL), 10 Del. C. § 6301, *et seq.* The *Rural Metro* case was appealed and affirmed by the Delaware Supreme Court in late 2015. See *RBC Capital Markets LLC v. Jervis*, 129 A.3d 816 (Del. 2015), which is discussed below.

The Late 2015 and 2016 Cases

On October 20, 2015, in *TIBCO Software Inc. Stockholders Litigation*, the Court of Chancery denied a financial advisor's motion to dismiss a claim of aiding and abetting a breach of its client directors' fiduciary duty even while dismissing the claims asserted against the directors themselves under Section 102(b)(7) of the DGCL. Several weeks earlier, the Court of Chancery issued a similar ruling against a financial advisor in *In re Zale Corp. Stockholders Litigation* ("Zale I"), but the court reversed its own decision and dismissed the claim asserted against the financial advisor ("Zale II") soon after an intervening decision of the Supreme Court in *Corwin v. KKR Financial Holdings LLC*, issued the day after *Zale I* was handed down. Finally, in perhaps the most

hotly anticipated opinion of the year in Delaware, on November 30, 2015 the Delaware Supreme Court affirmed the judgment of the Delaware Court of Chancery in *RBC Capital Markets v. Jervis*, holding that RBC aided and abetted a breach of fiduciary duty by the directors of Rural in connection with Rural's 2011 sale.

The emerging line of cases on financial advisor liability have involved claims for damages after the underlying merger closed. All of the recent financial advisor liability cases have involved a finding that a target company's directors (sometimes allegedly misled by their financial advisor) failed to act "reasonably," which created a predicate breach of fiduciary duty for which aiding and abetting liability was a possibility. Because of the presumption provided by the business judgment rule, Delaware law generally requires more than "unreasonable" conduct for a fiduciary breach. However, plaintiffs in the financial advisor cases have asserted that a more demanding standard of review was applicable under the landmark decision in *Revlon v. MacAndrews & Forbes Holdings Inc.* — which held that directors are obligated to obtain the best price reasonably available when selling the company. In its recent *KKR* decision, the Supreme Court raised significant doubts about the future viability of such claims when it held that *Revlon* was "designed to give stockholders and the Court of Chancery the tool of injunctive relief" and was not "designed with post-closing money damages claims in mind." If "gross negligence," rather than a mere failure to act reasonably, is the standard for a care breach, as *KKR* suggests, then it may be harder for future stockholder plaintiffs to establish an underlying breach of fiduciary duty by target company directors in the merger context that could be a predicate for aiding and abetting liability for their financial advisor. The *RBC* decision further clarified that the *Revlon* standard of review begins to apply from the time that a board initiates a sale process to the exclusion of other strategic alternatives.

In re TIBCO

In re TIBCO Software Inc. Stockholders Litigation, 2015 WL 6155894 (Del. Ch. Oct. 20, 2015), arose out of the acquisition of TIBCO by private equity fund Vista Equity Partners V, L.P., in which stockholders of TIBCO received \$24 per share representing an aggregate equity value for the transaction of approximately \$4.144 billion. The defendant bank had served as TIBCO's financial advisor. The plaintiff alleged that both Vista and TIBCO entered into the transaction under a mistaken belief that the aggregate equity value was \$4.244 billion based on a capitalization spreadsheet that double-counted certain TIBCO shares that were used by Vista during the bidding process and also by the defendant bank in its fairness analysis. The error was not discovered until after the merger agreement was signed, prompting stockholders to sue to enjoin the merger and seek to reform the merger agreement. The Court of Chancery denied plaintiff's motion to enjoin the merger, finding that it had failed to demonstrate a reasonable probability of proving by clear and convincing evidence (the standard for reformation) that Vista

and TIBCO had specifically agreed that the merger would be consummated at a \$4.244 billion value.

After discovery, the plaintiff amended its complaint and asserted claims for reformation, breach of fiduciary duty against the directors, aiding and abetting and malpractice against the defendant bank and unjust enrichment. The court granted motions to dismiss all of these claims, except for a claim against the defendant bank for aiding and abetting an alleged breach of fiduciary duty, concluding that the plaintiff failed to allege an offer by Vista to purchase all the TIBCO shares on the basis of an implied equity value of \$4.244 billion (instead of a price per share). However, for purposes of the motions to dismiss the Court of Chancery was willing to credit the plaintiff's allegation that the board "failed to adequately inform itself about the circumstances of the Share Count Error and what options and strategies it had to potentially capture some or all of the \$100 million." Although this alleged failure was not sufficient to state a claim for breach of the duty of loyalty or good faith, the court concluded that "it is reasonably conceivable that the [allegations regarding the share count error] would sustain a duty of care claim . . . that could form the predicate breach for an aiding and abetting claim" against the financial advisor. In particular, the court was concerned that the board of directors never considered a reformation claim and failed to ask its financial advisor how the error occurred and whether the financial advisor ever discussed the error with Vista. Although the directors were exculpated from liability for this alleged breach of the duty of care pursuant to the 102(b)(7) exculpatory provision in TIBCO's charter, the breach could be a predicate for aiding and abetting liability for the defendant bank.

The court then turned to whether the plaintiff sufficiently stated a claim against the defendant bank for aiding and abetting the directors' alleged breach. The court refused to dismiss that claim finding it "reasonably conceivable that [the financial advisor's] alleged failure to disclose this material information to the Board created an information vacuum at a critical juncture when the Board was still assessing its options." The court also noted plaintiff's allegation that the financial advisor may have been motivated to conceal the information by a desire to protect its fee, which was largely contingent on the merger transaction closing.

