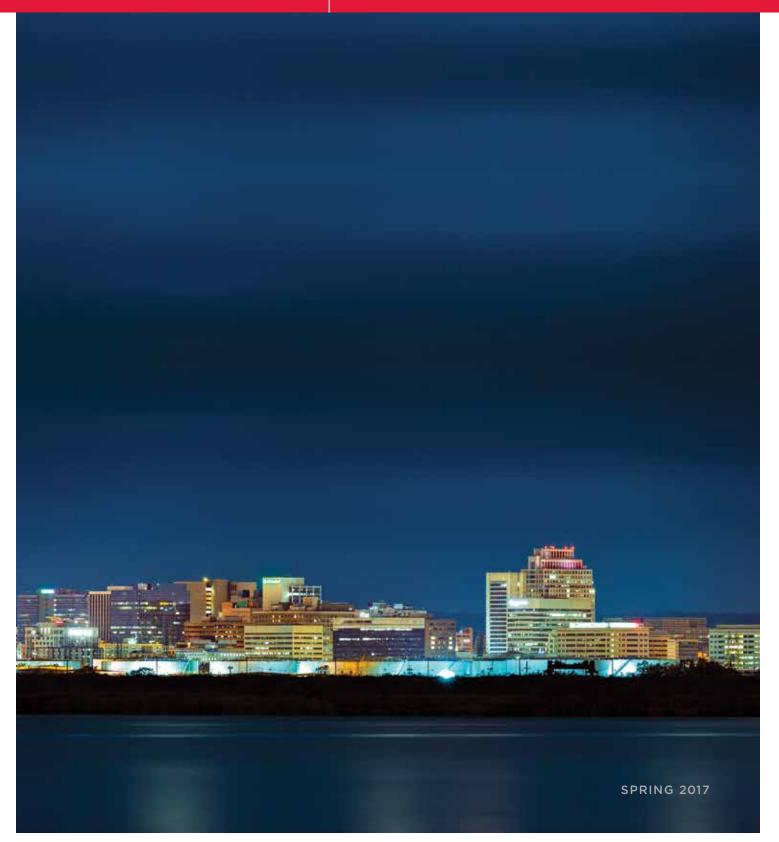
### Richards, Layton & Finger

Recent Developments in Delaware Law



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.

#### 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 update on Delaware law for more than two decades. In recent years, this update has been accompanied by a video, which allows clients and friends of the firm to gain insight into recent decisions. If you have not had the opportunity to receive our updates or watch our video discussions, 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 17 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



## **Breach of Fiduciary Duty**

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Following the Delaware Supreme Court decision in Corwin v. KKR Financial Holdings LLC, 125 A.3d 304 (Del. 2015), the Delaware courts have clarified and extended the application of the decision. In Corwin, the Delaware Supreme Court affirmed the Court of Chancery's ruling that the business judgment rule is the appropriate standard of review for a merger transaction that is not subject to the entire fairness standard of review and is approved by a fully informed, uncoerced vote of the disinterested stockholders. In so holding, the Delaware Supreme Court cited the "long-standing policy of [Delaware] law . . . to avoid the uncertainties and costs of judicial second-guessing" in such situations. In 2016 and early 2017, the Delaware courts have consistently applied Corwin, reinforcing that long-standing policy.

In *Singh v. Attenborough*, 137 A.3d 151 (Del. 2016), for example, the Delaware Supreme Court clarified that the business judgment rule *irrebuttably* applies to post-closing judicial review of a merger transaction that receives the fully informed, uncoerced vote of the disinterested stockholders. Although the Delaware Supreme Court in *Singh* noted that the Court of Chancery correctly found that a fully informed, uncoerced vote of disinterested stockholders invoked the business judgment rule, the Court held that the Court of Chancery erred by next proceeding to consider whether plaintiffs stated a claim for breach of the duty of care. In so doing, the Court explained that the Court of Chancery failed to "give [the] standard-ofreview-shifting effect to the vote." When the business judgment rule standard of review is invoked because of a fully informed, uncoerced vote of disinterested stockholders approving a transaction, a post-closing action for monetary damages will be dismissed absent a well-pled waste claim.

The Delaware courts next grappled with the extent to which *Corwin* applied to so-called "intermediate-form mergers" accomplished under Section 251(h) of the General Corporation Law of the State of Delaware ("Section 251(h)"). Under Section 251(h), subject to the satisfaction of certain specified statutory conditions, a merger can be consummated without a vote of the target stockholders where, immediately following the consummation of a tender or exchange offer, the stock irrevocably accepted for purchase or exchange pursuant to such offer and received by the depositary prior to the expiration of such offer, together with the stock otherwise owned by the consummating corporation or its affiliates and any rollover stock, equals at least such percentage of the shares of stock of the target corporation that, absent Section 251(h), would be required to adopt the merger agreement. Thus, in contrast with the Corwin and Attenborough mergers, mergers approved under Section 251(h) do not require a stockholder vote.

In In re Volcano Corporation Stockholder Litigation, 143 A.3d 727 (Del. Ch. 2016), the Court of Chancery held that when the fully informed, uncoerced and disinterested stockholders approve a merger under Section 251(h) by tendering their shares pursuant to the tender offer, that approval has the same cleansing effect under Corwin, and the business judgment rule irrebuttably applies to the merger. In Volcano, upon the expiration of the tender offer constituting the first step in a Section 251(h) merger, stockholders representing the holders of 89.1% of the issued and outstanding shares of common stock of the target corporation had validly tendered and not withdrawn their shares. Plaintiffs contended, in relevant part, that the board of directors approved the merger in an uninformed manner and the directors were motivated by certain benefits they received as a result of the merger, including the vesting of stock options

and restricted stock units and the execution of a consulting agreement between one of the directors and the buyer. The defendants moved for dismissal for failure to state a claim and argued for an extension of *Corwin* to preclude judicial review of the board's conduct in negotiating and approving the Section 251(h) merger. The Court held that, in the context of a Section 251(h) merger, the acceptance of the tender offer by a majority of fully informed, disinterested stockholders has the same cleansing effect as a vote in favor of the merger. In reaching its holding, the Court reasoned that there is no basis for distinguishing a stockholder's acceptance of a tender offer as part of a Section 251(h) merger from a stockholder's vote in favor of a long-form merger. The Court noted that in a Section 251(h) merger, the board of directors retains its involvement (and concomitant fiduciary duties) in negotiating the terms of the tender offer under Section 251(h), and such a tender offer has built-in protections against coercion: the tender offer must be for all outstanding stock, and the back-end merger must be accomplished as soon as practicable. After determining that Corwin applied, the Court ruled that plaintiffs failed to adequately plead that the stockholders were uninformed, and, in the absence of a waste claim, the Court dismissed the complaint. The Volcano decision was affirmed by the Delaware Supreme Court on February 9, 2017. No. 372, 2016 (Del. Feb. 9, 2017).

Other recent decisions from the Court of Chancery address whether Corwin applies when the board's approval of a transaction is alleged to have resulted from a tainted process. In City of Miami General Employees' & Sanitation Employees' Retirement Trust v. Comstock, 2016 WL 4464156 (Del. Ch. Aug. 24, 2016), the Court dismissed a complaint for failure to state a claim after applying Corwin to a merger transaction that garnered the approval of holders of 97.6% of the shares that voted and 81.7% of all shares. Plaintiffs brought a post-closing damages action alleging breaches of the duties of disclosure and loyalty. Plaintiffs argued that a majority of the directors were interested in a transaction with the buyer because they hoped to serve as directors of the surviving entity, and that the chief executive officer and chairman tainted the process by which the board considered the transaction through certain alleged deceptions. After

dismissing the disclosure claim, the Court analyzed the loyalty claim by first ruling that the complaint failed to allege that a majority of the directors were interested and failed to allege adequately that the chief executive officer and chairman tainted the board's process by deception. Although the Court ultimately dismissed the complaint under *Corwin*, the fact that the Court considered the potential conflicts among the corporation's directors suggested that *Corwin* may not preclude judicial review of a tainted sales process.

In Larkin v. Shah, 2016 WL 4485447 (Del. Ch. Aug. 25, 2016), plaintiffs filed a post-closing breach of fiduciary duty action seeking damages as compensation for an allegedly flawed sales process that netted inadequate consideration. The merger was accomplished under Section 251(h), and the stockholders approved the transaction by tendering approximately 78% of the shares into the tender offer. The Court of Chancery determined that "the business judgment rule irrebuttably applies if a majority of disinterested, uncoerced stockholders approve a transaction absent a looming conflicted controller" (emphasis in original). Stated differently, "[i]n the absence of a controlling stockholder that extracted personal benefits, the effect of disinterested stockholder approval of the merger is review under the irrebuttable business judgment rule, even if the transaction might otherwise have been subject to the entire fairness standard due to conflicts faced by individual directors." In Larkin, the Court rejected the assertion that venture capital funds holding a 23.1% block of common stock constituted a control group in the absence of any facts suggesting that those stockholders influenced the board's free exercise of judgment. Thus, finding that there was no controlling stockholder that extracted personal, nonratable benefits, the Court held that the acceptance of the tender offer by stockholders holding approximately 70% of the shares not contractually bound to tender invoked Corwin.

Most recently, in *In re Solera Holdings, Inc. Stockholder Litigation*, 2017 WL 57839 (Del. Ch. Jan. 5, 2017), the Court of Chancery applied *Corwin* to dismiss a complaint alleging a breach of fiduciary duty claim against the directors who approved the acquisition of a corporation by a private equity firm. Before reaching the merits as to whether the uncoerced vote of the disinterested stockholders to approve the merger was fully informed, the Court clarified how the burden of proof operates when applying *Corwin* to a merger transaction. Distinguishing between the burden of proving that a vote is fully informed (which burden the Court found was properly allocated to defendants) from the burden of pleading disclosure deficiencies, the Court explained that allocating the burden of pleading disclosure deficiencies to defendants would "create an unworkable standard, putting a litigant in the proverbially impossible position of proving a negative." As such, the Court explained that "a plaintiff challenging the decision to approve a transaction must first identify a deficiency in the operative disclosure document, at which point the burden would fall to defendants to establish that the alleged deficiency fails as a matter of law in order to secure the cleansing effect" of the stockholder vote under Corwin. Rejecting concerns about the fairness of requiring a plaintiff to plead disclosure deficiencies before obtaining discovery, the Court noted the ability of a plaintiff to conduct a books and records inspection under Section 220 of the General Corporation Law of the State of Delaware in non-expedited stockholder litigation to uncover information in support of such disclosure claims, as well as the ability of plaintiffs to avail themselves of the relatively low "colorability" pleading standard to obtain discovery in respect of such disclosure claims before a stockholder vote is taken on the transaction.

#### In re EZCORP Inc. Consulting Agreement Derivative Litigation, 2016 WL 301245 (Del. Ch. Jan. 25, 2016).

In *In re EZCORP Inc. Consulting Agreement Derivative Litigation*, 2016 WL 301245 (Del. Ch. Jan. 25, 2016), the Court of Chancery denied a motion to dismiss derivative claims challenging a series of payments between a corporation and its controlling stockholder, even though those payments had been approved by the audit committee of the corporation's board. After review of extensive case law, the Court concluded that the weight of authority called for application of the entire fairness standard at the pleading stage, with the possibility that an evidentiary showing of independent committee approval could support a shift in the burden of proof later in the case. The Court determined that such transactions could be subject to dismissal at the pleading stage under the business judgment rule only where the transaction is approved by both an independent committee of the board and a majority of the minority stockholders.

Headquartered in Austin, Texas, EZCORP Inc. ("EZCORP" or the "Company") provided instant cash solutions through a variety of products and services, including pawn loans, other short-term consumer loans, and purchases of customer merchandise. The plaintiff stockholder brought suit challenging the fairness of three advisory service agreements between the Company and defendant Madison Park, LLC, an affiliate of the Company's controlling stockholder, Phillip Cohen. Cohen was the sole stockholder of the general partner of the limited partnership that held all of the Company's voting common stock. Thus, Cohen held 100% of EZCORP's voting power, but only 5.5% of its equity.

In May 2014, the audit committee terminated the renewal of one of the service agreements, allegedly due in part to the committee's concern about the fairness of the relationship between the Company and Madison Park. In early July, the stockholder-plaintiff made a demand under Section 220 of the Delaware General Corporation Law to inspect the Company's books and records relating to the service agreements. Nine days after the books and records demand arrived, Cohen responded to the termination by removing three directors (including two members of the audit committee that had terminated the agreements and the Company's CEO) from the board; another director resigned the same day.

The Court considered at length the appropriate standard of review for transactions in which a corporation's controlling stockholder receives a nonratable benefit. The Court noted that, in an ordinary case involving self-dealing between a corporation and its controlling stockholder, the standard of review is entire fairness and the burden of proof rests on the defendants. However, in the context of a cash-out merger, the Delaware Supreme Court has held that application of the business judgment rule is appropriate if, but only if, the transaction is conditioned *ab initio* on both the affirmative recommendation of a sufficiently authorized, independent and disinterested committee of the board and the affirmative vote of a majority of the minority stockholders. *See Kahn v. M & F Worldwide*, 88 A.3d 635 (Del. 2014). If the controlling holder agrees to use only one of these protections, however, "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."

The Court then considered a controversy posed in the case law: whether challenges to controlling-stockholder transactions other than cash-out mergers may be dismissed under the business judgment rule where the transaction is conditioned on *either* approval by an independent and disinterested board committee *or* approval by a majority of the minority stockholders, but not both. After an extensive review of cases taking both sides of that issue, the Court concluded that the weight of the authority called for a broader application of the entire fairness framework.

The Court also considered the tension between that conclusion and the demand futility analysis articulated in Aronson v. Lewis, 473 A.2d 805 (Del. 1984), a case in which the Delaware Supreme Court had reversed (on discretionary interlocutory review) the Court of Chancery's denial of a motion to dismiss a derivative suit challenging a transaction with a 47% stockholder that had been approved by a majority disinterested and independent board, but not by the corporation's stockholders. The Supreme Court in Aronson held that, unless a stockholder plaintiff pleads particularized facts calling into question the board's ability to exercise properly its independent and disinterested business judgment in responding to a demand to institute suit, a board's refusal to sue is subject to business judgment review. After extended discussion of post-Aronson case law, the Court determined that Aronson applies only to the demand-excusal context and does not provide an independent basis for changing the substantive standard of review of controlling stockholder transactions.

After finding that the operative standard of review was entire fairness with possible burden shifting

based on the audit committee's approval of the service agreements, the Court held that the complaint supported a reasonable inference that the agreements were not entirely fair. Among the factors that the Court found to raise such inference were: (i) Cohen's voting control despite having only a 5.5% equity stake; (ii) the long history of advisory service agreements between the Company and Cohen's affiliates; (iii) the amount and timing of the payments; (iv) the minimal resources of Madison Park; (v) the duplication between the services Madison Park provided and the capabilities of the Company management; (vi) the lack of similar service agreements at any of EZCORP's peer companies; (vii) the decision by two members of the audit committee to cancel the renewal of one agreement; and (viii) Cohen's retaliation against those board members.

The Court added that at the motion to dismiss stage, the involvement of the audit committee in the transactions does not defeat the fiduciary duty claim because a determination of whether an independent committee is "well-functioning" requires a "fact intensive inquiry."

The Court next turned to its analysis under Court of Chancery Rule 23.1. The Court found that reasonable doubt existed as to the ability of a majority of the directors to exercise independent and disinterested business judgment over a demand, and thus that demand was excused. Notably, the Court found demand excused as to a retired board member whom Cohen brought out of retirement and reappointed after removing three directors in July 2014. While the Court acknowledged the general rule that a director's nomination or election by an interested party is, by itself, insufficient to raise a reasonable doubt about his independence, "it is not necessarily irrelevant." The Court found that this director's alleged "eagerness to be of use," combined with his participation as an audit committee member in approving some of the challenged agreements, could support the reasonable inference that "Cohen wanted to bring back a cooperative member of the placid antebellum regime."

## Corwin v. KKR Financial Holdings LLC, 125 A.3d 304 (Del. 2015).

In *Corwin v. KKR Financial Holdings LLC*, 125 A.3d 304 (Del. 2015), the Delaware Supreme Court affirmed a ruling by the Court of Chancery granting the defendants' motions to dismiss a suit challenging the acquisition of KKR Financial Holdings LLC ("KFN") by KKR & Co. L.P. ("KKR"). The Court held that the business judgment rule is the appropriate standard in post-closing damages suits involving mergers that are not subject to the entire fairness standard and that have been approved by a fully informed, uncoerced majority of the disinterested stockholders, even where such approval is statutorily required.

In December 2013, KKR and KFN executed a stock-forstock merger agreement, which was subject to approval by a majority of KFN shares held by persons other than KKR and its affiliates. The merger, which was priced at a premium of 35% to market, was approved in April 2013 by an independent board majority and by a majority of disinterested stockholders.

Following the merger, nine lawsuits challenging the merger were brought in the Court of Chancery and consolidated. The plaintiffs alleged that (i) the members of the KFN board breached their fiduciary duties by agreeing to the merger, and (ii) KKR breached its fiduciary duty as a controlling stockholder by causing KFN to enter into the merger agreement. The plaintiffs' control claims focused on the facts that a KKR affiliate managed the company's day-today operations and that KFN's primary business was financing KKR's leveraged buyout activities.

The Court of Chancery dismissed the complaint, finding that KKR, which owned only 1% of KFN's stock, was not a controlling stockholder. Additionally, the Court of Chancery held that the business judgment rule would apply to the merger because the merger was approved by a majority of the shares held by the disinterested, fully informed stockholders of KFN.

The Supreme Court, sitting *en banc*, unanimously affirmed the judgment of the Court of Chancery. With respect to the control issue, the Court found

that the plaintiffs had not alleged sufficient facts to support the argument that KKR had effective control of the board and could therefore prevent KFN's board from exercising its own independent judgment in determining whether to approve the merger. To support this finding, the Court noted that KKR "owned less than 1% of the stock, had no right to appoint any directors, and had no contractual right to veto any board decision." Accordingly, the Court rejected the plaintiffs' control claims.

The Court further held 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." The Court also declined to review the Court of Chancery's holding on the non-applicability of *Revlon*, finding that even if *Revlon* applied to the merger, the voluntary approval by an informed majority of disinterested stockholders was sufficient to support application of the business judgment rule. The Court stated that *Revlon* and *Unocal* were not designed to address post-closing claims for money damages, but rather to provide stockholders and the Court of Chancery the ability to address merger and acquisition decisions before closing.

In so holding, the Court agreed with the Court of Chancery's interpretation of *Gantler v. Stephens*, 965 A.2d 696 (Del. 2009). In *Gantler*, the Supreme Court stated that ratification is limited to circumstances where a fully informed stockholder vote approves director action that does not legally require stockholder approval in order to become effective. Using this interpretation, plaintiffs argued that the merger should be subject to heightened scrutiny regardless of the statutorily required stockholder vote approving the merger. The Court rejected this argument, finding that *Gantler* was a narrow decision that focused on the meaning of the term "ratification," and was not meant to overturn Delaware's "long-standing body of case law" regarding the effect of fully informed stockholder approval.

The Supreme Court noted, however, that its holding applies only to fully informed and uncoerced votes of disinterested stockholders. Thus, the business judgment rule is not invoked if material facts regarding the merger are not disclosed to the voting stockholders.

#### C&J Energy Services, Inc. v. City of Miami General Employees' and Sanitation Employees' Retirement Trust, 107 A.3d 1049 (Del. 2014).

In C&J Energy Services, Inc. v. City of Miami General Employees' and Sanitation Employees' Retirement Trust, 107 A.3d 1049 (Del. 2014), 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.

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

In *Houseman v. Sagerman*, 2014 WL 1600724 (Del. Ch. Apr. 16, 2014), 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 and did not support an aiding and abetting claim against the board's financial advisor.

