DELAWARE CORPORATE LAW AND LITIGATION:

WHAT HAPPENED IN 2014 AND WHAT IT MEANS FOR YOU IN 2015

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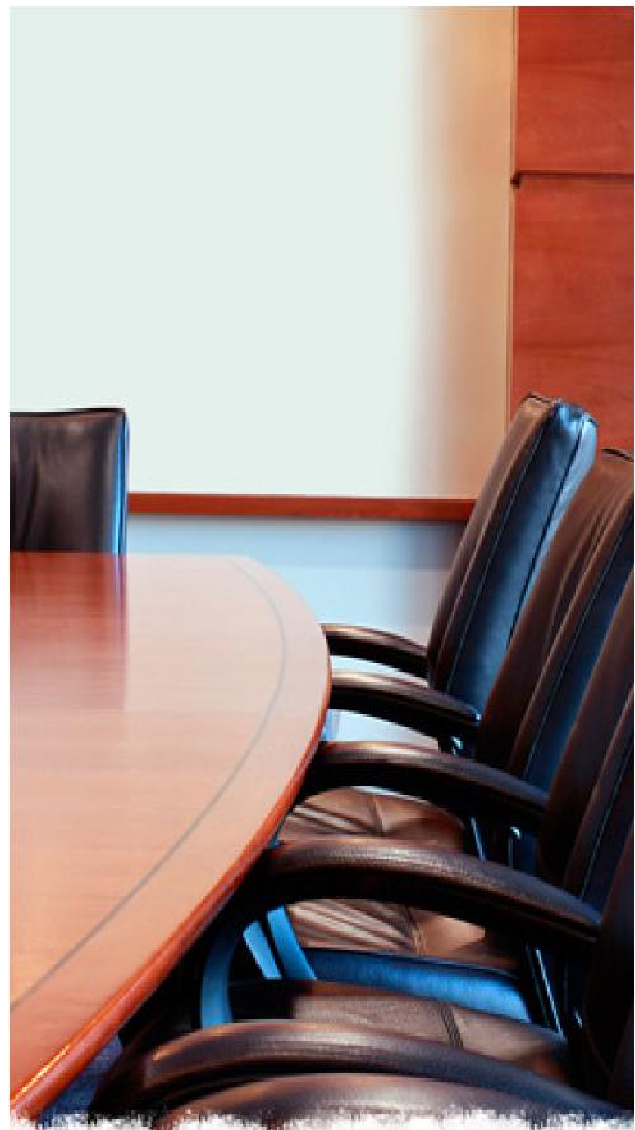
DELAWARE'S LEADING ROLE IN BUSINESS AND BUSINESS LITIGATION

Delaware has long been known as the corporate capital of the world, and it is now the state of incorporation for 66 percent of the Fortune 500 and more than half of all companies whose securities trade on the NYSE, Nasdaq and other exchanges. Each year, the Delaware courts issue a number of significant opinions demonstrating that the Delaware courts are neither stockholder nor management biased. Many of those recent and important cases are discussed in this Update, which is intended to provide sufficient detail so as to be helpful to in-house counsel, but is also written in a way so that the often-long and complex Delaware decisions can be easily understood by directors and other fiduciaries. Takeaway observations are also provided.

Delaware's preeminence in business law starts with its corporate code (the Delaware General Corporation Law) and alternative entity statutes, which are continuously reviewed and enhanced with innovations designed to meet the expanding needs of Corporate and Financial America.

The Delaware Court of Chancery and the Delaware Supreme Court have helped the state maintain its preeminence by striking a balance in the application of these laws between entrepreneurship by management and the rights of investors. Jurisdiction over a company and its management can be obtained based on the state of incorporation, and Delaware's courts are not just popular venues for resolving business disputes but are now the preeminent courts in the United States for resolving challenges to actions by boards of directors, such as breach of fiduciary duty claims, merger and acquisition litigation and virtually any issue implicating corporate governance and compliance with Delaware's business laws. In fact, for more than ten years, an annual assessment conducted by the United States Chamber of Commerce has ranked Delaware first among the court systems in all 50 states, noting the Delaware courts' fairness and reasonableness, competence, impartiality and timeliness in resolving disputes.

Delaware's guiding principles remain: strict adherence to fiduciary duties; prompt enforcement of articles of incorporation, bylaws and merger agreements; and the maximization of stockholder value. The business judgment rule remains alive and well in Delaware for directors who reasonably inform themselves of important information before making decisions, who are free of economic or other disabling conflicts of interest, and whose only agenda is that of advancing the best interests of the corporation. While the facts and legal analyses confronting directors are usually complex, the cases often boil down to the smell test. So long as independent directors can articulate why, in their best judgment, they acted as they did and why they believed those actions were in the best interests of the corporation, the Delaware courts will respect their decisions.



CURBING STOCKHOLDER LITIGATION: EXCLUSIVE FORUM AND FEE-SHIFTING PROVISIONS

In an effort to control the phenomena of multi-forum litigation, in which plaintiffs bring the same suit in multiple jurisdictions simultaneously, corporations have been adopting, either by charter amendment or bylaw approval, exclusive forum and/or fee-shifting provisions. Exclusive forum provisions require that lawsuits over the internal affairs of a Delaware corporation be brought in Delaware. Fee-shifting provisions, which are currently clouded in controversy, are essentially one-sided "loser pays" provisions.

