RICHARDS LAYTON & FINGER

RECENT DEVELOPMENTS IN DELAWARE LAW

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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 recent corporate and alternative entity cases and statutory developments in Delaware. This publication continues our long tradition of providing insight into the development of Delaware 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 and alternative entities teams, 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 publication, and have handled, as Delaware counsel, the most merger and acquisition transactions valued at $100 million or more for 13 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 we look forward to helping you whenever a need may arise.

—Richards, Layton & Finger

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Recent Decisions of Delaware Courts

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 business law. These materials also highlight recent amendments to the Delaware General Corporation Law and the laws regulating Delaware Alternative Entities.

Recent Decisions of Delaware Courts (continued)

2013 Amendments to Delaware Law

Recent Decisions of Delaware Courts

BUSINESS COMBINATIONS

Breach of Fiduciary Duty

In re Rural Metro Corporation Stockholders Litigation, C.A. No. 6350-VCL (Del. Ch. Mar. 7, 2014).

In a 91-page post-trial opinion in *In re Rural Metro Corporation Stockholders Litigation,* the Delaware Court of Chancery held RBC Capital Markets, LLC liable for aiding and abetting breaches of fiduciary duty by the board of directors of Rural/Metro Corporation in connection with Rural's acquisition by Warburg Pincus LLC. The case proceeded against RBC even though Rural's directors, as well as Moelis & Company LLC, which had served as financial advisor in a secondary role, had settled before trial.

The Court found that RBC, in negotiating the transaction on behalf of Rural, had succumbed to multiple conflicts of interest. According to the Court, RBC, motivated by its contingent fee and its undisclosed desire and efforts to secure the lucrative buy-side financing work, prepared valuation materials for Rural's board that made Warburg's offer appear more favorable than it was. Because those valuation materials were included in Rural's proxy statement, the Court found that RBC was also liable for aiding and abetting the board's breach of its duty of disclosure.

In addition, the Court found that RBC had failed to provide interim valuation materials to Rural's board or its special committee, and that the directors failed in their duty to be sufficiently informed to allow them to make a decision that the sale of the company would exceed "what the corporation otherwise would generate for stockholders over the long-term." Lacking valuation information until the 11th hour, the directors "did not have a reasonably adequate understanding of the alternatives available to Rural, including the value of not engaging in a transaction at all."

The Court also stressed that directors must maintain an "active and direct role" in the sale process "from beginning to end." Where the financial advisor that was ultimately selected from among those interviewed had indicated at the outset that it would seek to provide stapled financing to potential buyers, Rural's special committee was seen as failing to discharge its duty by failing to provide "guidance about when staple financing discussions should start or cease," failing to make "inquiries on that subject," and failing to impose a "practical check on [the investment bank's] interest in maximizing its fees."

Finally, the Court found that the potential for aiding and abetting liability for investment banks, which it characterized as "gatekeepers," would "create[] a powerful financial reason for the banks to provide meaningful fairness opinions and to advise boards in a manner that helps ensure that the directors carry out their fiduciary duties when exploring strategic alternatives and conducting a sale process, rather than in a manner that falls short of established fiduciary norms."

Despite its finding of liability, the Court stated that it is not yet in a position to determine an appropriate remedy. The Court also deferred ruling on plaintiffs' request for fee-shifting, but it noted that, "given the magnitude of the conflict between RBC's claims and the evidence, it seems possible that the facts could support a bad faith fee award."

In re BioClinica, Inc. Shareholder Litigation, 2013 WL 5631233 (Del. Ch. Oct. 16, 2013).

In *In re BioClinica, Inc. Shareholder Litigation*, Vice Chancellor Glasscock of the Delaware Court of Chancery held that plaintiffs' amended complaint failed to state a claim against the directors of BioClinica, Inc. ("BioClinica") for breaches of fiduciary duty and against JLL Partners, Inc., BioCore Holdings, Inc. and BC Acquisition Corp. (collectively, "JLL") for aiding and abetting.

In May 2012, the board of directors of BioClinica formed a special committee to explore a sale of the company. During an eight-month process, the financial advisor of the special committee, EP Securities LLC ("Excel"), reached out to 21 potential bidders, and the special committee entered into non-disclosure agreements with 15. Initially, the special committee decided to approach only financial sponsors in an effort to avoid disclosing certain confidential information to competitors, but it later approached potential strategic buyers. JLL initially declined to make a bid, but later expressed an interest at $7.00 to $7.25 per share. Then, after the only other serious potential buyer (a strategic buyer) decided not to make a final bid, the special committee agreed, at JLL's request, to grant exclusivity to JLL, so long as its final offer would be at least $7.25 per share.

Near the end of this process, BioClinica's projected capital expenditures increased to $11.9 million for 2013 from an earlier estimate of $6-8 million. In light of the change, JLL raised concerns about offering $7.25 per share. Nonetheless, on January 29, 2013, the board of directors of BioClinica approved a transaction with JLL, structured as a tender offer, at a price of $7.25 per share in cash, which represented a 23.2 percent premium over the stock's average closing price for the previous 90 days. The merger agreement contained several deal protection devices, including a no-solicitation provision, a $6.5 million termination fee, information rights and a top-up option.

Several stockholders of BioClinica sued to enjoin the transaction. In February 2013, Vice Chancellor Glasscock denied plaintiffs' motion to expedite proceedings for failure to state a colorable claim, thus foreclosing their attempt to enjoin the deal. The following month the transaction closed, and thereafter, plaintiffs amended their complaint in an effort to plead a non-exculpated claim for damages.

In considering a motion to dismiss the amended complaint, the Court rejected plaintiffs' argument that the vesting of stock options meant the directors had a self-interest in the transaction, and noted that Delaware courts have consistently held that stock ownership aligns the interests of directors and stockholders. The Court further found that allegations regarding the claimed interestedness of two of the directors were insufficient because those directors were not on the special committee and they were not alleged to dominate or control the members of that committee.

The Court also rejected the claim that the directors breached the duty of loyalty by failing to act in good faith. The Court found that "without a story of why the directors would artificially inflate expenditures," such an allegation was "purely conclusory."

Similarly, plaintiffs failed to allege facts showing that the directors failed to satisfy their *Revlon* duties in a non-exculpated manner because plaintiffs failed to show that the board of directors "knowingly and completely failed to satisfy those duties." The board's strategy to approach financial sponsors before strategic buyers was a reasonable way of protecting BioClinica's confidential information, especially where strategic buyers were later brought into the process. Moreover, the Court distinguished the case from *Koehler v. NetSpend Holdings, Inc.*, 2013 WL 2181518 (Del. Ch. May 21, 2013), where the Court held that directors were reasonably likely to be found to have breached their fiduciary duties in part because of their reliance on a "weak" fairness opinion. The Court noted that, unlike in *NetSpend*—where there was no market check, potential bidders were subject to a don't-ask-don't-waive provision, and plaintiff sought injunctive relief such that breaches of the duty of care could support viable claims—the board of directors of BioClinica employed a full market check, the board did not agree to don't-ask-don't-waive provisions, and plaintiffs were reduced to seeking post-closing money damages. The Court, in response to plaintiffs' allegations that the board of directors of BioClinica relied on a weak fairness opinion, clarified *NetSpend* by noting that "[t]he board's reliance on a 'weak' fairness opinion is relevant where the fairness opinion provides *the only equivalent of a market check*," and that a purportedly weak fairness opinion "does not create a new basis to challenge every sales process."

Addressing the disclosure claims, the Court explained that for plaintiffs to recover more than nominal damages on the post-merger claims, they must demonstrate both that the non-disclosures involved a breach of the duty of good faith and causation, *i.e.*, that the vote necessary to approve the merger would not have been obtained had the alleged undisclosed information been disclosed. Relying on its findings in the earlier opinion on the motion to expedite, the Court held that plaintiffs did not plead sufficient facts demonstrating that the failure to disclose why capital expenditure forecasts were adjusted upward or to disclose certain inputs in Excel's fairness opinion constituted material omissions supporting a finding of bad faith.

Moreover, the Court rejected the claim that the board of directors of BioClinica should have disclosed whether the non-disclosure agreements signed by potential bidders contained don't-ask-don't-waive provisions because plaintiffs had not alleged that they did contain such provisions, and "no disclosure could, or should attempt to, describe all clauses not included in NDAs."

The Court also dismissed plaintiffs' challenge to the combination of deal protection devices, including a no-solicitation provision, a selective poison pill exception, a reasonable termination fee, information rights and a top-up option.

Finally, the Court rejected plaintiffs' aiding and abetting claims against JLL on the grounds that plaintiffs had not pleaded either a predicate breach of the duty of loyalty or knowing participation in a breach of the duty of care.

In re Trados Shareholders Litigation, Consol. C.A. No. 1512-VCL (Del. Ch. Aug. 16, 2013).

In a 115-page post-trial opinion in *In re Trados Inc. Shareholder Litigation*, the Court of Chancery found entirely fair the decision to approve a merger in which common stockholders received no consideration.

In 2000, TRADOS Inc. ("Trados") obtained venture capital to support a growth strategy intended to lead to an initial public offering. The venture capital firms received preferred stock and placed representatives on the Trados board of directors.

In July 2005, Trados was acquired by SDL plc for $60 million in cash and stock. The preferred stockholders received $52.2 million of that amount in their liquidation preference, and management received $7.8 million as part of an existing management incentive plan. The common stockholders received no merger consideration. Plaintiff, a common stockholder, sought appraisal and sued the Trados directors for breach of fiduciary duties. In 2009, then-Chancellor Chandler denied in part a motion to dismiss, ruling that the plaintiff had sufficiently alleged that the venture firms' directors were interested in the decision to pursue the merger.

The Court reviewed the transaction for entire fairness and found that, although the process was not fair, the decision to approve the merger was entirely fair because the common stock had no economic value before the merger and its appraised value was zero. The Court also ordered the parties to enter into a schedule for briefing the issue of attorneys' fees.

Koehler v. NetSpend Holdings, Inc., 2013 WL 2181518 (Del. Ch. May 21, 2013).

In *Koehler v. NetSpend Holdings, Inc.*, Vice Chancellor Glasscock of the Court of Chancery denied plaintiff's motion for preliminary injunction despite finding that a majority independent and disinterested board of directors likely breached its fiduciary duties by approving a $1.4 billion merger with a third party. The Court concluded that the defendant directors did not act reasonably to maximize stockholder value by pursuing a single-bidder negotiating strategy, agreeing to certain deal protection devices, including a no-solicitation provision, and agreeing not to waive don't-ask-don't-waive standstill provisions that barred potential offers from previously interested bidders. The Court, however, determined that the balance of equities weighed against the issuance of an injunction in the instance of a premium transaction with no alternative bidder.

NetSpend was a public company that provided prepaid debit cards and financial services to consumers who do not have traditional bank accounts. Since 2007, NetSpend's board of directors had engaged in serious negotiations toward strategic transactions, only to have them fall apart before consummation. Because these transactions caused significant disruption to NetSpend's business, the directors were wary of engaging in an extensive process of selling the company. When Total System Services, Inc. ("Total System") indicated its interest in acquiring the company for $14.50 per share, NetSpend's directors communicated that the company was not for sale, and they would not entertain an offer unless Total Systems increased its offer price significantly. Although NetSpend's board declined Total System's request for exclusivity, the board did not reach out to any other potential acquirors. Instead, the board pushed Total System for a higher price and for a go-shop provision permitting the company to solicit higher bids after signing a merger agreement. But when Total System offered $16.00 per share, conditioned on deal protection provisions including a no-shop provision and a 3.9 percent termination fee, the directors accepted.

Significantly, in addition to these provisions, the merger agreement prohibited NetSpend from releasing any other potential acquirer from existing standstill agreements. This provision had force because, shortly before the merger was negotiated, the NetSpend board had entered into confidentiality agreements containing standstill provisions, with don't-ask-don't-waive clauses barring requests to waive them, with two private equity firms that were interested in buying a substantial minority stake in the company. The Court found that by entering into these agreements, failing to waive their standstill provisions, and then prohibiting itself from doing so, the board "blinded itself" to any interest from the "only two entities which had recently expressed an interest in acquiring at least a large minority position in NetSpend." Although it noted that such provisions are not per se impermissible and may be useful in certain cases, the Court was particularly troubled by the evidence that the board "did not consider, or did not understand, the import of the [don't-ask-don't-waive] clauses and of their importation into the Merger Agreement," and found them to be inappropriate in the context of a single-bidder process without a market check.

In addition, the Court found that the fairness opinion on which NetSpend directors based their recommendation of the merger was, in part, "weak." The offer price was on the low end of the range of prices that the board's financial advisor indicated would be fair, and indeed it was below the low end of the range indicated by the advisor's discounted cash flow analysis.

In analyzing the directors' efforts to obtain the best price reasonably available, the Court found that they acted reasonably in opting only to negotiate with a single bidder. But the Court also found that, having made this choice, the directors had to be "particularly scrupulous" in ensuring that they were well informed as to whether they had achieved the best price reasonably available for the company. In light of the no-shop provision, the don't-ask-don't-waive clauses, and the "weak" fairness opinion, the Court found that the plaintiff had shown a reasonable probability of success on the merits of her claim that the directors had not done so, and that approval of the merger was therefore a breach of fiduciary duty.

Nonetheless, because there was no alternative transaction available to the NetSpend stockholders, and consistent with other recent decisions of the Court of Chancery, the Court declined to enjoin the stockholder vote on the transaction.

Following oral argument on plaintiff's motion for preliminary injunction, Total System consented to NetSpend's waiver of the don't-ask-don't-waive standstill provisions, and the defendants notified the two potential private equity buyers. Neither expressed any interest in a transaction involving NetSpend. Eight days after the Court issued its decision, the parties announced that they had agreed to settle the action in exchange for a delay in the stockholder vote and a weakening of certain deal protection provisions in the merger agreement, including the termination fee and Total System's right to match a superior proposal.

In re Primedia, Inc. Shareholders Litigation, 2013 WL 2169415 (Del. Ch. May 10, 2013).

In *In re Primedia, Inc. Shareholders Litigation*, Vice Chancellor Laster of the Court of Chancery held that plaintiffs whose standing to pursue derivative insider trading claims had been extinguished by merger had standing to challenge directly the entire fairness of that merger based on a claim that the target board of directors failed to obtain sufficient value in the merger for the pending derivative claims.