In 2006, 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, 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 plaintiffs a put right obligating Whittington, under certain circumstances, to pay plaintiffs \$2.10 for each share of plaintiffs' 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 plaintiffs were, under certain circumstances, entitled to under the Put Contract.

After the merger closed, 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, 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 the re-litigation of the Put Contract claims and, accordingly, dismissed those claims.

In addressing 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, plaintiffs were required to allege facts sufficient to show that a majority of the directors acted in bad faith in approving the merger. Plaintiffs pled 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 plaintiffs had failed to allege that KeyBanc "knowingly participated" in any breach of duty. The Court distinguished Rural *Metro*, finding that 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 Universata's interest, not KeyBanc's, that drove the structure of the financial services provided in connection with the merger. Accordingly, the Court dismissed plaintiffs' aiding and abetting claims against KeyBanc.

The Court then addressed 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 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 plaintiffs alleged were invalidly issued to certain directors). The Court noted that as a threshold matter, under *Primedia,* 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 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."

### **Aiding and Abetting Liability**

## **RBC Capital Markets, LLC v. Jervis,** 2015 WL 7721882 (Del. Nov. 30, 2015).

In RBC Capital Markets, LLC v. Jervis, 2015 WL 7721882 (Del. Nov. 30, 2015), the Delaware Supreme Court affirmed a post-trial decision by the Court of Chancery holding that a financial advisor was liable for aiding and abetting breaches of fiduciary duty by directors of a corporation during a sale of control transaction. In doing so, the Court held that the evidence supported a finding that the advisor had the necessary scienter for an aiding and abetting claim; that is, the financial advisor "knowingly participated" in the breach by "exploiting its own conflicted interests to the detriment of [the corporation] and by creating an informational vacuum." The Court refused to require contribution from directors (who had previously settled with the stockholder-plaintiffs) because the board was exculpated from monetary liability under the Company's Section 102(b)(7) provision. The Court confirmed, however, that Section 102(b)(7) protections do not extend to third parties.

In December 2010, the board of Rural/Metro Corporation ("Rural" or the "Company") formed a special committee to explore strategic alternatives. While the special committee was authorized to hire a financial advisor to help explore these options, it was not expressly authorized to initiate a sale process. After interviewing two other financial advisors, the special committee engaged RBC Capital Markets ("RBC") as its primary financial advisor. In its presentation to the special committee, RBC had recommended a sale of the Company in a coordinated effort with the sale of Rural's competitor, Emergency Medical Services Corporation ("EMS"), because "healthcare was 'strong'" and selling the Company at that point in time was "opportunistic." But RBC "did not disclose that proceeding in parallel with the EMS process served RBC's interest in gaining a role on the financing trees of bidders for EMS." RBC sought to use as an "angle" its role as a sell-side advisor to secure a buy-side financing role for the EMS deal, which could entitle RBC to "\$60.1 million in fees from the Rural and EMS deals."

After contacting several private equity firms, six submitted indications of interest, and ultimately, Warburg Pincus LLC submitted the highest bid of \$17.25 per share. RBC unsuccessfully solicited a "buy-side financing role from Warburg," but did not disclose its attempt to the special committee. RBC and Moelis & Company ("Moelis"), the special committee's secondary financial advisor, provided fairness opinions. The Court of Chancery found that "RBC worked to lower the analyses in its fairness presentation so Warburg's bid looked more attractive. Specifically, the trial court found that RBC made a series of changes to its fairness analysis" without disclosing these changes to the special committee. That analysis was sent to the board just three hours before its meeting to decide on the deal. The board approved the merger with Warburg in March 2011, and in June 2011, the merger closed, after approval by the Company's stockholders.

The class plaintiffs sought relief against Rural's directors for breaches of fiduciary duty and against RBC and Moelis for aiding and abetting those breaches. Rural's directors and Moelis settled, and RBC went to trial. Post-trial, the Vice Chancellor held that RBC was liable for aiding and abetting breaches of the directors' duty of care and duty of disclosure. Specifically, the trial court held that the board breached its duty of care under *Revlon*'s enhanced scrutiny standard after an unreasonable sales process, and that the board failed to disclose material information in its proxy statement regarding RBC's valuation process and

conflicts. Concluding that RBC had knowingly aided and abetted these breaches, the Court of Chancery found RBC liable for \$75.7 million. This represented 83% of the damages, which the Court determined was reasonable, given the Delaware Uniform Contribution Among Tortfeasors Act and RBC's responsibility as a joint tortfeasor.

The Delaware Supreme Court affirmed. First, after concluding that Revlon applied, the Court reviewed the trial court's holding that Rural's board breached its duty of care under enhanced scrutiny. The Court of Chancery had found that the board's pursuit of the transaction was outside the range of reasonableness, because "RBC did not disclose that proceeding in parallel with the EMS process served RBC's interest in gaining a role on the financing trees of bidders for EMS," and that these actions "impeded interested bidders from presenting potentially higher value alternatives." The board, according to the Court, should have been aware of the negative implications of this dual-track structure and should have had a mechanism to identify RBC's conflicts. "[D]irectors need to be active and reasonably informed when overseeing the sales process, including identifying and responding to actual or potential conflicts of interest," and "the board should require disclosure of, on an ongoing basis, material information that might impact the board's process" when there is a conflicted advisor.

The Court of Chancery also had found that Rural's board was not "adequately informed as to Rural's value," including that the "Company's value on a stand-alone basis exceeded what a private equity bidder willingly would pay." And because the directors were not "well-informed" as to the value, their decision was "devoid of important efforts" necessary to "to protect ... stockholders and to ensure that the transaction was favorable to them." The "informational vacuum created by RBC" also made it impossible for stockholders to check the board and ensure that they had diligently contemplated the decision to sell the Company. This informational vacuum also contributed to the Court of Chancery's holding that Rural's board had violated its duty of disclosure by failing to disclose RBC's conflicts fully and characterize RBC's analysis accurately. The Supreme Court affirmed these rulings.

Next, the Court held that RBC had aided and abetted the board's breaches. The Court affirmed the trial court's "narrow holding" that "if [a] third party knows that the board is breaching its duty of care and participates in the breach by misleading the board or creating the informational vacuum, then the third party can be liable for aiding and abetting." Even though "the requirement that the aider and abettor act with scienter makes an aiding and abetting claim among the most difficult to prove," the Court found that the requisite scienter had been shown because RBC "intentionally duped" the board into breaching its duty of care and engaged in "fraud on the Board" by knowingly creating the informational vacuum.

Finally, the Court rejected RBC's argument that it had a right to contribution from joint tortfeasors, noting that the settlement agreements barred such a right. Importantly, the Court also held that Rural's Section 102(b)(7) exculpatory provision did not shield RBC from liability. "While Section 102(b)(7) insulates directors from monetary damages stemming from a breach of the duty of care, its protection does not apply to third parties such as RBC." The intended legislative purpose of Section 102(b)(7) was not to "safeguard third parties and thereby create a perverse incentive system wherein trusted advisors to directors could, for their own selfish motives, intentionally mislead a board only to hide behind their victim's liability shield."

### **Deal Protection Devices**

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

In *In re Converge, Inc. Shareholders Litigation*, 2014 WL 6686570 (Del. Ch. Nov. 25, 2014), the Delaware Court of Chancery granted in part the defendants' motion to dismiss a post-closing stockholder challenge to the acquisition of Converge, Inc. ("Converge") by H.I.G. Capital, L.L.C. ("HIG"), which acquisition the Court had previously declined to enjoin. The plaintiffs alleged that Converge's board of directors 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 at HIG's election 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 plaintiffs' 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 nonexculpated 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 had found to be within

a reasonable range for termination fees in its past decisions. 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.

### Disclosures

## *In re Trulia, Inc. Stockholder Litigation,* 2016 WL 325008 (Del. Ch. Jan. 22, 2016).

In *In re Trulia, Inc. Stockholder Litigation,* 2016 WL 325008 (Del. Ch. Jan. 22, 2016), the Delaware Court of Chancery refused to approve a class action settlement that called for marginal disclosures in exchange for a broad release of stockholder claims. In so doing, the Court announced that moving forward it would review such "disclosure settlements" with increased scrutiny.

The case arose from the stock-for-stock merger between online real estate companies Zillow, Inc. and Trulia, Inc. Shortly after the merger was announced in July 2014, four plaintiffs filed class action complaints seeking to enjoin the merger and alleging that the directors of Trulia breached their fiduciary duties by including misleading disclosures in the joint proxy statement. Within days, however, the plaintiffs agreed to release their claims if Trulia would provide supplemental disclosures about the financial opinion the Trulia directors relied upon when approving the transaction. Trulia provided the disclosures, and the stockholders of both companies subsequently adopted the merger agreement. A formal settlement agreement was then submitted to the Court for approval, which (i) sought certification of a class consisting of all

Trulia stockholders as of the date the merger was first announced through the closing date; (ii) included a broad release of "any claims arising under federal, state, statutory, regulatory, common law, or other law or rule" held by members of the proposed class relating in any way to the merger (with a limited carveout for antitrust claims); and (iii) permitted plaintiffs' counsel to seek an award of attorneys' fees totaling \$375,000.

The Court rejected the proposed settlement because the supplemental disclosures failed to provide a material benefit to the Trulia stockholders and were insufficient to justify the broad release of claims. In reaching this decision, the Court held that certain disclosures were immaterial because they contained information that was already publicly available, while other disclosures, which restated specific data points used by Trulia's financial advisor, were immaterial because Delaware law only requires companies to provide a summary of the financial advisor's opinion and not every detail necessary to recalculate the advisor's analysis.

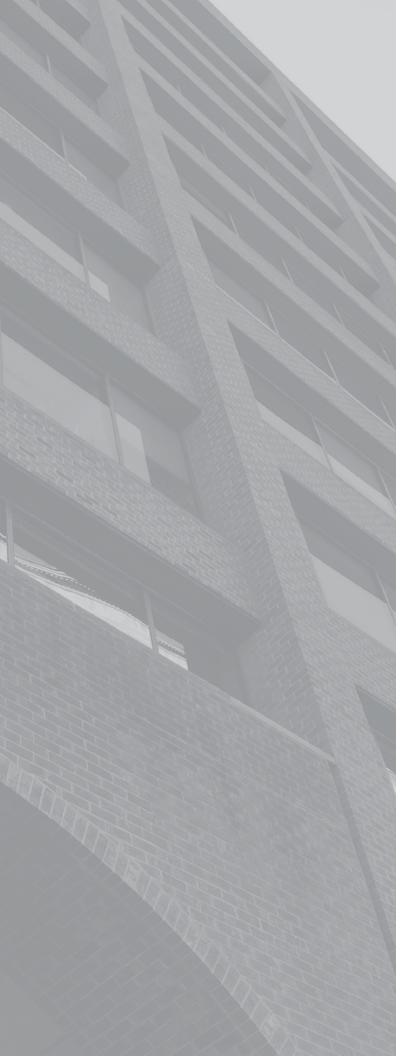
In addition to its ruling, the Court unambiguously announced its intention to review "disclosure settlements" in the future with heightened scrutiny. The Court acknowledged that defendants involved in deal litigation have strong incentives to settle quickly-particularly if such settlements can be obtained by offering minimal disclosures in exchange for a broad release of stockholder claims. The Court explained, however, that its prior willingness to approve settlements calling for marginal disclosures, sweeping releases of stockholder claims and six-figure attorney fees had led to an explosion of lawsuits that "serve[] no useful purpose." Stressing how it can be problematic to adjudicate disclosure claims in the context of settlement-approval proceedings, the Court further explained that such proceedings are non-adversarial, leaving the Court to determine the materiality of supplemental disclosures without the benefit of a full record or consulting opposing briefs. Given the surge in deal litigation and the risk that stockholders are losing potentially valuable claims that have not been adequately investigated, the Court proposed two solutions.

First, the Court recommended that disclosure claims be litigated outside of a settlement-approval proceeding and in an adversarial context. One such context would be a preliminary injunction motion, where plaintiffs would bear the burden of showing that disclosure of the omitted fact would likely have been material to a reasonable investor. Another context is when plaintiffs' counsel apply to the Court for an award of attorneys' fees after defendants voluntarily decide to supplement their proxy materials by making one or more of the disclosures sought by plaintiffs, thereby mooting some or all of their claims. In this situation, defendants are incentivized to oppose excessive fee requests.

Second, to the extent parties continue to pursue disclosure-based settlements, the Court warned that such settlements are "likely to be met with continued disfavor" by the Court unless the supplemental disclosures address a "plainly material misrepresentation or omission," and the subject matter of the proposed release is narrowly circumscribed to encompass nothing more than disclosure claims and fiduciary duty claims concerning the sale process.

Should supplemental information not be "plainly material," the Court recommended appointing an *amicus curiae*, paid for by both parties, to assist the Court in evaluating the alleged benefits of the supplemental disclosures. Finally, to mitigate the risk that parties will seek out forums willing to approve disclosure settlements of no genuine value, the Court also called on its sister courts in other states to adopt similar practices.

Following the settlement hearing, the Court noted that the parties agreed to narrow the release to exclude unknown claims, foreign claims, and claims arising under state or federal antitrust law. However, the Court held that this narrowed release was still overbroad as it was not limited to solely disclosure claims and fiduciary duty claims concerning the decision to enter into the merger.



## Merger Agreement Construction

#### Chicago Bridge & Iron Company N.V. v. Westinghouse Electric Company LLC, C.A. No. 12585-VCL (Del. Ch. Dec. 5, 2016).

In *Chicago Bridge & Iron Company N.V. v. Westinghouse Electric Company LLC*, C.A. No. 12585-VCL (Del. Ch. Dec. 5, 2016), the Court of Chancery held that pursuant to the language of a purchase agreement between Chicago Bridge & Iron Company N.V. (the "Seller") and Westinghouse Electric Company LLC (the "Buyer"), a dispute about the post-closing purchase price adjustment was to be submitted to and resolved by an independent auditor.

In 2015, an acquisition vehicle controlled by the Buyer purchased a subsidiary of the Seller. The purchase agreement between the parties provided for a purchase price of \$0 subject to post-closing adjustment and the potential for deferred future payments. The purchase price for the transaction was to be determined by a complex pricing mechanism that had the potential to vary greatly depending upon the post-closing adjustment.

Following closing, the parties disputed whether there was a surplus or deficit of working capital and the amount thereof. The Seller had calculated that it was owed approximately \$428 million. The Buyer, using different assumptions and judgments, calculated that it was owed approximately \$2.15 billion. After failing to resolve their differences, the Seller filed a complaint against the Buyer, claiming that the Buyer's method of calculating the post-closing adjustment breached the terms of the purchase agreement and the implied covenant of good faith and fair dealing.

The Seller argued that the purchase agreement's terms precluded the Buyer from "making any adjustments to items that appeared on the [Seller's] balance sheet or adding liabilities with the avowed goal of complying with GAAP," because the purchase agreement set forth that at closing, none of the Seller's representations and warranties, including the Seller's representation that its calculations were GAAP-compliant, would survive closing. The Seller argued that the Buyer was attempting to circumvent the purchase agreement's terms by claiming that it needed to make adjustments to the Seller's assumptions to make its calculations GAAP-compliant. The Buyer argued that the purchase agreement required the parties to submit their dispute to an independent auditor.

The purchase agreement provided that "any claim for breach of the seller's representation regarding GAAP compliance of the Reference Statement would be decided by arbitration." Additionally, the purchase agreement contained dispute resolution language that gave an independent auditor authority over "any and all matters that remain in dispute with respect to the Objections Statement, the Closing Statement and the calculations set forth therein." The Court held that the language of the dispute resolution provision was sufficiently broad to include determinations about GAAP compliance, and that both parties had contractually agreed to resolve disputes over the post-closing adjustment to an independent auditor. Pursuant thereto, the Court submitted the parties' dispute to an independent auditor.

#### *IAC Search, LLC v. Conversant LLC,* C.A. No. 11774-CB (Del. Ch. Nov. 30, 2016).

In *IAC Search, LLC v. Conversant LLC*, C.A. No. 11774-CB (Del. Ch. Nov. 30, 2016), the Court of Chancery held that in a purchase agreement between IAC Search, LLC (the "Buyer") and ValueClick, Inc. (the "Seller"), the Buyer's acknowledgment provision, an integration clause, and the Seller's disclaimer of making any extra-contractual representations collectively constituted a "clear disclaimer of reliance on extra-contractual statements" and barred the Buyer's fraud claim.

In 2013, the Buyer purchased six subsidiaries of the Seller. Following closing, the Buyer alleged that the Seller had misrepresented certain information to the Buyer about its internet ad-placing business, including falsified performance metrics concerning Investopedia's remnant ad revenue. The Buyer alleged, *inter alia*, that because of the falsified information it was fraudulently induced into purchasing Investopedia.

In determining whether plaintiff's claim for fraud survived a motion to dismiss, the Court examined the purchase agreement between the Buyer and the Seller. The purchase agreement contained a standard integration clause, a disclaimer by the Seller that it was not making any extra-contractual representations, and an acknowledgment by the Buyer wherein the Buyer acknowledged that the Seller "was not making any representation concerning information provided during due diligence" unless it was stated elsewhere in the purchase agreement. The Court compared these three provisions to the anti-reliance language litigated in Arby Partners V, L.P. v. F & W Acquisition LLC, 891 A.2d 1032 (Del. Ch. 2006), wherein the Court stated that "murky integration clauses, or standard integration clauses without explicit anti-reliance representations, will not relieve a party of its oral and extra-contractual fraudulent representation." The Court held that while the language contained in the purchase agreement was not as explicit as that in Arby, the three provisions collectively defined "the universe of information on which [the Buyer] relied and did not rely when it entered into the [purchase] agreement." Consequently, the Court dismissed the Buyer's extracontractual fraud claim.

#### **Cigna Health & Life Insurance Company v. Audax Health Solutions, Inc.,** 107 A.3d 1082 (Del. Ch. 2014).

In *Cigna Health & Life Insurance Company v. Audax Health Solutions, Inc.,* 107 A.3d 1082 (Del. Ch. 2014), 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 clawback) 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 clawback 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 because of the open-ended and unlimited indemnification provisions. The Court further held that the indemnification provisions were 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.

## Implied Covenant of Good Faith and Fair Dealing

Lazard Technology P'rs, LLC v. QinetiQ North America Operations LLC, 114 A.3d 193 (Del. Apr. 23, 2015).

In Lazard Technology P'rs, LLC v. QinetiQ North America Operations LLC, 114 A.3d 193 (Del. Apr. 23, 2015), the Delaware Supreme Court affirmed the Court of Chancery's post-trial bench ruling and held that the defendant-below did not breach an earn-out provision in a merger agreement or the implied covenant of good faith and fair dealing.

In 2009, QinetiQ North America Operations, LLC (the "Buyer"), a defense and security technology company, acquired Cyveillance, Inc. (the "Company"), a cybertechnology company. The Buyer paid \$40 million for the Company up front and was obligated to make additional earn-out payments of up to \$40 million if the Company achieved certain revenue targets over a defined period. Section 5.4 of the merger agreement prohibited the Buyer, post-closing, from "tak[ing] any action to divert or defer [revenue] with the intent of reducing or limiting the Earn-Out Payment." At the close of the earn-out period, revenues had not reached the level required to generate an earn-out.

Lazard Technology Partners, LLC, which represented former stockholders of the Company (collectively, the

"Seller"), filed suit in the Court of Chancery on August 29, 2011 against the Buyer. The Seller alleged that the Buyer breached both Section 5.4 of the merger agreement and the implied covenant of good faith and fair dealing by failing to take actions to achieve revenue sufficient to generate an earn-out. In a bench ruling following post-trial argument, the Court of Chancery entered judgment in favor of the Buyer on both claims. With respect to the breach of contract claim, the Court concluded that the literal terms of Section 5.4 required a showing of intent, which the Seller could not establish. The Court construed the implied covenant of good faith and fair dealing to prohibit only conduct undertaken with intent to reduce or avoid an earn-out payment altogether, consistent with the language of Section 5.4.

