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 with 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, play 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 we have handled, as Delaware counsel, the most merger and acquisition transactions valued at $100 million or more for 15 years running, as reported in *The Deal* and *Corporate Control Alert*. 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.

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C&J Energy Services, Inc. v. City of Miami General Employees' and Sanitation Employees' Retirement Trust, No. 655/657, 2014 (Del. Dec. 19, 2014).

In *C&J Energy Services, Inc. v. City of Miami General Employees' and Sanitation Employees' Retirement Trust,* the Delaware Supreme Court reversed the Court of Chancery's decision to grant an "unusual" 30-day preliminary injunction of the merger between C&J Energy Services, Inc., a Delaware corporation ("C&J"), and a division of Nabors Industries Ltd., a Bermuda company ("Nabors"). As an inversion transaction, the merger was structured such that C&J would acquire a subsidiary of Nabors, with Nabors retaining a majority of the surviving company's equity. Although it was the buyer, C&J bargained for a passive, post-signing "fiduciary out" to accept a superior proposal and for a relatively low termination fee.

Although the Court of Chancery found that C&J's board was fully informed as to C&J's value, and there was no finding that the board was conflicted, the Court of Chancery found it was "plausible" that the board had violated its duties under *Revlon* to seek the highest immediate value reasonably available, because the board did not engage in an active pre- or post-signing market check. The Court of Chancery enjoined the stockholder vote for 30 days and required C&J to shop itself, stating that the solicitation of proposals during that period would not breach the merger agreement.

The Delaware Supreme Court held that the Court of Chancery had misapplied the standard for issuance of a preliminary injunction, which requires the moving party to establish a "reasonable probability of success on the merits" and not (as the Court of Chancery formulated its finding) "a plausible showing of a likelihood of success on the merits." The Supreme Court also ruled that the Court of Chancery's analysis was based on the incorrect proposition that a company selling itself is required to conduct an active marketing process for its board to satisfy its duties under *Revlon*. After reiterating that there is no "single blueprint" that a board must follow when conducting a sales process, the Supreme Court stated that "when a board exercises its judgment in good faith, tests the transaction through a viable passive market check, and gives its stockholders a fully informed, uncoerced opportunity to vote to accept the deal, [the Court] cannot conclude that the board likely violated its *Revlon* duties."

Finally, the Supreme Court held that the Court of Chancery's mandatory preliminary injunction was improper because it was not issued on a factual record made after trial or on undisputed facts and because it stripped an innocent third party (Nabors) of its contractual protections while simultaneously binding that party to consummate the transaction.

In re Comverge, Inc., 2014 WL 6686570 (Del. Ch. Nov. 25, 2014).

In *In re Comverge, Inc. Shareholders Litigation,* the Delaware Court of Chancery granted in part the defendants' motion to dismiss a post-closing stockholder challenge to the acquisition of Comverge, Inc. ("Comverge") by H.I.G. Capital, L.L.C. ("HIG"), which acquisition the Court had previously declined to enjoin. The plaintiffs alleged that Comverge's board of directors (the "Board") breached its fiduciary duties by: (i) failing to bring suit against HIG for an alleged breach of a non-disclosure agreement ("NDA") between the parties; (ii) conducting a flawed sale process that failed to maximize value for Comverge's stockholders; and (iii) agreeing to preclusive deal-protection measures that prevented Comverge from soliciting alternative bidders. The plaintiffs also claimed that HIG had aided and abetted the Board in breaching its fiduciary duties.

Comverge had lost money every year of its existence and had long sought, to no avail, to solve its liquidity problems through various types of transactions. In November 2011, HIG contacted Comverge to express an interest in acquiring the company. In February 2012, the Board declined HIG's offer to buy the company for $2.25 per share, in part because another bidder had suggested interest in a transaction with Comverge at a higher price. An affiliate of HIG thereafter acquired certain notes issued by Comverge, which allegedly violated the two-year standstill provision of the NDA. Following notification of HIG's actions, the Board considered, but ultimately decided against, suing HIG for breach of the NDA. The notes gave HIG significant leverage over Comverge because they carried the right to accelerate Comverge's debt and provided HIG with prior approval rights over any acquisition transaction. HIG promptly took advantage of its leverage by notifying Comverge that it was in default under the notes and indicating that it would accelerate the debt under the notes unless the Board accepted HIG's new, lower-priced offer to acquire the company for $1.50 per share. After further negotiation with HIG, the Board agreed to a merger with HIG at a price of $1.75 per share. At the time of the Board's approval of the merger, Comverge's stock was trading at $1.88 per share. The merger agreement included a go-shop period during which HIG agreed not to exercise its blocking rights under the notes. During the go-shop period, Comverge had the right to terminate the transaction to pursue a superior proposal by paying HIG a total fee of 5.55% of the deal's equity value. After the go-shop period, the total payment required to terminate the agreement rose to 7% of the deal's equity value. In addition, Comverge entered into a $12 million bridge financing agreement with HIG pursuant to which Comverge issued HIG notes that were convertible into shares of Comverge common stock at a conversion price of $1.40 per share, which was $0.35 lower than the deal price and $0.48 lower than the then-current trading price of Comverge's shares.

The Court granted the defendants' motion to dismiss in part, finding that the Board's decision not to sue on the NDA and the Board's sale process did not violate the Board's fiduciary duties. The Court held that the Board's decision to pursue a sale transaction rather than uncertain, costly and potentially time-consuming litigation against HIG based on a possible violation of the NDA was reasonable, especially in light of Comverge's dire financial situation. With respect to the plaintiff's sale process claims, the Court found that the Board had engaged in "hard-fought" negotiations with HIG and had canvassed the market and considered alternatives to the transaction over an 18-month period before agreeing to the merger. While the sale process ultimately resulted in a lower deal price than HIG's initial offer due to HIG's superior bargaining position after acquiring the notes, the Court found that the Board's conduct at most amounted to a breach of the duty of care and did not support a claim for a non-exculpated breach of the duty of loyalty.

The Court also dismissed the aiding and abetting claims against HIG. The Court noted that Delaware case law recognizes an aiding and abetting claim if the acquirer in a merger induces the target board to breach its fiduciary duties "by extracting terms which require the opposite party to prefer its interests at the expense of the shareholders." While recognizing that HIG's "hard-nosed and aggressive" negotiating strategy was designed to take advantage of Comverge's precarious financial position, the Court concluded that HIG had not exploited self-interest on the part of the members of the Board in a manner that would give rise to liability for aiding and abetting a breach of fiduciary duty.

Finally, the Court found that it was conceivable that the combined effect of the termination fee, the expense reimbursement and the convertible bridge loan could have had an impermissibly preclusive effect on potential alternative bidders. The Court noted that, even at the lower end, the combined termination fee and potential expense reimbursement would be 5.55% of the equity value of the transaction and would test the limits of what the Court, in its past decisions, had found to be within a reasonable range for termination fees. At the higher end, the Court noted that the plaintiffs had contended that the combined fees and Comverge stock issuable under the notes upon termination of the merger agreement could amount to as much as 11.6% to 13.1% of the equity value of the transaction. In light of the potential magnitude of the combined fees and in the context of a deal with a negative premium to market, the Court held that it was reasonably conceivable that the Board had acted unreasonably in adopting the potentially preclusive deal-protection measures and refused to grant the defendants' motion to dismiss in respect of the plaintiffs' claim that the Board breached its fiduciary duties in agreeing to such measures.

Quadrant Structured Prods Co. v. Vertin, 102 A.3d 155 (Del. Ch. Oct. 1, 2014); *Quadrant Structured Prods Co. v. Vertin,* 2014 WL 5465535 (Del. Ch. Oct. 28, 2014).

In *Quadrant Structured Products Company, Ltd. v. Vertin,* 102 A.3d 155 (Del. Ch. Oct. 1, 2014), the Delaware Court of Chancery held that the contemporaneous ownership requirement of Section 327 of the General Corporation Law of the State of Delaware (the "DGCL") does not apply to corporate creditors for purposes of determining whether a creditor has standing to bring derivative claims against the board of directors of an insolvent corporation. The Court also declined to dismiss the creditor's fiduciary duty and fraudulent transfer claims related to certain transactions between the corporation and its controlling stockholder, but granted the motion to dismiss with respect to fiduciary duty claims related to the decision of the board of directors to pursue a "risk-on" business strategy that allegedly favored junior creditors over more senior creditors.

The individual defendants were members of the board of directors (the "Board") of Athilon Capital Corp. ("Athilon") that were allegedly controlled by EBF & Associates ("EBF"), Athilon's sole stockholder and the holder of junior notes issued by Athilon (the "Junior Notes"). The plaintiff, Quadrant Structured Products Company, Ltd. ("Quadrant"), owned debt securities issued by Athilon that were senior to the Junior Notes held by EBF. Quadrant alleged that the EBF-controlled Board took a number of actions while Athilon was insolvent to benefit EBF at the expense of its other stakeholders, including (i) paying interest on the Junior Notes instead of deferring the payments to future periods as permitted by the terms of the Junior Notes, (ii) entering into certain agreements with EBF's affiliates at above-market rates, and (iii) amending the limited purpose provisions in Athilon's certificate of incorporation to allow Athilon to pursue a riskier business model that allegedly preferred the interests of EBF over more senior creditors.

As a preliminary matter, the Court held that Quadrant, as a creditor of Athilon, had standing to pursue its claims derivatively. The Court clarified that the fact of insolvency does not give rise to any special duty that is owed by a board of directors *directly to the corporation's creditors,* but rather gives the corporation's creditors derivative standing to enforce the general fiduciary duty that the board of directors owes *to the corporation* to maximize the firm's value for all residual claimants. In addition, the Court declined to extend the contemporaneous ownership requirement of Section 327 of the DGCL to creditors, thereby holding that creditors are not prevented from bringing derivative claims in respect of transactions that pre-date the corporation's insolvency or their acquisition of an insolvent corporation's debt. Although the argument was not raised by the defendants, the Court noted that it is possible that creditors could be required to comply with other substantive principles of derivative actions, such as demand excusal and demand refusal, in order to pursue derivative claims.

With respect to Quadrant's substantive claims, the Court found that Quadrant's allegations adequately stated a claim for breach of fiduciary duty and fraudulent transfer with respect to the payment of interest on the Junior Notes and the agreements with EBF's affiliates. Furthermore, because EBF was a controlling stockholder that allegedly stood on both sides of the transactions, the Court held that the transactions would be subject to scrutiny under the entire fairness standard of review. The Court dismissed Quadrant's claims with respect to the Board's decision to pursue a riskier business strategy, finding that the directors had made decisions that appeared rationally designed to increase the value of the firm as a whole rather than impermissibly preferring the interests of EBF, as a junior creditor and stockholder, to the interests of other residual claimants. Finally, the Court concluded that none of the directors could invoke the protections of the exculpatory provision in Athilon's certificate of incorporation because three of the directors were officers of either Athilon or EBF and it was not possible at the motion to dismiss stage of the proceeding to determine whether any breach of fiduciary duty on the part of the other two directors resulted solely from a breach of the duty of care.

In a decision issued less than one month later, the Court of Chancery, in *Quadrant Structured Products Company, Ltd. v. Vertin,* 2014 WL 5465535 (Del. Ch. Oct. 28, 2014), denied Quadrant's motion for reconsideration of the dismissal of claims related to the Board's risk-on strategy. Quadrant contended that the Court had overlooked the importance of the fact that Athilon was a limited purpose corporation and that pursuing the riskier business strategy was outside the scope of its original purpose, as set forth in its certificate of incorporation. Quadrant also argued that the Court had failed to consider whether its allegations were sufficient to support an inference of bad faith and rebut the business judgment rule with regard to the Board's decision to amend the corporation's certificate of incorporation in order to pursue the riskier strategy. The Court noted that Quadrant's first argument did not present grounds for reconsideration because Quadrant's own complaint established that Athilon's governing documents authorized the Board's risk-on strategy. Specifically, the complaint recognized that the Board had the authority to amend Athilon's certificate of incorporation and, thus, could expand Athilon's limited purpose to make investments involving greater risk. With respect to Quadrant's second argument, the Court noted that the motion to dismiss opinion considered and rejected Quadrant's bad faith claims when it held that the Board had made a rational business decision to pursue a riskier investment strategy.

Houseman v. Sagerman, 2014 WL 1600724 (Del. Ch. Apr. 16, 2014).