The significance of this problem becomes shockingly clear when one considers the statistics on M&A litigation. While the 2014 information is still being compiled, a study prepared by Matthew D. Cain (University of Notre Dame, Department of Finance) and Steve M. Davidoff (Ohio State University, Michael E. Moritz College of Law) on M&A deals in 2013 showed:

- 97.5 percent of all transactions resulted in litigation
- Each transaction resulted in an average of 7 lawsuits (an all time high)
- 41.6 percent of all transactions experienced multi-jurisdictional litigation (down from 51.8 percent in 2012)
- Median attorneys' fee awards per settlement were US$485,000

EXCLUSIVE FORUM PROVISIONS

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

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

The *Chevron* case provided for exclusive jurisdiction in Delaware, but in a 2014 case involving a Delaware corporation − *City of Providence v. First Citizens Bancshares, Inc., et al.*, 2014 WL 4409816 (Del. Ch. Sept. 8, 2014) − the company's bylaw provided for exclusive jurisdiction in the United States District Court for the Eastern District of North Carolina, or, if that court lacks jurisdiction, any North Carolina state court with jurisdiction. Delaware's new Chancellor, Andre C. Bouchard, upheld the bylaw based on the same rationale in *Chevron* and dismissed the case.

Takeaways

1. The Delaware case law is important, but it is when the company and management are facing lawsuits in other states that they really need the exclusive forum provisions to be enforced − and that requires non-Delaware courts to accept their validity and enforce them. To enhance enforcement, such provisions should be adopted by charter amendment (if possible) rather than by management-approved bylaw. For example, in *Roberts v. TriQuint Semiconductor*, 2014 WL 4147465 (Cir. Ct. Or. Aug. 14, 2014), an Oregon court refused to enforce a forum selection bylaw adopted at the same time as the merger agreement being challenged by stockholders because of "the closeness of the timing of the bylaw amendment to the board's alleged wrongdoing, coupled with the fact that the board enacted the bylaw in anticipation of this exact lawsuit."

2. Mandatory arbitration for corporate governance disputes will be the next challenge. One could argue that certain actions expressly permitted by the DGCL should be excluded − *e.g.*, 211, 220, 225 and 262 actions − because the DGCL authorizes them without condition, but the rationale for exempting even these actions from a validly adopted charter or bylaw provision is not clear (other than a court making a public policy judgment call).

FEE-SHIFTING PROVISIONS

In *ATP Tour, Inc. et al. v. Deutscher Tennis Bund et al.*, --- A.3d ---, 2014 WL 1847446 (Del. May 8, 2014), the Delaware Supreme Court, sitting *en banc*, held that a Delaware corporate bylaw that requires a losing claimant to pay the legal fees and expenses of the defendants is not invalid per se, and if otherwise enforceable can be enforced against losing claimants whether or not they were already stockholders when the relevant bylaw provision was adopted. The court's ruling was in response to four certified questions from the United States District Court in Delaware.

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

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

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

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

Takeaways

1. Because this is the first case touching on this issue, the reaction of ISS, proxy advisory firms and others to the extension of the *ATP* rationale to general corporations is yet to be fully known. The court was careful to point out that such a bylaw may be facially valid but could be rendered unenforceable if used for an inequitable purpose.

2. If *ATP* could be extended to general corporations, the logistics are easy. If a company has an exclusive forum provision, it could make the fee-shifting provision apply to any and all claims covered by the exclusive forum provision, which would cover class actions, derivative claims and claims involving the internal affairs doctrine. Also, the adoption of a fee-shifting bylaw well before the possibility of any litigation would improve its chances of enforcement.

3. It is notable that despite the court's analysis of the fee-shifting mechanics in light of the "American Rule" versus "loser pays," the bylaw provision in question only shifted the expense to a losing claimant, and is arguably asymmetric in its effect. However, for class actions and derivative actions, a court has to approve of any fee to plaintiff's counsel, so a provision that says corporate-loser pays plaintiff-winner may not be enforceable.

LEGISLATION

All of the above considerations may become irrelevant. After wrangling behind closed doors, on May 29, 2014, the Corporation Law Section of the Delaware State Bar Association voted to recommend to the Delaware Legislature a statutory amendment that would quash the adoption of *ATP*-type bylaw provisions for general corporations – essentially making a legislative end-run around the Supreme Court's decision. Proposed changes to the DGCL are often given great deference: the Delaware State Bar Association recommends a change and the Delaware Legislature gives great weight to the advice of Delaware legal experts, which has worked quite well and has created the most widely-respected corporate legal framework in the world. Statutory changes generally occur on an annual cycle where new changes take effect on August 1. However, in an unusual turn of events, the proposed legislation was opposed by several corporations and has now been tabled for later discussion in 2015. In the interim, rather than rushing to have their boards adopt fee-shifting bylaws provisions, corporations will do well to step back and coolly observe the Delaware process at work. That said, some corporations have adopted fee-shifting bylaws and the issue is surely going to be well-litigated in the near future.

TWO-TIERED POISON PILL TARGETED AT HEDGE FUND ACTIVISTS SURVIVES CHALLENGE

In *Third Point LLC v. Ruprechet*, 2014 WL 1922029 (Del. Ch. May 2, 2014), the Court of Chancery found that a two-tiered poison pill adopted by Sotheby's, which limited activist investors to 10 percent stakes but permitted passive investors to acquire up to 20 percent, was a reasonable and therefore legally permissible response to rapid acquisitions of its stock by activist hedge funds.

