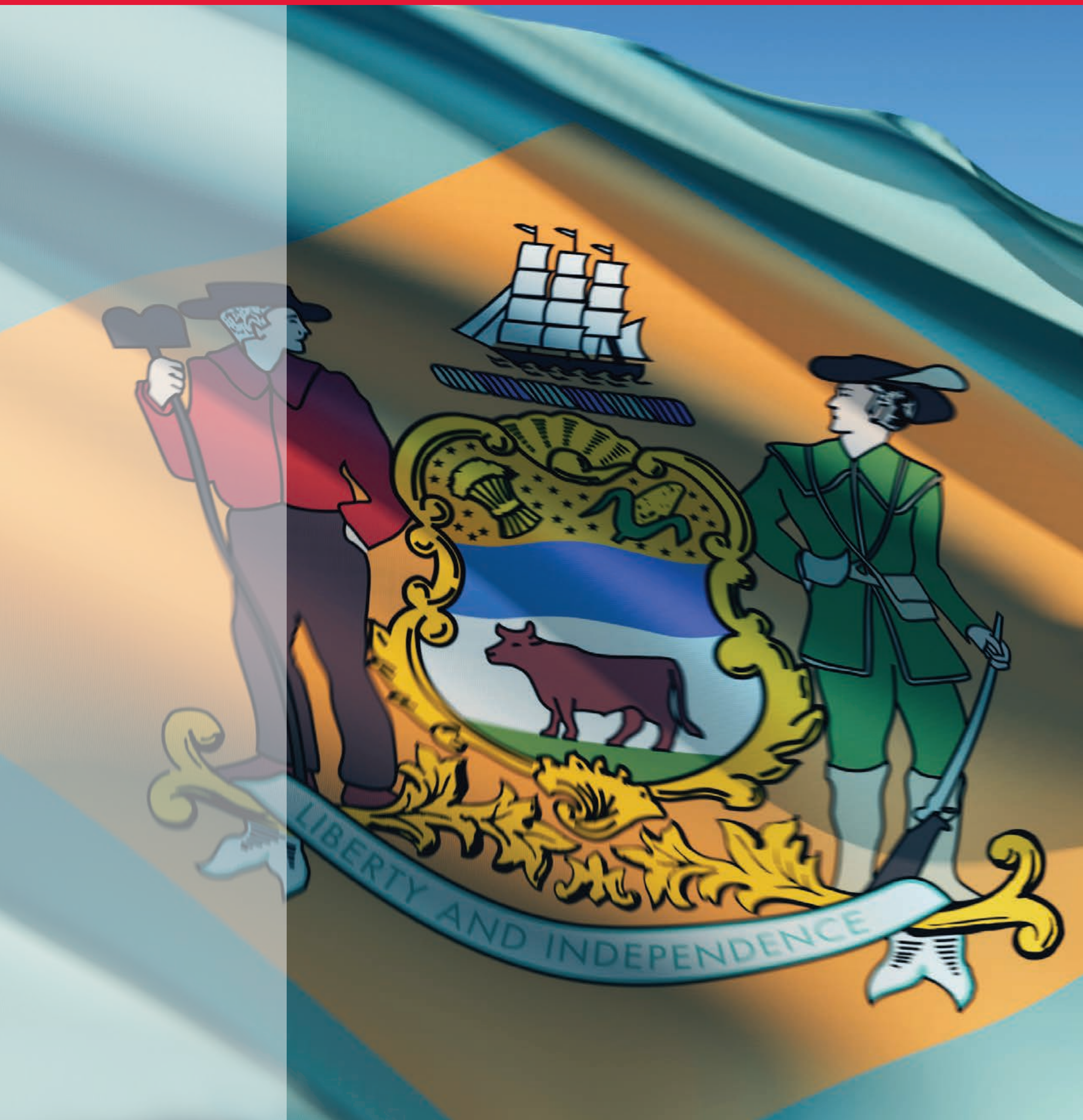
Richards Layton & Finger

RECENT DEVELOPMENTS IN DELAWARE CORPORATE LAW

SUMMER 2013



RICHARDS, LAYTON & FINGER, Delaware's largest firm and one of its oldest, has been committed from its founding to helping sophisticated clients navigate complex issues and the intricacies of Delaware law. Our lawyers have been involved in drafting many of the state's influential business statutes, and we have helped shape the law through our work on landmark cases decided in the Delaware courts. Our commitment to excellence spans decades and remains central to our reputation for delivering extraordinary counsel to our clients.

Introduction

WE ARE PLEASED TO PROVIDE RICHARDS LAYTON CLIENTS AND FRIENDS this publication, which highlights the key corporate cases and statutory developments in Delaware over the course of the last eighteen months. This publication continues our long tradition of providing insight into the development of Delaware corporate law. Our attorneys have provided our clients with a concise quarterly update on Delaware law for more than two decades. In recent years, this update has been accompanied by a quarterly video, which allows clients and friends of the firm to gain insight into recent decisions and to ask questions of our attorneys. If you have not had the opportunity to receive our quarterly updates or participate in our video conferences, please let one of us know or send a note to corporate@rlf.com.

While time has altered how we relay information, Richards Layton retains a unique ability to offer insight and counsel on Delaware corporate law. Our corporate team, the largest and most recognized in the state, plays a crucial role in Delaware. For decades, we have contributed to the development of key statutes, litigated the most influential decisions, and provided counsel on the most sophisticated transactions. Our lawyers continue to expand our deep understanding of Delaware law. We have been intimately involved with many of the cases highlighted in this booklet, and have handled, as Delaware counsel, the most merger and acquisition transactions valued at $100 million or more for 10 years running, according to Corporate Control Alert's annual rankings. We welcome the opportunity to discuss the practical implications of these recent developments in Delaware law with you, and look forward to helping you whenever a need may arise.

—Richards, Layton & Finger

These materials summarize and explain the significance of various recent decisions of the Delaware Supreme Court, Delaware Court of Chancery, Delaware Superior Court and U.S. District Court for the District of Delaware regarding Delaware corporate law. These materials also highlight amendments to the Delaware General Corporation Law that became effective in 2012.

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Recent Decisions of Delaware Courts

Breach of Fiduciary Duty

Kallick v. SandRidge Energy, Inc.,
C.A. No. 8182-CS (Del. Ch. Mar. 8, 2013).

In *Kallick v. SandRidge Energy, Inc.,* C.A. No. 8182-CS (Del. Ch. Mar. 8, 2013), Chancellor Strine of the Court of Chancery enjoined the board of directors of SandRidge Energy, Inc. (the "Company") from soliciting consent revocations in connection with the consent solicitation launched by a stockholder to install its own slate of directors on the Company's board, until the incumbent board of the Company approves the members of the opposing slate for purposes of a change in control provision in the Company's credit agreement.

Due to its frustrations with the management of the Company, TPG-Axon ("TPG"), a stockholder of the Company, launched a consent solicitation to amend the Company's bylaws to de-stagger its board, remove all of the incumbent directors, and install its own slate of directors who are committed to change the Company's management and explore strategic alternatives to maximize the value of the Company's assets. Notably, the staggered board was implemented pursuant to a provision of the Company's bylaws (as opposed to the Company's certificate of incorporation) leaving the staggered board subject to amendment or repeal by the Company's stockholders. In response to TPG's consent solicitation, the Company's incumbent board began soliciting consent revocations and warned stockholders that the election of TPG's slate of directors would result in a "Change of Control" under the Company's credit agreements, obligating the Company to offer to repurchase $4.3 billion of its existing debt (the "Proxy Put"). Pursuant to the Company's credit agreement, a "Change of Control" occurs, *inter alia,* as a result of a change in the majority of directors on the Company's board who are not approved by the incumbent board. Because the incumbent board refused to approve the members of TPG's slate, the plaintiff, a stockholder of the Company and a supporter of the TPG consent solicitation, brought this action against the Company and the incumbent board, arguing that failure to approve the TPG slate is a breach of the incumbent board's fiduciary duties. The plaintiff sought to enjoin the board from seeking consent revocations, voting proxies it received from consent revocations, or otherwise impeding TPG's consent solicitation until it approves the TPG slate.

Consistent with Delaware's policy of strictly upholding the fairness of corporate elections, the Court held that the board, in keeping with its fiduciary duty of loyalty, may refuse to grant approval of TPG's slate only if it determines that the members of the slate "posed such a material threat of harm" to the Company or its creditors that it would be a breach of the board's duty of loyalty to pass control of the Company to them. Because the incumbent board could not identify a specific and substantial risk to the Company or its creditors posed by the TPG slate and because the Court found that the incumbent board based its decision not to approve TPG's slate solely on its view that it was better qualified to manage the Company, the Court held that the incumbent board had breached its duty of loyalty. As a result, the Court enjoined the Company from soliciting consent revocations, voting proxies it received from consent revocations, or otherwise impeding TPG's consent solicitation in any way until the incumbent board approves the TPG slate.

While the plaintiff did not challenge the Company's decision to agree to the inclusion of a change of control provision containing a Proxy Put, the Court noted that "given the obvious entrenching purposes of a Proxy Put provision, one would hope that any public company would bargain hard to exclude that toll on the stockholder franchise and only accede to the Proxy Put after hard negotiation and only for clear economic advantage." The Court also suggested that independent directors should "police" provisions that affect the stockholder franchise to ensure that the Company is not agreeing to such provisions simply because of their entrenching effect or when there is no need to do so.

In re BJ's Wholesale Club Shareholders Litigation, 2013 WL 396202 (Del. Ch. Jan. 31, 2013).

In *In re BJ's Wholesale Club Shareholders Litigation,* 2013 WL 396202 (Del.Ch. Jan. 31, 2013), Vice Chancellor Noble of the Court of Chancery dismissed claims that the board of directors (the "Board") of BJ's Wholesale Club, Inc. ("BJ's") breached its fiduciary duties in a going-private transaction by consciously disregarding its so-called *Revlon* duties, and that acquirors Leonard Green & Partners, L.P. ("LGP") and CVC Capital Partners ("CVC") (together, the "Buyout Group") aided and abetted those breaches. In dismissing the claims of former stockholder plaintiffs (the "Plaintiffs"), the Court reiterated the difficulty of adequately pleading a duty of loyalty claim where disinterested and independent directors, with the assistance of independent financial and legal advisors, actively solicit interest from other bidders and establish procedural safeguards and where no other topping bids emerge after a lengthy public sales process.

On July 1, 2010, LGP signaled its interest in a private buyout of BJ's by disclosing its 9.5 percent beneficial ownership interest in BJ's on Schedule 13D. In response to LGP's filing, the Board engaged a financial advisor and formed a special committee of the Board (the "Special Committee") charged with evaluating potential strategic alternatives.

Shortly after announcing that the Special Committee had decided to explore strategic alternatives, BJ's received an expression of interest from Party A, a strategic competitor of BJ's. The Board discussed Party A's interest and determined that it was not comfortable sharing material, non-public information with a competitor at that stage of the process. Despite not providing confidential information to Party A, the Board provided a confidential offering memorandum to 23 private equity firms. A few months later, Party A sent a letter to BJ's proposing to acquire BJ's in an all-cash transaction at a purchase price in the range of \$55 to \$60 per share, subject to certain conditions. Upon receipt of the letter, and on Party A's request, BJ's regulatory counsel met with Party A's counsel to discuss regulatory concerns. Thereafter, BJ's representatives, including members of the Special Committee, met with representatives of Party A, after which BJ's determined that it was not in the best interest of BJ's to pursue the expression of interest.

In addition to the proposal from Party A, BJ's also received a proposal from Party B, who proposed a hybrid transaction that valued BJ's between \$62 to \$70 per share. The proposed transaction contemplated a one-time \$20 per share dividend and BJ's acquisition of Party B's warehouse club franchise. The Board rejected the proposal two days following its receipt, after which Party B proposed to acquire BJ's in an all-cash transaction at a price range of $50 to $53 per share. Despite this offer, Party B did not advance to the final round of bidding.

The Special Committee engaged in extensive negotiations with the Buyout Group, wherein the Special Committee rejected the Buyout Group's initial proposal of $50 per share in an all-cash transaction before finally accepting a "best and final" offer of $51.25 per share. BJ's publicly announced that it had agreed to be acquired by the Buyout Group on June 28, 2011. After the announcement of the transaction, Plaintiffs filed claims alleging that the Board breached its fiduciary duties by agreeing to a buyout that did not provide the best value to BJ's former stockholders on the basis that, among other things, the directors intentionally shunned Party A and Party B and were improperly motivated to support the Buyout Group in order to benefit management.

Upon finding that the transaction had been approved by a majority of disinterested and independent directors, the Court analyzed whether the Plaintiffs alleged sufficient facts to support a reasonable inference that the Board consciously disregarded its obligation to maximize stockholder value under *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.,* 506 A.2d 173 (Del. 1986). Key to the Court's analysis, and also to its conclusion that the Plaintiffs had failed to plead adequately that the Board had disregarded its *Revlon* duties, was the process in which the Board considered, negotiated and approved the transaction. Importantly, the Court noted that the Board met regularly to discuss strategic alternatives and formed the Special Committee to lead the process. Additionally, once formed, the Special Committee retained its own advisors, conducted a publicized review of strategic alternatives, and met with every party that made a serious overture. The Court stressed that the Board drove up the price of the Buyout Group's offer and negotiated favorable deal terms, including a fiduciary out clause and a reverse termination fee. The Board also relied upon its financial advisor's opinion that the price was fair.

Having concluded that the Board had not consciously disregarded its *Revlon* duties, the Court explained that in order for the Plaintiffs to succeed on their claim that the Board acted in bad faith, they must allege that the decision to sell BJ's on the agreed-upon terms was "so far beyond the bounds of reasonable judgment that it seems essentially inexplicable on any ground other than bad faith." Applying this standard, the Court rejected Plaintiffs' claims that the Board had acted in bad faith by failing to sufficiently explore preliminary expressions of interest by Party A and Party B.

Acknowledging the Court's recent decision in *Novell,* the Court noted that the Board's disparate treatment of Party A and Party B was explained by facts that tended to show that the Board's actions were reasonable. Namely, the Court found that the Board's decision not to pursue a transaction with Party B was reasonable because Party B's hybrid proposal was a "fundamentally different" transaction than what the Board was considering and was based upon Party B's speculative estimation of what the value of such a transaction would be worth to BJ's stockholders. Additionally, despite Party B's submission of a preliminary offer, it had failed to submit a formal proposal after being given access to BJ's confidential information. Additionally, the Board's decision not to pursue a transaction with Party A was reasonable because (i) Party A was a competitor of BJ's that had no history of acquiring domestic companies, and a transaction with Party A would raise serious regulatory issues, and (ii) the Special Committee's financial advisor, upon which the Board was entitled to rely, advised that Party A's expression of interest was not likely to lead to serious offer. Distinguishing *In re Novell, Inc. Shareholders Litig.,* 2013 WL 322560 (Del. Ch. Jan. 3, 2013), the Court explained that "[p]erhaps the crucial difference is that in *Novell* the board's actions, which resulted in an asymmetrical distribution of information, occurred after the board had determined that the bidder was a serious participant. In this case, however, the Board was making an initial assessment, in its business judgment, whether the pursuit of Party A's expression of interest was in the best interest of the Company...."

Following the Court's determination that the Plaintiffs had failed to plead a claim for bad faith conduct by the Board, the Court addressed Plaintiffs' argument that directors Herbert Zarkin, the non-executive chairman of the Board, and Laura Sen, the chief executive officer (both of whom the Court assumed for the purposes of its analysis were interested), manipulated the sales process in favor of the Buyout Group and that the remaining independent directors knowingly acquiesced. Reiterating the extensiveness of the process that the Board undertook in approving the transaction, the Court rejected Plaintiffs' allegation of manipulation of the process, noting, "In sum, the Plaintiffs would have this Court hold that it is reasonably conceivable that the Defendant Directors' year-long sales process, in which they solicited over twenty-three buyers, and met with all interested acquirors, was nothing but 'window dressing' to legitimize the Company's sale to the Buyout Group at a wholly disproportionate price."

Accordingly, because it was not reasonably conceivable based on the facts of the complaint that the Board breached its fiduciary duty of loyalty, or that the Buyout Group knowingly participated in such a breach, the Court dismissed the complaint.

In re Novell, Inc. Shareholder Litigation, 2013 WL 322560 (Del. Ch. Jan. 3, 2013).

In *In re Novell, Inc. Shareholder Litigation,* 2013 WL 322560 (Del. Ch. Jan. 3, 2013), Vice Chancellor Noble of the Court of Chancery declined to dismiss breach of fiduciary duty claims against the board of directors (the "Board") of Novell, Inc. ("Novell" or the "Company"), concluding that the plaintiffs' allegations that the Board had treated a serious bidder in a materially different manner than Novell's eventual acquiror supported a reasonable inference that the Board had acted in bad faith.

In early 2010, Novell received an unsolicited proposal from Elliott Associates LP ("Elliott") to acquire the Company for $5.75 per share in cash. Although the Board rejected Elliott's bid as inadequate, Novell publicly announced on March 20, 2010 that the Board would engage in a process to explore various alternatives to enhance stockholder value. From March 2010 to August 2010, the Board, with the assistance of J.P. Morgan, its financial advisor, contacted over 50 potential acquirors, 30 of which entered into non-disclosure agreements with Novell. Throughout the process, Novell received offers from parties interested in purchasing portions of Novell's business, Novell's patent portfolio and Novell as a whole.

Attachmate Corporation ("Attachmate") and an unidentified private equity firm ("Party C") emerged as the most serious potential acquirors of Novell. By August 27, 2010, Attachmate and Party C had submitted their "best and final" offers for Novell at the request of the Board. Although Attachmate's bid ($4.80 per share) was lower than Party C's bid ($4.86 per share), the Board granted Attachmate a period of exclusivity until September 27, 2010, which was later extended to October 25, 2010, to negotiate a transaction. Near the end of the extended exclusivity period, Novell received an offer from Microsoft Corporation ("Microsoft") to license or purchase a portion of Novell's patent portfolio for $450 million. Shortly thereafter, Attachmate increased its offer to $5.25 per share in cash, and on the same day, Party C submitted an unsolicited offer to acquire Novell for $5.75 per share.

The Board then approached Attachmate to gauge Attachmate's interest in engaging in a transaction whereby Attachmate would acquire Novell as a whole after Novell's patents were sold to Microsoft. On November 2, 2010, Attachmate raised its offer to $6.10 per share in cash, conditioned upon Novell receiving at least $450 million from the patent sale. On November 21, 2010, Novell entered into a merger agreement with Attachmate and a patent purchase agreement with Microsoft on those proposed terms. In order to facilitate Attachmate's acquisition of Novell, Elliott, who had been approached by J.P. Morgan about potentially providing financing for Attachmate in the transaction, entered into a separate agreement with Attachmate to contribute a portion of its Novell shares to an affiliate of Attachmate in exchange for a post-merger equity interest in the affiliate. On April 27, 2011, the merger and the patent sale were completed.

Plaintiffs sought post-closing money damages for breaches of fiduciary duty by the Board, alleging, among other things, that Novell's "improper and opaque" sale process failed to maximize stockholder value with respect to Attachmate's acquisition of Novell and the patent sale to Microsoft. These process-based claims centered around allegations that the Novell directors breached their fiduciary duties by improperly favoring Attachmate over Party C and other potential bidders throughout the sale process.

Specifically, plaintiffs alleged that the Board allowed Attachmate to partner with two of the Company's principal stockholders when submitting its preliminary proposal and authorized J.P. Morgan to seek potential financing sources for Attachmate, while not providing these benefits to Party C and other potential acquirors. Additionally, plaintiffs alleged that the Board unreasonably decided to pursue the Attachmate bid without seeking an increased bid from Party C before granting exclusivity to Attachmate, despite the fact that Party C had submitted a higher bid than Attachmate at two stages in the process. Finally, plaintiffs claimed that the Board withheld information from Party C that was shared with Attachmate, including information about the potential sales of Novell's other businesses and its patent portfolio, that may have incentivized Party C to increase its bid. As a result of these actions, plaintiffs alleged that the Board guided the outcome of the sales process toward a transaction with Attachmate and deprived stockholders of the opportunity to obtain a higher price for their shares.

In addressing the process claims, the Court of Chancery noted that where, as here, a corporation has a Section 102(b)(7) exculpation provision in its certificate of incorporation and the sale process has been run by concededly independent and disinterested directors, the complaint must adequately allege that the board of directors' conduct amounts to bad faith to survive a motion to dismiss. The Court stated that one way for plaintiffs to meet this standard would be to show that the Board's conduct was "so far beyond the bounds of reasonable judgment that it seems essentially inexplicable on any ground other than bad faith." 2013 WL 322560, at *10.

The Court of Chancery concluded that the Board's alleged conduct created a reasonable inference that the Novell directors and their financial advisor "treated Party C in a way that was both adverse and materially different from the way they treated Attachmate." *Id.* at *9. Specifically, the Court questioned the Board's decision not to tell Party C about the proceeds of the patent sale, while keeping Attachmate fully informed of the various strategic options Novell was considering throughout the process. While acknowledging that potential bidders need not be treated equally in all circumstances and that there may have been a plausible explanation for the Board's conduct, the Court stated that, at the motion to dismiss stage, the Court did not have access to any factual justifications for the Board's differential treatment of Attachmate and Party C. Accordingly, because it was reasonably conceivable that plaintiffs may be able to demonstrate that the Board's conduct was in bad faith, exculpation under Section 102(b)(7) might be unavailable, and the Court concluded that the fiduciary duty claims against the Board must survive the motion to dismiss.

Following entry of the Court's order with respect to plaintiff's fiduciary duty claims, the Novell defendants moved for certification of an interlocutory appeal with respect to the bad faith claim. While the Court acknowledged that application of the reasonable conceivability standard in the context of a bad faith claim can be "challenging," the Court refused to certify the appeal because the Novell defendants failed to demonstrate that the Court's ruling established a legal right within the meaning of Delaware Supreme Court Rule 42(b). The Supreme Court subsequently refused to hear the interlocutory appeal.

In re Comverge Inc. Shareholders Litigation, C.A. No. 7368-VCP (Del. Ch. May 8, 2012).

In *In re Comverge Inc. Shareholders Litigation*, C.A. No. 7368-VCP (Del. Ch. May 8, 2012), the Court of Chancery in an oral ruling denied a motion to preliminarily enjoin the acquisition of Comverge, Inc. ("Comverge") by HIG Capital LLC and its affiliates ("HIG"). The Court found that in hindsight certain choices made by Comverge's directors were debatable, but the Court declined to second-guess decisions made by the independent directors.

Comverge had lost money every year of its existence and had long sought, to no avail, to solve its liquidity problems through various types of transactions. In November 2011, HIG contacted Comverge to express an interest in acquiring the company. In February 2012, the Comverge board declined HIG's offer to buy the company for $2.25 per share, in part because another bidder had suggested a higher price. HIG thereafter acquired certain notes issued by Comverge. The notes carried the right to accelerate the company's debt and (because Comverge was, or soon would be, in default on the underlying loan) likely force it into bankruptcy, as well as to block other acquisition bids and to reject prepayment of the debt. HIG promptly indicated that it would exercise those rights unless the board accepted a new, lower-priced offer. The board negotiated for a somewhat higher price and for a go-shop period, and then took the deal at $1.75 per share.

The plaintiffs alleged that HIG's purchase of the notes breached a non-disclosure agreement ("NDA") entered into by Comverge and HIG in connection with due diligence, which prohibited HIG from acquiring Comverge's securities if that acquisition would violate U.S. securities laws. The plaintiffs argued that the directors breached their fiduciary duties under *Revlon* by accepting HIG's $1.75 per share offer rather than suing to enforce the NDA in order to decrease HIG's negotiating power. On April 27, 2012, the Court granted the motion to expedite based in part on this argument.

Eleven days later, however, the Court denied the plaintiffs' motion for a preliminary injunction. Although the Court was inclined to agree that Comverge may have had a claim against HIG for breach of the NDA, the Court reasoned that Comverge's board deliberately considered whether to file suit on more than one occasion and sought legal advice in connection with its decision. As the Court summarized, "the directors had to decide whether shareholders would be better off if the company fought to the end and even won in the legal arena if doing so exposed them to an increased risk of bankruptcy, or if it salvaged whatever value it could, however disappointing, for at least some shareholder return by avoiding litigation and proceeding to get the best deal that it could." The Court noted that the tactical advantages of either option could be debated, but held that the Comverge board's decisions were reasonable and therefore satisfied the directors' fiduciary duties.

In re Answers Corporation Shareholders Litigation, Consol. C.A. No. 6170-VCN (Del. Ch. Apr. 11, 2012).

In *In re Answers Corporation Shareholders Litigation*, Consol. C.A. No. 6170-VCN (Del. Ch. Apr. 11, 2012), the Court of Chancery refused to dismiss breach of fiduciary duty and aiding and abetting claims in connection with the acquisition of Answers Corporation ("Answers") by Summit Partners, L.P. ("Summit"), a private equity fund. The Court held that the plaintiffs adequately pled that three of Answers' seven directors were interested in the merger and four conceivably could have acted in bad faith by having known of the other directors' interest but nevertheless conducting an unnecessarily expedited sales process. The Court had previously refused to enjoin the merger, but at the motion to dismiss stage, the Court did not rely on the factual record developed in connection with the earlier preliminary injunction proceeding.

According to the plaintiffs' allegations, by early 2010 Redpoint Ventures ("Redpoint"), then a 30 percent stockholder of Answers, wanted to end its investment in Answers. Due to the size of Redpoint's investment and the fact that Answers' stock was thinly traded, Redpoint could only monetize its investment if Answers were sold. Two of Answers' seven directors, who had been appointed to the board by Redpoint, began arranging meetings between Answers' founder and CEO, also a director, and potential acquirors. Redpoint informed the board that if Answers were not sold in the near future, the entire management team, including the CEO, would be replaced.

In November 2010, Answers and Summit Partners agreed to a price of $10.25 per share, and in response to pressure from Summit Partners, the Answers board agreed to a two-week market check and did not perform any analysis regarding alternatives to the merger. The board allegedly sped up the sales process because Answers' financial outlook was improving, which could have caused Answers' stock price to rise above the offer price and placed the merger in jeopardy. Answers persuaded Summit Partners to increase its bid to $10.50 per share, and in February 2011—before Answers was required to report improved results—the Answers board obtained a fairness opinion and approved the merger. Answers' stockholders voted in favor of the merger in April 2011.

The Court held that the plaintiffs stated a claim against all seven of Answers' directors for breach of the duty of loyalty. The complaint adequately alleged that Answers' founder/CEO was interested in the merger because he knew from Redpoint that he would lose his job if he did not sell the company; allegedly, it was his desire to keep his job that caused him to approve the merger.

The complaint also adequately alleged that the two directors appointed by Redpoint were interested in the merger because of their desire to achieve liquidity for Redpoint.

Regarding the four remaining outside directors, according to the Court, the complaint adequately alleged that they acted in bad faith because they allegedly knew that the three interested directors wanted to enter into the merger before Answers' stock price rose above Summit Partner's offer price, but nevertheless agreed to expedite the sales process. The Court stated: "In other words, the Complaint alleges that [the four outside directors] agreed to manipulate the sales process to enable the Board to enter quickly into the Merger Agreement before Answers' public shareholders appreciated the Company's favorable prospects. That is a well-pled allegation that those Board members consciously disregarded their duty to seek the highest value reasonably available for Answers' shareholders."

The Court also held that the plaintiffs stated a claim against Summit Partners for aiding and abetting breach of fiduciary duties. The plaintiffs alleged that Summit Partners received confidential information showing that Answers' operating and financial performance was improving and then pressured the Answers board to conduct a flawed, expedited sales process. These allegations, the Court held, were sufficient to constitute the required "knowing participation" in the Answers directors' alleged breach of fiduciary duties.

In re Massey Energy Co. Derivative & Class Action Litigation, C.A. No. 5430-VCS (Del. Ch. May 31, 2011).

In *In re Massey Energy Company Derivative and Class Action Litigation*, the Delaware Court of Chancery declined to preliminarily enjoin a merger between Massey Energy Company ("Massey") and Alpha Natural Resources, Inc. ("Alpha"). The Court, in its denial of the requested injunction, discussed extensively the value of potential derivative claims against Massey directors and officers (the "Derivative Claims") in the context of the merger.

Massey is a coal mining corporation with a history of subpar safety practices. In April 2010, a massive explosion occurred at one of Massey's mines, killing 29 miners. At least one subsequent governmental investigation attributed the explosion to Massey's failure to comply with critical safety procedures. Massey's stock price plummeted and stockholders filed the Derivative Claims against Massey's directors and officers seeking to recover for Massey's losses flowing from the mine explosion. Following the disaster, Massey began to explore strategic alternatives and ultimately entered into a merger agreement with Alpha pursuant to which the Massey stockholders would become stockholders of Alpha.

The merger consideration reflected a 27 percent premium to Massey's stock price immediately prior to the mine explosion. While negotiating the transaction with Alpha, the Massey board did not attempt to value separately the Derivative Claims, but instead assumed, based on advice from counsel, that the Derivative Claims would survive the merger and transfer to Alpha. Following the announcement of the transaction, certain Massey stockholders filed suit to enjoin the transaction on the basis that the Massey board did not attempt to value the Derivative Claims and only entered into the merger agreement to limit the board's exposure to those claims.

The Court began its analysis by acknowledging that the Derivative Claims likely stated a claim for director oversight liability due to a failure of certain Massey directors to ensure Massey's compliance with applicable safety laws. The Court, however, rejected plaintiffs' valuation approach to the Derivative Claims. Plaintiffs had asserted that the Derivative Claims were worth between $900 million and $1.4 billion. In support of their valuation, plaintiffs submitted an expert report that equated the value of the Derivative Claims with the aggregate financial harm resulting from the mine disaster. Reasoning that the Derivative Claims were not an independent asset but at best a way for Massey to mitigate its potential monetary liability flowing from the mine disaster, the Court determined that the value of the Derivative Claims and the harm resulting from the mine explosion were not equal. Furthermore, Alpha's incentive to pursue the Derivative Claims to reduce its potential liability resulting from the mine disaster undermined the plaintiffs' argument that the Massey board entered into the merger agreement to limit its exposure to the Derivative Claims.

In rejecting plaintiffs' valuation approach, the Court identified several additional flaws in plaintiffs' case. First, based on the business judgment rule and Massey's exculpatory charter provision, plaintiffs would have to prove that the Massey directors and officers acted knowingly in order to receive a money judgment against them. The uncertainty of plaintiffs' ability to meet such a high burden decreased the value of the Derivative Claims. Second, if the Derivative Claims were proven, Massey could be exposed, and thereby its stockholders could be exposed, to severe financial harm in the form of judgments, fines and even punitive damages. Third, the value of any judgment on the Derivative Claims would be limited to the amount that could be collected from defendants. In this instance, the maximum coverage of the defendants' D&O insurance policy was $95 million, an immaterial amount in the context of an $8.5 billion merger. Furthermore, the insurance likely would not cover acts involving knowledge, which here would have to be proved to impose monetary liability. Finally, the fact that no other bidder made a topping bid evidences the public's view that Alpha did not undervalue the Derivative Claims.