In *Houseman v. Sagerman,* the Court of Chancery, by Vice Chancellor Glasscock, in addressing defendants' motion to dismiss claims related to the 2011 acquisition of Universata, Inc. ("Universata") by HealthPort Technologies, LLC ("HealthPort"), held that the failure to obtain a fairness opinion in connection with the acquisition did not rise to the level of bad faith on the part of the board of directors of Universata (the "Board") and did not support an aiding and abetting claim against the Board's financial advisor.

In 2006, the plaintiffs (husband and wife) sold their business to Universata for a seven-year stream of payments totaling $9 million. Several years later, in 2009, when Universata had difficulty satisfying its payment obligations, the plaintiffs agreed to convert some of their debt into shares of Universata common stock. As part of the transaction, Thomas Whittington, a director and stockholder of Universata, granted the plaintiffs a put right obligating Whittington, under certain circumstances, to pay the plaintiffs $2.10 for each share of their common stock (the "Put Contract"). In late 2010, HealthPort, and at least one other party, indicated an interest in acquiring Universata. At the suggestion of its legal counsel, Universata hired KeyBanc Capital Markets, Inc. ("KeyBanc"), an investment bank familiar with Universata's business, to assist the Board in conducting due diligence and identifying potential buyers. After considering the relative costs involved, the Board decided not to obtain a fairness opinion in connection with the merger, but did receive an informal recommendation from KeyBanc as to whether the merger consideration was within a range of reasonableness. On May 10, 2011, the Board approved a merger with HealthPort for consideration substantially less than the $2.10 per share that the plaintiffs were, under certain circumstances, entitled to under the Put Contract.

After the merger closed, the plaintiffs filed a lawsuit in Minnesota state court against Whittington for breach of the Put Contract. The Minnesota court dismissed the case with prejudice, finding that, upon the merger with HealthPort, the shares of Universata common stock ceased to exist, and thus the Put Contract was no longer enforceable. Unsatisfied with the result, the plaintiffs brought an action in the Delaware Court of Chancery attempting to re-litigate their claims related to the Put Contact and also alleging, among other things, breach of fiduciary duty for approving the merger and for failing to obtain consideration in the merger for certain "litigation assets" against the Board, and aiding and abetting breach of fiduciary duty against KeyBanc. The Court held, however, that the doctrine of issue preclusion prevented re-litigation of the Put Contract claims and, accordingly, dismissed those claims.

In addressing the plaintiffs' breach of fiduciary duty claim, the Court noted that because Universata's charter contained a Section 102(b)(7) provision exculpating the directors for breaches of the duty of care, and because it was undisputed that a majority of directors were disinterested in the merger, the plaintiffs were required to allege facts sufficient to show that a majority of the directors acted in bad faith in approving the merger. The plaintiffs pleaded that the Board acted in bad faith by "knowingly and completely" failing to undertake its responsibilities in connection with the merger. While acknowledging that the Board "did not conduct a perfect sales process," the Court found that the Board did not "utterly fail to undertake *any* action to obtain the best price for stockholders" by undertaking "some process," including (i) consulting with legal counsel, (ii) hiring KeyBanc to assist in shopping Universata and to provide an informal recommendation that the consideration was in a range of reasonableness, (iii) considering and deciding, due to the costs, not to obtain a fairness opinion, (iv) considering offers from various bidders, and (v) negotiating with HealthPort. Thus, the Court dismissed the breach of fiduciary claims against the Board.

The Court then turned to the aiding and abetting breach of fiduciary duty claim against KeyBanc. Relying on *In re Rural Metro Corp.,* 88 A.3d 54 (Del. Ch. 2014), the Court held that the Section 102(b)(7) provision did not protect KeyBanc against claims for aiding and abetting breaches of fiduciary duty by the Board. However, the Court determined that the plaintiffs had failed to allege that KeyBanc "knowingly participated" in any breach of duty. The Court distinguished *Rural Metro,* finding that the plaintiffs had failed to allege that KeyBanc "actively concealed information to which it knew the Board lacked access, or promoted the failure of a required disclosure by the Board," or that KeyBanc had misled the Board or created an "informational vacuum" sufficient to support a finding that KeyBanc knowingly participated in a breach of fiduciary duty. The Court also rejected a claim that the limited services provided by KeyBanc supported an inference that KeyBanc knew of a breach by the Board. Again distinguishing *Rural Metro,* the Court found that the evidence suggested that it was the Company's interest, not KeyBanc's, that drove the structure of the financial services provided in connection with the merger. Accordingly, the Court dismissed the plaintiffs' aiding and abetting claims against KeyBanc.

The Court then addressed the plaintiffs' claim that the Board failed to obtain consideration for certain "litigation assets" under *In re Primedia, Inc. Shareholders Litigation,* 67 A.3d 455 (Del. Ch. 2013). According to the plaintiffs, the "litigation assets" included, among other things, latent derivative claims based on the Board's decisions, on the day the merger was approved, to amend Universata's equity incentive plan to treat all employee stock options like outstanding shares of common stock in the merger and to vest certain warrants (including those that the plaintiffs alleged were invalidly issued to certain directors). The Court noted that as a threshold matter, under *Primedia,* the plaintiffs were required to plead that a derivative claim existed at the time Universata and HealthPort negotiated the merger price. Because the Court found that the alleged derivative claims came into existence, if at all, on the day the merger was approved, the Board could not have negotiated a merger price that considered those claims. However, the Court determined that the plaintiffs stated a claim for diversion of assets under *Golaine v. Edwards,* 1999 WL 1271882 (Del. Ch. Dec. 21, 1999), by pleading facts supporting an inference that the Board's actions "represented an improper diversion and that, absent the impropriety, the consideration would have gone to the stockholders."

Chen v. Howard-Anderson, 87 A.3d 648 (Del. Ch. 2014).

In *Chen v. Howard-Anderson,* the Court of Chancery, by Vice Chancellor Laster, ruling on a motion for summary judgment, held that, in a change of control case where the standard of review is enhanced scrutiny, directors and officers could be found liable for acting in bad faith (and thus breach their fiduciary duty of loyalty) if plaintiffs cite evidence sufficient to support an inference that the directors and officers acted unreasonably in conducting the sale process and allowed interests other than the pursuit of obtaining the best price reasonably available to influence their actions. In so holding, the Court distinguished the Delaware Supreme Court's decision in *Lyondell Chemical Co. v. Ryan,* 970 A.2d 235 (Del. 2009).

Viewing the facts in the light most favorable to the plaintiffs for purposes of the defendants' motion for summary judgment, the Court found that the record supported the inference that the directors and officers of Occam Networks, Inc. ("Occam") acted unreasonably in conducting the sale of Occam to Calix, Inc. ("Calix"). The Court next considered the defendants' argument that, under *Lyondell,* the directors were nonetheless protected from liability by the corporation's exculpatory provision unless the plaintiffs could show that the directors had acted in bad faith by "knowingly and completely failing to undertake their responsibilities." The Court rejected this argument. The Court explained that the *Lyondell* decision addressed a situation in which the plaintiffs sought to show bad faith by alleging that the directors had consciously disregarded known duties to act. However, this was not the only theory that plaintiffs could assert in an effort to show bad faith conduct outside the scope of an exculpatory provision. In particular, the Court of Chancery noted that plaintiffs may attempt to establish bad faith conduct by asserting that the directors were influenced by interests other than obtaining the highest price reasonably available for the stockholders. The Court found that the *Lyondell* decision did not address, and therefore was inapplicable to, situations in which plaintiffs attempted to make the bad faith showing through such allegations.

Turning to the evidence presented by the *Chen* plaintiffs, the Court concluded that the evidence was insufficient to support an inference that the outside director defendants acted in bad faith by allowing interests other than the pursuit of obtaining the best price reasonably available to influence their decisions. Accordingly, the Court granted summary judgment with regard to the process-based claims in favor of the outside directors. The Court, however, found that the evidence was sufficient to support such an inference against the officers of Occam. The Court further noted that Section 102(b)(7) of the Delaware General Corporation Law does not authorize exculpation of officers. Therefore, the Court declined to grant summary judgment with regard to the claims against the Occam officers.

Occam was a publicly traded Delaware corporation that developed, marketed and supported products for the broadband access market. From early 2009 to mid-2010, Occam, with the assistance of its financial advisor, Jefferies & Company, Inc. ("Jefferies"), engaged in a series of discussions with two broadband access companies, Calix and Adtran, Inc. ("Adtran"), regarding a potential sale of Occam, and also engaged in discussions with a third broadband access company, Keymile International GmbH ("Keymile"), regarding an acquisition of Keymile by Occam as part of a "stand-alone" alternative to a sales transaction. By June 2010, Occam had submitted a proposal to purchase Keymile for approximately $80 million, Calix had submitted three proposals to acquire Occam (the latest of which had an offer price of $7.72 per share to be paid in a mix of cash and stock), and Adtran had sent Occam a letter of intent proposing an all-cash offer for Occam at a price of $8.60 per share, representing a premium of approximately 11% over Calix's latest offer. After meeting to consider the three alternatives on June 30, 2010, the board of directors of Occam (the "Board") directed management and Jefferies to give Adtran a 24-hour deadline to submit a revised bid and instructed Jefferies to conduct a 24-hour market check to determine whether any other third parties might be interested in a transaction with Occam.

Neither Adtran nor any of the third parties contacted by Jefferies submitted a revised proposal to acquire Occam by the deadline set by the Board. Five of the seven parties contacted by Jefferies did, however, express some degree of interest in a transaction, but noted that the timeframe was too short for a meaningful response. Shortly thereafter, the Board directed management to enter into an exclusivity agreement with Calix based on its offer of $7.72 per share. Despite Occam's improved financial performance during the exclusivity period (which the parties subsequently extended), on September 15, 2010, the Board approved the merger with Calix for consideration then valued at $7.75 per share, consisting of a mix of 49.6% cash and 50.4% stock. The Occam stockholders approved the merger agreement, and the merger closed in February 2011.

In post-closing litigation, the plaintiffs alleged that the directors and officers of Occam breached their fiduciary duties during the sale process by unreasonably favoring Calix over Adtran and by failing to develop or pursue other alternatives to the merger that could have generated higher value for Occam's stockholders. The plaintiffs also claimed that the proxy statement contained materially misleading information regarding the sale process and projections prepared by Occam's management during the sale process.

The Court held that the transaction was subject to the enhanced scrutiny standard of review. Applying enhanced scrutiny review to the defendants' motion for summary judgment, the Court found that the record supported the inference that the process employed by the defendants fell outside the range of reasonableness by, among other things, unreasonably favoring Calix over Adtran and other potential bidders during the sale process, by giving Adtran a 24-hour ultimatum to revise an offer that was already at a premium to Calix's best offer, and by instructing Jefferies to conduct a 24-hour market check over a holiday weekend and then not following up with third parties that expressed interest. In light of the exculpation provision in Occam's charter that insulated the director defendants from liability for breaches of the duty of care and the Court's determination that the plaintiffs failed to establish that a majority of the directors were not independent and disinterested, the director defendants argued that they could not be found liable under enhanced scrutiny review unless their actions were motivated by bad faith. They argued that, under *Lyondell,* bad faith requires evidence that the director defendants had an actual intent to do harm or had consciously disregarded their obligations by utterly failing to attempt to obtain the best price reasonably available for Occam.

The Court rejected the argument that the category of bad faith conduct that was at issue in *Lyondell* is the only type of bad faith claim available to plaintiffs, and concluded that the plaintiffs could survive summary judgment under other recognized theories of bad faith, including the plaintiffs' claim that the defendants had acted in bad faith by intentionally acting with a purpose other than advancing the best interests of Occam. However, the Court concluded that the record did not support an inference that the outside directors had acted with such an improper purpose, and for that reason granted summary judgment in favor of the outside directors as to the process-based claims. The Court denied summary judgment on the process-based claims as against the officer defendants on the grounds that there was greater evidence of self-interest with respect to the officers and that the officers, when acting in such capacity, were not covered by the exculpatory provision.

The Court also declined to grant summary judgment with regard to the plaintiffs' disclosure-based claims. The Court noted that it was not clear at the summary judgment stage whether the alleged disclosure violations resulted from a breach of the duty of loyalty or the duty of care, and therefore a trial was necessary to determine whether, and to what degree, the exculpatory provision insulates the director defendants from potential liability related to such claims. The Court also noted that it could not infer that the directors acted in good faith due to evidence in the record that supported a finding that the directors knew about certain projections for the year 2012 that were not disclosed, that they were in a position to know that certain statements in the fairness opinion relating to those projections were false, and that the defendants had engaged in questionable conduct during discovery relating to the projections.