Third Point and several other hedge funds filed Schedule 13Ds with the SEC disclosing the amount of their holdings and their intent to effectuate corporate change at Sotheby's. In response, Sotheby's board adopted a poison pill with a two-tiered structure: Schedule 13G filers (those without any intent to influence the company) were permitted to acquire up to a 20 percent stake in Sotheby's, but Schedule 13D filers (those with an intent to effectuate change at the company) were limited to a 10 percent stake. Third Point alleged that Sotheby's board breached its fiduciary duties by adopting the pill in the first instance and by later rejecting Third Point's request for a waiver.

The court reviewed the board's action under the *Unocal* standard – derived from the Delaware Supreme court's seminal decision in *Unocal v. Mesa Petroleum Co*., 493 A.2d 946 (Del. 1985) – which requires a court to scrutinize defensive measures to determine whether a board had reasonable grounds for perceiving a threat to the company and whether its response to that threat was "reasonable" in relation to the type of threat perceived. The court found that there was a sufficient factual basis in the record for Sotheby's board to reasonably perceive a threat to the company. The company was facing the possibility of "creeping control" by several hedge funds which were acquiring its stock simultaneously and the court accepted the contention that it was not uncommon for hedge funds to form a "wolfpack" and coordinate their acquisition of stock or takeover efforts.

The court also found that the pill's two-tiered structure fell within the range of reasonableness. The court acknowledged that the two-tiered structure was "discriminatory," but went on to observe that "it also arguably is a 'closer fit' to addressing the Company's needs to prevent an activist or activists from gaining

control than a 'garden variety' [single-tier] rights plan," which has broad application.

Takeaway

The *Third Point* decision reaffirms the Delaware court's recognition of the board's dominant role in protecting the short-and long-term corporate strategy and its broad authority when responding to perceived "threats" to the corporation, including the ability to implement a carefully-crafted pill to deal with threats from activist investors.

CONTROLLING-STOCKHOLDER TRANSACTIONS: EVOLVING STANDARDS OF REVIEW

Delaware's treatment of controlling-stockholder transactions is in the midst of an important evolutionary stage. One aspect involves required protective measures and the other involves application of the same standard to both negotiated mergers and tender offers.

WHY THE STANDARD OF REVIEW IS SO IMPORTANT

The standard of review applicable to a transaction has enormous implications for any litigation − which inevitably follows from the announcement of a large public-company deal. Regardless of the merits of such suits, the standard of review affects the timing within which unmeritorious actions can be dismissed, and this affects litigation costs, people costs due to time devoted to discovery, etc., and it creates business uncertainty as well as uncertainty about personal liability for the directors involved.

In carrying out the business of the corporation, management is protected by the Business Judgment Rule, which is the standard by which courts review most, but not all, board decisions. The Business Judgment Rule reflects the legal premise that decisions made by directors who are fully informed and free from conflicts of interest should not, and will not, be second-guessed by a court, even if the business decision under review turns out to have been "poor." To receive a favorable presumption of the Business Judgment Rule, a director must be disinterested and independent (*i.e.*, satisfy the fiduciary duty of loyalty), review and consider all pertinent information reasonably available (*i.e.*, satisfy the fiduciary duty of care), and not act in a manner or with a motive prohibited by statute or otherwise improper, and at all times act in good faith when discharging his or her fiduciary duties. This is a process inquiry. If the directors are not conflicted and are fully informed, the action will be dismissed and the substance of the transaction will not be reviewed.

If the Business Judgment Rule cannot be asserted, the transaction is not void but voidable; however, the heightened "entire fairness" standard will be applied and, under such circumstances, the burden is on the directors to prove that the decision or transaction at issue is "entirely fair" to both the company and its stockholders. Even if the transaction is approved by an independent special committee or a vote of a majority of the minority stockholders, such procedural safeguards only shift the burden back to a stockholder-plaintiff to prove that the transaction was unfair, which means the substance of the transaction will be evaluated by a court. This is very different from transactions that are eligible for Business Judgment Rule protection where the court merely evaluates whether a board was fully informed (duty of

care) and whether a majority of the board was disinterested and independent (duty of loyalty). Satisfying the entire fairness standard is extremely difficult because the board must demonstrate both fair process and fair price. Failure to establish the entire fairness of the decision or transaction can render it void and lead to personal liability for directors. Endeavoring to satisfy the entire fairness standard means extensive discovery, a trial on the merits, a time-table that can now be more than a year instead of a few months, and a legal budget in the millions of dollars instead of a few hundred thousand.

NEGOTIATED MERGERS

On March 14, 2014, the Delaware Supreme Court issued an *en banc* opinion in *Kahn v. M&F Worldwide Corp.*, 88 A.3d 635 (Del. 2014), affirming then-Chancellor (now Chief Justice) Leo E. Strine, Jr.'s ruling in *In re MFW S'holders Litig.*, 67 A.3d 496 (Del. Ch. 2013) that a controlling stockholder may secure business judgment review of its purchase of the corporation through a going private merger by conditioning consummation *ab initio* upon the approval of (i) a special committee of independent directors and (ii) a majority of the minority stockholders.