The Court found that plaintiffs would not suffer irreparable injury without an injunction because they had other remedies at their disposal, such as appraisal, a direct action against the Massey directors for breach of fiduciary duty, a double-derivative action, or a continued pursuit of the Derivative Claims (in limited circumstances). Also, the Court noted that the stockholders could vote against the merger. All of these factors led the Court to conclude that plaintiffs' valuation of the Derivative Claims was faulty and that the likely actual value of those claims was not material to the value of the merger. Although the Court acknowledged that the Massey board's failure to value the Derivative Claims in connection with its evaluation of a deal with Alpha may be characterized as a breach of the duty of care, the Court ultimately declined to issue a preliminary injunction since the record before the Court did not support a conclusion that the Massey directors entered into the transaction with Alpha in order to diminish their exposure to liability for the Derivative Claims. The day after the Court's decision, the Massey's stockholders approved the merger.

In re Smurfit-Stone Container Corp. Shareholder Litigation, C.A. No. 6164-VCP (Del. Ch. May 20, 2011).

In *In re Smurfit-Stone Container Corp. Shareholder Litigation*, the Delaware Court of Chancery addressed "whether and in what circumstances *Revlon* applies when merger consideration is split roughly evenly between cash and stock." Although "not free from doubt" because the issue has not been addressed directly by the Delaware Supreme Court, Vice Chancellor Parsons found that the stockholder plaintiffs were likely to prevail on their argument that the enhanced reasonableness scrutiny required by *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986), would apply to the challenged merger transaction under which the target's stockholders would receive merger consideration consisting of 50% cash and 50% stock of the acquiring company in return for their shares. The Court, however, ultimately denied the plaintiffs' motion for a preliminary injunction because it found that the plaintiffs did not demonstrate a reasonable probability of success on their claim that the director defendants breached their fiduciary duties by approving the challenged merger.

In *Smurfit*, the board of directors of the target, Smurfit-Stone Container Corp. ("Smurfit"), unanimously approved a merger agreement whereby Smurfit would be acquired by Rock-Tenn Company ("Rock-Tenn") for $35 per share. Under the merger agreement, Smurfit's stockholders would receive $17.50 in cash and 0.30605 shares of Rock-Tenn common stock for each share of Smurfit common stock. Following the merger, Smurfit's stockholders would own approximately 45% of Rock-Tenn's outstanding common stock and control of Rock-Tenn would remain in a large, fluid market. Following the announcement of the merger, several Smurfit stockholders filed putative class actions and moved to enjoin the merger.

The Delaware Supreme Court has determined that enhanced reasonableness scrutiny under *Revlon* applies in at least three scenarios: (i) when a corporation initiates an active bidding process seeking to sell itself or to effect a business reorganization involving a clear break-up of the company; (ii) where, in response to a bidder's offer, a target abandons its long-term strategy and seeks an alternative transaction involving the break-up of the company; or (iii) when approval of a transaction results in a sale or change of control. If *Revlon* applies, the board's actions in approving the sale are subject to enhanced reasonableness scrutiny, rather than the business judgment rule.

In *Smurfit*, the Court considered "when a mixed stock and cash merger constitutes a change of control transaction for *Revlon* purposes." On the one hand, pure stock-for-stock transactions do not necessarily trigger *Revlon*. On the other hand, *Revlon* will govern a board's decision to sell a corporation where stockholders will receive cash for their shares. Based on economic implications and relevant judicial precedent, including *In re Lukens Shareholders Litigation*, 757 A.2d 720 (Del. Ch. 1999), the Court found *Revlon* to be applicable to the merger because the 50% cash and 50% stock consideration qualified the merger as a change of control transaction. According to the Court, "there is no 'tomorrow' for approximately 50% of each stockholder's investment in" Smurfit. While Smurfit's stockholders would have half of their equity transformed to Rock-Tenn equity, with the potential for future value, half of their investment would be liquidated and deprived of its "long-run" potential. The Court therefore concluded that the plaintiffs were likely to succeed on their argument that the 50% cash and 50% stock consideration triggered enhanced reasonableness scrutiny under *Revlon*.

The Smurfit decision is consistent with *Steinhardt v. Howard-Anderson*, C.A. No. 5878-VCL (Del. Ch. Jan. 24, 2011) (TRANSCRIPT), where Vice Chancellor Laster reviewed a board's actions for reasonableness in connection with a challenged merger under which the target's stockholders would receive approximately 50% cash and 50% stock of the acquiring company in return for their shares but, unlike in *Smurfit*, would own approximately 15% of the combined entity. Vice Chancellor Laster stated, "This is a situation where the target stockholders are in the end stage in terms of their interest in [the target]....This is the only chance that [the target] stockholders have to extract a premium, both in the sense of maximizing cash now, and in the sense of maximizing their relative share of the future entity's control premium."

In re Del Monte Foods Co. Shareholders Litigation, Consol. C.A. No. 6027-VCL (Del. Ch. Feb. 14, 2011).

In *In re Del Monte Foods Company Shareholders Litigation*, the Court of Chancery found on a preliminary record that a proposed $5.3 billion cash merger (including assumption of debt) with a group of private equity buyers was potentially tainted by alleged misconduct by the target banker, with the alleged knowing participation of the buyers. The Court preliminarily enjoined the defendants from proceeding with a stockholder vote on the proposed transaction for a period of 20 days and further enjoined the defendants from enforcing certain deal protection measures in the merger agreement (including no solicitation, termination fee and matching right provisions), pending the stockholder vote.

Under the terms of the merger agreement, a private equity group consisting of Kohlberg Kravis Roberts & Co., L.P. ("KKR"), Vestar Capital Partners ("Vestar") and Centerview Partners would acquire all outstanding shares of Del Monte common stock for $19 per share. The Court expressed that, on the preliminary record, the Del Monte board appeared to have "sought in good faith to fulfill its fiduciary duties" and predominantly made decisions that ordinarily would be regarded as falling within the range of reasonableness for purposes of *Revlon* enhanced scrutiny. The Court found, however, that the board "was misled by Barclays" Capital ("Barclays"), its financial advisor, and that Barclays "secretly and selfishly manipulated the sale process." In particular, the Court noted that (i) Barclays "crossed the line" in seeking permission from Del Monte to provide buy-side financing before a price was agreed to between KKR and Del Monte while failing to disclose to the board the fact that Barclays had intended to seek to provide buy-side financing since the beginning of the process; and (ii) Barclays had paired Vestar with KKR in violation of existing confidentiality agreements and then concealed the fact of the pairing from the board for several months. According to the Court, the pairing of KKR and Vestar materially reduced the prospect of price competition for Del Monte. Further, the Court found (on the preliminary record) that plaintiff had shown a reasonable probability of success on its claim that the board, despite not knowing the extent of Barclays' behavior, failed to act reasonably in ultimately acceding to Barclays' request to provide buy-side financing and Barclays' recommendation to permit Vestar to participate in KKR's bid, and by then permitting Barclays to run the go-shop process. The Court also found (on the preliminary record) that plaintiff had shown a reasonable probability of success on its claim that KKR "knowingly participated" with Barclays in these self-interested activities.

The Court concluded that loss of "the opportunity to receive a pre-vote topping bid in a process free of taint from Barclays' improper activities" constituted irreparable injury to the Del Monte stockholders. The Court held that the imprecision of a potential post-closing monetary remedy weighed in favor of injunctive relief, as did the powerful defenses available to the director defendants (including exculpation under Section 102(b)(7) and reliance on the advice of experts selected with reasonable care under Section 141(e) of the General Corporation Law of the State of Delaware).

Finally, regarding the balance of the hardships, the Court considered that an injunction could jeopardize the stockholders' ability to receive a premium for their shares and pose difficult questions regarding the parties' contract rights under the merger agreement. The Court also recognized that the deal had been subject to a 45-day go-shop period and to a continuing "passive market check" for several more weeks. Ultimately, however, the Court concluded that enjoining the deal protection devices was appropriate because "they are the product of a fiduciary breach that cannot be remedied post-closing after a full trial," and a 20-day injunction would "provide ample time for a serious and motivated bidder to emerge." The Court conditioned the injunction on plaintiff posting a bond in the amount of $1.2 million.

In re Dollar Thrifty Shareholder Litigation, Consol. C.A. No. 5458-VCS (Del. Ch. Sept. 8, 2010); Forgo v. Health Grades, Inc., C.A. No. 5716-VCS (Del. Ch. Sept. 3, 2010) (TRANSCRIPT).

In *In re Dollar Thrifty Shareholder Litigation*, Dollar Thrifty Automotive Group, Inc. ("Dollar Thrifty") stockholders sought to enjoin a merger between Dollar Thrifty and Hertz Global Holdings, Inc. ("Hertz"), arguing, among other things, that the Dollar Thrifty board breached its fiduciary duty to take reasonable steps to maximize value for its stockholders under *Revlon*. In April 2010, Hertz entered into a merger agreement (the "Agreement") to acquire Dollar Thrifty for a price of $41 per share, which included a $200 million special cash dividend to be paid by Dollar Thrifty only if the merger was consummated. The merger price represented a 5.5% premium over Dollar Thrifty's market price, and the Agreement contained a no-shop provision with a fiduciary out, matching rights and a termination fee. The merger was conditioned on, among other things, the receipt of antitrust approval, and required both parties to use their reasonable best efforts to obtain such approval. Accordingly, the Agreement also contained a reverse termination fee payable by Hertz in the event (among others) that such approval was not obtained. After execution of the Agreement, Avis Budget Group, Inc. ("Avis") made an offer to acquire Dollar Thrifty at a price of $46.50 per share. After examining the reasonableness of the board's process, and the board's determination that Avis's offer lacked deal certainty, the Court of Chancery denied plaintiffs' motion for a preliminary injunction.

From 2007 through 2009, Dollar Thrifty had engaged in unsuccessful negotiations with both Hertz and Avis. In late 2009, Dollar Thrifty renewed negotiations with Hertz, and after months of bargaining, Dollar Thrifty and Hertz executed the Agreement on April 25, 2010. On May 3, 2010, Avis's CEO sent Dollar Thrifty's CEO and chairman a letter announcing Avis's intention to make a substantially higher offer to acquire Dollar Thrifty. The board concluded that Avis's proposal could reasonably be expected to result in a superior proposal and agreed to execute a confidentiality agreement with Avis. Three months later, Avis made an offer to acquire Dollar Thrifty for a price of $46.50 per share, which included the same $200 million special cash dividend as the Hertz deal. Avis's offer, however, did not contain matching rights, a termination fee or a reverse termination fee. On August 3, 2010, Dollar Thrifty's CEO communicated to Avis that the board could not declare Avis's offer superior due to the lack of a reverse termination fee and antitrust approval concerns.

Plaintiffs' central argument was that, by failing to take affirmative steps to draw Avis into a bidding contest with Hertz before executing the Agreement, the Dollar

Thrifty directors breached their fiduciary duty to take a reasonable approach to immediate value maximization, as required by *Revlon*. Plaintiffs also challenged the deal protection measures contained in the Agreement.

The Court concluded that the Dollar Thrifty directors were properly motivated. The Court determined that there was no evidence in the record that Dollar Thrifty's CEO harbored any entrenchment motivation or any particular desire to sell Dollar Thrifty to Hertz. The Court also found no evidence in the record that the board preferred to do a deal with Hertz at some lower value if a better deal was actually attainable from Avis. Thus, the Court concluded that there was no basis to question the board's loyalty. The Court also noted that the board was closely engaged at all relevant times in making decisions regarding how to handle negotiations with Hertz and whether to try to bring Avis into the process.

The Court next addressed the alleged flaws in the board's decision-making process. Plaintiffs challenged the board's decision not to seek out other bidders, including Avis, or conduct a pre-signing market check. The Court held that the board's decision to negotiate only with Hertz was reasonable, rejecting the claim that a board is required to conduct a pre-signing market check. The Court also found that the board had reasonable grounds for not reaching out to Avis before executing the Agreement, including the board's substantial and legitimate concerns regarding Avis's ability to obtain financing and clear antitrust hurdles.

Plaintiffs also challenged the board's decision to enter into the Agreement with Hertz and the terms of the Agreement. The Court rejected plaintiffs' argument that the board's decision to enter into the Agreement was unreasonable because the 5.5% market premium that Dollar Thrifty's stockholders would obtain was insufficient, finding that the Dollar Thrifty board reasonably focused on the "company's fundamental value" rather than a spot market price in considering the sale of the company. The Court held that a well-motivated board is not obligated to refuse an offer that it reasonably believes appropriately meets or exceeds the fundamental value of the company merely because the market premium is comparatively low. The Court also determined that the deal protection measures were neither preclusive nor coercive. As for the termination fee, the Court concluded that the termination fee constituted approximately 3.5% of the value of the $1.275 billion deal (taking into account the special cash dividend and the amounts payable in respect of share-equivalents), and approximately 3.9% of the value when the additional $5 million in expenses was taken into account. This amount constituted approximately $1.60 per share and was therefore a relatively insubstantial barrier, as the Avis bid demonstrated, to any serious topping bid. The Court also concluded that the "relatively lenient no-shop provision" and the matching rights would not deter a bidder interested in making a materially higher bid.

Finally, the Court held that plaintiffs failed to demonstrate a likelihood of success on the merits. The record depicted a well-motivated and diligent board that responded with openness, rather than resistance, to Avis, who had twice before failed to reach an agreement with Dollar Thrifty. Although Avis's bid was superior in theory, the Court noted that value is not value if it is not ultimately paid. The Court held that the Dollar Thrifty board bargained hard with Hertz and extracted the best deal available for its stockholders. The reverse termination fee and significant divestitures to obtain regulatory approval provided deal certainty, which, at the time, Avis was unwilling to match. The balance of harms also tilted against an injunction because the Dollar Thrifty stockholders would have the ability to vote against the transaction—which they subsequently did—if they believed that Dollar Thrifty was better off as a stand-alone entity or if they believed that Avis would offer a superior transaction.

The Court of Chancery recently addressed another *Revlon* claim in the single-bidder context. In *Forgo v. Health Grades, Inc.*, plaintiffs sought to enjoin the all-cash tender offer by Vestar Capital Partners V, L.P. for all the outstanding shares of Health Grades, Inc. Just as in *Dollar Thrifty*, the Court of Chancery denied plaintiffs' motion in part on the ground that the stockholders of Health Grades should be permitted to decide for themselves whether to accept the tender offer price. In doing so, however, the Court questioned the board's process and expressed concern over the informational basis for the board's decision to deal exclusively with Vestar. The Court also remarked that Health Grades' chairman and CEO, who had agreed to tender his significant block of stock on the same terms as other stockholders, potentially had interests that diverged from those of the other stockholders, including the possibility of continued employment or post-closing equity participation. The Court noted the availability of the statutory appraisal remedy and post-closing monetary relief and declined to issue a preliminary injunction; however, the Court remarked that, had it been necessary to determine whether the plaintiffs had shown a likelihood of success on the merits of their claims, the Court might well have held that the plaintiffs had done so.

Deal Protection Devices

In re Micromet, Inc. Shareholders Litigation, C.A. No. 7197-VCP (Del. Ch. Feb. 29, 2012).

In *In re Micromet, Inc. Shareholders Litigation*, C.A. No. 7197-VCP (Del. Ch. Feb. 29, 2012), the Court of Chancery denied the plaintiffs' motion to preliminarily enjoin Amgen, Inc.'s ("Amgen") $1.16 billion acquisition of biopharmaceutical company Micromet, Inc. ("Micromet") in a tender offer at $11 per share followed by a second-step cash-out merger. The Court concluded that the plaintiffs failed to show a reasonable likelihood of success on their claims and specifically rejected the plaintiffs' challenges to Micromet's market check and the merger agreement's deal protection measures.

In 2010, Micromet and Amgen began a collaboration for certain cancer treatment technologies. Amgen's interest in Micromet grew, and Amgen made several offers to purchase Micromet in 2011. Micromet's board rejected Amgen's offers as inadequate, and Micromet continued to look for partnership opportunities with larger, more capitalized biopharmaceutical companies for commercialization and distribution of its drugs. In January 2012, after having reviewed updated financial projections, Micromet's board resolved to negotiate with Amgen regarding a sale.

While negotiating with Amgen regarding the key terms of the agreement, Micromet's board simultaneously contacted seven large pharmaceutical companies that the board determined might be interested in acquiring Micromet, six of which had completed due diligence on the company during a potential partnering process. Of the seven companies contacted, three expressed interest and conducted additional due diligence, but none were ultimately interested in acquiring Micromet.

Following a three-week period of negotiation and due diligence efforts, Micromet's board announced on January 26, 2012 that it had approved the merger agreement with Amgen at an $11 per share price—a 37 percent premium to Micromet's stockholders. The merger agreement contained several deal protection measures, including a no-shop provision, matching rights, a termination fee of $40 million, and an amendment to Micromet's rights agreement exempting Amgen from its poison pill, but otherwise leaving the pill in place. Several groups of Micromet stockholders filed complaints alleging that Micromet's board failed to conduct a meaningful market check and that the agreed deal protections would preclude competing bids.

In denying the plaintiffs' motion to enjoin the transaction, the Court of Chancery first found that the market check and week-long diligence period provided during the market check were reasonable given the Micromet board's understanding of the industry and Micromet's needs. Also, six of the seven companies had engaged in due diligence with Micromet during a prior partnering process and were therefore familiar with the company and the potential value of its products. The Court rejected the plaintiffs' argument that Micromet's board should have expanded its search to private equity buyers on the grounds that Micromet's business needed not only capital but also technical expertise to develop and distribute its products.

The plaintiffs also failed to convince the Court that the deal protection measures in the merger agreement precluded potential bidders from making competing bids or that a termination fee of roughly 3 percent of equity value was unreasonable. In particular, the plaintiffs argued that a change of recommendation provision—giving Amgen a four-day period to negotiate with Micromet's board in response to any superior offer, after which Micromet's board would determine whether to change its recommendation—was problematic under the Court of Chancery's recent opinion in *In re Compellent Technologies, Inc. Shareholder Litigation*, 2011 WL 6382523 (Del.Ch. Dec. 9, 2011). The Court, however, characterized the recommendation provision in *Compellent* as "less clear than in this case and could be read to mean that upon the Board's having determined that it had a fiduciary duty to change its recommendation, it still would have had to wait four business days before satisfying those duties by, e.g., notifying its shareholders." In contrast, the Court determined that the recommendation provision challenged by the plaintiffs was distinguishable because the provision could not be read as restricting the Micromet board's ability to fulfill its fiduciary duties promptly after determining to change its recommendation.

In re OPENLANE, Inc. Shareholders Litigation, Consol. C.A. No. 6849-VCN (Del. Ch. Sept. 30, 2011).

In *In re OPENLANE, Inc. Shareholders Litigation*, the Court of Chancery denied a motion to enjoin preliminarily the merger between OPENLANE, Inc. and KAR Auction Services, Inc. (through its wholly owned subsidiary, ADESA, Inc.) ("KAR"), even though the merger agreement did not include a fiduciary out and the transaction was effectively locked-up within 24 hours after signing by written consents from the holders of a majority of its stock.

After engaging in a lengthy process to locate potential acquirors, OPENLANE ultimately entered into a merger agreement with KAR on August 11, 2011. The terms of the merger agreement required OPENLANE to obtain stockholder approval of the merger quickly but gave the board the right to terminate the agreement without paying a termination fee if approval was not received within 24 hours. OPENLANE ultimately received consents from the holders of a majority of its stock within 24 hours of the execution of the merger agreement.

Shortly after OPENLANE filed its proxy statement with the SEC on September 8, 2011, plaintiff, an OPENLANE stockholder, filed a complaint and motion for preliminary injunction asserting, *inter alia*, that the board breached its fiduciary duties by failing to engage in an adequate process to sell the company. In a challenge to the deal protection measures, plaintiff focused on the merger agreement's no-solicitation covenant (which did not contain a fiduciary out) and the fact that the directors and executive officers of OPENLANE together held more than 68 percent of OPENLANE's outstanding stock and thus had the combined voting power to approve the merger. Plaintiff alleged that these were improper defensive devices similar to those employed in the transaction in *Omnicare, Inc. v. NCS Healthcare, Inc.*, 818 A.2d 914 (Del. 2003).

The Court, however, upheld the OPENLANE merger under the Supreme Court's ruling in *Omnicare*. In *Omnicare*, the Supreme Court held that stockholder voting agreements "negotiated as part of a merger agreement, which guaranteed shareholder approval of the merger if put to a vote, coupled with a merger agreement that both lacked a fiduciary out and contained a Section 251(c) provision requiring the board to submit the merger to a shareholder vote, constituted a coercive and preclusive defensive device" and made the merger an "impermissible *fait accompli*." Unlike the transaction in *Omnicare*, the Court of Chancery found that the OPENLANE merger was not a *fait accompli*. Regardless of the fact that the combined voting power of the directors and executive officers was sufficient to approve the merger, the Court held that there was no stockholder voting agreement and the record merely suggested that the board approved the merger and the holders of a majority of shares quickly consented. Additionally, the provision allowing the board to terminate the merger agreement without paying a termination fee if stockholder approval was not received within 24 hours caused the no-solicitation clause to be "of little moment" because the board was able to back out of the agreement if the consents were not obtained.

While the Court acknowledged that *Omnicare* could be read to say that there must be a fiduciary out in every merger agreement, the Court found that when a board enters into a merger agreement that does not contain such a provision, "it is not at all clear that the Court should automatically enjoin the merger when no superior offer has emerged." *Omnicare* put hostile bidders on notice that Delaware courts may not enforce a merger agreement that does not contain a fiduciary out if they present the board with a superior offer. The Court noted that enjoining a merger when no superior offer has emerged "is a perilous endeavor because there is always the possibility that the existing deal will vanish, denying stockholders the opportunity to accept any transaction."

In addition, the Court found that the board made a reasonable effort to maximize stockholder value under *Revlon* despite the fact that the board did not obtain a fairness opinion and did not contact any financial buyers about a potential transaction. Thus, the Court reaffirmed that "[t]here is no single path that a board must follow in order to maximize stockholder value, but directors must follow a path of reasonableness which leads toward that end." The Court further noted that if a board does not utilize a "traditional value maximization tool, such as an auction, a broad market check, or a go-shop provision" the board must possess an "impeccable knowledge of the company's business." Because OPENLANE was actually managed by, as opposed to under the direction of, its board, the Court found that the OPENLANE board was one of the few boards with an "impeccable knowledge" of its company's business.

Disclosures

Dent v. Ramtron International Corporation, C.A. No. 7950-VCP (Del. Ch. Nov. 19, 2012).

In a bench ruling in *Dent v. Ramtron International Corporation,* C.A. No. 7950-VCP (Del. Ch. Nov. 19, 2012), Vice Chancellor Parsons of the Court of Chancery declined to preliminarily enjoin a stockholder vote on a proposed merger between Cypress Semiconductor Corporation ("Cypress") and Ramtron International Corporation ("Ramtron" or the "Company"). The Court found that the plaintiff had not demonstrated a reasonable likelihood of success with respect to his claim that the Ramtron board of directors (the "Board") was required, but failed, to disclose financial projections prepared by management upon which the Board's financial advisor relied.

After over a year of courting that had been rebuffed by Ramtron, Cypress made an unsolicited offer to acquire Ramtron for $2.48 per share. The Board rejected the offer and began a process to consider strategic alternatives. During this process, Ramtron's financial advisor reached out to 24 potential bidders, but did not receive any bids to acquire the Company. Cypress then raised its unsolicited offer to $2.68 per share and later to $2.88 per share. Thereafter, the Board entered into negotiations with Cypress and eventually agreed to a transaction whereby Cypress would acquire all publicly held shares of Ramtron for $3.10 per share. The parties structured the transaction as a tender offer to be followed by a back-end merger.

In connection with considering Cypress's offer, Ramtron provided its financial advisor (Needham & Co.) certain internal projections. Although Ramtron had a history of badly missing its internal projections and had stopped providing guidance to the market for more than the next quarter, there was no evidence that Ramtron informed Needham that the projections were unreliable. Needham used the projections to prepare a discounted cash flow ("DCF") analysis, which was presented to the Board in connection with the Board's consideration of the Cypress offer. Needham also prepared comparable companies and comparable transactions analyses. The $3.10 per share deal price was within the range of values determined by both of the comparables analyses, but was below the range of values determined by the DCF.

During the course of the negotiations, Cypress never received Ramtron's internal projections. In fact, Cypress publicly stated that it felt that Ramtron's projections were unreliable given the difficulty of preparing accurate projections in the industry and the fact that Ramtron had missed its guidance for three of the past four years.

Cypress acquired 78 percent of Ramtron's stock through the tender offer, which was below the number of shares needed to exercise the top-up option. Accordingly, Ramtron scheduled a stockholders meeting to consider completion of the acquisition through a long-form merger. The proxy statement described Needham's financial analyses, including the DCF, and advised stockholders that the DCF was based on management's projections. However, the proxy statement did not disclose the underlying management projections.

The plaintiff sought to preliminarily enjoin the stockholders' meeting, alleging that the management projections were material information that should have been disclosed in the proxy statement. The Court refused to issue the injunction and concluded that the plaintiff had failed to demonstrate a reasonable likelihood of success on the disclosure claim. As an initial matter, the Court noted that "[t]here is no *per se* duty to disclose financial projections furnished to and relied upon by an investment banker. To be a subject of mandated disclosure, the projections must be material in the context of the specific case." *McMillan v. Intercargo Corp.,* 1999 WL 288128, at *6 (Del. Ch. May 3, 1999). The Court found that, in this instance, there were no facts suggesting that the undisclosed management projections were inconsistent with Needham's DCF analysis, which was disclosed. The Court explained that the proxy statement disclosed that the DCF was based on management projections and resulted in a range of values fairly substantially above the merger price. Based on this disclosure, a reasonable stockholder would understand that management's projections supported a higher price than the merger price. Thus, relying on *Skeen v. Jo-Ann Stores, Inc.*, 750 A.2d 1170 (Del. 2000), the Court found that the disclosure of the management projections would be merely consistent with the DCF analysis that the stockholders were already given. The Court also found it significant that stockholders were informed that Ramtron attempted to achieve a higher price that would have been within the range of values determined by the DCF analysis, but neither Cypress nor any other bidder was willing to pay such a price.

The Court found that two cases relied on by the plaintiff in which the Court of Chancery found that management projections were material, *Maric Capital Master Fund, Ltd. v. Plato Learning, Inc.*, 11 A.3d 1175, 1178 (Del. Ch. 2010), and *In re Netsmart Technologies Inc. S'holders Litig.*, 924 A.2d 171, 202-03 (Del. Ch. 2007), were factually distinguishable. The Court further noted that its decision did not turn on whether the projections were reliable. Rather, the Court indicated that the issue was whether disclosure of the projections would be substantially likely to alter the total mix of information provided to stockholders. For the reasons previously stated, the Court found that the plaintiff had failed to show a reasonable likelihood of success on this issue. However, the Court stated that if the plaintiff continued the litigation to trial and was ultimately able to show on a more complete record that there was a material non-disclosure, then quasi-appraisal may be an available remedy.

In re Atheros Communications, Inc. Shareholder Litigation, Consol. C.A. No. 6124-VCN (Del. Ch. Mar. 4, 2011).

In *In re Atheros Communications, Inc. Shareholder Litigation*, the Court of Chancery preliminarily enjoined Atheros Communications, Inc. ("Atheros") from holding a meeting of its stockholders to vote on a $3.1 billion all-cash merger agreement with Qualcomm Incorporated ("Qualcomm"), pending appropriate distribution of curative proxy disclosures regarding contingency fees to be paid to Atheros' financial advisor, and the potential employment of Atheros' CEO by Qualcomm.

Applying the *Revlon* standard, the Court first rejected the plaintiffs' breach of fiduciary duty claims due to an allegedly inadequate sale process, instead finding that the board had deployed a "robust and sophisticated process" resulting in a fair price. In so holding, the Court pointed out that a board need not follow one single path under *Revlon*; rather, the issue is whether the approach adopted by a board represented a reasonable choice under the circumstances it faced. In evaluating the board's process, the Court noted that the independent Atheros board had taken an active role at an early point in the lengthy sale process, meeting twelve times with management to discuss the process, vetting eleven potential acquirers and pursuing communications with three of those corporations. While two potential buyers eventually emerged, the Court found that the Atheros board acted reasonably by entering into an exclusivity agreement with Qualcomm in its efforts to preserve the Qualcomm increased offer—rather than risk the offer to pursue a potential competing bid from a sluggish suitor that had provided only vague overtures. Accordingly, the Court declined to second guess the actions of the Atheros board leading up to the execution of the merger agreement.

Regarding the plaintiffs' disclosure claims, the Court found that the Atheros board had omitted a material fact by failing to disclose that 98 percent of the financial advisor's fee was contingent on the success of the transaction. Reaffirming prior statements by the Court regarding the disclosure standards with respect to financial advisors, the Court pointed out that there should be full disclosure of advisors' compensation and potential conflicts that may influence the financial advisor in the exercise of its judgment. Even though contingency fees are "undoubtedly routine" and "customary," the Court stated, "[s]tockholders should know that their financial advisor, upon whom they are being asked to rely, stands to reap a large reward only if the transaction closes and, as a practical matter, only if the financial advisor renders a fairness opinion in favor of the transaction." The Court emphasized that while there is no bright-line rule for determining whether a contingency percentage requires disclosure, "it is clear that an approximately 50:1 contingency ratio requires disclosure."

In addressing the plaintiffs' other disclosure claims, the Court found that the Atheros board failed to provide sufficient disclosures in the proxy statement regarding the corporation's CEO and his knowledge that Qualcomm intended to offer him employment after the closing of the merger. While the proxy statement contained robust disclosures regarding the terms of the CEO's post-closing employment, the Court noted that the CEO was also aware prior to the time disclosed in the proxy statement that he would likely receive an offer for employment from Qualcomm, which was during the same time period in which he was heavily involved in the price negotiations for the transaction.

Two-Step Merger Transactions

Olson v. ev3, Inc., C.A. No. 5583-VCL (Del. Ch. Feb. 21, 2011).

In *Olson v. ev3, Inc.*, the Court of Chancery awarded plaintiff's counsel the full amount of attorneys' fees and expenses requested—$1.1 million—for what was, according to the Court, "the first meaningful full-scale challenge to the use of a top-up option." Under the terms of the merger agreement entered into between defendant ev3, Inc. ("ev3") and Covidien Group S.a.r.l. ("Covidien"), Covidien would acquire ev3 pursuant to a standard two-step acquisition, facilitated by a top-up option if certain conditions were met. Plaintiff Joanne Olson (the "Plaintiff") brought an action challenging the use of the top-up option. Specifically, the Plaintiff had advanced four arguments in seeking a preliminary injunction to block the transaction: (i) the top-up option failed to comply with Sections 152, 153, and 157 of the Delaware General Corporation Law (the "DGCL"); (ii) the exercise of the top-up option would be coercive, forcing stockholders to tender under the threat of "appraisal dilution"; (iii) the ev3 directors breached their fiduciary duties in granting the top-up option; and (iv) Covidien aided and abetted such breach of fiduciary duties by the ev3 directors.

The Court had previously granted the Plaintiff's motion to expedite because the Plaintiff "advanced a strong claim" regarding the purported failure of the top-up option to comply with Sections 152, 153, and 157 of the DGCL. Reaffirming prior cases where the Delaware courts emphasized strict statutory compliance with respect to matters involving a corporation's capital structure, the Court noted that if the second step of the acquisition were to be effected using shares received through the exercise of an invalid top-up option, then the merger itself would be subject to attack as *ultra vires* and void. The Court had further granted the motion to expedite because, at the time of the hearing, limited Delaware authority existed on top-up options, none of which addressed the concept of "appraisal dilution." Shortly after the motion to expedite was granted, the parties entered into a memorandum of understanding (the "MOU") which the Court found "provided the plaintiff with all the relief she could have hoped to achieve on the merits." Pursuant to the MOU, certain terms of the merger agreement and top-up option were amended to correct the statutory defects, and the parties agreed that no shares issued under the top-up option would be considered in an appraisal proceeding.