The Delaware Supreme Court affirmed. The Court agreed that Section 5.4 employed an intent standard, not a knowledge standard, and rejected the Seller's assertion that the contract precluded conduct by the Buyer that the Buyer knew would compromise the Seller's ability to receive an earn-out payment. On the implied covenant claim, the Court noted both the specific standard in Section 5.4 and the negotiating history (in which the Seller had sought tighter objective controls on the Buyer's post-closing conduct, but had failed to obtain them), stated that the Court of Chancery "was very generous in assuming that the implied covenant of good faith and fair dealing operated at all as to decisions affecting the earn-out," and held that the Court of Chancery had correctly concluded that the implied covenant "did not inhibit the buyer's conduct unless the buyer acted with the intent to deprive the seller of an earn-out payment."

#### **STOCKHOLDER LITIGATION**

### Appraisal Actions and Proceedings

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

In In re Appraisal of Dell Inc., 143 A.3d 20 (Del. Ch. 2016), the Court held that 14 mutual funds sponsored by T. Rowe Price & Associates, Inc. ("T. Rowe") and the institutions that relied on T. Rowe to direct the voting of their shares (the "T. Rowe Petitioners") were not entitled to an appraisal of their shares of Dell Inc. in connection with Dell's go-private merger, because the record holder had voted the shares at issue in favor of the merger, thus failing to meet the "dissenting stockholder" requirement of Section 262 of Delaware's General Corporation Law. The T. Rowe Petitioners held their shares through custodians. The custodians, however, were not record holders of the shares; they were participants of the Depository Trust Company, which held the shares in the name of its nominee, Cede & Co., which, for purposes of Delaware law, was the record holder. As the record holder, Cede had the legal right to vote the shares on the Dell merger and to make a written demand for an appraisal of the shares.

The Court noted that, through a "Byzantine" system, Cede was constrained to vote the T. Rowe Petitioners' shares in accordance with T. Rowe's instructions. Although T. Rowe had publicly opposed the merger, it had in fact submitted instructions to vote the T. Rowe Petitioners' shares in favor of the merger due to its internal voting processes. To assist in its voting processes, T. Rowe had retained Institutional Shareholders Services Inc. ("ISS"). On matters on which a stockholder vote was sought, the voting system generated default voting instructions. In the case of management-supported mergers, such as Dell's merger, the default voting instructions were to vote in favor of the merger. The special meeting of Dell's stockholders to vote on the merger was originally scheduled for July 18, 2013. For that meeting, T. Rowe confirmed that its shares were to be voted against the merger. Dell opened the July 18 meeting for the sole purpose of adjourning it. After a series of subsequent adjournments, the special meeting was held on September 12, 2013. Shortly before the meeting, the voting system generated a new meeting record, which had the effect of replacing the prior instructions (i.e., "against") with new default instructions (i.e., "for"). After the switch, no one from T. Rowe logged into the ISS system to check the status of its voting instructions. As a result, the T. Rowe Petitioners' shares were voted in accordance with the new default instructions-that is, they were voted in favor of the merger, a fact that came to light after certain of the T. Rowe Petitioners submitted filings required by federal law disclosing their vote.

Section 262 of Delaware's General Corporation Law confers appraisal rights upon a stockholder of record who holds shares on the date an appraisal demand is made, continuously holds the shares through the effective date of the merger, submits a demand for appraisal in compliance with the statute, and has not voted in favor of the merger or consented to it in writing. The Court noted that Section 262's requirements could be read as "all-or-nothing propositions," such that a stockholder of record, like Cede, would be foreclosed from asserting appraisal rights if it voted a single share in favor of the merger. The Court observed that the Delaware Supreme Court, recognizing that a broker or nominee may hold shares of record on behalf of multiple clients, has permitted a stockholder of record to split its vote and seek appraisal for shares not voted in favor of the merger. The key consequence of such vote splitting, the Court stated, is that a record holder can only seek appraisal for the specific shares that were not voted in favor of the merger. The key consequence for the T. Rowe Petitioners is that their shares held of record by Cede, having been voted in favor of the Dell merger, were not entitled to appraisal rights.

In arriving at its holding, the Court noted that language in several of its recent "appraisal arbitrage" opinions, if read literally, would preclude it from considering anything other than Cede's aggregated votes on the merger. The Court stated, however, that there was no evidence in those cases regarding how the particular shares were voted. The Court concluded that the appraisal arbitrage cases deal only with the situation involving the absence of proof; they do not stand for the proposition that, where evidence as to how the shares were voted exists and the parties can introduce it, the Court is precluded from considering it.

The Court's solution was to provide that once an appraisal petitioner has made out a *prima facie* case that its shares are entitled to appraisal (which, where the shares are held of record by Cede, it can meet by showing that there were sufficient shares held by Cede that were not voted in favor of the merger to cover the appraisal class), the burden shifts to the respondent corporation to demonstrate that Cede actually voted the shares for which appraisal is sought in favor of the merger. The Court noted that the corporation could introduce public filings or other evidence from providers of voting services, such as internal control numbers and voting authentication records. If the corporation demonstrates that Cede (or any other record holder) actually voted the shares for which appraisal rights have been asserted in favor of the merger, the requirements of Section 262 will not have been met, and the petitioner will not be entitled to an appraisal of those shares.

Merlin Partners LP v. AutoInfo, Inc., 2015 WL 2069417 (Del. Ch. Apr. 30, 2015); In re LongPath Capital, LLC v. Ramtron International Corporation, 2015 WL 4540443 (Del. Ch. June 30, 2015).

In two recent post-trial opinions in appraisal cases under 8 *Del. C.* § 262, the Court of Chancery addressed the importance of merger price and process as well as the reliability of discounted cash flow (DCF) analyses in determining fair value. In *Merlin Partners LP v. AutoInfo, Inc.,* 2015 WL 2069417 (Del. Ch. Apr. 30, 2015), Vice Chancellor Noble found that, where there was an adequate sale and negotiation process conducted at arm's length and there were no reliable cash flow projections from which to make a DCF analysis nor available alternate valuations, the price received in the merger, \$1.05 per share, was the best indication of fair value at the time of the merger. Two months later, in *In re LongPath Capital, LLC v. Ramtron International Corporation,* 2015 WL 4540443 (Del. Ch. June 30, 2015), Vice Chancellor Parsons similarly determined that there were no reliable means of appraisal valuation other than the merger price, but also found that the fair value at the time of the merger was \$0.03 below the deal price of \$3.10 per share after accounting for synergies.

Under Section 262, stockholders who choose not to participate in certain merger transactions may petition the Court to determine the fair value of their stock. "Fair value" represents "the value to a stockholder of the firm as a going concern, as opposed to the firm's value in the context of an acquisition or other transaction." To determine fair value, the Court independently evaluates the evidence and may consider techniques or methods that are generally considered acceptable in the financial community and otherwise admissible in court. Depending on the case, the Court may rely upon a DCF analysis, a comparable transactions analysis, a comparable companies analysis or the merger price itself. Delaware courts tend to favor a DCF model over other available methodologies in an appraisal proceeding. However, a DCF analysis has "much less utility" in cases where the transaction was an arm's-length merger or where the data inputs used in the model are not reliable.

After struggling financially, AutoInfo began a sale process. As part of the process, Stephens Inc., AutoInfo's financial advisor retained to assist with the sale process, asked management to prepare five-year financial projections that were "aggressively optimistic" for use in marketing AutoInfo. AutoInfo's management had never prepared multi-year projections before, and the company's CEO described the process as "a bit of a chuckle and a joke." Despite this, AutoInfo engaged in an extensive sales process, with Stephens contacting 164 potential strategic and financial buyers, 70 of which entered into non-disclosure agreements. Several bidders submitted letters of intent, including Comvest, which signed a letter of intent at \$1.26 per share but eventually reduced its price to \$1.05 per share after discovering problems with the reliability of AutoInfo's financial information.

Merlin Partners filed an appraisal action and, relying on two comparable companies analyses and a DCF analysis prepared by its financial expert, argued that the fair value of the company was \$2.60 per share. The Court first found that Merlin's DCF analysis deserved little deference because Merlin had failed to establish the credibility of the management projections upon which it relied. Not only were they AutoInfo's first attempt at such projections, they had also been specifically prepared to "paint the most optimistic and bright current and future condition of the company" possible in connection with the sales process. The Court also gave no weight to Merlin's comparable companies analyses because the companies used for comparison differed significantly in size from AutoInfo (from more than twice to 300 times its size) and also used storebased business models rather than AutoInfo's riskier agent-based model. Conversely, AutoInfo's expert relied on merger price, and the Court found that it could place "heavy weight" on a merger price in the absence of any other reliable valuation analysis. Finding that fair value was the deal price, the Court noted that the merger was the result of a competitive and fair auction because AutoInfo: (i) retained an investment bank experienced in the transportation industry using an incentive-based fee structure; (ii) contacted numerous companies in the sales process; (iii) formed a special committee; (iv) was sold at a premium to market; and (v) had no other topping bid emerge between announcement and closing of the merger.

In *Ramtron*, after rejecting Cypress Semiconductor Corporation's bear hug letter to acquire all of its shares, as well as engaging in a subsequent sales process that involved its advisor contacting 24 potential buyers and executing non-disclosure agreements with six of those potential buyers, Ramtron engaged in negotiations with Cypress. After rejecting two more offers from Cypress, Ramtron agreed with Cypress on a final transaction price of \$3.10 per share. LongPath, which acquired its shares after announcement of the merger, demanded appraisal and argued that fair value was \$4.96 per share. The Court determined that LongPath's DCF analysis was not appropriate because it relied on management projections prepared by newer employees who were creating multi-year projections for the first time, which also utilized a point-of-sale revenue recognition methodology rather than Ramtron's historic point-of-purchase method. As further evidence of the unreliability of the projections, the Court noted that they were created after Cypress's bear hug letter, in anticipation of potential litigation or a hostile takeover bid, and that Ramtron, which already had a questionable track record at forecasting, prepared separate projections to provide to its bank. The Court also afforded no weight to LongPath's comparable transactions analysis, as the petitioner's expert had a "dearth of data points" and could only point to two comparable transactions with vastly different multiples. Instead, the Court found it could give "one-hundred percent weight" to merger price as evidence of fair value when the merger resulted from a proper process. Here, only one company, Cypress, ever made a bid even after an active solicitation process, and Ramtron could and did repeatedly (and publicly) reject Cypress's overtures, after which Cypress raised its price. In addition, the Court determined that it was appropriate to subtract LongPath's estimate of net synergies of \$0.03 per share (which was reached by netting negative revenue synergies and transaction costs from Ramtron's estimate of positive synergies) from the merger price to reach a fair value determination of \$3.07 per share.

As these decisions illustrate, even though Delaware courts "tend to favor a DCF model in appraisal proceedings," they will be willing to rely entirely upon or afford substantial weight to the merger price to determine fair value where there is reason to question the reliability of the underlying management projections and where no other viable alternate valuation technique exists.

Merion Capital LP v. BMC Software, Inc., 2015 WL 67586 (Del. Ch. Jan. 5, 2015); In re Appraisal of Ancestry.com, Inc., 2015 WL 66825 (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., 2015 WL 67586 (Del. Ch. Jan. 5, 2015), and In re Appraisal of Ancestry.com, Inc., 2015 WL 66825 (Del. Ch. Jan. 5, 2015), 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 undervalued 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 goingprivate 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 it (rather than the record holder, Cede & Co.) did not vote the shares in favor of the merger. Moreover, Ancestry.com argued that 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.

## **Advance Notice Bylaws**

Hill International, Inc. v. Opportunity Partners L.P., 119 A.3d 30 (Del. 2015).

In *Hill International, Inc. v. Opportunity Partners L.P.,* 119 A.3d 30 (Del. 2015), the Delaware Supreme Court affirmed the Court of Chancery's grant of mandatory injunctive relief enjoining Hill International, Inc. ("Hill") from conducting any business at its 2015 annual meeting, other than convening the meeting for the sole purpose of adjourning it for a minimum time period, in order to permit Opportunity Partners ("Opportunity"), the stockholder-plaintiff, to present certain items of business and director nominations at Hill's 2015 annual meeting.

The key issue in the case was whether Opportunity had complied with Hill's advance notice bylaw in submitting its proposed business and nominations. On April 30, 2014, Hill publicly disclosed in its 2014 definitive proxy statement that it anticipated that its 2015 annual meeting would be "on or about June 10, 2015" and that stockholders who wished to submit a proposal for the 2015 annual meeting must submit their proposal no later than April 15, 2015. The following year, on April 13, 2015, Opportunity delivered to Hill a notice of its intent to propose business and nominate two directors at Hill's 2015 annual meeting. On April 30, 2015, Hill filed its definitive proxy statement for its 2015 annual meeting and announced that its 2015 annual meeting would be held on June 9, 2015. Subsequently, on May 5, 2015, Hill asserted that Opportunity's April 13 notice was defective because it failed to include information about the director nominees required by the bylaws. On May 7, Opportunity delivered another notice to Hill of its intent to present at the 2015 annual meeting two different proposals than had been included in its April 13 notice, as well as nominations for election to Hill's board of the same two nominees as had been named in the April 13 letter. On May 11, Hill notified Opportunity that its notice was untimely under Hill's advance notice bylaw and that its proposals and nominations would not be presented at the 2015 annual meeting. Opportunity brought suit in the Court of Chancery claiming its notice was timely under Hill's bylaws.

Unlike many advance notice bylaws where stockholder notice of intent to make nominations or propose business is required to be delivered some number of days prior to the anniversary of the prior year's meeting or the mailing of the prior year's proxy statement, Hill's advance notice bylaw provides:

To be timely, a stockholders' notice must be delivered to or mailed and received at the principal executive offices of the Corporation not less than sixty (60) nor more than ninety (90) days prior to the meeting; provided, however, that in the event that less than seventy (70) days' notice or prior public disclosure of the date of the annual meeting is given or made to stockholders, notice by a stockholder, to be timely, must be received no later than the close of business on the tenth (10th) day following the day on which such notice of the date of annual meeting was mailed or such public disclosure was made, whichever first occurs.

In support of its contention that Opportunity's notice was untimely, Hill argued that the disclosure in its 2014 definitive proxy statement that the annual meeting would be "on or around June 10, 2015" constituted prior public disclosure of the date of the meeting such that Opportunity was required to notify Hill of its intent to propose business and nominations not less than 60 days prior to the meeting. In response, Opportunity claimed that the first notice of the date of the meeting—June 9, 2015—was not given until April 30, less than 70 days prior to the date of the annual meeting, such that its May 7 notice was timely.

The Court of Chancery agreed with Opportunity, explaining that, although Hill could have triggered the requirement for at least 60 days' advance notice of proposals and nominations by announcing the specific date of the meeting prior to the filing of its definitive proxy statement, because it did not, Opportunity had 10 days from the date of the filing to submit its notice to Hill. Therefore, because the May 7 notice was timely, the Court of Chancery held that Hill was violating the plain language of its bylaws and that, because Opportunity would suffer irreparable harm absent injunctive relief and the balance of hardships favored Opportunity, Opportunity was entitled to mandatory injunctive relief.

Reviewing the bylaws *de novo*, the Delaware Supreme Court held that Hill's "clear and unambiguous" advance notice bylaw required Hill to provide notice of the specific day—and not a range of possible days on which the annual meeting was to occur in order to trigger the time periods under the advance notice bylaw. In particular, the Court explained:

The plain meaning of "the date" means a specific day—not a range of possible days. The 2014 Proxy Statement's reference to "on or about June 10, 2015" does not refer to "the date" of Hill's 2015 Annual Meeting. Rather, "on or about" refers to an approximate, anticipated, or targeted time frame that is intended to encompass more than one "date"—*i.e.*, June 10—apparently in order to give Hill some flexibility in scheduling. Thus, the 2014 Proxy Statement did not provide "prior public disclosure of the date" of Hill's 2015 Annual Meeting.

As such, because Hill did not provide notice of the specific date of its annual meeting until it filed its proxy statement for the 2015 annual meeting on April 30, 2015 announcing the June 9 date, the Court held that Opportunity's May 7 notice was timely.

In affirming the Court of Chancery's grant of mandatory injunctive relief, the Delaware Supreme Court provided additional guidance to practitioners in drafting advance notice bylaws. Notably, the Court suggested that corporations could avoid the situation in which Hill found itself by either pegging the notice period for timely stockholder proposals and director nominees to the anniversary date of the corporation's prior annual meeting or by publicly announcing the specific date of its annual meeting prior to the sending of notice of such annual meeting in the manner required by Section 222 of the Delaware General Corporation Law, which requires, among other things, that such notice be sent not more than 60 days prior to the annual meeting. The Court noted that the Hill board had fixed the June 9, 2015 date of the 2015 meeting on March 12, 2015, but made no announcement when it did so.

Corporations with advance notice bylaws that key the notice period for stockholder proposals and nominations off the current year's meeting date rather than the anniversary of the prior year's annual meeting or the mailing of the prior year's proxy statement should not rely on the statement of anticipated meeting date in the prior year's proxy statement as announcing the meeting date and should make public announcement of the specific meeting date once it has been fixed. Alternatively, to avoid having the window for business proposals and nominations opened after they have filed their proxy materials, corporations may want to consider amending their advance notice bylaws to key the notice period from the anniversary of the prior year's annual meeting or the date of mailing of the prior year's proxy statement.

## **Fee-Shifting Bylaws**

## **Solak v. Sarowitz,** 2016 WL 7468070 (Del. Ch. Dec. 27, 2016).

In *Solak v. Sarowitz*, 2016 WL 7468070 (Del. Ch. Dec. 27, 2016), the Court of Chancery denied in part a motion to dismiss a declaratory judgment and breach of fiduciary duty action challenging a fee-shifting bylaw adopted by the board of directors of Paylocity Holding Corporation ("Paylocity" or the "Company"). The Court rejected a ripeness challenge and held on the merits that the fee-shifting bylaw was facially invalid under Section 109(b) of the General Corporation Law of the State of Delaware (the "DGCL"), which the Court read as creating a blanket prohibition on "'any provision' that would shift fees 'in connection with an internal corporate claim' without regard to where such a claim is filed."

The Delaware General Assembly amended Section 109(b) of the DGCL after the Delaware Supreme Court's ruling in ATP Tour, Inc. v. Deutscher Tennis Bund, 91 A.3d 554 (Del. 2014), in which the Delaware Supreme Court held that a bylaw adopted by the board of directors of a Delaware nonstock corporation that shifted litigation expenses in an "intra-corporate litigation" to a plaintiff who failed substantially to obtain the relief sought was facially valid under the DGCL. As amended, Section 109(b) prohibits "any" bylaw "that would impose liability on a stockholder for the attorneys' fees or expenses of the corporation or any other party in connection with an internal corporate claim." Effectively limiting ATP to nonstock corporations, the amendment, which became effective on August 1, 2015, addressed concerns that stock corporations would adopt similar bylaws and stockholders would be deterred from enforcing otherwise meritorious claims as a result. New Section 115 of the DGCL, which permits a corporation to include a mandatory Delaware forum selection

provision in its certificate of incorporation or bylaws in respect of internal corporate claims, was adopted and become effective concurrently with the amendment to Section 109(b).

On February 2, 2016, the Paylocity board amended its bylaws to adopt new Article VIII, which contained two provisions. New Section 8.1 added an exclusive forum provision designating the Delaware courts as the "sole and exclusive forum" for internal corporate claims. New Section 8.2 contained a fee-shifting provision requiring any stockholder who became involved in an action in another forum (absent a written waiver of the applicability of the fee-shifting bylaw by the Company), and failed to obtain a judgment on the merits that substantially achieved the full remedy sought, to reimburse Paylocity for its litigation expenses, including attorneys' fees. On February 5, 2016, Paylocity filed a Form 8-K with the Securities and Exchange Commission disclosing the adoption of Article VIII. On May 5, 2016, plaintiff brought an action seeking a declaratory judgment that the fee-shifting bylaw violated Sections 109(b) and 102(b)(6) of the DGCL, and alleging that the Paylocity directors breached their fiduciary duties in adopting the fee-shifting bylaw.