In late 2005 and early 2006, two plaintiffs filed derivative complaints on behalf of Primedia, Inc. ("Primedia" or the "Company") generally asserting that the members of the Company's board of directors had breached their fiduciary duties by causing Primedia to sell assets and redeem preferred stock in a manner that benefitted certain affiliates of KKR, Primedia's controlling stockholder. Primedia's board formed a special litigation committee (the "SLC") and authorized it to investigate plaintiffs' allegations. While the SLC's investigation was ongoing, plaintiffs amended their complaint to assert corporate opportunity claims against the KKR affiliates and indicated to the SLC their belief that the documents produced to plaintiffs during the SLC's investigation would support an insider trading claim against the KKR affiliates under *Brophy v. Cities Service Co.*, 70 A.2d 5 (Del. Ch. 1949).

The SLC ultimately resolved to recommend dismissal of the plaintiffs' claims. With respect to the *Brophy* claim, the SLC's view was that it was likely barred by the statute of limitations. It also found that the evidence supported the view that the KKR affiliates did not possess the requisite *scienter* to support such a claim.

On June 14, 2010, the Court of Chancery granted the SLC's motion to dismiss the derivative complaint over plaintiffs' objection. With respect to the *Brophy* claim in particular, the Court rejected the SLC's view that no evidence supported a finding of *scienter*, and held that the elements of such a claim were likely well-pleaded and would survive a motion to dismiss. The Court nevertheless held that the SLC's decision not to pursue the *Brophy* claim was reasonable, in reliance on Court of Chancery decisions that would limit the Company's potential remedy for such a claim to harm actually suffered by the corporation (which the Court estimated at approximately $1.5 million) as opposed to full disgorgement of trading profits (which could have required a payment of up to $190 million from the KKR affiliates). Taking into account the risks associated with litigation, including the real risk of an adverse ruling on the statute of limitations defense, the Court determined that the SLC's decision not to pursue the *Brophy* claim fell within a range of reasonableness.

The derivative plaintiffs appealed, and the Delaware Supreme Court reversed. Among other things, the Supreme Court clarified that full disgorgement of all profits obtained by an insider-trading fiduciary was an available remedy for a successful *Brophy* claim. *Kahn v. Kohlberg Kravis Roberts & Co.*, 23 A.3d 831, 837-40 (Del. 2011).

While the appeal was pending, Primedia entered an agreement to be acquired by a third party by merger for approximately $316 million. While considering whether to approve the merger, the Primedia board considered whether the derivative claims had any value and concluded that for the reasons discussed in the SLC report and in light of the dismissal by the Court of Chancery, the claims had limited, if any, value. After the Supreme Court issued its ruling, the Primedia board met to discuss the Supreme Court's opinion and determined that it was not in the best interest of the Company to pursue the derivative claims. The merger was completed within a month after the Supreme Court's decision. The derivative plaintiffs entered a stipulation dismissing their claims on the ground that the merger had deprived them of standing.

However, after the merger was announced but before it was completed, the same plaintiffs filed a putative class action in the Court of Chancery, in which they alleged, among other things, that the merger failed the test of entire fairness because the Primedia board failed to obtain any value for the *Brophy* claim against the KKR affiliates.

Defendants moved to dismiss. The Court denied the motion, relying primarily on *Parnes v. Bally Entertainment Corp.*, 722 A.2d 1243 (Del. 1999), and *In re Massey Energy Co.*, 2011 WL 2176479 (Del. Ch. May 31, 2011). The Court held that a plaintiff seeking to assert such a "failure to value" claim must first establish its standing to sue, which can be done by satisfying a three-part test. First, the underlying derivative claim either must have survived a motion to dismiss or must otherwise state a claim upon which relief can be granted. Second, the value of that claim must be material in the context of the merger. Finally, the plaintiff must adequately allege facts supporting an inference that the acquiror would not assert the underlying derivative claim and did not provide value for it in the merger price.

With respect to the first prong, the Court held (as it had during the *Zapata* hearing in the derivative action) that, while there were litigable issues related to laches and the statute of limitations that would need be addressed, the allegations of plaintiffs' complaint easily stated a claim. The Court had previously dismissed plaintiffs' *Brophy* claims at the request of the SLC, but it had done so based on its belief that the value of the *Brophy* claim was in the low seven-figure range. After the Supreme Court clarified on appeal that full disgorgement was a possible remedy for a fiduciary's insider trading, the potential value of the plaintiffs' claim increased substantially, to the point where it may have been material in the context of the merger, thereby satisfying the second element of the standing test. Finally, relying in part on case law suggesting that acquiring parties are typically interested in the value of the business they are acquiring, not derivative claims, the Court held that the complaint adequately alleged that the acquiror was unlikely to assert the derivative claims, and the third prong of the standing test was met.

The Court then moved on to the entire fairness claim, and held that the allegations of the complaint were sufficient to render it reasonably conceivable that the merger conferred a unique and material benefit on the KKR affiliates, the Company's controlling stockholders, that was not shared with the Company's minority stockholders. That is, before the merger, the KKR affiliates faced potential liability on the derivative *Brophy* claim, but all stockholders would benefit proportionately from any recovery. The merger eliminated all stockholders' potential benefit from a recovery on the derivative claim, but also eliminated the KKR affiliates' potential liability. Thus, the Court held that the merger had effectively diverted the minority stockholders' ratable share of the potential derivative recovery (which the Court quantified at $80 million) to the KKR affiliates who controlled Primedia. Because the complaint adequately alleged that the KKR affiliates received a material benefit not shared with other stockholders, the Court determined that the transaction would be subject to entire fairness scrutiny. The Court therefore denied the defendants' motion to dismiss.

Carsanaro v. Bloodhound Technologies, Inc., 2013 WL 1104901 (Del. Ch. Mar. 15, 2013).

In *Carsanaro v. Bloodhound Technologies, Inc.*, Vice Chancellor Laster of the Court of Chancery denied defendants' motion to dismiss a complaint alleging breaches of fiduciary duties and statutory violations, among other things, in connection with several rounds of venture capital financings for a start-up healthcare technology company ("Bloodhound" or the "Company").

In the late 1990s, Bloodhound began developing a web-based software application to monitor healthcare claims for fraud. From 1999 to 2002, the Company issued five series of preferred stock, designated Series A through Series E. Plaintiffs, former common stockholders of Bloodhound, alleged that in the Series D and Series E capital raises, the venture capital firms investing in the Company used their control over the Company's board of directors to approve financings that unfairly diluted the common stock, undervalued the Company, and improperly benefitted the venture capital firms and management. Plaintiffs also challenged a 1-for-10 reverse stock split of the common stock carried out in connection with the Series E refinancing in 2002. In addition to their challenges to transactions in 2001 and 2002, plaintiffs alleged that the board had acted wrongfully in 2011 when it agreed to sell the Company to a third party for $82.5 million, and approved a management incentive plan ("MIP") that allocated $15 million, or about 19 percent of the merger proceeds, to the Company's management. Plaintiffs alleged that, as a result of the dilutive financings and the MIP, they received only approximately $36,000 for their common shares in the merger.

As an initial matter, certain venture capital defendants argued that, as non-Delaware entities, the Court lacked personal jurisdiction over them. The Court disagreed, stating that "[s]ophisticated investors should reasonably expect to face suit in Delaware when they place their employees or principals on the board of directors of a Delaware corporation, then allegedly use those representatives to channel benefits to themselves through self-dealing transactions that require acts in Delaware for their implementation." In this case, the "acts" in Delaware were filings made by the Company with the Delaware Secretary of State in connection with the preferred stock issuances, the reverse stock split and the merger.

On the substantive fiduciary duty claims, the Court held that the allegations relating to the Series D and Series E financings and the MIP stated claims that were subject to entire fairness review. The Court further held that the claims relating to the 2001 and 2002 refinancing transactions were not barred by laches. The Court also rejected an argument that Section 124 of the Delaware General Corporation Law ("DGCL") barred plaintiffs' claims. Section 124 provides that "[n]o act of a corporation...shall be invalid by reason of the fact that corporation was without capacity or power to do such act" except in certain limited situations. Defendants argued that because none of the limited situations enumerated in Section 124 applied, Section 124 barred plaintiffs' claims that the reverse stock split and Series E preferred issuance were null and void due to alleged failure to comply with the statutory requirements relevant to those transactions.

After examining the historical context of Section 124 and the broadly enabling nature of the DGCL, the Court held that Section 124 has a narrow purpose: mostly abolishing the application of the *ultra vires* doctrine as way to challenge a Delaware corporation's capacity to act. That is, Section 124 significantly restricts when a corporate act can be challenged based on a lack of capacity. Section 124, however, does not address whether a given action was in fact undertaken in compliance with applicable law (such as other sections of the DGCL) or common law fiduciary duties. Because plaintiffs' claims rested on, among other things, an allegation that the reverse stock split and the Series E preferred issuance were not enacted in compliance with Section 242 of the DGCL—and not a claim that the Company lacked the ability (*i.e.*, capacity) to undertake the challenged actions—the Court held that Section 124 did not bar plaintiffs' claims.

Finally, the Court addressed defendants' argument that plaintiffs lacked standing because they sought to assert derivative claims after the merger had closed.

In relation to plaintiffs' challenges to the Series D and Series E preferred stock issuances, the Court acknowledged that a claim that a company issued stock at a below-market valuation (and hence was underpaid for a corporate asset) is a classic derivative claim. Nonetheless, the Court held that plaintiffs stated a direct claim for "wrongful expropriation" under the rationale of *Gentile v. Rossette*, 906 A.2d 91 (Del. 2006). The Court reasoned that a dilutive stock issuance at an unfair price harms both the company (because it receives too little compensation) and stockholders (because their proportional rights to vote and receive dividends are reduced). The Delaware Supreme Court has previously held that dilutive stock issuances benefitting controlling stockholders may give rise to both derivative and direct claims. In this opinion, the Court of Chancery stated that "[s]tanding will exist if a controlling stockholder stood on both sides of the transaction. Standing will also exist if the board that effectuated the transaction lacked a disinterested and independent majority." Accordingly, because the various venture capital investors allegedly constituted a control group, the Court concluded that the complaint pleaded a direct claim.

With regard to the 2011 merger, the Court reasoned that plaintiffs' primary challenge was to the amount of merger consideration awarded to management through the MIP and the allocation of the bulk of the transaction consideration to the preferred stockholders. The Court, citing case law on when "side deals" or payments to management may be challenged on a direct, and not derivative, basis, held that the size of the MIP payments (almost 19 percent of the total proceeds) was facially material and that the plaintiffs could therefore assert a direct challenge to the fairness of the merger based on the allegedly excessive MIP.

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

In *Kallick v. SandRidge Energy, Inc.*, 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 has approved 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 was 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 approved 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 determined 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 approved 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 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.

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*, 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

In re Wayport, Inc. Litigation,
2013 WL 1811873 (Del. Ch. May 1, 2013).

In a post-trial opinion, *In re Wayport, Inc. Litigation*, Vice Chancellor Laster of the Court of Chancery held that corporate fiduciaries do not have a duty to disclose information about the corporation in connection with direct stock purchases from stockholders absent knowledge of "special facts." The Court, however, held one trading fiduciary liable for common law fraud due to its failure to correct a statement to the selling stockholder that was truthful when made, but became inaccurate due to subsequent events.

Plaintiff Brett Stewart was the original chief executive officer and a named inventor on most of the patents of Wayport, Inc. ("Wayport" or the "Company"), an Austin, Texas based technology company. In 1998 and 1999, Wayport sold preferred stock to Trellis Partners Opportunity Fund, L.P. ("Trellis") and funds associated with New Enterprise Associates ("NEA"). In connection with the stock purchases, Trellis obtained the right to appoint a member of Wayport's board of directors, and NEA obtained the right to designate a board observer. Plaintiff resigned his positions as director and CEO by late 2001, and at the time of the challenged transactions in 2007, he received no information from the Company other than quarterly and annual financial reports.

Plaintiff's claims centered on sales of his common stock to Trellis and funds affiliated with NEA, which closed in June 2007 and late September 2007, and a patent sale agreement between Wayport and Cisco Systems, which was signed at the end of June 2007, approximately a week after plaintiff's earlier sales. Plaintiff was not aware of the transaction with Cisco until after the last of his stock sales was completed. In December 2008, AT&T acquired Wayport for $7.20 per share.

Following announcement of the AT&T transaction, plaintiff filed suit against Wayport's board of directors, Trellis and NEA, among others, asserting that the Company's board breached its fiduciary duties by failing to disclose material information to him in connection with his stock sales and a claim for common law fraud. Plaintiff sought damages equal to the difference between $2.50 per share, the price at which he sold his shares in 2007, and $7.20 per share price, the price at which AT&T acquired the Company.

In addressing the plaintiff's breach of fiduciary duty claim, the Court noted that there are four common scenarios in which the duty of disclosure is implicated. The first is common law ratification, in which directors seek approval for a transaction that does not otherwise require a stockholder vote under the Delaware General Corporation Law. The second scenario occurs when directors submit to the stockholders a transaction that requires stockholder approval or a stockholder investment decision. The third scenario arises when a corporate fiduciary speaks outside the context of soliciting or recommending stockholder action. In the first and second scenarios, the directors owe a duty to disclose all material facts, but in the third, they are obliged only to refrain from knowingly making false statements. Finally, the fourth scenario arises when a corporate fiduciary buys shares directly from or sells shares directly to an existing outside stockholder. The Court of Chancery held that in this scenario, the fiduciary's duty of disclosure is governed by the "special facts" doctrine described in the Delaware Supreme Court's decision in *Lank v. Steiner*, 224 A.2d 242 (Del. 1966). The special facts doctrine requires a director to disclose information in the context of a sale of the stock of a privately held corporation "only when a director is possessed of special knowledge of future plans or secret resources and deliberately misleads a stockholder who is ignorant of them." To satisfy the special facts requirement, a plaintiff must point to knowledge of a substantial transaction, such as an offer to acquire the whole company. The Court held that the purchasers' failure to volunteer information about the patent sale transaction to the plaintiff was not actionable under the special facts doctrine. The Court reasoned that although the completion of the patent transaction might have been material to plaintiff, the transaction was not so substantial as to trigger the special facts doctrine. The Court accordingly entered judgment in the defendants' favor on the fiduciary duty claims.