In ruling on the Plaintiff's contested fee application, the Court applied the factors established in *Sugarland Industries, Inc. v. Thomas*, 420 A.2d 142 (Del. 1980). With regard to the benefits achieved, the Court first found that the agreement between the parties that no shares issued under the top-up option would be considered in an appraisal proceeding completely alleviated the threat of appraisal dilution. The Court noted, however, that this benefit was "ephemeral at best" given that any legal uncertainty could have been addressed by an agreement of the constituent corporations in their disclosure documents that the top-up option shares would not be considered in any appraisal proceeding. In contrast, by correcting the statutory issues with respect to the top-up option, the Court found that the settlement conferred a "meaningful benefit" on ev3 and its stockholders. In particular, the settlement required that the merger agreement specify the terms of the promissory note to be issued in exchange for the top-up shares, ensuring that the instrument evidencing the option, the merger agreement, set forth the option terms and the consideration to be paid for the shares as required by Section 157(b). The settlement also required the ev3 board's approval of the amended merger agreement, ensuring that that board had approved the option terms and determined the sufficiency of the consideration to be received for the top-up shares as required by Sections 152, 153(a), and 157(d). The ev3 board was further required to adopt an implementing resolution for the creation and issuance of the top-up option, as required by Section 157(b). In its analysis of these statutory provisions, the Court pointed out that Sections 152, 153, and 157 of the DGCL were to be read narrowly and that these provisions do not contain similar grants of statutory authority to condition terms on facts ascertainable outside the governing instrument, such as is found in the provisions of Sections 151(a) (the terms of a class or series of stock) or Section 251(b) (the terms of a merger agreement). Accordingly, knowing the generalities of a transaction is not sufficient for a board of directors to satisfy the requirements of Sections 152, 153, and 157(b) and (d). Finally, the merger agreement was amended to require Covidien to pay, in cash, the par value of any top-up shares, thus eliminating any question as to whether the value of the consideration for the top-up shares was less than the par value of those shares in violation of Section 153(a). The Court concluded that because the top-up option and any shares issued pursuant to it likely were void under the merger agreement as originally structured, this litigation and subsequent settlement "prevented the seeds of a future legal crisis from germinating," and thus the Plaintiff's counsel was entitled to its full fee award that it submitted.

In re Cogent, Inc. Shareholder Litigation, Consol. C.A. No. 5780-VCP (Del. Ch. Oct. 5, 2010), *appeal refused*, 30 A.3d 782 (Del. 2010).

In *In re Cogent, Inc. Shareholder Litigation*, the Delaware Court of Chancery denied plaintiffs' motion for a preliminary injunction, which sought to enjoin a two-step acquisition in which a third-party acquiror, 3M Company ("3M"), agreed to commence a tender offer for the stock of the target corporation, Cogent, Inc. ("Cogent"), to be followed by a back-end merger at the same tender offer price.

In 2008, Cogent, with the aid of financial advisors, began exploring strategic opportunities and in connection therewith reached out to 27 potential suitors. By the summer of 2010, however, only two of these potential suitors emerged as *bona fide* potential counter-parties —3M and Company D. Both 3M and Company D had been discussing a transaction with Cogent at various levels since 2008. No competitive offers materialized, however, until July 2, 2010, when 3M submitted a written nonbinding proposal to acquire Cogent for $10.50 per share in cash, followed by a formal written proposal and draft merger agreement on August 11. On August 17, Company D responded by submitting a preliminary nonbinding indication of interest in acquiring Cogent for between $11.00 and $12.00 per share, contingent, however, upon completion of satisfactory due diligence. On August 19, 3M responded to Company D's expression of interest by notifying Cogent that it would formally withdraw its offer, if not accepted, at 5 p.m. on August 20. After reviewing the merits and risks associated with each offer, the Cogent board decided to negotiate a merger agreement with 3M at the $10.50 per share price.

On August 29, Cogent entered into an agreement and plan of merger (the "Merger Agreement") with 3M at the $10.50 per share price. The Merger Agreement included several deal protection devices, including granting 3M five days to match any superior proposal, a no-shop provision with a fiduciary out clause, a termination fee of $28.3 million, and a top-up option through which 3M had the option to purchase approximately 139 million shares of Cogent stock at the tender offer price of $10.50 per share, which could be financed with a promissory note due in one year. Pursuant to the terms of the Merger Agreement, the Cogent board filed a Schedule 14D-9 recommending that Cogent's stockholders accept 3M's proposal (the "Recommendation Statement").

Plaintiffs filed suit on September 1, 2010, asserting that the Cogent directors breached their fiduciary duties of loyalty and good faith as well as their fiduciary duty to disclose all material information regarding the transaction, and thereafter sought a preliminary injunction to prevent the transaction with 3M from moving forward.

Plaintiffs first attacked the sale process undertaken by the Cogent board. The Court determined that the Cogent board followed a reasonable course of action and found plaintiffs' criticism of the board's sale process unwarranted, citing the number of potential suitors that were contacted, the board's engagement in various levels of discussions with strategic acquirors and reengagement with potential suitors on multiple occasions, the independence and disinterestedness of three of the four members of Cogent's board, and that the interests of Cogent's founder, CEO and 38.88% stockholder appeared to be closely aligned with the interests of the Cogent stockholders as a whole. Plaintiffs also attacked the board's determination that $10.50 per share was a fair price on the ground that there was potential for a higher offer from Company D. The Court found that the Cogent board "acted reasonably when it effectively discounted Company D's [$11.00 to $12.00 per share] offer based on, among other things, the risk that Company D would not make a firm offer."

Plaintiffs then attacked the Merger Agreement as providing unreasonably preclusive defensive measures such that a superior proposal was unlikely to emerge. Plaintiffs alleged that the no-shop provision and the matching rights provision discouraged potential buyers because they unfairly tilted the playing field towards 3M, that the $28.3 million termination fee was unreasonably high, and that the top-up option was exceedingly broad.

The Court rejected each of plaintiffs' contentions. First, the Court found that the no-shop and matching rights provisions were reasonable and mitigated by the fiduciary out provision, which provided the Cogent board with sufficient ability to engage with any bidder who makes a definitively higher or reasonably competitive bid. Second, the Court found that the termination fee (representing approximately 3% of Cogent's equity value and 6.6% of its enterprise value) was not unreasonably high, rejecting plaintiff's argument that the cash on Cogent's balance sheet should be excluded (which would increase the percentage of the fee in relation to the transaction value) for purposes of evaluating the reasonableness of the termination fee.

The Court held that the relevant transaction value should be quantified as the amount of consideration flowing to the stockholders, not the amount of money coming exclusively from the bidder. Third, the Court found that the top-up option was likely reasonable because: (i) the exercise of the option was conditioned upon a majority of the outstanding shares being tendered to 3M (*i.e.*, a minimum tender condition), subject to waiver only with the consent of the Cogent board; (ii) in order for 3M to meet the 90% threshold necessary to effect a short-form merger, 3M would have to acquire a majority of the minority's outstanding shares; and (iii) the Merger Agreement explicitly provides that a promissory note issued by 3M to pay for the top-up shares is a recourse obligation against 3M. In light of these findings, the Court concluded that the deal protection provisions, separately and in combination, were not unreasonable or preclusive.

Finally, plaintiffs alleged that the Cogent directors breached their fiduciary duty of disclosure with regard to material omissions in Cogent's Recommendation Statement. The Court summarily rejected plaintiffs' contentions, finding that the information requested by plaintiffs was either sufficiently disclosed or immaterial and cumulative.

Ultimately, the Court found that plaintiffs failed to demonstrate a reasonable probability of success on the merits or an imminent threat of irreparable harm and that the balance of equities weighed against enjoining the tender offer. The Court therefore denied plaintiffs' motion for a preliminary injunction.

In response to the Court's denial of their motion, plaintiffs filed an application for certification of an interlocutory appeal from the portion of the Court's opinion concerning the validity of the top-up option. In a letter opinion dated October 15, 2010, the Court of Chancery denied plaintiffs' application, finding that its opinion did "not involve such exceptional circumstances that the challenged ruling can be said to have determined a substantial issue, established a legal right, or satisfied one of the criteria in Rule 42(b)(i)–(v) sufficient to warrant an interlocutory appeal." *In re Cogent, Inc. S'holder Litig.*, C.A. No. 5780-VCP (Del. Ch. Oct. 15, 2010). The Delaware Supreme Court affirmed the Court of Chancery's letter opinion denying plaintiffs' application for an interlocutory appeal. *In re Cogent, Inc. S'holder Litig.*, 30 A.3d 782 (Del. 2010).

Merger as Implicating Anti-Assignment Agreement

Meso Scale Diagnostics, LLC v. Roche Diagnostics GmbH, 2013 WL 655021 (Del. Ch. Feb. 22, 2013).

In *Meso Scale Diagnostics, LLC v. Roche Diagnostics GmbH,* 2013 WL 655021 (Del. Ch. Feb. 22, 2013), Vice Chancellor Parsons of the Court of Chancery, ruling on a motion for summary judgment, held that a reverse triangular merger did not constitute an assignment by operation of law on the part of the surviving corporation. This ruling clarified a question left open in an earlier ruling on a motion to dismiss in the same case, 2011 WL 1348438 (Del. Ch. Apr. 8, 2011).

In 2003, a foreign holding company, Roche, entered into a series of agreements that, among other things, granted it a non-exclusive license to certain patented technology. Plaintiffs, two Delaware limited liability companies involved in the 2003 transactions, had disputed springing rights to that patented technology. In connection with the 2003 transactions, the licensed intellectual property assets were transferred to BioVeris. In 2007, Roche acquired BioVeris through a reverse triangular merger. Three years later, plaintiffs initiated this action claiming that Roche and its affiliates, by effecting the merger, breached two agreements related to the 2003 transactions. One of those agreements was a global consent with a provision that prevented assignment of the assets by operation of law without consent of the other parties.

Plaintiffs claimed that the 2007 reverse triangular merger was an assignment by operation of law that required their consent. Defendants moved for summary judgment on multiple grounds, including laches, that the anti-assignment clause in the global consent provision did not apply to the assets at issue, and that a reverse triangular merger cannot be an assignment by operation of law. The Court rejected the laches argument and found that the anti-assignment clause did in fact apply to the intellectual property rights. The Court sided with defendants on their third argument, however, and held that because a reverse triangular merger is not an assignment by operation of law, the global consent provision was not intended to cover the merger. The Court began its analysis by noting that "[g]enerally, mergers do not result in an assignment by operation of law of assets that began as property of the surviving entity and continued to be such after the merger." The Court also noted that under 8 *Del. C.* § 259, only the non-surviving corporation's rights and obligations are transferred to the surviving corporation by operation of law. Further, this issue had not previously been before the Court, and thus the Court noted that leading commentators have also concluded that a reverse triangular merger does not constitute an assignment by operation of law.

Plaintiffs advanced three theories in support of their argument that the anti-assignment clause was intended to cover reverse triangular mergers: (i) the acquisition of BioVeris practically resulted in the assignment of its intellectual property rights to Roche; (ii) Delaware case law governing forward triangular mergers compels the conclusion that provisions covering assignments by operation of law apply to all mergers; and (iii) the Court should adopt the holding of a California case where the court held that a reverse triangular merger did result in an assignment by operation of law.

The Court rejected each of these arguments in turn. As to the first, the Court found that this argument was unavailing because it "ignores Delaware's long-standing doctrine of independent legal significance," which posits that actions taken under different provisions of the DGCL have independent legal significance even if the end result may be the same under different sections. The Court found the second argument unpersuasive since the two cases cited by plaintiffs were distinguishable, as they involved forward triangular mergers where the target company was not the surviving entity. Here, BioVeris was the surviving entity and thus there was no assignment or transfer of its assets. The Court then rejected plaintiffs' assertion that it should adopt the California court's holding in *SQL Solutions, Inc. v. Oracle Corp.* In that case, the California court reasoned that a reverse triangular merger is an assignment by operation of law because "an assignment or transfer of rights does occur through a change in the legal form of ownership of a business." The Court of Chancery found that adopting this reasoning would conflict with Delaware's jurisprudence regarding stock acquisitions where Delaware courts have consistently held that a corporation may lawfully acquire the stock of another corporation and such a change of ownership is not regarded as assigning the contractual rights or duties of the corporation whose securities are purchased. The Court found that since both stock acquisitions and reverse triangular mergers "involve changes in legal ownership...the law should reflect parallel results."

Confidentiality Agreements

In re Complete Genomics, Inc. Shareholder Litigation, C.A. No. 7888-VCL (Del. Ch. Nov. 27, 2012) (TRANSCRIPT); ***In re Ancestry.com Inc. Shareholder Litigation,*** C.A. No. 7988-CS (Del. Ch. December 17, 2012) (TRANSCRIPT).

In two recent bench rulings in the preliminary injunction context, the Court of Chancery addressed "don't ask, don't waive" provisions of standstill agreements in connection with a target company's auction process. In *In re Complete Genomics, Inc. Shareholder Litigation,* C.A. No. 7888-VCL (Del. Ch. Nov. 27, 2012), Vice Chancellor Laster questioned the validity under Delaware law of a "don't ask, don't waive" provision prohibiting private requests for waiver of a standstill agreement, and enjoined enforcement of the provision in that case. Several weeks later, in *In re Ancestry.com Inc. Shareholder Litigation,* C.A. No. 7988-CS (Del. Ch. December 17, 2012), Chancellor Strine stated that Delaware has no per se rule against "don't ask, don't waive" provisions, but made clear that such provisions will be subject to close scrutiny. Going forward, "don't ask, don't waive" provisions will be closely scrutinized on a case-by-case basis.

"Don't ask, don't waive" provisions, while relatively new, have become common features of standstill agreements entered into by potential bidders for a target that has put itself up for auction. Although terms of standstill agreements can vary greatly, their purpose is to ensure an orderly auction by prohibiting potential bidders from making a public bid for the target outside of the target-controlled auction process. A "don't ask, don't waive" provision of a standstill agreement prohibits a potential bidder from requesting, publicly or privately, a waiver by the target of the standstill agreement so as to allow the potential bidder to make another bid for the company after the bidder was outbid during the auction process. Thus, the provision is designed to ensure an orderly auction that encourages bidders to put their best bids forward prior to the target's execution of a definitive merger agreement.

In *Complete Genomics,* a potential bidder for Complete Genomics was subject to a standstill agreement that contained a "don't ask, don't waive" provision, which prohibited it from requesting, publicly or privately, that the target board waive the standstill agreement. In the bench ruling, Vice Chancellor Laster did not question the target's ability to prohibit a *public* waiver request, but stated that the prohibition against a *private* waiver request resembled an impermissible "bidder-specific no-talk clause." By agreeing to the "don't ask, don't waive" provision and prohibiting "incoming information from that bidder under any circumstances," "the Genomics board impermissibly limited its ongoing statutory and fiduciary obligations to properly evaluate a competing offer, disclose material information, and make a meaningful merger recommendation to its stockholders." The Court enjoined Complete Genomics from enforcing the "don't ask, don't waive" provision in the standstill.

In *Ancestry.com,* Chancellor Strine acknowledged that "don't ask, don't waive" provisions could be used "for value-maximizing purposes," by forcing bidders to come forward with their best price during the auction, and stated that such provisions are not per se invalid under Delaware law. Referring to *Complete Genomics,* the Chancellor stated, "I know people have read a bench opinion that way," but "there was a lot going on in that case" and "there is a role that bench opinions play, and I don't think it's to make per se rules." The Chancellor cautioned that a "don't ask, don't waive" provision is "potent" and stated that the use of such a provision will be evaluated in light of the factual context, including whether the board was informed about the provision and used the provision for the purpose of enhancing stockholder value. Before the preliminary injunction hearing, the target sent letters to the unsuccessful bidders waiving the "don't ask, don't waive" provision, but the Court nevertheless granted a limited injunction against the stockholder vote, requiring the target to disclose to its stockholders information about the "don't ask, don't waive" provision and how it was used in the bidding process, which the Court considered to be "absolutely essential" information.

Martin Marietta Materials, Inc. v. Vulcan Materials Co., 2012 WL 2783101 (Del. July 12, 2012).

In *Martin Marietta Materials, Inc. v. Vulcan Materials Co.*, 2012 WL 2783101 (Del. July 12, 2012), the Delaware Supreme Court affirmed the Court of Chancery's decision enjoining Martin Marietta Materials, Inc. ("Martin") from taking any action in connection with its hostile takeover bid for Vulcan Materials Co. ("Vulcan"), including proceeding with its exchange offer and prosecuting its proxy contest, for a period of four months, in order to remedy Martin's breach of two confidentiality agreements between the companies.

Over a period of several years, Martin and Vulcan occasionally discussed the possibility of a friendly business combination, and in the spring of 2010, those discussions restarted. Because both companies were concerned that disclosure of such discussions could put either company "in play" and subject to a hostile takeover bid, they entered into two strict confidentiality agreements—the non-disclosure agreement (the "NDA") and the joint defense agreement (the "JDA" and together with the NDA, the "Confidentiality Agreements"). Accordingly, the Confidentiality Agreements protected both companies from disclosure of the fact that negotiations were taking place and also protected the use and disclosure of the companies' confidential information, except in certain specific circumstances. Both agreements were governed by Delaware law and the NDA contained a Delaware choice of forum provision, though neither company is incorporated in Delaware.

In 2011, with market conditions favoring Martin and negotiations for a friendly business combination with Vulcan stalling, Martin began using Vulcan's confidential information to evaluate alternatives to a friendly business combination. Shortly thereafter, Martin launched an unsolicited exchange offer for Vulcan's shares and announced its proxy contest to oust several members of the Vulcan board of directors. In connection with Martin's hostile takeover bid, Martin disclosed Vulcan's non-public, confidential information and the existence of the negotiations between Martin and Vulcan regarding a business combination to third-party advisors and to the public in its filings with the Securities and Exchange Commission.

On the same day that it launched its exchange offer, Martin filed an action in the Court of Chancery for a declaratory judgment that it did not breach the NDA in conducting its exchange offer or proxy contest. In response, Vulcan filed a counterclaim for a judgment that Martin's actions breached the Confidentiality Agreements and for an injunction prohibiting Martin from proceeding with its hostile takeover bid.

Following a trial on the merits, the Court of Chancery found that Martin breached the Confidentiality Agreements by impermissibly using and disclosing Vulcan's confidential information. The trial court enjoined Martin from proceeding with its exchange offer and proxy contest, from otherwise taking steps to acquire control of Vulcan, and from further violating the confidentiality agreements for a period of four months. As a result, Martin terminated its exchange offer and proxy contest and filed an appeal to the Delaware Supreme Court. In its appeal, Martin challenged the Court of Chancery's determination that it violated the Confidentiality Agreements and its imposition of injunctive relief.

Before addressing Martin's substantive claims of error, the Supreme Court addressed Martin's claim that the trial court's interpretation of the Confidentiality Agreements improperly and "stealthily" converted those documents into a standstill agreement. As to this issue, the Supreme Court found that Martin's claim was factually incorrect—the trial court properly interpreted and enforced the agreements as confidentiality agreements—and that Martin's claim confused the distinction between a standstill agreement (which protects a party from a hostile takeover) and a confidentiality agreement (which protects a party from unauthorized use or disclosure of its confidential information).

Turning to Martin's substantive claims that the trial court erred in finding that Martin's use and disclosure of Vulcan's non-public information violated the Confidentiality Agreements, the Supreme Court affirmed the Court of Chancery's decision that (i) the JDA prohibited Martin from using and disclosing Vulcan's confidential information without Vulcan's consent except "for purposes of pursuing and completing" the transaction being discussed between Vulcan and Martin, which the Court of Chancery found was limited to a friendly business combination; (ii) the NDA prohibited Martin from using and disclosing Vulcan's confidential information without Vulcan's pre-disclosure consent except for disclosure in response to certain external demands and only after complying with a notice and vetting process; and (iii) Martin's actions in connection with its hostile takeover bid breached these disclosure restrictions.

With regard to the trial court's imposition of an injunction against Martin for a period of four months, Martin claimed not only that the Court of Chancery erred in balancing the equities because there was no evidence that Vulcan suffered any irreparable harm, but also that the scope of the injunction was unreasonable because it would have the effect of delaying Martin's takeover bid for a period of one year. The Supreme Court affirmed the Court of Chancery's decision in balancing the equities, finding that Vulcan suffered irreparable harm as a result of Martin's breach. More specifically, the Supreme Court held that the provisions of the confidentiality agreements that stipulated that a breach of such agreements would entitle the non-breaching party to equitable relief were sufficient to establish irreparable harm for purposes of an injunction and affirmed the Court of Chancery's factual finding that Vulcan suffered irreparable harm through the loss of its negotiating leverage due to Martin's breach, which was "exactly the same kind of harm [Martin] demanded the Confidentiality Agreement shield [it] from." In connection with Martin's claims regarding the scope of the injunction, the Supreme Court found that, although the expiration date of the NDA combined with Vulcan's advance notice bylaw provision may prevent Martin from prosecuting its proxy contest for a period of one year, the Court of Chancery had properly balanced the need to vindicate Vulcan's reasonable contractual expectations with the delay imposed on Martin due to its own conduct.

RAA Management, LLC v. Savage Sports Holdings, Inc., 45 A.3d 107 (Del. 2012).

In *RAA Management, LLC v. Savage Sports Holdings, Inc.*, 45 A.3d 107 (Del. 2012), the Delaware Supreme Court affirmed the Superior Court's dismissal of a fraud claim based on a non-disclosure agreement ("NDA") entered into between RAA Management, LLC ("RAA") and Savage Sports Holdings, Inc. ("Savage"). In the action, RAA sought to recover costs incurred performing due diligence in preparation for a potential transaction with Savage, which RAA alleged it would not have pursued but for certain misrepresentations by Savage. The Court analyzed the NDA and determined that, under either Delaware or New York law, the non-reliance and waiver provisions in the NDA foreclosed Savage's fraud claims.

On September 17, 2010, RAA entered into an NDA with Savage in order to obtain confidential documents and information as part of a due diligence process aimed at potentially acquiring Savage. The NDA explicitly provided that (i) Savage would not be held liable for RAA's reliance on information provided during the course of due diligence; (ii) Savage did not make any representations or warranties as to the accuracy or completeness of the information provided; and (iii) RAA waived its right to bring claims against Savage except with respect to any representations and warranties that may be made in a final agreement of sale. On December 22, 2010, subsequent to a cursory due diligence process, the parties executed a letter of intent ("LOI") contemplating a cash acquisition of $170 million. Thereafter, RAA continued to engage in due diligence, until finally notifying Savage in March 2011 that it was no longer interested in the acquisition and believed it was entitled to $1.2 million for its "sunken due diligence costs."

In April 2011, RAA filed suit against Savage alleging that Savage had told RAA at the outset of discussions that there were "no significant unrecorded liabilities or claims against Savage." However, during the due diligence, Savage disclosed three such matters: (i) an investigation by the New York State Department of Environmental Conservation, (ii) the potential unionization of the employees at Savage's BowTech facility, and (iii) a lawsuit that constituted a "multi-million" dollar potential liability. RAA claimed that had Savage disclosed any one of the foregoing matters early in the discussions, as it was obligated to do, RAA would not have expended any of its resources on due diligence. While RAA acknowledged that the NDA included non-reliance and waiver of claims provisions, RAA argued that such provisions should be construed as limited to mistakes, oversights, or simple disclosure negligence, but "not willful falsehoods."

In affirming the lower court's dismissal, the Supreme Court relied heavily on two cases that formerly analyzed NDA provisions similar to the NDA at issue. In *Great Lakes Chemical Corp. v. Pharmacia Corp.*, 788 A.2d 544 (Del. Ch. 2001), the Court of Chancery found that where two sophisticated parties entered into an NDA disclaiming liability for the transfer of information, such parties were barred from asserting claims of fraud because such claims would effectively "defeat the reasonable commercial expectations of the contracting parties and eviscerate the utility of written contractual agreements." Similarly, in *In re IBP, Inc. S'holders Litig.*, 789 A.2d 14 (Del. Ch. 2001), the Court of Chancery considered provisions "nearly identical" to the NDA provisions at issue in *RAA v. Savage* and found that such provisions precluded liability for fraud claims under New York law. In that case, then-Vice Chancellor (now Chancellor) Strine reasoned that because the confidentiality agreement emphasized that the acquisition negotiation process would not provide a basis for reliance claims, it was reasonable to require the potential buyer to convert its reliance into actual contractual warranties and representations in order to establish a basis for legal claims. Following the reasoning of these decisions, the Supreme Court found that the non-reliance and waiver provisions were unambiguous and, under their plain language, were not limited to unintentional inaccuracies.

The Supreme Court also rejected RAA's assertions that the non-reliance and waiver provisions should not bar its claims under New York's "peculiar knowledge" exception and/or on public policy grounds. While the Court acknowledged New York's peculiar knowledge exception—that claims of fraudulent inducement could not be barred by non-reliance provisions if the facts at issue were "peculiarly within the misrepresenting party's knowledge"—it found that the exception had been rejected by New York courts in circumstances where sophisticated parties could have easily insisted on contractual protections for themselves. Accordingly, assuming that New York law applied (an issue that was disputed by the parties), the Court found that the "peculiar knowledge" exception would not be applicable in these circumstances. Regarding public policy, the Court relied on *Abry Partners v. F&W Acquisition LLC*, 891 A.2d 1032 (Del. Ch. 2006), wherein the Court of Chancery found that "to fail to enforce non-reliance clauses is not to promote a public policy against lying[;] [r]ather, it is to excuse a lie made by one contracting party in writing—the lie that it was relying only on contractual representations and that no other representations had been made—to enable it to prove that another party lied." The Supreme Court concluded that "*Abry Partners* accurately states Delaware law and explains Delaware's public policy in favor of enforcing contractually binding written disclaimers of reliance on representations outside of a final agreement of sale or merger." ■

Scrutiny of Settlements

Scully v. Nighthawk Radiology Holdings, Inc., C.A. No. 5890-VCL (Del. Ch. Dec. 17, 2010) (TRANSCRIPT).

At a status conference in *Scully v. Nighthawk Radiology Holdings, Inc.*, Vice Chancellor Laster stated that there was *prima facie* evidence of collusive forum shopping in connection with a settlement of multi-jurisdictional, representative litigation challenging the fairness of a merger and announced that he would appoint special counsel to the Court to investigate these issues and possibly to recommend disciplinary action.

Following the announcement of the proposed merger of Nighthawk Radiology Holdings, Inc. and Virtual Radiologic Corporation, putative class actions challenging the deal were filed in the Delaware Court of Chancery and Arizona state court. The parties to the Delaware action briefed and argued a motion to expedite, during which (i) defendants expressed a strong preference for litigating the cases in Delaware; (ii) the Court signaled that plaintiffs' disclosure claims were not colorable; and (iii) the Court signaled that the case presented meaningful, litigable process claims, which plaintiffs had ignored.

Shortly thereafter, the parties to the Delaware action notified the Court that they had entered into a memorandum of understanding that, subject to confirmatory discovery, would result in a global disclosure-only settlement. Further, the parties informed the Court that they intended to present the settlement for approval in Arizona, where there had been no litigation activity. In response, Vice Chancellor Laster immediately scheduled a status conference.

During the status conference, the Vice Chancellor expressed concern that the settlement consideration involved only disclosure claims that he already had said were not colorable and that there was no apparent effort to address the process claims, which he had expressed "had legs." Further, the parties were seeking approval of the settlement from a court that had not yet looked at any of these issues and might never discover that the Court of Chancery had made preliminary determinations as to the merits.

According to the Vice Chancellor, it appeared that what took place was "the classic reverse auction...where defendants benefit and utilized multiple [fora] to force plaintiffs essentially to constructively reverse-bid for the lowest possible settlement." Defendants could accomplish this goal by, for example, giving preferential access to documents, stipulating to consolidation and certification of a class, and threatening to cut certain plaintiffs' counsel completely out of settlement negotiations.

The Vice Chancellor noted that historically plaintiffs' lawyers have been criticized for suing on the announcement of every deal and then agreeing to disclosure-only settlements. "But what needs to be understood is that defense lawyers benefit from this game, too. They get to bill hours without any meaningful reputational risk from a loss. They then get to get a cheap settlement for their client." The Vice Chancellor went on to explain that while many defense counsel rightly regard this dynamic as benefitting their clients, as he "tried to remind people in the *Revlon* case,[1] you're dealing with fiduciaries for a class. And when you knowingly induce a fiduciary breach, you're an aider and abettor."

Vice Chancellor Laster concluded that the Arizona court would determine whether or not to approve the settlement and that Delaware would give full faith and credit to its decision. However, he entered an order directing that the status conference transcript and the case files be sent to the Arizona court with a letter indicating that he was available to discuss his views.

He also indicated that he will appoint special counsel to the Court to investigate the *prima facie* case of collusion and forum shopping and will consider revocation of *pro hac vice* admissions and possible referrals to disciplinary counsel. All parties and their counsel were ordered to submit, by February 11, separate briefs and affidavits detailing every aspect of the settlement negotiations. The Vice Chancellor expressed that his mind was open to being convinced that what he has called collusive forum shopping "is a necessary part of the practice and should not be condemned," but that he was deeply skeptical.

1 In *In re Revlon, Inc. Shareholders Litigation,* Consol. C.A. No. 4578-VCL (Del. Ch. Mar. 16, 2010), the Court of Chancery replaced lead representative plaintiffs and their counsel after concluding that the plaintiffs and their counsel failed to litigate the case adequately and exaggerated their litigation efforts in filings submitted to the Court.

Gregory P. Williams, a director at Richards, Layton & Finger, has been appointed the special counsel to the Court for this matter to, *inter alia*, advise the Court as to potential changes to judicial procedures and rules pertaining to multi-forum litigation.

Preferred Stock Issues

Shiftan v. Morgan Joseph Holdings, Inc., C.A. No. 6424-CS (Del. Ch. Jan. 13, 2012).

In *Shiftan v. Morgan Joseph Holdings, Inc.*, the Court of Chancery concluded on summary judgment that a specific, non-speculative future redemption right of preferred stockholders must be taken into account when determining the fair value of their shares in an appraisal under 8 *Del. C.* § 262(h).

In December 2010, Morgan Joseph Holdings, Inc. ("Morgan Joseph") merged with another investment bank, Tri-Artisan Capital Partners, LLC. Instead of exchanging their Series A preferred stock for new Series A preferred stock, petitioners demanded appraisal. Under the terms of Morgan Joseph's certificate of incorporation, an "Automatic Redemption" would have been triggered on July 1, 2011, entitling the Series A preferred stockholders to $100 per share. The petitioners argued that because the Automatic Redemption triggered an unconditional obligation to redeem their shares on July 1, 2011 for $100, the $100 per share redemption value should be given effect in the Court's determination of fair value. Morgan Joseph responded with two separate arguments: first, the Automatic Redemption clause was subject to an Excess Cash requirement; second, the Court should disregard the Automatic Redemption because it was not triggered by the merger and had not occurred as of the merger. The Court sided with petitioners on both issues.