Nearly two decades ago, in *Kahn v. Lynch Commc'n Sys.*, 638 A.2d 1110 (Del. 1994), the Delaware Supreme Court held that entire fairness review applies to controlling-stockholder transactions, and that approval by a special committee or a majority of the minority stockholders would mean that the plaintiff, not the defendant, would bear the burden of persuasion on entire fairness at trial. Until the *MFW* opinion, no case presented the opportunity for the Delaware Supreme Court to rule on the effect of using both procedural protections together.
MacAndrews & Forbes owned 43 percent of M&F Worldwide (MFW). MacAndrews & Forbes announced its interest in buying the rest of MFW's equity in a going private merger at US$24 per share. MacAndrews & Forbes simultaneously announced it would not proceed with the merger absent the approval of a special committee of independent directors and the approval of a majority of the minority stockholders. MFW's board of directors established a Special Committee to consider the proposed transaction, which met eight times over three months, negotiated a US$1 increase in merger consideration, and approved the deal. A substantial majority of MFW's minority stockholders (65 percent) voted in favor of the merger. Plaintiff stockholders commenced an action in the Court of Chancery, first seeking injunctive relief based on alleged disclosure issues, but they later abandoned those claims in favor of a post-closing damages action alleging the board of directors breached its fiduciary duties. The defendant directors moved for summary judgment on the breach of fiduciary duty claim, which the Court of Chancery granted. The plaintiffs appealed.

In its opinion, the Delaware Supreme Court summarized the *new* standard applicable to buyouts by controlling stockholders as follows:

> The business judgment standard of review will be applied *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 vote of the minority is informed; and (vi) there is no coercion of the minority.

The Supreme Court reasoned that this new standard is appropriate because: (i) the undermining influence of a controlling stockholder does not exist in every controlled merger setting; (ii) the "dual procedural protection merger structure optimally protects the minority stockholders in controlling buyouts," (iii) it is consistent with the central purpose of Delaware law to defer decisions to independent, fully-informed directors; and (iv) the dual protection merger structures ensures a fair price.
While the Court of Chancery's opinion suggested a new standard could lead to dismissal of complaints at the pleading stage, the Delaware Supreme Court indicated that obtaining early dismissal could be much more difficult. In footnote 14 of its opinion, the court explained that the plaintiff's complaint would have likely survived a motion to dismiss under this new framework, reasoning that plaintiff's "allegations about the sufficiency of the price call into question the adequacy of the Special Committee's negotiations, thereby necessitating discovery on all of the new prerequisites to the application of the business judgment rule." As nearly all plaintiffs' lawsuits involving similar transactions challenge the adequacy of the price, it appears that early dismissal will be extremely difficult until greater clarity on this area of the law is developed.

The Supreme Court emphasized that defendants must establish that the challenged transaction qualifies for business judgment protection prior to trial in order to avoid entire fairness review: "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 did note, however, that "[b]are allegations that directors are friendly with, travel in the same social circles as, or have past business relationships with the proponent of a transaction or the person they are investigating are not enough to rebut the presumption of independence."

Takeaway

The level or standard of review applied to special committees will impact the future of *MFW*. Nothing in the *MFW* opinion alters what the Delaware Supreme Court held in *Americas Mining Corp. v. Theriault*, 51 A.3d 1213 (Del. 2012), when it affirmed the Court of Chancery's 105-page post-trial opinion in *In re Southern Peru Copper Corporation Shareholder Derivative Litigation*, 52 A.3d 761 (Del. Ch. 2011). There, the Court of Chancery concluded that there is "no way" to determine whether a special committee is "well-functioning" without "taking into consideration the substantive decisions of the special committee, a fact intensive exercise that overlaps with the examination of fairness itself." A 1997 Delaware Supreme Court case, *Kahn v. Tremont Corp.,* 694 A.2d 422 (Del. 1997), required the Chancellor to determine whether the committee was well-functioning by, as he put it, taking "a look back at the substance, and efficacy, of the special committee's negotiations, rather than just a look at the composition and mandate of the special committee." The court acknowledged that there are "several problems with this approach," the most obvious being that it reduces the incentive to use a special committee if all of its decisions can be second-guessed and weakens its utility as a "reliable pre-trial guide to the burden of persuasion." On appeal, the Delaware Supreme Court, although given the opportunity to hold otherwise, reaffirmed the status of the law on review of special committee decisions. In fact, it quoted the *Tremont* passage with approval in its affirmance.

TENDER OFFERS

Several years ago, in *In re CNX Gas Corporation Shareholders Litigation*, 4 A.2d 397 (Del. Ch. 2010), the Court of Chancery developed a "unified standard" for reviewing controlling stockholder going-private transactions. The unified standard provides business judgment rule review, but only if the transaction is: (1) negotiated and recommended by a special committee; and (2) approved by a majority of the minority stockholders. Historically, Delaware courts have applied different standards of review for negotiated mergers and transactions accomplished via a unilateral tender offer. Negotiated mergers have been reviewed under the "entire fairness" doctrine and unilateral tender offers (assuming no disclosure issues) have left the cashed-out stockholders with appraisal rights and no fiduciary review. If the Delaware Supreme Court were to affirm the unified standard enunciated in *CNX*, it would eliminate the dichotomy between controlling-stockholder tender offers and negotiated cashout deals.

The *CNX* case arose from the acquisition of CNX Gas Corporation (CNX) by CONSOL Energy, Inc. (CONSOL). Prior to the acquisition, CONSOL owned 83.5 percent of CNX's common stock and its representatives controlled the CNX board. CONSOL commenced a tender offer for all publicly held shares of CNX. The tender offer was subject to a non-waivable condition that a majority of CNX's outstanding minority shares be tendered, excluding shares owned by the officers and directors of CONSOL or CNX.

The Court of Chancery applied its two-prong unified standard − *i.e.*, negotiation and approval by a special committee and approval by a majority of the minority − and held that neither requirement had been met. Because the special committee created to evaluate the offer did not affirmatively recommend the deal, the court found the first prong of the standard was not met. The court also noted that the special committee was not initially empowered to negotiate with the controlling stockholder and did not have full board authority such as the ability to adopt a poison pill or pursue alternatives. With regard to the second prong, the court found that the majority of the minority condition was ineffective because certain interested shares were counted as part of the minority for purposes of satisfying the condition.