However, the Court reached a different conclusion with regard to plaintiff's common law fraud claims, as to one defendant. During the course of negotiations over the content of the representations and warranties to be included in the stock purchase agreement for the June 2007 transaction, a representative of Trellis had written in an email to plaintiff that Trellis was "not aware of any bluebirds of happiness in the Wayport world right now and have graciously offered to rep that." The trial witnesses offered varying interpretations of the email, and the Court agreed with plaintiff's assertion that the email referred to any unspecified good news. The Court concluded that the statement, although truthful when made, became false when the patent sale transaction occurred and remained false at the time of plaintiff's September 2007 sale. The Court held that Trellis, by speaking, had undertaken "a duty to update its statement to the extent that subsequent events rendered its representation materially misleading." The Court found that the other elements of the common law fraud test, including *scienter*, reasonable reliance and causation, had been met, and awarded plaintiff damages of $4.70 per share as to his September 2007 sale to Trellis.

Merger Agreement Construction

Great Hill Equity Partners IV, LP v. SIG Growth Equity Fund I, LLLP, C.A. No. 7906-CS (Del. Ch. Nov. 15, 2013).

In *Great Hill Equity Partners IV, LP v. SIG Growth Equity Fund I, LLLP,* the Court of Chancery interpreted Section 259 of the General Corporation Law of the State of Delaware to hold that all privileges—including the attorney-client privilege—pass in a merger from the acquired corporation to the surviving corporation. Specifically, the Court held that, without a contractual provision to the contrary, even the seller's pre-merger attorney-client communications with respect to the merger itself would pass to the surviving corporation. The Court suggested that parties concerned about this issue should "use their contractual freedom in the manner shown in prior deals to exclude from the transferred assets the attorney-client communications they wish to retain as their own."

In re NYSE Euronext Shareholders Litigation, C.A. No. 8136-CS (Del. Ch. May 10, 2013) (TRANSCRIPT).

In *In re NYSE Euronext Shareholders Litigation*, Chancellor Strine of the Court of Chancery, ruling from the bench following oral argument, declined to enjoin preliminarily a stockholder vote on the proposed merger between NYSE Euronext ("NYSE") and IntercontinentalExchange, Inc. ("ICE"). The Court found that plaintiffs had not established any of the necessary elements for injunctive relief, but nonetheless criticized a provision in the merger agreement that restricted the NYSE board's ability to change its recommendation when faced with a partial-company competing bid.

The proposed $9.5 billion merger between NYSE and ICE offered NYSE stockholders a mix of cash and stock valued at $33.12 per share. The stock portion of the consideration represented 67 percent of the total consideration offered to NYSE's stockholders. Based on the Delaware Supreme Court's decision in *In re Santa Fe Pacific Corp. Shareholder Litigation*, 669 A.2d 59 (Del. 1995), the Court rejected plaintiffs' argument that *Revlon* applied to the mixed-consideration deal. After concluding that *Revlon* did not apply, the Court considered the reasonableness of the board's process and concluded that plaintiffs did not have a reasonable probability of success on the merits.

The Court thereafter considered the recommendation provision in the merger agreement. After the deal was announced, no other potential acquiror expressed serious interest in any alternative transaction—such as an acquisition of Liffe, NYSE's European derivatives business. Had a potential alternative transaction emerged, however, the NYSE board may have been restricted under the terms of the merger agreement from changing its recommendation to vote in favor of the merger with ICE. That is, the provision at issue only allowed the board to change its recommendation where an alternative proposal emerged that was unsolicited and was determined by the board to be a Superior Proposal, defined in the merger agreement as a sale of 100 percent of NYSE's assets or stock.

During oral argument and in its ruling, the Court expressed skepticism toward forced-recommendation provisions in general, characterizing them as "contractual promises to lie in the future," which, among other things, "potentially subjects people to liability" and "deal risk." Despite such criticism, the Court acknowledged that the board's "fiduciary judgment in dealing with a contract, can't be just isolated provision by provision," particularly where such a provision might be used as a bargaining chip to obtain the highest value reasonably available for the stockholders. Notwithstanding the Court's criticism, the Court ultimately ruled that the provision at issue could not support an injunction because there was no alternative offer or indication of interest that the NYSE board would have been constrained from considering. Finally, with respect to the balance of the equities, the Court concluded that NYSE's stockholders had the ability to choose for themselves whether to approve the transaction. Accordingly, the Court denied plaintiffs' motion for preliminary injunction.

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*, 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*, 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.

Definition of Business Combination

Activision Blizzard, Inc. v. Hayes,
No. 497, 2013 (Del. Nov. 15, 2013).

In *Activision Blizzard, Inc. v. Hayes*, the Delaware Supreme Court addressed the question of whether the purchase by Activision Blizzard, Inc. ("Activision") of shares of its own stock, as well as net operating loss carryforwards ("NOLs"), from Vivendi, S.A. ("Vivendi") constituted a "merger, business combination or similar transaction" under Activision's amended certificate of incorporation and, as a result, required the approval of stockholders. The Court held that, despite its form as the combination of two entities, the transaction at issue did not require the approval of stockholders. "Indeed," observed the Court, "it is the opposite of a business combination. Two companies will be separating their business connection."

The dispute reached the Court as an interlocutory appeal from entry of a preliminary injunction by the Court of Chancery, halting consummation of the stock purchase agreement ("SPA") between Activision, a global developer, publisher and developer of video games, and Vivendi, a French digital entertainment company, with video game and other businesses. On July 25, 2013, Vivendi, which before the transaction at issue had owned 62 percent of Activision's stock, entered into the SPA with Activision, under which Activision agreed to pay Vivendi $5.83 billion for 429 million shares of Activision stock, as well as $675 million for NOLs. This part of the SPA was to be effectuated through the acquisition of a newly created and wholly owned subsidiary of Vivendi, New VH (referred to as "Amber"), whose only purpose was to hold the Activision stock and NOLs. Activision would acquire Amber, and the stock acquired would be treated as treasury shares, reducing the total number of Activision shares outstanding. Further, the SPA provided that Vivendi would sell an additional 172 million shares of Activision stock to ASAC II, LP, a limited partnership owned in part by two Activision directors.

Following the announcement of the stock purchase, Douglas Hayes, an Activision stockholder, filed a class action and derivative complaint in the Court of Chancery on September 11, 2013, alleging, *inter alia*, that Section 9.1(b) of Activision's certificate of incorporation, which required approval of the holders of a majority of stock unaffiliated with Vivendi "with respect to any merger, business combination or similar transaction," was triggered by the SPA.

In a bench ruling on September 18, 2013, the day before the scheduled closing of the SPA, the Court of Chancery entered a preliminary injunction enjoining consummation of the SPA. *See Hayes v. Activision Blizzard, Inc.*, 2013 WL 5293536 (Del. Ch. Sept. 18, 2013) (TRANSCRIPT). Relying on *Martin Marietta Materials, Inc. v. Vulcan Materials Co.*, 56 A.3d 1072 (Del. Ch. 2012), the trial court held that the term "business combination" was inherently ambiguous and should be interpreted "expansively," including within its meaning the purchase of the stock of a wholly owned subsidiary. Further, the Vice Chancellor maintained that the proposed transaction fell "squarely within Section 9.1" of Activision's certificate of incorporation because the purchase was a "value-transfer transaction," which was bound to impact minority stockholders. "This is an $8 billion reorg. of Activision. Value is moving. Value is moving to the former controller. Value is moving to management," the Vice Chancellor reasoned.

The Delaware Supreme Court vacated the preliminary injunction entered by the Court of Chancery and remanded for further action. The Supreme Court held that the phrase "business comation" in Section 9.1(b) was not ambiguous and clearly did not apply to the transactions contemplated in the SPA. The Court observed that, "technically, Activision would combine with Amber" and the size of the transaction would be considerable, but the Court reasoned that "[n]either the form of the transaction nor its size changes its fundamental nature." That fundamental nature, the Court found, was of the two businesses (Activision and Vivendi) "separating"—not of "Vivendi having a greater connection with and/or control over Activision's business," as the Court concluded would happen in a "business combination or similar transaction."

Moreover, Amber could not be considered a business, the Court found. It was merely a company created to effectuate this transaction. Therefore, its acquisition by Activision was not a "business combination." Additionally, the Court found nothing in the language of Section 9.1(b) to suggest that a transaction qualified as a "business combination or similar transaction" simply based on its magnitude. Finally, the Court pointed out that the general protection of minority stockholders, which was a concern of the Court of Chancery, was addressed elsewhere in Activision's bylaws, not in Section 9.1(b) of the certificate of incorporation. ■

Scrutiny of Settlements

Forsythe v. ESC Fund Management Co. (U.S.), Inc., C.A. No. 1091-VCL (Del. Ch. May 9, 2012).

In *Forsythe v. ESC Fund Management Co. (U.S.), Inc.*, the Court of Chancery implemented a novel form of relief in resolving an objection to the adequacy of the consideration received in the settlement of representative litigation. Although the Court was prepared to approve the proposed $13.25 million settlement, the Court gave the objectors the option of continuing the case in pursuit of a larger recovery if they agreed to post a secured bond that would ensure that the partnership would, at a minimum, receive the full amount of the proposed settlement consideration once the litigation had ultimately been resolved.

The parties' long-running dispute involved the performance of the CIBC Employee Private Equity Fund (U.S.) I, L.P. (the "Fund"), which was formed in 1999 by Canadian Imperial Bank of Commerce ("CIBC") to give senior CIBC employees the opportunity to coinvest with CIBC in private equity opportunities. The Fund performed poorly, generating approximately $200 million less than the returns generated by the lowest quartile of comparable funds during the first nine years of its existence. In 2005, the plaintiffs filed a derivative action on behalf of the Fund against the Fund's general partner, the individual directors of the Fund's general partner, the Fund's investment advisor, the Fund's special limited partners and CIBC, claiming breaches of fiduciary duties in connection with the management and oversight of the Fund, and asserting claims for losses suffered in each of the Fund's investment categories.

In August 2010, the Court entered summary judgment in favor of the defendants with respect to the largest portion of the plaintiff's damages claims. The parties then engaged in a pretrial mediation session in March 2011 that resulted in the proposed settlement. In exchange for a global release from liability, the defendants agreed to pay the Fund $10.25 million in cash and forgo claims for indemnification from the Fund in the amount of approximately $3 million. The named plaintiffs initially agreed to the settlement, but by January 2012, they had joined a group of 57 objectors in opposing the proposed settlement.

In assessing the reasonableness of the proposed settlement, the Court noted that several significant factors weighed in favor of approval: the parties negotiated at arm's length with the assistance of a mediator, the plaintiffs had settled on the eve of trial after completing discovery, and the settlement consideration included a cash component and was not composed of merely intangible or therapeutic benefits. On the other hand, the Court also indicated that a number of factors weighed against approval: a large number of objectors with a significant stake in the litigation (including the named plaintiffs) opposed the settlement, the objectors had hired separate counsel, and the objectors had advanced an argument for reviving the largest portion of the plaintiffs' damages claims that, if successful, could result in a significantly larger recovery for the Fund. After weighing the various factors, the Court concluded that the settlement consideration was within the range of fairness, albeit at the low end of that range. Nevertheless, the Court recognized that if the objectors were able to revive part of the damages claims, the settlement consideration would be inadequate.

The Court discussed the potentially divergent interests of counsel and objecting clients at the settlement stage of representative litigation. The Court noted that counsel, who had at this stage invested substantial resources in the case, might be inclined to settle rather than pursue a case to the end, particularly in a situation where a significant increase in recovery would involve the uncertainties inherent in trial and a potentially costly appeal process. The objectors, who to this point had not been directly burdened with the costs of litigating the action, rationally could prefer to continue the case in an attempt to secure a larger recovery.

In an effort to resolve these potentially conflicting interests, the Court devised a method to protect the interests of the non-objecting plaintiffs while providing the objectors the opportunity to continue the litigation in pursuit of a larger recovery for the Fund as a whole.

If the objectors posted a secured bond, letter of credit or similar security for the benefit of the Fund in the amount of the full $13.25 million settlement consideration, the Court would allow the objectors to take over the case. If the objectors were successful in recovering more than the proposed settlement, the increased consideration would inure to the benefit of the Fund. If the objectors ultimately recovered less than the proposed settlement, the Fund would have the right to execute on the security to collect the difference. The Court indicated that if no secured bond had been posted by the objecting plaintiffs within 60 days, the proposed $13.25 million settlement would be approved.

Creditor Claims and Debt Instruments

Bank of N.Y. Mellon Trust Co. v. Liberty Media Corp., 29 A.3d 225 (Del. 2011).

In *Bank of New York Mellon Trust Co. v. Liberty Media Corp.*, the Delaware Supreme Court held that the split-off of the Capital and Starz business groups (the "Capital Split-off") following three other major distributions of assets since 2004 did not constitute a transfer of "substantially all" of the assets of Liberty Media Corporation and its wholly owned subsidiary, Liberty Media LLC (together, "Liberty"), under the terms of an indenture.

Shortly after the Capital Split-off was announced, Liberty received a letter from an anonymous bondholder alleging that Liberty had pursued a "disaggregation strategy" designed to shift substantially all of the assets against which the bondholders have claims into the hands of Liberty's stockholders in violation of an indenture dated July 7, 1999 (the "Indenture"). In response, Liberty commenced an action against the Bank of New York Mellon Trust Company, N.A., as trustee under the Indenture (the "Trustee"), seeking injunctive relief and a declaratory judgment that the proposed Capital Split-off would not constitute a disposition of "substantially all" of Liberty's assets in violation of the Indenture. While all parties agreed that, considered in isolation, the Capital Split-off would not constitute a transfer of substantially all of Liberty's assets, the Capital Split-off would be Liberty's fourth major distribution of assets since March 2004, and the Trustee argued that the Capital Split-off should be aggregated with the prior dispositions by Liberty in determining whether "substantially all" of Liberty's assets had been transferred.

In the underlying proceeding, the Court of Chancery held that the Capital Split-off and the three other major distributions of assets should not be aggregated. Applying New York law, which governed the Indenture, Vice Chancellor Laster concluded that the Capital Split-off was not "sufficiently connected" to the prior transactions to warrant aggregation, noting the seven-year period over which the dispositions occurred, the different facts and circumstances surrounding each disposition, and that each disposition resulted from an independent decision by Liberty rather than "a plan to engage in *seriatim* distributions that would remove the assets from Liberty's corporate form and evade the bondholders' claims." In so holding, the Court of Chancery relied on the Second Circuit's 1982 decision in *Sharon Steel Corp. v. Chase Manhattan Bank, N.A.*, 691 F.2d 1039 (2d Cir. 1982). Additionally, Vice Chancellor Laster applied the "step-transaction doctrine" in determining not to aggregate the dispositions. Under the step-transaction doctrine, dispositions are to be aggregated if the dispositions are (i) prearranged parts of a single transaction intended to achieve the ultimate result, (ii) so interdependent as to be fruitless without the series, or (iii) pursuant to a prearranged and binding commitment to undertake the later steps. With none of these conditions satisfied, the Court of Chancery held that the dispositions should not be aggregated.