In re Zale Corp.

In re Zale Corp. Stockholders Litigation, 2015 WL 5853693 (Del. Ch. Oct. 1, 2015), reconsideration granted, 2015 WL 6551418 (Del. Ch. Oct. 29, 2015), addressed a proposed sale by a large shareholder of a corporation. In September 2013, Golden Gate Capital notified Zale that it intended to sell its shares (totaling 23.3 percent of Zale's outstanding common stock) into the public market. Zale and Golden Gate engaged a financial advisor as lead underwriter and filed a Form S-3. Four days later, Signet Jewelers Limited reached out to Zale, informing its directors that Signet

was considering making an offer to acquire Zale. A month later, Signet offered to purchase all of Zale's outstanding common stock for \$19 per share in an all-cash deal. The offer also required Golden Gate to agree to vote in favor of the merger. In response, Golden Gate promptly cancelled its proposed public offering.

Plaintiff stockholders of Zale alleged that the financial advisor previously informed the board of directors it had "limited prior relationships and no conflicts with Signet," and, according to plaintiffs, the Zale board purportedly made no further inquiry of the potential for conflicts based on that representation. The plaintiffs alleged that the financial advisor in fact had received approximately \$2 million in fees from Signet in the year prior to the merger agreement and previously had made a presentation to Signet advocating a purchase of Zale. A senior banker on the Zale engagement had been a member of the team that previously pitched the idea to Signet.

On motions to dismiss brought by defendants, the Court of Chancery analyzed various alleged conflicts on the part of the Zale directors, but found that none of such allegations constituted breaches of the directors' loyalty and that the plaintiffs had not sufficiently alleged bad faith with respect to the directors' actions. The court next analyzed plaintiffs' claims that the directors breached their duty of care because, although the directors were exculpated from liability based on the 102(b)(7) provision, the due care analysis was relevant to the aiding and abetting claim against their financial advisor.

The court found that it was "reasonably conceivable that the Director Defendants did not act in an informed manner" – that, at the pleading stage, it could reasonably be alleged that the board should have done more to find out about potential conflicts, including (i) negotiating for representations and warranties in the engagement letter or (ii) asking probing questions about past interactions between its financial advisor and known potential buyers. The court also relied on the allegation that the Zale board did not consider any other financial advisors and acted with haste in deciding which financial advisor to hire. Importantly, in reaching its conclusions, the court evaluated whether the Zale directors breached their duty of care under the lens of the *Revlon* standard of review, which inquiry "focuses on whether the [director defendants'] actions fall within a range of reasonableness with the ultimate goal of maximizing the [c]ompany's sale price in mind." The court initially applied *Revlon* – even though the transaction had been approved by an uncoerced, fully informed majority of disinterested stockholders – based on its strict reading of Supreme Court precedent.

In its original opinion, the court refused to dismiss the aiding and abetting claim against the financial advisor, finding sufficient allegations at the pleading stage of (i) "knowledge" of the underlying breach of duty of care by the Zale directors, because a senior banker on the Zale engagement also had been a member

of the earlier pitch to Signet and (ii) "participation" in the breach because the financial advisor allegedly delayed disclosing the conflict until after the merger agreement was signed.

On October 29, 2015, however, the Court of Chancery reversed its own decision, based on the Supreme Court's intervening decision in *KKR*. In *KKR*, the Supreme Court clarified that in post-closing damages actions (such as *Zale I*), the business judgment rule standard of review is invoked, even where *Revlon* otherwise might apply, if the underlying transaction was submitted to and then approved by an uncoerced, fully informed vote of a majority of disinterested stockholders. *KKR* therefore required the Zale directors' conduct in approving the underlying merger to have been reviewed under the deferential *business judgment rule* standard. As the *Zale II* court explained, the "threshold for finding a breach of the duty of care in the *Revlon* reasonableness context is lower than in the business judgment rule context . . . [which] is predicated upon concepts of gross negligence." Unlike the "searching" reasonableness review, gross negligence has been described as "reckless indifference or a gross abuse of discretion." In *Zale II*, although the court previously had found that the Zale directors' conduct was *unreasonable* (under *Revlon*), the court found that the plaintiffs had not adequately alleged that the directors had been so negligent as to rise to "reckless indifference or a gross abuse of discretion." Accordingly, on reconsideration, the aiding and abetting claim against the financial advisor was also dismissed because there was no basis for a predicate fiduciary duty breach by the board.

RBC Capital Markets v. Jervis

The history of the *RBC Capital Markets LLC v. Jervis*, 129 A.3d 816 (Del. 2015), and the Court of Chancery's ruling are discussed above. On appeal, the Delaware Supreme Court agreed with the Court of Chancery's findings with regard to the following process-related deficiencies: (1) the sale process was designed to run in parallel with a bidding process for Rural/Metro's principal competitor, Emergency Medical Services Corporation (EMS), which deterred EMS and the bidders for EMS from participating in bids for Rural/Metro; (2) that faulty sale process design was caused by RBC's efforts, unbeknownst to the Rural/Metro board, to get on buy-side financing trees for private equity firms bidding for EMS; (3) RBC provided the Rural/Metro board with inadequate and misleading valuation information, without affording the board adequate time to review that material before it approved the private equity firm's final bid; and (4) RBC actively pursued opportunities to provide staple financing to the private equity buyer, and shared confidential information about the Rural/Metro board's bottom line on price with the private equity firm, at the same time it was engaged in final price negotiations with the private equity firm on behalf of Rural/Metro. In evaluating the board's conduct under *Revlon*, the court affirmed the Court of Chancery's determination that the *Revlon* standard of review

begins to apply from the time that a board initiates a sale process to the exclusion of other strategic alternatives. The court also affirmed the Court of Chancery's finding that "the Board violated its situational duty by failing to take reasonable steps to attain the best value reasonably available to stockholders," but that the conduct did not rise to the level of gross negligence.