The defendants petitioned the court to certify an interlocutory appeal of its refusal to dismiss the action. The court granted the request and provided additional analysis in its opinion certifying the question for review. *See In re CNX Gas Corporation Shareholders Litigation*, 2010 WL 2705147 (Del. Ch. July 5, 2010). The Delaware Supreme Court exercised its discretion and, unfortunately, refused to accept the appeal, stating that it would prefer to wait until the factual record is developed. *See In re CNX Gas Corporation Shareholders Litigation*, 30 A.3d 782 (Del. 2010).

Takeaway

Sophisticated parties understand the standard of review dynamics in structuring transactions involving controlling stockholders. So the question here is: should the dichotomy between controlling-stockholder tender offers and negotiated cashout deals be eliminated? There are strong views on both sides.

Those that oppose unification emphasize that for negotiated mergers, the DGCL requires a board to first approve a merger agreement and adopt a resolution recommending its advisability to the stockholders. The stockholders cannot unilaterally propose and vote on a merger because the board, by express statutory mandate, is a gatekeeper. There is no such requirement for tender offers. "Entire fairness" applies to negotiated controlling-stockholder transactions because the controlling stockholder has the ability to exercise control over some or all of the directors and therefore dictate the terms, often to the detriment of the minority who can be cashed out against their will due to the voting power of the controlling stockholder. However, if the controlling stockholder is merely going to the market with a tender offer, the minority gets to decide whether or not to tender − if the price is right they will and vice versa. Requiring a controlling stockholder to have the company appoint a special committee to play a role can cause delay, cause litigation over the makeup of the committee, etc., and it defeats the right to go directly to the stockholders and bypass the board altogether.

The argument for unification is grounded on the basis for imposing entire fairness review to controlling-stockholder transactions in the first place. Whether a transaction is friendly or hostile, Delaware has always recognized that the board has a role and can do many things to protect the interests of the company and its stockholders (from a mere recommendation to not tender to the adoption of a pill). A controlling stockholder has the ability to exploit information and relationships, and exert influence over what a board does or does not do, to the detriment of the minority. Imposition of a unified standard would eliminate any doubt about the fairness of the process and price, and would therefore promote the maximization of stockholder value. Without it, the same rationale for differential treatment of tender offers could be used to extend business judgment protection to deals conditioned only on a vote of a majority of the minority − and that is clearly not Delaware law.

FINANCIAL ADVISOR GETS TAGGED FOR AIDING AND ABETTING A FIDUCIARY BREACH

As highlighted in our 2012-2013 and 2013-2014 Updates, plaintiffs' attorneys are now focusing on the roles of bankers in an effort to enjoin otherwise independent third-party transactions.

THE HISTORY

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

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

In 2012, the Court of Chancery, in *In re El Paso Corporation Shareholder Litigation*, 41 A.3d 432 (Del. Ch. 2012), denied a motion to enjoin a merger between El Paso Corporation and Kinder Morgan, Inc. However, the court severely criticized the actions of El Paso's management and its financial advisor. El Paso's financial advisor owned approximately 19 percent of Kinder Morgan (valued at US$4 billion) and controlled two board seats. The conflicts were fully disclosed and a second financial advisor was brought in to handle the sale. Nonetheless, first advisor continued as the lead advisor on a spinoff option and helped El Paso craft the second advisor's engagement letter in a way that provided for a fee only if the company was sold as a whole.

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

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

Also in 2013, the Court of Chancery, in *Miramar Firefighters Pension Fund v. AboveNet, Inc.*, 2013 WL 3995257 (Del. Ch. July 31, 2013), granted defendants' motion to dismiss where the plaintiff failed to allege facts supporting an inference that the board knew of alleged deficiencies in the financial advisor's analysis and where the board refused to allow the financial advisor to provide staple financing to a potential acquiror and, in *SEPTA v. Volgenau*, 2013 WL 4009193 (Del. Ch. Aug. 5, 2013), *aff'd*, 2014 WL 1912537 (Del. May 13, 2014), dismissed a claim of advisor conflict based upon the allegation that a US$8.4 million fee paid only upon the completion of the deal. All things considered, bankers appeared to be turning things around in 2013, but then came 2014.

THE *RURAL METRO* LIABILITY DECISION

On March 7, 2014, the Court of Chancery issued its decision in *In re Rural Metro Corporation Stockholders Litigation*, 2014 WL 971718 (Del. Ch. Mar. 7, 2014), holding RBC Capital Markets, LLC liable for aiding and abetting breaches of fiduciary duty by the board of directors of Rural/Metro Corporation in connection with Warburg Pincus LLC's acquisition of Rural. The case proceeded to trial against RBC even though Rural's directors, as well as a financial advisor serving in a secondary role, settled before trial. The court's 91-page opinion makes clear that when financial advisors step outside their roles as gatekeepers, and take active steps to manipulate a company's sale for their own self-interests, they risk incurring liability for aiding and abetting a breach of fiduciary duty.

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

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

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

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

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

Only Warburg offered a formal bid for Rural, at US$17.00 per share on March 22, 2011. After some negotiation, Warburg offered US$17.25 on March 25, saying that it was Warburg's "best and final offer," and that it expired on March 28. RBC spent March 26 attempting to get a piece of the financing for Warburg's bid. RBC then submitted valuation materials to its internal fairness committee, but later tweaked the valuations in ways that made the offer more appealing. On March 27, 2011, the board accepted Warburg's US$17.25 offer. At 9:42 pm, the board received Warburg's valuation information − the first valuation information the board ever received during this process. At 11:00 pm, the meeting began, and the board approved the merger after midnight.