The Delaware Supreme Court affirmed the decision based on the Court of Chancery's application of the principles outlined in *Sharon Steel*. However, the Supreme Court concluded that it was unnecessary to determine whether the step-transaction doctrine would be adopted as New York law in a similar analysis because the legal conclusions would have been the same under an independent reading of *Sharon Steel*.

Forum Selection Bylaws

Boilermakers Local 154 Retirement Fund v. Chevron Corp., C.A. No. 7220-CS (Del. Ch. Jun. 25, 2013); ***Iclub Inv. P'ship v. FedEx Corp.,*** C.A. No. 7238-CS (Del. Ch. Jun. 25, 2013).

The Court of Chancery has rejected statutory and contractual challenges to forum-selection bylaws adopted unilaterally by the boards of directors of Chevron Corporation and FedEx Corporation. In an opinion deciding motions for partial judgment on the pleadings in *Boilermakers Local 154 Retirement Fund, et al. v. Chevron Corp., et al.* and *Iclub Inv. P'ship v. FedEx Corp., et al.*, Chancellor Strine determined that a board of directors, if granted authority to adopt bylaws by the certificate of incorporation, has the power under the Delaware General Corporation Law to adopt a bylaw requiring litigation relating to the corporation's internal affairs to be conducted exclusively in the Delaware courts, and that such a bylaw may become part of the binding agreement between a corporation and its stockholders even though the stockholders do not vote to approve it. The Court emphasized, however, that stockholder-plaintiffs retain the ability to challenge the enforcement of such a bylaw in a particular case, either under the reasonableness standard adopted by the Supreme Court of the United States in *Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1 (1972), or under principles of fiduciary duty. The Court also left open the possibility that the boards' actions in adopting such bylaws could be subject to challenge as a breach of fiduciary duty.

The boards of both Chevron and FedEx had adopted bylaws providing that the Delaware Court of Chancery would be the sole and exclusive forum for (i) any derivative action brought on behalf of the corporation, (ii) any action asserting breach of fiduciary duty claims, (iii) any action asserting a claim arising under the Delaware General Corporation Law, or (iv) any action asserting a claim governed by the internal affairs doctrine. Chevron subsequently amended its bylaw to permit such suits to be brought in "a state or federal court located within the state of Delaware" and to make the bylaw subject to the relevant court possessing personal jurisdiction over "the indispensable parties named as defendants." Both bylaws allowed litigation in another forum with the corporation's consent.

The Court considered and rejected a claim that these bylaws were not authorized under 8 *Del. C.* § 109(b), which provides that a corporation's bylaws "may contain any provision, not inconsistent with law or with the certificate of incorporation, relating to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors, officers or employees." The Court analogized its holding to the Delaware Supreme Court's seminal decision authorizing poison pill rights plans in *Moran v. Household Int'l, Inc.*, 500 A.2d 1346 (Del. 1985), and wrote, "[T]hat a board's action might involve a new use of plain statutory authority does not make it invalid under our law, and the boards of Delaware corporations have the flexibility to respond to changing dynamics in ways that are authorized by our statutory law." The Court emphasized that forum-selection bylaws, like rights plans, are subject to challenge if applied inequitably, and further noted that, unlike rights plans, bylaws may be repealed by vote of the stockholders.

The Court also rejected plaintiffs' contention that the bylaws were invalid as a matter of contract law because the Chevron and FedEx boards of directors had adopted those bylaws unilaterally, without a vote of the stockholders. The Court wrote, "Stockholders are on notice that, as to those subjects that are subject of regulation by bylaw under 8 *Del. C.* § 109(b), the board itself may act unilaterally to adopt bylaws addressing those subjects. Such a change by the board is not extra-contractual simply because the board acts unilaterally; rather it is the kind of change that the overarching statutory and contractual regime the stockholders buy into explicitly allows the board to make on its own."

Finally, the Court reiterated that a stockholder-plaintiff is free to sue in a forum other than the one required by the bylaw and to argue, in response to a motion to dismiss, that enforcement of the forum-selection provision would be unreasonable under the circumstances, under the *Bremen* doctrine, or that the forum-selection provision is being used for an inequitable purpose in breach of the directors' fiduciary duties, under *Schnell v. Chris-Craft Indus., Inc.*, 285 A.2d 437 (Del. 1971).

The Court of Chancery's decision was appealed to the Delaware Supreme Court. The stockholder-plaintiffs challenging these bylaws subsequently dismissed their appeals voluntarily. Accordingly, the Court of Chancery's decision in these cases is no longer subject to appeal.

Derivative Actions and Claims

Pyott v. Louisiana Municipal Police Employees' Retirement System, 2013 WL 1364695 (Del. Apr. 4, 2013).

In 2010, pharmaceutical company Allergan, Inc. announced a $600 million settlement with the Department of Justice related to alleged off-label marketing of its drug, BOTOX. Following the announcement, several Allergan stockholders filed derivative suits in the Court of Chancery and the United States District Court for the Central District of California (the "District Court"). Allergan and its directors moved to dismiss both actions for failure to plead demand futility, and in January 2012, the District Court granted the defendants' motion to dismiss with prejudice.

Subsequently, the defendants asserted in the Court of Chancery that the dismissal of the California suit mandated dismissal of the Delaware suit based on the doctrine of collateral estoppel. Denying the defendants' motion to dismiss, the Court of Chancery declined to give preclusive effect to the District Court decision for two reasons. First, the Court determined that collateral estoppel applies only where parties are in privity, and, by virtue of the internal affairs doctrine, Delaware law governs whether stockholders who bring derivative suits in different jurisdictions are in privity. The Court concluded that the California plaintiffs were not in privity with the Delaware plaintiffs under Delaware law, reasoning that until a derivative plaintiff survives a motion to dismiss under Court of Chancery Rule 23.1, the plaintiff is asserting an "individual claim to obtain equitable authority to sue" and does not act on behalf of the corporation. Second, the Court determined that the California plaintiffs were not adequate representatives of Allergan because they filed suit shortly after the announcement of Allergan's settlement with the Department of Justice and without reviewing Allergan's books and records pursuant to 8 *Del. C.* § 220. In reaching this conclusion, the Court applied a presumption pursuant to which a "fast-filing stockholder with a nominal stake, who sues derivatively after the public announcement of a corporate trauma…but without first conducting a meaningful investigation, has not provided adequate representation." After determining that it was not bound by the District Court decision, the Court held that the Delaware plaintiffs had adequately pleaded demand futility.

The Delaware Supreme Court reversed the Court of Chancery's decision on appeal. The Supreme Court noted that pursuant to the Full Faith and Credit Clause of the U.S. Constitution, "a state court is required to give a federal judgment the same force and effect as it would be given under the preclusion rules of the state in which the federal court is sitting." Consequently, the Court of Chancery erred by applying Delaware law rather than California law to determine the preclusive effect of the District Court's judgment. The Supreme Court held that the Court of Chancery should have dismissed the Delaware suit, as the District Court's judgment satisfied the requirements of collateral estoppel under California law. The Supreme Court emphasized that "the undisputed interest that Delaware has in governing the internal affairs of its corporations must yield to the stronger national interests that all state and federal courts have in respecting each other's judgments." Because the Court of Chancery should have applied California law in determining the preclusive effect of the District Court judgment, the Supreme Court declined to address the Court of Chancery's analysis of privity in the context of derivative litigation under Delaware law.

The Supreme Court next addressed the Court of Chancery's conclusion that the California plaintiffs were inadequate representatives. The Supreme Court rejected the Court of Chancery's irrebutable presumption against plaintiffs who file derivative suits shortly after a corporate trauma without first demanding inspection of corporate books and records, finding "no record support" for such a presumption. Absent application of the "fast filer" presumption, the Supreme Court found no basis in the record on which to conclude that the California plaintiffs were inadequate representatives. The Supreme Court also noted that remedies for the problems created by fast-filing plaintiffs "should be directed at the lawyers, not the stockholder plaintiffs or their complaints."

Arbitration

Delaware Coalition for Open Government, Inc. v. Strine, et al., No. 12-3859 (3d Cir. 2013).

In *Delaware Coalition for Open Government, Inc. v. Strine, et al.*, the United States Court of Appeals for the Third Circuit considered whether the District Court for the District of Delaware correctly ruled that confidential arbitration proceedings conducted by members of the Delaware Court of Chancery under 10 *Del. C.* § 349 must be open to the public under the First Amendment to the Constitution of the United States. In a divided decision in which each member of the panel wrote a separate opinion, the Third Circuit held that there is a First Amendment right of access to Chancery arbitrations.

Under 10 *Del. C.* § 349, the Court of Chancery was granted authority to create a program under which sitting members of the Court would act as arbitrators for certain business disputes. The statute limited the categories of cases eligible for arbitration and required the parties to the dispute to agree to participate in Chancery arbitration. Arbitration petitions and submissions in the arbitration proceeding were to be protected from public disclosure, and the arbitration hearings were to be held in private. The arbitrator's decision was to be entered as a judgment of the Court, with appeal rights limited to grounds similar to those on which a private arbitrator's decision could be vacated, such as corruption, fraud or misconduct. The Delaware Coalition for Open Government, Inc. sued in the District Court, arguing that the confidentiality of such arbitrations violates the First Amendment. The District Court granted the plaintiff's motion for judgment on the pleadings striking down the entire statute, and the members of the Court of Chancery appealed.

On appeal, the Third Circuit, in a majority opinion authored by Judge Dolores Sloviter, applied the "experience and logic" test and held that a proceeding is subject to the First Amendment right of public access when there has been a tradition of accessibility to that kind of proceeding and when access plays a significant positive role in the functioning of the particular process. Under the experience prong of the test, the Court noted that there is a long tradition of civil trials and court filings associated with them being open to the public with limited exceptions, but that the tradition as to the openness of arbitration proceedings has been mixed. The Court held that, because Chancery arbitrations take place before active judges in a courthouse, because they result in a binding order of the Court of Chancery, and because appeal rights are limited, the experience prong counseled in favor of making arbitration proceedings open to the press and the public. Under the logic prong of the test, the Court determined that opening Chancery arbitration proceedings to the public would yield numerous benefits (including promotion of informed public discussion, promotion of the public perception of fairness, and checking corruption and fraud) and that the drawbacks did not outweigh the benefits. Accordingly, the Court determined that there is a First Amendment right of access to Chancery arbitrations.

Judge Julio Fuentes joined in the Court's opinion and wrote a concurring opinion, stressing that in his view the problem with the Chancery arbitration statute was that arbitrations "are conducted outside the public view, not because of any problem otherwise inherent in a Judge-run arbitration scheme." Judge Jane Roth wrote a dissenting opinion, concluding that the experience test weighed against public access because arbitration proceedings historically have been private and confidential, and that the logic test also weighed against public access because "the resolution of complex business disputes, involving sensitive financial information, trade secrets, and technological developments, needs to be confidential so that the parties do not suffer the ill effects of this information being set out for the public—and especially competitors—to misappropriate."

The Court of Chancery has filed a petition for a writ of certiorari asking the U.S. Supreme Court to overturn the Third Circuit's decision declaring its confidential arbitration program unconstitutional.

Viacom International, Inc. v. Winshall, 72 A.3d 78 (Del. 2013).

In *Viacom International, Inc. v. Winshall*, the Delaware Supreme Court affirmed the Court of Chancery's decision to uphold an arbitration determination resolving a dispute between Viacom International, Inc. ("Viacom") and the stockholders of Harmonix Music Systems, Inc. ("Harmonix"). The disagreement concerned an "Earn-Out" payment provision adopted under the 2006 Agreement and Plan of Merger ("Merger Agreement") between the two companies. The Court held that the arbitrator's decision to exclude evidence that was not identified in Viacom's initial submission, supporting its argument that there should be an inventory write-down, did not constitute misconduct, and that the arbitrability of the inventory write-down dispute was an issue for the arbitrator to decide.

In 2006, Viacom acquired Harmonix for $175 million in cash plus a contingent right to receive uncapped Earn-Out payments based on Harmonix's 2007 and 2008 gross profits. Walter A. Winshall, the designated representative of Harmonix's former stockholders, disputed Viacom's calculation of the 2008 Earn-Out statement, from which Viacom deducted the cost of Harmonix's unsold inventory. In accordance with the Merger Agreement, Winshall presented his disagreements in a Summary of Issues. The parties were unable to resolve the dispute and submitted the Earn-Out disagreement to arbitration, with a nationally known accounting firm serving as the arbitrator.

In its pre-hearing submission, Viacom argued that if it were unable to properly deduct the cost of Harmonix's unsold inventory, it could account for that inventory by taking an inventory write-down deduction. Winshall countered that because this argument was not included in the 2008 Earn-Out statement, it could not be considered in arbitration. As the inventory write-down was not included in the original submission of unresolved items from the Summary of Issues, the arbitrator asked for the parties' consent to consider it in reaching its decision, which Winshall refused to grant. The arbitrator issued its decision in December 2011, agreeing with Winshall that costs of unsold inventory should not be deducted from net revenue. The arbitrator did not address the inventory write-down.

Viacom filed a complaint in the Court of Chancery seeking a declaration vacating the arbitrator's determination. Viacom alleged that the arbitrator disregarded the terms of the Merger Agreement and failed to consider Viacom's arguments in reaching its decision, as well as that Winshall breached the Merger Agreement by refusing to consent to the arbitrator's consideration of Viacom's argument. The Court of Chancery granted Winshall's motion for summary judgment and confirmed the arbitrator's decision.

On appeal, the Delaware Supreme Court considered two issues. First, the Court considered whether the arbitrator's refusal to consider evidence of the inventory write-down amounted to misconduct requiring the Court to vacate its decision. The Court then addressed whether the question of whether to consider the inventory write-down provision in reaching its determination was a question of procedural arbitrability that was properly decided by the arbitrator.

The Court found that the arbitrator properly limited its analysis of the Earn-Out dispute and did not ignore any relevant evidence. The Merger Agreement required the parties' initial submissions to include all matters to be decided by the arbitrator. The question of whether the inventory write-down was an appropriate method of accounting for unsold Harmonix inventory was not identified in the initial submissions. The arbitrator's determination that it could not consider the issue absent the express consent of the parties was thus appropriate and did not constitute misconduct.