RBC argued to the Supreme Court that a third party cannot knowingly participate in a board's breach of the duty of care because such breaches are, by definition, only grossly negligent, and therefore lack the level of intentionality necessary for a third party to "knowingly participate" in them. The Delaware Supreme Court rejected this contention. It explained that "[i]t is the aider and abettor," not the predicate fiduciary, "that must act with scienter," and affirmed the trial court's holding that "if the third party knows that the board is breaching its duty of care and participates in the breach by misleading the board or creating the informational vacuum, then the third party can be liable for aiding and abetting."

The court cautioned that its holding was a "narrow one that should not be read expansively to suggest that any failure on the part of a financial advisor to prevent directors from breaching their duty of care gives rise to a claim for aiding and abetting a breach of the duty of care." The court added that the *scienter* requirement "makes an aiding and abetting claim among the most difficult to prove." Notably, the court expressly declined to adopt the trial court's description of a financial advisor's role in M&A transactions as a "gatekeeper." The court explained that this "amorphous 'gatekeeper' language would inappropriately expand [its] narrow holding here by suggesting that any failure by a financial advisor to prevent directors from breaching their duty of care gives rise to an aiding and abetting claim."

Singh v. Attenborough

In *Singh v. Attenborough*, 137 A.3d 151 (Del. 2016), the Delaware Supreme Court, in dicta reaffirmed that Delaware law generally provides advisors with "a high degree of insulation from liability by employing a defendant-friendly standard that requires plaintiffs to prove scienter." However, as held in *RBC* "an advisor whose bad-faith actions caused its board clients to breach their situational fiduciary duties to breach their fiduciary duties (e.g., the duties *Revlon* imposes in a change-of-control transaction) is liable for aiding and abetting."

In re Dole

In *In re Dole Food Co., Inc. Stockholder Litigation*, 2015 WL 5052214 (Del. Ch. Aug. 27, 2015), Vice Chancellor Laster concluded that Deutsche Bank was not liable for aiding and abetting. In *Dole*, David Murdock acquired all remaining shares of the company. Before the transaction, Murdock was its chairman, CEO, and *de facto* controller, by virtue of the fact he owned about 40

percent of Dole's common stock. The court found that Murdock and an affiliate had provided false information to the committee regarding company projections, causing the evaluation of the merger not be on a fully informed basis.

The plaintiff, however, failed to prove that Deutsche Bank knew about any of the misrepresentations to the committee. In short, the Vice Chancellor stressed that at the time Deutsche Bank participated in certain meetings, because it was acting as Murdock's advisor and lead financier, it was not Deutsche Bank's job to "call the Committee, its counsel, or Lazard to make sure everything was OK"; rather, "[t]he fault lay with Dole's officers and employees . . . who owed their duties to Dole." Plaintiffs also took issue with the fact that Murdock shared confidential information with Deutsche Bank to plan the freeze-out. But the court noted that "a fiduciary sharing of information with an affiliated stockholder and its advisors, standing alone, is not inherently a breach of duty," and thus Deutsche Bank could not be liable for its part in planning the freezeout using certain confidential information about Dole. In *dicta*, Vice Chancellor Laster observed that a bright-line anti-sharing rule might be warranted, and if there were such a rule, the outcome for Deutsche Bank may have been different.

Takeaways

- The *Revlon* standard of review begins to apply when a board commences a sale process to the exclusion of other alternatives. In order to avoid triggering *Revlon*, boards should ensure that any sales process is part of an overall strategic review of all alternatives.
- When *Revlon* applies and the court determines a board's conduct falls outside the range of reasonableness, such a finding is a sufficient predicate for third-party aiding and abetting liability, even if the directors are exculpated from liability.
- While financial advisors are not labeled "gatekeepers," they may still face liability if they contributed to a board's failure to meet its duties.
- How Delaware courts resolve the apparent tension between *Corwin*, which stated that "*Unocal* and *Revlon* are primarily designed to give stockholders and the Court of Chancery the tools of injunctive relief . . . [t]hey were not tools designed with post-closing money damages in mind, the standards they articulate do not match the gross negligence standard for director due care liability under *Van Gorkom*," and *RBC*, which held that "if [directors] were subject to *Revlon* duties, and their conduct was unreasonable," they could be deemed to have violated their "situational duty" even if they did not act with gross negligence, remains to be seen.



“ENTIRE FAIRNESS” REVIEW APPLIES TO NON-SQUEEZE OUT TRANSACTIONS IN WHICH CONTROLLER EXTRACTS NON-RATABLE BENEFITS

In *In re EZCORP Inc. Consulting Agreement Derivative Litigation*, 2016 WL 301245 (Del. Ch. Jan. 25, 2016) (Vice Chancellor J. Travis Laster), held that the entire fairness standard of review, not the business judgment rule, should govern the review of transactions whereby a controller extracts non-ratable benefits from the company, even when such transactions ultimately were approved by a committee of independent directors.