Applying Delaware's traditional contract interpretation principles, the Court found that the Automatic Redemption provision's unambiguous terms did not support a reading that the provision was subject to an Excess Cash requirement, and that the clause clearly created an unconditional obligation to redeem the shares on July 1, 2011 at the $100 redemption value. The Court did not address, and thus implicitly rejected, a related argument made by Morgan Joseph based on the Chancery Court's recent opinion in *SV Investment Partners, LLC v. ThoughtWorks, Inc.* that the Company's redemption obligation was not fixed because of uncertainty over whether the Company would have "lawful funds" on the mandatory redemption date. While the Court noted that under Section 160 of the DGCL a company must have "lawful funds" to redeem its stock, it did not suggest that Section 160 required anything other than that the company have statutory surplus therefor.

Despite finding that the terms of Morgan Joseph's certificate of incorporation were unambiguous, the Court nonetheless took the opportunity to address a doctrinal tension that emerges when contractual ambiguity in the preferred stock context does exist. Delaware courts generally adhere to the doctrine of *contra proferentem*—that a contract should be interpreted against the drafter—in order to resolve ambiguity in governing instruments of business entities in favor of investors. However, the principle of *contra proferentem* is in tension with another well-settled principle of Delaware contract law requiring strict construction of preferences claimed by preferred stockholders. Thus, a Delaware court will not imply or presume a preference of a preferred stockholder unless it is clearly set forth in the certificate. In *dicta*, the Court concluded that while the strict construction principle does not preclude considering parol evidence where ambiguity exists, "unless the parol evidence resolves the ambiguity with clarity in favor of the preferred stock, the preferred stockholders should lose."

Finally, the Court explained that because the Series A preferred stockholders would have been entitled to an Automatic Redemption six months after the merger, this specific, non-speculative contractual right must be taken into account in the appraisal analysis. The Court distinguished *In re Appraisal of Metromedia International Group, Inc.*, 971 A.2d 893, 905 (Del. Ch. 2009), a case relied upon by Morgan Joseph in arguing that the Automatic Redemption cannot be considered in an appraisal, because the rights claimed by the preferred stockholders in that case were based on future events that were not certain to occur.

SV Investment Partners, LLC v. ThoughtWorks, Inc., 37 A.3d 205 (Del. 2011).

In *SV Investment Partners, LLC v. ThoughtWorks, Inc.*, the Delaware Supreme Court affirmed the Court of Chancery's holding that SV Investment Partners, LLC ("SVIP") failed to prove that ThoughtWorks, Inc. ("ThoughtWorks") had "funds legally available" to satisfy SVIP's redemption demand, even assuming that SVIP was correct in arguing that the phrase "funds legally available," as used in ThoughtWorks' certificate of incorporation, was equivalent to the term "surplus," as used in 8 *Del. C.* § 160. Thus, the Supreme Court determined that it did not need to address the Court of Chancery's other holding that "funds legally available" was not equivalent to "surplus."

In 2000, SVIP invested $26.6 million in ThoughtWorks in exchange for Series A Preferred Stock that was redeemable at the option of the holder after five years, subject to the funds being legally available (the "Redemption Provision"). Specifically, the Redemption Provision provided that "each holder of Preferred Stock shall be entitled to require the Corporation to redeem for cash out of any funds legally available therefor."

In 2005, SVIP demanded redemption of the preferred stock. In response, the ThoughtWorks board of directors convened a special meeting to consider the extent to which ThoughtWorks had the "funds legally available" to redeem the stock. Determining that ThoughtWorks had $500,000 in funds legally available for redemption, the board redeemed shares of preferred stock up to that amount. In each of the 16 successive quarters, the board evaluated the financial state of ThoughtWorks, consulting with its financial advisors as to the amount of funds legally available to redeem the preferred stock. During this period, ThoughtWorks redeemed a total of $4.1 million of preferred stock. Nevertheless, SVIP claimed that more preferred stock should have been redeemed, and sought a declaratory judgment in the Court of Chancery as to the meaning of "funds legally available" and a monetary judgment for the full amount of the funds legally available for redemption, which it argued was equivalent to statutory "surplus."

The Court of Chancery rejected SVIP's contention that "funds legally available" meant statutory "surplus" and held that "funds legally available therefor" meant "cash funds on hand that can be legally disbursed for redemption without violating 8 *Del. C.* § 160 or any other statutory or common law." Alternatively, the Court of Chancery held that, assuming "funds legally available" did mean statutory "surplus," SVIP failed to prove that ThoughtWorks had "funds legally available" to redeem the preferred stock. The Court of Chancery premised this aspect of its decision, in part, on the insufficiency of SVIP's expert witness testimony at trial. In particular, the Court of Chancery noted that the expert did not consider the amount of funds ThoughtWorks could use to redeem the stock while still operating as a going concern. Thus, while the expert's testimony was "defensible as a theoretical exercise," it did not reflect "real economic value or bear any relationship to what ThoughtWorks might borrow or its creditors recover." Further, because the board had made determinations as to the amount of funds legally available for redemptions, SVIP was required to prove that the board had acted in bad faith, had relied on methods and data that were unreliable, or had made a determination so far off the mark as to constitute actual or constructive fraud. Because the expert testimony did not offer any evidence that went to those issues, the Court of Chancery held that SVIP failed to carry its burden in proving that ThoughtWorks had the "funds legally available" to redeem the preferred stock, even assuming that "funds legally available" was equivalent to statutory "surplus."

The Delaware Supreme Court affirmed the Court of Chancery's decision solely on the ground that SVIP failed to carry its burden of proof to establish that ThoughtWorks had "funds legally available" to redeem the preferred stock, regardless of the construction of the term "funds legally available." Thus, the Supreme Court did not address whether SVIP's definition of "funds legally available" as statutory surplus was legally correct. Rather, the Supreme Court noted that "a factual finding based on a weighing of expert opinion may be overturned only if arbitrary or lacking any evidential support" and concluded that the Court of Chancery had explained a logical rationale for rejecting the testimony of SVIP's expert witness. Accordingly, because the Court of Chancery's finding that SVIP had failed to carry its burden of proving that ThoughtWorks had the funds legally available did not constitute reversible error, the Supreme Court affirmed.

Alta Berkeley VI C.V. v. Omneon, Inc., C.A. No. N10C-11-102 JRS CCLD (Del. Super. July 21, 2011), *aff'd*, 41 A.3d 381 (Del. 2012).

In *Alta Berkeley VI C.V. v. Omneon, Inc.*, the Delaware Superior Court's Complex Commercial Litigation Division[2] denied a claim for a liquidation preference by certain former preferred stockholders of Omneon, Inc. in connection with a merger between Omneon and Harmonic, Inc.

In May 2010, Omneon entered into an Agreement and Plan of Reorganization (the "Reorganization Agreement") with Harmonic pursuant to which Harmonic was to acquire Omneon for approximately $190 million in cash and $120 million in stock. The Reorganization Agreement provided for a sequence of transactions, including as a first step a conversion of all but one series of Omneon's preferred stock into common stock, subject to a vote of Omneon's preferred stockholders. Once that conversion took place, the Reorganization Agreement contemplated a series of steps that would culminate in Omneon being merged with and into an acquisition vehicle formed by Harmonic.

Plaintiffs, who were holders of one of the series of preferred stock that was converted into common stock, brought an action for breach of contract against Omneon alleging that Omneon wrongfully denied them a liquidation preference in connection with the merger. Plaintiffs asserted that each step of the proposed merger, including the vote to convert preferred stock into common stock, was part of a "series of related transactions" that comprised a Liquidation Event under Omneon's certificate of incorporation and allegedly entitled plaintiffs to a liquidation preference. Omneon argued that the vote to convert Omneon preferred stock to common stock occurred prior to the Liquidation Event (the merger), and therefore the right to a liquidation preference never accrued.

2 The Superior Court Complex Commercial Litigation Division was created in May of 2010 to handle complex business disputes. A panel of four Superior Court judges comprises the Division and has drafted rules and procedures for the expeditious handling of these cases. *See* Superior Court Complex Commercial Litigation Division, http://courts.delaware.gov/Superior/complex.stm.

In addressing the parties' respective contentions, the Court confirmed that, under Delaware law, the rights of preferred stockholders as set forth in a certificate of incorporation are contractual rights, but cautioned that Delaware courts may not "by judicial action, broaden the rights obtained by a preferred stockholder at the bargaining table."

The Court found that Omneon's certificate of incorporation clearly and unambiguously provided that plaintiffs were entitled to a liquidation preference if and only if the Liquidation Event occurred prior to the conversion of their shares. On this issue, the Court held that while the conversion was clearly an "integral part" of the proposed merger, it was "equally clear that a 'reasonable third party' would read the Reorganization Agreement to stage the automatic conversion as a condition, *inter alia*, to the first-step merger, not to include the conversion among the 'series of related transactions' that comprised the merger itself." Because the conversion occurred prior to the Liquidation Event, the Court held that plaintiffs were not entitled to a liquidation preference and granted summary judgment to the defendants.

Plaintiffs appealed the decision to the Delaware Supreme Court. On March 5, 2012, the Delaware Supreme Court issued a written opinion affirming the Court of Chancery's holding that the overall transaction did not constitute a "Liquidation Event," as defined in Omneon's certificate of incorporation, because the conversion and the merger were legally separate events.

Fletcher International, Ltd. v. ION Geophysical Corp., C.A. No. 5109-VCS (Del. Ch. Mar. 29, 2011).

The efforts of Fletcher International, Ltd. ("Fletcher") to block a joint venture between ION Geophysical Corp. ("ION") and China National Petroleum Corporation ("China National") have resulted in multiple opinions interpreting Fletcher's rights as a preferred stockholder of ION. In the latest opinion, *Fletcher International, Ltd. v. ION Geophysical Corp.*, the Court of Chancery reaffirmed the primacy of contract principles when interpreting the rights of preferred stockholders under Delaware law and refused to expand the rights of Fletcher beyond the clear and unambiguous terms of ION's certificate of incorporation.

The preferred stock provision at issue provided that the prior consent of a majority of the holders of ION's Series D preferred stock (in this case, Fletcher) was necessary to "permit *any Subsidiary* of [ION] to issue or sell, or obligate itself to issue or sell, *except to [ION]* or any wholly owned Subsidiary, any security of such Subsidiaries." In two of the Court's previous opinions, Fletcher successfully argued that this provision required ION to obtain Fletcher's consent before a different ION subsidiary could issue a convertible note in connection with the joint venture. Fletcher failed to persuade the Court, however, to enjoin the overall transaction, which was completed on March 24, 2010 when ION transferred 51% of the stock of INOVA Geophysical Equipment Limited ("INOVA"), a wholly owned subsidiary of ION, to China National pursuant to a term sheet and share purchase agreement. After the joint venture transaction had been completed, Fletcher amended its complaint alleging that (i) ION had breached its contractual rights as a preferred stockholder by permitting INOVA to sell or issue securities to China National without Fletcher's prior consent, and (ii) INOVA had tortiously interfered with these same rights. ION and INOVA moved to dismiss both claims, arguing that the preferred stock provision did not give Fletcher a consent right with respect to ION's sale of INOVA stock.

Fletcher's primary argument in support of its claims was that ION had violated Fletcher's consent rights when it entered into the term sheet and the share purchase agreement with China National because ION essentially "permit[ed] INOVA to 'sell and obligate itself to sell securities equaling 51% of its equity to [China National]' without first obtaining Fletcher's consent." Alternatively, Fletcher asserted that, while formally speaking, the sale of INOVA stock was from ION to China National, the economic substance of the entire joint venture transaction was a sale by INOVA of INOVA stock to China National. Fletcher urged the Court to look beyond the form of the transaction and treat ION's transfer of 51% of its INOVA stock to China National as an issuance by INOVA of those shares directly to China National.

The Court rejected both arguments, finding them to be "meandering in the sense that [they are] selectively formal and deconstructive in [their] logical approach." On the one hand, Fletcher argued that the term sheet bound INOVA to transfer its own shares of stock to China National while admitting that under the plain terms of the term sheet, ION would be the one doing the selling of the to-be-formed subsidiary's stock. On the other, if the Court accepted the argument that INOVA was, from its creation, intended to be an entity owned 51% by China National and only 49% owned by ION, then INOVA was never an ION subsidiary under the terms of the preferred stock provision and thus not subject to Fletcher's consent right.

Ultimately, the Court held that the rights that Fletcher had bargained for as set forth in the ION certificate of incorporation were clear and unambiguous and did not provide Fletcher with a consent right under any of the scenarios advanced by Fletcher. The Court reiterated the principles that a preferred stockholder's rights are contractual in nature, are to be strictly construed, and must be expressly set forth in the relevant governing document. Applying these principles, the Court concluded that in the transaction at issue the plain language of the preferred stock provisions did not give Fletcher a consent right and that the Court was not empowered to rewrite an unambiguous contract in order to meet Fletcher's current business interests. Further, the Court noted that it was immaterial whether ION, in structuring the transaction, purposefully chose a structure that did not trigger Fletcher's consent rights. In the Court's view, Fletcher was a sophisticated contracting party that could have bargained for the right to consent to ION's sale of its subsidiary's stock, but failed to do so. Accordingly, both Fletcher's breach of contract claim and the dependent tortious interference claim were dismissed.

Section 220 Actions

Central Laborers Pension Fund v. News Corp., 45 A.3d 139 (Del. 2012).

In *Central Laborers Pension Fund v. News Corp.*, 45 A.3d 139 (Del. 2012), the Delaware Supreme Court affirmed the Court of Chancery's dismissal of the plaintiff's complaint, which sought to enforce a demand for inspection of books and records under Section 220 of the Delaware General Corporation Law ("Section 220"). The Supreme Court based its decision on the plaintiff's failure to attach to its demand documentary evidence of its beneficial ownership of News Corporation's ("News Corp.") stock and stressed that stockholders seeking inspection of books and records must strictly comply with the "form and manner" requirements of Section 220.

On March 7, 2011, plaintiff Central Laborers Pension Fund ("Central Laborers") sent to News Corp.'s general counsel a demand letter for inspection of certain books and records related to News Corp.'s then-pending acquisition of Shine Group Ltd. (the "Shine Transaction"). The Shine Group Ltd. is an international television production company that had been formed in 2001 by Elizabeth Murdoch, the daughter of News Corp.'s founder and CEO, Rupert Murdoch. Central Laborers asserted that the purpose of its demand was to investigate potential breaches of fiduciary duty or other wrongdoing in connection with the Shine Transaction. The demand letter further stated that Central Laborers wanted to "determine whether a presuit demand is necessary or would be excused prior to commencing any derivative action on behalf of the Company."

On March 16, 2011, Central Laborers, along with another stockholder plaintiff, filed a verified derivative complaint (the "Derivative Complaint") in the Court of Chancery challenging the Shine Transaction and asserting claims for breach of fiduciary duty against each member of News Corp.'s board. The Derivative Complaint alleged that demand on the News Corp. board was excused because the directors had shown an unwillingness or inability to challenge Rupert Murdoch's purported control over News Corp.

Approximately one hour after the filing of the Derivative Complaint, Central Laborers filed another complaint (the "Section 220 Complaint") in the Court of Chancery seeking to enforce its demand letter pursuant to Section 220. The Section 220 Complaint alleged that one of the primary purposes for the requested inspection was "to investigate possible breaches of fiduciary duty" and, ultimately, "to determine whether a presuit demand is necessary or would be excused *prior* to commencing any derivative action on behalf of the Company" (emphasis added).

News Corp. moved to dismiss the Section 220 Complaint on the grounds that: (i) the demand letter was not accompanied by evidence of Central Laborers' beneficial stock ownership; (ii) the filing of the Derivative Complaint refuted Central Laborers' purported purpose for seeking the inspection *(i.e.,* investigating whether to pursue a derivative claim and determining whether demand on the News Corp. board was excused); and (iii) the scope of the inspection sought was overbroad. The Court of Chancery granted the motion to dismiss on the second ground. The Court of Chancery reasoned that "[b]ecause Central Laborers' currently-pending derivative action necessarily reflects its view that it had sufficient grounds for alleging both demand futility and its substantive claims without the need for assistance afforded by Section 220, it is, at this time, unable to tender a proper purpose for pursuing its efforts to inspect the books and records of News Corp." The Court of Chancery did not reach the other grounds for dismissal argued by News Corp.

On appeal, Central Laborers asserted that the Court of Chancery decision constituted error in two regards: (i) the time to evaluate whether a stockholder has a proper purpose is when the inspection demand is made, and such proper purpose cannot be mooted by the subsequent filing of a derivative action; and (ii) even if an otherwise proper purpose can be impacted by the subsequent filing of a derivative action, such proper purpose exists so long as the documents sought by the plaintiff could be used to amend the derivative complaint. Thus, according to Central Laborers, a Section 220 demand should be deemed to have a proper purpose despite the stockholder's filing of a derivative action, so long as leave to amend in the derivative action had not been explicitly precluded. For its part, News Corp. asked that the Supreme Court affirm the judgment of the Court of Chancery on the grounds expressed by that Court and on the alternative basis that Central Laborers failed to attach evidence of its beneficial ownership of News Corp. stock to its demand letter.

The Supreme Court affirmed the judgment on the alternative ground that Central Laborers had failed to comply with the "form and manner" requirements of Section 220 by not accompanying its demand with evidence of its beneficial ownership. The Court stressed that the express statutory requirements of Section 220 must be strictly followed by a stockholder seeking an inspection of books and records. Absent compliance with the statutory requirements, the Court held that "the stockholder has not properly invoked the statutory right to seek inspection, and consequently, the corporation has no obligation to respond." Accordingly, the Court rejected Central Laborers' argument that it had cured the defect in its demand when Central Laborers submitted evidence of beneficial ownership of News Corp. stock along with its brief in opposition to the motion to dismiss in the Court of Chancery. The Supreme Court explained that such subsequent action could not satisfy the statutory requirement that the demand "*shall…be accompanied by* documentary evidence of beneficial ownership of the stock." Because Central Laborers had failed to submit a procedurally proper demand letter, the Supreme Court found that it was unnecessary and would be inappropriate to express a view on whether the Derivative Complaint affected the propriety of the purpose set forth in the demand letter.

King v. VeriFone Holdings, Inc., 12 A.3d 1140 (Del. 2011).

In *King v. VeriFone Holdings, Inc.*, the Delaware Supreme Court reversed the Court of Chancery's decision that established a bright-line rule barring stockholder-plaintiffs from seeking books and records pursuant to 8 *Del. C.* § 220 ("Section 220") solely because they filed a derivative action first. The Supreme Court reaffirmed "long-standing Delaware precedent which recognizes that it is a proper purpose under Section 220 to inspect books and records that would aid the plaintiff in pleading demand futility in a to-be-amended complaint in a plenary derivative action, where the earlier-filed plenary complaint was dismissed on demand futility-related grounds without prejudice and with leave to amend."

On December 3, 2007, VeriFone Holdings, Inc. ("VeriFone") restated its reported earnings and net income for the prior three fiscal quarters. In response, plaintiff filed a derivative action in federal court alleging, among other things, that the directors and officers of VeriFone breached their fiduciary duties and committed corporate waste. The federal court dismissed the plaintiff's complaint for failure to allege particularized facts that would excuse pre-suit demand. In granting leave to amend the complaint, the federal court suggested that plaintiff utilize Section 220 to obtain facts that might aid in pleading demand futility. In 2009, plaintiff submitted to VeriFone a written demand pursuant to Section 220, and VeriFone produced documents responsive to all but one of plaintiff's requests. VeriFone declined to produce an audit committee report, which contained the results of an internal investigation of VeriFone's accounting and financial controls that had been conducted after the 2007 restatement. Thereafter, plaintiff filed a complaint under Section 220 seeking an order permitting him to inspect the audit committee report. The Court of Chancery dismissed plaintiff's complaint for failure to state a proper purpose as required by Section 220. In doing so, the Court of Chancery held that plaintiff lacked a proper purpose under Section 220 because he elected to prosecute the derivative action before conducting a pre-suit investigation, including use of the Section 220 process. The Court of Chancery stated: "[S]tockholders who seek books and records in order to determine whether to bring a derivative suit should do so before filing the derivative suit. Once a plaintiff has chosen to file a derivative suit, it has chosen its course and may not reverse course and burden the corporation (and its other stockholders) with yet another lawsuit to obtain information it cannot get in discovery in the derivative suit."

On appeal, the Supreme Court concluded that the Court of Chancery's bright-line rule "does not comport with existing Delaware law or with sound policy." The Supreme Court noted that Delaware courts have strongly encouraged stockholder-plaintiffs to utilize Section 220 to obtain facts sufficient to plead demand futility before filing a derivative action. The decision to file a derivative complaint before using the Section 220 inspection process, the Supreme Court noted, is "ill-advised" but not "fatal" to a stockholder-plaintiff's right to seek books and records pursuant to Section 220. The Supreme Court relied on earlier decisions, such as *In re Walt Disney Co. Derivative Litigation*, *Ash v. McCall* and *Melzer v. CNET Networks, Inc.*, as examples of situations in which Delaware courts have dismissed derivative complaints, but recommended that stockholder-plaintiffs utilize Section 220 as a tool to obtain facts sufficient to replead demand futility in an amended derivative complaint. In each case noted above, the plenary court dismissed the stockholder-plaintiff's derivative complaint without prejudice and with leave to amend. These factors distinguished the cases relied upon by VeriFone, cases which held that stockholder-plaintiffs lack a proper purpose because their earlier-filed derivative action was dismissed with prejudice or without leave to amend. Thus, the Supreme Court held that a stockholder-plaintiff seeking books and records under Section 220 does not lack a proper purpose simply because the stockholder-plaintiff filed a derivative action first, which was dismissed for failure to plead demand futility adequately.

Lastly, the Supreme Court concluded that the bright-line rule adopted by the Court of Chancery was "overbroad and unsupported by the text of, and the policy underlying, Section 220." The Supreme Court, however, cautioned that "filing a plenary derivative action without having first resorted to the inspection process afforded by [Section 220] may well prove imprudent and cost-ineffective. But, absent some other, sufficient ground for dismissal, that sequence is not fatal to the prosecution of a Section 220 action." Expressing its sensitivity to the policy concerns raised by the Court of Chancery, the Supreme Court recognized that the plenary court may fashion remedies to deter a race to the courthouse and the premature filing of derivative actions. For example, the Supreme Court noted that the plenary court may deny lead plaintiff status, grant a motion to dismiss with prejudice and without leave to amend as to the named plaintiff, or require the plaintiff to pay the defendants' attorneys' fees incurred on the initial motion to dismiss. Automatically foreclosing a stockholder-plaintiff's ability to utilize the Section 220 inspection process after filing a derivative complaint, however, is not warranted under Delaware law.

City of Westland Police & Fire Retirement System v. Axcelis Technologies, Inc., 1 A.3d 281 (Del. 2010).

In *City of Westland Police & Fire Retirement System v. Axcelis Technologies, Inc.*, the Delaware Supreme Court affirmed the dismissal of a books and records action under 8 *Del. C.* § 220 ("Section 220"), holding that plaintiff did not meet its evidentiary burden to demonstrate a "proper purpose" to support inspection where a board of directors rejected the resignations of three directors who failed to receive a majority of the votes cast in an uncontested election.

Defendant Axcelis Technologies, Inc. ("Axcelis") followed the plurality voting provisions of Delaware statutory law, under which a director may be elected upon receiving a plurality of votes cast. *See* 8 *Del. C.* § 216(3). Importantly, the Axcelis board of directors also had adopted a "plurality plus" governance policy, which provided that any nominee in an uncontested election receiving a greater number of votes "withheld" than votes "for" his or her election would be required to submit a letter of resignation for consideration by the board of directors. All three directors seeking reelection at the 2008 annual meeting received less than a majority of the votes cast and in accordance with the "plurality plus" governance policy tendered their resignations. The board, however, decided not to accept the tendered resignations.

The Court acknowledged that plaintiff's stated purpose for its Section 220 demand—the investigation of possible wrongdoing or mismanagement—was a proper purpose, but held that plaintiff failed to present any evidence to suggest a credible basis from which a court could infer possible mismanagement or wrongdoing that would warrant further investigation.

The Court also rejected plaintiff's argument that the board must show a "compelling justification" under *Blasius* for its decision not to accept the three directors' resignations because the board's nonacceptance of the resignations frustrated the stockholder vote. The Court concluded that plaintiff's *Blasius* argument improperly attempted to shift to Axcelis plaintiff's burden to establish a "proper purpose" and affirmed the Court of Chancery's decision not to adopt the *Blasius* standard for reviewing a board of directors' discretionary decision to reject resignations where a "plurality plus" governance policy is triggered and requires that resignations be tendered.

Importantly, the Court also discussed that another proper purpose for seeking inspection of corporate books and records under Section 220 is to determine an individual's suitability to serve as a director, a purpose that plaintiff did not rely upon for seeking relief. In this connection, the Court noted that Axcelis's "plurality plus" policy was adopted unilaterally as a resolution by the board of directors. The Court explained that where a board confers upon itself the power to override the determination of a stockholder majority by unilaterally adopting a "plurality plus" policy, the board should be held accountable for its exercise of that "unilaterally conferred power" by being subject to a stockholder's right under Section 220 to seek inspection of any documents or other records upon which the board relied in deciding to reject the tendered resignations, indicating that in such circumstances there is a credible basis to infer that a director is unsuitable, thereby warranting further investigation. The Court indicated, however, that the filing of a Section 220 action for the purpose of investigating the suitability of directors whose tendered resignations are rejected in the context of a "plurality plus" policy will not automatically entitle a plaintiff stockholder to relief. A plaintiff still must satisfy the other evidentiary burdens required, including the necessity of the requested information to assess the suitability of the director.

Appraisal Actions and Proceedings

In re Appraisal of Orchard Enterprises, Inc., 2012 WL 2923305 (Del. Ch. July 18, 2012).

In *In re Appraisal of Orchard Enterprises, Inc.*, 2012 WL 2923305 (Del. Ch. July 18, 2012), the Court of Chancery, in a post-trial decision, determined that the petitioners, certain common stockholders of The Orchard Enterprises, Inc. ("Orchard"), were entitled to $4.67 per share, rather than the $2.05 per share they received in a going-private transaction.

Orchard is a specialty music company which primarily generates revenue through the retail sale of a catalog of licensed music through digital stores such as Amazon and iTunes. Prior to the going-private transaction, Orchard was traded on the NASDAQ stock exchange. A large block, around 40 percent, of Orchard's common stock was owned by Dimensional Associates, LLC ("Dimensional"), which also owned nearly all of Orchard's preferred stock. Because the preferred stock could vote on an as-converted basis, Dimensional controlled 53 percent of the voting power of Orchard's outstanding stock.

In July 2010, Orchard's common stockholders were cashed out for $2.05 per share in a merger with Dimensional (the "Merger"). The petitioners claimed that the value of each Orchard common share was $5.42 at the time of the Merger. Respondent Orchard maintained that the Merger was generous and that in fact each share of common stock was only worth $1.53. The Court stated that the primary issue behind the parties' price disparity was whether a $25 million liquidation preference of Orchard's preferred stock should be taken into account when valuing the common stock.

The certificate of designations governing Orchard's preferred stock required payment of a $25 million liquidation preference to Dimensional in three circumstances: (i) a dissolution of the company, (ii) a sale of all or substantially all of Orchard's assets leading to a liquidation, or (iii) a sale of control of Orchard to an "unrelated third party." The Court held that the liquidation preference was not triggered by the Merger, noting that Dimensional still owned the preferred stock and could potentially receive the preference in the future.

Despite the fact that the liquidation preference was not triggered, Orchard asserted that the Court was required to take the liquidation preference into account during the valuation process. Orchard first argued that the common stock could not be properly valued without subtracting the $25 million preference because the preference was implicitly a negotiated part of the Merger. The Court quickly rejected this argument as "non-factual." The Court held that the plain terms of the preferred stock's certificate of designations required the payment of the liquidation preference in only three scenarios, none of which the Merger triggered.

The Court also rejected Orchard's "market-based" argument that the value of the common stock should be reduced because the liquidation preference effectively created a $25 million liability that should be factored into the appraisal price. According to Orchard, the real-world implications of Dimensional's voting control and contractual rights as a preferred stockholder made payment of the preference a near certainty.

Siding with petitioners, the Court concluded that Orchard's position was wrong as a matter of law. The Court found that the untriggered contractual rights of the preferred stock reflected only speculative value. In the context of an appraisal proceeding, the Court held that it could not assign value to a liquidation preference based on the occurrence of uncertain future events that did not have to occur by any particular time.

Although acknowledging that this argument "may be grounded in market realities," the Court held that it nonetheless conflicts with the Delaware Supreme Court's determination that an appraisal must be focused on a company's going-concern value. That is, the company must be valued without regard to the possibility of liquidation or other "post-merger events or…possible business combinations." Thus, because the specific terms of the preferred stock's certificate of designations were not triggered by the Merger, the voting control and other blocking rights of the preferred stock were not accorded any value.

After resolving the liquidation preference issue, the Court went on to resolve various disputes between the parties over the proper valuation methods and metrics. The Court rejected a comparable companies or precedent transaction analysis, instead relying on a discounted cash flow ("DCF") analysis.

Of note to practitioners familiar with the Court's treatment of DCF analyses, the Court commented on the appropriateness of using a supply-side premium as opposed to a historical equity risk premium. The Court noted that in *Global GT LP v. Golden Telecom, Inc.*, 993 A.2d 497 (Del. Ch. 2010), *aff'd*, 11 A.3d 214 (Del. 2010), it discussed a perceived shift in the academic community to favoring the supply-side equity risk premium.

Gearreald v. Just Care, Inc., C.A. No. 5233-VCP (Del. Ch. Apr. 30, 2012).

In *Gearreald v. Just Care, Inc.*, C.A. No. 5233-VCP (Del. Ch. Apr. 30, 2012), the Court of Chancery found in an appraisal proceeding that the fair value of Just Care, Inc. ("Just Care") was $34,244,570, approximately $6 million less than the acquisition price.

Just Care—a privately held company that operates a private healthcare detention facility in South Carolina—was acquired in a strategic transaction for $40 million. The appraisal petitioners included Just Care's founder and former CEO, who voted in favor of the merger as a director before voting against it as a stockholder, and Just Care's CFO. The petitioners claimed that the fair value of Just Care as of the merger was $55.2 million; Just Care contended $33.6 million.

The Court relied upon a discounted cash flow analysis in determining fair value. Initially, the Court considered the credibility of Just Care's management projections, which were prepared outside of the ordinary course and at a time when the CEO and CFO risked losing their positions if the acquisition bid succeeded and were trying to convince Just Care's board to pursue different alternatives. Accordingly, the Court found that the projections were not entitled to the same deference usually afforded to contemporaneously prepared management projections. Additionally, the Court determined that an out-of-state expansion scenario included in the projections was too speculative to be included in the valuation of Just Care, which had operated only one facility in 11 years of existence.

In determining a discount rate for the DCF analysis, the Court stated that the correct capital structure for an appraisal of Just Care is the theoretical capital structure it would have maintained as a going concern. Specifically, changes to Just Care's capital structure made in relation to the merger—in this case, Just Care's paying off all debt as a condition of the merger—should not be considered in determining appraised value. Accordingly, the Court explained that it was inappropriate to apply Just Care's actual capital structure as of the merger's closing in the appraisal analysis.