Defendants moved to dismiss the complaint under Court of Chancery Rule 12(b)(1) for lack of subject matter jurisdiction, on the theory that plaintiff's claims were not ripe for review because no Paylocity stockholder had filed an action outside of Delaware triggering the fee-shifting bylaw and plaintiff had not pled an intent to do so. Rejecting this argument, the Court reasoned that the fee-shifting bylaw would likely inhibit any stockholder from filing a claim that might trigger it. Declining review under these circumstances would thus mean that the validity of Paylocity's fee-shifting bylaw might never be subject to judicial review, despite the likelihood that other corporations would adopt similar, potentially invalid bylaws. The risk of "perpetuating uncertainty concerning the permissibility of fee-shifting bylaws," especially in light of the recent amendments to the DGCL, compelled the Court to review the validity of the fee-shifting bylaw.

Defendants also advanced several arguments in favor of the validity of the fee-shifting bylaw under Section

109(b). The Court rejected defendants' argument that the simultaneous amendment of Section 109(b) and enactment of Section 115 required those provisions to "be read in tandem" such that the Section 109(b) provision would permit fee shifting only for actions filed in violation of a forum selection provision adopted pursuant to Section 115. The Court determined that nothing in the plain text of Section 109(b) or Section 115 indicated that the legislature intended to create such an exception to Section 109(b).

The Court reached a similar conclusion with regard to defendants' argument that fee shifting remains permissible at common law. Distinguishing the case relied upon by defendants, El Paso Natural Gas Co. v. TransAmerican Natural Gas Corp., 669 A.2d 36 (Del. 1995), the Court found that existing common law pertaining to fee-shifting provisions applies to contractual provisions, not bylaws. The Court also ruled that the amendment to Section 109(b) was in direct conflict with the common law as established in ATP, negating any inference that stock corporations were permitted to adopt fee-shifting bylaws. The Court then turned to defendants' argument that the savings clause in Paylocity's fee-shifting bylaw "carve[d] out all interpretations inconsistent with Delaware law" and likewise rejected it, holding that a savings clause cannot negate a facial challenge to the validity of a bylaw where the bylaw has been found entirely invalid.

The Court then granted defendants' motion to dismiss with respect to plaintiff's remaining allegations. In particular, the Court held that plaintiff failed to state a claim for breach of fiduciary duty. Paylocity's directors were exculpated from breaches of the duty of care pursuant to a Section 102(b)(7) provision in its certificate of incorporation, and plaintiff did not plead that any of the directors were interested or lacked independence. Thus, the Paylocity directors would be subject to personal liability only if they were found to have acted in bad faith. The Court found that the bare allegation that the fee-shifting bylaw was adopted after the Section 109(b) provision took effect was insufficient by itself to support a reasonable inference of scienter. Furthermore, although the presence of the savings clause could not resuscitate the facially invalid fee-shifting bylaw, it negated any inference that

the directors knew they would be violating the law in adopting it.

## **Strougo v. Hollander,** 2015 WL 1189610 (Del. Ch. Mar. 16, 2015).

In Strougo v. Hollander, 2015 WL 1189610 (Del. Ch. Mar. 16, 2015), the first opinion of the Delaware Court of Chancery to address the validity of a fee-shifting bylaw since the Delaware Supreme Court's opinion in ATP Tour, Inc. v. Deutscher Tennis Bund, 91 A.3d 554 (Del. 2014), the Court held that a corporation's fee-shifting bylaw adopted after the consummation of a 10,000-to-I reverse stock split did not apply to the stockholders whose entire interest was cashed out in the split. Although noting the "serious policy questions" implicated by fee-shifting bylaws in general," the Court based its holding on the timing of the bylaw's adoption. The Court held that the bylaw did not apply to the stockholders whose entire interest had been cashed out in the split, because Section 109 of the DGCL does not authorize a bylaw that "regulates the rights or powers of former stockholders who were no longer stockholders when the bylaw was adopted."

The Court clarified, however, that its conclusion does not mean that a stockholder whose interest in the corporation is eliminated ceases to be subject to the corporation's bylaws. Instead, the Court held that, "[i]n determining the bylaw provisions that should apply to a lawsuit initiated by a former stockholder challenging the terms of a cash-out transaction, . . . the governing bylaws are those in effect when the former stockholder's interest as a stockholder was eliminated." After that date, a stockholder ceases to be a party to the "corporate contract" and accordingly ceases to be bound by subsequent amendments to that contract.

### **Director Removal**

## *Frechter v. Zier,* C.A. No. 12038-VCG (Jan. 24, 2017).

In *Frechter v. Zier*, C.A. No. 12038-VCG (Jan. 24, 2017), the Court of Chancery granted the plaintiff's motion

for summary judgment and invalidated Nutrisystem's bylaw that required a two-thirds stockholder vote to remove a director from the company's board. The court held that Section 141(k) of the Delaware General Corporation Law (the "DGCL") unambiguously grants to stockholders the power to remove directors by a majority vote.

In January 2016, the board of directors of Nutrisystem amended its bylaws to remove the "for cause" justification required for stockholders to remove a director. The amendment left intact the bylaw language that no director could be removed except by the affirmative vote of not less than twothirds of the voting power of all the outstanding stock of the company.

The plaintiff filed a class action suit seeking a declaratory judgment that the company's two-thirds vote requirement to remove directors was invalid under Section 141(k) of the DGCL. Section 141(k) provides that "[a]ny director or the entire board of directors may be removed, with or without cause, by the holders of a majority of the shares then entitled to vote at an election of directors." The defendants contended that Section 141(k)'s language is "merely permissive, in that it provides only that a majority of stockholders may remove directors, thereby leaving the bylaws free to require a minority, a supermajority or even unanimity as a requisite for director removal."

The Court rejected the defendants' argument, stating that the defendants' interpretation of Section 141(k) would leave the statutory provision "an effective nullity." The Court explained that the DGCL is broadly an enabling statute that allows corporations to adopt any bylaws not inconsistent with the law or its certificate of incorporation. In contrast, the Court pointed out that Section 141(k) confers power on stockholders to remove one of more directors by majority vote. The Court concluded that the word "may" in Section 141(f) does not entitle corporations to raise the percentage threshold necessary to remove directors by stockholder vote; rather, it allows such power to go unexercised if stockholders so choose.



#### In re Vaalco Energy, Inc. Stockholder Litigation, C.A. No. 11775-VCL (Del. Ch. Dec. 21, 2015) (TRANSCRIPT).

In In re Vaalco Energy, Inc. Stockholder Litigation, C.A. No. 11775-VCL (Del. Ch. Dec. 21, 2015) (TRANSCRIPT), the Court of Chancery granted the plaintiffs' motion for summary judgment and invalidated certain provisions of Vaalco's certificate of incorporation and bylaws, which provided that members of its board of directors could only be removed for cause. The Court held that the default rule under Section 141(k) of the General Corporation Law of the State of Delaware (the "DGCL") that directors "may be removed, with or without cause" may be limited to removal only for cause solely in corporations that either (i) have a board classified pursuant to Section 141(d) of the DGCL (i.e., a staggered board), or (ii) provide for cumulative voting pursuant to Section 214 of the DGCL.

Before its 2010 annual meeting, Vaalco had a staggered board and provisions in its certificate of incorporation and bylaws mandating that directors could be removed only for cause. In 2010, Vaalco de-staggered its board, but failed to remove the provisions of its certificate and bylaws providing for removal of directors for cause only. After a group of dissident stockholders announced its intention to remove certain members of Vaalco's board in late 2015, Vaalco asserted that these provisions prohibited such action without cause. In response, the group of stockholders brought an action seeking a declaratory judgment that Vaalco's certificate of incorporation and bylaw provisions permitting only for-cause removal of directors were void under Section 141(k).

Section 141(k) provides that "[a]ny director or the entire board of directors may be removed, with or without cause, by the holders of a majority of the shares then entitled to vote at an election of directors" except in the case of a corporation with either (i) a staggered board, or (ii) cumulative voting. The defendants advanced several arguments in favor of the validity of the Vaalco certificate of incorporation and bylaw provisions, including the alleged fact that approximately 175 public Delaware corporations had similar provisions in their governing documents regarding director removal despite lacking a staggered board or cumulative voting. Of these, the Court found most persuasive the defendants' argument that Section 141(d) permits a classified board to "be divided into 1, 2 or 3 classes," and thus allows for a board to be classified into a single class. Accordingly, the defendants argued that a single-class board would be classified for the purposes of Section 141(k), and could properly be subject to removal for cause only.

The Court, however, rejected this argument, which, in its view, would create a "somewhat oxymoronic concept of a single-class classified board." In so holding, the Court relied upon commentary on the 1974 amendments to the DGCL, which explained that the language in Section 141(d) permitting a board to be "divided into 1, 2 or 3 classes" was intended to clarify that the right of any class or series of stock to elect one or more directors would not create an additional class of directors and did not support the notion of a single-class classified board. Additionally, while Vaalco advanced its interpretation of Section 141(d), it never actually established that its board was classified. Thus, the Court alternatively held that, even if Section 141(d) permitted a single-class classified board, Vaalco did not have such a board.

Following the ruling described above, the plaintiffs' bar began sending demand letters to the 175 companies identified by the defendant in Vaalco. Suits have been filed against several of those companies. For companies that have de-staggered their boards within the last several years, it may be worthwhile to determine whether similar issues exist before the plaintiffs' bar initiates contact.

# Derivative Actions and Claims

#### Sandys v. Pincus, 152 A.3d 124 (Del. 2016).

In Sandys v. Pincus, 152 A.3d 124 (Del. 2016), the Delaware Supreme Court reversed the Court of Chancery's dismissal of a derivative suit for failure to plead demand excusal, holding that plaintiff had pled facts, including co-ownership of an airplane and interlocking business relationships, that created a pleading-stage reasonable doubt as to the ability of a majority of the board to adequately consider a demand.

In the derivative action below, stockholder plaintiff alleged that members of the board of directors of Zynga Inc. ("Zynga") breached their fiduciary duties by approving exceptions to lock-up agreements and other trading restrictions that allowed certain officers and directors, including its controlling stockholder, to sell their shares in a secondary offering before Zynga announced earnings for the first quarter of 2012 (which earnings announcement reflected a decline in certain of Zynga's operating metrics). Analyzing the board's actions under the Rales test, the Court of Chancery found that plaintiff failed to plead sufficient particularized facts showing that a majority of the Zynga board lacked independence and that a demand on the board would have been futile, and granted the defendants' motion to dismiss.

Writing for the majority, Chief Justice Strine disagreed with the Court of Chancery's findings with respect to the independence of three Zynga directors. Although the Court noted that the case "again highlight[ed] the wisdom of the representative plaintiff bar heeding the repeated admonitions of [the Delaware Supreme Court] to make a pre-suit investigation into the board's independence," it found that plaintiff pled enough particularized facts at the pleading stage to create a reasonable doubt that a majority of the directors could impartially consider a demand.

In particular, the Court disagreed with the Court of Chancery's determination as to the independence of a director who, together with her spouse, co-owned a plane with Mark Pincus, Zynga's controlling stockholder and former chief executive officer. The Court characterized such co-ownership as a "powerful and unusual fact" that was indicative of a very close personal relationship that would heavily influence such director's ability to impartially consider a demand.

The Court further disagreed that two other directors, who were partners at a venture capital firm that controlled more than 9% of Zynga's equity, were

able to impartially consider a demand. The venture capital firm affiliated with those directors invested in other companies that had ties to Mr. Pincus and to another director who was given an exemption to sell in the secondary offering. The Court noted that these "interlocking relationships" could "give rise to human motivations that would materially affect the parties" ability to impartially consider a demand adverse to each other."

In addition, in considering the independence of these two directors, the Court referenced Zynga's filings with the Securities and Exchange Commission showing that the board had determined that those directors did not qualify as independent under the NASDAQ rules. In considering this factor at the trial court level, the Court of Chancery found that plaintiff failed to allege why the directors lacked independence under the NASDAQ rules in support of his demand excusal claim and that without this additional information, the directors' lack of independence under the NASDAQ rules and the other facts pled by plaintiff were insufficient to question the directors' independence. The Delaware Supreme Court disagreed, stating that "to have a derivative suit dismissed on demand excusal grounds because of the presumptive independence of directors whose own colleagues will not accord them the appellation of independence creates cognitive dissonance that our jurisprudence should not ignore." Although the Court did agree with the Court of Chancery that the Delaware independence standard is context-specific and does not perfectly marry with the standards of the stock exchange, the Court noted that the criteria NASDAQ has articulated as bearing on independence are relevant under Delaware law and likely influenced by Delaware law. As such, the Court held that where plaintiff pled facts suggesting that directors have a mutually beneficial ongoing business relationships with a company's controller and "the company's own board has determined that the directors . . . cannot be considered independent, a reasonable doubt exists under Rales."

Justice Valihura dissented, stating that she would have affirmed the Court of Chancery decision. With respect to the directors affiliated with the venture capital firm, Justice Valihura noted that in the absence of further facts, such as facts relating to the size, profits or materiality of the investments and interests that plaintiff had pled in support of his demand futility claim, the investments and interests (as pled) were insufficient to raise a reasonable doubt as to the directors' independence. Justice Valihura further noted that the fact that such directors were designated as not independent under the NASDAQ rules was relevant, but not dispositive, to the independence analysis and that, in the absence of pleadings as to why such directors were determined not to be independent, it was not difficult to conceive a situation in which a director might not be independent under stock exchange rules but yet be independent for demand futility purposes. Justice Valihura also noted, with respect to the close personal relationship that the majority opinion inferred from co-ownership of a plane, that plaintiff had only pled that the coownership of the plane constituted an existing business relationship between the director and Mr. Pincus. Accordingly, because plaintiff had not pled specific factual allegations in support of a disabling personal relationship between the director and Mr. Pincus, the dissent stressed that the Court could not and should not consider facts outside the complaint in its analysis of whether a particular relationship is of a "bias-producing nature."

#### *Quadrant Structured Products Company, Ltd. v. Vertin,* 115 A.3d 535 (Del. Ch. May 4, 2015).

In *Quadrant Structured Products Company, Ltd. v. Vertin,* 115 A.3d 535 (Del. Ch. May 4, 2015), the Delaware Court of Chancery denied the defendants' motion for summary judgment, held that Delaware law imposes neither a continuous insolvency nor an irretrievable insolvency requirement, and found sufficient evidence in the record to support a reasonable inference that the debtor corporation was insolvent on the date the complaint was filed. In so holding, the Court provided an in-depth analysis of creditor derivative standing following the Delaware Supreme Court's decision in *N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla,* 930 A.2d 92 (Del. 2007).

The individual defendants are members of the board of directors of the corporate debtor, Athilon Capital

Corp. Athilon's equity is wholly owned by defendant Merced Capital LP. Plaintiff Quadrant Structured Products Company, Ltd. is an owner of debt securities issued by Athilon. In this action, Quadrant alleged that following Merced's acquisition of Athilon, the board took numerous actions to benefit Merced at the expense of Athilon's other stakeholders. In February 2015, the defendants moved for summary judgment on the theory that Athilon had returned to solvency and Quadrant therefore had lost standing to pursue any derivative claims.

The Court first analyzed in depth Delaware law on creditor breach of fiduciary duty claims, both before and after *Gheewalla*. The Court concluded that *Gheewalla* and the cases following it implemented a new regime in evaluating such claims. The current regime holds that there is no longer any zone of insolvency, no cause of action for deepening insolvency, and no fiduciary duties owed directly to creditors. Therefore, after *Gheewalla*, there is no need under Delaware law for derivative standing hurdles that may be "unnecessary and counterproductive impediments to the effective use of the derivative action as a meaningful tool for oversight." Directors of Delaware corporations are already sufficiently protected by other aspects of Delaware law.

In addressing the defendants' argument that Delaware law should recognize a continuous insolvency requirement, the Court also looked to the purposes of a derivative action. Derivative suits are intended to remedy wrongdoing by directors and allow equitable owners to increase the company's value. Creditors share each of those incentives when a company is insolvent, and continue to have such incentives as long as they remain a creditor of the company. Thus, the Court concluded that the proper analogy in the creditor derivative context is a continuous creditor requirement, not a continuous insolvency requirement. In addition, the Court found that depriving creditors of standing to pursue derivative claims on behalf of a company that goes back and forth over the insolvency line while the equity is owned entirely by one stockholder would lead to a "failure of justice" because conflicted fiduciaries could prevent the corporation or its stockholders from pursuing valid claims.

For these reasons, among others, the Court held that "to maintain a derivative claim, the creditor-plaintiff must plead and later prove that the corporation was insolvent at the time suit was filed. The creditorplaintiff need not, however, plead and prove that the corporation was insolvent continuously from the time of suit through the date of judgment." Finally, the Court also held that the proper test to assess creditor derivative standing at the time the litigation is filed is to determine whether the company "has liabilities in excess of a reasonable market value of its assets." While this test potentially conflicts with certain passages quoted in *Gheewalla*, which were originally written in the receivership context, the Court drew a distinction between claims in the receivership setting and fiduciary duty claims of creditors. Using this test, Quadrant's showing that Athilon's GAAP balance sheet showed a \$300 million negative equity value was sufficient to create an issue of material fact as to Athilon's solvency at the time suit was filed.

Quadrant Structured Products Company, Ltd. v. Vertin, 102 A.3d 155 (Del. Ch. Oct. 1, 2014); Quadrant Structured Products Company, Ltd. 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 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.

### Section 205 Actions

*In re Genelux Corporation,* 126 A.3d 644 (Del. Ch. 2015); *In re Baxter International Inc.,* C.A. No. 11609-CB (Del. Ch. Jan. 15, 2016) (TRANSCRIPT).

Two recent decisions by the Delaware Court of Chancery have helped to define the contours of the Court's authority in proceedings under Section 205 of the General Corporation Law of the State of Delaware (the "DGCL"). In *In re Genelux Corporation*, 126 A.3d 644 (Del. Ch. 2015), the Court of Chancery held that a corporation cannot use Section 205 to invalidate prior corporate acts, and in *In re Baxter International Inc.*, C.A. No. 11609-CB (Del. Ch. Jan. 15, 2016) (TRANSCRIPT), the Court of Chancery held that a corporation cannot use Section 205 as a means to ensure the validity of future corporate acts.

Section 205, which became effective April 1, 2014, and was amended effective August 1, 2015, confers jurisdiction on the Court of Chancery to determine the validity of defective corporate acts and stock issuances. Since Section 205 was enacted in 2014, the Court of Chancery has used its powers under Section 205 to resolve issues relating to a corporation's valid existence, including confirming the identity of the members of the corporation's board of directors (see In re Trupanion, C.A. No. 9496-VCP (Del. Ch. Apr. 28, 2014) (ORDER)), and to validate defective stock issuances (see In re Numoda Corporation Shareholders Litigation, C.A. No. 9163-VCN (Del. Ch. Jan. 30, 2015), and In re CertiSign Holding, Inc., C.A. No. 9989-VCN (Del. Ch. Aug. 31, 2015)). However, both Genelux and Baxter involved unique petitions that had the potential to expand the scope of the Court of Chancery's authority under Section 205 beyond the validation of past defective corporate acts.