In re Rural Metro Corporation Stockholders Litigation, 88 A.3d 54 (Del. Ch. Mar. 7, 2014); C.A. No. 6350-VCL (Del. Ch. Oct. 10, 2014).

In a 91-page post-trial opinion in *In re Rural Metro Corporation Stockholders Litigation,* C.A. No. 6350-VCL (Del. Ch. Mar. 7, 2014), the Delaware Court of Chancery held RBC Capital Markets, LLC (RBC) liable for aiding and abetting breaches of fiduciary duty by the board of directors of Rural/Metro Corporation ("Rural") 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.

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 the 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 an opinion assessing damages in *In re Rural/Metro Corp. S'holders Litig.,* C.A. No. 6350-VCL (Del. Ch. Oct. 10, 2014), the Court of Chancery held that RBC, which had been held liable in the earlier opinion for aiding and abetting breaches of fiduciary duty by a board of directors in connection with approving a merger and related disclosures, would be required to pay 83% of the damages to the stockholder class. Relying on a discounted cash flow analysis, the Court determined that the fair value of Rural on a quasi-appraisal basis fell short of the merger price by $4.17 per share, and that the damages to the class of stockholders not affiliated with the defendants totaled approximately $91.3 million.

Rural/Metro, its directors and the company's other financial advisor had settled before trial and obtained "joint tortfeasor" releases, under which the plaintiff class agreed that the damages recoverable against other tortfeasors would be reduced to the extent of the settling defendants' respective pro rata shares, as permitted by the Delaware Uniform Contribution Among Tortfeasors Law, 10 *Del. C.* § 6301, *et seq.* The Court held that the unclean hands doctrine barred the non-settling financial advisor from claiming a settlement credit as to claims involving that financial advisor's adjudicated "fraud upon the board," but that it could claim a settlement credit as to other claims. The Court determined that the record at trial supported a finding that two of Rural/Metro's directors were joint tortfeasors, but did not support such a finding as to the other directors or the settling financial advisor. Allocating responsibility for the various claims on which liability had been previously found, the Court entered judgment for approximately $75.8 million against RBC.

In re Answers Corporation Shareholders Litigation, 2014 WL 463163 (Del. Ch. Feb. 3, 2014).

In *In re Answers Corporation Shareholders Litigation,* the Court of Chancery, by Vice Chancellor Noble, granted summary judgment in favor of the defendants in an action brought by stockholder plaintiffs challenging the merger by which Answers Corporation ("Answers") was acquired by AFCV Holdings, LLC ("AFCV"), a portfolio company of private equity firm Summit Partners, L.P. (together with AFCV, the "Buyout Group"), for $10.50 per share (the "Merger"). In so ruling, the Court found that there was no evidence that the board of directors of Answers (the "Board"), which was made up of a majority of independent and disinterested directors, acted in bad faith or was controlled by the alleged conflicted directors on the Board, and thus reaffirmed the Court's deference to boards composed of a majority of independent and disinterested directors in conducting a sales process.

Answers was a public corporation that operated the website answers.com, a leading question and answer website that was dependent, in large part, on Google for its traffic and advertising revenue. Prior to the merger, Answer's largest stockholder was the venture capital firm Redpoint Venture ("Redpoint"), which had the right to designate two directors to the Board (the "Redpoint-Designated Directors"). It was undisputed that four of the seven directors—those other than Answers' chief executive officer and founder, Robert Rosenschein, and the two Redpoint-Designated Directors—were independent. In early 2010, Redpoint received an unsolicited expression of interest from AFCV concerning a potential acquisition of Answers. Shortly thereafter, the Board decided to engage a financial advisor to assist it in considering the proposed transaction with AFCV and exploring other strategic alternatives for Answers. Over the next approximately nine months, the Board considered various strategic alternatives for Answers, considered other unsolicited expressions of interest, and negotiated with AFCV regarding a potential acquisition.

By December 2010, after months of negotiations with AFCV and the Board's repeated rejections of AFCV's requests for exclusivity, the Board succeeded in obtaining a price increase from the originally proposed range of $7.50 to $8.25 per share to $10.25 per share. Around this time, the Board authorized its financial advisor to conduct a market check of 10 other possible strategic buyers, which did not result in any other offers. By the end of 2010, the financial performance of Answers appeared to improve. The Board was aware, however, that Answers' dependence on Google and the possibility that Google might begin a competing business could affect Answers' financial performance in the future. Regardless, the Board used the improved financial performance to obtain another increase in price from $10.25 to $10.50 per share. Thus, following receipt of a fairness opinion as well as advice from its financial advisor that another bidder was unlikely to emerge, the Board approved the Merger.

Following announcement of the merger agreement, plaintiffs unsuccessfully sought a preliminary injunction to prevent the stockholder vote on the Merger. In earlier post-closing litigation, the Court held that the plaintiffs' breach of fiduciary duty of loyalty claims against the Board were sufficient to survive a motion to dismiss. In addressing the defendants' motion for summary judgment, the Court noted that, because the Merger was approved by a board composed of a majority of disinterested and independent directors, and because Answers' certificate of incorporation contained an exculpatory provision, the plaintiffs "must rely on claims that the Board acted in bad faith or that it was controlled by an interested party to survive" summary judgment. Accordingly, the plaintiffs alleged that Rosenschein and the Redpoint-Designated Directors were conflicted and controlled the negotiation process with AFCV and that the Board acted in bad faith by agreeing to sell Answers before its stock price exceeded AFCV's offer by (i) purposefully engaging in a limited shopping process, (ii) failing to act in the interests of Answers' public stockholders by accepting an offer price that was too low, and (iii) intentionally ignoring alternatives to the Merger.

The Court rejected the plaintiffs' claims of bad faith in the sale process. The Court held that defendants had established that the Board, among other things, considered a variety of transactions, rejected AFCV's requests for exclusivity, rejected several of AFCV's offers as inadequate, performed a market check through Answers' financial advisor, attempted to increase the price obtained until the deal was approved, and received advice from its financial advisor that additional bidders were unlikely to come forward. In response to the plaintiffs' objections to the two-week duration of the market check and the Board's decision to pursue only 10 strategic acquirers, the Court found that "even this limited market check does not constitute a complete abandonment of fiduciary duty" and is sufficient to defeat a bad faith claim. In addition, the plaintiffs contended that the Board did not respond to changed circumstances and gain an adequate increased price after Answers achieved better than expected fourth-quarter results. The Court found, however, that the Board had plausible business concerns about the stability and future success of Answers, including its dependence on Google, and that AFCV did in fact increase its offer price after being provided with the fourth-quarter results.

In addressing the plaintiffs' claims that Rosenschein and/or the Redpoint-Designated Directors controlled the Board, the Court found that the record demonstrated that there was no evidence that Rosenschein and/or the Redpoint-Designated Directors applied pressure to the other members of the Board in connection with the transaction. The Court further found that the Board's decision to sell the Company was supported by various reasons cognizable under the business judgment rule (such as concern over future competition from Google and an uncertain future revenue stream). As a result, the Court concluded that the Board did not act in bad faith and that Rosenschein and the Redpoint-Designated Directors did not control the Board, and therefore granted summary judgment in favor of the defendants.

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. The 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.

Deal Protection Devices

In re Family Dollar Stores, Inc. Stockholder Litigation, C.A. No. 9985-CB (Del. Ch. Dec. 19, 2014).

In *In re Family Dollar Stores, Inc. Stockholder Litigation,* the Court of Chancery declined to preliminarily enjoin the stockholder vote on the merger of Family Dollar Stores, Inc. and Dollar Tree, Inc., pursuant to which Dollar Tree would acquire Family Dollar for a combination of cash and Dollar Tree stock. After Family Dollar agreed to merge with Dollar Tree, Dollar General, Inc. sought to acquire Family Dollar. When Family Dollar's board refused to engage in negotiations, Dollar General commenced a public tender offer to acquire Family Dollar shares. Unlike the merger between Family Dollar and Dollar Tree, where antitrust approval was considered to be a formality, Dollar General's tender offer has not received antitrust approval.

Stockholders of Family Dollar sought to enjoin the vote on the merger until Family Dollar's board engaged with Dollar General and made corrective disclosures. The plaintiffs' core claim was that Family Dollar's board breached its fiduciary duty under *Revlon* when it declined to engage with Dollar General. The Court concluded that the plaintiffs failed to demonstrate a reasonable probability of success on any of their claims. The Court found that Family Dollar's board was properly motivated to maximize Family Dollar's value. Noting the advice that Family Dollar's board received with respect to the significant antitrust risks associated with a potential transaction with Dollar General, the Court found that Family Dollar's board had acted reasonably under the no-shop provisions of its agreement with Dollar Tree in determining not to engage with Dollar General.

The Court also concluded that the plaintiffs failed to demonstrate the existence of irreparable harm or that the balance of the equities favored a preliminary injunction, stating that nothing prevented Dollar General from improving its offer to address the antitrust risks, while noting that the entry of a preliminary injunction would deprive Family Dollar's stockholders of the opportunity to decide whether to approve a premium transaction offering apparent deal certainty.

Merger Agreement Construction

Cigna Health & Life Insurance Co. v. Audax Health Solutions, Inc., 2014 WL 6784491 (Del. Ch. Nov. 26, 2014).

In *Cigna Health & Life Insurance Company v. Audax Health Solutions, Inc.,* the Delaware Court of Chancery found invalid features of a private company merger agreement that required stockholders, as a condition to receiving their merger consideration, to submit a letter of transmittal agreeing to provide a release of all claims against the acquirer and that further required stockholders to indemnify, for an indefinite period of time, the acquirer for claims arising from the seller's breach of representations and warranties.

The opinion arose from the acquisition of Audax Health Solutions, Inc. ("Audax") by Optum Services, Inc. ("Optum"). In connection with the merger, certain stockholders of Audax executed support agreements that included: (i) a release of all claims against Optum and its affiliates, (ii) an agreement to be bound by the terms of the merger agreement, specifically including the provisions indemnifying Optum and its affiliates for any breaches of the representations and warranties, and (iii) an appointment of a stockholder representative. In order to receive the merger consideration under the merger agreement, stockholders who did not execute the support agreements were required to execute the letter of transmittal containing the release. Following the merger, Cigna Health and Life Insurance Company ("Cigna"), a holder of preferred stock of Audax who did not execute a support agreement and refused to execute the letter of transmittal, challenged, among other things, the validity of the release in the letter of transmittal and the indemnification provisions of the merger agreement.

On Cigna's motion for judgment on the pleadings, the Court held that the purported release in the letter of transmittal was unenforceable due to a lack of consideration. In so holding, the Court rejected the defendants' argument that the release was integral to the overall transaction, noting that provisions in the merger agreement that required the letter of transmittal to be in form and substance reasonably acceptable to the acquirer did not indicate that the stockholders would be required to agree to the release. The Court further explained that endorsing the defendants' position would permit buyers to force post-closing conditions or obligations not referenced in the merger agreement on the stockholders in a letter of transmittal. Accordingly, the Court found that the release constituted a new obligation that was unenforceable absent consideration. The Court held that the merger consideration could not constitute consideration for the release because the stockholders had already become entitled to it by operation of law upon the closing of the merger.

The Court also held that the indemnification provisions were unenforceable against stockholders who had not executed the support agreements. In response to Cigna's challenges to the indemnification provisions, the defendants argued that the indemnification obligation was substantively no different from an escrow arrangement, which is common in private company mergers and has previously been recognized by the Delaware courts as enforceable. Despite noting the economic similarities between the indemnification provisions and an escrow arrangement, the Court found that "the merger consideration here more aptly can be described as cash, subject to an open-ended post-closing price adjustment." In this connection, the Court explained that such price adjustments are permissible under Delaware law if they comply with Section 251 of the General Corporation Law of the State of Delaware (the "DGCL"), which requires a merger agreement to set forth a determinable merger consideration by stating the cash, property, rights or securities that the stockholders are entitled to receive in the merger.