In addition, the Court found that the arbitrator's unwillingness to consider the inventory write-down issue constituted a decision that the issue was not arbitrable, a determination that the arbitrator was entitled to make because the question was one of procedural arbitrability.

The Court defined issues of procedural arbitrability as those concerning whether or not the parties have complied with the terms of an arbitration provision; for example, a determination of whether certain conditions precedent to arbitration have been met. These issues are presumptively handled by arbitrators. In contrast, the Court defined issues of substantive arbitrability as those that necessitate a determination of the scope of a given arbitration provision and its applicability to a given dispute. Answering a question of substantive arbitrability effectively determines whether the parties should be arbitrating at all, a gateway question that is presumptively decided by a court.

Overruling certain earlier decisions of the Court of Chancery, the Court explained that, whether an arbitration provision is broad or narrow, the only issue of arbitrability that should be decided by the court is "whether the subject matter in dispute falls within it." Where the subject matter generally in dispute (*e.g.*, in this case, the calculation of an earn-out) falls within the arbitration provision, subsidiary questions like "what financial or other information should be considered in performing the calculation" are questions of procedural arbitrability and are properly decided by the arbitrator. Finally, the Court determined that whether or not the Court of Chancery was correct in agreeing with the arbitrator's decision was irrelevant, as the decision was properly made by the arbitrator. ■

Section 225 Actions

Klaassen v. Allegro Development Corporation, 2013 WL 5739680 (Del. Ch. Oct. 11, 2013).

In *Klaassen v. Allegro Development Corporation*, Eldon Klaassen, the former CEO of Allegro Development Corporation ("Allegro"), brought an action under Section 225 of the Delaware General Corporation Law, requesting that the Court of Chancery declare that he: (i) was still the CEO of Allegro, (ii) had validly removed two of Allegro's directors and appointed their replacements, and (iii) had validly filled a preexisting director vacancy. Klaassen claimed that his removal as CEO of Allegro by the board of directors was void. If he was indeed still CEO, he had the power to remove directors and appoint new ones under Allegro's governing documents. In a post-trial opinion, the Court of Chancery found that Klaassen was barred from challenging his removal as CEO by the equitable doctrines of laches and acquiescence. Regarding his changes to the board, the Court of Chancery determined that Klaassen did succeed in removing one director and filling the preexisting vacancy on the Allegro board, but that he did not remove the second director and new CEO, nor validly appoint a replacement for the removed director.

Klaassen, founder and nearly 100 percent stockholder of Allegro, sought outside investment in Allegro and obtained it from two outside investors (the "Series A Investors") in exchange for shares of Series A Preferred Stock of Allegro. The parties agreed to a corporate governance structure where Klaassen and the Series A Investors shared control at both the director and stockholder levels of Allegro. In an amended certificate of incorporation, Klaassen and the Series A Investors agreed to a seven-member board. The holders of the Series A Preferred would elect three directors, the holders of the common stock (a majority of which was held by Klaassen) would elect one director (the "Common Director"), and the holders of a majority of Allegro's outstanding voting power (also held by Klaassen) would elect the remaining three directors (the "Remaining Directors"). In a separate stockholders' agreement, Klaassen and the Series A Investors agreed that one Remaining Director seat would be occupied by the CEO, and that the other two Remaining Directors seats would be occupied by outsiders designated by the CEO and approved by the Series A Investors (the "Outside Directors").

On November 1, 2012, the board removed Klaassen as CEO during a regular board meeting, and replaced him with Raymond Hood (then serving as an Outside Director), because of operational and managerial failures. The board chose not to give Klaassen advance notice that they were removing him as CEO, although the Outside Directors had warned Klaassen that his position was in jeopardy. Instead, the Outside Directors procured the attendance of Allegro's CFO and general counsel through the admitted "ruse" of telling Klaassen that their attendance was necessary to discuss redemption of the Series A Preferred. After his removal, Klaassen seemed to accept his termination (even if he was displeased by it). Then, on June 5, 2013, seven months after his termination, Klaassen for the first time asserted that he was still CEO and, in his purported capacity as CEO, claimed that he was removing the two Outside Directors (Hood and George Simpkins) from the board without cause and filling the vacant Common Director seat with non-party John Brown.

In the Court of Chancery, Klaassen argued that because a majority of the directors breached their duties of loyalty and good faith in removing him as CEO, the removal was void. As support, he claimed that the Outside Directors (i) improperly "tricked" him by concealing the purpose of the meeting at which he was terminated, thereby preventing him from taking preemptive action, (ii) bribed Hood with the offer of a CEO position, and (iii) threatened Klaassen's removal only to convince Klaassen to buy them out at a higher price.

Disagreeing, the Court of Chancery held that because Klaassen was attempting to use equitable principles to invalidate the board's actions—even if Klaassen succeeded on these equitable theories—his removal was only potentially voidable, not void. That is, because Klaassen never contended that the board violated a mandatory bylaw, he was relying on equity and thus his claims were subject to equitable defenses.

The Court of Chancery held that Klaassen was barred from challenging his removal as CEO under the equitable doctrines of laches and acquiescence. Laches applied because Klaassen had understood the material facts surrounding his removal and obtained legal advice about his rights, but still waited seven months to assert any claims. In the meantime, the new management had made many changes, such that the company would be thrown into chaos if Klaassen returned. In addition, acquiescence applied because, even though Klaassen did eventually express displeasure over his removal, his overall conduct had made it reasonable for the board to believe that he accepted Hood's installation as CEO. Accordingly, the Court found Klaassen could not contest his removal as CEO.

Next, the Court turned to Klaassen's alleged board changes. Klaassen had served as the CEO Director until his termination as CEO. The defendants urged that upon Klaassen's termination, he was no longer qualified to be the CEO Director and was not qualified to be an Outside Director, and hence had become the Common Director. The Court rejected this claim and held that Klaassen continued as a Remaining Director and that the Common Director seat had remained vacant until Klaassen validly filled the seat with Brown. The Court noted that the result could have been different had the qualifications for the various board seats appeared in a clear, self-executing provision of the certificate of incorporation. However, because the qualifications appeared in the stockholders' agreement, Klaassen's cessation to satisfy the qualifications could not affect his continuing status as a director.

Regarding Klaassen's attempt to remove Hood and Simpkins, the Court held that the stockholders' agreement limited Klaassen's ability to remove Outside Directors. However, the Court held that Klaassen retained the right under that agreement to remove without cause directors whom he had originally been entitled to designate, but whom he was no longer entitled to designate. The Court held that Klaassen was the person originally entitled to designate Simpkins as an Outside Director and hence retained the power to remove him even after Klaassen's removal as CEO. However, the Court held that Hood had ceased to be an Outside Director and instead filled the CEO Director seat, and thus that Klaassen could not remove him without cause. Finally, the Court found that although Klaassen had validly removed Simpkins from the board, he had not validly replaced him because the stockholders' agreement required that Outside Director seats be filled by nominees designated by the CEO and approved by the Series A Directors. Because Klaassen was no longer the CEO when he attempted to alter the composition of the board, neither of his nominees validly became a director.

On December 18, 2013, on expedited appeal, the Delaware Supreme Court heard argument and soon thereafter affirmed the Court of Chancery's decision, noting that a formal opinion would be forthcoming. *Klaassen v. Allegro Development Corporation*, 2013 WL 6798468 (Del. Dec. 20, 2013). ■

In re Morton's Restaurant Group, Inc. Shareholders Litigation, 74 A.3d 656 (Del. Ch. 2013).

In *In re Morton's Restaurant Group, Inc. Shareholders Litigation*, the Court of Chancery granted the director defendants' motion to dismiss, reasoning that the plaintiffs' complaint was "devoid of…well-pled facts compromising the independence of a supermajority of the board, challenging the adequacy of the board's market check, or suggesting that any bidder received favoritism" and also failed to "plead any facts supporting a rational inference of a conflict of interest" on the part of Morton's largest stockholder or any director.

Morton's Restaurant Group, Inc. had a 10-member board that approved the merger. The board included two executives from the company's 27.7 percent stockholder, Castle Harlan, Inc. The rest of the board included one insider, CEO Christopher Artinian, and seven independent directors. The board conducted a nine-month search for a buyer, beginning in January 2011, before entering into a merger agreement with subsidiaries of Landry's, Inc. Morton's stockholders received $6.90 per share, a 33 percent premium over Morton's pre-announcement market closing price, and all stockholders received the same per share consideration.

Plaintiffs argued that Castle Harlan was a controlling stockholder acting in its own self-interest and causing the Morton's board to sell the company "quickly" and without regard for the long-term interests of the public stockholders, because Castle Harlan allegedly had a unique need for liquidity to invest in a new investment fund.

First, the Court disagreed with plaintiffs' contention that a 27.7 percent stockholder, who nominated only two of ten board members, was a controlling stockholder. The Court declined to equate the facts with those in *In re Cysive, Inc. Shareholders Litigation*—the Court's "most aggressive finding" that a minority blockholder was a controlling stockholder. There, a 35 percent stockholder was also the company's visionary founder, CEO and chairman. In *Morton's*, the Court found nothing in the complaint suggesting that Castle Harlan could control the corporation in the same way the defendant in *Cysive* had, regardless of the fact that Castle Harlan had once owned the entire company.

Second, the Court reasoned that even if Castle Harlan was a controlling stockholder, plaintiffs nonetheless failed to plead facts supporting the inference that Castle Harlan had an improper conflict of interest. Plaintiffs argued that Castle Harlan wanted to sell the company quickly as a means of gaining liquidity for its new investment fund. But the plaintiffs also conceded that, during the sales process, the board reached out to over 100 bidders, signed over 50 confidentiality agreements, employed two different investment banks to help test the market, and treated all bidders evenhandedly. In fact, plaintiffs admitted they could not identify a single logical buyer that Morton's did not contact. The Court therefore concluded that plaintiffs failed to plead facts supporting the conclusion that the merger was a fire sale in which Castle Harlan's interest in selling quickly trumped its own natural interest in maximizing the sales price, and therefore created a conflict of interest with the other stockholders.

Moreover, the Court noted that when the largest stockholder supports an arm's-length transaction that spreads the merger consideration ratably across all stockholders, without any special treatment for itself, the stockholder's conduct presumptively falls within a safe harbor and immunizes the transaction from challenge.

The Court also rejected the argument that the board breached its fiduciary duties by allowing its financial advisor to provide financing for the Landry's bid. Morton's M&A committee had weighed the decision and only allowed its advisor to finance the bid if it recused itself from further negotiations and reduced its fee by $600,000. The company took those funds and hired a second financial advisor. The Court concluded that these steps could not support an inference that the directors breached their duty of loyalty.

Because Morton's had an exculpatory provision in its certificate of incorporation, plaintiffs needed to plead a non-exculpated breach of duty to survive a motion to dismiss. Because the Court of Chancery concluded that the board did not breach its duty of loyalty and did not act in bad faith in agreeing to the merger agreement, it granted the motion to dismiss.

In re MFW Shareholders Litigation, 67 A.3d 496 (Del. Ch. 2013).

Chancellor Strine granted summary judgment in a stockholder class action brought to challenge a merger of M&F Worldwide Corp. with its controlling stockholder, MacAndrews & Forbes Holdings Inc. In *In re MFW Shareholders Litigation*, the Court of Chancery decided a novel question of law, ruling that "when a controlling stockholder merger has, from the time of the controller's first overture, been subject to (i) negotiation and approval by a special committee of independent directors fully empowered to say no, and (ii) approval by an uncoerced, fully informed vote of a majority of the minority investors, the business judgment rule standard of review applies."

MacAndrews & Forbes owned 43 percent of M&F Worldwide and offered to purchase the remaining equity of M&F Worldwide in a going-private merger for $24 per share. From the outset, MacAndrews & Forbes stated that it would not proceed with any such transaction that was not approved by an independent special committee and by a majority of the unaffiliated minority stockholders. The transaction received both approvals.

Stockholder plaintiffs withdrew a motion for preliminary injunction in favor of seeking a post-closing damages remedy for breach of fiduciary duty. After discovery, defendants moved for summary judgment.

The Court of Chancery recognized the well-settled law from the Delaware Supreme Court that approval by either a special committee or a majority of the minority stockholders would shift the burden of proof from the defendants to the plaintiffs but would not change the standard of review, which remained entire fairness. After extensive review of the Delaware Supreme Court's precedents, the Court of Chancery concluded that it had never been decided which standard of review would apply if *both* procedural mechanisms were employed, and that statements in those precedents suggesting application of the entire fairness standard to such a case were *dicta*. Viewing the issue as open, the Court of Chancery determined that "the rule of equitable common law that best protects minority investors is one that encourages controlling stockholders to accord the minority this potent combination of procedural protections." Because no factual dispute remained that both mechanisms were employed properly in this transaction, the Court applied the business judgment rule and entered summary judgment for defendants on all counts.

Frank v. Elgamal, C.A. No. 6120-VCN (Del. Ch. Mar. 30, 2012).

In *Frank v. Elgamal*, the Court of Chancery held that entire fairness review would apply to the merger of American Surgical Holdings, Inc. ("American Surgical") with an unaffiliated private equity purchaser in which American Surgical's minority stockholders were cashed out. Because the Court concluded that the plaintiff had adequately alleged the existence of a control group, the Court found that the merger would be subject to entire fairness review under the standard set forth in *In re John Q. Hammons Hotels Inc. Shareholder Litigation.*, 2009 WL 3165613 (Del. Ch. Oct. 2, 2009).

The American Surgical board designated two directors as a special committee charged with negotiating the terms and conditions of any potential transaction involving the sale of the company. After conducting a strategic process, the company entered into a merger agreement with an unaffiliated private equity firm, Great Point Partners I, LP ("Great Point"). The plaintiff alleged that the company had received a proposal from a different private equity firm for a multimillion-dollar investment that would have allowed the company to fund its expansion plans and allowed the company's public stockholders to continue their investment in the company. However, this proposed investment was allegedly less lucrative than the Great Point merger proposal to the company's alleged "control group," which included two directors who also served as top managers of the company and two other managers. Accordingly, the plaintiff alleged that the control group pushed forward with the merger with Great Point's affiliate, AH Holdings, Inc.

(“Holdings”), and that the special committee acquiesced to the control group.