In *Genelux*, Genelux Corporation ("Genelux") petitioned the Court of Chancery to invalidate 1.5

million shares of Genelux's Series A Preferred shares (the "Disputed Shares") that Genelux purportedly issued to Aladar Szalay, one of Genelux's founders ("Szalay"), under Section 205 and to declare the elections of two directors invalid under Section 225 of the DGCL as a result of the invalid issuance of the Disputed Shares. Genelux claimed that the Disputed Shares were invalid because, among other things, (i) the Disputed Shares were allegedly issued in exchange for shares of Genelux common stock that were invalid; (ii) Szalay released his claim to the Disputed Shares in a settlement of litigation with a third party; (iii) the issuance of the Disputed Shares was not supported by valid consideration; and (iv) Genelux was fraudulently induced by Szalay to issue the Disputed Shares.

Before reaching the merits of Genelux's claims with respect to the validity of the Disputed Shares, the Court of Chancery addressed the threshold issue of whether Section 205 can be used to invalidate purportedly defective corporate acts. Genelux argued that because Section 205(a)(4) authorizes the Court of Chancery to determine the validity of any stock (and not just putative or defective stock), the Court of Chancery should have the ability to determine that the stock subject to the petition is invalid. Szalay argued that Section 205, when read as a whole, only granted the Court of Chancery the power to validate defective stock issuances, not stock issuances that have been treated by the corporation as valid as evidenced by, in this case, the issuance of stock certificates, entries in the corporate stock ledger and board resolutions. The Court of Chancery found that the plain language of Section 205 was ambiguous as to whether the Court of Chancery is permitted to invalidate corporate acts. Accordingly, the Court looked to extrinsic evidenceincluding the legislative synopsis of House Bill 127 (which became Section 205 and Section 204 of the DGCL), the other provisions of Section 204 and Section 205, and commentary in Delaware law treatises concerning Section 205-to resolve the ambiguity.

After reviewing these materials, the Court of Chancery concluded that Section 205 is a "remedial statute" that was only designed to "cure otherwise incurable defective corporate acts, not a statute to be used to launch a challenge to stock issuances on grounds already available through the assertion of plenary-type claims based on alleged fiduciary duty or common law fraud or a Section 225 action, if the stock had been voted." Thus, the Court of Chancery dismissed for failure to state a claim Genelux's petition under Section 205 seeking a declaration that the Disputed Shares were invalid. The Court of Chancery also dismissed Genelux's Section 225 claims, concluding that (i) Genelux had failed to prove by a preponderance of the evidence that it did not approve the issuance of the shares of common stock for which the Disputed Shares were exchanged; (ii) the settlement did not include a general release of claims that Szalay may have against Genelux; (iii) the exchange of the shares of common stock and Szalay's release of his claims to additional shares of Genelux constituted valid consideration for the issuance of the Disputed Shares; and (iv) Szalay's conduct in pressing Genelux to issue the Disputed Shares in connection with an unrelated third-party financing did not rise to the level of fraud.

In Baxter, the certificate of incorporation of Baxter International Inc. ("Baxter") contained a provision that stated that Article SIXTH of the certificate of incorporation could not be amended without the vote of at least "two-thirds of the holders of all the securities of [Baxter] then entitled to vote on such change" (the "voting provision"). Baxter planned to seek an amendment of Article SIXTH at its upcoming annual meeting, and its board of directors adopted a resolution (the "voting resolution") stating that the board had determined to count votes on the amendment on a "per share basis, rather than on a per capita basis," even though the voting provision, on its face, seemed to call for a per capita vote and previous public disclosures indicated that Baxter had counted votes subject to the provision on a per capita basis in the past. Baxter filed a petition with the Court of Chancery under Section 205 requesting that the Court validate the voting resolution as well as the voting standard set forth in the voting resolution. In effect, Baxter requested the Court to declare that the voting resolution properly provided that the upcoming vote on the amendment to the certificate should be determined on a per share basis, rather than a per capita basis. Although Baxter's Section 205 petition was initially unopposed, the Court of Chancery appointed

Richards, Layton & Finger as special counsel to file an opposition brief if no stockholder came forward to oppose the petition after notice was given.

The Court of Chancery, issuing its ruling from the bench after oral argument, distinguished between determining the validity of the voting resolution itself and determining the proper voting standard for the proposed certificate amendment. The Court of Chancery indicated that it could address under Section 205 the validity of the voting resolution if there had been some defect in its adoption (for example, if it was not adopted by a sufficient number of directors), but that Section 205 did not permit the Court to provide an opinion on the underlying contents of the voting resolution.

Moreover, the Court of Chancery determined that Section 205 did not empower the Court to validate future corporate acts. While Baxter argued that a corporate act had already occurred because the board had adopted the voting resolution, the Court of Chancery pointed out that the annual meeting where the vote on the amendment was to occur had not been held and might never occur. The Court of Chancery likened Baxter's Section 205 petition to a request for an advisory opinion on an unripe issue and dismissed the case. However, the Court of Chancery acknowledged that Section 205 is a flexible statute "intended to promote equitable outcomes and to provide certainty to stockholders," and that relief under Section 205 may be possible under appropriate circumstances. The Court of Chancery noted that if Baxter held its annual meeting, received sufficient votes counted on a per-share basis to amend, and actually amended its certificate of incorporation on that basis, Baxter would have a stronger argument that the Court should validate the amendment under Section 205 because a corporate act actually would have occurred.

## Dissolution

## *The Huff Energy Fund, L.P. v. Gershen,* 2016 WL 5462958 (Del. Ch. Sept. 29, 2016).

In *The Huff Energy Fund, L.P. v. Gershen,* 2016 WL 5462958 (Del. Ch. Sept. 29, 2016), the Court of

Chancery rejected a significant stockholder's claim that the implementation and adoption of a plan of dissolution was subject to enhanced scrutiny under *Revlon* and *Unocal*. Furthermore, finding that the adoption of the plan of dissolution had been approved by a fully informed, non-coerced vote of the stockholders, the Court held that under *Corwin* the business judgment rule irrebuttably applied to the board's decision to approve the plan of dissolution, and granted the defendants' motion to dismiss.

In Huff Energy, the Huff Energy Fund, L.P. ("Huff Energy"), holder of approximately 40% of the issued and outstanding shares of common stock of Longview Energy Company ("Longview"), challenged the adoption and implementation of a plan of dissolution in connection with the sale of a significant portion of Longview's assets. The plan of dissolution and asset sale were approved by Longview's board of directors and stockholders following Longview's active pursuit of a liquidity event that had allegedly been motivated by the desire of Longview's chief executive officer and chief operating officer (each of whom also served as a director) to trigger the significant severance payments upon a change of control under their employment agreements. At the board meeting to approve the sale and dissolution, one of the directors designated by Huff Energy who was present abstained from voting due to "the insufficiency of information and the rushed nature of the process." The abstention and the reasons for it were not disclosed in the proxy statement soliciting the vote of Longview's stockholders. Following the adoption and implementation of the plan of dissolution, Huff Energy filed an action in the Court of Chancery against Longview and the directors not designated by Huff Energy, alleging, among other things, that the directors had breached their fiduciary duties and had violated a stockholder agreement in adopting and implementing the plan of dissolution.

Addressing Huff Energy's fiduciary claims, the Court held that Huff Energy had failed to allege facts allowing for a reasonable inference that a majority of the board acted under a disqualifying conflict of interest with respect to the decision to adopt and implement the plan of dissolution. The Court then turned to Huff Energy's claims that the decision was

subject to enhanced scrutiny under Revlon or Unocal. With respect to the applicability of *Revlon*, the Court explained that policy concerns implicated by "final stage" transactions such as a cash sale, break-up or change of control transaction were not present in the dissolution context because Longview would continue its existence for a period of at least three years following its dissolution to wind up its affairs. During the wind-up period, the board would maintain its control over Longview and would retain its duty to act in the best interests of Longview's stockholders as well as its creditors. Accordingly, because the adoption of the plan of dissolution did not constitute a final stage transaction or otherwise constitute a change of control implicating Revlon concerns, the Court held that Revlon did not apply.

With respect to the applicability of Unocal, the Court was unpersuaded by Huff Energy's argument that adoption and implementation of the plan of dissolution constituted the adoption of an "unreasonable poison pill" due to, among other things, the inability of Longview to purchase any additional shares of common stock following Longview's dissolution. Noting that the only allegations in the complaint that supported Huff Energy's argument that Unocal applied to the dissolution were that the adoption of the plan of dissolution constituted a defensive measure designed to wrest control over a sale process from Huff Energy and its director designees, and that the defendant directors perceived Huff Energy as a threat to the chief executive officer's power over Longview, the Court found that Huff Energy had failed to cite any support for the proposition that such allegations implicated the "omnipresent specter" present in cases invoking Unocal scrutiny. In particular, the Court noted that the adoption and implementation of a plan of dissolution avoids any specter of entrenchment due to the fact that following dissolution, the corporation is required to wind up its affairs. Accordingly, the Court held that Unocal did not apply.

Following its determination that *Revlon* and *Unocal* did not apply, the Court noted that even if the adoption and implementation of the plan of dissolution did implicate some form of enhanced scrutiny, the approval of the plan of dissolution by the Longview



stockholders cleansed the transaction, thereby irrebuttably reinstating the protection of the business judgment rule under Corwin. In so holding, the Court rejected Huff Energy's argument that the vote of the stockholders was not fully informed due to the failure of the proxy statement to include the fact that Huff Energy's designee had abstained from the decision to approve the dissolution and the reasons for his abstention. Stating that Delaware law is clear that individual directors need not state the grounds of their judgment for or against a proposed stockholder action, the Court further explained that the fact of an abstention was not material because the adoption of the plan of dissolution did not require unanimous approval. Accordingly, because the information was not material and the omission of the information was not misleading, the Court held that Huff Energy failed to plead that the stockholder vote was uninformed. As such, and in the absence of any allegations that the stockholder vote was coerced or tainted by interestedness, the Court held that Corwin applied and dismissed the fiduciary claims against the director defendants.

In addition to rejecting the fiduciary claims raised by Huff Energy, the Court also held that the approval of the plan of dissolution did not constitute a breach of the stockholder agreement between Longview, Huff Energy and the other stockholders party thereto. As a preliminary matter, the Court upheld settled Delaware law that only a party to an agreement may be sued for breach of such agreement, and held that individual Longview directors could not be held individually liable for a breach of the stockholder agreement because those directors had not signed the stockholder agreement in an individual capacity.

With respect to Huff Energy's claims that Longview breached the stockholder agreement, Huff Energy highlighted, among other things, a provision that required unanimous board approval of "any action or omission that would have a material adverse effect on the rights of any Shareholder, as set forth in [the stockholder agreement]." In rejecting Huff Energy's claim that the approval of the plan of dissolution triggered the unanimous board approval requirement, the Court held that the requirement only applied to rights created by the agreement, such as the right to designate two directors to the board (which the Court noted "continue[d] without infringement throughout the winding up process") and not rights merely referenced in such agreement, such as the right of Huff Energy to transfer shares of its Longview stock. The Court was also unpersuaded that the approval of the plan of dissolution violated a covenant under the stockholder agreement that Longview "continue to exist," which the Court noted "appear[ed] to be nothing more than a recognition by Longview that it will remain in good standing as a Delaware corporation" and was not a provision that required Longview to "exist eternally unless Huff Energy agrees otherwise."

## **Stock Option Plans**

### **CDX Holdings, Inc. v. Fox,** 141 A.3d 1037 (Del. 2016).

In *CDX Holdings, Inc. v. Fox,* 141 A.3d 1037 (Del. 2016), the Delaware Supreme Court, applying a "clearly erroneous" standard of review, deferred to the Court of Chancery's findings of fact and upheld the Court of Chancery's determination that a corporation breached its stock option plan in connection with a spinoff and merger transaction.

Caris Life Sciences, Inc. ("Caris"), a privately held Delaware corporation, operated three business units: Caris Diagnostics, TargetNow and Carisome. With the goal of securing financing for TargetNow and Carisome and generating a return for its stockholders, Caris sold Caris Diagnostics (its only consistently profitable business unit) to Miraca Holdings, Inc. ("Miraca"). To facilitate the transaction, Caris conducted a spinoff by first transferring ownership of TargetNow and Carisome to a new subsidiary and then spinning off that subsidiary to Caris's stockholders. Following the consummation of the spinoff, Caris was merged with a wholly owned subsidiary of Miraca (the "Merger" and together with the spinoff, the "Transaction"). The Court found that the Transaction was structured in this manner to minimize taxes.

Following the Merger, holders of options granted under Caris's 2007 Stock Incentive Plan (the "Plan") brought claims against Caris asserting that the Plan had been breached in connection with the Transaction. Under the terms of the Plan, each Caris option holder had the right to receive in the Merger the amount by which the Fair Market Value (as defined in the Plan) of each share exceeded the exercise price. Under the Plan. Fair Market Value was defined as an amount determined by the Caris board of directors. The board was also the administrator under the Plan. Under the Plan, the board's good faith determination of Fair Market Value was conclusive unless it was the result of an arbitrary and capricious process. The Plan also required the board, as administrator, to adjust the options to account for the spinoff. Plaintiff claimed that Caris breached the Plan because members of management, not the board, determined the value that the option holders would receive in the Transaction. Plaintiff further claimed that, regardless of who made the determination, the process utilized was arbitrary and capricious and therefore the determination was not made in good faith.

The Court of Chancery found that, rather than the board, Caris's chief financial officer (who was also its chief operating officer) had made the value determination required under the Plan, which determination was later signed off on by Caris's founder. The Court further found that regardless of who made the value determination, the value received by the option holders in the Transaction was not determined in good faith because the value determination was made to obtain tax-free treatment of the spinoff rather than to accurately ascertain the Fair Market Value of the stock under the Plan. Finally, the Court found that the chief financial officer engaged in an arbitrary and capricious process to determine such value. In accordance with these findings, the Court of Chancery concluded that Caris breached the Plan and awarded plaintiff damages, plus pre- and postjudgment interest.

Upon review, the Delaware Supreme Court, in a majority opinion, noted that findings of historical fact are subject to the deferential "clearly erroneous" standard of review. The Court explained that it "must give deference to findings of fact by trial courts when supported by the record, and when they are the product of an orderly and logical deductive reasoning process, especially when those findings are based in part on testimony of live witnesses whose demeanor and credibility the trial judge has had the opportunity to evaluate." Stating that "the record in this appeal compels an application of that standard of appellate review," the Delaware Supreme Court affirmed the judgment of the Court of Chancery.

In a lengthy dissent, Justice Valihura disagreed with the majority opinion and concluded that because "[t]he Court of Chancery's ultimate findings are logically disconnected from the record evidence before it, from the trial court's own immediate, on the record impressions of the trial, and from the requirements of the legal test established by the Plan," the Court of Chancery's findings were not entitled to deference. In this regard, Justice Valihura noted, among other things, that plaintiff was required to prove that the board breached its contractual duty of subjective good faith either by demonstrating that the board acted in subjective bad faith or by showing that it consciously disregarded a known duty to act. Notwithstanding the requirement that plaintiff make such a showing, the dissent found that the Court of Chancery did not make, and that the record below did not support, any finding that the board acted in subjective bad faith or consciously disregarded a known duty to act. In support of this finding, the dissent noted, among other things, that the board engaged legal counsel and hired an independent advisor to assist the directors in determining the Fair Market Value of the stock in connection with the Transaction.

In addition to the foregoing reasons for not according deference to the Court of Chancery's conclusions, the dissent also stated that such conclusions were not entitled to deference due to the Court of Chancery's implicit rejection of trial testimony of the directors on the basis of a "hindsight bias" theory. The dissent explained: "In my view, this Court should be skeptical of court rulings predicated on social science studies, particularly where, as here, such theories impact a trial court's own post-trial impressions of the testimony offered."

## **Multi-Forum Litigation**

### In re Wal-Mart Stores, Inc. Delaware Derivative Litigation, 2016 WL 2908344 (Del. Ch. May 13, 2016).

In *In re Wal-Mart Stores, Inc. Delaware Derivative Litigation,* 2016 WL 2908344 (Del. Ch. May 13, 2016), the Court of Chancery, applying Arkansas law, held that plaintiff stockholders were precluded from arguing demand futility in a derivative action filed in Delaware because the same issue had already been fully litigated and decided in an Arkansas court by adequate representatives in privity with the stockholder plaintiffs in the Delaware action. On this basis, the Court of Chancery granted the defendants' motion to dismiss.

In 2012, the *New York Times* published an article alleging that employees of a foreign subsidiary of Wal-Mart Stores, Inc. ("Wal-Mart"), Wal-Mart de Mexico ("WalMex"), had bribed Mexican government officials. After the publication of the *New York Times* article, Wal-Mart stockholders filed 15 derivative suits in Delaware and Arkansas, Wal-Mart's place of incorporation and Wal-Mart's headquarters, respectively.

Plaintiffs in the actions filed in the Court of Chancery (the "Delaware plaintiffs") demanded inspection of Wal-Mart's books and records under Section 220 of the General Corporation Law of the State of Delaware ("Section 220"), seeking to uncover information in support of their derivative claims. Following Wal-Mart's production of certain documents in response to the Section 220 demand, the Delaware plaintiffs filed a complaint under Section 220 alleging deficiencies in Wal-Mart's document production (the "220 Action"). Ultimately, the Delaware plaintiffs obtained some of the additional documents sought, but the 220 Action took three years to resolve and involved proceedings in the Court of Chancery and an appeal to the Delaware Supreme Court.

In the actions filed in Arkansas, plaintiffs did not seek access to Wal-Mart's books and records, and instead determined to move forward with their lawsuit without waiting for the outcome of the 220 Action. Wal-Mart moved to dismiss the Arkansas complaint for failure to adequately allege demand futility. About a month before the 220 Action was resolved, Wal-Mart prevailed on its motion to dismiss in Arkansas, and the Arkansas case was dismissed with prejudice.

After the 220 Action was resolved, the Delaware plaintiffs filed a complaint alleging a single count of breach of fiduciary duty related to the alleged coverup of the WalMex bribery. Wal-Mart then moved to dismiss the Delaware action, arguing, among other things, that the Arkansas judgment precluded the Delaware plaintiffs from re-litigating demand futility.

The Court of Chancery, analyzing the issue under Arkansas law, concluded that the Delaware plaintiffs were precluded from re-litigating demand futility in light of the Arkansas judgment because: (i) the issue was the same in both actions; (ii) the issue was actually litigated in Arkansas; (iii) the issue was determined by a valid and final judgment; (iv) the determination was essential to the judgment; (v) although the Delaware plaintiffs were not the same parties as the Arkansas plaintiffs, they were in privity; and (vi) the Delaware plaintiffs were adequately represented in the Arkansas litigation.

Although the Court's analysis involved whether the elements of issue preclusion were met under Arkansas law, including whether the Delaware plaintiffs were adequately represented in the Arkansas litigation, the Court's holding has implications for multi-forum litigation. As explained in the Court's analysis, the Delaware Supreme Court has previously noted that there is no requirement that a plaintiff bring an action under Section 220 in order to be considered an adequate representative under Delaware law, but Delaware courts have also encouraged plaintiffs to use all of the "tools at hand" (including Section 220) to investigate derivative claims before filing suit. The Court of Chancery concluded that while the Arkansas plaintiffs' litigation strategy may have been "imperfect" and the decision not to pursue books and records under Section 220 potentially "ill-advised," it was not "so grossly deficient as to render them inadequate representatives" for purposes of the issue preclusion analysis. Thus, while pursuing a pre-suit Section 220

demand may have provided the Delaware plaintiffs with useful information to support their claim against Wal-Mart's directors, they were ultimately unable to pursue such claim due to the actions of plaintiffs in another jurisdiction.