In determining whether the indemnification provisions violated Section 251 of the DGCL, the Court distinguished the facts at hand from those in *Aveta, Inc. v. Cavallieri,* 23 A.3d 157 (Del. Ch. 2010). In *Aveta,* the Court of Chancery found that the post-closing price-adjustment procedures in a merger agreement (which included an earn-out, adjustments based on the company's financial statements, and a potential claw-back) were permissible under Section 251 of the DGCL. The Court noted that, unlike the merger agreement in *Aveta,* the indemnification provisions in the Audax-Optum merger agreement were not limited in terms of the amount of money that might be subject to a claw-back or the time period during which Optum could potentially bring a claim for indemnification. Rather, the indemnification structure in the Audax-Optum merger agreement continued indefinitely and made the value of the merger consideration indeterminable. Accordingly, the Court held that the merger agreement failed to set forth the value of the merger consideration as required by Section 251 of the DGCL, and the indemnification provisions were thus unenforceable against stockholders who did not specifically agree to such obligations by executing the support agreements or the merger agreement itself.

The Court specifically noted the narrow scope of the opinion and clarified that it was not deciding issues relating to (i) escrow agreements generally, (ii) the general validity of post-closing price adjustments requiring direct repayment from stockholders, (iii) whether a time-limited price adjustment that covers all of the merger consideration may be valid, or (iv) whether an indefinite adjustment period as to a portion of the merger consideration may be valid. Instead, the Court explained that it was the combination of the indefinite and contingent nature of the entirety of the consideration payable under the Audax-Optum merger agreement that resulted in the violation of Section 251 of the DGCL.

Great Hill Equity Partners IV, LP v. SIG Growth Equity Fund I, LLLP, C.A. No. 7906-CS (Del. Ch. Nov. 15, 2013; Nov. 26, 2014).

In *Great Hill Equity Partners IV, LP v. SIG Growth Equity Fund I, LLLP,* C.A. No. 7906-CS (Del. Ch. Nov. 15, 2013), 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 a fact-intensive, 76-page motion to dismiss opinion, *Great Hill Equity Partners IV, LP v. SIG Growth Equity Fund I, LLLP,* C.A. No. 7906-VCG (Del. Ch. Nov. 26, 2014), the Delaware Court of Chancery largely denied the defendants' motions to dismiss fraud claims arising out of the sale of Plimus, a private Delaware corporation (the "Company"), to Great Hill, a private equity fund. The Court analyzed the specific factual allegations of a complaint that had been amended following the Court's earlier opinion holding that the Company's privileges, including pre-sale communications with counsel, passed to Great Hill in the merger by which it acquired the Company. *See Great Hill Equity Partners IV, LP v. SIG Growth Equity Fund I, LLLP,* 80 A.3d 155

(Del. Ch. 2013). The Court found that the amended complaint stated a claim for civil conspiracy and aiding and abetting fraud against a private equity fund that before the sale was the Company's single largest stockholder and had two designees on the Company's five-person board of directors. The Court also held that the amended complaint stated a claim for fraud against the selling private equity fund's two director designees.

The *Great Hill* opinion provides significant insight into issues arising in connection with private company M&A transactions, applying well-established law in the context of detailed factual allegations of fraud.

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 and publisher 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% 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. The Vice Chancellor reasoned, "This is an $8 billion reorg. of Activision. Value is moving. Value is moving to the former controller. Value is moving to management."

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 combination" 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.

Termination Fees

Cooper Tire & Rubber Co. v. Apollo (Mauritius) Holdings Pvt. Ltd., 2014 WL 5654305 (Del. Ch. Oct. 31, 2014).

In *Cooper Tire & Rubber Company v. Apollo (Mauritius) Holdings Pvt. Ltd,* the Delaware Court of Chancery found that Cooper Tire & Rubber Company ("Cooper") had not satisfied all of the conditions to closing its merger with Apollo (Mauritius) Holdings Pvt. Ltd ("Apollo") as of the trial date, and thus was likely barred from seeking a $112 million reverse termination fee under the merger agreement.

Cooper and Apollo entered into a merger agreement pursuant to which Apollo would acquire Cooper. Shortly thereafter, a series of events occurred that precipitated the deal's demise. First, a labor union at Chengshan Cooper Tires ("CCT"), a Chinese facility that was majority owned by Cooper, publicly stated its opposition to the merger and commenced an employee strike in protest. The union also physically barred Cooper-appointed managers from entering the facility or obtaining access to CCT's financial data entry systems. It was alleged that the parties later determined that the CCT strike had been initiated by Cooper's minority partner at CCT, who opposed the merger. At the same time, Cooper encountered resistance from its domestic union, the United Steel Workers ("USW"), which claimed that the merger triggered Cooper's obligations to renegotiate its collective bargaining agreements. Apollo attempted to negotiate with the USW, but was unsuccessful in resolving the dispute.

Once it became clear that the deal was in danger of failing, Cooper sued Apollo in the Court of Chancery seeking specific performance or damages for breach of contract based on Apollo's alleged failure to negotiate with the USW in good faith. The Court of Chancery, in an earlier opinion, *Cooper Tire & Rubber Company v. Apollo (Mauritius) Holdings Pvt. Ltd,* 2013 WL 5977140 (Del. Ch. Nov. 9, 2013), ruled against Cooper, which then sought interlocutory appeal of the Court's decision to the Delaware Supreme Court. While the appeal was pending, Cooper notified the Delaware Supreme Court that it intended to terminate the merger agreement and seek a reverse termination fee under the merger agreement rather than pursue its appeal. Apollo then sought to prevent Cooper from collecting the reverse termination fee by seeking a declaratory judgment from the Court that Cooper had not satisfied all conditions to closing the merger. Specifically, Apollo alleged that Cooper was, at the time of trial, in breach of its obligation under the merger agreement to cause each of its subsidiaries to operate in the ordinary course of business. Cooper argued that the interim covenant only applied to actions within Cooper's complete control and that the alleged breaches involved third parties, such as CCT's employees and the USW, that were outside the scope of the interim covenant.

The Court rejected Cooper's interpretation of the interim covenant and held that the events that had occurred at the CCT facility prevented Cooper from complying with its contractual obligations necessary to close the merger. The Court stated that "ordinary course" means "the normal and ordinary routine of conducting business," and that the cessation of CCT's production of Cooper-branded tires, the physical exclusion of Cooper employees from CCT's facilities, and the limitation of Cooper's access to CCT's financials did not comply with that standard. While stating that its opinion only addressed whether Cooper had satisfied its obligations under the merger agreement and the conditions to closing, the Court noted that the effect of the opinion likely would be dispositive of Cooper's ability to collect a reverse termination fee. ■

Stockholder Rights Plans

Third Point LLC v. Ruprecht, et al., C.A. No. 9469-VCP (Del. Ch. May 2, 2014).

In *Third Point LLC v. Ruprecht, et al.,* the Delaware Court of Chancery denied preliminary injunctive relief against Sotheby's annual meeting, scheduled for May 6, 2014. The plaintiffs, including Third Point LLC and other stockholders, claimed that the board had violated its fiduciary duties by (i) adopting a stockholder rights plan with a two-tiered trigger, capping stockholders who file Schedule 13Ds at 10% of the outstanding stock, but permitting passive investors who file Schedule 13Gs to acquire up to 20% of the outstanding stock; and (ii) refusing to grant Third Point, the company's largest stockholder, a waiver enabling it to acquire up to 20% of the outstanding stock. Claiming that the board had acted for the primary purpose of inhibiting Third Point's ability to wage a successful proxy contest, Third Point asked the Court to apply the *Blasius* standard, and argued alternatively that the board's actions were impermissible under the *Unocal* standard. The board argued, among other things, that Third Point's accumulation of Sotheby's stock posed a legally cognizable threat to Sotheby's and that the board's actions in response were proportionate to the threat.

The Court held on a preliminary basis that *Unocal,* rather than *Blasius,* provides the appropriate framework of analysis. Applying the *Unocal* standard, the Court held on a preliminary basis that the majority-independent board had shown that it acted reasonably in identifying a legally cognizable threat—that Third Point, alone or with others, might acquire a controlling interest in the company without paying Sotheby's other stockholders a premium—and that its response to the threat was reasonable. The Court wrote that the issue of the board's refusal of Third Point's request for a waiver presented "a much closer question" than the original adoption of the rights plan, but determined that the board made a sufficient showing as to the threat that Third Point might be able to exercise "negative control" if permitted to accumulate up to 20% of the outstanding stock. Accordingly, the Court denied the application for preliminary injunction.

On May 5, 2014, Sotheby's and Third Point announced a resolution of the dispute, under which Third Point will be allowed to increase its ownership to 15% of the outstanding stock, the board will expand from 12 members to 15, and Third Point's three nominees will be appointed to the board and added to the company's slate of nominees at the 2014 annual meeting, which will be convened and adjourned to allow updated solicitation materials to be distributed.

Section 220 Actions

Wal-Mart Stores, Inc. v. Indiana Elec. Workers Pension Trust Fund IBEW, 95 A.3d 1264 (Del. 2014).

In *Wal-Mart Stores, Inc. v. Indiana Elec. Workers Pension Trust Fund IBEW,* the Supreme Court for the first time held that the *Garner* doctrine, which recognizes an exception to the attorney-client privilege when a "corporation is in suit against its stockholders on charges of acting inimically to stockholder interests," applies in both plenary stockholder/corporation proceedings and demands for company books and records pursuant to Section 220 of the Delaware General Corporation Law. In doing so, the Court affirmed the ruling of the Court of Chancery requiring Wal-Mart Stores, Inc. ("Wal-Mart") to permit the stockholder plaintiff ("IBEW") to inspect, and ordered production of, documents that were subject to the attorney-client privilege or work-product doctrine.

IBEW's Section 220 demand (the "Demand") on Wal-Mart was triggered by an article in *The New York Times* describing allegations of bribery at Wal-Mart's Mexican subsidiary ("Wal-Mex") and a potentially flawed internal investigation of those allegations. IBEW sought to inspect corporate books and records for purposes of investigating potential mismanagement and wrong-doing, ultimately for use in a potential derivative litigation. In response to the Demand, Wal-Mart reviewed over 160,000 documents and produced over 3,000 documents,

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including board and audit committee materials and documents concerning Wal-Mart's compliance program. In response to IBEW's subsequent Section 220 complaint alleging various deficiencies in Wal-Mart's production, the Court of Chancery ordered Wal-Mart to produce an expansive additional set of documents, including documents otherwise protected from disclosure by the attorney-client privilege or the work-product doctrine, finding that they were necessary and essential to IBEW's stated purposes and that there was good cause to invoke the fiduciary exception in *Garner v. Wolfinbarger,* 430 F.2d 1093 (5th Cir. 1970). In *Garner,* the Fifth Circuit established a test for determining whether company stockholders should be allowed access to privileged communications between the company and its counsel. Under the *Garner* doctrine, a corporation may assert the attorney-client privilege to justify withholding documents from its stockholders, "[b]ut where the corporation is in suit against its stockholders on charges of acting inimically to stockholder interests," stockholders may obtain privileged documents on a showing of "good cause."

The Court agreed with the Court of Chancery that the privileged documents sought by IBEW were "necessary and essential" to the purposes in the Demand because IBEW was questioning not only Wal-Mex's actions in Mexico, but the propriety of Wal-Mart's internal investigation itself. The Court first pointed out that "the *Garner* doctrine fiduciary exception to the attorney-client privilege is narrow, exacting, and intended to be very difficult to satisfy." But, when applicable, the Court held that in a Section 220 proceeding, "the necessary and essential inquiry must precede any privilege [*Garner*] inquiry because the necessary and essential inquiry is dispositive of the threshold question—the scope of document production to which the plaintiff is entitled under Section 220," which it found the Court of Chancery had done here. Noting that any *Garner* inquiry will require a court to consider several factors when evaluating whether the stockholder had met its "good cause" burden to apply the privilege exception, the Court found that IBEW had demonstrated good cause, as IBEW was not simply "blindly fishing," the communications sought did not concern the litigation itself, and also, among other factors, the underlying allegations implicated potential criminal conduct.

Appraisal Actions and Proceedings

In re Appraisal of Ancestry.com, Inc., 2015 WL 66825 (Del. Ch. Jan. 5, 2015); ***Merion Capital LP v. BMC Software, Inc.,*** 2015 WL 67586 (Del. Ch. Jan. 5, 2015).