The merger was structured as a reverse-triangular merger, in which Holdings merged with American Surgical and American Surgical was the surviving entity. Under the terms of the merger agreement, each share of American Surgical common stock was converted into the right to receive $2.87 in cash. However, on the same day as the execution of the merger agreement, the members of the alleged control group entered into exchange agreements pursuant to which they would exchange, immediately prior to the merger, some of their American Surgical stock for shares of Holdings. As a result, while all other American Surgical stockholders would be cashed out through the merger, the members of the control group would retain an interest in the company. The members of the control group also entered into voting agreements, pursuant to which they agreed to vote all of their American Surgical common shares in favor of the merger. Finally, the members of the control group also each executed employment agreements with Holdings, which became effective with the merger.

In addressing the complaint’s breach of fiduciary duty claims, the Court primarily focused on whether the plaintiff had adequately alleged the existence of a control group. The Court began its analysis by noting that Delaware case law has recognized that a number of stockholders could together constitute a control group “where those shareholders are connected in some legally significant way—*e.g.*, by contract, common ownership, agreement, or other arrangement—to work toward a shared goal.” If such a control group exists, it is accorded controlling stockholder status and each of its members owes fiduciary duties to the minority stockholders of the corporation.

Although none of the individuals in the alleged control group owned more than 30 percent of the company’s common stock, they collectively owned more than 70 percent of the common stock as of the record date for voting on the merger. Moreover, the complaint alleged that each member of the control group acted in concert and had contemporaneously entered into the voting agreements, the exchange agreements and the employment agreements. The Court concluded that, for the purposes of a motion to dismiss, these allegations were sufficient to establish the existence of a control group. The Court noted that private equity purchasers often condition a transaction on the continued employment of key members of management and sometimes provide that those persons receive an equity stake in the company. The Court recognized that, in other circumstances, the Court of Chancery had found it permissible to structure a transaction in this way. However, the Court noted that where the complaint adequately alleges that the managers who will be given a continuing interest in the company are members of a control group, it is reasonable for the Court to infer that the managers/control group members are using their control to acquire unique benefits for themselves at the expense of the minority stockholders.

Having concluded that the existence of a control group was adequately alleged, the Court explained that the merger is analogous to the transaction at issue in *Hammons*. Following the reasoning of *Hammons*, the Court explained that, in such circumstances, the controlling stockholders and the minority are “competing” for portions of the consideration that the third-party acquiror is willing to pay. In *Hammons*, the Court of Chancery held that the business judgment rule would apply to such a situation only if the merger was subject to “robust procedural protections,” such as a non-waivable vote of a majority of the minority stockholders and a recommendation by a disinterested and independent special committee. Because American Surgical had not conditioned the merger on approval by a majority of the minority stockholders, the Court found that the transaction would be subject to entire fairness review and therefore refused to grant American Surgical’s motion to dismiss. ■

Allen v. Encore Energy Partners, L.P., No. 534, 2012 (Del. July 22, 2013).

In the latest of a series of decisions addressing conflict of interest transactions involving Delaware limited partnerships, the Delaware Supreme Court once again confirmed that clear, express and unambiguous language modifying default fiduciary duties will be enforced. The transaction at issue in *Allen v. Encore Energy Partners, L.P.* was a merger of a publicly traded Delaware limited partnership with its general partner's controller. Plaintiff was a limited partner of Encore who alleged that the general partner, its controller, and its directors breached the contractual duties imposed by the limited partnership agreement in connection with the merger. The Court of Chancery dismissed the complaint, and the Delaware Supreme Court affirmed such dismissal upon appeal by the plaintiff.

The Supreme Court noted that the limited partnership agreement replaced default fiduciary duties with a contractual duty that would be satisfied if the transaction at issue was approved in "good faith" (as defined by the limited partnership agreement) by the conflicts committee of the board of directors of the general partner. The Supreme Court concluded that the contractual "good faith" standard under the Encore limited partnership agreement required a subjective belief that the determination or other action is in the best interests of Encore. Thus, for plaintiff to meet his pleading burden, he would have to adequately plead either that (i) the conflicts committee believed it was acting against Encore's best interests when approving the merger or (ii) the conflicts committee consciously disregarded its duty to form a subjective belief that the merger was in Encore's best interests. As the Supreme Court observed, it would likely take an extraordinary set of facts to meet such a pleading burden, and plaintiff failed to do so here.

The *Allen v. Encore* Energy decision is yet another example that Delaware courts will not import standards of conduct from corporate or tort law where a limited partnership agreement effectively modifies default duties and establishes clear contractual standards. The contractual flexibility afforded to Delaware limited partnerships can be used to provide general partners with significant protections.

Gerber v. Enterprise Products Holdings, LLC, 67 A.3d 400 (Del. 2013).

In *Gerber v. Enterprise Products Holdings, LLC*, the Supreme Court affirmed in part, reversed in part, and remanded a decision by the Court of Chancery dismissing all claims arising out of the sale of a subsidiary by Enterprise GP Holdings, L.P. ("EPE") to an affiliate and the subsequent merger of EPE into the same affiliate.

In April 2009, EPE sold Texas Eastern Products Pipeline Company, LLC to Enterprise Products Partners, L.P., a publicly traded partnership managed by a subsidiary of EPE (the "Sale"). The Audit, Conflict, and Governance Committee (the "Committee") of EPE's general partner, Enterprise Product Holdings, LLC ("Enterprise Products GP"), composed of independent directors, approved the Sale after receiving a fairness opinion from Morgan Stanley & Co. The Sale was only one half of a two-part transaction in 2009, and Morgan Stanley opined on the fairness of the total consideration for both parts of the transaction—not on the fairness of the portion of the total consideration specifically allocable to the Sale.

In September 2010, Enterprise Products Partners and EPE entered into a merger agreement that provided for Enterprise Products Partners to issue units in exchange for all of the outstanding units of EPE (the "Merger"). Again, the Committee approved the Merger after receiving a fairness opinion from Morgan Stanley, but Morgan Stanley did not independently value derivative claims regarding the Sale and a 2007 transaction that had been challenged.

EPE's limited partnership agreement (the "LPA") supplanted fiduciary duties with a contractual definition of good faith. The LPA also created a "safe harbor" for conflict-of-interest transactions like the Sale and the Merger, providing that any such transaction would be deemed approved by all partners and would not be a breach of the LPA or "any duty stated or implied by law or equity" if it were approved by the Committee. Further, the LPA allowed a "conclusive presumption" that Enterprise Products GP acted in good faith when it took an act in reliance on an expert's opinion.

The plaintiff alleged, among other claims, that the Sale and the Merger were breaches of defendants' express contractual duties under the LPA as well as the implied covenant of good faith and fair dealing. Dismissing all claims, the Court of Chancery ruled that the plaintiff did not state a claim in connection with either transaction.

On appeal, the Supreme Court addressed two major issues: (i) whether the plaintiff's claims were precluded by the "conclusive presumption" provision in the LPA; and (ii) if so, whether the plaintiff adequately pleaded that Enterprise Products GP breached the implied covenant.

The Court first concluded that the LPA's "conclusive presumption" provision did not bar a claim under the implied covenant. The Supreme Court noted that the concept of good faith as a contractual fiduciary duty was very different from the good faith concept addressed by the implied covenant. Unlike a contractual fiduciary duty of good faith, which looks to the parties' relationship at the time of the alleged wrong, the implied covenant looks to the past and asks "what the parties would have agreed to themselves had they considered the issue in their original bargaining positions at the time of contracting." The Court held that the "conclusive presumption" provision only provided a procedure by which Enterprise Products GP could conclusively establish that it met its contractual fiduciary duty, and the presumption could not bar an implied-covenant claim. Further, the Court noted that Enterprise Products GP's attempt to take advantage of the "conclusive presumption" provision could itself be subject to an implied-covenant claim.

The Court then ruled that the plaintiff pleaded a cognizable implied-covenant claim as to the Sale because Morgan Stanley did not opine as to the consideration specifically allocable to the Sale. As to the Merger, the plaintiff pleaded a cognizable implied-covenant claim because he alleged that a principal purpose of the Merger was terminating the derivative claims and Morgan Stanley did not independently value those derivative claims. The Committee's approval did not provide a safe harbor as to either the Sale or the Merger because the plaintiff pleaded that Enterprise Products GP's attempt to obtain the Committee's approvals breached the implied covenant. The Supreme Court noted that only Enterprise Products GP could be liable for breach of the implied covenant because the other defendants were not parties to the LPA.

The Supreme Court then remanded to the Court of Chancery to determine whether the plaintiff had pleaded valid claims against the other defendants for unjust enrichment, tortious interference with contract rights, and aiding and abetting Enterprise Products GP's breach of contract.

Brinckerhoff v. Enbridge Energy Company, Inc., et al., C.A. No. 574, 2001 (Del. May 28, 2013).

In *Brinckerhoff v. Enbridge Energy Company, Inc., et al.*, the Delaware Supreme Court affirmed the Court of Chancery's dismissal of derivative and class claims brought by Peter Brinckerhoff and his trust ("Brinckerhoff"), which held limited partnership units of Enbridge Energy Partners, L.P. ("EEP"). Brinckerhoff's claims arose from a proposed joint venture agreement ("JVA") between EEP and Enbridge, Inc. ("Enbridge"), the indirect parent of EEP's general partner, Enbridge Energy Company, Inc. ("GP").

Under the proposed JVA, Enbridge would finance a portion of the construction and operation of a pipeline, and EEP and Enbridge would share profits from the pipeline proportionate to their capital contributions. GP's board of directors formed a three-member special committee to consider Enbridge's proposal, to determine whether the JVA was fair and reasonable to EEP, and to make a recommendation to the board. The special committee hired legal advisors and a financial advisor who opined that the terms of the JVA were representative of those that would have been maintained in an arm's-length transaction. GP's board accepted the special committee's recommendation that EEP enter into the JVA with Enbridge.

The Court of Chancery dismissed all four counts of the complaint, holding that Brinckerhoff failed to allege facts to support a finding of bad faith. On remand, the Court of Chancery found that Brinckerhoff waived his claims for reformation or rescission. The issue on appeal was whether the terms of EEP's limited partnership agreement (the "LPA") barred Brinckerhoff's claims of (i) breach of express and implied duties under the LPA by causing EEP to enter into the JVA on terms that were not fair or reasonable, and (ii) tortious interference and unjust enrichment.

In relevant part, the LPA indemnified GP and its affiliates for losses sustained as a result of acts or omissions made in good faith. Moreover, the LPA provided GP with a conclusive presumption of good faith if it relied on a consultant's opinion, as long as GP reasonably believed the opinion was within the consultant's professional or expert competence. The Court of Chancery concluded that GP was presumed to have acted in good faith and that Brinckerhoff failed to plead bad faith because the special committee had hired a financial advisor to opine on the terms of the JVA. Additionally, the Court of Chancery found that even though the other appellees besides GP did not have the benefit of the conclusive presumption, the complaint otherwise failed to allege bad faith on their part.

The Supreme Court affirmed, but declined to address the effectiveness of a conclusive presumption in a limited partnership agreement because the Court of Chancery separately found that Brinckerhoff failed to allege facts suggesting that GP acted in bad faith.

Norton v. K-Sea Transportation Partners L.P., et al., No. 238, 2012 (Del. May 28, 2013).

In *Norton v. K-Sea Transportation Partners L.P., et al.*, the Supreme Court affirmed the Court of Chancery's dismissal of a complaint and upheld the enforcability of a provision in a limited partnership agreement providing for a conclusive presumption of good faith where the general partner reasonably relied upon an opinion prepared by a competent expert.

The dispute arose out of a merger between K-Sea Transportation Partners L.P. ("K-Sea"), a Delaware master limited partnership, and Kirby Corporation ("Kirby"). K-Sea's general partner, K-Sea General Partner L.P. ("K-Sea GP"), held incentive distribution rights ("IDRs") that entitled K-Sea GP to percentages of K-Sea's distributions once payments to K-Sea's limited partners exceeded certain levels. After making an initial offer for all of K-Sea's equity interests, Kirby submitted a modified offer for K-Sea on February 15, 2011 that included a payment for the IDRs (the "IDR Payment"). K-Sea's board referred the proposed transaction to a conflicts committee, which retained independent legal and financial advisors. The financial advisor opined that the consideration K-Sea's unaffiliated common unitholders would receive was fair from a financial point of view. After receiving the fairness opinion, the conflicts committee recommended that the K-Sea board approve the transaction, and it did so.

Plaintiff Norton alleged that (i) the conflicts committee breached its fiduciary duties by recommending the transaction without evaluating the fairness of the IDR Payment; (ii) K-Sea GP, its general partner, K-Sea General Partner GP LLC ("KSGP") and the K-Sea board breached their fiduciary duties by approving an unfair transaction; (iii) K-Sea GP, KSGP and the K-Sea Board breached their fiduciary duties by approving a transaction in reliance on an improperly constituted conflicts committee; and (iv) the K-Sea board breached its duty of disclosure by causing K-Sea to issue a materially misleading Form S-4. The Court of Chancery dismissed the complaint in its entirety. On appeal, the Supreme Court considered the contractual standards in K-Sea's limited partnership agreement (the "LPA") that applied to the transaction, including, among other provisions, a provision creating a conclusive presumption that K-Sea GP acted in good faith if K-Sea GP relied on a competent advisor's opinion.

Although the conflicts committee of the board of KSGP actually obtained the financial advisor's opinion, the Court concluded that K-Sea GP nevertheless was entitled to the protection of the presumption because it would be unreasonable to infer that the entire board did not rely on the opinion obtained by the conflicts committee, and because K-Sea GP is a pass-through entity controlled by KSGP. The provision at issue required only that K-Sea GP rely upon its financial advisor's opinion "as to matters that [K-Sea GP] reasonably believes to be within such Person's professional or expert competence" in order to trigger the conclusive presumption that K-Sea GP acted in good faith, but the Court nevertheless expressly noted that Norton failed to substantively attack the financial advisor's opinion. Specifically, Norton did not allege (i) that the financial advisor lacked expertise to render the opinion, or (ii) that the analyses underlying the fairness opinion were flawed, and he conceded that the unaffiliated unitholders received a fair price. Accordingly, the Court concluded that K-Sea GP was entitled to a conclusive presumption that it acted in good faith and did not breach the LPA. Norton's remaining claim necessarily failed because he could not state a cognizable claim against the other defendants for causing K-Sea GP to take an action that was not in breach of K-Sea GP's duties under the LPA. Finally, the Court observed that Norton did not claim on appeal that the defendants breached the implied covenant of good faith and fair dealing, thereby suggesting that an implied covenant claim would not be foreclosed even where a conclusive presumption of good faith was triggered.

Senior Housing Capital, LLC v. SHP Senior Housing Fund, LLC, 2013 WL 1955012 (Del. Ch. May 13, 2013).