The Court of Chancery's decision was appealed to the Delaware Supreme Court, and on January 18, 2017, the Court remanded the case back to the Court of Chancery for the limited purpose of answering the following question: "In a situation where dismissal by the federal court in Arkansas of a stockholder plaintiff's derivative action for failure to plead demand futility is held by the Delaware Court of Chancery to preclude subsequent stockholders from pursuing derivative litigation, have the subsequent stockholders' Due Process rights been violated? *See Smith v. Bayer Corp.*, 564 U.S. 299 (2011)." *Cal. State Teachers*' *Retirement Sys. v. Alvarez*, 295,2016D, at \*18 (Del. Jan. 18, 2017). ■

### CORPORATE GOVERNANCE ISSUES

## **Directors and Officers**

### Pell v. Kill, 135 A.3d 764 (Del. Ch. 2016).

In *Pell v. Kill*, 135 A.3d 764 (Del. Ch. 2016), the Court of Chancery granted a preliminary injunction enjoining the implementation of a plan to reduce the size of a classified board and to reduce the number of directors in the class of directors standing for election at the next annual meeting that was adopted to neutralize the threat of a proxy contest by one of the corporation's directors.

In March 2015, Cogentix Medical, Inc. ("Cogentix"), a medical device manufacturer and developer, was formed through a stock-for-stock merger between Vision-Sciences, Inc. ("VSI") and Uroplasty, Inc. ("Uroplasty"). Cogentix's classified board consisted of eight members: five former Uroplasty directors and three former VSI directors. Robert C. Kill, the former Uroplasty chief executive officer, president and chairman, continued in those roles at Cogentix; Lewis C. Pell, co-founder and former chairman of VSI, served as a director. The board was divided into three classes. Class I consisted of three directors, including Pell, former VSI director Howard I. Zauberman and former Uroplasty director James P. Stauner. The Class I directors' terms expired in 2016.

Shortly after the merger, disputes arose between Pell and Kill. In February 2016, Pell sent his fellow directors a letter in which he announced his desire to change Cogentix's management and signaled his willingness to run a proxy contest. Pell was largely critical of Cogentix's performance under Kill and expressed his belief that Kill had too much control over Cogentix and the board. Two days after the letter was sent, the board held a regularly scheduled meeting, at which it selected the date for its annual meeting and discussed Pell's letter. After the meeting, the remaining directors chose sides between Pell and Kill, with the VSI-legacy directors siding with Pell and the Uroplastylegacy directors siding with Kill. Hoping to avoid a proxy contest, Kill and his strongest supporters—Uroplasty-legacy directors Kevin H. Roche and Kenneth H. Paulus—devised a plan whereby Roche and Paulus would lead the outside directors to identify director nominees who might be acceptable to both Pell and Kill. If a negotiated resolution failed, the three believed Pell would launch a proxy contest to elect himself, Zauberman and a third Class I director who would be allied with Pell. If Pell succeeded, the board would move from a five-to-three majority in favor of the Uroplasty-legacy directors to a four-four split.

Kill, Roche and Paulus came up with a "Plan B" to avoid a proxy fight—a board reduction plan that would reduce the size of the board from eight to five directors, with the number of Class I directors reduced from three to one and Class II directors reduced from three to two (after the resignation of a Class II Uroplastylegacy director) (the "Board Reduction Plan"). Following Pell's formal nomination of three Class I directors, the board passed the Board Reduction Plan, with the three VSI-legacy directors voting against it.

In April 2016, Pell filed suit in the Court of Chancery, seeking a preliminary injunction to prevent the Board Reduction Plan from taking effect. In determining whether Pell had established a reasonable probability of success on the merits, the Court explained that enhanced scrutiny would apply to the board's adoption of the Board Reduction Plan. The Court stated that enhanced scrutiny applies "[w]hen there is director conduct 'affecting either an election of directors or a vote touching on matters of corporate control." The Court explained that the Board Reduction Plan affected an election of directors because it reduced the number of seats that the stockholders could vote on from three to one. As such, the Board Reduction Plan had "a clear and obvious effect on the ability of the stockholders 'to vote either contrary to the will of the incumbent board members generally or to replace the incumbent board members in a contested election." It also touched on matters of corporate control because, prior to the plan's adoption, control over Cogentix "was in play" as the stockholders could have elected three directors that could have formed a new board majority. After the adoption of the Board

Reduction Plan, however, the stockholders could only re-elect one incumbent director, without affecting the composition of the board or the direction of Cogentix.

Applying enhanced scrutiny in the context of reviewing director action affecting stockholder voting, the Court explained that enhanced scrutiny requires defendants to prove "(i) that their motivations were proper and not selfish, (ii) that they 'did not preclude stockholders from exercising their right to vote or coerce them into voting in a particular way,' and (iii) that the directors' actions 'were reasonable in relation to their legitimate objective." The Court went on to note that when a vote involves an election of directors or touches on matters of corporate control, the directors' justification must not only be reasonable, but must be "compelling." The Court noted that the burden of showing a "compelling" justification requires directors to establish a closer fit between means and ends and serves as a reminder that courts should approach such situations with a "gimlet eye."

The Court, assuming that defendants' motives were proper and not selfish, nevertheless found that Pell had established a reasonable probability of success on the merits due to the unlikelihood of defendants establishing that the Board Reduction Plan was not preclusive. The Court explained that "[f]or a measure to be preclusive, it must render a successful proxy contest realistically unattainable given the specific factual context." The Court held that in the current context, the Board Reduction Plan made a successful proxy contest realistically unattainable by both eliminating the possibility of success for two board seats (due to the reduction from three seats to one seat) and preventing the stockholders from establishing a new board majority. The Court further noted that even if the Board Reduction Plan was not viewed as preclusive, defendants would likely not be able to show a compelling justification for the plan due to the Court's determination that the director defendants approved the plan because it "enabled them to avoid a proxy contest . . . that could shift control at the Board level."

In its discussion of Pell's likelihood of success on the merits, the Court observed that the results may have been different if the Board Reduction Plan had been approved on a "clear day"—that is, approved not in response to an anticipated proxy contest, but for otherwise legitimate objectives.

In granting the preliminary injunction, the Court further determined that there was a threat of irreparable harm to the stockholders if the injunction was not granted due to the fact that the Board Reduction Plan preordained the results of the annual meeting, thereby depriving the stockholders of their right to vote. Additionally, the Court found that granting the injunction would result in no hardship to the defendant directors. As a result of such determinations, the Court preliminarily enjoined defendants from completing the Board Reduction Plan by reducing the number of seats from seven to five and fixing the number of Class I seats at one until the Court rendered a final decision on the merits.

### Gorman v. Salamone, 2015 WL 4719681 (Del. Ch. July 31, 2015).

In *Gorman v. Salamone*, 2015 WL 4719681 (Del. Ch. July 31, 2015), the Delaware Court of Chancery held that a stockholder-adopted bylaw amendment that purported to grant stockholders the authority to remove corporate officers over the objection of the corporation's board of directors was invalid under Delaware law. In so holding, the Court found that the amended bylaw, which permitted stockholders to remove and replace officers without cause, would allow stockholders to "make substantive business decisions" for the corporation and thereby "unduly interfere with directors' management prerogatives" under Section 141(a) of the General Corporation Law of the State of Delaware (the "DGCL").

The Court of Chancery's opinion in *Gorman* is the most recent installment in an ongoing dispute over the composition of the board of directors of Westech Capital Corp. (the "Company" or "Westech"). *See In re Westech Capital Corp.*, 2014 WL 2211612 (Del. Ch. May 29, 2014) (designating a four-member board and determining the composition thereof), *aff'd in part, rev'd in part sub. nom. Salamone v. Gorman*, 106 A.3d 354 (Del. 2014) (designating a five-member board and determining the composition thereof). Critical to both

the Court of Chancery's earlier post-trial opinion and the Delaware Supreme Court's opinion on appeal was the operation of a voting agreement that required the stockholders party thereto to vote, or cause to be voted, their shares of stock to elect as directors the individuals designated in the manner provided in the agreement. In this respect, the voting agreement provided, among other things, for the election of the Company's chief executive officer as a director, provided that if for any reason the chief executive officer were to cease to serve as the chief executive officer, the stockholders party to the agreement were required to vote their shares to remove the chief executive officer from the board and to elect the new chief executive officer to the board.

Following the Court of Chancery's earlier post-trial opinion, John Gorman, as the Company's majority stockholder, acted by written consent to amend the bylaws of the Company to provide, among other things, that "[a]ny officer may be removed, with or without cause, at any time by the board or by the stockholders acting at an annual or special meeting or acting by written consent pursuant to Section 2.8 of these Bylaws. The Board shall, if necessary, immediately implement any such removal of an officer by the stockholders." In reliance on the amended bylaw, Gorman then removed Gary Salamone as the Company's chief executive officer and elected himself to fill the resulting vacancy. Following his appointment as chief executive officer, Gorman sought to appoint a new director to serve in his newly vacant director seat. Thereafter, Gorman filed suit in the Court of Chancery seeking confirmation that, among other things, Salamone was no longer the chief executive officer or a director of the Company.

The Court of Chancery held that the amended bylaw was invalid, stating that "Delaware law does not allow stockholders to remove directly corporate officers through authority purportedly conferred by a bylaw." The Court of Chancery rejected Gorman's argument that Section 142(b) of the DGCL (providing that "[o]fficers shall be chosen in such manner . . . as [is] prescribed by the bylaws or determined by the board of directors") and Section 142(e) of the DGCL (providing that "[a]ny vacancy occurring in any office . . . shall be filled as the bylaws provide") permitted the adoption of a bylaw that would allow stockholders to remove and replace officers. In this regard, the Court explained that neither Section 142(b) nor Section 142(e) expressly provided guidance on how officers may be removed, but only on the manner in which officers could be selected and the *manner* in which any vacancy in an office could be filled. Thus, the Court found that the amended bylaw was not authorized by Section 142 of the DGCL. In reaching this conclusion, the Court noted that, prior to its 1967 revision, the DGCL explicitly authorized directors or stockholders to elect corporate officers, and notes that Professor Earnest Folk, in the first edition of his treatise on the DGCL, commented that the 1967 revision intended no substantive change. That commentary stated that, while the phrase "by directors or officers" was deleted and the phrase "in the manner provided by the bylaws" was added, the changes were not intended to effect any substantive change as to who may choose the officers.

Turning to the argument that stockholders generally have the power under Section 109 of the DGCL to adopt and amend bylaws "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 nonetheless held that the amended bylaw was outside the scope of bylaws permitted by Section 109. In particular, the Court noted that the amended bylaw required the board to "immediately implement any such removal of an officer by the stockholders," thereby allowing the stockholders to remove an officer over the objection of the board. Explaining that such a directive, if enforceable, "could compel board action, potentially in conflict with its members' fiduciary duties," the Court held that the "stockholders' right to remove officers for any (or no) reason would unduly constrain the board's ability to manage the Company." As a result of such undue constraint, the Court held that the amended bylaw was invalid and that any actions taken in reliance thereon, including the removal of Salamone as chief executive officer, were of no effect.

Notably, the amended bylaw also provided that "[a]ny vacancy occurring in any elected office of the Corporation may be filled by the board except that any such vacancy occurring as a result of the removal of an officer by the stockholders shall be filled by the stockholders." The Court of Chancery expressly declined to address the validity of this provision, stating that "[t]he Court need not (and does not) analyze [the vacancy-filling] aspect of the Amended Bylaw because its validity is irrelevant to the matter at hand." The Court noted, however, that "[p]ermitting stockholders to set the mode for officer replacement would allow them to dictate a procedure, and would not necessarily step unduly on management's toes."

## Section 220 Actions

**Amalgamated Bank v. Yahoo! Inc.,** 2016 WL 402540 (Del. Ch. Feb. 2, 2016).

In a post-trial decision in *Amalgamated Bank v. Yahoo! Inc.*, the Court of Chancery ordered respondent Yahoo! Inc. to produce additional documents in response to plaintiff Amalgamated Bank's demand to inspect Yahoo's books and records pursuant to 8 *Del. C.* § 220. In doing so, the Court interpreted Section 220 to provide for the production of electronically stored information in addition to physical documents.

The facts centered on Yahoo's hiring of Henrique de Castro as its chief operating officer in October 2012 and de Castro's subsequent termination just 14 months later. The Court of Chancery examined the details surrounding: (i) the involvement of Yahoo's board of directors and compensation committee in the hiring process, (ii) the value of de Castro's compensation package, (iii) the termination of de Castro, (iv) the payout de Castro received upon termination, and (v) the alleged unilateral involvement of Yahoo's CEO, Marissa Mayer, in the hiring and firing of de Castro and the construction of his compensation package.

Amalgamated filed its first demand for inspection of Yahoo's books and records on February 24, 2014, for the purpose of investigating "potential mismanagement, including mismanagement in connection with the payment of compensation to a corporation's officers and directors." Throughout 2014, Amalgamated and Yahoo engaged in negotiations surrounding the demand, and Yahoo eventually produced 677 pages of documents. When Yahoo denied Amalgamated's demand for additional categories of documents, Amalgamated filed suit on March 10, 2015.

The Vice Chancellor's opinion offers clarification on what is sufficient to meet the statutory "form and manner" requirements necessary for bringing a books and records demand under 8 Del. C. § 220. Yahoo argued that Amalgamated failed to prove that it owned Yahoo stock at the time the demand was filed because the proof submitted by Amalgamated was dated three days before the date demand was made—as opposed to being dated the same day as the demand—but the Court rejected that argument. The Vice Chancellor ruled that Section 220 only requires "documentation sufficient in time to the date of demand as to be consistent with and corroborate the averment of stock ownership made in the demand itself." Additionally, the Court found that Amalgamated was not required to provide Yahoo with an ongoing stream of ownership records to confirm continuous ownership of stock.

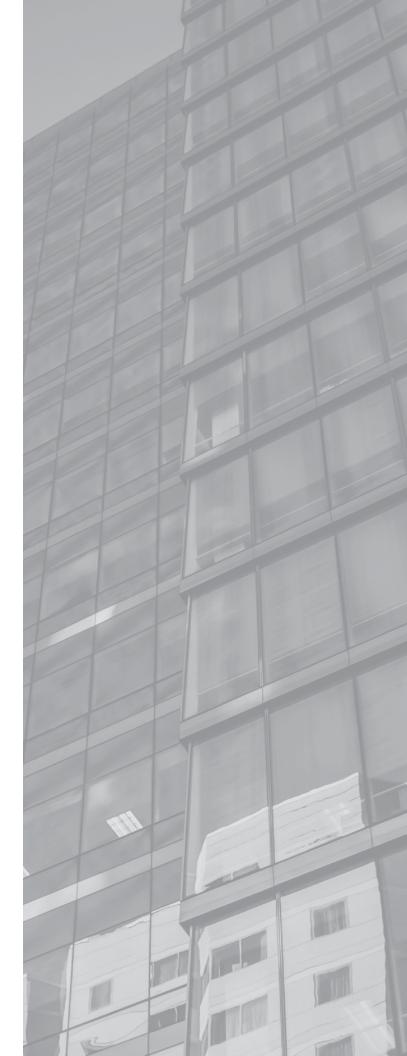
The Court also analyzed the sufficiency of Amalgamated's stated purpose of demanding inspection of Yahoo's books and records to investigate potential corporate wrongdoing in connection with de Castro's hiring and firing. Distinguishing *Se. Pa. Transp. Auth. v. Abbvie, Inc.,* 2015 WL 1753033 (Del. Ch. Apr. 15, 2015), *aff'd,* 2016 WL 235217 (Del. Jan. 20, 2016), the Court held that Amalgamated had not limited its stated purposes to investigating potential causes of action that would be subject to exculpation, but rather had met the "credible basis" standard with respect to its potential claims for breach of the duty of good faith and waste.

The Court then turned to the scope of inspection. Amalgamated sought production of emails and other files of Yahoo's CEO, Marissa Mayer. The Court found that "[t]he evidence establishes that the Mayer Documents are necessary for a meaningful investigation of de Castro's hiring," due to the direct and personal involvement Mayer had with the negotiations and hiring of de Castro. The Court reached a similar conclusion with regard to Mayer's documents relating to de Castro's termination. The Court ruled that the "scope of the production of the Mayer Documents, which count as corporate books and records." The Vice Chancellor rejected Yahoo's argument that such documents are not subject to 8 *Del. C.* § 220 because the language of the statute does not explicitly mention electronic information. The Court reasoned that "[a]s with other categories of documents subject to production under Section 220, what matters is whether the record is essential and sufficient to satisfy the stockholder's proper purpose, not its source." The Court further clarified that the production of Mayer's emails should include emails from any personal account she may have used to conduct Yahoo business.

The Vice Chancellor also ordered Yahoo to produce emails and other electronically stored documents in the possession of the members of Yahoo's compensation and leadership development committee, to the extent those documents related to de Castro's hiring or termination. The Court also ordered additional production of documents relating to Yahoo's director recruitment process.

The Court rejected Amalgamated's request for production of documents reflecting consultations with counsel. Recognizing that those documents could be subject to production, notwithstanding the attorney-client privilege and work-product doctrine, under *Garner v. Wolfinbarger*, 430 F.2d 1093 (5th Cir. 1970), the Court determined that it would require Yahoo to log communications with counsel relating to the subjects of the inspection, to the extent those communications were identified in searching for documents produced pre-litigation or in response to the Court's order. The Court left open the possibility that Amalgamated might later show that these privileged documents might be essential to the proper purpose of inspection.

Finally, on an issue of first impression, the Vice Chancellor found that any further document production by Yahoo "is conditioned on Amalgamated agreeing that the entirety of Yahoo's production in response to the Demand is incorporated by reference in any derivative action complaint it files relating to the subject matter of the demand." The Court explained the basis for this condition as a means to protect Yahoo and the Court from the filing of a complaint based on "cherry-picked documents," and to prevent Amalgamated from forging a complaint based on a few documents taken out of context.



### CONTROLLING STOCKHOLDER ISSUES

### *In re Cornerstone Therapeutics Inc. Stockholder Litigation,* 115 A.3d 1173 (Del. 2015).

In *In re Cornerstone Therapeutics Inc. Stockholder Litigation*, 115 A.3d 1173 (Del. 2015), the Delaware Supreme Court resolved two consolidated interlocutory appeals. In the underlying cases *(In re Zhongpin Inc. Stockholders Litigation*, 2014 WL 6735457 (Del. Ch. Nov. 26, 2014), and *In re Cornerstone Therapeutics Inc. Stockholder Litigation*, 2014 WL 4418169 (Del. Ch. Sept. 10, 2014)), the Court of Chancery refused to dismiss independent directors because the governing standard of review was held to be entire fairness.

The Supreme Court reversed and remanded, holding that a "plaintiff seeking only monetary damages must plead non-exculpated claims against a director who is protected by an exculpatory charter provision to survive a motion to dismiss, regardless of the underlying standard of review for the board's conduct—be it *Revlon, Unocal,* the entire fairness standard, or the business judgment rule." Therefore, even in a situation where entire fairness applies *ab initio,* independent directors may seek dismissal under a charter provision authorized by 8 *Del. C.* § 102(b)(7) where the plaintiffs are solely seeking monetary relief.

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, 101 A.3d 980 (Del. Ch. 2014), In re Crimson Exploration Inc. Stockholder Litigation, 2014 WL 5449419 (Del. Ch. Oct. 24, 2014), and In re Sanchez Energy Derivative Litigation, 2014 WL 6673895 (Del. Ch. Nov. 25, 2014), the Court concluded that the minority stockholder at issue did not constitute a controlling stockholder, while in In re Zhongpin Inc. Stockholders Litigation, 2014 WL 6735457 (Del. Ch. Nov. 26, 2014), 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 Oaktree's 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 Ir. (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 that 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.

### In re KKR Financial Holdings LLC Shareholder Litigation, 101 A.3d 980 (Del. Ch. 2014).

In *In re KKR Financial Holdings LLC Shareholder Litigation*, 101 A.3d 980 (Del. Ch. 2014), 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-forstock 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.

# *Kahn, et al. v. M&F Worldwide Corp., et al.,* 88 A.3d 635 (Del. 2014).

In Kahn, et al. v. M&F Worldwide Corp., et al., 88 A.3d 635 (Del. 2014), 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.