Background

Defendant Phillip Cohen controlled EZCORP Inc. through his ownership of the limited partnership that owned all of the company's 2,970,171 shares of voting stock; all of the company's 50,612,246 shares of non-voting stock was publicly traded. Cohen therefore controlled 100 percent of the voting power of EZCORP, but held only 5.5 percent of the company's equity. From 2011 to

2014, the company entered into advisory services agreements with other entities controlled by Cohen, some of which called for services capable of being performed by EZCORP's management team. All such agreements were approved by the company's audit committee of the board and resulted in compensation payments amounting to significant portions of EZCORP's annual revenue. As the company began performing poorly, the board terminated the 2014 advisory services agreement, and soon after, plaintiff made demand to inspect of the company's books and records. Cohen responded by using his voting power to remove and replace several members of the board; two of the removed directors were members of the audit committee. The company then refused plaintiff's demand. The plaintiff filed suit in 2014, challenging the related-party agreements and asserting claims of breach of fiduciary duties and waste against the directors, and aiding and abetting and unjust enrichment against Cohen and his

affiliate entities. Essentially, the plaintiff asserted that the advisory services agreements were illegitimate means by which Cohen could extract cash from the company with little exposure on the EZCORP side (also known as tunneling). The remaining directors for purposes of the court's opinion were Cohen, his affiliates and one of the directors, who was a member of the audit committee that approved some of the advisory services agreements, moved to dismiss under Court of Chancery Rule 12(b)(6) for failure to state a claim and Rule 23.1 for failure to plead demand futility.

The Court's Decision: The Entire Fairness Standard Of Review Applies Any Time Controllers Extract Non-Ratable Benefits

Defendants argued that the business judgment standard of review should apply to the court's review of the advisory services agreements, as the agreements related to ordinary business transactions (*i.e.*, compensation) and were approved by an independent committee of the board. The defendants relied on three Court of Chancery decisions (*Friedman v. Dolan*, 2015 WL 4040806 (Del. Ch. June 30, 2015); *In re Tyson Foods, Inc. Consol. S'holder Litig.*, 919 A.2d 563 (Del. Ch. 2007); *Canal Capital Corp. v. French*, 1992 WL 159008 (Del. Ch. July 2, 1992)) that relied on one of the Delaware Supreme Court's seminal demand futility decisions, *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984), for the proposition that the business judgment rule and not the entire fairness framework provided the standard of review for a transaction in which a controller received non-ratable benefits, at least where the transaction involved compensation or a consulting agreement and was approved by a board or committee with an independent majority of outside directors. After reviewing in detail dozens of other decisions of the Delaware courts, however, the Court of Chancery concluded that the great weight of authority supported the view that, instead, the entire fairness standard should govern transactions whereby controllers extract non-ratable benefits. The only established exception to this, the court noted, is if the controller agrees up front (and before any negotiations) that the controller will not proceed without the affirmative recommendation of the independent and disinterested directors and the affirmative vote of the majority of the unaffiliated stockholders. See *Kahn v. M & F Worldwide Corp.*, 88 A.3d 635, 642 (Del. 2014) ("*MFW*"). Vice Chancellor Laster also expressed his personal view that *Aronson* should not be extended beyond its application to demand futility, and certainly not to cut back on post-*Aronson* case law governing entire fairness transactions.

After determining that entire fairness should govern the court's review of the agreements, the court concluded that the plaintiff's complaint supported a reasonable inference that the agreements were not entirely fair to the company (*i.e.*, that they represented a means by which Cohen extracted a non-ratable personal return from EZCORP), and thus, the plaintiff stated a claim for breach

of fiduciary duty. The court therefore largely denied defendants' Rule 12(b)(6) motion. In so finding, the court took into account the company's capital structure, which incentivized tunneling, the history of EZCORP's executing agreements with Cohen-affiliated entities, the magnitude of the compensation, the company's decision to terminate the agreements, and Cohen's retaliation. As to the plaintiff's waste and aiding and abetting claims, the court determined they could proceed, but noted that breach of fiduciary duty likely would be the relevant theory for relief. Finally, the court also found, largely based on the circumstances created by Cohen's retaliatory reorganization, a reasonable doubt that the board lacked a majority of independent and disinterested directors and thus was incapable of exercising valid business judgment in evaluating a litigation demand. The court therefore denied defendants' Rule 23.1 motion as well. Subsequently, the court refused to certify an interlocutory appeal.

Takeaways

- Unless a controller takes advantage of the Supreme Court's decision in the *MFW* case, the entire fairness standard will govern transactions in which a controller extracts non-ratable benefits, even as to transactions other than squeeze-out mergers or other transformative transactions.
- Whether the Delaware Supreme Court will adopt Vice Chancellor Laster's view on *Aronson*'s applicability outside demand futility is an open question.



“ANTI-RELIANCE” PROVISIONS MUST BE EXPRESSED CLEARLY AS AN AFFIRMATIVE STATEMENT

Adding further dimension to Delaware law on disclaimers of extra-contractual liability (so-called anti-reliance provisions), the Court of Chancery held in *FdG Logistics LLC v. A&R Logistics Holdings, Inc.*, 131 A.3d 842 (Del. Ch. 2016) (Chancellor Andre G. Bouchard), that such disclaimers, to be effective, must be expressed unambiguously as an affirmative statement by the allegedly aggrieved party.