In *Senior Housing Capital, LLC v. SHP Senior Housing Fund, LLC*, the Court of Chancery considered, *inter alia*, the level of judicial review applicable to an appraisal process required by an LLC agreement. The Court held that "[w]here, as here, (i) a contract written by one party, (ii) says that that party will make a payment based on a formula, (iii) the formula says that an input into the formula will be determined by an appraiser, and (iv) the party making the payment gets the contractual right to select the appraiser, the parties have clearly agreed to be bound by that appraiser's professional judgment." The Court will not disturb the results of such an appraisal unless the objecting party can show that the result was tainted by improper conduct of the other party.

The parties to this dispute were investors in SHP Senior Housing Fund, LLC (the "Fund"), a company formed to invest in retirement homes. The main plaintiff ("Plaintiff") was the former manager of the Fund and held a minority interest. The main defendant ("Defendant") held a majority interest in the Fund. Under the Fund's LLC agreement, Plaintiff was to receive an "Incentive Distribution" at the end of 2007 and a payment in redemption of its limited liability company interest when Plaintiff withdrew as a member of the Fund. Both payments were to be calculated based upon the fair market value of the Fund's assets, and the LLC agreement provided that such value was to be determined by an appraiser selected by Defendant. The LLC agreement did not provide a mechanism whereby a party unhappy with the results of an appraisal could appeal to a court for review.

In 2007, the assets of the Fund were appraised for purposes of calculating the Incentive Distribution. In 2008, Plaintiff withdrew from the Fund, and a new appraisal was conducted for purposes of calculating the redemption payment. The appraisal showed substantial appreciation in the value of the assets, and such appraisal would have entitled Plaintiff to payments in excess of $50 million. Defendant balked at the high payment and pressured Plaintiff to renegotiate the terms of the LLC agreement. Failing to achieve a compromise, Defendant pressured the appraisers to revise their estimates and hired additional appraisers, hoping to receive lower estimates. Defendant did not pay either the Incentive Distribution or the redemption, and Plaintiff filed suit.

The key issue to resolving both the Incentive Distribution and the redemption payment was the appropriate judicial standard of review where "one of the parties seeks to dispute the value determined by the contractually designated appraiser." The Court agreed with Plaintiff and held that a court may not second-guess appraised values that have been contractually committed to determination by an expert, but a court may consider claims that the appraisal process has been tainted by the conduct of one of the parties. In reaching this conclusion, the Court noted that Delaware respects the freedom of contract, and when parties agree that the valuation of the property will determine a contractual payment, the parties may also agree to establish the level of judicial review over that valuation. Here, the parties designated an appraiser to determine definitively the value of property and did not provide for substantive review by a third party; therefore, a court may not review the appraiser's determination of value. Judicial review was limited to a determination of whether misconduct by the opposing party tainted the appraisal process.

The Court did not find any evidence of misconduct by Plaintiff. However, the Court found that Defendant's conduct in pressuring the appraisers to reduce their estimates improperly tainted the appraisal process, thereby breaching the implied covenant of good faith and fair dealing. Therefore, for purposes of calculating the Incentive Distribution and the value of the limited liability company interests, the Court ruled that the parties must use the original appraisal values.

Poppiti v. Conaty, 2013 WL 1821621 (Del. Ch. May 1, 2013).

In a brief letter opinion, the Court of Chancery granted partial summary judgment to the liquidating trustee of a dissolved LLC and instructed him to distribute the assets of the LLC in accordance with Section 18-804 of the Delaware LLC Act, as contemplated by the LLC's liquidation agreement. In so holding, the Court declined to apply the doctrine of *quantum meruit* where the evidence showed the existence of an express agreement among the parties.

The dispute arose from the 2010 dissolution of a law firm in which Thomas Conaty and James Curran had been the sole members. Under the firm's operating agreement, Conaty and Curran split the firm's profits evenly between them. On September 24, 2010, Conaty and Curran entered into a liquidation agreement under which a liquidating trustee was appointed. The liquidation agreement provided, in relevant part, that the liquidating trustee should distribute firm assets in accordance with Section 18-804 of the LLC Act.

The parties disputed the distribution of a substantial award of fees resulting from the 2011 settlement of litigation. The liquidating trustee sought to distribute the award equally between Conaty and Curran. Conaty objected, however, and argued that he was entitled to receive the full award because he had done substantial post-dissolution work on behalf of his clients in connection with the litigation. The Court found that Curran had not waived his interest in the fees.

In his brief, Conaty conceded that the award was a firm asset. The Court concluded that the liquidating trustee's decision to distribute firm assets to members in proportion to their interests in the firm was "consistent with his obligations under the Liquidation Agreement." The Court noted that contrary to Conaty's assertion that the liquidation agreement did not address the distribution issue, the liquidation agreement plainly provided that the liquidating trustee should distribute firm assets in compliance with Section 18-804 of the LLC Act. Thus, as the Court explained, the liquidating trustee should make distributions first to the firm's creditors, second to reimburse members' capital contributions, and then third to the members in proportion to their interests in the firm.

Similarly, in declining to apply the doctrine of *quantum meruit*, the Court found no evidence to support Conaty's claim that his post-dissolution work rendered him a creditor of the firm. *Quantum meruit*, a quasi-contractual principle of restitution, serves as a basis for recovery to prevent unjust enrichment. In order to recover in *quantum meruit*, "the performing party under a contract must establish that it performed services with an expectation that the receiving party would pay for them, and that the services were performed under circumstances that should have put the receiving party on notice that the performing party expected the recipient to pay for those services." *Avantix Laboratories, Inc. v. Pharmion, LLC*, 2012 WL 2309981, at *10 (Del. Super. June 18, 2012) (internal citations omitted). Typically, the doctrine of *quantum meruit* only applies where there is no express agreement between the parties. Here, the Court found that the liquidation agreement expressly vested the liquidating trustee with the sole authority to act on the firm's behalf in winding up the affairs of the firm, including with regard to the distribution of profits. As such, the Court held that the application of the doctrine of *quantum meruit* would be improper and ordered the liquidating trustee to distribute residual firm assets to the members in proportion to their membership interests.

Auriga Capital Corporation v. Gatz Properties, LLC, C.A. 4390-CS (Del. Ch. Jan. 27, 2012).

In *Auriga Capital Corporation v. Gatz Properties*, the Court of Chancery stated that, unless a limited liability company agreement expands, restricts or eliminates the fiduciary duties owed by a manager, a manager is subject to the fiduciary duties of loyalty and care. After holding a trial, the Court concluded that the manager of Peconic Bay, LLC breached both his fiduciary duties and contractual duties under Peconic Bay's limited liability company agreement.

Peconic Bay was formed for the purpose of acquiring a leasehold interest in a piece of land owned by Peconic Bay's manager, Gatz Properties, LLC, developing the land into a golf course and subleasing the course to American Golf Corporation, a professional golf course operator. Gatz Properties and its affiliates owned a sufficient percentage of interests in Peconic Bay to veto or approve any transaction proposed for the company. Gatz Properties was in turn managed by William Gatz, and it is Gatz's actions that were the Court's focus.

The plaintiffs accused Gatz of being a disloyal and negligent fiduciary and having breached Peconic Bay's limited liability company agreement. The plaintiffs alleged that Gatz and his affiliates were able to obtain fee simple ownership of a piece of property improved by millions of dollars of investment for a price well below market value. As a defense Gatz argued, first, that his actions were not subject to any fiduciary duty analysis because Peconic Bay's limited liability company agreement displaced fiduciary duties, and, second, that his actions were taken in good faith and with due care and that he was able to obtain the improved property at a low price because Peconic Bay was insolvent at the time of the acquisition. After a trial, the Court agreed with the plaintiffs.

On Gatz's first defense, the Court concluded that a manager of a Delaware limited liability company owes the traditional duties of loyalty and care unless the duties are expanded, restricted or eliminated by a limited liability company agreement. While the Delaware Limited Liability Company Act does not plainly state that traditional fiduciary duties of loyalty and care apply to a manager, the Act provides for the application of principles of equity in any case not provided for in the Act. In addition, a manager is a fiduciary because a manager is vested with discretionary power to manage the business of the company, and there is an expectation that it will act in the interests of the members of the company. Thus, because Peconic Bay's limited liability company agreement did not contain any general provision modifying the fiduciary duties of a manager, but rather contained a provision that contemplated that a manager would pay a fair price in any transaction between it and Peconic Bay, the traditional duties of loyalty and care were applicable.

On Gatz's second defense, the Court found that Gatz pursued "a bad faith course of conduct to enrich himself and his family without any regard for the interests of Peconic Bay or its Minority Members." In summary, the conduct that gave rise to this finding included (i) a bad faith and grossly negligent refusal to explore strategic alternatives for Peconic Bay when it became clear that American Golf would terminate its sublease, (ii) a bad faith refusal to consider a third party's interest in purchasing Peconic Bay or leasing the golf course, (iii) a bad faith presentation of misleading information about the third party's interest in purchasing Peconic Bay in connection with Gatz's attempt to buy out minority members, and (iv) bad faith and grossly negligent conduct in running a sham auction of Peconic Bay. ■

2013 Amendments to Delaware Law

2013 Amendments to the Delaware General Corporation Law

Legislation amending the DGCL was adopted by the Delaware General Assembly and was signed by the Governor of the State of Delaware on June 30, 2013. Most of the amendments to the DGCL became effective on August 1, 2013, while the remaining amendments will become effective on April 1, 2014. The amendments result in several significant changes to the DGCL. The primary components of the amendments are as follows:

Ratification of Defective Corporate Acts
The Ratification Amendments represent an important development in corporate law, as they enable corporations to use self-help mechanisms to remedy actions that, due to a failure in the original authorization, could be challenged as void or voidable under existing case law. Where the defect is such that the self-help procedure is not available or practical, the Ratification Amendments provide that certain interested parties may petition the Court of Chancery to validate or invalidate, as the case may be, the defective act. The Ratification Amendments include two primary components: new Section 204, which sets forth the procedures and requirements for the self-help remedy, and new Section 205, which gives the Court jurisdiction to hear and determine cases regarding defective corporate acts, whether or not ratified under the self-help procedures.

Under the Ratification Amendments, no corporate act is void or voidable solely on the basis of a "failure of authorization," so long as the act is ratified in accordance with the procedures outlined in new Section 204 or validated by the Court in a proceeding under new Section 205. The Ratification Amendments were designed to overturn the rigid holdings in cases such as *STAAR Surgical Co. v. Waggoner*, 588 A.2d 1130 (Del. 1991), that have held that stock issued in violation of statutory or charter-based requirements is void and cannot be cured or ratified. This precedent has led the Court, in cases such as *Blades v. Wisehart*, 2010 WL 4638603 (Del. Ch. Nov. 17, 2010), to invalidate certain defective corporate acts, even if such invalidation is inequitable. New Section 204 and new Section 205 give corporations (as well as the Court, upon application by specified parties) a path to avoid such inequitable outcomes. While intended principally to address defects in stock issuances, the Ratification Amendments encompass a broad array of corporate acts that, due to a failure of authorization, could be susceptible to challenge. In so doing, the Ratification Amendments provide corporations (and, upon application, the Court) the ability to give legal effect to acts that parties had intended to be valid.

Two concepts are fundamental to the application of the Ratification Amendments: "defective corporate act," which is the act that the parties seek to validate, and "failure of authorization," which is the defect in the original approval of the act the parties seek to validate. The term "defective corporate act" is intended to include all types of corporate acts and transactions, including elections or appointments of directors, that were within the power of the corporation under the DGCL. The concept of the corporation's power under the DGCL, as used in the Ratification Amendments, refers to the general powers that any Delaware corporation is authorized to exercise. The "defective" component is the "failure of authorization," which is generally defined as non-compliance with the DGCL, the corporation's certificate of incorporation or bylaws, or any plan or other agreement to which the corporation is a party, where the failure to comply with such provisions, documents or instruments would render such act void or voidable. Through this definition, new Section 204 recognizes that not all failures to comply with any "plan or other agreement" would render an act "void or voidable." New Section 204 should not be read as creating a negative implication that failure to comply with any plan or agreement, of itself, necessarily renders any particular act void or voidable.

The term "defective corporate act" includes an "overissue" of stock and other defects in stock issuances that could cause stock to be treated as void or voidable. New Section 204 thus provides a means of cure, as contemplated by Section 8-210 of the Delaware Uniform Commercial Code, for stock issued in excess of the number of shares the corporation is authorized to issue. New Section 204 also provides a means to give effect to the provisions of Section 8-202(b) of the Delaware Uniform Commercial Code, which provides that stock in the hands of a purchaser for value without notice of the defect is generally valid in the hands of such purchaser even if issued with a defect going to its validity. New Section 204 also provides a means of determining which shares constitute the "overissued" shares in various circumstances.

New Section 204 enables the board of directors to take steps, without the need to seek assistance from the Court, to validate defective corporate acts. Implicit in the board's power to take such self-help measures, though, is the existence of a valid board. In cases where, due to defects in the corporate structure or for other reasons, a valid board is not in place, parties would need to take action under new Section 205 or existing Section 225 for relief.

While new Section 204 is intended to mitigate the harsh outcomes that might otherwise result from non-compliance with statutory or other corporate requirements, it is not a *carte blanche* for boards of directors to avoid those requirements. The defective corporate act would have to be approved by board resolution. That resolution would have to contain certain information regarding the defective corporate act to be ratified, including a summary of the act, the time at which the act was taken, and the nature of the defect in its authorization. This would include, in the case of a defective corporate act relating to the issuance of shares, the number of shares purportedly issued, the date they were purportedly issued, the class or series of such shares, and the problem with the issuance.

In cases where the defective corporate act would have required stockholder approval, the board of directors would be required to submit the ratifying resolution to a vote of stockholders. To ensure that the Ratification Amendments are not used as a means of circumventing Section 203, the DGCL's principal anti-takeover statute, new Section 204 requires any defective corporate act resulting from a failure to comply with Section 203 to be submitted to stockholders for ratification, regardless of whether a stockholder vote would have been required at the time of the defective corporate act.

New Section 204 includes provisions that establish the quorum and voting requirements applicable to any board vote required to adopt a ratifying resolution. Those requirements are based on the quorum and vote applicable at the time of adoption for the type of defective corporate act proposed to be ratified. If the certificate of incorporation or bylaws of the corporation, any plan or agreement to which the corporation was a party, or any provision of the DGCL at the time of the defective corporate act would have required a larger number or portion of directors or of specified directors for a quorum to be present or to approve the defective corporate act, the presence or approval of such larger number or portion of such directors or of such specified directors would be required. New Section 204, however, recognizes that in cases where directors elected by specified class(es) or series of stock are no longer in office because such class(es) or series are no longer outstanding, the vote of such directors would not be required.