The Court also applied an equity size premium to account for the higher rate of return demanded by investors to compensate for the greater risk associated with smaller companies. Both experts agreed that, by size alone, Just Care falls within Ibbotson decile 10b, which includes companies with market capitalizations of $1.6 million–$136 million, but the petitioners argued for the application of an equity size premium implied for larger decile 10a companies. Since one of the reasons investors demand higher returns from smaller companies is because smaller companies tend to be less liquid, the petitioners advocated applying a lower equity size premium to eliminate the "liquidity effect" contained within the size premium. While the Court agreed that a liquidity discount related to transactions between a company's shareholders and other market participants is prohibited in an appraisal proceeding, the liquidity effect the petitioners advocated eliminating in this case arose in relation to transactions between Just Care and its providers of capital and, as such, was part of Just Care's value as a going concern.

Derivative Actions and Claims

Metropolitan Life Insurance Company v. Tremont Group Holdings, Inc., 2012 WL 6632681 (Del. Ch. Dec. 20, 2012).

In *Metropolitan Life Insurance Company v. Tremont Group Holdings, Inc.,* 2012 WL 6632681 (Del. Ch. Dec. 20, 2012), Vice Chancellor Parsons of the Court of Chancery further clarified Delaware law with respect to the distinction between direct and derivative claims in litigation involving Delaware limited partnerships. Plaintiffs, each a limited partner in a Delaware limited partnership which invested in a related fund that, in turn, heavily invested in Bernie Madoff's now-infamous Ponzi scheme, asserted numerous direct and derivative claims against the limited partnership, its general partner and numerous current and former officers, directors and managers of the parent entities. The defendants moved to dismiss the complaint on various grounds, including that claims for breach of fiduciary duty and unjust enrichment, styled as direct claims, were derivative in nature and thus barred by a prior settlement of Madoff-related individual, class and derivative claims brought against the defendants in an action in the United States District Court for the Southern District of New York (the "Settlement").

The Court began its analysis by reiterating that "[t]he determination of whether a claim is derivative or direct in nature is substantially the same for corporate cases as it is for limited partnership cases." The Court then set forth the well-known, two-prong standard established by the Delaware Supreme Court in *Tooley v. Donaldson, Lufkin & Jenrette, Inc.,* 845 A.2d 1031 (Del. 2004), which requires the Court to answer two questions when determining whether a claim is direct or derivative: (i) who suffered the alleged harm; and (ii) who would receive the benefit of any recovery or other remedy. Following established Delaware law, the Court further noted that "the manner in which a plaintiff labels its claim and the form of words used in the complaint are not dispositive; rather, the court must look to the nature of the wrong alleged, taking into account all of the facts alleged in the complaint."

Applying the *Tooley* standard, the Court concluded that plaintiffs' breach of fiduciary duty and unjust enrichment claims were derivative, as the harm alleged—the limited partnership's diminution in value following discovery of the Ponzi scheme—was suffered by the limited partnership and not by the limited partners individually. In short, the complaint alleged simply that the defendants' purported mismanagement made the limited partnership less valuable, an injury the Court determined was suffered secondarily by the plaintiffs as a function of their *pro rata* investment in the limited partnership.

Plaintiffs argued that the nature of their claims was altered by their decision to opt out of the Settlement. Specifically, plaintiffs contended that they satisfied the *Tooley* test because (i) they received no benefit from the Settlement and would suffer a unique harm as they would be left without any recourse for their alleged injuries; and (ii) they alone would benefit from any recovery in this litigation, presumably because the limited partnership and its other limited partners all participated in the Settlement. The Court rejected this argument because plaintiffs' breach of fiduciary duty and unjust enrichment claims were derivative in nature at the time of the Settlement and plaintiffs had no right under Delaware or federal law to opt out of a derivative suit. Accordingly, plaintiffs' decision to opt out of the Settlement could not serve as a basis to convert their derivative claims into direct causes of action, and their derivative claims were barred by the Settlement under principles of *res judicata* and release.

South v. Baker, 2012 WL 4372538 (Del. Ch. Sept. 25, 2012).

In *South v. Baker,* 2012 WL 4372538 (Del. Ch. Sept. 25, 2012), Vice Chancellor Laster of the Court of Chancery dismissed a derivative claim for breach of fiduciary duty based on the *Caremark* theory of liability, finding that because the plaintiffs failed adequately to represent the company, dismissal of their complaint would be with prejudice to the named plaintiffs only and would not preclude the litigation efforts of other stockholders.

Plaintiffs Steven and Linda South ("Plaintiffs") sought to recover on behalf of Hecla Mining Company ("Hecla") damages Hecla might suffer from pending federal securities actions filed in response to numerous incidents that occurred at Hecla's mines, the citations Hecla received from the United States Mine Safety and Health Administration ("MSHA") for such safety violations, and a January 2012 press release that lowered Hecla's projections for silver production in light of losses anticipated to arise from compliance with an MSHA. *Id.* at *1, *6. The Court noted that in order to survive a motion to dismiss for failure to plead demand futility, Plaintiffs' complaint—one of several purported derivative complaints asserting *Caremark* theories of liability arising from Hecla's compliance issues and the related earnings adjustment—would have had to contain "facts sufficient to establish board involvement in conscious wrongdoing." *Id.* at *1. Specifically, Plaintiffs needed to plead facts establishing a sufficient connection between the corporate trauma and a substantial threat of director liability. *Id.* at *9. However, the complaint was found to negate its own premise; *i.e.,* the "very existence" of Hecla's "Safety Committee," comprised of the four most experienced members of Hecla's seven-member, majority-independent board tasked with reviewing issues relating to health, safety and environmental policies, was "inconsistent with the complaint's central premise of intentionally indolent directors." *Id.* at *3, *12. The Court therefore dismissed the "cursory complaint" under Court of Chancery Rule 23.1 for failure to make a demand or adequately plead demand futility, and the dismissal was with prejudice with respect to the named plaintiffs. *Id.* at *1.

Having determined to dismiss the complaint, the Court evaluated the options available to courts confronted with such inadequate derivative complaints, as articulated by the Delaware Supreme Court in *King v. VeriFone Holdings, Inc.,* 12 A.3d 1140, 1151-52 (Del. 2011). *Id.* at *13-14 (citing *King* at 1151-52 (offering three options: (i) "deny the plaintiff lead plaintiff status," (ii) "dismiss the derivative complaint with prejudice and without leave to amend as to the named plaintiff," as contemplated by Rule 15(aaa), or (iii) "grant leave to amend one time, conditioned on the plaintiff paying the defendants' attorneys' fees incurred on the initial motion to dismiss")). The Court determined to dismiss the complaint with prejudice with respect to the named plaintiffs because Plaintiffs failed to engage in an adequate pre-suit investigation, including failing to seek an inspection of corporate records under 8 *Del. C.* § 220, and because such a result would not prejudice Hecla. Next, the Court concluded that Plaintiffs were inadequate representatives by applying "a presumption that when a stockholder hastily files a *Caremark* claim after the public announcement of a corporate trauma, in an effort to shift the still-developing losses to the corporation's fiduciaries, but without first conducting a meaningful investigation, the plaintiff has not adequately represented the corporation." *Id.* at *7, *17. Because Plaintiffs' counsel confirmed the Court's suspicions that a "plaintiff who hurries to file a *Caremark* claim after the announcement of a corporate trauma behaves contrary to the interests of the corporation but consistent with the desires of the filing law firm," the Court determined that the circumstances "support an inference of disloyalty and a finding of inadequacy." *Id.* at *17, *20. Therefore, the dismissal was with prejudice to the named plaintiffs, but would not prejudice other litigants. The Court noted that this result would "freshen[] the litigation environment so other plaintiffs whose lawyers...conducted a pre-suit investigation might feel that they could now lead the case." *Id.* at *14 (citation omitted).

Louisiana Municipal Police Employees' Ret. Sys. v. Pyott, 46 A.3d 313 (Del. Ch. 2012).

In *Louisiana Municipal Police Employees' Ret. Sys. v. Pyott*, 46 A.3d 313 (Del. Ch. 2012), the Court of Chancery held that a federal court's decision to dismiss derivative litigation for failure to plead demand futility adequately under Rule 23.1 did not preclude relitigation of that same issue in another case involving a different stockholder plaintiff. The defendants have appealed the Court's ruling, and that appeal remains pending.

On September 1, 2010, Allergan, Inc.—the manufacturer of the drug Botox—announced that it had entered into a settlement with the United States Department of Justice. The settlement arose out of allegations that Allergan had misbranded Botox and illegally marketed the drug for "off-label" uses. Allergan pled guilty to criminal misdemeanor misbranding, paid a total of $600 million in civil and criminal fines, and entered into a five-year Corporate Integrity Agreement with the Department of Health and Human Services, Office of Inspector General.

Within 48 hours of the announcement of the settlement, Allergan stockholders began to file derivative actions against Allergan's board of directors for their alleged complicity in the misbranding, and by September 24, 2010, at least four separate cases had been filed in the Delaware Court of Chancery and the United States District Court for the Central District of California.

In addition, on November 3, 2010, U.F.C.W. Local 1776 ("UFCW"), an Allergan stockholder, sent Allergan a books and records demand pursuant to 8 *Del. C.* § 220. After receiving documents, UFCW joined in the existing Delaware Court of Chancery action, and the Delaware plaintiffs filed an amended complaint. Allergan shared the books and records it produced to UFCW with the plaintiffs in the California action, who also filed an amended complaint.

The defendants moved to dismiss in both Delaware and California. The California court reached a decision first, holding in January 2012 that the California plaintiffs had failed to plead demand futility adequately and that their amended complaint would be dismissed with prejudice pursuant to Rule 23.1.

In the Delaware action, the defendants argued that the doctrine of collateral estoppel precluded relitigation of the demand futility issue, in addition to their substantive arguments that the complaint was inadequate under Rules 23.1 and 12(b)(6). In response to the collateral estoppel argument, the Court of Chancery noted a "growing body of precedent" holding that a Rule 23.1 dismissal has a preclusive effect on other derivative complaints, based on the theory that all stockholder plaintiffs are in privity with each other because they all are suing in the name of the corporation.

The Court declined to follow that authority, holding that the Delaware Supreme Court has made clear that a stockholder whose litigation efforts are opposed by the nominal defendant corporation does not have authority to sue on the corporation's behalf until either (i) there is a finding of demand excusal, or (ii) a court holds that the corporation wrongly refused the stockholder's demand to sue. Because a stockholder who *loses* a Rule 23.1 motion necessarily fails to win the right to sue on the corporation's behalf, the basis of previous court holdings that collateral estoppel prevented relitigation of demand futility allegations—that successive stockholders were in "privity" with each other because they were all suing in the corporation's name—is inconsistent with Delaware law. The Court therefore held that a Rule 23.1 dismissal of one stockholder's derivative complaint would not preclude a different stockholder from relitigating that issue in a separate case.

Going further, the Court held that an "independent basis" for its refusal to apply collateral estoppel to the case at hand applied: the plaintiffs in the California action did not adequately represent Allergan. The Court addressed at length what it referred to as the "fast-filing problem" and held that in cases such as the one at issue where swift action was not required in order to prevent irreparable harm, a plaintiff who files a derivative action shortly after announcement of a corporate loss without first conducting a meaningful investigation has not provided adequate representation to the corporation it is seeking to represent.

Having determined that the California court's judgment did not collaterally estop the Delaware plaintiffs from proceeding with their demand futility arguments, the Court addressed the substance of the claims. The Court of Chancery held that the complaint at issue contained adequate factual allegations from which it could reasonably be inferred that the Allergan directors faced a substantial risk of liability if the litigation were pursued, and demand would therefore have been futile. Not surprisingly, given its holding that the complaint survived the more rigorous scrutiny required by Rule 23.1, the Court also denied the defendants' motion to dismiss for failure to state a claim upon which relief can be granted.

In re Goldman Sachs Group, Inc. Shareholder Litigation, C.A. No. 5215-VCG (Del. Ch. Oct. 12, 2011), *aff'd sub nom. Southeastern Pennsylvania Trans. Authority v. Blankfein*, 44 A.3d 922 (Del. 2012) (TABLE).

In his first major corporate decision, Vice Chancellor Glasscock dismissed a stockholder derivative action brought against directors and officers of Goldman Sachs. In *In re Goldman Sachs Group, Inc. Shareholder Litigation*, the Court of Chancery dismissed the plaintiffs' claims for failure to make demand on Goldman Sachs's board of directors. Plaintiffs had claimed that Goldman Sachs's directors breached their fiduciary duties by failing to set or pay appropriate compensation for Goldman Sachs employees and by failing to monitor Goldman Sachs's operations adequately and allowing Goldman Sachs to act in a "grossly unethical manner." The plaintiffs' claims generally addressed Goldman Sachs's compensation and trading practices during the mortgage crisis and the subsequent fallout.

Because the plaintiffs had not first made a demand that the directors pursue these claims, the Court analyzed whether the plaintiffs had adequately alleged that demand would have been futile. The Court first found that the plaintiffs failed to raise a reasonable doubt that Goldman Sachs's directors were disinterested or independent, even though plaintiffs' amended complaint alleged that the Goldman Sachs Foundation had made contributions to charitable organizations affiliated with a number of the directors. The Court next determined that the plaintiffs failed to raise a reasonable doubt that the Goldman Sachs compensation scheme was implemented in good faith and on an informed basis. Finally, the Court determined that the plaintiffs failed to plead facts showing a substantial likelihood of liability on the directors' part because no reasonable inference could be made that the directors consciously disregarded their duty to be informed about business risk—assuming that such a duty exists, which the Court discussed but did not decide. The Court therefore dismissed the plaintiffs' claims with prejudice and did not need to reach the issue of whether plaintiffs had stated a valid claim. On May 3, 2012, the Delaware Supreme Court issued a table opinion affirming the Court of Chancery's holding.

Independence and Good Faith of the Special Committee

In re Southern Peru Copper Corp. Shareholder Derivative Litigation, 30 A.2d 60 (Del. Ch. 2011).

In *In re Southern Peru Copper Corp. Shareholder Derivative Litigation*, the Court of Chancery awarded $1.263 billion as damages in a derivative action challenging the acquisition by Southern Peru Copper Corporation of another corporation controlled by Southern Peru's controlling stockholder, since the Court determined after trial that the controlling stockholder defendants breached their duty of loyalty.

Grupo Mexico, S.A.B. de C.V. is the controlling stockholder of Southern Peru. In 2004, Grupo Mexico proposed that Southern Peru acquire its 99.15 percent interest in Minera Mexico, S.A. de C.V. for approximately $3.05 billion in the form of shares of Southern Peru common stock. In response, the Southern Peru board of directors formed a special committee to evaluate the transaction, which in turn retained its own advisors. After initially engaging in an "illustrative give/get analysis" indicating a $1.4 billion disparity between the value (based on trading price) of the Southern Peru common stock that would be issued to Grupo Mexico and the value of Minera, the special committee's financial advisor abandoned such analysis and instead focused on "relative" value metrics reflecting the projected relative contribution to cash flows of the two entities to the combined corporation and similar analyses. This approach, which the Court found essentially ignored the market value of the shares being issued by Southern Peru, enabled the special committee's financial advisor to opine that the transaction was fair, and the special committee approved the transaction.

As of the signing of the definitive agreements, the value of the Southern Peru shares to be delivered to Grupo Mexico, based on Southern Peru's share price, was approximately $3.1 billion. But that value increased through closing since the consideration payable to Grupo Mexico, at the special committee's insistence, was a fixed number of shares of Southern

Peru common stock and since Southern Peru's share price increased substantially during the post-signing, pre-closing time period.

Consistent with the views of the parties, the Court determined that entire fairness was the appropriate standard of review for a transaction where a controlling stockholder stood on both sides of the transaction, regardless of the existence of the special committee. Indeed, although admittedly not outcome determinative in this case, the Court determined that the defendants (other than the special committee members who had previously been dismissed since the plaintiff had failed to allege non-exculpated breaches of their fiduciary duties) bore the burden of demonstrating the entire fairness of the transaction. The Court concluded that the defendants were not entitled to a shift of the burden of persuasion given the special committee's relative ineffectiveness and issues with the supermajority stockholder vote, including that the vote was not "conditioned up front" and the proxy statement omitted material facts regarding the negotiation process.

Criticizing, among other actions, the special committee's extraction of a narrow mandate for evaluating the proposed transaction and failure to attempt to explore alternatives to the acquisition offered by the controlling stockholder, the "strenuous lengths" the special committee and its financial advisor went to equalize the values of Minera and Southern Peru, the special committee's ignorance of the market value of the Southern Peru shares being issued (when there was no dispute as to the cash value of those shares), and the special committee's failure to consider changing its recommendation with respect to the transaction prior to the stockholder vote in light of the post-signing performance of Southern Peru relative to its projections as well as the substantial increase in the Southern Peru share price after the execution of the definitive acquisition agreement, the Court determined that the transaction was not entirely fair. As a remedy, the Court awarded damages to approximate the difference between the price that would have been paid in an entirely fair transaction and the price actually paid. Using the trading value of the shares issued as of closing of $3.672 billion and the Court's view of the actual value of Minera as of closing of $2.409 billion (based on discounted cash flow and comparable companies analyses as well as a value implied by an initial counteroffer by the special committee), the Court determined the resulting damages to be $1.263 billion, which the Court indicated that Grupo Mexico could satisfy by returning Southern Peru shares.

In re Orchid Cellmark Inc. Shareholder Litigation, C.A. No. 6373-VCN (Del. Ch. May 12, 2011).

In *In re Orchid Cellmark Inc. Shareholder Litigation*, the Delaware Court of Chancery denied plaintiffs' motion to enjoin preliminarily a cash tender offer by Laboratory Corporation of America Holdings, Inc. ("LabCorp") for all of the shares of Orchid Cellmark Inc. ("Orchid") for $2.80 per share under an Agreement and Plan of Merger, dated April 5, 2011 (the "Merger Agreement"). This decision reaffirms that the Court of Chancery is unlikely to overturn business decisions of boards comprised of a majority of independent directors that utilize special committees of independent directors in sale of control transactions. In addition, while not indicating at what point an amalgamation of deal protection devices becomes so burdensome and costly to render a fiduciary out illusory—but acknowledging that there could be such a point—the Court determined that the combination of deal protections in this transaction was reasonable under the circumstances. Of note, the Delaware Supreme Court declined to accept an interlocutory appeal of the decision.

Orchid has a six-member board of directors (the "Board") consisting of five independent directors and one inside director, the CEO. The Board formed a special committee consisting of three independent directors (the "Special Committee") to evaluate LabCorp's initial indication of interest. The Special Committee selected Oppenheimer & Co. ("Oppenheimer") as its financial advisor. After several rounds of negotiations and substantial work by the Special Committee and Oppenheimer, the Board ultimately voted to approve the Merger Agreement and recommended that Orchid's stockholders tender their shares to LabCorp, with the CEO abstaining from the vote.

Plaintiffs alleged that the transaction, valued at $85.4 million, was the result of a flawed and inadequate process and that Orchid's stockholders had been provided with materially misleading and incomplete information in a recommendation statement on SEC Form 14D-9 (the "Registration Statement"). Under the preliminary injunction standard, the Court first assessed whether there was a reasonable probability that plaintiffs would be successful on the merits of their claims at trial.

While plaintiffs challenged the sufficiency of the market check, the Court found that there was no indication that Orchid favored LabCorp over any other potential bidder, noting that LabCorp's earlier expressions of interest were rejected and that during the market check Oppenheimer solicited the interest of six potential bidders. As for the language used by Oppenheimer in its market check that Orchid "was not putting itself up for sale but, having received an unsolicited indication of interest, was checking the indication against the market," the Court noted that potential bidders seemingly understood that they were invited to make a bid. Most important to the Court, at the time Oppenheimer stated that the company was not for sale, the statement was true because the Board had not formally decided to accept the LabCorp proposal.

Plaintiffs also alleged that the Board ignored the possibility that an alternative transaction involving only Orchid's U.K. operations could provide substantially superior value to Orchid's stockholders. The Court found that the Special Committee and the Board had adequately considered this alternative with Oppenheimer, which had calculated that one such indication of interest by a U.K. private equity buyer equaled approximately $2.93 per share. Nevertheless, due to the risks and uncertainties involved in pursuing an alternative transaction where no offer had yet been made by any of these private equity firms, the Board determined that a transaction with a private equity firm for only the company's U.K. business was not superior to the LabCorp offer. The Court found no reason to second guess the Board's decision.

Plaintiffs also alleged that the Board and Oppenheimer disregarded management input, resulting in financial projections that undervalued Orchid. Despite plaintiffs' claim that the projections were manipulated in favor of the transaction, the Court found no basis to question the motivations of the Special Committee or to doubt the independence and credentials of Oppenheimer. The Court stated that the Special Committee and its financial advisor "are not precluded from considering various sets of financial projections before determining that one set reflects the best estimate of future performance." Also, with respect to the Board's consideration of the CEO's dissent, the Court found that the Board did not fail to consider it as plaintiffs alleged, but rather simply disagreed with the CEO's optimism toward Orchid remaining as a stand-alone company.

Finally, the Court turned to the numerous deal protection terms: a top-up option, a no-shop clause, match rights, informational match rights, a termination fee payable either where Orchid pulls out of the deal or where stockholders fail to tender a majority of shares, and Orchid's agreement to pull its rights plan with respect to LabCorp only. Taken individually, the Court found these provisions insufficient to deter a serious bidder. The Court noted that the no-shop provision was balanced by a fiduciary out that allows the Board to negotiate and exchange confidential information with a bidder who presents what is, or is likely to become, a superior offer. Rejecting plaintiffs' argument that termination fees should be measured by a company's enterprise value (*i.e.*, Orchid's value after discounting its cash on hand), the Court followed *Cogent*[3] and found the $2.5 million termination fee to be 3 percent of Orchid's equity value and therefore reasonable. In evaluating the cumulative effect of all the deal protection devices, as it was also required to do, the Court found that a sophisticated buyer could overcome them if it wanted to make a serious bid; accordingly, they were reasonable under the circumstances.

Plaintiffs also alleged that defendants had made several inadequate or misleading disclosures in the Registration Statement. First, plaintiffs alleged that the disclosures surrounding several U.K. private equity firms' interest in purchasing only Orchid's U.K. operations were inadequate. While the Court stated that the materiality of disclosing the $2.93 per share price was a close call, the Court ultimately determined that such disclosure was not required. Relatedly, plaintiffs alleged that the terms of Oppenheimer's engagement biased it towards recommending the LabCorp tender offer and against a sale of only Orchid's U.K. operations. Plaintiffs argued that Oppenheimer was only engaged to advise Orchid regarding transactions involving the sale of "all or substantially all of the assets or outstanding securities of

3 *In re Cogent, Inc. S'holder Litig.*, 7 A.3d 487 (Del. Ch. 2010).

the Company," which would exclude a transaction involving only a sale of Orchid's U.K. operations, but the Court found that the engagement involved a broader range of transactions. Distinguishing the recent *Atheros* decision,[4] the Court found that the terms of Oppenheimer's engagement did not create an unavoidable conflict of interest that required a curative disclosure.

Second, plaintiffs alleged that Orchid should have disclosed projections by Orchid's management regarding its prospects as a continuing stand-alone entity, which were more optimistic than those used by Oppenheimer in its fairness opinion and disclosed to stockholders in the Registration Statement. However, given that (i) the Board was independent and deemed a different set of projections more reliable, (ii) such projections were disclosed, and (iii) stockholders were cautioned about the reliability of such projections, the Court found that plaintiffs had not shown a reasonable probability that they would succeed in showing that disclosure of management's projections would be material to a reasonable stockholder's decision, although the Court noted that this too was a close call.

Third, plaintiffs argued that Orchid should have disclosed that Oppenheimer told potential bidders that the company was not conducting an auction. The Court reiterated that sophisticated buyers knew that they could have indicated their interest in response to Oppenheimer's inquiries and found that further disclosures would not be material to a stockholder's decision.

Fourth, plaintiffs argued that Orchid should have disclosed the reasons why its two largest stockholders decided not to enter tender agreements sought by LabCorp in conjunction with the transaction. The Court confirmed that Orchid should not be held responsible for or otherwise required to report on a third-party stockholder's thought process.

Fifth, plaintiffs alleged that additional details regarding conflicts within the Board over negotiations with LabCorp must be disclosed. Although the Registration Statement did not disclose a preliminary 4-to-2 vote to continue negotiations with LabCorp (with the CEO opposing), the Court found that disclosing the CEO's opposition to the transaction and his abstention from the final vote put the stockholders on notice that there was disagreement within the Board about whether to proceed.

Finding no reasonable probability of success on plaintiffs' price and process or disclosure claims, the Court briefly commented that the irreparable harm prong counseled against an injunction as well. Finally, in balancing the equities, the Court noted that it should be careful about depriving stockholders of their opportunity to make a choice to tender, especially with a significant premium of 40 percent to market price, and that this tipped the balance against an injunction.

Krieger v. Wesco Financial Corp., C.A. No. 6176-VCL (Del. Ch. May 10, 2011) (TRANSCRIPT).

In *Krieger v. Wesco Financial Corporation*, the Delaware Court of Chancery denied plaintiff stockholder's motion for a preliminary injunction against a proposed acquisition of Wesco Financial Corporation (the "Company") by Berkshire Hathaway ("Berkshire"), the holder of 80.1 percent of the Company's common stock, in which Berkshire sought to acquire the remaining outstanding shares of common stock.

The transaction was negotiated under the direction of and approved by a fully empowered and independent special committee of the board of directors of the Company and was subject to a nonwaivable majority of the minority voting condition. Additionally, to the extent that no transaction was approved, the Company would continue to operate as it did prior to the proposal and Berkshire would maintain its 80.1 percent ownership of the Company. Under the terms of the proposed acquisition, Company stockholders would be entitled to elect either Berkshire Class B shares or cash valued at the book value per share of the Company, without any proration or reallocation.

The Court followed the "unified standard of review" of *In re CNX Gas Corp. Shareholder Litigation*, 4 A.3d 397 (Del. Ch. May 25, 2010), under which the business judgment rule presumptively applies where a transaction is (i) negotiated and approved by a special committee and (ii) conditioned on the affirmative vote of a majority of the unaffiliated stockholders. The Court found

4 *In re Atheros Commc'ns, Inc.*, 2011 WL 864928 (Del. Ch. Mar. 4, 2011).

that the transaction satisfied both prongs of the unified standard of review and refused to issue the preliminary injunction. In reaching its conclusion, the Court did not find plaintiff's arguments persuasive that certain members of the special committee were interested based on their ownership of shares of Berkshire. The Court also rejected plaintiff's argument that the majority of the minority vote was defective because it failed to exclude the Company's largest minority stockholder who was also a member of the special committee. The Court, in declining to exclude such stockholder, noted that although there may be times when the Court would be concerned about the divergent interests of a large stockholder and other minority stockholders, this was not such an instance.

The plaintiff stockholder also asserted that stockholders were entitled to appraisal rights in connection with the permitted acquisition and, relatedly, that the Company did not adequately disclose in the proxy statement the existence of such appraisal rights. The Company's proxy statement stated that appraisal rights are only available under Delaware law where stockholders are required to accept cash for their shares and, because stockholders were able to choose between cash or stock (although the default option was receiving cash consideration), neither the Company nor Berkshire "believe[d] that Wesco shareholders will have any appraisal rights with respect to the shares of Wesco common stock they hold in connection with the merger." The Court appeared to be unpersuaded by the plaintiff stockholder's argument that the option to choose between cash or shares, with a default of cash, resulted in a stockholder being "required to" accept cash for purposes of appraisal rights. Similarly, the Court was unwilling to find that the Company's description of its view of the matter in the proxy statement was an inadequate disclosure. Rather, the Court found that the Company had expressed its view on the unsettled matter of law and held that such statement was sufficient under *General Datacomm Industries v. Wisconsin Investment Board*, 731 A.2d 818 (Del. Ch. 1999). Moreover, the Court found that the threat of irreparable harm to the stockholders if they were in fact entitled to appraisal rights was *de minimis*, as any such harm could be remedied at a later time as part of a quasi-appraisal proceeding.

S. Muoio & Co. LLC v. Hallmark Entertainment Investments Co., C.A. No. 4729-CC (Del. Ch. Mar. 9, 2011), *aff'd*, 35 A.3d 419 (Del. 2011) (TABLE).

In *S. Muoio & Co. LLC v. Hallmark Entertainment Investments Co.*, the Court of Chancery held that a recapitalization of Crown Media Holdings, Inc. ("Crown") by its controlling stockholder and primary debtholder, Hallmark Cards, Inc. and its affiliates (collectively, "Hallmark"), was entirely fair. The Court closely examined the special committee process at issue, and its post-trial opinion demonstrates the benefits of a properly functioning special committee.

Hallmark first proposed a recapitalization of Crown on May 28, 2009. At that time, Crown owed Hallmark over $1.1 billion in debt and the debt service on Crown's obligations had risen to $100 million a year. Crown's cash flows, however, were insufficient to pay the interest or principal on the debt, which matured in 2011. To allow Crown to operate despite its debt load, Hallmark and Crown had in prior years negotiated waiver and standstill agreements that enabled Crown to defer payment on the debts and avoid an event of default and potential bankruptcy.

Upon receiving the recapitalization proposal, Crown's board of directors formed a special committee consisting of three independent directors of Crown (the "Special Committee"). The authorizing resolutions empowered the Special Committee to consider Hallmark's proposal as well as such other matters as the Special Committee deemed advisable. Following its establishment, the Special Committee retained Richards, Layton & Finger as its legal advisor and Morgan Stanley as its primary financial advisor; at a later stage in the process, the Special Committee also retained Houlihan Lokey to render an opinion as to the fairness of the recapitalization.

In consultation with Morgan Stanley, the Special Committee considered all available options, including a third-party refinancing, a third-party sale, simply rejecting Hallmark's proposal in favor of the status quo, or negotiating the recapitalization with Hallmark. After extensive due diligence, Morgan Stanley advised the Special Committee that Crown's value did not exceed the value of its debt and that Crown was unlikely to be able to meet its debt obligations as they matured. In light of these facts, the Special Committee determined that the status quo (*i.e.*, expecting Hallmark to grant further extensions to Crown to repay its debt) was unsustainable and that Crown faced serious insolvency risks. Thus, the Special Committee decided not to seek further debt extensions from Hallmark. Additionally, while the Special Committee remained open to the possibility of a third-party refinancing or sale, it considered both events unlikely, given Crown's financial situation, prior extensive sale efforts and the advice of its financial advisors.

The Special Committee's initial response to Hallmark's proposal was to ask Hallmark to take Crown private at a price fair to the minority stockholders; however, Hallmark rejected that alternative. In response, the Special Committee then submitted a counterproposal to the recapitalization. Following months of negotiation, Crown and Hallmark announced the approval of a non-binding term sheet, and nearly a month later the parties entered into a formal agreement providing for the terms of the recapitalization. The recapitalization agreed to by the parties significantly improved on the terms of Hallmark's initial proposal. Notable terms of the recapitalization included Hallmark exchanging its $1.1 billion in debt for $315 million in new debt and $185 in preferred stock, Hallmark's guarantee of a new revolver for Crown, and a standstill agreement limiting Hallmark's ability to purchase or sell Crown stock (and, importantly, restricting its ability to effect a short-form merger). As the Court noted in its analysis of the transaction, the Special Committee had negotiated for a lower amount of debt with lower interests rates and longer maturities than Hallmark had originally proposed. The Court also noted that the Special Committee achieved one of its important goals when Hallmark agreed to reduce Crown's debt level to $500 million. This reduction meant that Crown's minority stockholders' equity would have value to the extent Crown was worth more than $500 million, instead of the pre-recapitalization level of $1.1 billion.