Background

The case arose out of a private equity firm's purchase of a trucking company, now owned by A&R Logistics Holdings, Inc. The firm's purchase of the company was structured as a merger, whereby the capital stock the sellers owned immediately before the closing was canceled and extinguished and converted into the right to receive a cash payment, as well as a pro rata share of any amounts to be disbursed in accordance with the merger agreement. As is common, the merger agreement contained an indemnification clause and, covered by that, a series of

representations and warranties made by the seller, and also a disclaimer that seller made no representations and warranties except as expressly stated in the merger agreement itself. In addition, the agreement contained a plain vanilla, neutrally-drafted integration clause: "This Agreement, the Transaction Documents and the documents referred to herein and therein contain the entire agreement between the Parties and supersede any prior understandings, agreements or representations by or between the Parties, written or oral, which may have related to the subject matter hereof in any way."

Less than six months after executing the merger agreement, the buyer sent to the sellers at least 12 indemnification claim notices, asserting, in summary, that sellers had engaged in an extensive series of illegal and improper activities that were concealed from it during pre-merger due diligence before buyer entered the merger agreement. For example, the buyer asserted that the company's drivers had falsified hours-of-service logs to increase their "daily miles driven," that the company's tank wash facility

illegally dumped wastewater, and that the company had issued fake “wash tickets” indicating that trucks had been washed before hauling sensitive loads and then charging customers for the never-performed washes. The sellers disputed all of these claims.

FdG Logistics LLC, the representatives of the sellers, commenced this lawsuit to recover a pre-closing tax refund that the A&R obtained, but which FdG purportedly was entitled to under the merger agreement; A&R then asserted counterclaims for, among other things, indemnification and common law fraud.

The Court’s Ruling

This opinion further clarifies the law since the seminal Delaware opinion on anti-reliance provisions, *Abry Partners V, L.P. v. F & W Acquisition LLC*, 891 A.2d 1032 (Del. Ch. 2006). Writing then as Vice Chancellor, Chief Justice Strine counseled in *Abry*:

The teaching of this court, through cases such as [*Great Lakes Chem. Corp. v. Pharmacia Corp.*, 788 A.2d 544 (Del. Ch. 2001)]; [*H-M Wexford LLC v. Encorp, Inc.*, 832 A.2d 129 (Del. Ch. 2003)]; [*Progressive Int’l. Corp. v. E.I. Du Pont de Nemours & Co.*, 2002 WL 1558382 (Del. Ch. July 9, 2002)], and [*Kronenberg v. Katz*, 872 A.2d 568 (Del. Ch. 2004)] is that a party cannot promise, in a clear integration clause of a negotiated agreement, that it will not rely on promises and representations outside of the agreement and then shirk its own bargain in favor of a ‘but we did rely on those other representations’ fraudulent inducement claim.

But, keeping in mind the state’s strong public policy against fraud, the Court of Chancery has long held that, to effectively insulate oneself from liability relating to a counterparty’s reliance on statements made outside of a contract, the contract must contain an express integration provision clearly and unambiguously disclaiming such reliance.

Reviewing *Abry* and two recent opinions issued by the Court of Chancery interpreting it – *Prairie Capital III, L.P. v. Double E Holding Corp.*, 2015 WL 7461807 (Del. Ch. Nov. 24, 2015); *Anvil Holding Corp. v. Iron Acquisition Co., Inc.*, 2013 WL 2249655 (Del. Ch. May 17, 2013) – the Chancellor held that, to be enforceable, an anti-reliance provision must be expressed clearly as an affirmative statement by the party claiming to be defrauded. In *Anvil*, the court refused to dismiss the case because clauses in issue were framed neutrally, not from the point of view of the buyer, and thus did not “reflect a clear promise by the Buyer that it was not relying on statements made to it outside of the Agreement to make its decision to enter the Agreement.” In *Prairie Capital*, the court reached the opposite result because the clause in issue was stated as a clear expression of non-reliance by the aggrieved party.

Following the above case law, because the clauses in issue were stated neutrally, as in *Anvil*, the Chancellor held they were unenforceable as anti-reliance provisions against the buyer. The court therefore denied the seller’s motion to dismiss.

The Delaware Supreme Court *en banc* summarily affirmed the Court of Chancery’s decision in FdG “on the basis of and for the reasons assigned in its well-reasoned decision dated February 23, 2016.” *A&R Logistics Holdings, Inc. v. FdG Logistics LLC*, 148 A.3d 1171 (TABLE) (Del. 2016).

Takeaway

- The Court of Chancery will continue to follow the *Abry* line of cases and enforce anti-reliance provisions. But, to be truly effective, such provisions must be framed as an affirmative statement by the party against whom it is to be enforced.

“FOR CAUSE” REMOVAL OF DIRECTORS DECLARED UNENFORCEABLE UNLESS THE COMPANY HAS A CLASSIFIED BOARD

As a general matter, charter and bylaw provisions are presumed to be valid. But the DGCL expressly prohibits the adoption of a charter provision or bylaw that is contrary to the laws of Delaware. See 8 Del. C. § 102(b)(1); 8 Del. C. § 109(b). In a December 21, 2015 transcript ruling in *VAALCO Energy Inc.*, Consol. C.A. No. 11776-VCL (Del. Ch.), the Court of Chancery squarely addressed the validity of a charter and bylaw provision that provided directors could be removed only “for cause.” The court held that the removal only for cause requirement in VAALCO’s charter and bylaws was invalid because it conflicted with 8 Del. C. § 141(k).