In two opinions issued the same day, the Delaware Court of Chancery addressed standing requirements under Delaware's appraisal statute, Section 262 of the General Corporation Law of the State of Delaware. In both *Merion Capital LP v. BMC Software, Inc*. and *In re Appraisal of Ancestry.com, Inc.,* the Court found that a 2007 amendment to the appraisal statute did not impose a "share-tracing" requirement on an appraisal petitioner's right to demand appraisal of shares acquired after the record date for determining the stockholders entitled to vote on a merger. In so doing, the Court rejected a potential obstacle to so-called "appraisal arbitrageurs" that seek to use Delaware's appraisal process to capitalize on potentially under-valued transactions by purchasing shares of the target company's stock after announcement of a merger.

In *BMC Software,* petitioner Merion Capital LP ("Merion") sought appraisal for 7.6 million shares of common stock of BMC Software, Inc. ("BMC") that were purchased after the record date for a going-private merger. Merion, the beneficial owner of the shares, requested its broker to direct the nominee record holder of its shares to demand appraisal with respect to the purchased shares on Merion's behalf, but the broker refused. Merion then transferred record ownership of the shares into its own name and delivered a formal demand for appraisal to the company. BMC argued that, in order to have standing to pursue its appraisal claims, Merion had the burden of showing that each share it acquired after the record date had not been voted in favor of the merger by the previous holders. The Court rejected this contention and held instead that the unambiguous language of the appraisal statute required Merion to show only that the record holder of the shares that made the demand (in this case, Merion itself) had not voted the shares in favor of the merger.

In *Ancestry.com,* Merion sought appraisal for 1,255,000 shares of common stock of Ancestry.com, Inc. ("Ancestry") purchased after the record date for a cash-out merger. Unlike in *BMC Software,* Merion never transferred its shares into record name, but instead directed Cede & Co., the nominee record holder of the shares, to demand appraisal on Merion's behalf. As permitted by a 2007 amendment to the appraisal statute, Merion, in its capacity as the beneficial owner of the shares, filed a petition for appraisal in the Court of Chancery. Ancestry.com argued that since Merion, as the beneficial owner of the shares, filed the petition for appraisal, Merion was required to show that Merion (rather than the record holder, Cede & Co.) did not vote the shares in favor of the merger. Moreover, Ancestry.com argued because Merion acquired beneficial ownership of its shares after the record date, Merion was also required to show that its predecessor beneficial owners did not vote in favor of the merger. The Court rejected this argument as well, holding that an appraisal petitioner is only required to show that the record holder held of record at least as many shares not voted in favor of the merger as the number for which appraisal demands were submitted.

In both *BMC Software* and *Ancestry.com,* the Court identified, but declined to address, the potential for a theoretical "over-appraisal" scenario, in which a record holder (such as Cede & Co.) would hold shares as nominee for many beneficial owners, would follow those beneficial owners' voting instructions, and would end up owning of record fewer shares not voted in favor of the merger than the number of shares as to which the record holder demanded appraisal. The Court noted that such a theoretical problem at most threatened the policy goals of the appraisal statute, but did not render the statute absurd or inoperable.

Forum-Selection Bylaws

City of Providence v. First Citizens Bancshares, Inc., Consol. C.A. No. 9795-CB (Del. Ch. Sept. 8, 2014).

In *City of Providence v. First Citizens Bancshares, Inc., et al.,* the Court of Chancery granted a motion to dismiss a challenge to a bylaw, adopted by the board of directors of First Citizens Bancshares, Inc. ("FC North"), that requires, to the extent permitted by law, certain intra-corporate claims to be brought exclusively in the United States District Court for the Eastern District of North Carolina, or, if that court lacks jurisdiction, in any North Carolina state court that possesses jurisdiction. The Court held that the logic and reasoning of *Boilermakers Local 154 Retirement Fund v. Chevron Corp.,* 73 A.3d 934 (Del. Ch. 2013) ("*Chevron*"), compelled the decision upholding the facial validity of the forum-selection bylaw, notwithstanding the choice of a non-Delaware forum. The Court also held that the plaintiff had failed to state a claim for breach of fiduciary duty in connection with the adoption of the bylaw and had failed to demonstrate that it would be unreasonable, unjust or inequitable to enforce the bylaw. The Court therefore applied the bylaw to dismiss for improper venue a challenge to the FC North board's decision to enter into a merger agreement with a related party on the same day that it adopted the forum-selection bylaw.

On June 10, 2014, FC North announced both that its board had exercised the authority delegated to it in the certificate of incorporation to adopt several amendments to the bylaws, and that FC North had entered into an agreement to acquire First Citizens Bancorporation, Inc. ("FC South"), a South Carolina corporation under common control with FC North. Among the amendments to the bylaws was a new provision requiring that certain categories of intra-corporate disputes, identical in substance to those covered by the bylaw upheld against facial attack in *Chevron,* be brought in federal court in North Carolina, or if that court lacked jurisdiction, then in North Carolina state court. The plaintiff, the City of Providence, Rhode Island, filed a complaint challenging the validity of the bylaw, both facially and as applied, and a separate complaint challenging the fairness of the proposed merger. The defendants, FC North and its directors, moved to dismiss both actions.

The Court of Chancery rejected the plaintiff's challenge to the facial validity of the forum-selection bylaw, holding that the FC North board's choice of a North Carolina forum, rather than a Delaware forum, "does not ... call into question the facial validity of the Forum Selection Bylaw." The Court also held that the plaintiff had not stated a claim that the FC North board had adopted the bylaw for an inequitable purpose. Consequently, the Court dismissed the challenge to the bylaw under Rule 12(b)(6).

The Court then applied the bylaw to dismiss the challenge to the proposed merger under Rule 12(b)(3). Applying the test stated in *The Bremen v. Zapata Off-Shore Co.,* 407 U.S. 1 (1972), and adopted in Delaware in *Ingres Corp. v. CA, Inc.,* 8 A.3d 1143 (Del. 2010), the Court held that Delaware does not have a public policy mandating that claims of the nature asserted in the challenge to the proposed merger be litigated in Delaware. Noting that FC North is based in North Carolina, most of its deposits and its branches are located in North Carolina, its directors are subject to personal jurisdiction in North Carolina, and complete relief is available in North Carolina, the Court held that application of the forum-selection bylaw to the challenge to the merger was reasonable. The Court accordingly dismissed the challenge to the proposed merger under Rule 12(b)(3).

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 *The 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 the plaintiffs' contention that the bylaws were invalid as a matter of contract law because the Chevron and FedEx boards 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.

Fee-Shifting Bylaws

ATP Tour, Inc. v. Deutscher Tennis Bund, 2014 WL 1847446 (Del. May 8, 2014).

In *ATP Tour, Inc. v. Deutscher Tennis Bund,* the Delaware Supreme Court, by Justice Berger, in responding to certified questions of law from the United States District Court for the District of Delaware (the "District Court"), held that a provision of a Delaware nonstock corporation's bylaws that shifted litigation expenses to the losing party in intra-corporate litigation was facially valid under Delaware law and may be enforced if the provision was adopted through appropriate corporate procedures and for a proper corporate purpose.

ATP Tour, Inc. ("ATP") is a Delaware nonstock corporation that operates a professional tennis tour. The dispute arose from litigation filed in District Court by the plaintiffs, two members of ATP, against ATP and six of its seven directors challenging ATP's decision to downgrade a tournament owned and operated by the plaintiffs. Following a jury trial, judgment was entered in favor of ATP on all claims. Because the plaintiffs did not prevail on any of their claims, ATP sought to recover its litigation expenses from the plaintiffs pursuant to a provision in ATP's bylaws providing that, in intra-corporate litigation, a plaintiff who "does not obtain a judgment on the merits that substantially achieves, in substance and amount, the full remedy sought" is obligated to reimburse ATP "for all fees, costs and expenses of every kind and description." Because the validity and enforceability of a fee-shifting bylaw presented a novel question of Delaware law, the District Court certified questions to the Delaware Supreme Court.

The Supreme Court began its analysis by noting that, to be facially valid, a bylaw provision must be authorized by the General Corporation Law of the State of Delaware (the "DGCL"), it must be consistent with the corporation's certificate of incorporation, and its enactment must not be otherwise prohibited. Finding that such a bylaw was not prohibited by the DGCL, any other Delaware statute or common law, the Supreme Court held that a fee-shifting bylaw is facially valid under Delaware law. The enforceability of a fee-shifting bylaw, however, turns on the circumstances under which the bylaw is adopted and applied. Because the Court did not have sufficient facts to determine whether ATP's fee-shifting bylaw was properly adopted or applied and because certified questions by their nature only address questions of law, the Supreme Court did not opine on the enforceability of ATP's fee-shifting bylaw. Rather, the Supreme Court held that a fee-shifting bylaw, like the one adopted by ATP, may be enforceable if adopted by appropriate corporate procedures and for a proper corporate purpose. The Court further noted that bylaws that are facially valid will not be enforced if adopted or applied for an inequitable or improper purpose. Because the intent to deter litigation is not invariably an improper purpose, the fact that a board adopted a fee-shifting bylaw for the purpose of deterring litigation would not necessarily render the bylaw unenforceable. Finally, the Court held that, assuming that a fee-shifting bylaw is otherwise valid and enforceable, members who join the corporation prior to its adoption will be bound by the fee-shifting bylaw.

Proposed amendments to the DGCL have been introduced in the Delaware General Assembly to clarify the application of the *ATP Tour* decision to Delaware stock corporations. If these proposed amendments are approved, they would limit the applicability of the *ATP Tour* decision to nonstock corporations and clarify that, subject to limited statutory exceptions, charter and bylaw provisions may not be used to impose monetary liability on holders of stock in Delaware stock corporations.

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 for the District of Delaware, 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 issues such as "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 (the "Board") 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% 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 "Series A Preferred"). 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. The Supreme Court issued its formal opinion affirming the Court of Chancery's decision on March 14, 2014. *Klaassen v. Allegro Development Corporation,* C.A. No. 583, 2013 (Del. Mar. 14, 2014). ■

In re KKR Financial Holdings LLC Shareholder Litigation, 101 A.3d 980 (Del. Ch. 2014); **_In re Crimson Exploration Inc. Stockholder Litigation,_** 2014 WL 5449419 (Del. Ch. Oct. 24, 2014); **_In re Sanchez Energy Derivative Litigation,_** 2014 WL 6673895 (Del. Ch. Nov. 25, 2014); **_In re Zhongpin Inc. Stockholders Litigation,_** 2014 WL 6735457 (Del. Ch. Nov. 26, 2014); **_In re Cornerstone Therapeutics Inc. Stockholder Litigation,_** 2014 WL 4418169 (Del. Ch. Sept. 10, 2014).

In four opinions issued within three months of one another, four different members of the Delaware Court of Chancery have considered, at the motion to dismiss procedural stage, whether allegations in a complaint were sufficient to establish that a minority stockholder constituted a controlling stockholder under Delaware law. In *In re KKR Financial Holdings LLC Shareholder Litigation, In re Crimson Exploration Inc. Stockholder Litigation* and *In re Sanchez Energy Derivative Litigation,* the Court concluded that the minority stockholder at issue did not constitute a controlling stockholder, while in *In re Zhongpin Inc. Stockholders Litigation,* the Court found that allegations that a minority stockholder controlled a company and its board of directors were sufficient to withstand a motion to dismiss.

KKR Financial involved a suit challenging the acquisition of KKR Financial Holdings LLC ("KFN") by KKR & Co. L.P. ("KKR"). The Court held that KKR, which owned less than 1% of KFN's stock, was not a controlling stockholder despite allegations that a KKR affiliate managed the day-to-day business of KFN and that KFN was used primarily as a public vehicle for financing KKR-sponsored transactions. In dismissing the complaint, the Court focused on whether KKR had the ability to control the board of directors of KFN and found that the complaint lacked any allegation that KKR had a contractual right to appoint members of the board of directors, that KKR dictated any specific course of action to the board of directors, or that KKR prevented the members of the board of directors from exercising their judgment in determining whether or not to approve the merger with KKR. Accordingly, the Court held that the plaintiffs had failed to demonstrate that it was reasonably conceivable that KKR was a controlling stockholder under Delaware law and dismissed the complaint.