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

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

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

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

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

Takeaways on Liability

1. Whether "reasonableness" is the appropriate standard for determining that an underlying breach of fiduciary duty occurred is a significant issue. Traditionally, the standard for determining liability for a breach of the fiduciary duty of care has been "gross negligence," not mere negligence or unreasonable conduct. Until that issue is resolved, this opinion serves as the latest example of the Court of Chancery's willingness to impose liability when an advisor manipulates a sales process for its own self-interest. Regardless, the opinion suggests ways for advisors to avoid incurring this kind of liability.

2. An advisor who serves in the traditional role of a gatekeeper faces little risk of liability. The court discussed at great length academic literature concerning "gatekeepers." The court defined a "gatekeeper" as "a reputational intermediary … [that] receives only a limited payoff from any involvement in misconduct …." If a firm takes a fee for advice and its total financial interest in the transaction stems only from that fee, it should in most circumstances be on safe ground.

3. Boards should actively inform themselves of potential conflicts of their advisors prior to structuring a sales process and monitor any conflicts that may exist throughout the entire process.

4. Advisors must disclose and monitor potential conflicts of interest, and receive clear direction from the board. The Court of Chancery has taken a zero-tolerance approach to undisclosed conflicts of interest.

THE *RURAL METRO* DAMAGES OPINION

On October 10, 2014, the court issued its opinion on damages in *In re Rural/Metro Stockholders Litigation*, 2014 WL 5280894 (Del. Ch. Oct. 10, 2014). The court: (i) determined that Rural's stockholders suffered US$91.3 million in damages from both director and financial advisor misconduct; (ii) allocated 83 percent of the

damages (US$75.8 million) to RBC; and (iii) held that RBC's liability could not be reduced to account for damages attributable to directors who settled prior to trial but who would have otherwise qualified for protection under Rural's exculpatory provision. The opinion provides an extensive analysis of allocation of liability between directors and officers and those who may aid and abet a breach of fiduciary duty (like financial or other advisors) under Delaware's Uniform Contribution Among Tortfeasors Law (DUCATL), 10 *Del. C.* § 6301, *et seq.* The opinion, which will surely be appealed, appears to interpret Section 102(b)(7) as shifting − rather than reducing or eliminating − liability for defendants not covered by the provision.

The court determined that the plaintiffs were entitled to the difference between the value of their stock at the time of the merger and the transaction price. Using a discounted cash flow analysis, the court held that the Company was worth US$21.42 per share at the time of the transaction, resulting in a damages award of US$4.17 per share (US$21.42 less the US$17.25 transaction price) or US$91.3 million. Before determining the amount of RBC's liability, the court noted that the DUCATL contemplates non-settling defendants receiving "settlement credit" for the "pro rata share" of any damages attributable to the conduct "joint tortfeasors."

RBC argued that because there were seven, equally responsible "tortfeasors" who settled, RBC should only be responsible for 12.5 percent or 1/8th of the US$91.3 million in total damages. The court held that the equitable doctrine of "unclean hands" barred RBC from receiving credit for certain types of conduct, such as its "fraud upon the board" when it provided false information to the directors in its fairness presentation and its failure to disclose conflicts for inclusion in the definitive proxy statement relied upon by the stockholders. The court also held that the directors who qualified for exculpation under the Company's 102(b)(7) provision were not "joint tortfeasors" and excluded them from the available settlement credit.

After determining who was and who was not a "joint tortfeasor" under the DUCATL, the court held that the two types of wrongful conduct (i.e., disclosure violations and sale process violations) each represented 50 percent of the total damages. The court further divided the sale process violations into two parts (i.e., (i) the decision to initiate the sale process without board approval and (ii) the decision to approve the Merger) and held that each represented 25 percent of the total damages. Because RDC's misrepresentations to the board caused the definitive proxy statement to be materially misleading, the court held RBC solely responsible for the 50 percent of the total damages attributable to the disclosure violations. With regard to the 25 percent in total damages attributable the initiation of the sale process, the court allocated 8 percent to RBC. Finally, because RBC had misled the board, the court held it solely responsible for 25 percent of the total damages attributable to the decision to approve the merger. The court further noted that RBC's "unclean hands" barred settlement credit on that portion of the damage. The court then assessed total liability against RBC in the amount of US$75.8 million.

Takeaways on Damages

1. If the court's determination that Section 102(b)(7) shifts liability instead of reducing or eliminating the liability covered by exculpatory provisions, it will have a significant impact. Non-exculpated defendants run the risk of joint and several liability for the entire amount of a judgment without any reduction for the damages caused by the conduct of exculpated defendants. It is not clear that this consequence is consistent with the public policy of the DUCATL, which modified the common law on joint and several liability by allocating liability based on proportionate fault. As a practical matter, for defendants not eligible for exculpation (e.g., officers, controlling stockholders and financial or even legal advisors), they may want to reconsider pursuing a joint defense where no defendant points a finger at another. Moreover, if they hope to obtain credit for damages attributable to settling defendants, non-settling defendants may want to compel any settling defendants to appear at trial so their conduct can be fully vetted.