Section 141(k) of the DGCL provides that “[a]ny director or the entire board of directors may be removed, with or without cause, by the holders of a majority of the shares entitled to vote at an election” with two express exceptions: (1) when the board is classified as provided in Section 141(d); or (2) where a corporation has cumulative voting, if less than the entire board is to be removed. Neither exception applied in VAALCO’s circumstances, so the removal only for cause requirement was void because it conflicted with the statute.

Takeaways

- In recent years many corporations have declassified their boards of directors and VAALCO was one of them. When the stockholders of VAALCO voted to do so, they did not have the opportunity to vote to eliminate the director removal only for cause provisions in the company’s charter and bylaws. It was pointed out to the Court of Chancery that at least 175 corporations have similar removal only for cause provisions. This was of no moment because the provisions in VAALCO’s charter and bylaws were contrary to law. Corporations with similar provisions and circumstances should amend their charter and bylaws to eliminate the removal for cause requirement. Otherwise, activists may demand it and seek attorney’s fees for accomplishing the change either through litigation or agreement. The VAALCO case confirms the settled public policy that there can be no limitation on the right of stockholders to remove a director without cause except for the narrow exceptions expressly provided within Section 141(k).
- One question not answered in VAALCO is whether the vote threshold to remove a director can be raised. Pursuant to 8 Del. C. § 102(b)(4), which provides that “the certificate of incorporation may ... contain any or all of the following matters: ... Provisions requiring for any corporate action, the vote of a larger portion of the stock or any class or series

thereof, or of any other securities having voting power, or a larger number of the directors, than is required by this chapter,” a charter provision can raise the vote threshold to remove a director to a unanimous vote. That is not inconsistent with Section 141(k). In addition, it is also arguable that raising the voting requirement can be effected in a company bylaw, so long as the charter expressly delegates such authority to the providence of bylaws. A very similar issue was presented in *Frechter v. Zier*, C.A. No. 12038-VCG (Del. Ch. Jan. 24, 2017), where the court reviewed whether a super majority requirement in a bylaw (as opposed to the charter) is lawful. Section 102(b)(4) expressly requires that any such change in the required vote threshold be in the charter, not a bylaw. However, the company argued that Section 216 of the DGCL, dealing with what is required for a quorum in order to vote at a meeting, confers such authority. The court rejected the argument as inconsistent with the plain language of Section 141(k). In a footnote, the court acknowledged the important differences between what can be in a bylaw under Section 109(b) and what can be modified in a charter pursuant to Section 102(b)(4), but the court did not answer the question of whether the case would have turned out differently had the super majority threshold been in the charter.

WHAT TO LOOK FOR IN 2017

In 2017, we can expect merger activity to grow, but given Delaware's willingness to give business judgment protection to companies that follow the procedural steps outlined in *MFW* (i.e., approval by both a special committee and a fully informed vote of the majority of the minority outstanding), along with Delaware's crackdown on disclosure-only settlements, the downward trend in stockholder litigation evident in the statistics for the first half of 2016 may continue or at least stabilize at the decreased levels. In late 2016, the Delaware Supreme Court, in *Employees Retirement System of the City of St. Louis v. TC Pipelines, GP, Inc.*, 2016 WL 7338592 (Del. Supr. Dec. 19, 2016), reaffirmed that the pleading stage is an appropriate point to determine if a transaction complied with *MFW*'s procedural requirements. As to disclosure-only settlements, an unanswered question is whether companies will waive Delaware as the exclusive forum for disputes in order to get a broader release elsewhere. If that is the case, one would expect to see more non-Delaware courts applying *Trulia*.

Aiding and abetting liability should be more difficult to establish in light of some very strong language used in the *RBC* decision, but it remains to be seen how the Court of Chancery will deal with the "situational duties" of directors when selling the company, as expressly recognized in *RBC*, and whether there will be a more expansive or searching "reasonableness" inquiry in litigation challenging sale transaction or whether market checks will evolve to moot such claims as in *Corwin*.

Corporate law reform to curb stockholder litigation abuses will continue to be a subject of debate, including efforts to work around or mitigate concerns raised by Delaware's 2015 ban on fee-shifting provisions. Clearly, if the *Solak* decision is affirmed and the ban is interpreted to extend even to a provision that puts enforcement teeth in an exclusive forum bylaw or charter provision, perhaps further legislation will be required.

2016 AMENDMENTS TO THE DELAWARE GENERAL CORPORATION LAW AND ALTERNATIVE ENTITY STATUTE

2016 Amendments to the Delaware General Corporation Law

The following amendments became effective on August 1, 2016, except that amendments to Sections 111(a)(2), 251(h), and 262(c) and (d) are effective only as to corporate acts on or after August 1, 2016:

§ 104, Certificate of Incorporation

Section 104 was amended in connection with other amendments to Sections 311 (Restoration of Certificate of Incorporation), 312 (Revival of Certificate of Incorporation), and 313 (Revival of Certificate of Incorporation or Charter of Exempt Corporations), which amendments are explained below.