In *Crimson Exploration,* the plaintiffs alleged that Oaktree Capital Management and its affiliates ("Oaktree") collectively controlled Crimson Exploration Inc. ("Crimson") based on its ownership of 33.7% of Crimson's voting stock, its status as a large creditor of Crimson, and its designation of a majority of Crimson's directors and senior management (including three directors employed by Oaktree). After reviewing relevant Delaware precedent, the Court explained that a minority stockholder will not be considered a controlling stockholder unless the minority stockholder actually controls the board's decisions about the challenged transaction. The Court then found that the complaint had failed to plead specific allegations that Oaktree controlled the actions of the board of directors during its negotiation of the merger. Thus, although the Court noted its hesitancy to conclude that the complaint's other allegations could not conceivably state a claim that Oaktree was a controller, the Court ultimately decided that the plaintiffs' complaint (which the Court characterized as supplying "little in the way of specific allegations of control") nevertheless failed to show that Oaktree was conflicted as to the transaction or received some unique benefit from the transaction, and consequently failed to plead that the entire fairness standard applied to the transaction.

In *Sanchez Energy,* the Court examined the controller issue in the context of a derivative action governed by the stricter pleading requirements of Court of Chancery Rule 23.1. The plaintiffs argued that the failure to make a demand on the board of directors of Sanchez Energy Company should be excused because two of the company's co-founders and the collective owners of 21.5% of its stock, A.R. Sanchez Jr. (the company's board chairman) and his son A.R. Sanchez III (the company's chief executive officer), were controlling stockholders who exercised direct managerial control over the company, and the transaction at issue involved another company in which they were investors. While the plaintiffs had alleged that the Sanchezes directed the company's management, the Court found that they did not exercise greater control over the company than that typical of a chief executive officer. Further, citing *KKR Financial and Crimson Exploration,* the Court held that, absent particularized allegations that the Sanchezes controlled the decisions of the board of directors with respect to the challenged transaction, the plaintiffs failed to plead sufficiently that the Sanchezes were controlling stockholders under Delaware law.

In contrast to *KKR Financial, Crimson Exploration* and *Sanchez Energy,* the Court in *Zhongpin* denied a motion to dismiss, finding that the plaintiffs had sufficiently pleaded indicia of domination to raise an inference that Xianfu Zhu, the founder of Zhongpin Inc. ("Zhongpin"), was a controlling stockholder under Delaware law. Zhu held 17.3% of the outstanding voting stock of Zhongpin and was also Zhongpin's chairman of the board and chief executive officer. The plaintiffs, former stockholders of Zhongpin, challenged a going-private transaction in which Zhu acquired all of the company's outstanding stock, alleging that Zhu was a controlling stockholder who stood on both sides of the transaction. Unlike in *Sanchez Energy,* the Court determined that the plaintiffs' allegations (gleaned primarily from the company's own disclosures in a Form 10-K filed with the Securities and Exchange Commission) supported an inference that Zhu exercised significantly more power over Zhongpin than would be expected of a chief executive officer and 17% stockholder. In addition to crediting the plaintiffs' argument that the alleged controller possessed active control over Zhongpin's day-to-day operations, the Court found that the complaint raised an inference that Zhu possessed latent control over Zhongpin through his stock ownership. The Court noted that disclosure in the company's 10-K cited by the plaintiffs implied that Zhu could exercise significant influence over stockholder approvals for the election of directors, mergers and acquisitions, and amendments to the company's bylaws.

In addition, in *Zhongpin* and another controlling stockholder case recently decided by the Court, *In re Cornerstone Therapeutics Inc. Stockholder Litigation,* 2014 WL 4418169 (Del. Ch. Sept. 10, 2014), a separate issue arose as to whether, assuming entire fairness review applied to claims against a controlling stockholder, claims against the disinterested directors could nevertheless be dismissed at the pleading stage because they were exculpated from personal liability under a company's certificate of incorporation. The disinterested directors in both cases argued that in the absence of any allegations raising an inference that they breached any non-exculpated duty, the exculpation provision in the company's certificate of incorporation mandated dismissal even if the Court concluded that entire fairness was the operative standard of review. In both *Cornerstone* and *Zhongpin,* the Court held that, despite the persuasive force of the argument, precedent directs that the Court must await a developed post-trial record before determining the liability of the directors. The Court of Chancery has certified interlocutory appeals in both *Cornerstone* and *Zhongpin,* and the plaintiffs in both *KKR Financial* and *Sanchez Energy* are pursuing appeals from the Court of Chancery's judgments dismissing their claims.

In re KKR Financial Holdings LLC Shareholder Litigation, Consol. C.A. No. 9210-CB (Del. Ch. Oct. 14, 2014).

In *In re KKR Financial Holdings LLC Shareholder Litigation,* the Court of Chancery granted the defendants' motions to dismiss with prejudice a suit challenging the acquisition of KKR Financial Holdings LLC ("KFN") by KKR & Co. L.P. ("KKR").

In December 2013, KKR and KFN executed a stock-for-stock merger agreement, which was subject to approval by a majority of KFN shares held by persons other than KKR and its affiliates. The merger was approved on April 30, 2014, by the requisite majority vote.

Nine lawsuits challenging the merger were brought in the Court of Chancery and consolidated. The operative complaint alleged that the members of the KFN board breached their fiduciary duties by agreeing to the merger, that KKR breached its fiduciary duty as a controlling stockholder by causing KFN to enter into the merger agreement, and that KKR and its subsidiaries aided and abetted the KFN board's breach of fiduciary duty.

The Court ruled that KKR, which owned less than 1% of KFN's stock, was not a controlling stockholder. The plaintiffs focused on a management agreement by which a KKR affiliate managed the day-to-day business of KFN, but the Court ruled that the plaintiffs' allegations were not sufficient to support an inference that KKR thereby controlled the KFN board "such that the KFN directors could not freely exercise their judgment in determining whether or not to approve and recommend to the stockholders a merger with KKR." Therefore, the Court dismissed the claim premised on KKR's status as an alleged controlling stockholder.

The Court then held that business judgment review applied to the merger because a majority of the KFN board was disinterested and independent. The Court held alternatively that, even if a majority of the KFN directors were not independent, "the business judgment presumption still would apply because of the effect of untainted stockholder approval of the merger." The Court rejected the plaintiffs' disclosure challenges and ruled that the business judgment standard of review would apply to the merger "because it was approved by a majority of the shares held by disinterested stockholders of KFN in a vote that was fully informed." Accordingly, the Court dismissed the claim against the KFN directors. Because the plaintiffs had not pleaded a viable claim against the KFN directors, the Court also dismissed the claim for aiding and abetting.

Hamilton Partners, L.P. v. Highland Capital Management, L.P., 2014 WL 1813340 (Del. Ch. May 7, 2014).

In *Hamilton Partners, L.P. v. Highland Capital Management,* L.P., C.A. No. 6547-VCN, 2014 WL 1813340 (Del. Ch. May 7, 2014), the Court of Chancery, by Vice Chancellor Noble, in connection with a challenge to a going-private transaction whereby American HomePatient, Inc. ("AHP") was acquired by an affiliate of one of its stockholders, Highland Capital Management, L.P. ("Highland"), refused to dismiss breach of fiduciary duty claims against Highland. The Court held that, for purposes of the defendants' motion to dismiss, the plaintiff alleged facts sufficient to support an inference that Highland, which owned 48% of AHP's stock and 82% of AHP's debt, was the controlling stockholder of AHP and that the merger was not entirely fair.

Before the challenged transaction, AHP was a publicly traded Delaware corporation that specialized in home health services. In February 2006, Highland, which at the time was AHP's largest secured creditor and owned 9.9% of AHP's stock, proposed to acquire AHP. After its proposal was rejected, Highland began purchasing AHP's stock in the public market and, by April 2007, increased its stock ownership in AHP to 48%. Due to its increased ownership in AHP's stock, Highland became an "interested stockholder" under Section 203 of the General Corporation Law of the State of Delaware ("Section 203"), which limited Highland's ability to consummate a business combination with AHP for a period of three years. In 2009, when AHP struggled to refinance a large line of credit, Highland, which by that time had acquired 82% of AHP's debt, agreed to enter into a series of one-month forbearance agreements with AHP, the last of which expired in May 2010. The last forbearance agreement expired shortly after the expiration of the three-year period applicable to Highland as an "interested stockholder" under Section 203.

In April 2009, Highland made another proposal to acquire AHP. The board of directors of AHP formed a special committee, which retained legal and financial advisors, but did not conduct sales efforts beyond phone calls to two potential suitors. In late 2009, following negotiations with Highland that resulted in an increased merger price, AHP and Highland agreed to a restructuring transaction that involved (i) a small debt purchase by AHP, (ii) a reincorporation by merger of AHP into a Nevada corporation ("New AHP"), (iii) a self-tender offer by New AHP, (iv) a debt refinancing by New AHP, (v) resignations of the directors of New AHP and appointment of directors designated by Highland, and (vi) a merger of New AHP with an affiliate of Highland. Although the parties agreed to the restructuring transaction in late 2009, the parties did not enter into a definitive restructuring agreement (the "Restructuring Agreement") until April 2010, after the three-year waiting period applicable to Highland under Section 203 expired. Part of the special committee's rationale for recommending the transaction was that Highland was unlikely to agree to continued forbearance agreements.

The plaintiff filed a stockholder class action alleging that, in connection with the merger with a Highland affiliate (which was the final step in the restructuring transaction), Highland was the controlling stockholder of AHP and had used its control to cause AHP to agree to an unfair transaction. The plaintiff further alleged that AHP's CEO, who was also a director, breached his fiduciary duties through his actions in connection with the merger. The Court noted that the plaintiff made the unusual choice to not plead any claims for breach of fiduciary duty against the AHP directors other than the CEO (and implicitly that the plaintiff failed to allege that a majority of the directors were interested in the going-private transaction or lacked independence).

As an initial matter, the Court addressed whether the plaintiff's claims arose under Delaware or Nevada law. The Court noted that the "guiding principle" in its determination is the internal affairs doctrine, under which claims relating to a corporation's internal affairs are governed by the law of the state of incorporation. Applying the internal affairs doctrine, the Court found that actions taken by AHP (a Delaware corporation) and actions contractually agreed to in the Restructuring Agreement (which was executed by AHP), including the merger with Highland, were governed by Delaware law, and actions taken by New AHP (a Nevada corporation), other than those required by the Restructuring Agreement, were governed by Nevada law.

The Court then considered, for purposes of the defendants' motion to dismiss, whether the plaintiff's allegations supported a reasonable inference that, at the time the parties agreed to the merger as part of the Restructuring Agreement, Highland was the controlling stockholder of AHP, despite holding less than a majority of AHP's stock and having no representatives on the board of directors of AHP. While the Court acknowledged that a corporation's creditor, even one that owns a majority of a corporation's debt like Highland, does not owe fiduciary duties to the corporation's stockholders, the Court held that, when the parties agreed to the Restructuring Agreement, Highland's ownership of 48% of the stock and 82% of the debt (which was in default) of AHP was sufficient to support an inference of control such that Highland owed fiduciary duties to the minority stockholders of AHP. The Court further noted that Highland's alleged willingness to enter into multiple forbearance agreements with AHP only until shortly after the expiration of the three-year waiting period required by Section 203 was further support for an inference of Highland's control over AHP. In addition, the Court found that the plaintiff's allegations that the fairness opinion that the board of directors relied upon as support for its approval of the merger was based upon an unreasonable discount rate supported the inference that the price offered in the merger was not entirely fair. As a result, the Court found that the plaintiff sufficiently alleged that Highland exercised its control over AHP to facilitate the restructuring on unfair terms and thus declined to dismiss the allegations for breach of fiduciary duty against Highland as AHP's controlling stockholder in connection with the merger.

The Court, however, did dismiss the claims against AHP's CEO under both Delaware and Nevada law. Noting that the plaintiff challenged only the actions of the CEO director in connection with the merger and not the actions of the other four directors, the Court held that under both Delaware and Nevada law a plaintiff is required to allege facts sufficient to overcome the business judgment rule as against a majority of the directors in order to state a claim. Because the plaintiff did not allege facts sufficient to do so as to any of the other four directors, the Court dismissed the breach of fiduciary claims against the CEO director.

Kahn, et al. v. M&F Worldwide Corp., et al., No. 334, 2013 (Del. Mar. 14, 2014).

In *Kahn, et al. v. M&F Worldwide Corp., et al.,* the Delaware Supreme Court affirmed the Court of Chancery's decision in *In re MFW Shareholders Litigation,* 67 A.3d 496 (Del. Ch. 2013), which granted summary judgment in favor of a board accused of breaching its fiduciary duties by approving a buyout by a 43.4% controlling stockholder, where the controller committed in its initial proposal not to move forward with a transaction unless approved by a special committee, and further committed that any transaction would be subject to a non-waivable condition requiring the approval of the holders of a majority of the shares not owned by the controller and its affiliates. The stockholder plaintiffs initially sought to enjoin the proposed transaction, but withdrew their preliminary injunction application and instead sought post-closing damage relief. After extensive discovery, the defendants sought summary judgment.