### LIMITED LIABILITY COMPANIES AND PARTNERSHIPS

## *Dieckman v. Regency GP LP,* 2017 WL 243361 (Del. Jan. 20, 2017).

In the latest in a series of decisions addressing conflict of interest transactions involving Delaware limited partnerships, the Delaware Supreme Court confirmed in *Dieckman v. Regency GP LP*, 2017 WL 243361 (Del. Jan. 20, 2017), that although Delaware courts will enforce clear, express and unambiguous language modifying or eliminating default fiduciary duties, a conflict of interest transaction may still run afoul of implied contractual standards.

In Dieckman, the transaction at issue involved a merger of Regency Energy Partners LP, a publicly traded Delaware limited partnership (the "MLP"), with an affiliated entity. To reconcile this inherent conflict of interest, the general partner of the MLP attempted to satisfy two safe harbor mechanisms enumerated in the partnership agreement, either of which could be used to insulate the transaction from legal challenge-"Special Approval" by the independent Conflicts Committee and "Unaffiliated Unitholder Approval." The plaintiff, a common unitholder of the MLP, alleged that (i) the general partner failed to satisfy the Special Approval safe harbor because there was a conflicted member on the Conflicts Committee, and (ii) the general partner failed to satisfy the Unaffiliated Unitholder Approval safe harbor because the general partner made false and misleading statements in a proxy statement to secure such approval. The Court of Chancery, while not reaching the defendants' Special Approval defense, found that the Unaffiliated Unitholder Approval safe harbor had been satisfied because (i) the partnership agreement had eliminated all fiduciary duties, including the duty of disclosure, and (ii) the disclosures expressly required by the partnership agreement had been made. The Court of Chancery therefore granted the defendants' motion to dismiss.

On appeal, the Delaware Supreme Court noted that even when a partnership agreement waives fiduciary duties, investors of publicly traded partnerships still have protections afforded to them through principles of *contra proferentem* (ambiguities are construed against the drafter to give effect to the reasonable expectations of the investors) and the implied covenant of good faith and fair dealing. The Supreme Court focused on the safe harbor process in its entirety and found that the language in the partnership agreement's conflict resolution provision implicitly required the general partner to act in a manner that would not undermine the protections afforded to the unitholders in connection with the safe harbor process.

In analyzing the Unaffiliated Unitholder Approval defense, the Supreme Court noted that the general partner had issued a comprehensive proxy statement, which went far beyond the minimal disclosures required by the express terms of the partnership agreement, to induce the unitholders to approve the merger transaction. The Supreme Court held that once the general partner determined to go beyond the minimal disclosure requirements under the partnership agreement, then—pursuant to the implied covenant of good faith and fair dealing-the general partner had an obligation not to mislead investors. The Supreme Court found that the plaintiff pled facts raising sufficient doubt concerning whether the proxy statement misled investors by creating the false appearance that the Conflicts Committee, which had approved the transaction, was composed solely of unaffiliated and independent persons.

In analyzing the Special Approval defense, the Supreme Court found the general partner had an obligation to form a conflicts committee as set forth in the partnership agreement, which required committee members to be independent from and unaffiliated with the general partner. The plaintiff alleged the general partner created a two-member committee that included an individual who began reviewing the merger transaction while still a member of an affiliate board, which is not consistent with the independent status of the Conflicts Committee members as required by the partnership agreement. The Supreme Court concluded that the plaintiff had raised sufficient doubt as to whether the Conflicts Committee was properly constituted, which would call into question whether the general partner could utilize the safe



harbor provisions under the partnership agreement to preclude judicial review of the merger transaction.

The *Dieckman* decision is a reminder that although contractual flexibility afforded to Delaware limited partnerships can be used to provide general partners with significant protections, general partners must still comply with implied contractual responsibilities in the partnership agreement.

### *El Paso Pipeline GP Company, L.L.C. v. Brinckerhoff,* No. 103, 2016 (Del. Dec. 20, 2016).

In *El Paso Pipeline GP Company, L.L.C. v. Brinckerhoff,* the Delaware Supreme Court reversed the Court of Chancery's holding that a limited partner maintained standing to pursue his claims challenging a dropdown transaction after the limited partnership was acquired by merger. The Supreme Court rejected the Chancery Court's holding that the plaintiff's claims arose out of a breach of the partnership agreement and therefore were direct in nature. As the claims were derivative, they passed to the buyer in the merger, thereby extinguishing the plaintiff's standing.

In the fall of 2010, El Paso Corporation ("El Paso Parent"), which owned El Paso Pipeline GP Company, L.L.C. (the "GP"), the sole general partner of El Paso Pipeline Partners, L.P. (the "MLP"), sold assets to the MLP in a "dropdown" transaction. The plaintiff filed suit derivatively on behalf of the MLP challenging the transaction. While the litigation was pending, Kinder Morgan, Inc. ("Kinder Morgan") acquired El Paso Parent. After this acquisition, Kinder Morgan acquired the MLP by merger. After the consummation of the MLP merger, the defendants moved to dismiss, arguing plaintiff's claims were exclusively derivative and that plaintiff lost standing as a result of the merger. The Chancery Court then issued an opinion holding the GP liable for breach of the MLP's partnership agreement, finding that the conflicts committee of the MLP "did not subjectively believe" that the approval of the dropdown transaction "was in the best interests of the partnership," and that the MLP suffered \$171 million in damages. Subsequently, the Chancery Court denied the defendants' motion

to dismiss. First, the Chancery Court distinguished the case at hand from the test articulated in Tooley v. Donaldson, Lufkin & Jenrette, Inc., 845 A.2d 1031 (Del. 2004), for determining whether a claim is direct or derivative, stating that "Tooley does not apply to contract rights." Nevertheless, the Chancery Court analyzed the claim under the two-part part test in *Tooley*—which involves an inquiry into (i) who suffered the alleged harm, and (ii) who would receive the benefit of any recovery or other remedy-and concluded that plaintiff had asserted a "dual-natured" claim and thus could pursue the claim post-merger. As to the first prong, the Chancery Court found that the dropdown injured the limited partners by reallocating value from the unaffiliated limited partners to the GP and that, because the GP received benefits to the exclusion of the limited partners generally, the limited partners suffered a distinct injury. As to the second prong, the Chancery Court decided that because both the MLP and the limited partners were harmed, either could recover for the alleged breach.

On appeal, the Supreme Court determined that plaintiff's claims were and remained derivative. The Supreme Court explained that while claims for breach of a commercial contract are normally direct in nature, a partnership agreement is not merely a traditional commercial contract; rather, it is the constitutive contract of a partnership and sets forth the rights and duties of the partners. The Supreme Court found the plaintiff's claim sounded in breach of a contractual duty owed to the MLP and thus applied Tooley. As to the first prong, the Supreme Court concluded that the harm alleged in plaintiff's complaint solely affected the MLP, noting that plaintiff alleged the MLP had overpaid for the assets in the dropdown and that overpayment claims are normally treated as harming the entity and are therefore regarded as derivative. The Supreme Court noted that where an entity is alleged to have overpaid for an asset, the entity is harmed through the depletion of its assets, which harms its equity holders derivatively through the diminution of the value of their interests. The Court further noted that not every breach of a provision of the partnership agreement is "dual" by reason of rights and duties under the partnership agreement flowing to either the limited partners or the MLP. While recognizing

that its opinion in *Gentile v. Rossette*, 906 A.2d 91 (Del. 2006), allowed for a dual-natured claim in circumstances where there is both an improper transfer of economic value and voting power from the minority stockholders to the controlling stockholder so-called "equity dilution" claims—the Supreme Court found the plaintiff's claims failed to satisfy the unique circumstances presented by *Gentile*. The Supreme Court declined to extend *Gentile* and dual-natured claims to circumstances where the "extraction of solely economic value from the minority by a controlling stockholder constitutes direct injury."

As to the second prong of *Tooley*, the Supreme Court found that any recovery from the claim would benefit the MLP's partners pro rata in proportion to their partnership interests. The Supreme Court rejected the Chancery Court's reliance on cases where claims involving "insider transfers" or "stock dilution" were found to be dual-natured. The Supreme Court found that those cases were inapposite, as the plaintiff did not allege that the dropdown affected his voting rights or relative control of the MLP.

While the Supreme Court recognized the Chancery Court's equitable concerns with a holding that would allow the claims to be extinguished, the Supreme Court declined to change settled law, noting the importance of certainty in the law for all parties. The Supreme Court stated that, in most circumstances, "permitting pending derivative claims to survive a merger would be inefficient and overly costly for public investors" and that "[u]seful transactions would be deterred or priced at a lower value because third-party acquirers would find themselves having bought into litigation morasses, the persistence of which they cannot control."

In his concurrence, Chief Justice Strine wrote separately to state that the present case "highlights" that *Gentile* "muddies the clarity of [Delaware] law in an important context," stating that "it ought to be overruled, to the extent it allows for a direct claim in the dilution context when the issuance of stock does not involve subjecting an entity whose voting power was held by a diversified group of public equity holders to the control of a particular interest." Even in the case of a transaction that shifts control from a disaggregated investor base to a controller, the Chief Justice noted, stockholders would already have a direct claim under *Revlon*, leaving no "gap" for *Gentile* to fill.

This decision provides helpful guidance in finding that the contractual nature of Delaware limited partnerships does not eliminate the application of the two-part *Tooley* test when determining whether certain claims involving Delaware limited partnerships.

# **Obeid v. Hogan,** C.A. No. 11900-VCL (Del. Ch. June 10, 2016).

In Obeid v. Hogan, the Delaware Court of Chancery held that the board of directors of a board-managed Delaware limited liability company and the managers of a manager-managed Delaware limited liability company did not have the authority under the respective limited liability company agreements to delegate to a non-manager the power to act as a special litigation committee. Based primarily on the language of the limited liability company agreements, the Court found that, on the factual record before it, the "core governance function" of controlling litigation on behalf of the companies could be discharged only by the board (or a committee) of the board-managed company and by the managers (or a subset of managers) of the manager-managed company, notwithstanding the provisions of Section 18-407 of the Delaware Limited Liability Company Act (the "Act") providing members and managers broad authority to delegate managerial powers.

The dispute in *Obeid* arose out of a series of internal disputes involving the members and managers of Gemini Equity Partners, LLC, the board-managed company (the "Corporate LLC"), and Gemini Real Estate Advisors, LLC, the manager-managed company (the "Manager LLC"). The Corporate LLC and the Manager LLC had the same three members, William T. Obeid, Christopher S. La Mack and Dante A. Massaro, each of whom initially served on the board of the Corporate LLC and as a manager of the Manager LLC. In 2014, La Mack and Massaro took action to remove Obeid from the board of the Corporate LLC and as operating manager (but not as a manager) of the Manager LLC. Shortly thereafter, Obeid filed

claims against La Mack and Massaro, both directly and derivatively in the name of the companies, in the U.S. District Court for the Southern District of New York (the "NY Action"), alleging, among other things, usurpation of corporate opportunities and other breaches of fiduciary duty. In connection with the derivative claims, Obeid did not make a demand that the managers of the companies institute an action in the name of the companies, as he contended that, due to alleged conflicts of interest, demand would be futile. The Court found that the NY Action had proceeded beyond the stage at which La Mack and Massaro could contest Obeid's authority to assert such derivative claims.

In August 2015, La Mack and Massaro, each acting as member-manager of the two companies, executed an engagement letter with Michael R. Hogan, a retired federal judge, with the apparent intent of delegating to him the powers of a special litigation committee for purposes of asserting control over the derivative litigation. Judge Hogan was not a member of either company, he was not appointed as a manager of either company, and there were no formal resolutions of either company establishing a special litigation committee or appointing Judge Hogan to that role. After Obeid learned of Judge Hogan's engagement, he filed suit in the Court of Chancery, seeking a declaration that Judge Hogan could not act as a special litigation committee for either company. Obeid also sought an injunction preventing Judge Hogan from taking any action on behalf of either company, including exerting influence or control over the derivative claims.

In addressing whether Judge Hogan had been duly vested with the authority of a special litigation committee, the Court reviewed the provisions of the limited liability company agreement of each of the Corporate LLC and the Manager LLC. The Court found that the Corporate LLC's limited liability company agreement was designed to recreate the governance structure of a Delaware corporation. Specifically, it provided that the business and affairs of the Corporate LLC would be managed by or under the direction of its board, using the same basic language found in Section 141(a) of the Delaware General Corporation Law (the "DGCL"). Likewise, the Corporate LLC's limited liability company agreement, using language drawn primarily from Section 141(c) of the DGCL, provided that the board could delegate its powers to committees consisting solely of board members. The Court found that the presence of these provisions, among other features of the agreement embracing the governance structure of a Delaware corporation, counseled in favor of applying corporate-law analogies to guide the determination as to whether the Corporate LLC's board could validly delegate its powers to a non-director.

The Court noted that in *Zapata v. Maldonado*, 430 A.2d 779 (Del. 1981), the Delaware Supreme Court held that a committee of a board of directors retained the power to dismiss derivative litigation, subject to an inquiry into the independence and good faith of the directors and the determination that the recommendation falls within a range of reasonable outcomes. According to the *Obeid* Court, central to the *Zapata* Court's holding was the observation that, under Section 141(c) of the DGCL, a committee could exercise the power of the board of directors with respect to the litigation asset. The *Obeid* Court found that delegating such power to an officer or non-director would constitute an improper abdication of the board's authority.

In an effort to overcome the argument that the authority to control derivative litigation could only be delegated to a committee of directors, the Corporate LLC pointed to Section 18-407 of the Act, which provides, in relevant part, that "unless otherwise provided in the limited liability company agreement, a member or manager of a limited liability company has the power and authority to delegate to 1 or more other persons the member's or manager's . . . rights and powers to manage and control the business and affairs of the limited liability company." The Court rejected the Corporate LLC's argument, observing that the "general default provision" regarding delegation did not overcome the specific provisions of the Act vesting the power to bring derivative suits in "managers or members" and finding, in any event, that by embracing a governance structure modelled after Sections 141(a) and 141(c) of the DGCL, the Corporate LLC's limited liability company agreement "provided otherwise" for purposes of Section 18-407 of the Act-that is, the

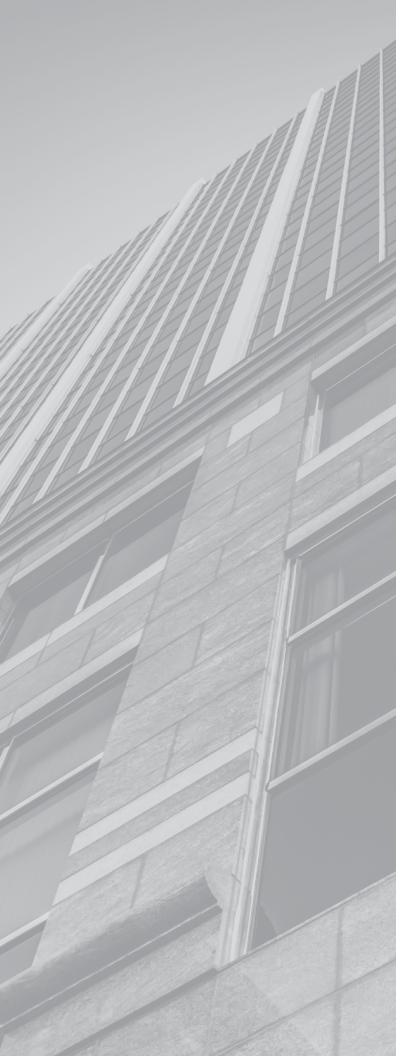
Corporate LLC's limited liability company agreement, by mirroring a corporate structure, imported the relevant principles of the DGCL restricting the delegation of the board's core governance functions to third parties.

While noting that similar reasoning may likewise apply to the Manager LLC, as its limited liability company agreement also evidenced the governance features of a Delaware corporation (albeit to a lesser degree), the Court did not need to reach that issue, as it found a separate basis on which the Manager LLC's limited liability company agreement "provided otherwise" for purposes of Section 18-407 of the Act. The Court found that specific provisions of the Manager LLC's limited liability company agreement evidenced a distinction between matters relating to the ordinary course of business of the LLC and more significant matters vested solely in the managers. Because such provisions demonstrated the apparent intent of the drafters of Manager LLC's limited liability company agreement to limit the delegation of core functions to managers, the Court found that the power to control litigation could not be delegated to non-manager Judge Hogan.

The Court's opinion in *Obeid* confirms that Delaware courts may review the provisions of limited liability company agreements to determine the governance structure the parties intended and, absent other factors, may view that as evidence of an intent to have aspects of the entity law of similarly managed entities apply to the limited liability company. In drafting limited liability company agreements, transaction planners and their counsel should give careful consideration to the provisions authorizing or restricting the delegation of authority to various parties and whether the governance structure may impact the ability to delegate certain authority to third parties.

### In re Kinder Morgan, Inc. Corporate Reorganization Litigation, 2015 WL 4975270 (Del. Ch. Aug. 20, 2015).

The Delaware courts have consistently held, in the context of Delaware limited partnerships, that clear, express and unambiguous language modifying default fiduciary duties will be enforced. Given this precedent,



the Court of Chancery's decision in *In re El Paso Pipeline Partners, L.P. Derivative Litigation,* C.A. No. 7141-VCL (Del. Ch. Apr. 20, 2015), in which the Court awarded damages against the general partner of a master limited partnership ("MLP") in connection with a conflict of interest transaction, received significant attention. The Court's later decision in *In re Kinder Morgan, Inc. Corporate Reorganization Litigation,* C.A. No. 10093-VCL (Del. Ch. Aug. 20, 2015), confirmed that the Delaware courts will continue to enforce the language of partnership agreements (and modifications of fiduciary duty in partnership agreements) as written.

*Kinder Morgan* involved a corporate reorganization in which Kinder Morgan, Inc. ("Parent") would emerge as the only publicly traded entity and, among other things, two previously publicly traded entities controlled by Parent-Kinder Morgan Energy Partners, L.P. (the "Partnership") and Kinder Morgan Management, LLC ("GP Delegate")-would become wholly owned indirect subsidiaries of Parent. The acquisition of the Partnership was approved by a conflicts committee at the general partner of the Partnership, and the acquisition of the GP Delegate was approved by a conflicts committee at the general partner of the GP Delegate. Both of these conflicts committees consisted of the same three individuals. The plaintiffs alleged, among other things, that the committee did not act in good faith. They claimed that had the committee acted in good faith, it would have refused to approve Parent's acquisition of the Partnership and, if there were to be a transaction, would have extracted greater consideration from Parent and greater consideration relative to what was paid to acquire GP Delegate.

The Court ruled that based on the language of the Partnership's partnership agreement and Delaware Supreme Court precedent interpreting identical language, all default fiduciary duties had been eliminated and replaced by a contractual obligation for the general partner to act in manner that it "reasonably believed ... to be in, or not inconsistent with, the best interests of the Partnership." Therefore, there could be no breach of fiduciary duty claim. Turning to the language of the partnership agreement, the Court held that the relevant standard required that the conflicts committee consider and make a determination as to the fairness of the transaction to, and the best interests of, the Partnership itself as opposed to the limited partners of the Partnership. Notably, the Court stated that if the partnership agreement had required the conflicts committee to make a determination as to the best interests of the limited partners, then the complaint would have been sufficient to withstand a motion to dismiss. Nevertheless, given that the standards in the partnership agreement were based on the interests of the Partnership, the Court applied the standards as written and dismissed the plaintiffs' claims.

The *Kinder Morgan* decision further confirms the contractual flexibility with Delaware limited partnerships and that Delaware courts will enforce clear, express and unambiguous language modifying default fiduciary duties. As the *El Paso* decision demonstrated, however, care should be taken in structuring transactions and the process to comply with the contractual standards established by a partnership agreement.

### In re El Paso Pipeline Partners, L.P. Derivative Litigation, 2015 WL 1815846 (Del. Ch. Apr. 20, 2015).

The post-trial decision in *In re El Paso Pipeline Partners*, *L.P. Derivative Litigation*, C.A. No. 7141-VCL (Del. Ch. Apr. 20, 2015), demonstrates that even where default fiduciary duties have been modified or eliminated, a conflict of interest transaction may still run afoul of the contractual standards set forth in a partnership agreement.