§ 111(a)(2), Court of Chancery Jurisdiction

Amended Section 111(a)(2) permits the Court of Chancery to exercise non-exclusive jurisdiction over civil actions involving certain instruments, documents, or agreements (i) “to which a corporation and one or more holders of its stock are parties, and pursuant to which any such holder or holders sell or offer to sell any of such stock,” and (ii) “by which a corporation agrees to sell, lease or exchange any of its property or assets, and which by its terms provides that one or more holders of its stock approve of or consent to such sale, lease or exchange.” Amended Section 111(a)(2) will not affect concurrent subject matter jurisdiction over civil actions at law involving such matters.

§ 141, Quorum and Voting Rules for Boards of Directors, Committees and Subcommittees

Section 141(b) was amended to eliminate surplus language otherwise addressing the minimum voting requirement for a one-person board of directors: “except that when a board of 1 director is authorized under this section, then 1 director shall constitute a quorum.”

Amendments to Section 141(c) were two-fold. First, the amended Section 141(c)(3) now provides that all references in the DGCL to “committees” (and “members” of committees) will be deemed to include references to “subcommittees” (and, likewise, “members” of such subcommittees). Second, Section 141(c)(4) was amended to provide that a majority of the directors serving on a committee or subcommittee shall constitute a quorum, unless

the certificate of incorporation, bylaws, resolution of the board of directors, or the committee that created a subcommittee, requires a greater or lesser number, except that in no case shall a quorum be less than 1/3 of the directors then serving on the committee or subcommittee.

Section 141(d) was amended to harmonize the statute with amended Section 141(c)(3) by eliminating the express reference to subcommittees of committees of a board of directors.

§ 158, Execution of Stock Certificates

Section 158 was amended to eliminate the requirement that all stock certificates must be executed “by the chairperson or vice-chairperson of the board of directors, or the president or vice-president, and by the treasurer or an assistant treasurer, or the secretary or an assistant secretary.” Amended Section 158 now provides instead that “any two authorized officers of the corporation” may execute stock certificates. The General Assembly explained in the Bill’s synopsis that the amendment to Section 158 “was not intended to change the existing law that the signatures on a stock certificate may be the signatures of the same person, so long as each signature is made in a separate officer capacity of such person.”

§ 251(h), Intermediate-Form Mergers

The General Assembly amended Section 251(h) in several ways. First, to use Section 251(h), the target corporation’s stock must be listed on a national exchange or be held by more than 2,000 stockholders. This requirement applies even if not all classes or series of the target’s stock are so listed or held. Second, Section 251(h)(2), as amended, states that a tender or exchange offer may be “conditioned on the tender of a minimum number or percentage of shares of [] stock,” and that such condition may be effectuated through separate offers. Third, Section 251(h)(3) now provides that buyers can include in calculating whether the merger obtains the minimum number of shares required, both “rollover” stock* and shares of the target’s stock that are held in treasury, or “held by any person that owns, directly or indirectly, all of the outstanding stock of the” offeror or a direct or indirect wholly-owned subsidiary of the offeror and that such stock may be excluded from the requirement that it be converted in the merger consideration. Fourth, amended Section 251(h)(6)(f) clarifies the means by which the target’s stock is “received” for purposes of determining whether the statutory minimum

tender condition has been satisfied. For example, “certificated” shares are “received” upon physical receipt of a stock certificate accompanied by an executed letter of transmittal. Further, “uncertificated” shares held by a clearing corporation as nominee will be “received” by transfer into the depository’s account “by means of an agent’s message,”** and as to “uncertificated” shares not so held, such shares will be “received” upon physical receipt of a stock certificate accompanied by an executed letter of transmittal. Under this amendment, regardless of how uncertificated shares are held, as explained by the General Assembly, they will “cease to be ‘received’ to the extent such [] shares have been reduced or eliminated due to any sale of such shares prior to the consummation of the [o]ffer.”

- * “Rollover” stock is defined in the statute, subject to certain conditions, as “any shares of stock of such constituent corporation that are the subject of a written agreement requiring such shares to be transferred, contributed or delivered to the consummating corporation or any of its affiliates in exchange for stock or other equity interests in such consummating corporation or an affiliate thereof; *provided, however*, that such shares of stock shall cease to be rollover stock for purposes of paragraph (h)(3) of this section if, immediately prior to the time the merger becomes effective under this chapter, such shares have not been transferred, contributed or delivered to the consummating corporation or any of its affiliates pursuant to such written agreement.” (Emphasis in original.)
- ** An “agent’s message” is defined in the General Assembly’s bill synopsis as “a message transmitted by the clearing corporation acting as nominee, received by the depository, and forming a part of the book-entry confirmation, which states that such clearing corporation has received an express acknowledgment from a stockholder that such stockholder has received the offer and agrees to be bound by the terms of the offer, and that the offeror may enforce such agreement against such stockholder.”

§ 262, Appraisal Rights and Proceedings

The General Assembly amended Section 262 in two principal respects. First, under amended Section 262(g), the Court of Chancery “shall dismiss” the appraisal proceedings “as to all holders of such shares who are otherwise entitled to appraisal rights unless (1) the total number of shares entitled to appraisal exceeds 1 percent of the outstanding shares of the class or series eligible for appraisal, (2) the value of the consideration provided in the merger or consolidation for such total number of shares exceeds \$1 million, or (3) the merger was approved pursuant to [Section 253] or [Section 267].” As explained by the General Assembly, this amendment is intended to reduce the risk of appraisal proceedings being pursued as settlement leverage. Second, amended Section

262(h) permits the corporation the subject of appraisal proceedings to prepay plaintiff stockholders to avoid accrual of interest during the proceedings. Interest will still accrue, however, as to the difference, if any, between the amount prepaid and the fair value as determined by the court, and any interest previously accrued. The intent behind this amendment is to reduce instances of appraisal arbitrage.