The Court of Chancery held that the transaction could be reviewed under the business judgment standard, rather than entire fairness, and granted the defendants' motion. On appeal, the Supreme Court affirmed the Court of Chancery's decision and adopted its formulation of the standard, holding that the business judgment standard of review will be applied in controller buyouts if and only if: (i) the controller conditions the procession of the transaction on the approval of both a special committee and a majority of the minority stockholders, (ii) the special committee is independent, (iii) the special committee is empowered to freely select its own advisors and to say no definitively, (iv) the special committee meets its duty of care in negotiating a fair price, (v) the minority vote is informed, and (vi) there is no coercion of the minority.

The Court further held, however, that if "after discovery triable issues of fact remain about whether either or both of the dual procedural protections were established, or if established were effective, the case will proceed to a trial in which the court will conduct an entire fairness review." The Court also noted that the complaint in the action would have survived a motion to dismiss based on allegations attacking the fairness of the price, which called into question the adequacy of the special committee's negotiations, thereby necessitating discovery on all of the prerequisites to the application of the business judgment rule.

In re Orchard Enterprises, Inc., 2014 WL 811579 (Del. Ch. Feb. 28, 2014).

In *In re Orchard Enterprises, Inc.,* the Court of Chancery, by Vice Chancellor Laster, on cross motions for summary judgment, held, among other things, that the entire fairness standard of review will apply at trial to fiduciary duty claims challenging a squeeze-out merger, with the burden of persuasion on the defendants, notwithstanding that the merger was negotiated by a special committee and approved by a majority of the minority stockholders.

The action arose from a 2010 squeeze-out merger by Dimensional Associates, LLC, then the controlling stockholder of The Orchard Enterprises, Inc., a Delaware corporation ("Orchard"), in which Dimensional paid minority stockholders $2.05 per share. After the Court of Chancery held in an appraisal action that the fair value of Orchard's common stock at the time of the merger was $4.67 per share, former minority stockholders sued Dimensional and Orchard's former directors for breach of fiduciary duty and disclosure violations.

In response to a 2009 going-private proposal by Dimensional, the Orchard board formed a special committee with the exclusive power and authority to (i) negotiate with Dimensional, (ii) terminate consideration of Dimensional's proposal, (iii) solicit interest from third parties, and (iv) retain independent advisors. After preliminary negotiations, the special committee concluded that it would recommend a transaction with Dimensional on three conditions: a price in the range of $2.05 to $2.15 per share (subject to confirmation by the committee's financial advisor that such a price would be fair), approval by a majority of the minority stockholders, and a go-shop period. Dimensional countered with $2.00 per share with a go-shop period, but without a majority-of-the-minority approval condition. After further negotiations and advice from its financial advisor, the special committee accepted an offer of $2.05 per share with a go-shop period and a majority-of-the-minority approval condition. The merger was approved by the stockholders (including a majority of the minority) in July 2010.

In considering the plaintiffs' disclosure claims, the Court granted summary judgment in the plaintiffs' favor on their disclosure claim that the proxy materials materially misstated whether the merger triggered a preferred stock liquidation preference (an issue resolved in the negative in the earlier appraisal action). One of the inaccurate disclosures relating to the liquidation preference appeared in the notice of meeting as part of the summary of a proposed amendment to the certificate of incorporation that was sought in connection with the merger. Because this summary is one of the few items required to be included in the notice of meeting pursuant to the General Corporation Law of the State of Delaware, the Court held that the misstatement was per se material.

The Court then addressed the appropriate standard of review for the plaintiffs' breach of fiduciary duty claims. Referring to the Court's decision in *In re MFW Shareholders Litigation,* 67 A.3d 496 (Del. Ch. 2013) (which was affirmed on appeal after the *Orchard* decision was issued), the Court explained that if "a controller agrees up front, before any negotiations begin, that the controller will not proceed with the proposed transaction without both (i) the affirmative recommendation of a sufficiently authorized board committee composed of independent and disinterested directors and (ii) the affirmative vote of a majority of the shares owned by stockholders who are not affiliated with the controller, then the controller has sufficiently disabled itself such that it no longer stands on both sides of the transaction, thereby making the business judgment rule the operative standard of review." But, the Court continued, if "a controller agrees to use only one of the protections, or does not agree to both protections up front, then the most that the controller can achieve is a shift in the burden of proof such that the plaintiff challenging the transaction must prove unfairness." If a pretrial determination regarding burden shifting cannot be made, the defendants will bear the burden at trial of proving entire fairness.

The Court first held that entire fairness, not business judgment, was the appropriate standard of review because Dimensional "did not agree up front, before any negotiations began," that it would not proceed without a qualified special committee and a majority-of-the-minority condition. The Court next held that the approval of the merger by a majority of the minority was not sufficient to shift the burden of proving entire fairness to the plaintiffs before trial because Dimensional did not prove as a matter of law that the stockholder vote was fully informed (due to at least one misstatement that was material as a matter of law and the potential for evidence at trial to show that other disclosures were materially false or misleading). The Court further held that the use of the special committee also was not sufficient to shift the entire fairness burden to the plaintiffs before trial because (i) at minimum, the members of the special committee must be independent and disinterested, and triable issues of fact existed as to the independence of the chairman of the special committee from Dimensional, and (ii) the plaintiffs "pointed to evidence which raises litigable questions about the Special Committee's negotiation process."

The Court declined to determine on summary judgment whether the merger was entirely fair, as fact issues precluded that determination. The Court noted that, although the disclosure violation "provides some evidence of unfairness," at trial "a single disclosure problem may not be outcome-determinative." In addition, while the appraisal decision, which valued Orchard's common stock at more than two times the merger price, "is certainly evidence of financial unfairness," the merger price nevertheless may fall within a range of fairness for purposes of the entire fairness determination. As a result, the Court held that the action would proceed to trial with the burden on the defendants to prove that the merger was entirely fair. The Court noted, however, that if the defendants could prove at trial that one or both of the special committee or the majority-of-the-minority vote "was effective, it will 'significantly influence' the determination of fairness and any potential remedy."

With respect to potential remedies, the Court held that (i) Section 102(b)(7) exculpation could not support a summary dismissal of facially independent and disinterested directors because, in an entire fairness case involving a controlling stockholder, it was not possible to rule as a matter of law that the plaintiffs' claims solely implicated the duty of care and not the duty of loyalty; (ii) rescissory damages (i.e., "the monetary equivalent of rescission") are one appropriate measure of damages for a squeeze-out merger and could be imposed in this action "if the merger is found not to be entirely fair and if one or more of the defendants are found to have violated their fiduciary duty of loyalty"; (iii) a "quasi-appraisal" remedy (i.e., "the quantum of money equivalent to what a stockholder would have received in an appraisal") is one possible remedy for breaches of the duty of disclosure and thus one form of possible remedy in this action if defendants fail to prove that the merger was entirely fair; and (iv) under certain circumstances, "Delaware law continues to recognize the possibility of a post-closing award of damages as a remedy for a breach of the fiduciary duty of disclosure." ■

Orckit Communications Ltd. v. Networks^3 Inc. et al., C.A. No. 9658 (Del. Ch. Jan. 28, 2015) (TRANSCRIPT).

In *Orckit Communications Ltd. v. Networks^3 Inc. et al,* the Delaware Court of Chancery granted defendant Networks^3's motion to dismiss a claim that it had wrongfully terminated an agreement to purchase patents from plaintiff Orckit. The purchase of the patents was contingent upon the issuance of an approval by an Israeli government agency, and the agreement provided that "the terms in the ... Approval shall be satisfactory in the sole discretion (which for purposes of this condition shall not, to the extent permitted by law, be subject to the implied covenant of good faith and fair dealing) of Networks^3." The Court held that, under the agreement, whether the terms of the approval were satisfactory to Networks^3 was "a decision that is unreviewable in the sense that, if it is timely taken, the defendant could then ... terminate."

Plaintiff Orckit had alleged that, under the agreement, Networks^3's exercise of its sole discretion was qualified by either (i) a "commercially reasonable efforts" standard appearing elsewhere in the contract, or (ii) a default good faith standard that could not be disclaimed, and that, under either standard, Networks^3 had breached the agreement. The Court rejected both arguments. In regard to the first, the Court found it unreasonable to assume that the parties would expressly disclaim the application of the implied covenant of good faith and fair dealing only to impose a higher standard. Further, the Court held that basic "canons of construction" provided that a specific discretionary standard in a particular provision controls over a general one elsewhere in a contract. In regard to the second, the Court, emphasizing that "Delaware is a contractarian state" and that "the language that the parties have agreed to ... governs the enforcement of contracts," stated that the provision's "language ... could not be any clearer," and that it was, in fact, "as clear as it gets." ■

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. The 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 the 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 the 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 the 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 enforceability 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 KSGP board 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.

Allen v. El Paso Pipeline Partners, L.P., C.A. 7520-VCL (Del. Ch. June 20, 2014)

In *Allen v. El Paso Pipeline Partners, L.P.,* C.A. 7520-VCL (Del. Ch. June 20, 2014), the Delaware Court of Chancery once again addressed issues relating to compliance with a contractual standard in the context of a conflict of interest transaction. The transaction at issue was an asset purchase by El Paso Pipeline Partners, L.P. ("El Paso MLP") from El Paso Corporation ("El Paso Parent"), which was the parent of El Paso Pipeline GP Company, L.L.C. ("El Paso GP"), which was the general partner of El Paso MLP. The El Paso MLP partnership agreement (the "El Paso Agreement") contained provisions eliminating all common law and fiduciary duties. Furthermore, the El Paso Agreement provided that, where a conflict of interest existed, it would not constitute a violation of any obligation if such transaction was approved "by a majority of the members of the Conflicts Committee acting in good faith." The El Paso Agreement defined good faith in this context to be a subjective belief that the conflict of interest transaction is in the best interests of El Paso MLP. The Conflicts Committee engaged legal and financial advisors and, after considering the proposed asset acquisition and receiving a fairness opinion from its financial advisor, approved the transaction. Following closing, the plaintiffs claimed that El Paso GP and its directors breached the terms of the El Paso Agreement and their implied contractual covenant of good faith and fair dealing.

First, the Court considered the claims against the individual director defendants. The Court noted that these were claims that the director defendants breached their express and implied obligations under the El Paso Agreement. None of the director defendants was a signatory of or a party to the El Paso Agreement. The Court noted that Delaware law provides that only parties to a contract may be sued for breach of contract. Accordingly, the Court granted summary judgment in favor of the director defendants.

Next, the Court considered the claim that El Paso GP breached its express contractual obligations under the El Paso Agreement. The relevant inquiry was whether the members of the Conflicts Committee believed subjectively, in good faith, that the drop-down transaction was in the best interests of El Paso MLP. The Court concluded that the plaintiffs had not submitted any evidence that the members of the Conflicts Committee did not subjectively believe that the asset purchase transaction was in the best interests of El Paso MLP. Accordingly, the Court granted summary judgment in favor of El Paso GP with respect to the claim that it breached an express term of the El Paso Agreement.

Finally, the Court considered the claim that El Paso GP breached its implied contractual obligations under the El Paso Agreement. Delaware law permits the implied contractual covenant of good faith and fair dealing to imply a term into a contract if it was clear that the parties must have intended that the term apply, but that such a gap-filling application should be used sparingly and not to rewrite a contract. The plaintiffs contended that El Paso GP breached an implied term of the El Paso Agreement because the fairness opinion relied upon by the Conflicts Committee did not consider all of the elements of the consideration paid by El Paso MLP in connection with the drop-down transaction, and the implied covenant required that the fairness opinion address all elements of the consideration. The El Paso Agreement contained a provision that the general partner or the Conflicts Committee would be conclusively presumed to have acted in good faith if such action was taken in reliance on a fairness opinion. The Court noted, however, that it is not certain whether this conclusive presumption would be applicable where the underlying fairness opinion did not consider all of the elements of the consideration paid by El Paso MLP. Therefore, rather than rely on the provision affording this conclusive presumption, the Court instead focused its analysis on whether the plaintiffs had raised any genuine issue of material fact indicating that the Conflicts Committee had not subjectively believed, in good faith, that the drop-down transaction was in the best interests of El Paso MLP. The Court found that the plaintiffs had failed to meet their burden in this regard and, accordingly, granted summary judgment in favor of El Paso GP with respect to the claims that it breached an implied term of the El Paso Agreement.