2. What about fairness? If the adoption of a 102(b)(7) provision (or investment in a company that has one) is viewed as a waiver by stockholders of damages caused by directors intended to be covered by such provisions, why should these same stockholders be able to recover damages attributable to the conduct of those they agreed to exculpate? Further, how is it that exculpated defendants can be excluded from the definition of "joint tortfeasors"? Exculpation provisions merely eliminate the ability to obtain money damages for a breach − they do not eliminated the liability and they are certainly not an indication that those who invoke them did not engage in wrongdoing.

3. The court's opinion will also cause many to re-evaluate financial advisor engagement letters and indemnification agreements/provisions. Although the enforceability of indemnification provisions in financial advisor agreements will be an issue, strong provisions may create early settlement opportunity for non-exculpated defendants. Engagement letters may attempt to preserve the right of a financial advisor to later litigate the question of a director's loyalty or bad faith in the face of that director settling with court approval.

THE IMPACT OF A "FAIR PRICE" ON THE "ENTIRE FAIRNESS" TEST

As reported in last year's Update, while management and the preferred stockholders of Trados, Inc. received all of the merger consideration in an end-stage transaction and the common stockholders received nothing, the Court of Chancery found that the transaction was still "entirely fair" to the common stockholders because the common stock had no monetary value before the merger. The court's 114-page opinion in *In re Trados Inc. S'holders Litig.*, 2013 WL 4511262 (Del. Ch. Aug. 16, 2013) (Vice Chancellor J. Travis Laster) dealt extensively with a variety of issues that directors and investors should consider.

The court found that the Trados directors failed to demonstrate that they had followed a fair process. Although Trados's new CEO suggested that he might be able to develop a new line of business rather than sell the company, the board never considered any alternative to the sale. The court went so far as to say: "[T]here was no contemporaneous evidence suggesting that the directors set out to deal with the common stockholders in a procedurally fair manner." The court held: "In this case, the VC directors pursued the Merger because Trados did not offer sufficient risk-adjusted upside to warrant either the continuing investment of their time and energy or their funds' ongoing exposure to the possibility of capital loss."

The court pointed to a number of particular procedural failings. The court intimated that the board should have at least considered the sale from the standpoint of the common stockholders. Instead, "[t]he VC directors did not make this decision [to sell Trados] after evaluating Trados from the perspective of the common stockholders, but rather as holders of preferred stock with contractual cash flow rights that diverged materially from those of the common stock and who sought to generate returns consistent with their VC funds' business model." The court also held that the defendants missed chances to improve the record on the process by failing to either secure a fairness opinion or condition the transaction on the approval of a majority of the common stockholders.

With respect to the fair price analysis, the court found that the defendants had satisfied their burden of establishing that the price was entirely fair to the common stockholders. In making this determination, the court emphasized that the preferred shares held an 8 percent accumulating dividend, meaning that the

preferred shares' liquidation preferences grew by 8 percent per year. The court found that Trados "did not have a realistic chance of generating a sufficient return to escape the gravitational pull of the large liquidation preference and cumulative dividend."

Because the common stock had no value, the court found that the directors did not breach their fiduciary duty: "In light of this reality, the directors breached no duty to the common stock by agreeing to a Merger in which the common stock received nothing."

Takeaway

Because the *In re Trados* case is in the process of being settled, the issue of whether the court's fair price finding should have resulted in a determination that the Trados directors did not breach their fiduciary duties will not be reviewed by the Delaware Supreme Court, but it is certainly a subject for debate. In any sale transaction, stockholders of a Delaware corporation are entitled to a fair price *and*, at all times, they are entitled to have their fiduciaries perform like fiduciaries. The court made multiple findings that the Trados directors utterly failed to consider the interests of the common stockholders and failed to consider the future prospects for Trados. Under Delaware's "entire fairness" test, the "fair dealing" and "fair price" prongs are co-equal and the Delaware Supreme Court has made that clear:

> We examine the transaction as a whole and both aspects of the test must be satisfied; a party does not meet the entire fairness standard simply by showing that the price fell within a reasonable range that would be considered fair.

William Penn Partnership v. Saliba, 13 A.3d 749, 756-757 (Del. 2011). In the *William Penn* case, the Delaware Supreme Court affirmed a breach of fiduciary duty finding based on a process failure even though the transaction price was higher than the price determined by an independent, court-appointed valuation expert and accepted by the court as fair.

Can a transaction be "entirely" fair if only one prong of the fairness test is satisfied? Certainly, the inverse could not be true – *i.e.*, one could not satisfy the entire fairness test by passing the fair process prong and failing the fair price prong. Delaware Supreme Court jurisprudence in this area suggests that, if the price in hindsight turns out to be fair, a failure of the fair process prong means there is a breach of fiduciary duty with no *actual* damage, not that there is no breach of duty, leaving the court to consider alternative remedies. That is the conclusion reached in two recent decisions. *See Ross Holding and Management Co. v. Advance Realty Group, LLC*, 2014 WL 437426, at *33 (Del. Ch. Sept. 4, 2014); *In re Nine Systems Corp. S'holders Litig.,* 2014 WL 4383127, at *1 (Del. Ch. Sept. 4, 2014) ("a price that, based on the only reliable valuation methodologies, was more than fair does not ameliorate a process that was beyond unfair").

Further, the court in *In re Trados* never ruled on whether the Trados Directors acted in bad faith, presumably because the no monetary damages finding would have made it a fruitless exercise. However, the court's findings that the Trados Directors consciously failed to consider the interests of the common stockholders and failed to consider the future prospects for Trados appear to fit squarely within the standard for bad faith and breach of the duty of loyalty enunciated by the Delaware Supreme Court in *Lyondell Chem. Co. v. Ryan*, 970 A.2d 235, 243-244 (Del. 2009) (holding that directors breach their fiduciary duty if they "knowingly and completely failed to undertake their responsibilities" and "utterly failed to attempt to obtain the best sale price").