New Section 204 also contains detailed provisions for providing notice to, and seeking a vote of, stockholders in cases where a stockholder vote would be required. In these cases, the corporation would need to provide notice to all current holders of the corporation's valid stock and "putative stock" (generally, stock that would be valid but for a defect in authorization) as well as to holders of valid stock and putative stock as of the time of the defective corporate act, in each case, whether such shares are voting or non-voting shares. In the latter case, new Section 204 provides that the notice need not be provided if the holders at such earlier date cannot be determined from the corporation's records. New Section 204 requires that the notice contain a copy of the ratifying resolution as well as a statement regarding the 120-day limitations period, imposed by new Section 204 on challenges to acts ratified under new Section 204 or validated under new Section 205. New Section 204 then provides for the quorum and stockholder vote necessary to adopt the ratifying resolutions. As a general matter, the quorum and vote required at the time the ratifying resolution is submitted to the stockholders would be sufficient to adopt the resolution, unless the DGCL, the certificate of incorporation or bylaws, or another plan or agreement in effect at the time of the defective corporate act would have required a greater vote. As with the quorum and vote required for the board's vote, the stockholder quorum and vote provisions make exceptions, in the latter case, for shares of any class(es) or series that are no longer outstanding. In the case of an election of directors, ratification requires the affirmative vote of the majority of shares present at the meeting and entitled to vote on the election of the director (or such greater vote that would have been required under the certificate of incorporation or bylaws at the time of the election). Thus, a "plurality" of the votes would not be sufficient to ratify an election. In addition, ratification of a failure to comply with Section 203 requires the vote required under Section 203(a)(3)—generally, 66 2/3 percent of the voting stock owned by holders other than the "interested stockholder."

New Section 204 provides that, if the defective act being ratified would have required a filing with the Delaware Secretary of State (*e.g.*, a certificate of amendment, certificate of designation, certificate of merger or other instrument), the corporation is required to file a new instrument called a "certificate of validation." The certificate of validation must set forth (i) a copy of the ratifying resolution, (ii) the date of its adoption by the board of directors and, if applicable, the stockholders, (iii) the information that would have been specified in the filing that would otherwise be required, and (iv) if a certificate was previously filed with respect to the defective corporate act being ratified, the title and the date of the filing of such previously filed certificate and any certificate of correction thereto.

New Section 204 gives effect to existing case law that the ratification of a prior act relates back to the time of the original act. Thus, under new Section 204, unless otherwise determined by the Court in an action pursuant to new Section 205, each defective corporate act (or each share purportedly issued) that is ratified pursuant to new Section 204 would be retroactively valid as of the time of the defective corporate act. Thus, for purposes of the DGCL, shares that were intended to be issued at a certain date, or options that were intended to be granted at a certain date, would be valid as of those dates if properly ratified in accordance with new Section 204.

To further ensure that new Section 204 does not operate to prejudice the rights of any party in interest, it requires that notice of the ratifying resolution be provided even where no stockholder approval is necessary. This notice would need to be provided to all current stockholders as well as to holders of valid and putative stock as of the time of the defective corporate act to be ratified (unless those holders cannot be identified from the corporation's records). This notice would need to contain substantially the same notice provided to stockholders in the case where a vote of stockholders is required.

Given that the Ratification Amendments were designed to give corporations an opportunity to cure defective corporate acts that, under existing law, would be void and not susceptible to cure under the common law of ratification, they recognize that the new provisions are not intended to preempt or restrict other means of ratifying acts that are merely voidable.

The corollary to new Section 204 is new Section 205. New Section 205 confers jurisdiction on the Court of Chancery to hear and determine the validity of any ratification effected pursuant to new Section 204 and the validity of any corporate act or transaction and any stock or rights or options to acquire stock, and to modify or waive any of the procedures set forth in new Section 204. New Section 205 gives corporations (upon application by specified interested parties) the ability to seek a determination of the validity of acts that are not susceptible to cure under new Section 204. It also gives various parties the right to challenge the validity of ratifications under new Section 204 as well as the right to challenge defective corporate acts. Where a party is challenging a defective act ratified in accordance with new Section 204, it would be required to do so within a 120-day limitations period, subject to certain exceptions. After that date, the act would not be invalidated.

While the Ratification Amendments provide corporations with substantial authority to seek ratification of defective corporate acts, they do not affect the fiduciary duties applicable to any particular decision—either the initial decision by the board to approve the defective corporate act or the later decision by the board to seek ratification of the act. The new sections are concerned solely with statutory validity; they would not limit equitable review or restrict the courts from invalidating corporate acts or transactions on equitable grounds.

Formula for Stock Issuance Consideration

The amendments add language to Section 152 of the DGCL, which addresses the authorization and issuance of capital stock, to clarify that a board of directors may determine the price or prices at which the corporation's stock is issued by approving a formula by which such price or prices is determined. This enables, among other things, stock to be issued for consideration derived by reference to, for example, the market price of the stock measured over a period of time.

Elimination of Required Vote in Certain Second-Step Mergers

The amendments add a new subsection (h) to Section 251, which (absent a provision in a corporation's certificate of incorporation to the contrary) eliminates the requirement for a stockholder vote to authorize a second-step merger that follows a public tender offer, subject to certain requirements. The new subsection applies only to target corporations whose shares are listed on a national securities exchange or held of record by more than 2,000 holders immediately prior to the execution of the merger agreement. New subsection 251(h) simplifies the consummation of a second-step back-end merger of a public target corporation which follows a first-step tender offer by, subject to satisfying the requirements for its application, eliminating the need to satisfy the short-form merger 90 percent ownership requirement (directly in the first-step tender offer or through the use of a top-up option after the tender) in order to avoid the requirement for a stockholder vote thereon.

Under new subsection 251(h), a vote of the target corporation's stockholders is not be required to authorize the merger if: (i) the merger agreement expressly provides that the merger shall be governed by this new subsection and shall be effected as soon as practicable following the consummation of the offer described below; (ii) a corporation consummates a tender or exchange offer for any and all of the outstanding stock of the target corporation on the terms provided in such merger agreement that would otherwise be entitled to vote on the adoption of the merger agreement; (iii) following the consummation of the offer, the consummating corporation owns at least the percentage of the stock of the target corporation that otherwise would be required to adopt the merger agreement; (iv) at the time the target corporation's board of directors approves the merger agreement, no other party to the merger agreement is an "interested stockholder" (as defined in Section 203(c) of the DGCL) of the target corporation; (v) the corporation consummating the offer merges with the target corporation pursuant to such merger agreement; and (vi) the outstanding shares of the target corporation not canceled in the merger are converted in the merger into the same amount and kind of consideration paid for shares in the offer.

The amendments also amend Section 252 of the DGCL to reflect the usage of subsection 251(h) in the context of a Delaware corporation merging with a non-Delaware corporation. The amendments make additional changes to Section 262 of the DGCL to provide that appraisal rights would be available for a merger effected pursuant to subsection 251(h), unless all of the stock of the target corporation is owned by the offering corporation immediately prior to the merger.

New subsection 251(h) does not change the fiduciary duties of directors in connection with such mergers or the level of judicial scrutiny that would apply to the decision to enter into such a merger agreement, each of which would be determined based on the common law of fiduciary duty, including the duty of loyalty. Since subsection 251(h) applies only if provided for in the merger agreement, the target board would retain the negotiating leverage it currently has regarding top-up options.

Public Benefit Corporations

In a development that may be of significant interest to social entrepreneurs, the amendments add a new subchapter XV to the DGCL (Sections 361 through 368) to enable Delaware corporations to be incorporated as, or subject to certain restrictions, to become, "public benefit corporations." Such corporations remain subject to all other applicable provisions of the DGCL, except as modified or supplanted by the new subchapter.

In general, a public benefit corporation is a corporation managed in a manner that balances the stockholders' pecuniary interests, the interests of those materially affected by the corporation's conduct, and one or more public benefits identified in its certificate of incorporation. To this last point, each public benefit corporation is required, in its certificate of incorporation, to identify itself as a public benefit corporation and to state the public benefits it intends to promote. The new subchapter generally defines "public benefits" as positive effects (or minimization of negative effects) on persons, entities, communities or interests, including those of an artistic, charitable, cultural, economic, educational, literary, medical, religious, scientific or technological nature.

Central to the new subchapter's operation is the statutory mandate imposed on directors that directors, in managing the business and affairs of the public benefit corporation, shall balance the pecuniary interests of the stockholders, the interests of those materially affected by the corporation's conduct, and the identified public benefits. The new subchapter also provides that directors shall not have any duty to any person solely on account of any interest in the public benefit and would provide that, where directors perform the balancing of interests described above, they will be deemed to have satisfied their fiduciary duties to stockholders and the corporation if their decision is both informed and disinterested and not such that no person of ordinary, sound judgment would approve.

The new subchapter imposes special notice requirements on public benefit corporations, mandating periodic statements to stockholders regarding the corporation's promotion and attainment of its public benefits. The new subchapter also provides a means of enforcing the promotion of the public benefits. By statute, stockholders holding at least 2 percent of the corporation's outstanding shares (or, in the case of listed companies, the lesser 2 percent of the outstanding shares or shares having at least $2 million in market value) are able to maintain a derivative lawsuit to enforce specified requirements in the subchapter.

The new subchapter contains limitations on the power of public benefit corporations to adopt amendments to their certificates of incorporation or effect mergers or consolidations if the effect would be to abandon their public benefit purpose. These limitations would be imposed through a 66 2/3 percent vote of each class of the public benefit corporation's outstanding stock.

The new subchapter also contains limitations on the power of corporations that are not public benefit corporations to amend their certificates of incorporation to become public benefit corporations or to effect mergers or consolidations that would result in their stockholders receiving shares in a public benefit corporation. These actions would require a 90 percent vote of each class of the corporation's outstanding stock. New subchapter XV also provides appraisal rights to any stockholder of a corporation that is not a public benefit corporation that, by virtue of an amendment to the corporation's certificate of incorporation or any merger or consolidation, receives equity interests in a public benefit corporation. Corresponding changes to Section 262 of the DGCL, the appraisal section, have also been made.

Restrictions on "Shelf" Corporations

The amendments also make changes to Section 312(b) of the DGCL and Section 502(a) of title 8 of the Delaware Code that are intended to deter the practice of forming "shelf" corporations—that is, corporations with no stockholders or directors that are "aged" for use many years in the future. The amendments accomplish this goal by confirming the limited powers of an incorporator. The amendments clarify that only a corporation's directors or stockholders may authorize a renewal or revival of a corporation that has ceased to be in good standing. The amendments also prohibit an incorporator from signing any annual franchise tax report other than the corporation's initial report. In addition, the amendments prohibit such later reports from listing "no directors," except in the case of a report filed in connection with the corporation's dissolution.

2013 Amendments to Delaware Alternative Entity Law

The Delaware General Assembly has recently enacted legislation amending the Delaware Limited Liability Company Act (DLLCA), the Delaware Revised Uniform Limited Partnership Act (DRULPA) and the Delaware Revised Uniform Partnership Act (DRUPA) (collectively, the "Acts"). The recent amendments reflect Delaware's continuing commitment to maintaining statutes governing Delaware limited liability companies (Delaware LLCs), limited partnerships (Delaware LPs) and general partnerships (Delaware GPs) that effectively serve the business needs of the national and international business communities.

The recent amendments to DLLCA are contained in House Bill No. 126 (effective August 1, 2013). The amendments to DRULPA are contained in House Bill No. 124 (except for Sections 1, 2 and 4 thereof, effective August 1, 2013; Sections 1, 2 and 4 thereof (i) contain certain clarifying amendments to DRULPA relating to Delaware limited liability limited partnerships, which are limited partnerships where the general partner may have limited liability, and (ii) become effective April 1, 2014). The amendments to DRUPA are contained in House Bill No. 123 (effective August 1, 2013).

The following is a brief summary of some of the more significant amendments that affect Delaware LLCs, Delaware LPs and Delaware GPs (each, a Delaware Alternative Entity and collectively, Delaware Alternative Entities).

Default Fiduciary Duties Applicable to Delaware LLCs

In *Gatz Properties, LLC v. Auriga Capital Corp.*, 59 A.3d 1206 (Del. 2012), the Delaware Supreme Court invited the Delaware legislature to clearly answer the question as to whether default fiduciary duties apply to Delaware LLCs. In response to the invitation in *Gatz*, DLLCA has been amended to confirm that in some circumstances default fiduciary duties apply to Delaware LLCs. The synopsis accompanying the amendments to DLLCA provides, as an example, that a manager of a manager-managed limited liability company would ordinarily have fiduciary duties even in the absence of a provision in the limited liability company agreement establishing such duties. DLLCA continues to provide that fiduciary duties may be expanded, restricted or eliminated by provisions in a limited liability company agreement.

Charging Order Exclusive Remedy for Judgment Creditor

The Acts have been amended to confirm that a charging order is the exclusive remedy by which a judgment creditor of a member, a partner or a member's or partner's assignee, as applicable, of a Delaware Alternative Entity may satisfy a judgment out of the judgment debtor's interest in a Delaware Alternative Entity. The amendments specifically provide that attachment, garnishment, foreclosure and other legal and equitable remedies are not available to a judgment creditor of a member, partner or assignee.

Confirmation of Applicability of DLLCA Provisions to Single-Member and Multi-Member Delaware LLCs

DLLCA has been amended to confirm that the provisions of DLLCA (including the provision regarding a charging order) apply whether a Delaware LLC has one member or more than one member.

Domestications, Transfers, Continuances, Conversions and Mergers Involving Delaware Alternative Entities

The Acts have been amended to confirm that in connection with a domestication, transfer, continuance or conversion, rights or securities of, or interests in, an entity that is domesticating or converting to a Delaware Alternative Entity and rights or securities of, or interests in, a Delaware Alternative Entity that is transferring to or domesticating or continuing in another jurisdiction or converting to a different type of entity or another jurisdiction may remain outstanding in connection with such domestication, transfer, continuance or conversion. In connection with a merger involving a Delaware Alternative Entity, the amendments to the Acts confirm that the rights or securities of, or interests in, a constituent party that is the surviving entity in a merger may remain outstanding in connection with the merger. ■

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