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).

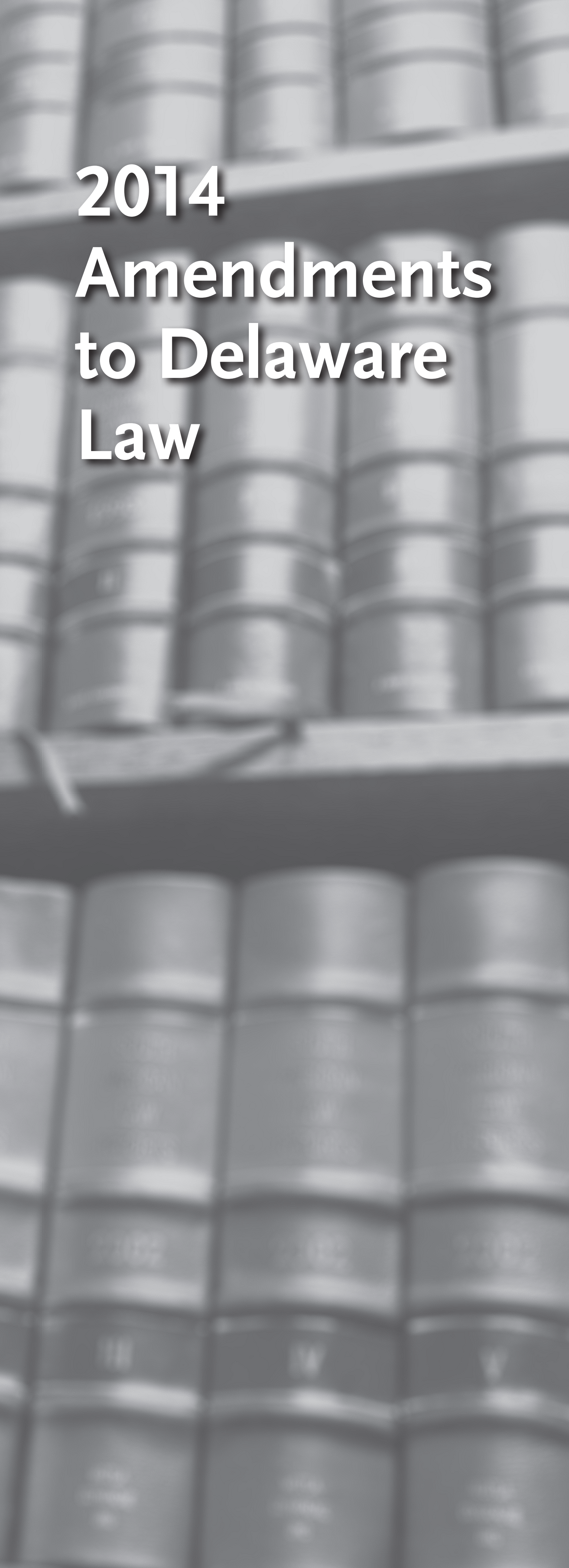
In *Auriga Capital Corporation v. Gatz Properties,* the Court of Chancery stated that, unless a limited liability company agreement expands, restricts or eliminates the fiduciary duties owed by a manager, a manager is subject to the fiduciary duties of loyalty and care. After holding a trial, the Court 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 Gatz's actions were the Court's focus.

The plaintiffs accused Gatz of being a disloyal and negligent fiduciary and breaching 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. ■



2014 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 July 15, 2014. The amendments to the DGCL became effective on August 1, 2013 (except for the amendments to Section 251(h), as further described below). The amendments result in several significant changes to the DGCL. The primary components of the amendments are as follows:

Section 251(h) Mergers

In 2013, the DGCL was amended to eliminate, subject to certain conditions, the need for a back-end merger vote in a two-step merger involving a front-end tender or exchange offer. Early experience with Section 251(h) demonstrated the statute's utility, but also gave rise to various questions among practitioners regarding certain aspects of its use and application. The amendments to the DGCL are designed to address those questions.

The amendments eliminate the prohibition against the statute's use in circumstances where a party to the merger agreement is an "interested stockholder" (as defined in Section 203 of the DGCL). This change, among other things, eliminates any question as to whether an offeror's entry into certain voting agreements or other arrangements with existing stockholders would render the offeror an "interested stockholder" and therefore incapable of taking advantage of Section 251(h). The amendments also clarify various timing and other requirements in respect of the back-end merger. The amendments replace the existing "ownership" requirement in respect of the target's stock with a requirement that, following the offer, the stock irrevocably accepted for purchase or exchange and received by the depository prior to the expiration, plus the stock owned by the consummating corporation, must equal at least the percentage of stock (and of each class or series) that, absent Section 251(h), would be required to adopt the merger. The amendments also replace the existing language requiring that shares of the target corporation "not to be canceled in the merger" receive the same consideration paid to holders of shares of the same class or series upon the consummation of the offer with language providing that shares that are the "subject of and not irrevocably accepted for purchase or exchange in the offer" must be converted into the same consideration paid for shares of the same class or series irrevocably accepted for purchase or exchange in the offer.

In addition, the amendments clarify that the merger agreement in respect of a transaction under Section 251(h) may either permit or require the merger to be effected under Section 251(h). Thus, the amendments expressly enable the parties to provide in the merger agreement that the proposed merger under Section 251(h) may be abandoned in favor of a merger accomplished under a different statutory provision. As a related matter, the amendments clarify that the merger agreement must provide that the back-end merger shall be effected as soon as practicable after the offer if the merger is effected under Section 251(h). The amendments also clarify that the offeror's tender for all of the target corporation's outstanding voting stock may exclude stock that, at the commencement of the offer, is owned by the target corporation, the offeror, persons that directly or indirectly own all of the stock of the offeror, and direct or indirect wholly owned subsidiaries of the foregoing parties.

In furtherance of the foregoing changes, the amendments add a new paragraph to Section 251(h) setting forth the meaning of certain terms used in Section 251. Of particular note, the term "consummates" (and correlative terms) is expressly defined to mean the time at which the offeror irrevocably accepts for purchase or exchange stock tendered pursuant to a tender or exchange offer, to help eliminate questions regarding the time at which the conditions to effecting the back-end merger have been satisfied. As with the legislation originally enacting Section 251(h), the synopsis to the amendments states that the amendments to the subsection do not change the fiduciary duties of directors in connection with any merger accomplished under the subsection or the judicial scrutiny applied to any decision to enter into a merger agreement under the subsection. The amendments to Section 251(h) are effective with respect to merger agreements entered into on or after August 1, 2014.

Escrowing Director Consents

Section 141(f) of the DGCL has been amended to clarify that any person, whether or not then a director, may provide, by instruction or otherwise, that a consent to board action will be effective at a future time, including a time determined upon the occurrence of an event, no later than 60 days after the instruction is given or other provision is made, and that the consent will be deemed to have been given at that effective time as long as the person is then a director and did not, prior to the effective time, revoke the consent. The amendment to Section 141(f) was adopted in response to concerns, stemming from *AGR Halifax Fund, Inc. v. Fiscina,* 743 A.2d 1188 (Del. Ch. 1999), over the validity of consents executed by persons who have not yet become directors at the time they execute board consents. The amendments, among other things, enable acquisition financing transactions to be structured such that the person or persons who are to become the directors of the surviving corporation may execute consents, to be held in escrow, authorizing the financing and security transactions and related documents, which consents will become effective upon the signing person's or persons' election to the board of the surviving corporation concurrently with the closing of the transaction.

Escrowing Stockholder Consents

Consistent with the bases for the proposed changes to Section 141(f), Section 228(c) has been amended to clarify that any person executing a stockholder consent may provide, by instruction or otherwise, that the consent will be effective at a future time, including a time determined upon the occurrence of an event, no later than 60 days after the instruction is given or other provision is made, and, if evidence of the instruction or provision is given to the corporation, the later effective time will constitute the date of signature.

Amendments to the Certificate of Incorporation

The amendments effect two substantive changes to Section 242 of the DGCL, which deals with amendments to the corporation's certificate of incorporation. First, the amendments eliminate the requirement that the notice of the meeting at which an amendment to the certificate of incorporation is to be voted on contain a copy of the amendment itself or a brief summary of the amendment when the notice constitutes a notice of internet availability of proxy materials under the Securities Exchange Act of 1934. Second, the amendments authorize a corporation, by action of its board of directors, to amend its certificate of incorporation to change its name or to delete historical references to its incorporator, its initial board of directors or its initial subscribers for shares, or to provisions effecting changes to its stock (e.g., language effecting an earlier stock split), without the need to submit the amendment to a vote of stockholders.

Voting Trusts

Section 218 of the DGCL previously required that a voting trust agreement, or any amendment thereto, be filed with the corporation's registered office in the State of Delaware. The amendments to Section 218 provide that a voting trust agreement, or any amendment thereto, may be delivered to the corporation's principal place of business instead of its registered office.

Incorporator Unavailability

The amendments accomplish two changes to address issues that arise when a corporation's incorporator has become unavailable before completing his, her or its statutory functions. Section 103(a)(1) previously provided that if the incorporator was unavailable by reason of death, incapacity, unknown address or refusal or neglect to act, a person for whom or on whose behalf the incorporator was acting could, subject to certain conditions, execute any such certificate with the same effect as if it were executed by the incorporator. The amendments to Section 103(a)(1) eliminate any limitation arising from the reason for the incorporator's unavailability. In addition, the amendments add a new Section 108(d) that renders the concepts embodied in Section 103(a)(1) applicable to instruments in addition to certificates filed with the Delaware Secretary of State. Thus, new Section 108(d) provides that if an incorporator is not available to act, any person for whom or on whose behalf the incorporator was acting may, subject to certain conditions, take any action that the incorporator would have been entitled to take under Sections 107 or 108 of the DGCL. ■

2014 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 LLC and Partnership Acts). The following is a brief summary of some of the more significant amendments that affect Delaware limited liability companies (Delaware LLCs), Delaware limited partnerships (Delaware LPs) and Delaware general partnerships (Delaware GPs).

Providing Information to Communications Contact

Every Delaware LP and Delaware LLC is required to maintain a Communications Contact who is authorized to receive communications from its registered agent. DRULPA and the DLLCA have been amended to require a Delaware LP or Delaware LLC, upon receipt of a request by its Communications Contact, to provide to such Communications Contact the name, business address and business telephone number of a natural person who has access to the record that contains the name and last known business, residence or mailing address of each partner, member and manager of such Delaware LP or Delaware LLC.

Consents with a Future Effective Date

The LLC and Partnership Acts have been amended to confirm that, unless otherwise provided in a partnership agreement or limited liability company agreement, a person who is not then a partner, member or manager of a Delaware LP, Delaware GP or Delaware LLC may consent to any matter as a partner, member or manager provided that such consent will only be effective at a time when such person is a partner, member or manager of such Delaware LP, Delaware GP or Delaware LLC.

Books and Records Requests by Agents

The LLC and Partnership Acts have been amended to confirm that a partner or member of a Delaware LP, Delaware GP or Delaware LLC may make a books and records request in person or by an attorney or other agent.

Books and Records Requirements
DRULPA and the DLLCA have been amended to require a Delaware LP or Delaware LLC to maintain a current record of the name and last known business, residence or mailing address of each partner, member and manager.

Revocation of Dissolution
DRULPA and the DLLCA have been amended to provide additional means by which a dissolution of a Delaware LP or Delaware LLC may be revoked, including to provide that a dissolution may be revoked in the manner provided in the partnership agreement of such Delaware LP or the limited liability company agreement of such Delaware LLC, and to confirm that a dissolution of a Delaware LP or Delaware LLC may be revoked by any other means permitted by law.

The recent amendments reflect Delaware's continuing commitment to maintaining statutes governing Delaware LLCs, Delaware LPs and 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. 327 (effective August 1, 2014). The recent amendments to DRULPA are contained in House Bill No. 328 (effective August 1, 2014). The recent amendments to DRUPA are contained in House Bill No. 326 (effective August 1, 2014). Additionally, the annual franchise taxes payable to the State of Delaware by Delaware LLCs, Delaware GPs or Delaware LPs have been increased pursuant to amendments to the LLC and Partnership Acts contained in House Bill No. 265, as amended by House Amendment Nos. 1 and 3 (effective January 1, 2014). ■

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