In *El Paso*, the transaction at issue was the second of two so-called dropdown transactions by which El Paso Pipeline Partners, L.P. ("El Paso MLP") acquired all of the business involving the liquefied natural gas terminal on Elba Island, Georgia, from El Paso Corporation ("Parent"). Parent owned the general partner of El Paso MLP, and thus controlled El Paso MLP. El Paso MLP's partnership agreement eliminated default fiduciary duties and replaced them with a contractual standard requiring that the persons approving an action on behalf of El Paso MLP subjectively believe that the action is in the best interests of El Paso MLP. Here, the conflicts committee responsible for approving the dropdown transaction was composed solely of independent directors, had engaged its own legal and financial advisors, had received from its financial advisor an opinion that the challenged transaction was fair from a financial point of view to the unaffiliated unitholders of El Paso MLP, and ultimately approved the transaction.

The Court ruled that under El Paso MLP's partnership agreement each conflicts committee member had an affirmative duty to conclude that the challenged transaction was "in the best interests of [El Paso MLP]." The Court found several flaws with the conflicts committee's process and the valuation analysis. More significantly, the Court found that, despite trial testimony to the contrary, the conflicts committee members did not actually conclude that the challenged transaction was in the best interests of El Paso MLP. The Court found that the conflicts committee had focused extensively on the expected accretion from the challenged transaction—*i.e.*, the amount by which the cash distributions for common unitholders of El Paso MLP would be expected to increase—but failed to take sufficiently into account the valuation of the assets being acquired under traditional valuation analyses. As a result of these findings, the Court awarded damages of \$171 million, which the Court determined to be the difference between what El Paso MLP actually paid for the assets acquired in the challenged transaction and the fair value of the assets. Notably, only the general partner entity was held liable for the award, as none of the other defendants was a party to the partnership agreement and the plaintiff did not present a meaningful theory of secondary liability.

The *El Paso* decision is a reminder that, although contractual flexibility afforded to Delaware limited partnerships can be used to provide general partners with significant protections, there is still room for courts to scrutinize compliance with contractual standards.

# Recent Developments in Delaware Law

## 2016 Amendments to the Delaware General Corporation Law

Several important amendments to the General Corporation Law of the State of Delaware (the "DGCL") were signed into law by Delaware Governor Jack Markell on June 16, 2016. The 2016 amendments to the DGCL effect, among others, the following significant changes.

### Section 251(h): Intermediate-Form 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. Since its adoption, Section 251(h) has become a preferred method of accomplishing a tender offer in public M&A transactions. The 2016 amendments to Section 251(h) are designed largely to clarify the procedures and requirements of the subsection.

### Eligibility to Use Section 251(h); Offers for Different

Classes or Series of Stock. As originally drafted, Section 251(h) was intended to make the "intermediateform" merger available principally to public companies. Thus, prior to the 2016 amendments, Section 251(h) provided that, unless expressly required by the certificate of incorporation, no vote of stockholders of a target corporation whose shares are listed on a national securities exchange or held of record by more than 2,000 holders immediately prior to the execution of the merger agreement is required to authorize the merger, so long as the other requirements of the subsection are satisfied. The 2016 amendments to Section 251(h) clarify that the subsection applies to any target corporation that has any class or series of stock listed on a national securities exchange or held of record by more than 2,000 holders immediately prior to the execution of the merger agreement-and that not all classes or series of stock need be so listed or held. Thus, a target corporation whose common stock is listed on a national securities exchange may take advantage of Section 251(h), even if it has a series of preferred stock that is not listed or held of record

by more than 2,000 holders. The 2016 amendments also clarify that the offer for the stock of the target corporation contemplated by the subsection (the "Offer") may be effected through separate offers for separate classes or series of stock.

**Additional Minimum Conditions.** The 2016 amendments clarify that the Offer may be conditioned on the tender of a minimum number or percentage of the shares of the stock of the constituent corporation, or of any class or series thereof.

*Rollover Stock.* Prior to the 2016 amendments, one of the requirements of accomplishing a merger under Section 251(h) was that, following the consummation of the Offer, the stock irrevocably accepted for purchase or exchange and received by the depositary, plus the stock otherwise owned by the offeror, equals the percentage of stock, and of each class and series thereof, that would otherwise be required to adopt the merger agreement. The 2016 amendments permit, for purposes of determining whether such requirement has been met, the inclusion of shares of stock of the target held by any person that owns, directly or indirectly, all of the outstanding stock of the offeror, or that is a direct or indirect wholly owned subsidiary of such person or persons or of the offeror (collectively, "offeror affiliates"). The 2016 amendments also provide that shares of stock of the target corporation that are the subject of a written agreement requiring such shares to be transferred, contributed or delivered to the offeror or any offeror affiliate in exchange for stock or other equity interests in the offeror or any offeror affiliate may be counted for purposes of determining whether the minimum condition required by the statute has been met, so long as such shares are in fact so transferred, contributed or delivered before the effective time of the merger ("rollover stock"). The 2016 amendments further provide that rollover stock and shares of the target corporation held in treasury, by any direct or indirect wholly owned subsidiary of the target or by the offeror affiliates, are excluded from the requirement that they be converted in the merger into, or into the right to receive, the same consideration paid in the Offer. In this manner, the 2016 amendments provide a more direct and efficient means of enabling certain target stockholders to "rollover" their shares in the transaction.

**Receipt of Stock.** The 2016 amendments clarify the means by which shares of stock of the target corporation are "received" for purposes of determining whether the minimum tender condition required by the subsection has been satisfied. The 2016 amendments clarify that shares represented by certificates will be "received" upon physical receipt of the certificate, together with an executed letter of transmittal, so long as the certificate representing such shares was not cancelled prior to consummation of the Offer. Under the 2016 amendments, uncertificated shares held of record by a clearing corporation as nominee would be "received" by transfer into the depository's account by means of an agent's message, and all other uncertificated shares would be "received" by physical receipt of an executed letter of transmittal by the depository. In all cases, however, under the 2016 amendments, uncertificated shares would cease to be "received" to the extent they have been reduced or eliminated due to any sale of such shares prior to the consummation of the Offer. The 2016 amendments prescribe what constitutes an "agent's message" for these purposes, specifying that it is a message transmitted by the clearing corporation acting as nominee, received by the depository, and forming part of the book-entry confirmation, which states that the clearing corporation has received an express acknowledgment from a stockholder that such stockholder has received the Offer and agrees to be bound by the terms of the Offer, and that the offeror may enforce such agreement against such stockholder.

### Section 262: Appraisal Rights

The 2016 amendments amend Section 262 of the DGCL, which governs appraisal rights, in two principal respects. First, the 2016 amendments impose *de minimis* limitation on appraisal claims in certain public company transactions. Second, the 2016 amendments give surviving corporations the option to pay each stockholder entitled to appraisal at an earlier stage of the appraisal proceeding as a means of cutting off the accrual of interest under the statute with respect to the amount paid.

**De Minimis Exception.** To implement the first of these changes, the 2016 amendments provide that the Court

of Chancery shall dismiss an appraisal proceeding as to all stockholders otherwise entitled to appraisal rights, unless (i) the total number of shares entitled to appraisal exceeds 1% of the outstanding number of shares of the class or series entitled to appraisal: (ii) the value of the consideration for such total number of shares exceeds \$1 million; or (iii) the merger was effected as a short-form merger under Section 253 or Section 267 of the DGCL. The amendment is designed to mitigate the risk that a plaintiff will use the appraisal process solely to gain leverage in a settlement negotiation. That is, the amendment is designed to prevent stockholders from demanding an appraisal in cases where the number of shares (or the value of those shares) is minimal, but the surviving corporation may be inclined to settle the claim to avoid the litigation costs attendant to the appraisal proceeding. As noted above, however, short-form mergers would not be subject to the *de minimis* carveout because appraisal may be the stockholders' only remedy in such a merger. In addition, the *de minimis* carve-out would apply only in cases where the shares as to which appraisal is sought were listed on a national securities exchange immediately before the merger or consolidation.

In connection with the foregoing changes, the 2016 amendments provide that where the corporation has adopted a provision in its certificate of incorporation granting appraisal rights in circumstances where they would not otherwise exist (e.g., in connection with amendments to the certificate of incorporation or sales of all or substantially all of the corporation's assets), an appraisal proceeding brought there under will be dismissed if the *de minimis* carve-out would apply.

**Tender of Payment.** To implement the second of the principal changes to Section 262, the 2016 amendments modify Section 262(h) to provide corporations the option of limiting the accrual of statutory interest on appraisal awards by making an early payment to the appraisal claimants. Prior to the 2016 amendments, Section 262(h) provided that, unless the Court of Chancery determines otherwise for good cause shown, interest on the amount that is determined to be the "fair value" of appraisal shares will accrue from the effective date of the merger through the date of payment of judgment, will be compounded quarterly, and will accrue at 5% over the Federal Reserve discount rate (including any surcharge) as established from time to time during that period. Since payment of "fair value" in an appraisal proceeding is not made until such amount is determined after trial, interest accrues on the full amount of the award, even if the fair value is ultimately determined to be the same as or less than the consideration paid in the merger. The 2016 amendments permit the surviving corporation to pay the appraisal claimants, at any time before the entry of judgment in the proceeding, a sum of money that it determines to be appropriate.

After making the payment, interest would only accrue upon the sum of (i) the difference, if any, between the amount so paid and the fair value of the shares as determined by the Court of Chancery, and (ii) interest theretofore accrued, unless paid at that time. Any surviving corporation electing to make such a payment would be required to make the payment to all of the appraisal claimants, unless the surviving corporation has a good faith basis for contesting a particular claimant's entitlement to an appraisal of such claimant's shares, in which case the surviving corporation may elect to make payment only to those stockholders whose entitlement to appraisal is uncontested. The amount that the surviving corporation pays would not give rise to any inference as to the fair value of the shares as to which an appraisal is sought.

### **Section 111: Jurisdiction**

Section III(a) of the DGCL generally provides that any civil action to interpret, apply, enforce or determine the validity of provisions of various documents, agreements and instruments may be brought in the Court of Chancery, except to the extent that a statute confers exclusive jurisdiction on a court, agency or tribunal other than the Court of Chancery. Prior to the 2016 amendments, Section III(a)(2) of the DGCL conferred such jurisdiction with respect to any instrument, document or agreement by which a corporation creates or sells, or offers to create or sell, any of its stock, or any rights or options respecting its stock. The 2016 amendments modify Section III(a)(2) to permit the Court of Chancery to exercise subject matter jurisdiction over civil actions involving certain other instruments, documents or agreements, including (i) those to which a Delaware corporation is a party and pursuant to which one or more holders of the corporation's stock sell or offer to sell any of such stock, and (ii) those by which a Delaware corporation agrees, subject to specified conditions, to sell, lease or exchange any of its property or assets.

### Section 141: Board of Directors and Committees

### *Default Quorum and Voting Requirements for Committees and Subcommittees.* The 2016

amendments modify Section 141(c) of the DGCL, which deals with the establishment of committees of the board of directors, to specify the default quorum and voting requirements for committees and subcommittees. After the 2016 amendments, a majority of the directors then serving on a committee or a subcommittee would constitute a quorum (except as otherwise provided in the certificate of incorporation, bylaws, resolutions of the board establishing the committee or resolutions of the committee establishing the subcommittee, provided that in no case may a quorum be less than one-third of the directors serving on the committee or subcommittee). The 2016 amendments also provide that the vote of a majority of the members present at a meeting of the committee or subcommittee at which a quorum is present shall be the act of the committee or subcommittee, unless the certificate of incorporation, the bylaws, the resolutions of the board establishing the committee or the resolutions of the committee establishing the subcommittee require a greater number.

### References to Subcommittees. The 2016

amendments clarify that references in the DGCL to board committees (and committee members) will be deemed to include references to subcommittees (and subcommittee members). The 2016 amendments make other conforming changes to Section 141.

### Section 158: Stock Certificates

Prior to the 2016 amendments, Section 158 of the DGCL provided that every holder of stock represented by certificates shall be entitled to have a certificate signed

by or in the name of the corporation by the chairperson or vice-chairperson of the board of directors, or the president or vice-president, and by the treasurer or an assistant treasurer, or the secretary or an assistant secretary of such corporation representing the number of shares registered in certificate form. (It should be noted that Section 142 also requires the corporation to have officers as may be necessary to enable it to sign instruments and stock certificates.) In recent years, many corporations have dispensed with the offices of president and treasurer and have assigned the role historically assumed by the president and treasurer to the chief executive officer and chief financial officer, respectively. In light of developments in practice, the 2016 amendment to Section 158 provides that any two officers of the corporation who are authorized to do so may execute stock certificates on behalf of the corporation. Thus, as a result of the 2016 amendments, any two duly empowered officers, regardless of their official title in the bylaws, would be authorized to execute stock certificates. The 2016 amendment is not intended to change the existing law that the signatures on a stock certificate may be the signatures of the same person, so long as each signature is made in a separate officer capacity of such person.

### Section 311: Restoration

The 2016 amendments modify Section 311 of the DGCL to include a procedure to restore a corporation's certificate of incorporation after it has expired by limitation. This change is consistent with Section 278 of the DGCL, which currently provides that Sections 279 through 282, relating to corporations that have dissolved, apply to any corporation that has expired by its own limitation. Section 311 is also amended to clarify that a corporation desiring to revoke its dissolution or restore its certificate of incorporation must file all annual franchise tax reports that the corporation would have had to file if it had not dissolved or expired by limitation and pay all franchise taxes that the corporation would have had to pay if it had not dissolved or expired.

### Section 312: Revival

The 2016 amendments to Section 312 distinguish the procedure to extend the term of a corporation's certificate of incorporation or to restore a corporation's certificate of incorporation if it has expired by limitation from the procedure to revive a corporation's certificate of incorporation when it has become forfeited or void. Under the 2016 amendments, Section 312 applies only to a corporation whose certificate of incorporation has become forfeited or void. Accordingly, the 2016 amendments modify Section 312 such that it uses only the term "revival" to reflect the process for reviving such a corporation. (The 2016 amendments eliminate the terms "renewal," "extension" and "restoration.")

The 2016 amendments also clarify and simplify the procedures to be followed by a Delaware corporation to revive its certificate of incorporation after the certificate has become forfeited or void. (The amendments clarify that the provisions of Section 312 do not apply to a corporation whose certificate of incorporation has been forfeited or revoked by the Court of Chancery pursuant to Section 284.) Of significance, the 2016 amendments provide that a majority of the directors then in office, even if less than a quorum, or the sole director in office may authorize the revival of the certificate of incorporation. The 2016 amendments identify such directors as those who, but for the certificate of incorporation having become forfeited or void, would be the duly elected or appointed directors of the corporation. The 2016 amendments also clarify the process for elections of directors if no directors are in office and the effect of a revival with respect to actions taken by the corporation's directors, officers, agents and stockholders.

## The Delaware Rapid Arbitration Act

On April 2, 2015, Delaware Governor Jack Markell signed a highly specialized arbitration statute into law: the Delaware Rapid Arbitration Act (the "DRAA"). The DRAA provides a quick and inexpensive process for starting an arbitration proceeding, accelerates the arbitration itself to ensure a swift resolution, eliminates confirmation proceedings, and allows for challenges directly to the Delaware Supreme Court. Speed and efficiency are key features of the DRAA. Arbitrations brought under the new statute must be completed within 120 days of the arbitrator accepting appointment. With the unanimous consent of the parties and the arbitrator, that timeline can be extended to 180 days. Arbitrators who do not issue final awards within the prescribed timeframe face reductions in their fees corresponding to the length of the delay in the issuance of the final award.

The legislation gives broad powers to expert arbitrators. Arbitrability is determined solely by the arbitrator, who also has the authority to grant a full array of injunctive and other remedies. The arbitrator's final award is deemed confirmed simply by the passage of time. Challenges to the final award are made directly to the Delaware Supreme Court, skipping review by the trial court. Unless altered by contract, such challenges proceed under the narrow Federal Arbitration Act standard of review.

The DRAA was designed to address resolution of disputes where sophisticated parties most need nononsense, swift resolution. The DRAA may not be used to resolve disputes involving consumers, and it may only be invoked against parties who sign an express agreement to arbitrate under the DRAA. One of the parties must be a Delaware business entity, although it need not be located in Delaware.

The DRAA was developed by an interdisciplinary team of arbitration practitioners led by Delaware's Chief Justice Leo E. Strine Jr., Delaware's Chancellor Andre G. Bouchard, and Delaware's Secretary of State Jeffrey Bullock. Richards, Layton & Finger lawyers also played key roles in developing the DRAA: two of our partners were deeply involved in drafting the statute, and a third played a principal role in drafting the proposed model rules.

### 2016 Amendments to Delaware Alternative Entity Law

The Delaware General Assembly has recently enacted legislation amending the Delaware Limited Liability Company Act (LLC Act), the Delaware Revised Uniform Limited Partnership Act (LP Act) and the Delaware Revised Uniform Partnership Act (GP Act) (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 GPs).

# Automatic Admission of Assignees to Single Member Delaware LLCs

The LLC Act has been amended to add a new subsection 18-704(a)(3) that provides that in connection with a voluntary assignment by the sole member of a Delaware LLC of all its limited liability company interests to a single assignee, the assignee will be admitted as a member of the Delaware LLC unless otherwise provided in connection with the assignment or unless otherwise provided in the limited liability company agreement of the Delaware LLC by a specific reference to Section 18-704(a)(3) of the LLC Act. Section 18-704(a)(3) of the LLC Act provides that an assignment will be voluntary for purposes of Section 18-704(a)(3) of the LLC Act if it is consented to by the member at the time of the assignment and is not effected by foreclosure or other similar legal process.

Default rules under the LLC Act provide that (i) a member ceases to be a member of a Delaware LLC upon the assignment of all of the member's limited liability company interests unless otherwise provided in the limited liability company agreement of the Delaware LLC, and (ii) a Delaware LLC dissolves at any time there are no members of the Delaware LLC. The addition of Section 18-704(a)(3) to the LLC Act will reduce the risk of triggering an inadvertent dissolution of a Delaware LLC that may have otherwise occurred if the admission of an assignee as a member was not otherwise provided for in connection with an assignment of all of a sole member's limited liability company interests in the Delaware LLC.

### Default Rule Requiring Approval or Consent to Be in Writing Eliminated

The LLC Act, the LP Act and the GP Act have been amended to change the default rule in certain instances that required written approvals or written consents to now only requiring approvals or consents. This amendment will allow approvals or consents to be provided by means other than in writing. The amendment also brings certain provisions, such as approving a transaction, dissolution of the entity, revocation of dissolution and admission of members or partners, in line with the merger and conversion provisions of the LLC and Partnership Acts, which did not require approvals or consents to be written.

### Service of Process on a Series of a Delaware LLC or Delaware LP

The LLC Act and the LP Act have been amended to provide a manner for effecting service of process on a series of a Delaware LLC or a series of a Delaware LP. Previously, the LLC Act and LP Act only specifically addressed service of process on the entity itself and not on a series of such entity.

Cross-Collateralization and Cross-Default by a Series of a Delaware LLC or Delaware LP

The LLC Act and the LP Act have been amended to clarify that a series of a Delaware LLC or a Delaware LP can agree to be liable for any or all of the debts, liabilities, obligations or expenses incurred, contracted for or otherwise existing with respect to the entity generally or another series of the entity, and that a Delaware LLC or Delaware LP can agree to be liable for any or all of the debts, liabilities, obligations or expenses incurred, contracted for or otherwise existing with respect to a series.

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 the LLC Act, LP Act and GP Act are contained in House Bill Nos. 372, 367 and 368, respectively (each effective August 1, 2016). ■



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