§§ 311, 312, 313, 314, Renewal, Revival, Extension and Restoration of Certificates of Incorporation

Section 311, as amended, permits a corporation to restore, through a series of specified procedures, its certificate of incorporation to continue its business following the expiry of the corporation’s existence as set forth in the certificate. Such restoration may be pursued during the three-year winding-up period provided by Section 278, or a longer time as ordered by the Court of Chancery.

Amended Section 312 distinguishes the difference between extending the term of a corporation’s certificate or restoring an expired certificate from “reviving” a certificate that has been forfeited or void. The amendment eliminated from the statute the words “renewal,” “extension,” and “restoration.” Among other things, the amendment to Section 312 also has streamlined the process of approving the revival of the certificate by providing “a majority of the directors or members of the governing body then in office, even though less than a quorum, or the sole director or member of the governing body then in office” can authorize the revival of the certificate.

Sections 313 and 314 were amended to conform to the amendments to Sections 311 and 312.

2016 Amendments to Delaware’s Alternative Entity Statutes

The following amendments to the Delaware Limited Liability Company Act, 6 Del. C. §§ 18-101, et seq., and the Delaware Revised Uniform Limited Partnership Act, 6 Del. C. §§ 17-101, et seq., are effective as of August 1, 2016:

§§ 17-105, 18-105, Service of Process

Amendments providing the method of service of process on a series.

§ 17-218(b), 18-215(b), Agreement of Series to be Liable for Debts of Entity

Amendments clarifying that neither the first sentence of the Section (providing for limitation of liability for entity and its series) nor language in an organizational agreement shall be construed as limiting a series from agreeing to be liable for any or all debts of the entity.

§§ 17-218(k), 17-401(b), 17-402(a), 17-704(a), 17-801, 17-806, 18-215(k), 18-304, 18-702(a), 18-704(a), 18-801, 18-806, Consent to Actions

Amendments eliminating the requirement for a written consent and providing that members or partners may consent to a specified action by means other than a writing.

§§ 17-302(e), 17-405(d), 18-304(d), 18-404(d), Approval of Members/Managers and Limited/General Partners

Amendments providing that members/managers or limited/general partners may take actions without a meeting, prior notice, or a vote if “consented to and approved, in writing, [be] electronic or by any other means permitted by law.” As explained by the General Assembly in the bill’s synopsis, the amendments are “intended to be enabling and not intended to restrict the way in which [members/managers or limited/general partners] may vote on, consent to or approve any matter.”

§ 18-704(a)(3), Voluntary Assignment of Interests by Sole Member

Amendment providing that unless otherwise provided in the LLC agreement, or otherwise provided in connection with an assignment of interest, upon a voluntary assignment by the sole members of all LLC interests to a single assignee, such assignee is considered admitted as a member of the LLC. Such an assignment is “voluntary” under amended Section 18-305 if it is consented to by the member and not affected by foreclosure or similar legal process.

ABOUT DLA PIPER

DLA PIPER WORLDWIDE

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Our Mergers and Acquisitions group acts each year as counsel on a large number of mergers and acquisitions transactions. We are consistently ranked among the top US firms in number of announced and completed deals. As *mergermarket* notes, since January 2005, we have acted on more global M&A deals than any other law firm, according to *mergermarket*'s league tables for legal advisors, in 2016 DLA Piper again earned the No. 1 ranking globally for overall deal volume.

DLA PIPER IN DELAWARE

DLA Piper's Wilmington, Delaware office is an integral part of the firm's national and international practice and significantly enhances the firm's capacity to provide full-service solutions to our clients in all significant areas of business law. DLA Piper's Delaware lawyers are established trial and transactional lawyers recognized by *Chambers USA*, with substantial experience in handling matters in multiple venues focusing on the core areas for which Delaware is nationally and internationally renowned.

The corporate lawyers in DLA Piper's Delaware office represent corporations, boards of directors, individual officers and directors, special board committees and large investors. In addition to counseling on corporate and governance issues, this practice involves advising on deal structure and compliance with fiduciary duties as well as representation in the Delaware courts. The litigation aspect of the corporate practice covers class actions and derivative breach of fiduciary claims, corporate control disputes, merger and acquisition litigation, actions involving the interpretation of charter provisions and bylaws, actions by directors and/or officers seeking advancement and/or indemnification, stockholder appraisal actions, stockholder requests for books and records, internal corporate investigations, litigation arising out of transactions involving subsidiaries, tender offers, asset sales, capital restructurings, stockholder meetings and votes, dissolutions, corporate reporting and compliance programs and other matters involving corporate governance and the Delaware General Corporation Law.

Also resident in DLA Piper's Wilmington office is a former two-term governor and nine-term congressman of Delaware, whose extensive state and federal experience provides a unique understanding of a wide array of issues faced by businesses that are either incorporated in Delaware or deal with Delaware entities.

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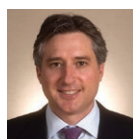
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