Plaintiff S. Muoio & Co. LLC ("Muoio"), a Crown stockholder, filed suit on July 13, 2009, seeking to enjoin the recapitalization. The parties agreed to stay the litigation while the Special Committee considered Hallmark's proposal. After the Special Committee approved the recapitalization agreement with Hallmark, Muoio filed an amended complaint seeking rescission of the recapitalization. Muoio alleged that the recapitalization process was flawed, including claims that (i) Hallmark dominated the Special Committee process; (ii) the chair of the Special Committee was not independent; (iii) the Special Committee's mandate was too narrow; and (iv) the recapitalization was timed to disadvantage Crown's minority stockholders. Muoio further alleged that the recapitalization significantly undervalued Crown and therefore improperly transferred wealth and voting power from Crown's minority stockholders to Hallmark.

The Court examined the recapitalization pursuant to the exacting entire fairness standard, requiring a review as to fair price and fair dealing. While the initial burden of establishing entire fairness rests with the party who stands on both sides of a transaction, the Court shifted the burden of proof to Muoio because the recapitalization had been negotiated and approved by an independent special committee.

After evaluating the actions of the Special Committee, the Court held that the recapitalization was the result of a fair process. The Court noted that the Special Committee met 29 times over a nine-month period to consider the recapitalization and potential alternatives. The Court disagreed with Muoio's allegations that Hallmark dominated the formation of the Special Committee by drafting the resolutions establishing and empowering the Special Committee and by suggesting possible counsel for the Special Committee. Instead, the Court pointed out that the Special Committee's counsel had completely redrafted the resolutions—which, significantly, provided the Special Committee with veto power over any transaction. The Court also found that the Special Committee selected its counsel based on the recommendation of one of its members, and not at Hallmark's behest.

The Court also rejected Muoio's challenge to the independence of the chairman of the Special Committee. Muoio had argued that the chairman lacked independence by virtue of (i) his charitable and civic service (which included serving on certain advisory boards with Hallmark executives and members of the Hall family, which controls Hallmark) and (ii) his fundraising efforts on behalf of the University of Kansas (which received funding from the Hall family).

The Court declined to find that the chairman was not independent, noting, among other things, that he had received no salary from the University of Kansas and that he had never solicited the Hall family or Hallmark on the university's behalf. Further, the Court stated that "the individual committee members impressed me as directors willing to assume the task of the committee 'in a rigorous and independent manner.'"

Muoio further argued that the Special Committee was "hamstrung by its narrow mandate." The Court rejected this argument, noting that the Special Committee was broadly empowered to consider the recapitalization as well as other matters it deemed advisable. Further, the Court found that the Special Committee members viewed their mandate broadly and understood that they had the power and authority to negotiate with Hallmark, recommend or reject the recapitalization, and consider all alternatives.

In addition, the Court did not credit Muoio's allegation that Hallmark's recapitalization proposal was opportunistically timed. The Court noted that this "timing" theory was almost entirely based on Muoio's allegation that Crown had recently turned EBITDA-positive and was poised for substantial growth. The Court stated that if Crown was likely to experience a sudden and dramatic increase in value, either Hallmark or one of the sophisticated industry players that had recently examined Crown would have sought to capture this upside. Instead, despite the fact that Crown had been extensively shopped since 2005, no offer exceeding the value of Crown's debt had emerged.

In evaluating fair price of the recapitalization under the entire fairness standard, the Court stated that Crown's financial situation, which included serious liquidity issues, could not be ignored. The Court analogized this case to *In re Vision Hardware Group, Inc.* and *In re Hanover Direct, Inc. Shareholder Litigation*. In those cases, both of which involved the valuation of insolvent or nearly insolvent corporations, the Court recognized the reality that the value of a corporation's equity may approach zero as it approaches insolvency. In light of the economic problems facing Crown, the Court held that the recapitalization was entirely fair on its face.

Despite finding the recapitalization to be entirely fair, the Court nonetheless examined the parties' competing valuations. Muoio's expert witness proffered a valuation of Crown nearly three times higher than any other valuation. Further, Muoio's expert rejected his own comparable companies and comparable transactions analyses as absurdly low. In contrast, the defendants' experts utilized a variety of valuation techniques and considered valuations of Crown recently performed by potential acquirers. The Court held that the defendants' valuation analyses were more reliable because, among other reasons, the multiple methods of analysis served as a check on the reasonableness of each individual valuation technique.

The Court ultimately concluded that the recapitalization was entirely fair, and stated that the Special Committee "reached the best deal possible through intense negotiations that were appropriately adversarial." Muoio filed an appeal of the decision on April 7, 2011.

Governing Pleading Standard in Delaware

Central Mortgage Co. v. Morgan Stanley Mortgage Capital Holdings LLC, 27 A.3d 531 (Del. 2011).

In *Central Mortgage Co. v. Morgan Stanley Mortgage Capital Holdings LLC*, the Delaware Supreme Court declined to address whether the "plausibility" standards set forth in *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007), and *Ashcroft v. Iqbal*, 129 S. Ct. 1937 (2009), should be applied in Delaware, and instead unanimously held that until the Delaware Supreme Court "decides otherwise or a change is duly effected through the Civil Rules process, the governing pleading standard in Delaware to survive a motion to dismiss is reasonable 'conceivability.'"

Central Mortgage Company ("CMC") brought this action against Morgan Stanley Mortgage Capital Holdings LLC ("Morgan Stanley") after certain mortgages for which CMC purchased servicing rights from Morgan Stanley began to fall delinquent during the early financial crisis in 2007. CMC made a variety of claims, and the Court of Chancery dismissed those claims with prejudice, except for two breach of contract claims, which the Court dismissed without prejudice. As to those claims, the Court of Chancery determined that CMC failed to follow the requirements of the notice provision of the master contract by failing to provide Morgan Stanley adequate notice of the alleged breaches and an opportunity to cure. In dismissing these claims, the Court of Chancery cited the *Twombly-Iqbal* plausibility standard.

The Supreme Court noted that since *Twombly* was decided in 2007, the Court of Chancery has, on various occasions, cited with approval the "plausibility" standard. Prior to this case, however, the Delaware Supreme Court had not addressed the appropriate pleading standard since it reaffirmed the "conceivability" standard in 2002. Because the issue had not been briefed by either party, the Supreme Court declined to use this case as a vehicle to make a final determination on whether *Twombly-Iqbal* should apply in Delaware. Instead, it made clear that until it (or the legislature) decides otherwise, the standard in Delaware is "conceivability."

The Court explained that Delaware's "conceivability" standard is "more akin to possibility." The federal "plausibility" standard, by contrast, falls somewhere between mere "possibility" but short of "probability." Under Delaware's "minimal" pleading standard, "a trial court should accept all well-pleaded facts as true, accept even vague allegations in the Complaint as 'well-pleaded' if they provide the defendant notice of the claim, draw all reasonable inferences in favor of the plaintiff, and deny the motion unless the plaintiff could not recover under any reasonably conceivable set of circumstances susceptible of proof."

The Supreme Court determined that under the conceivability standard, it was sufficient that the complaint alleged that CMC did provide prompt notice with specific grounds for breach. By deciding that CMC did not provide adequate notice, reasoned the Supreme Court, the trial court inappropriately shifted the burden, holding CMC to a higher pleading standard than required. The Supreme Court made clear, however, that it was not making a judgment on the substantive adequacy of the notice or whether the notice provided could survive a motion for summary judgment.

Stockholder Rights Plans

Air Prods. & Chems., Inc. v. Airgas, Inc., 16 A.3d 48 (Del. Ch. 2011).

Marking the latest chapter in the attempt of Air Products and Chemicals, Inc. to acquire Airgas, Inc., the Court of Chancery ruled for defendant Airgas. In *Air Products & Chemicals, Inc. v. Airgas, Inc.*, the Court found following trial that the Airgas board had not breached its fiduciary duties and refused to order Airgas to redeem its poison pill. Describing his holding as constrained by Delaware Supreme Court precedent, Chancellor Chandler found that the Airgas board had met its burden under *Unocal* to articulate a legally cognizable threat—the allegedly inadequate price of Air Products' offer, coupled with the fact that a majority of Airgas's stockholders would likely tender into that inadequate offer—and had taken defensive measures—including the maintenance of a stockholder rights plan—that fall within a range of reasonable responses proportionate to that threat. Concluding that the Airgas board had not breached its fiduciary duties by preventing Air Products from taking its tender offer to Airgas stockholders for over a year, the Court found that the Airgas board had acted in good faith and in the honest belief that Air Products' $70 per-share offer is inadequate. Noting that, in his personal view, Airgas's rights plan had "served its legitimate purpose," the Chancellor followed the Delaware Supreme Court's recognition that inadequate price could be a valid threat to corporate policy and effectiveness. Therefore, the Court noted, a board acting in good faith, after reasonable investigation and reliance on the advice of outside advisors, could address that threat by blocking a tender offer and forcing the bidder to elect a board majority that supports its bid.

Yucaipa Am. Alliance Fund II, L.P. v. Riggio, 1 A.3d 310 (Del. Ch. 2010), *aff'd*, 15 A.3d 218 (Del. 2011) (TABLE).

In *Yucaipa American Alliance Fund II, L.P. v. Riggio*, the Delaware Court of Chancery confirmed in a post-trial decision that a board's decision to adopt and maintain a stockholder rights plan triggered upon the acquisition of beneficial ownership of more than 20% of the company's shares is subject to *Unocal* review, even where the board "grandfathers" an existing significant stockholder from the operation of the plan. The Court ultimately concluded in the instant case that the board's adoption and use of the rights plan was a good faith, reasonable response to a threat to the company and its stockholders and, therefore, dismissed the plaintiffs' claims for breach of fiduciary duty.

In November 2009, funds associated with Ronald Burkle ("Yucaipa") doubled their stake in Barnes & Noble, Inc. ("B&N") to nearly 18% through open-market purchases. Yucaipa disclosed these acquisitions on Schedules 13D in which it criticized B&N's management and indicated that it might pursue various M&A transactions. In response, B&N's board adopted a rights plan with a 20% triggering threshold. The rights plan included a "grandfather" clause for Leonard Riggio, B&N's founder and the holder of approximately 30% of B&N's stock, but limited further acquisitions by Riggio. Yucaipa brought suit, claiming that the adoption of the rights plan, and the board's refusal to amend the plan according to Yucaipa's requests, constituted a breach of fiduciary duties.

Yucaipa argued in the first instance that the board's decision to adopt the rights plan was subject to entire fairness review, claiming that Riggio, as the largest stockholder, stood on both sides of that matter. The Court rejected this argument, noting that the rights plan did not confer any special benefit upon Riggio. While the rights plan "grandfathered" his existing stake, it also prevented him from acquiring a majority stake in B&N. In any case, the approval of the rights plan by an independent board majority invoked the business judgment rule standard. Alternatively, Yucaipa argued that the board was required to demonstrate a "compelling justification" under *Blasius* for adopting the rights plan, arguing that the plan was adopted for the purpose of disenfranchising stockholders. Noting that the *Blasius* standard of review applies where the board acts for the primary purpose of impeding a stockholder vote, the Court rejected Yucaipa's argument. The Court found that the evidence reflected that the board's motivation was to protect B&N from the threat of a group of stockholders potentially acquiring control without paying a control premium.

Yucaipa also challenged the rights plan on the basis that it prevented groups of stockholders holding over 20% in the aggregate from forming coalitions to mount a proxy contest. To this argument, the Court confirmed the following: (i) it is not unprecedented for rights plans to restrict stockholders collectively owning shares in excess of the triggering threshold from banding together to promote a joint slate in a proxy context, and (ii) the test articulated in *Unocal* (generally, the board must reasonably perceive a threat to corporate policy and effectiveness, and the response must be proportionate to the threat posed) is the appropriate standard of review in determining whether a rights plan is being exercised in a manner consistent with the board's fiduciary duties.

In its *Unocal* analysis, the Court noted that the concepts of preclusion and coercion are useful in determining whether the defensive measure is reasonable. In a footnote, the Court expressed skepticism about the view that a rights plan is "not preclusive if it merely leaves open a mathematical or theoretical possibility of winning a proxy contest," suggesting instead that the rights plan must not prevent the insurgent from having a "fair chance for victory." The Court further stated that where a plan "unfairly tilts the electoral playing field" against the insurgent, its operation may be enjoined. In the present case, however, B&N's rights plan did not unreasonably restrict Yucaipa's ability to mount a proxy contest because, according to the Court, even with the rights plan in place, Yucaipa had a fair chance to prevail in the proxy contest.

The Court next addressed Yucaipa's argument that the rights plan was not a reasonable response to the threat posed. Specifically, Yucaipa argued that Riggio's significant equity stake made the use of a 20% threshold unreasonable. Yucaipa argued that the board's refusal to amend the rights plan to increase the triggering threshold to 37% at Yucaipa's request was unreasonable. (A 37% threshold would have enabled Yucaipa and fellow investor Aletheia, which had amassed a 17% stake in B&N and which had a history of following Yucaipa's investment decisions, to select and promote a joint slate.) The Court acknowledged that Riggio likely had reasons to view other significant stockholders as a threat and that those concerns were distinct from the threats posed to B&N. The Court also expressed some concern with the process through which the rights plan was adopted, noting in particular that the independent directors did not exclude Riggio and other arguably interested directors from the board room during a discussion of Riggio's own interests and the possibility that those interests might pose a threat to corporate policy and effectiveness. Nonetheless, the Court was convinced that the board acted loyally—that is, in the best interests of B&N and its stockholders generally, rather than just Riggio—and also was convinced that the rights plan is not an unreasonable device that "fundamentally restricts" Yucaipa from winning a proxy contest.

Limitations on and Sanctions for Plaintiff-Representatives' Trading

In re Celera Corporation Shareholder Litigation, No. 212, 2012 (Del. Dec. 27, 2012).

In *In re Celera Corporation Shareholder Litigation*, No. 212, 2012 (Del. Dec. 27, 2012), the Delaware Supreme Court upheld the Court of Chancery's decision to certify as class representative a plaintiff that had sold its stock prior to the challenged merger, but held that, under the facts and circumstances of the case, the Court of Chancery had abused its discretion by failing to provide a significant stockholder with the right to opt out of the class. BVF Partners, L.P., Celera Corporation's largest stockholder, objected to the proposed settlement Celera had entered into with New Orleans Employees' Retirement System (NOERS) to resolve litigation challenging Quest Diagnostic Incorporated's acquisition of Celera for $8.00 per share. BVF argued on appeal that NOERS was not an adequate class representative because, among other things, it had sold its stock after execution of the merger agreement but before the transaction closed. BVF also asserted that it should have been permitted to opt out of the class to pursue its individual claims for monetary damages.

In March 2011, Celera's board approved a merger agreement under which Quest would launch a tender offer followed by a back-end merger. Under the terms of the agreement, Celera was required to pay a termination fee of $23.45 million if it accepted a competing bid; Celera's board was subject to a "no-shop" provision; and several initial bidders were bound by a "don't-ask-don't-waive" standstill agreement. Shortly after the transaction's announcement, NOERS filed a class action complaint alleging breach of fiduciary duty claims. After expedited discovery, NOERS and the defendants entered into a non-binding memorandum of understanding providing for certain therapeutic benefits, including a reduction in the termination fee from $23.45 million to $15.6 million, the elimination of the "don't-ask-don't-waive" standstill agreements, an extension of the tender offer, and supplemental disclosures. The MOU was conditioned on NOERS' general release of all claims (including monetary damages) by any member of the class, including BVF.

BVF objected to the settlement, claiming that the therapeutic benefits were of no value to it and stating that it sought monetary damages to reflect the real value of its stock. On March 23, 2012, over BVF's objection, the Court of Chancery certified the class as a non-opt-out class under Court of Chancery Rules 23(b)(1) and (b)(2) and approved the settlement. On appeal, the Supreme Court held that NOERS was an adequate class representative because, although it sold its stock four days before the transaction closed and ten months before the settlement was approved, it had owned its stock at the time Celera's board approved and executed the merger agreement and at the time the parties executed the MOU.

While the Supreme Court held that the Court of Chancery did not abuse its discretion by certifying the class under Rules 23(b)(1) and (b)(2), it held that the trial court did abuse its discretion by denying BVF a discretionary right to opt out of the class. Recognizing that Rule 23, similar to its federal counterpart, does not contain a provision that authorizes the court to grant opt-out rights to class members of any class not certified under Rule 23(b)(3), the Supreme Court held that Rule 23(d)(2), providing for notice to class members, permits a discretionary opt-out right. The Supreme Court also recognized that the litigation as originally filed presented claims that were primarily for equitable relief, which typically supports certification of a non-opt-out class. Nonetheless, the Supreme Court observed that "in somewhat unique circumstances, the parties agreed to a *de facto* settlement of those equitable claims without formal court approval, leaving only monetary damage claims as the subject of a later formal, *de jure* application for a court-approved settlement." The Supreme Court held that the Court of Chancery, in considering whether to certify a class, "should not—and indeed cannot—blind itself to that reality and treat the settlement as one in which the equitable claims were still viable and predominant." Because the Court of Chancery, in determining whether to certify a class, must consider the posture of the case "as it realistically exists," the Supreme Court held that the Court of Chancery erred by denying a discretionary opt-out right where the policy favoring a global settlement was outweighed by due process concerns. Accordingly, the Supreme Court held that the Court of Chancery had to provide an opt-out right under these particular facts and circumstances.

Steinhardt v. Howard-Anderson, C.A. No. 5878-VCL (Del. Ch. Jan. 6, 2012).

In *Steinhardt v. Howard-Anderson*, the Court of Chancery imposed sanctions on representative plaintiffs for improper trading by plaintiff-fiduciaries. Michael Steinhardt and two funds managed by him filed suit as representative plaintiffs on behalf of stockholders of Occam Networks, Inc. ("Occam") challenging the acquisition of Occam by Calix, Inc. ("Calix"). Steinhardt short-sold shares of Calix stock after the Court entered a confidentiality order restricting trading on the basis of confidential information obtained in the lawsuit and after Steinhardt had received information about the lawsuit from another representative plaintiff. The Court sanctioned Steinhardt and the funds by (i) dismissing them from the case with prejudice, (ii) barring them from recovering anything from the litigation, (iii) requiring them to self-report to the SEC, (iv) directing them to disclose the Court's opinion in any future application to serve as lead plaintiff, and (v) ordering disgorgement of profits in the amount of $534,071.45.

Steinhardt and other representative plaintiffs filed suit on October 6, 2010, alleging that Occam directors breached their fiduciary duties in approving the merger at an unfair price. The merger agreement provided that Occam would merge with an acquisition subsidiary of Calix, with Occam stockholders receiving $3.8337 in cash and 0.2925 shares of Calix stock for each share of Occam common stock. On November 12, 2010, the Court entered a confidentiality order, which explicitly prohibited persons receiving confidential discovery information from trading in securities of Calix or Occam on the basis of such information, and document production began on December 1, 2010. Another representative plaintiff, Herbert Chen, worked out of Steinhardt's offices. Chen had pre-merger holdings of Occam stock amounting to approximately 20 to 25 percent of his net worth and was deeply involved in the case. Although Steinhardt was not as deeply involved in the prosecution of the action, Chen provided Steinhardt with regular updates concerning the litigation. Despite the confidentiality order, Steinhardt began short-selling Calix common stock on December 28, 2010.

The Court explained that when a stockholder files a representative action, the plaintiff voluntarily assumes the role of fiduciary for the putative class and that it is unacceptable for a plaintiff-fiduciary to trade on the basis of nonpublic information obtained in the litigation, as such trading undermines the integrity of the representative litigation process. According to the Court, the fact that a representative plaintiff does not have direct access to confidential information produced in discovery is not determinative. While Steinhardt did not speak directly with plaintiffs' counsel until two days before his deposition in May 2011 and did not have direct access to discovery, Steinhardt nevertheless received regular written and oral updates about the litigation from Chen, whose insights in turn were based on discussions with counsel and the discovery record. The Court therefore held that by trading after receiving information from Chen, which was derived from confidential discovery material, Steinhardt and the funds breached their fiduciary obligations as representative plaintiffs and violated the confidentiality order.

The defendants also sought sanctions against Chen. Chen sold Occam shares between October 29 and November 2, 2010, but the Court did not find these trades improper because the defendants had not yet produced nonpublic information and the Court had not yet entered the confidentiality order. Chen also sold Occam shares on January 25, 2011, but the Court found that trade to have been inadvertent. Additionally, Chen's January 25 trade came a day after the Court's preliminary injunction ruling, which, according to the Court, eliminated the principal benefit Chen obtained from the confidential information by making it reasonably clear to the public that the merger was highly likely to close after the issuance of supplemental disclosures. The Court also found Chen to be a highly motivated and effective representative plaintiff and stated that Chen's removal would harm the class. The Court accordingly declined to impose sanctions on Chen.

Plaintiffs' Attorneys' Fees Awards

Americas Mining Corp. v. Theriault, No. 29, 2012 (Del. Aug. 27, 2012).

In *Americas Mining Corp. v. Theriault*, No. 29, 2012 (Del. Aug. 27, 2012), the Delaware Supreme Court affirmed the Court of Chancery's post-trial decision and final judgment awarding more than $2 billion in damages (including interest) and $304 million in attorneys' fees in *In re Southern Peru Copper Corp. Shareholder Derivative Litigation*, C.A. No. 961-CS (Del. Ch. Oct. 14, 2011, revised Dec. 20, 2011). In *Southern Peru*, the plaintiff brought a derivative action challenging the fairness of Southern Peru's acquisition of Minera México, S.A. de C.V., which was 99.15 percent owned by Southern Peru's controlling stockholder, in a stock-for-stock merger. The Court of Chancery determined that Southern Peru overpaid for Minera and awarded damages in the amount of the overpayment, plus pre- and post-judgment interest.

The defendants raised several issues on appeal, arguing that the Court of Chancery impermissibly denied the defendants an opportunity to present testimony from a key witness (namely, an employee of the special committee's investment banker); committed reversible error by failing to determine which party bore the burden of proof before trial and by incorrectly allocating that burden to the defendants, despite the existence of a well-functioning special committee; made an arbitrary and capricious determination regarding the fair price of the transaction; and abused its discretion in granting a $304 million award of attorneys' fees. In its nearly 110-page opinion, the Supreme Court rejected each of these arguments.

First, the Court found that the Court of Chancery did not impermissibly exclude the testimony of a key defense witness. Rather, the Court found that the Court of Chancery, acting within its discretion to control its docket, simply declined to change the trial scheduling order to accommodate the defendants' "eleventh-hour" request. The Court reasoned that the defendants' assertion that they were unfairly prejudiced by the denial of the request was undermined by the record, given that they had previously acknowledged that they may not have a live witness from the investment banker at trial. Moreover, the Court held that the Court of Chancery's finding that allowing the "eleventh-hour" request would have been unfair to the plaintiff was supported by the record and was the product of a logical and deductive reasoning process.

Second, the Supreme Court found no fault with the Court of Chancery's determinations on the burden of persuasion as to fairness in this context, where the controlling stockholder was on both sides of the transaction and the entire fairness standard applied *ab initio* and the only question was whether to shift the burden of persuasion to the plaintiff. Given the fact-intensive nature of this exercise, the Court did not fault the Court of Chancery for failing to allocate the burden before trial, although it did state that "which party bears the burden of proof must be determined, if possible, before the trial begins." In any event, the Court affirmed the Court of Chancery's determination that the outcome of the case would have been the same regardless of which party bore the burden of persuasion. Regarding future entire fairness cases in this context, the Court held that "if the record does not permit a pretrial determination that the defendants are entitled to a burden shift, the burden of persuasion will remain with the defendants throughout the trial to demonstrate the entire fairness of the interested transaction." Nevertheless, the Court suggested that transaction participants will continue to have an incentive to use special committees, since "a fair process usually results in a fair price" and the use of a special committee of independent directors remains a valuable means of demonstrating the integrity of the process.

The Court adopted the Court of Chancery's characterization of the special committee's process as one that was cramped by a "controlled mindset." In addition, the Court rejected the defendants' argument that the

Court of Chancery failed to give appropriate weight to the special committee's "relative valuation" method. Reciting the Court of Chancery's method of determining the transaction's fairness, the Court found that it applied a "disciplined balancing test" and "considered the issues of fair dealing and fair price in a comprehensive and complete manner." That determination, the Court noted, must be accorded substantial deference on appeal. Given that the Court of Chancery's factual findings were supported by the record, and that its conclusions were the product of an orderly and logical reasoning process, the Court affirmed its determination on the question of fairness.

Third, the Court affirmed the Court of Chancery's calculation of damages and its award of attorneys' fees (which fees amounted to 15 percent of the total judgment (inclusive of pre-judgment interest), plus post-judgment interest through satisfaction of the award). Noting that a post-trial award of damages in an entire fairness proceeding is reviewed for abuse of discretion—and that the Court of Chancery has wider discretion in a case involving loyalty breaches (as in the present case) than in an appraisal action—the Court found that the Court of Chancery fashioned a proper remedy based on its multi-factored "give-get" analysis. On the issue of attorneys' fees, the Court rejected the defendants' arguments that the Court of Chancery improperly applied the so-called *Sugarland* factors, which are considered in determining attorney fee awards. The defendants argued, among other things, that the Court of Chancery gave undue weight to the "results achieved" component of the *Sugarland* test and that it committed reversible error by allowing plaintiff's counsel to collect fees premised on nearly $700 million in pre-judgment interest, despite plaintiff's counsel's delay in prosecuting the litigation. The Supreme Court held that the Court of Chancery had not abused its discretion, agreeing that the "extraordinary benefit" achieved through the plaintiff's efforts merited "a very substantial award of attorneys' fees." The Court also found it was not improper to use the total damages award (inclusive of pre-judgment interest) in calculating the fee award, given that the Court of Chancery had already factored the "slow pace" of the litigation into the overall percentage of the benefit it was awarding as fees.

It is worth noting that Justice Berger, although concurring on the merits, dissented on the issue of whether the Court of Chancery properly applied the law when it awarded attorneys' fees. In Justice Berger's view, the Court of Chancery's indication that whether a fee is "reasonable" should be based on whether it establishes a good incentive for plaintiffs to take cases to trial was not grounded in *Sugarland*.

In re Compellent Technologies, Inc. Shareholder Litigation, Consol. C.A. No. 6084-VCL (Del. Ch. Dec. 9, 2011).

In *In re Compellent Technologies, Inc. Shareholder Litigation*, the Court of Chancery ruled on an application for attorneys' fees brought by class counsel who had secured a settlement loosening the "buyer-friendly" deal protection provisions of a merger agreement. Based upon the benefits conferred by the settlement, which shifted the merger agreement's protective array of defensive measures from the aggressive end of the spectrum towards the middle, the Court rejected plaintiffs' counsel's request for a $6 million fee award and awarded $2.4 million.

On December 13, 2010, Dell Inc. ("Dell") and Compellent Technologies, Inc. ("Compellent" or the "Company") announced a definitive merger agreement whereby Dell agreed to acquire Compellent for $27.75 per share, valuing the Company's equity at approximately $960 million. Following announcement of the transaction, eight putative stockholder class actions were filed in Delaware and Minnesota. Each lawsuit challenged, among other things, the various deal protection measures included in the merger agreement. The merger agreement contained a no-shop provision with a fiduciary out, information and matching rights, a "force-the-vote" provision, support agreements from the holders of 27% of Compellent's outstanding stock, and a termination fee of 3.85% of equity value, and required Compellent to adopt a stockholder rights plan, which exempted Dell, with a 15% trigger. The Court observed that "to identify defensive measures by type without referring to their details ignores the spectrum of forms in which deal protections can appear" and that the merger agreement "combined aggressive variants of each familiar [deal protection] provision with additional pro-buyer twists."

Following expedited discovery, Dell and Compellent agreed to modify certain deal protection provisions and to issue supplemental disclosures in order to settle the litigation. In considering whether to approve the settlement, the Court focused on five provisions of the original merger agreement: (i) the no-shop provision; (ii) the information rights provision, including the matching rights; (iii) the recommendation or "force-the-vote" provision; (iv) adoption of the stockholder rights plan; and (v) the termination fee.

With respect to the no-shop provision, the Court observed that the prohibition on solicitation in the original merger agreement was "expansive and unqualified," while the exception to the prohibition was "cabined and constrained." The Court found that several features of the no-shop provision were particularly pro-buyer. These included the imposition of strict contractual liability for any breach by any representative of the Company, the lack of knowledge or materiality qualifiers on the requirements of the provision, the broad definition of the terms "Acquisition Proposal" and "Acquisition Inquiry," and the requirement that a potential bidder enter into a 275-day (or nine-month) standstill agreement before the Company could provide any information. The Court also noted that Compellent's compliance with the mechanics of the no-shop provision "literally required the Board to knowingly breach its fiduciary duties, albeit for a limited period of time, by first requiring the Board to determine that failing to act constituted a breach of its fiduciary obligations and then forbidding the Board to act until subsequent contractual conditions were met."

Next, the original information rights provision, which required the Company to notify Dell of the identity of a competing bidder at least two days before initiating negotiations, to provide Dell with any non-public information at least 24 hours before the competing bidder, and to update Dell on negotiations with any competing bidder, was characterized by the Court as "expansive." The merger agreement also required Compellent to submit the transaction for approval at a special meeting of the Company's stockholders, regardless of whether the Company's board changed its recommendation, and imposed procedural restrictions on the board's ability to change its recommendation. The Court noted that the "aggressive [recommendation] provision raise[d] a host of questions," including, among others, whether the board could agree to delay changing its recommendation with respect to the merger consistent with its duty of candor to the stockholders, and whether the board could agree not to postpone or to adjourn a special meeting without Dell's consent if the board had determined such action was required to fulfill its fiduciary duties.

Further, the merger agreement required Compellent to adopt a stockholder rights plan with a 15% trigger that exempted Dell. The Court stated that the stockholder rights plan was "novel and bidder-friendly" and that merger agreements "have not traditionally required that a target board adopt a rights plan." Finally, the Court stated that the 3.85% termination fee, together with the expense reimbursement fee, gave the board a "strong financial inducement not to respond to a bid or provide stockholders with an updated recommendation."

As part of the settlement, each of these deal protections was modified. The no-shop provision was changed to eliminate the 275-day standstill requirement and to add materiality qualifiers relating to breaches committed by representatives of the Company other than directors, officers, or financial advisors. The "force-the-vote" provision was modified to allow the Company's board to change its recommendation in a wider variety of circumstances. The information rights were modified by reducing the advance notice periods to require notification "prior to" entering into discussions with a competing bidder, by adding a materiality qualifier to Dell's right to receive summaries of initial communications between Compellent and potential competing bidders, and by eliminating Dell's right to receive copies of subsequent written communications with bidders, substituting a general provision obliging Compellent to keep Dell "reasonably informed." The termination fee was reduced from $37 million to $31 million, or from 3.85% to 3.23%. Finally, Compellent rescinded the stockholder rights plan in its entirety—relief that the Court described as "exceptional." Compellent also issued six supplemental disclosures concerning the background of the transaction and the bankers' fees paid by Compellent and Dell. Compellent also agreed to delay the Company's meeting of stockholders for at least 21 days.

In determining the appropriate fee to award, the Court stated that "plaintiffs achieved significant benefit by loosening the aggressive deal protections." The Court noted that modifications to deal protections benefit stockholders because they increase the probability that an alternative bidder will submit a higher bid for a company. According to the Court, this benefit exists whether or not an alternative bidder actually emerges. Under the analytical framework developed by the Court, the amount of the fee awarded to plaintiffs' counsel should therefore "depend[] on the increased likelihood of a topping bid under the revised defensive measures." Accordingly, "[b]ecause more extreme defensive measures should have a more powerful dampening effect, settlements that ameliorate stronger forms of deal protection should warrant larger fees."

Using statistical evidence submitted in an expert report provided by the plaintiffs and data submitted by the defendants to rebut the report, the Court concluded that the realistic likelihood of a topping bid for Compellent under the original merger agreement was negligible, but that the modifications to the merger agreement raised the probability of a topping bid to approximately 8%. Based upon the 11.37% expected premium of a topping bid calculated by the Court and the Court's determination that the efforts of the plaintiffs' attorneys were entitled to 25% of the benefit conferred upon the stockholders, the Court determined that a fee award of $2.3 million was reasonable under the circumstances. The Court also awarded $100,000 for the six supplemental disclosures.

Although noting that the calculation was "admittedly rough," the Court stated that "estimating the benefit of reduced defensive measures in this fashion helps anchor this Court's discretionary fee determinations to something more objective than the boldness of the plaintiffs' ask and the vigor or passivity of the defendants' response."

In re Del Monte Foods Co. Shareholders Litigation, Consol. C.A. No. 6027-VCL (Del. Ch. June 27, 2011).

In *In re Del Monte Foods Company Shareholders Litigation*, the Delaware Court of Chancery awarded plaintiff's counsel $2.75 million in attorneys' fees and expenses for supplemental disclosures achieved during the preliminary injunction phase of the case. Previously, the Court had enjoined for a period of 20 days the stockholder vote on this $5.3 billion transaction, in which a private equity group consisting of Kohlberg Kravis Roberts & Co., L.P. ("KKR"), Vestar Capital Partners ("Vestar") and Centerview Partners acquired all outstanding shares of Del Monte common stock.[5]

As an initial matter, the Court noted that granting an interim fee award is within its equitable and discretionary powers. Referencing *Louisiana State Employees Retirement Systems v. Citrix Systems, Inc.*, 2001 WL 1131364 (Del. Ch. Sept. 17, 2001), the Court concluded that an interim fee award was appropriate in this instance because "the benefits [resulting from dissemination of the supplemental disclosures] cannot be revised or modified as a result of future events." Although Vice Chancellor Laster cautioned that he will not "invariably entertain post-injunction fee applications" and that other members of the Court of Chancery may not share this preference, he will consider an interim fee petition where the Court has expended judicial resources ruling on a preliminary injunction motion and the resulting benefit is not subject to reversal or alteration as litigation proceeds.[6]

Next, the Court applied the factors established in *Sugarland Industries, Inc. v. Thomas*, 420 A.2d 142 (Del. 1980). With regard to the benefits conferred by the supplemental disclosures, the Court identified three general categories of supplemental disclosures: (i) disclosures that "adverted to Barclays' behind-the-scenes activities during the sales process"; (ii) disclosures of Barclays' and Perella Weinberg's estimates of Del Monte's future cash flows and additional information about the summaries of the investment bankers' analyses; and (iii) disclosures pertaining to Del Monte executives' individual compensation arrangements. With respect to the first category, the Court used the fee award in *In re Lear Corp. Shareholder Litigation*, C.A. No. 2728-VCS (Del. Ch. June 3, 2008)

5 *See In re Del Monte Foods Co. S'holders Litig.*, 2011 WL 1677458 (Del. Ch. Feb. 14, 2011).
6 In *Forgo v. Health Grades, Inc.*, C.A. No. 5716-CS (Del. Ch. June 29, 2011) (TRANSCRIPT), Chancellor Strine expressed concern with a divided fee approach. Tr. at 57. *But see Frank v. Elgamal,* C.A. No. 6120-VCN (Del. Ch. July 28, 2011) (declining to award interim fees).

(TRANSCRIPT), where the negotiator of a transaction was conflicted, as a starting point. The Court distinguished *Lear* on the grounds that the plaintiff's counsel in the present case uncovered facts previously unknown to the Del Monte board of directors, thus informing two corporate decision-making bodies—the board and the stockholders—and "empower[ing] the Del Monte directors to re-evaluate their prior decisions and reliance on Barclays." Accordingly, the Court awarded $1.6 million for this aspect of the fee application. For the second category, the Court concluded that disclosures regarding the Barclays and Perella Weinberg opinions, bankers' fees and historical engagements warranted a fee of $950,000, well above the usual $400,000–$500,000 range awarded for supplemental disclosures about banker analyses and relationships. The third category of supplemental disclosures, which warranted a fee award of $200,000, provided a comparison between the proceeds each executive would receive upon consummation of the merger as opposed to what they would receive if terminated without a change in control.

The Court declined, however, to award interim fees based on the benefit conferred by the preliminary injunction because "the fruits of post-injunction discovery and the insights provided by live witnesses at trial should help...develop a more tailored assessment" of an appropriate award. The Court offered guidance on the value of the injunction, noting that the benefit conferred does not vary depending on whether or not a topping bid actually emerged. Moreover, the Court stated that pricing the benefit requires two inputs: "(i) the overall likelihood of a topping bid,"[7] and "(ii) the incremental gain that the likely topping bid would have created." As to the first input, the Court indicated an intent to rely on an article by Professor Guhan Subramanian, which examined the percentage of instances of topping bids generated in certain going-private deals between January 2006 and August 2007 where the transaction included a no-shop or go-shop provision.[8] As to the second input, the Court noted that the negotiated termination fee should serve as a lower bound for the incremental value of a topping bid because it "represented the parties' responsible estimate of the minimum incremental price increase that a serious acquirer would be willing to offer." ■

7 In *Health Grades,* Chancellor Strine seemed to reject the quantification approach taken by Vice Chancellor Laster in *Del Monte,* noting, "I don't pretend to know how you would price [the assurance for strategic buyers that, if they made a topping bid, they would not be blocked] in some sort of market for options in reduced deal protections and how that translates into the probability of a topping bidder emerging. And I think it's actually counterproductive to try to quantify something that's unquantifiable." *Health Grades, Inc.,* C.A. No. 5716-CS, Tr. at 77.

8 Guhan Subramanian, *Go-Shops vs. No-Shops in Private Equity Deals: Evidence and Implications,* 63 Bus. Law. 729 (2008).

Annual Meetings and Meeting Procedures

Sherwood v. Chan, C.A. No. 7106-VCP (Del. Ch. Dec. 20, 2011).

In *Sherwood v. Chan*, the Court of Chancery issued a temporary restraining order enjoining ChinaCast Education Corporation ("ChinaCast") and certain of its directors (collectively, "Defendants") from holding ChinaCast's annual meeting for a period of 20 days so that stockholders could express their "fully informed" views in the corporate election. Plaintiffs Ned Sherwood and ZS EDU, L.P. (collectively, "Plaintiffs") brought the action on December 12, 2011, asserting claims for breach of fiduciary duty and defamation and seeking a temporary restraining order against Defendants so that certain corrective disclosures could be made and Plaintiffs' competing slate of nominees could be considered prior to the annual meeting, which was scheduled to take place on December 20, 2011. The Court noted that, of the Plaintiffs' claims, only the disclosure claims could warrant a temporary restraining order, and proceeded to find that: (i) those claims were colorable, (ii) irreparable harm existed because of the threat of an uninformed stockholder vote, and (iii) while the equities claimed by both Plaintiffs and Defendants might be in equipoise, the balance of equities as between Defendants and ChinaCast's stockholders tipped decidedly in favor of granting the temporary restraining order.

In a definitive proxy statement filed with the SEC on November 14, 2011, ChinaCast recommended Sherwood, a ChinaCast director and stockholder, for reelection to its board of directors. Then, on December 8, 2011, 12 days before the scheduled annual meeting, the board issued supplemental proxy materials (the "Proxy Supplement") removing Sherwood from ChinaCast's slate of nominees to the board. Among the reasons provided in the Proxy Supplement for removing Sherwood from the slate were alleged insider trading activity in violation of ChinaCast's internal policies, and behavior that was deemed detrimental to "a productive and professional working relationship." The Proxy Supplement stated that Sherwood's alleged insider trading activity was reported to the SEC, but it did not disclose the existence or status of any SEC investigation.

The Court found that Sherwood had shown two possible ways in which the Proxy Supplement could be misleading, sufficient to support a finding that a colorable disclosure claim existed. First, the Court found that the Proxy Supplement might be misleading by failing to disclose candidly the board's motivations for removing Sherwood from ChinaCast's slate of nominees, which could have been based on avoiding policy disputes between Sherwood and other directors. Second, the Court found that the Proxy Supplement might be misleading in that it stated that management informed the SEC of Sherwood's alleged insider trading activity (thus creating the impression that Sherwood was unsuitable to serve as a director because of a possible criminal or civil enforcement action), but failed to state that Sherwood informed ChinaCast that he had been told that the SEC had determined not to pursue an action against him. Defendants contended that any SEC action was not material. The Court rejected this, noting that "if the SEC's actions were not material . . . it begs the question why the Company disclosed their reporting of the [alleged insider trading activity] to the SEC at all."

Next, the Court found irreparable harm because, absent a temporary restraining order, ChinaCast's stockholders would not have adequate time to consider corrective disclosures or Plaintiffs' competing slate of nominees prior to the vote, thereby rendering the vote uninformed. Defendants argued that there was no risk of harm with respect to Plaintiffs' competing slate, because Plaintiffs could not comply with the advance notice bylaw and thus were prevented from nominating a competing slate at the upcoming election. The Court stated that a finding of irreparable harm was not dependent on two properly nominated slates, because misleading disclosures might affect reasonable stockholders' decisions to vote "for" or "withhold," and therefore, "a threat of irreparable harm may exist in even an uncontested election where shareholders are not fully and fairly informed." Furthermore, the Court found that Defendants' argument that the advance notice bylaw precluded Plaintiffs from nominating their slate was "less than compelling," and that absent a temporary restraining order, federal regulations guaranteed Plaintiffs would lose because their proxies would not become effective until after December 21.

The Court also found that the balance of the equities weighed in favor of granting a temporary restraining order. Although the parties disputed whether Plaintiffs acted in a timely fashion to present their grievances to the stockholders, the Court found that the facts supported a reasonable inference that both parties pursued aggressive, but good faith, negotiating strategies to resolve their disputes leading up to the date of the Proxy Supplement, and that Plaintiffs acted relatively quickly to preserve their rights once they learned Sherwood would not be on ChinaCast's slate. The Court noted that the situation was reminiscent of *Blasius Industries, Inc. v. Atlas Corp.*, 564 A.2d 651 (Del. Ch. 1988), where a board's good faith effort to protect its incumbency in order to thwart implementation of a corporate policy that it reasonably feared would be harmful to the company interfered with the effectiveness of a stockholder vote. In this instance, the board's inaction in failing to resolve differences among its members and not taking steps to alleviate the issues created by belatedly removing Sherwood from the slate operated inequitably against the Plaintiffs and the interests of corporate democracy. The Court concluded that allowing the annual meeting to proceed on December 20 would not comport with the "scrupulous fairness" required in corporate elections, and thus enjoined the meeting for 20 days. However, to allay Defendants' concerns that delaying the annual meeting would require ChinaCast to incur additional significant expense, the Court required Plaintiffs to post a $250,000 bond.

Goggin v. Vermillion, Inc., C.A. No. 6465-VCN (Del. Ch. June 3, 2011).

In *Goggin v. Vermillion, Inc.*, Vice Chancellor Noble, interpreting the Delaware Supreme Court's opinion in *Airgas, Inc. v. Air Products and Chemicals, Inc.*, 8 A.3d 1182 (Del. 2010), denied plaintiff's motion to enjoin the 2011 annual stockholders meeting of Vermillion, Inc. ("Vermillion" or the "Company"), which was scheduled to occur six months after the 2010 annual meeting. Plaintiff requested that the Court delay the meeting by at least one month, determine that stockholder proposals made before any rescheduled meeting be considered, and enjoin any threatened use of Vermillion's rights plan to restrict stockholders' ability to communicate with one another about the Company.

From its inception, Vermillion held its annual meeting of stockholders in June, with one class of its classified board standing for election each year. In March 2009, the Company filed for bankruptcy. While in bankruptcy, the Company did not hold an annual stockholders meeting. After emerging from bankruptcy in January 2010, Vermillion held an annual meeting on December 3, 2010, at which Class III directors (who would have stood for election at the 2009 annual meeting if it had been held) were elected to a two-year term and Class I directors were elected to a three-year term. The Class II directors were serving for a term expiring at the 2011 annual meeting.

In anticipation of the 2010 annual stockholders meeting, the Company issued a proxy statement in October 2010 notifying stockholders of the 2010 annual meeting. Vermillion included in the proxy statement language requiring stockholders to submit proposals for the 2011 annual stockholders meeting—including proposals for director nominees—by January 1, 2011. Vermillion then announced on February 28, 2011 in its annual report that the 2011 annual meeting would take place in June—approximately six months after the 2010 annual meeting.

In early 2011, plaintiff began communicating his dissatisfaction with Vermillion's board of directors and management to Vermillion's board and requested that the board call an emergency stockholder meeting to consider the CEO's tenure, to adopt more stockholder-friendly bylaws and to remove the Company's rights plan. After considering plaintiff's request, the Company's board amended Vermillion's bylaws to include an advance notice provision for future annual meetings relating to stockholder proposals and director nominations, and determined to not remove the rights plan or take any other action. After receiving similar complaints from four other stockholders, Vermillion requested information from plaintiff and the other stockholders relevant to the stockholders' communications for purposes of the rights plan. Instead of responding to the Company's request for information, plaintiff filed suit alleging that the Company's directors were entrenching themselves in office.

In denying plaintiff's motion for a preliminary injunction, the Court addressed three issues: (i) the scheduling of the 2011 annual stockholders meeting, (ii) the advance notice requirement for stockholder proposals to be presented at an annual meeting, and (iii) the allegedly preclusive effect of the rights plan on stockholder communications.

First, plaintiff relied on the Delaware Supreme Court's decision in *Airgas, Inc. v. Air Products and Chemicals, Inc.* to argue that the 2011 annual meeting, scheduled only six months after the 2010 annual meeting, violates Delaware law "because it is not approximately twelve months after the 2010 annual meeting and future annual meetings held in June will truncate the terms of the Vermillion directors elected in 2010." The Court of Chancery disagreed and determined that the scheduling of the 2011 annual stockholders meeting was consistent with Delaware law and the Company's charter, bylaws and practices pre-bankruptcy. Thus, the 2011 annual stockholders meeting did not "run afoul of *Airgas*; there, the Supreme Court invalidated a shareholder bylaw that advanced the annual meeting with the effect of 'so extremely truncat[ing] the directors' term as to constitute a *de facto* removal....'" Accordingly, plaintiff failed to demonstrate a reasonable probability of success with respect to his annual meeting claim.

Second, plaintiff argued that the advance notice requirement for stockholder proposals to be presented at the 2011 annual stockholders meeting was unwarranted and entrenched the board. The Court noted that "Delaware law does not require that shareholders provide advance notice of proposals or of director nominations to be raised at an annual meeting, unless the corporation has duly imposed such a requirement." Here, the Company set forth its notice requirement for the 2011 annual stockholders meeting in the October 2010 proxy. The Court determined that since the advance notice requirement was in place before plaintiff expressed any dissatisfaction with the Company's board of directors, the record did not support an entrenching or defensive motive on behalf of the board.

Third, plaintiff sought to limit the board's use of the Company's rights plan. Plaintiff asserted that the Company's letter requesting information concerning the dissatisfied stockholders' relationships was an indication of the board's willingness to use the rights plan as a defensive device against Vermillion's stockholders. Plaintiff also argued that the amended bylaws expanded the board's power to utilize the rights plan "by adopting and defining the phrase 'acting in concert.'" The Court held, however, that a complete reading of that provision indicated that whether a person is "acting in concert" was relevant only to the proper form of notice required by a stockholder giving advance notice of a meeting proposal or a director nomination. As a result, the events triggering the Company's rights plan remained unchanged from the original rights plan adopted by Vermillion's board of directors.

The Court of Chancery also addressed the cumulative effect of (i) the scheduling of the 2011 annual stockholders meeting, (ii) the advance notice requirements, and (iii) the Company's rights plan. Plaintiff argued "that the record reflects 'a pattern of conduct in which Defendants manipulate[d] Vermillion's corporate machinery to ensure that the incumbent Board and management are perpetuated in office indefinitely....'" The Court disagreed and denied plaintiff's motion for a preliminary injunction.

Void and Voidable Stock Issuances

Keyser v. Curtis, 2012 WL 3115453 (Del. Ch. July 31, 2012).

In a summary proceeding under Section 225 of the Delaware General Corporation Law, the Court of Chancery in *Keyser v. Curtis*, 2012 WL 3115453 (Del. Ch. July 31, 2012), applied the entire fairness test to a sole director's effort to prevent stockholders from electing a new board by issuing a new series of preferred stock with powerful voting rights to himself for one cent per share, held that the issuance was not entirely fair, and determined that the newly issued stock could not be counted in determining whether the plaintiff-stockholders had delivered sufficient written consents to elect a new board.

Plaintiffs Robert D. Keyser, Jr., Frank Salvatore and Scott Schalk sued for a determination that they had been elected as the new board of directors of Ark Financial Services, Inc. ("Ark") by stockholder written consent. Ark contended that one of the plaintiffs, Robert Keyser, was required under a prior settlement agreement to transfer approximately seven million shares of common stock back to Ark, and that Keyser therefore could not give written consents to elect a new board as to those shares. Although the Court determined that Keyser had breached the settlement agreement, the Court declined to order specific performance on the ground that Keyser also had breached an obligation under the same agreement to pay Keyser $50,000. Consequently, the Court held that Keyser was entitled to execute written consents as to the shares, and that the written consents delivered to Ark represented a majority of the outstanding common stock.

Ark also contended that the written consents were insufficient to elect a new board because, approximately a year before the consents were delivered, Albert Poliak, then the CEO and sole director of Ark, had authorized and issued to himself 25,000 shares of a newly created, super-voting Series B preferred stock. Poliak paid $0.01 per share for the Series B stock, but acquired both the right to redeem the stock on demand for $1.00 per share and overwhelming voting power over any matter subject to a vote of Ark's stockholders.

The Court noted that Poliak admitted that the purpose of the Series B issuance was to prevent the election of a new board, which purpose arguably triggered review under the standard set forth in *Blasius Industries Inc. v. Atlas Corp.*, 564 A.2d 651 (Del. Ch. 1988). However, the Court explained that, unlike the directors in *Blasius*, Poliak engaged in a self-dealing transaction. Under Delaware law, self-dealing transactions are subject to review under the more burdensome entire fairness standard.

The defendants argued that because Ark was insolvent at the time of the Series B stock issuance, the shares Poliak received were worthless and thus the penny per share price was fair. The Court rejected this argument, stating that "even if Ark had absolutely no money, it was self-dealing for Poliak to pay $250 for an option to demand $25,000 from Ark in the event it became solvent." The Court continued that "[c]ontrol of an insolvent corporation is worth something because there is always a chance it will become solvent." The Court determined that the issuance was not entirely fair and hence that it was invalid.

Accordingly, the Court affirmed that the plaintiffs constituted Ark's board of directors. The Court declined to award attorneys' fees to the plaintiffs. The Court's decision clarified uncertainty around the composition of Ark's board of directors and the validity of the Series B preferred stock, and thus provided a corporate benefit that could justify awarding the plaintiffs their costs and fees. However, the Court concluded that in bringing the action, Keyser was principally motivated by a desire to benefit himself rather than a desire to benefit Ark.

Johnston v. Pedersen, C.A. No. 6567-VCL (Del. Ch. Sept. 23, 2011).

In *Johnston v. Pedersen*, the Court of Chancery held that the directors of a Delaware corporation violated their duty of loyalty when designing and issuing a new series of preferred stock because those directors intentionally "structure[d] the stock issuance to prevent an insurgent group from waging a successful proxy contest."

In *Johnston*, an action brought pursuant to 8 *Del. C.* § 225, the Court was called on to determine the proper board of directors of Xurex, Inc. ("Xurex" or the "Company"). Xurex is an early stage company which sells protective coatings primarily used in the oil and gas industry. Between 2005 and 2009, Xurex raised over $10 million through the sale of common stock and Series A Preferred Stock. Notably, however, two founders continued to control a majority of the Company's outstanding voting power.

Despite its substantial fundraising, Xurex had never developed a commercial product of its own. Rather, 99 percent of Xurex's sales were to one distributor, DuraSeal Pipe Coatings Company ("DuraSeal"), which had developed unique methods of using Xurex's coatings in the oil and gas industry. As a result of Xurex's lack of commercial success, and following allegations of financial misconduct by one of its founders, the Company underwent several director changes in 2009 and early 2010. The board that was eventually elected in early 2010 was concerned about the Company's financial viability. Also, because of the Company's tumultuous relationship with the founders (who continued to hold a majority of the outstanding shares), the board was concerned that the founders would again support an effort to change the board. The Court found that the board decided to address both of these issues at once through the issuance of a new series of preferred stock.

The board first pursued a bridge loan offering in the spring of 2010. Investors in the bridge loan had the right to convert their bridge loan notes into a planned new preferred stock series at a 50 percent discount to its issue price. Several months later, in August 2010, the board offered the Series B Preferred Stock (the "Series B"). The Series B contained an expansive class voting provision (the "Class Vote Provision") which required the affirmative support of a majority of the Series B for the approval of "any matter that is subject to a vote of the [Company's] stockholders." The Court found that the board had developed the idea of vesting the Series B with a "super vote right" during the bridge loan offering. However, the board only selectively disclosed this information to stockholders whom the directors believed were likely to support the incumbent board in a future control contest. Similarly, even though the defendants argued that the Class Vote Provision was necessary to induce investment in the Series B, the Series B private placement memorandum only contained a brief discussion of the provision on page 29 of the 34-page document. The Court found that the apparent tension between the avowed necessity of the Class Vote Provision and the lack of disclosure was easily resolved: "[T]he directors needed to provide the class vote to induce favored (viz. incumbent-supporting) stockholders to invest. There was no need to call this attractive feature to the attention of other non-favored and potentially non-incumbent-supporting investors."

In April 2011, DuraSeal began soliciting proxies from Xurex stockholders to remove the incumbent directors and elect a new board. On June 14, 2011, five written consents and supporting proxies (the "Written Consents") representing a majority of the outstanding shares of the Company were delivered to the Company and its registered agent. The Written Consents purported to remove the board and elect a new slate of directors. Although the Written Consents represented a majority of the Company's outstanding voting power, they were not supported by a majority of the outstanding shares of the Series B.

Promptly after delivering the Written Consents, the plaintiffs filed suit seeking a determination that the consents were valid and effective. In opposition, the incumbent directors argued that they were not validly removed because the Class Vote Provision of the Series B required that the Written Consents be supported by a majority of the shares of the Series B.

After trial, the Court held that the board issued the Series B in breach of their duty of loyalty. Therefore, the Court would not enforce the Class Vote Provision of the Series B in connection with the removal of the incumbent board and the election of a new board. The Court held that enhanced scrutiny applied because the board's actions in issuing the Series B affected the stockholder franchise. Additionally, because the Class Vote Provision affected the ability of stockholders to vote for directors or determine corporate control, the Court found that the defendant directors must demonstrate a "compelling justification" for their actions in accordance with *Blasius Indus., Inc. v. Atlas Corp.*, 813 A.2d 1113 (Del. Ch. 1988).

The Court held that the record established that the board specifically intended for the Class Vote Provision to prevent the common stock and the Series A Preferred holders from electing a new board. While the Court credited the defendants' position that they honestly believed that the Company would benefit from a period of "stability," the Court noted that "[w]hat the directors actually meant by 'stability' was to prevent themselves from being removed from office, making 'stability' a euphemism for entrenchment." Thus, even though the Court found that the directors in good faith believed that preventing another control dispute would best serve the Company, the Court held that the directors essentially usurped the stockholders' ability to choose the directors of Xurex. The Court stated that the board could not act loyally while depriving stockholders of this right.

Also, the Court noted that even if the board had subjectively intended to include the Class Vote Provision solely to raise capital, it would still be invalid. Two defendants admitted at trial that the Class Vote Provision was broader than necessary to achieve its stated goal (*i.e.*, to entice investment). The Court further noted that the board effectively transferred negative control of Xurex to the Series B holders for too low of a price. For these reasons as well, the defendants were unable to satisfy the compelling justification standard.

Thus, the Court concluded that while the board honestly believed that preventing a change of control was in the best interests of Xurex, their efforts to deprive stockholders of the ability to elect new directors constituted a violation of the duty of loyalty. As such, the Court refused to enforce the Class Vote Provision with respect to the Written Consents.

Blades v. Wisehart, C.A. No. 5317-VCS (Del. Ch. Nov. 17, 2010).

In *Blades v. Wisehart*, the Court of Chancery held that a corporation had not validly effectuated a stock split because it had not complied with the requisite corporate formalities, notwithstanding that the corporation's board and stockholders all had the subjective intent to effectuate the split.

Blades involved a dispute under 8 *Del. C.* § 225 over the proper composition of the board of directors of Global Launch, Incorporated ("Global Launch"). Global Launch was the brainchild of plaintiff Rusty Blades, and was dedicated to pursuing Blades' idea of taking the concept of layaway purchasing to the internet.

When Global Launch was formed, Blades received roughly two-thirds of its 10 million shares of authorized stock. The remaining one-third interest went to The Ohio Company, in exchange for its agreement to provide Global Launch with $500,000 in capital.

Shortly after Global Launch was formed, Blades and The Ohio Company agreed to amend Global Launch's certificate of incorporation by increasing the authorized stock from 10 million to 50 million shares, and to engage in a 1 for 5 forward stock split. The additional stock was intended to be sold to other investors to raise capital, and a portion was intended (by Blades) to become gifts to certain Global Launch employees. Defendant Richard Wetzel, an Ohio attorney who had assisted with Global Launch's formation and who was familiar with Blades and a number of people interested in investing in Global Launch, was tasked with effectuating these transactions. While Wetzel prepared (and the board, Blades and The Ohio Company approved) resolutions authorizing the increase in capital stock and amending Global Launch's certificate of incorporation to reflect this increase, he never prepared a resolution or amended Global Launch's charter to reflect the stock split.

Notwithstanding this failure, all interested parties acted as if the split had taken place. Accordingly, for the next several months, The Ohio Company identified a number of potential investors and the Global Launch board of directors proceeded with plans to issue stock to interested investors. Wetzel was tasked with making investor presentations and materials, and with documenting the transactions once they were completed.

In late 2008, Blades resigned from the Global Launch board and from his position as president of the company due to legal troubles. Shortly thereafter, Wetzel and certain members of the Global Launch board "stepped up a series of purported transfers of Global Launch stock" with little or no notice to Blades. Some transfers went to individuals identified by The Ohio Company, others went to employees Blades had previously identified; but in all instances, Wetzel's cursory attempts to document the transfers "did not accurately or reliably reflect the substance of these transactions."

For the next year, and while these purported transfers were ongoing, Blades claimed that he was "increasingly frozen out" from Global Launch business. Accordingly, in November 2009 Blades convinced an ally on the company's board to notice an annual meeting. At that meeting, the stockholders elected seven new directors for a one-year term. Wetzel briefly attended the meeting, informed the stockholders of his belief that the meeting had been improperly called and would not result in valid stockholder action, and was then escorted out. After the meeting, the new board (among other things) purported to adopt new bylaws, remove all of the current officers, install Blades back in his position as president, and terminate Wetzel's representation of the Company.

Concerned that the annual stockholders meeting had not been properly called, on March 8, 2010 Blades and The Ohio Company executed a unanimous written consent ratifying the actions from the annual meeting.

Blades then initiated this action to confirm the actions taken through the consent.

As all of the purported transfers of stock had relied on the stock split and were intended to be comprised of post-split shares, the Court of Chancery's decision hinged on whether the stock split had validly been effectuated. If the split was invalid, the transfers of post-split shares would be void, and Blades and The Ohio Company would be the only two stockholders of Global Launch.

Blades argued that the split had not validly been effectuated because of the failure to comply with three requirements set forth in the Delaware General Corporation Law to split stock—(i) passage of a board resolution setting forth an amendment to the certificate of incorporation effectuating the split, declaring the advisability of the amendment, and calling for a stockholder vote; (ii) proper notice of the proposed amendment and stockholder meeting; and (iii) if the vote is approved, a certificate of amendment being filed. Defendants argued that the split should be recognized because Blades and The Ohio Company admitted that they supported the concept, and evidence existed suggesting that the board also supported the concept.

The Court of Chancery held that Global Launch's (and Wetzel's) attempts to effectuate the split were ultimate failures. Analogizing to the Delaware Supreme Court's decisions in *Waggoner v. Laster* and *STAAR Surgical Company v. Waggoner* (which involved issuances of stock), the Court held that "the same policy reasons recognized in those cases for requiring scrupulous adherence to corporate formalities are germane to a board's adoption of a stock split because both board actions involve a change in the corporation's capital structure." Thus, notwithstanding that the Court found it "clear from the record" that both the Global Launch board and the two pre-split stockholders subjectively wished to adopt a stock split, the failure to adhere to the requirements of the DGCL in adopting that split was fatal.

Because all of the purported transfers were with post-split shares, those transfers were declared void. Global Launch's only two stockholders—Blades and The Ohio Company—had therefore validly taken action to replace the company's board through the March 8, 2010 written consent.

The Court's opinion concluded with a warning that plaintiffs' victory "may not be the cause for celebration they may have anticipated at the outset of this litigation." Global Launch—a struggling company—and its newly elected board now have to address various claims brought by investors, employees and certain of the defendants regarding the stock transfers that had been declared invalid.[9]

Liability for Usurpation of Corporate Opportunity

Dweck v. Nasser, Consol. C.A. No. 1353-VCL (Del. Ch. Jan. 18, 2012).

In its post-trial opinion, *Dweck v. Nasser*, the Court of Chancery found that officers and directors of children's apparel manufacturer Kids International Corporation ("Kids") breached their fiduciary duties of loyalty to Kids by establishing competing clothing companies that usurped opportunities and converted resources from Kids. In addition, the Court found that an officer who approved expense reimbursements of another officer and director without considering their validity or asking any questions failed to act in the face of a known duty to act, and imposed liability for the improper expenses on a joint and several basis.

In 1993, Gila Dweck and her brother formed Kids with financial assistance from Albert Nasser. By 2001, Dweck owned 30 percent of Kids' stock and was CEO and a director. Nasser held a 50 percent stake in the company and was chairman of the board. As the company proved to be quite profitable, Dweck sought to increase her equity share, but she was rebuffed by Nasser and her brother.

9 While *Blades* makes clear that failure to follow requisite corporate formalities can be fatal to a corporation's efforts to implement a stock split, an even more recent Court of Chancery decision suggests that stock splits are also subject to equitable attack. More specifically, in *Reis v. Hazelett Strip-Casting Corp.,* C.A. No. 3552-VCL (Del. Ch. Jan. 21, 2011), the Court of Chancery held that a reverse stock split implemented at the behest of a controlling stockholder was susceptible to a claim for a breach of the duty of loyalty, that therefore the controlling stockholder bore the burden of demonstrating the entire fairness of the reverse stock split that cashed out minority stockholders, and ultimately awarded plaintiffs monetary damages based on the Court's appraisal-like going-concern analysis of the fair price of the relevant shares.

Convinced that her compensation was inadequate, Dweck formed two competing clothing companies, Success Apparel LLC ("Success"), which she formed with Kids' president Kevin Taxin in October 2001, and Premium Apparel Brands LLC ("Premium"), which she formed in June 2004. Dweck and Taxin channeled business opportunities from Kids to Success and Premium. In addition, they operated Success and Premium out of Kids' facilities and utilized Kids' employees, letters of credit, and vendors. According to the Court, Dweck and Taxin "operated Success and Premium as if the companies were divisions of Kids, but kept the resulting profits for themselves."

Around January 2005, Nasser became concerned about Dweck's management of Kids and attempted to gain more control over the company. Dweck and Taxin subsequently decided to leave Kids in May 2005. Before doing so, Dweck and Taxin diverted orders placed by Wal-Mart and Target from Kids to Success, took boxes of company files, and, with the assistance of Kids CFO David Fine, convinced a number of Kids employees to join Success. Litigation ensued, with Dweck and Nasser each alleging that the other had breached fiduciary duties.

In analyzing the conduct of Dweck and Taxin, the Court applied the corporate opportunity doctrine, which holds that a corporate officer or director may not take a corporate opportunity for his own if: (i) the corporation is financially able to exploit the opportunity; (ii) the opportunity falls within the corporation's line of business; (iii) the corporation has an interest or expectancy in the opportunity; and (iv) the officer or director will be placed in a position inimical to his or her duties to the corporation by exploiting the opportunity. Under this standard, the Court determined that Dweck and Taxin had violated their duty of loyalty to Kids by diverting opportunities to Success and Premium. The fact that Success and Premium utilized Kids' resources and personnel convinced the Court that Kids could have pursued the opportunities in its own name. As a remedy, the Court awarded damages for Kids' lost profits from the founding of Success and Premium through May 2005, as well as profits lost after May 2005 from license agreements signed by Success and Premium while Dweck and Taxin were Kids employees.

In their defense, Dweck and Taxin argued that because Kids had focused on the manufacture of non-branded clothing, they were free to exploit opportunities related to branded clothing. The Court rejected this contention, noting that a corporation's interest in a line of business should be "broadly interpreted." The Court also rejected Dweck's contention that Nasser had consented to her establishing the competing companies. Dweck referenced purported oral communications and pointed to drafts of an agreement among Kids' stockholders that contained a "free-for-all" provision permitting the parties to exploit corporate opportunities that belonged to Kids. Acknowledging that such a provision would raise "complex legal issues," the Court ultimately concluded that it had never become effective because Nasser had never signed or approved the stockholders' agreement or any of its drafts. Finally, Dweck argued that her conduct was justified by a similar "free-for-all" provision in the operating agreement of Essential Childrenswear, a different company formed by Nasser, Dweck, and Dweck's brother. The Court responded that even if the provision applied with regard to Essential Childrenswear, it could not eliminate the duty of loyalty for other entities formed by the same parties.

The Court also concluded that Dweck, Taxin, and Fine had breached their duties of loyalty in May 2005 by diverting orders from Kids to Success, taking boxes of company files, and orchestrating a mass departure of Kids' employees. As Kids failed following these events, Nasser argued that Kids was entitled to damages equal to the company's going concern value in May 2005. Since Dweck and Taxin were not bound by restrictive covenants and, in the Court's opinion, could have captured Kids' core business had they left the company legitimately, the Court awarded damages only for those orders that Dweck and Taxin had diverted from Kids to Success.

In addition, the Court found Dweck liable to Kids for over $300,000 in personal expenses she had billed to the company, including vacations and luxury goods. Finding that Fine had abdicated his responsibilities as CFO by failing to review such expenses before reimbursing Dweck, the Court found Fine jointly and severally liable for the expenses.

Finally, the Court also considered Dweck's claim that Nasser had received improper consulting fees from Kids. Due to Nasser's position as Kids' controlling stockholder, the Court applied the entire fairness standard. Because Nasser had not performed any actual consulting work for Kids, the Court determined that the consulting payments were not fair to Kids and ordered Nasser to return them.

Executive Compensation

Zucker v. Andreessen, 2012 WL 2366448 (Del. Ch. June 21, 2012).

In *Zucker v. Andreessen*, 2012 WL 2366448 (Del. Ch. June 21, 2012), the Court of Chancery applied the heightened pleading burden under Court of Chancery Rule 23.1 and dismissed a derivative complaint for failure properly to allege demand futility.

The derivative plaintiff in *Zucker* challenged the Hewlett-Packard Co. ("HP") board's payment of severance benefits to the company's CEO, Mark Hurd ("Hurd"). The board determined to terminate Hurd after an internal investigation revealed that his conduct had fallen short of HP's standards of business conduct. The board appointed HP's chief financial officer to serve as interim CEO while it worked to locate a permanent replacement. The plaintiff claimed that HP's directors breached their fiduciary duty of care by failing to adopt a long-term succession plan to provide for leadership in the event of Hurd's departure as CEO. In addition, the plaintiff alleged that the severance agreement, which provided Hurd with over $40 million in benefits, constituted a waste of corporate assets.

The derivative plaintiff conceded that HP's directors were independent of Hurd and had no interest in the severance agreement. As a result, in order to avoid dismissal under the standard articulated in *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984), the plaintiff must have alleged "particularized facts that raise a reasonable doubt that the Severance Agreement was the product of a valid exercise of business judgment." The Court explained that this standard was particularly difficult in the context of a waste claim, which requires a showing that the board's decision was so egregious or irrational that it could not have been based on a valid assessment of the corporation's best interests. In reviewing the complaint under this standard, the Court noted that HP received certain consideration in exchange for the severance payments, including, among other things, a release of any claims Hurd may have had against HP, an agreement to extend his confidentiality obligations to HP, and an agreement to assist the company in several areas post-termination. The Court further found that the board's decision to approve the severance agreement may also have benefitted the company in other ways, including by avoiding the costs and negative publicity that could have resulted from a dispute with Hurd. Also, under Delaware law, executive compensation may be based on successful past performance. The complaint failed to allege that Hurd's tenure at HP was not successful; therefore, the severance payment could also have been rational compensation for past performance. For these reasons, the Court found that the complaint failed to include particularized allegations raising a reasonable doubt that the severance agreement was a good faith business judgment.

The Court addressed the board's alleged inaction, *i.e.,* its failure to adopt a succession plan, under the standard stated in *Rales v. Blasband* 634 A.2d 927, 934 (Del. 1993). This standard requires a plaintiff to plead particularized facts that create a reasonable doubt regarding whether the board could have exercised its independent and disinterested business judgment when responding to a stockholder demand.

The Court noted that unless the alleged failure to have an appropriate succession plan in place represented a bad faith breach of the directors' duties, the HP directors would not be deemed to suffer a disabling likelihood of personal liability. The Court concluded that directors are not under a *per se* obligation to implement a succession plan, and hence the HP directors could not have consciously disregarded a known duty. Thus, because the plaintiff failed to allege demand futility adequately under either *Aronson* or *Rales*, the amended complaint was dismissed. ■

Controlling Stockholder Issues

In re Synthes, Inc. Shareholder Litigation, 2012 WL 3594293 (Del. Ch. Aug. 17, 2012).

In *In re Synthes, Inc. Shareholder Litigation*, 2012 WL 3594293 (Del. Ch. Aug. 17, 2012), the Court of Chancery dismissed an amended class action complaint alleging that Synthes, Inc.'s ("Synthes") chairman and controlling shareholder Hansjoerg Wyss ("Wyss") and its board of directors (the "Board") breached their fiduciary duties by approving a merger with Johnson & Johnson ("J&J"). Significantly, the Court rejected the plaintiffs' claim that Wyss had conflicts of interest with the minority stockholders that required application of the entire fairness standard, holding that the business judgment rule applied because Wyss would receive *pro rata* treatment with the minority stockholders.

Synthes was a global medical device company headquartered in Switzerland. Wyss owned approximately 38.5% of the company's outstanding stock. The plaintiffs alleged that Wyss also beneficially controlled 52% of Synthes's stock held by family members and trusts. In April 2010, the Board approached Wyss regarding a potential sale of the company, appointed an independent director to lead the sale process, and retained Credit Suisse as its financial advisor. Three of the nine strategic buyers contacted by the Board, including J&J, executed confidentiality agreements and began due diligence. The Board also approached six private equity firms, four of which executed confidentiality agreements and received due diligence.

In December 2010, three of the potential financial buyers submitted separate non-binding indications of interest to acquire Synthes at ranges up to CHF (Swiss franc) 150 per share in cash. J&J submitted its first non-binding offer of CHF 145-150 per share, with more than 60% of the consideration to be paid in J&J stock. The private equity buyers sought, and were granted, permission to join together to attempt to secure sufficient financial resources. By February 2011, the private equity consortium offered a firm CHF 151 per share, conditioned on Wyss converting a substantial portion of his equity investment in Synthes into an equity investment in the post-transaction company. Having considered these offers, the Board negotiated with J&J to seek a higher price, and ultimately J&J increased its offer to CHF 159 per share—composed of 65% stock (subject to a collar) and 35% cash. Notably, under J&J's proposal, Wyss was to receive only his *pro rata* share of the transaction proceeds. Then the Board and J&J negotiated a merger agreement containing several deal protection provisions, including a no-shop clause with a fiduciary out, a force-the-vote provision, matching rights and a termination fee of 3.05%. Wyss, together with family members and family trusts, agreed to vote approximately 37% of the company's stock in favor of the transaction.

The parties announced the $21.3 billion acquisition of Synthes by J&J on April 26, 2011. The deal represented a 26% premium to Synthes's 30-day trading price (the "Merger"). The plaintiffs filed suit alleging breach of fiduciary duty claims against Wyss and the Board. The plaintiffs argued that the Merger was subject to entire fairness review because Wyss had financial motives adverse to the best interests of Synthes's stockholders and was supposedly anxious to sell his equity stake rapidly to facilitate his own exit. The plaintiffs further alleged that the Merger was subject to enhanced scrutiny under *Revlon* because it was an "end stage" transaction. The Court rejected the plaintiff's claims and dismissed the complaint with prejudice.

The Court rejected a review under entire fairness, holding that the business judgment rule applies to a merger resulting from an open and deliberative sale process when a controlling stockholder shares the control premium ratably with the minority stockholders. Because a large stockholder's interests are generally aligned with the minority's interest in obtaining the highest price reasonably available, the Court observed that "there is a good deal of utility to making sure that when controlling stockholders afford the minority *pro rata* treatment, they know that they have docked within the safe harbor created by the business judgment rule." Thus, the Court held that the plaintiffs failed to plead facts to suggest that Wyss forced a fire sale of the company in order to satisfy some urgent need for liquidity or that he was in any particular rush to sell his stake in Synthes. Rather, the plaintiffs' arguments ran contrary to the facts pled about the strategic process that the Board pursued. The Court also rejected the plaintiffs' claim that they were unfairly deprived of the chance to sell all of their shares for cash because Wyss refused to support a deal that would require him to remain a substantial investor in the post-transaction entity. The Court stated that the plaintiffs' argument was "astonishing" and reflected "a misguided view of the duties of a controlling stockholder under Delaware law." That is, Delaware law does not impose on controlling stockholders a duty to engage in self-sacrifice for the benefit of the minority stockholders.

The Court also rejected the plaintiffs' *Revlon* and *Unocal* claims. The plaintiffs argued that the Merger was subject to *Revlon*'s enhanced scrutiny because Synthes's stockholders received mixed consideration of 65% J&J stock and 35% cash. Relying on Delaware Supreme Court precedent, the Court held that a change of control for purposes of *Revlon* does not occur where control of the corporation post-merger is in a large, fluid market. Here, J&J's stock is widely held. Lastly, the Court dismissed the plaintiffs' challenge to the deal protection measures under *Unocal*. The Court concluded that the plaintiffs made no attempt to show how the deal protections would have unreasonably precluded the emergence of a genuine topping bidder willing to make a materially higher bid.

In re Delphi Financial Group Shareholder Litigation, Consol. C.A. No. 7144-VCG (Del. Ch. Mar. 6, 2012).

In *In re Delphi Financial Group Shareholder Litigation*, the Court of Chancery declined to enjoin Tokio Marine Holdings, Inc.'s proposed takeover of Delphi Financial Group. The Court found that the plaintiffs had demonstrated a likelihood of success on the merits with respect to their allegations against Delphi's founder and controlling stockholder, Robert Rosenkranz, but it found that the balance of the equities weighed against an injunction because the deal was a large premium to market, damages were available as a remedy, and no other potential purchaser had emerged.

Delphi had two classes of common stock: Class A, with one vote per share, and Class B, with ten votes per share. Rosenkranz and his affiliates owned all of the Class B and some of the Class A, but Rosenkranz's voting power was capped at 49.9% under Delphi's certificate of incorporation and a voting agreement. Delphi's certificate of incorporation prohibited disparate treatment between the Class A and Class B in a merger. The Court noted that these provisions were in place at the time of Delphi's initial public offering and that, while they preserved Rosenkranz's voting power, they limited his ability to realize additional benefits through his ownership of Class B shares.

Tokio Marine approached Delphi with a takeover proposal, and Rosenkranz negotiated on Delphi's behalf. Rosenkranz later indicated to the Delphi board that he was a seller, but only if he obtained a control premium for his stake. The board formed a special committee to negotiate the proposed transaction with Tokio Marine, and the special committee, in turn, formed a sub-committee to negotiate the "price differential" with Rosenkranz. Ultimately, the parties settled on a transaction in which the Class A would receive approximately $45 per share (representing a 76% premium to market), while Rosenkranz would receive approximately $54 per share for his Class B shares. The transaction was conditioned on a non-waivable vote of a majority of the disinterested Class A stockholders as well as on an amendment to Delphi's certificate of incorporation allowing Rosenkranz to receive a control premium.

Although the Court stated that a controlling stockholder is entitled to negotiate for a control premium, it found that, in this case and at the preliminary injunction stage, the prohibition in Delphi's post-IPO certificate of incorporation on disparate merger consideration reflected that Rosenkranz had already received a control premium in connection with the sale of Class A shares, which enabled him to exercise voting control despite retaining only 12.9% of Delphi's equity. Presumably, the Court noted, the Class A shares were priced to reflect Rosenkranz's inability to receive an additional control premium in the event of a merger. While noting that Rosenkranz could have negotiated to amend the certificate of incorporation on a clear day, the Court suggested that Rosenkranz's attempt to "coerce such an amendment" by tying it to the merger proposal rendered the existing provisions "illusory." Ultimately, the Court found that the plaintiffs were reasonably likely to demonstrate at trial that Rosenkranz breached his fiduciary duties in "negotiating for disparate consideration and only agreeing to support the merger if he received it." Thus, although it did not enjoin the transaction, the Court indicated that it could remedy this potential breach by ordering disgorgement of the improper consideration.

In re John Q. Hammons Hotels Inc. S'holder Litig., C.A. No. 758-CC (Del. Ch. Jan. 14, 2011).

In *In re John Q. Hammons Hotels Inc. S'holder Litig.*, the Court of Chancery applied the entire fairness standard to review the September 2005 merger of John Q. Hammons Hotels, Inc. ("JQH") with and into an acquisition vehicle indirectly owned by Jonathan Eilian. The Court's holding was significant because it applied the entire fairness standard of review to a merger involving a third-party purchase of a corporation that had a controlling stockholder, even though the Court held that the controlling stockholder was not "on both sides" of the transaction and that *Kahn v. Lynch*[10] did not apply to the transaction.

In early 2004, John Q. Hammons, who owned roughly 76% of the total vote of JQH through his ownership of 5% of JQH's Class A common stock and all of the nonpublic Class B common stock, told the JQH board that he was considering selling JQH (or his interest in JQH) to a third party. In October 2004, Barceló Crestline Corporation ("Barceló") informed the JQH board that it was offering $13 per share to acquire all of JQH's Class A stock. Soon after the Barceló transaction was announced, the JQH board formed a special committee of independent and disinterested directors to evaluate and negotiate proposed transactions on behalf of the unaffiliated stockholders and to make a recommendation to the board. The special committee retained Lehman Brothers as its financial advisor.

In December 2004, Jonathan Eilian submitted a proposal to the special committee, and the special committee rejected Barceló's original $13-per-share offer after Lehman Brothers advised the special committee that, based on its preliminary evaluation, the offer was inadequate, from a financial point of view, for the minority stockholders. Barceló and Eilian submitted revised proposals, and in January 2005 Eilian offered to take JQH private and acquire all outstanding Class A common stock for $24 per share.

Over the next few months, the terms of a transaction were negotiated with Eilian. The special committee negotiated with Eilian on behalf of the minority stockholders, and Hammons negotiated with Eilian on his own behalf. In June 2005, Lehman provided the special committee with a fairness opinion that the $24-per-share price for the JQH minority stockholders was fair from a financial point of view. Hammons had negotiated several side agreements with Eilian for his Class B stock, and Lehman calculated the value of Hammons's consideration to be between $11.95 and $14.74 per share. Lehman also advised the special committee of its opinion that the allocation of the consideration between Hammons and the minority stockholders was reasonable. Based on the special committee's recommendation, the JQH board (after Hammons recused himself) voted to approve the merger agreement and the agreements between Hammons and Eilian.

Pursuant to the merger agreement, each share of Class A common stock was converted into the right to receive $24 per share in cash. The merger was contingent on approval by a majority of the unaffiliated Class A stockholders. Although this condition was waivable by the special committee, the special committee never waived it. In addition to the merger agreement, Hammons entered into a number of other agreements with Eilian designed to provide Hammons the ability to continue developing hotels without triggering tax liability. Hammons's Class B shares were eventually converted into a preferred interest in the surviving limited partnership, in which he was allocated a 2% interest in the cash-flow distributions and preferred equity. Hammons was also provided with other rights and obligations, including a $25 million short-term line of credit and a $275 million long-term line of credit. At a special meeting of stockholders on September 15, 2005, over 72% of the issued and outstanding shares of Class A stock voted to approve the merger.

Plaintiffs brought a class action alleging, *inter alia*, breach of fiduciary duties against Hammons as controlling stockholder for negotiating benefits for himself that were not shared with the minority stockholders and against the JQH directors for deficient process in negotiating the merger and for approving the merger. All defendants filed motions for summary judgment, and plaintiffs filed a cross-motion for partial summary judgment, leaving only the issue of fair price for trial. The Court granted defendants' motions in part (related to one of plaintiffs' disclosure claims) and otherwise denied all parties' motions, holding that entire fairness was the appropriate standard of review.

10 *Kahn v. Lynch Commc'n Sys., Inc.*, 638 A.2d 1110 (Del. 1994).

At the outset, the Court held that the merger did not fall under the *Kahn v. Lynch* line of cases. Even though Hammons retained a minor stake in the surviving entity, the Court noted that a third party had made the offer to the minority stockholders and held that Hammons was not "on both sides" of the transaction.

Nevertheless, the Court held that entire fairness applied. Because Hammons was in a sense "competing" with the minority stockholders for the merger consideration, the Court held that business judgment review would only apply if the transaction were (i) recommended by a disinterested and independent special committee *and* (ii) approved by stockholders in a non-waivable vote of the majority of all the minority stockholders.

The Court then held that defendants had not met the two procedural requirements. Even though plaintiffs had conceded that the special committee was independent and disinterested, the Court left open for further factual development that the special committee had been "coerced" because Hammons's controlling position and alleged self-dealing conduct depressed the pre-transaction value of JQH's shares. Furthermore, the merger's majority-of-the-minority condition was waivable and was based only on those voting (and not all minority stockholders), so the Court held that entire fairness applied—even though the condition was not waived and even though a majority of all minority stockholders did approve the transaction. The Court also left open for future resolution plaintiffs' challenge of Lehman's opinion regarding the consideration Hammons received; therefore, the Court refused to find that Hammons had made a showing of fair price.

Following trial, on January 14, 2011, the Court of Chancery ruled in favor of defendants, finding that the merger price was fair value, that controlling stockholder John Q. Hammons did not breach his fiduciary duties, and that the third-party acquirers did not aid and abet a (nonexistent) fiduciary duty breach. In its post-trial opinion, the Court noted that defendants "may actually have been entitled to business judgment rule protection," but it analyzed the transaction under the entire fairness standard and found the process and the price to be fair. The Court found that Mr. Hammons did not breach any fiduciary duties, particularly as he took less per-share consideration than the minority stockholders received. Finally, because no fiduciary duties had been breached, the Court rejected the claim against the acquirers for aiding and abetting.

In re CNX Gas Corp. S'holders Litig., C.A. No. 5377-VCL (Del. Ch. May 25, 2010).

In *In re CNX Gas Corp. Shareholders Litigation*, the Delaware Chancery Court attempted to clarify the standard applicable to controlling stockholder tender offers and mergers. In a challenge to a controlling stockholder's proposed freeze-out transaction (a first-step tender offer followed by a second-step short-form merger), the Court applied a standard derived from *In re Cox Communications, Inc. Shareholders Litigation* to hold that the presumption of the business judgment rule would apply to a controlling stockholder freeze-out only if the first-step tender offer is both (i) negotiated and recommended by a special committee of independent directors and (ii) conditioned on a majority-of-the-minority tender or vote (as the case may be) condition. The Court held that, because CNX's special committee did not make a recommendation in favor of the tender offer, the transaction would be reviewed under the entire fairness standard. While that fact, under the Court's analysis, was sufficient to trigger the application of the entire fairness standard, the Court also noted that the special committee was not provided with the authority to bargain with the controller on an arm's-length basis and that the majority-of-the-minority tender condition may have been ineffective. Nonetheless, the Court declined to issue an injunction since any harm to the stockholders could be remedied through post-closing money damages.

In 2005, CONSOL formed CNX to conduct its natural gas operations, and CONSOL's board approved a public offering of less than 20 percent of CNX's stock. A few years later, CONSOL sought to acquire all of CNX's publicly held stock. In March 2010, CONSOL entered into (and publicly announced) an agreement with T. Rowe Price, the holder of 37 percent of CNX's public float, in which T. Rowe Price agreed to tender its shares to CONSOL in a public tender offer. CNX's board then formed a special committee, consisting of CNX's sole independent director, to evaluate CONSOL's tender offer. But the special committee's authority was limited; it was authorized only to evaluate the tender offer, to prepare a Schedule 14D-9 and to engage legal and financial advisors. It was not authorized to negotiate the terms of the tender offer or to consider alternatives.

On April 28, 2010, CONSOL launched its public tender offer with a price of $38.25 per share, committing to effect a short-form merger at the same price. The tender offer was subject to a non-waivable majority-of-the-minority condition. Even though the special committee was not expressly authorized to negotiate the offer, it sought a price increase, indicating that it could not recommend the offer at $38.25, but likely could recommend an offer at $41.20. CONSOL declined to increase the price. In May 2010, the special committee issued a Schedule 14D-9 in which it remained neutral on the tender offer, citing concerns about the determination of the price and CONSOL's unwillingness to negotiate over price.

Because plaintiffs argued that the tender offer should be reviewed for entire fairness, the Court stated it was required to "weigh in on a critical and much debated issue of Delaware law: the appropriate standard of review for a controlling stockholder freeze-out." The Court noted that a negotiated merger between a controlling stockholder and its subsidiary is subject to entire fairness review under the Delaware Supreme Court's holding in *Kahn v. Lynch Communication Systems, Inc.* But, the Court stated, under *In re Siliconix*, a controlling stockholder tender followed by a short-form merger is reviewed under "an evolving standard far less onerous than *Lynch*." The Court then noted the previous efforts in *In re Pure Resources* to harmonize these cases and to set forth three elements for determining whether a controlling stockholder tender offer should be viewed as non-coercive (*i.e.*, whether it is subject to a non-waivable majority-of-the-minority tender condition, whether the controller commits to consummate a short-form merger at the same price, and whether the controller has made no retributive threats). The Court suggested that this standard was effectively revised in *Cox Communications*, indicating that *Cox* stands for the proposition that "if a freeze-out merger is both (i) negotiated and approved by a special committee of independent directors and (ii) conditioned on an affirmative vote of a majority of the minority stockholders, then the business judgment rule presumptively applies." (Notably, the Court in *Cox* essentially indicated that applying its proposed standard in a negotiated merger context would require overturning the Delaware Supreme Court's holding in *Kahn v. Lynch*). If either requirement is not met, the Court stated, then the transaction must be reviewed for entire fairness.

The Court applied *Cox*'s requirements to controlling stockholder tender offers as well (amending the test slightly to require that the special committee affirmatively recommend the transaction), and found that CONSOL's tender offer failed to meet these requirements. Most important, the special committee did not recommend the transaction, nor was it authorized to negotiate the transaction or consider alternatives. The Court stated that an effective special committee must be "provided with authority comparable to what a board would possess in a third-party transaction," including (contrary to the holding in *Pure Resources*) potentially adopting a poison pill. Next, the Court found that the involvement of T. Rowe Price "undercut the effectiveness of the majority-of-the-minority tender condition." Citing to the Delaware Supreme Court's recent opinion in *Crown EMAK Partners, LLC v. Kurz*, which addressed the validity of so-called third-party vote buying arrangements, the Court noted that economic incentives should be taken into account when determining the "effectiveness of a legitimizing mechanism like a majority-of-the-minority tender condition or a stockholder vote." In this case, the Court expressed concern that T. Rowe Price's interests were potentially in conflict with those of the public stockholders. Due to its 6.5 percent ownership stake in CONSOL, the Court stated, T. Rowe Price was either "indifferent to the allocation of value between CONSOL and CNX" or had an incentive to favor CONSOL.

Finally, the Court noted that, if it had evaluated the tender offer under *Pure Resources*, the structural problems with the tender offer—the defects in the tender condition and the limitations on the special committee's authority—likely would have counseled in favor of an injunction. Because the Court applied its "*Cox Communications* unified standard," however, there was no need to enjoin the transaction. The transaction was an all-cash deal to which no alternative had been identified. Here, given the lack of any evidence casting doubt on CONSOL's ability to satisfy a money judgment, the remedy of post-trial money damages would be sufficient. ■

2012 Amendments to the General Corporation Law

2012 Amendments

(Effective August 1, 2012 or August 1, 2013)

Legislation amending the DGCL was adopted by the Delaware General Assembly and was signed by the Governor of the State of Delaware on June 29, 2012. Most of the amendments to the DGCL became effective on August 1, 2012, while the remaining amendments will become effective on August 1, 2013. The DGCL amendments are designed to keep Delaware law current and address issues raised by practitioners, the judiciary and legislators with respect to the current language or interpretation of the DGCL.

Section 254 (Merger or consolidation of domestic corporation and joint-stock corporation or other association); Section 263 (Merger or consolidation of domestic corporations and partnerships); Section 265 (Conversion of other entities to a domestic corporation); and Section 267 (Merger of parent entity and subsidiary corporation or corporations)
Section 254(d)(1) of the DGCL has been amended to provide that a certificate of merger effecting the merger of a domestic corporation and a joint-stock corporation or other association must now state the type of entity of each of the constituent entities to the merger. Section 263(c)(1), which governs the merger of a domestic corporation and a partnership, has been amended to require that the certificate of merger state the type of entity of each of the constituent entities to the merger. Section 265(c)(2) has been amended to require that a certificate of conversion effecting a conversion of another entity to a domestic corporation state the type of entity of the other entity converting to a domestic corporation. Section 267, which governs short-form mergers involving a parent entity other than a corporation, also has been amended to require that the certificate of ownership and merger provide the type of entity of each constituent entity to the merger.

Section 311 (Revocation of voluntary dissolution)
Section 311 of the DGCL, which governs the revocation of a voluntary dissolution by a Delaware corporation, has been amended to require that the certificate of revocation of dissolution include the address of the corporation's registered office in the State of Delaware and the name of its registered agent at such address.

Section 312 (Renewal, revival, extension and restoration of certificate of incorporation)
Section 312 of the DGCL sets forth the requirements for a Delaware corporation to renew or revive its existence. Section 312(d)(2) has been amended to clarify that the address of the registered office which must be stated in the certificate of renewal or revival must be stated in accordance with Section 131(c) of the DGCL.

Section 377 (Change of registered agent)
Section 377 of the DGCL addresses how a foreign corporation registered to do business in the State of Delaware may change its registered agent. Sections 377(a) and 377(b) have been amended to clarify the types of entities that may serve as registered agents for foreign corporations registered to do business in the State of Delaware. Section 377(a) now refers to Section 371(b)(2)(i) of the DGCL, which provides that the registered agent may be the foreign corporation itself, an individual resident in the State of Delaware, a domestic corporation, a domestic partnership (whether general (including a limited liability partnership) or limited (including a limited liability limited partnership)), a domestic limited liability company, a domestic statutory trust, a foreign corporation (other than the foreign corporation itself), a foreign partnership (whether general (including a limited liability partnership) or limited (including a limited liability limited partnership)), a foreign limited liability company or a foreign statutory trust. Section 377(b) has been amended to change the reference from "corporation" to "entity."

Section 377 also was amended to add a new requirement for the reinstatement of a foreign corporation when such foreign corporation has been forfeited for failure to appoint a registered agent. New subsections (d) and (e) were added to Section 377 to provide that a foreign corporation whose qualification to do business has been forfeited may be reinstated if it files a certificate of reinstatement setting forth the name of the foreign corporation, the effective date of the forfeiture, and the name and address of the foreign corporation's registered agent. Upon the filing of the certificate of reinstatement, the qualification of the foreign corporation to do business in the State of Delaware is reinstated with the same force and effect as if it had not been forfeited.

Section 381 (Withdrawal of foreign corporation from State; procedure; service of process on Secretary of State)
Section 381 of the DGCL, which addresses the withdrawal of a foreign corporation from the State of Delaware, has been amended to eliminate the option of filing a certificate of dissolution issued by the proper official of the other jurisdiction as a means to effect such a withdrawal. As amended, a foreign corporation must file a certificate of withdrawal to withdraw from the State of Delaware. Section 381 also has been amended to remove the requirement that the Secretary of State of the State of Delaware (the "Secretary of State") issue a certificate of withdrawal to the agent of the withdrawing corporation, which conforms the DGCL to the Secretary of State practice of only providing such certificate to the withdrawing corporation.

Section 390 (Transfer, domestication or continuance of domestic corporations)
Section 390 of the DGCL permits a Delaware corporation to transfer to a foreign jurisdiction. In connection with a transfer, a Delaware corporation files with the Secretary of State a certificate of transfer which must state, among other things, the address to which service of process may be sent to the corporation that has transferred out of the State of Delaware. Section 390(b)(5) has been amended to provide that such address cannot be the address of the corporation's registered agent without the written consent of such registered agent, which consent must be filed with the certificate of transfer.

Section 391 (Amounts payable to Secretary of State upon filing certificate or other paper)
Section 391 of the DGCL, which sets forth the amounts payable to the Secretary of State in connection with the filing of certificates and other documents, has been amended to clarify that charges assessed by the Secretary of State pursuant to Section 391 are not taxes. In addition, Section 391 was amended to set forth the fee for filing a certificate of reinstatement of a foreign corporation.

Effective Date
Except for the amendments to Section 377 of the DGCL adding subsections (d) and (e), all of the foregoing amendments to the DGCL became effective on August 1, 2012. The addition of subsections (d) and (e) to Section 377 of the DGCL will become effective on August 1, 2013. ■

This publication is provided as a service to clients and other friends of Richards, Layton & Finger. It discusses legal developments and should not be regarded as legal advice for specific situations. Although Richards Layton acted as counsel in some of the cases discussed herein, the views expressed do not necessarily represent views of the firm or its clients.

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