MANAGING THE SALES PROCESS: FURTHER CLARIFICATION OF WHAT *REVLON* REQUIRES

In *C&J Energy Services, Inc. v. City of Miami General Employees' and Sanitation Employees' Retirement Trust*, 2014 WL 7243153 (Del. Ch. Dec. 19, 2014), following review of what Delaware's new Chief Justice Leo E. Strine, Jr. labeled an "unusual preliminary injunction," the Delaware Supreme Court reversed an order of the Court of Chancery enjoining a business combination between C&J Energy Services and a division of Nabors Industries Ltd. In a November 24, 2014 bench ruling, the Court of Chancery (i) enjoined the C&J Energy stockholder vote to approve the merger for 30 days, (ii) mandated that C&J Energy shop itself during the 30-day period in contravention of the Merger Agreement between the parties, and (iii) declared, at the outset, that the solicitation of proposals pursuant to the imposed go-shop period would not constitute a breach of the no-shop clause and similar deal protection mechanisms in the Merger Agreement.

The Delaware Supreme Court used the case as an opportunity to further clarify the *Revlon* standard of review, which derives from *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986), a seminal decision in 1986 by the Delaware Supreme Court. There, the Revlon board put the company up for sale, and what followed was an effective bidding competition. The *Revlon* court held that a selling board is charged with maximizing the company's value for the benefit of the stockholders when the company is put up for sale. However, there is "no single blueprint" that must be adhered to in order to satisfy *Revlon*. The doctrine does not necessitate, among other things, that a selling board maintain the right to terminate an agreement in favor of a superior offer that later arises, engage in an active market check, or even accept the deal with the highest monetary value. Rather, once a company is for sale and *Revlon* is triggered, the court reviewing the sales process will apply a heightened standard of review, reflecting narrowed judicial deference to the business decisions of the board. *Revlon*, accordingly, requires only that the selling board act within a range-of-reasonableness under the circumstances, effectively obligating the target board to perform its fiduciary duties of care and loyalty with the objective of attaining the best sale price for the company realistically attainable through a wholesome sales process.

The *Revlon* standard of review has been continuously expanded upon. In 2009, the Delaware Supreme Court decided *Lyondell Chemical Co. v. Ryan*, 970 A.2d 235 (Del. 2009), which reinforced the principle that *Revlon* does not create new fiduciary duties for directors, but merely requires the board to perform its fiduciary responsibilities with the objective of maximizing the sale price of the enterprise. *Revlon*'s progeny has shown that a target company and its board of directors may be subjected to narrower judicial deference in at least five scenarios:

- *First*, as seen in *Paramount Communications, Inc. v. QVC Network, Inc*., 637 A.2d 34 (Del. 1994), the doctrine applies where a company commences an "active bidding process" with the goal of selling itself or reorganizing the business with a "clear break-up of the company."

- *Second*, when a target company "abandons its long-term strategy and seeks an alternative transaction involving the break-up of the company" as a response to a bidder's advance.

- *Third*, where control of the company is transferred from unrelated stockholders to a controlling stockholder.

- *Fourth*, as in *Revlon* itself, a complete cashout of the target company's stockholders, given that the stockholders will no longer maintain an interest in the target company, suggesting that their primary interest is maximized value.

- *Fifth*, when a board considers even a single offer, calling for the directorship to be adequately informed as to the deal price and the value of the company, while simultaneously engaging in an "effective" market check. However, only the board can put the company in play. As the Delaware Supreme Court articulated in *Lyondell*, the selling company and its board, in order to trigger *Revlon*, must "embark[] on a transaction—on its own initiative or in response to an unsolicited offer—that will result in a change of control."

The C&J Energy-Nabors Transaction: As part of a transaction structured as a tax inversion, C&J Energy Services, Inc., a Delaware corporation, would acquire a subsidiary of Nabors Industries, Ltd., a Bermuda

domiciliary, with Nabors retaining a majority of the equity in the surviving company. For favorable tax purposes, the surviving company would be based in Bermuda and be managed by C&J Energy leadership. In view of the fact that Nabors, the nominal target, held a majority of the equity in the surviving entity, the nominal acquiror, C&J Energy, negotiated for (a) supermajority voting requirements, (b) the right designate four initial board members and to hold two of the three positions on the board member nomination committee thereafter, (c) a fiduciary out in the event that a superior proposal emerged during a passive market check, (d) a standstill obligation imposed on Nabors, (e) a by-law ensuring that all stockholders would share *pro rata* in any future sale of the surviving company, and (f) a "modest" US$65 million termination fee, constituting 2.27 percent of the deal value.

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

The Delaware Supreme Court Reversal: The Court of Chancery decision was reversed on multiple grounds, but with respect to *Revlon*, Chief Justice Strine, writing for the court, noted that there is "no specific route that a board must follow when fulfilling its fiduciary duties" upon entering *Revlon*-land. To the extent that the Court of Chancery mandated that the C&J Energy board "actively" shop the company in order to satisfy *Revlon*, the Delaware Supreme Court said it did so incorrectly. *C&J Energy* thus reiterates that a board may "pursue the transaction that it reasonably views as most valuable to stockholders, so long as the transaction is subject to an effective market check under circumstances in which any bidder interested in paying more has a reasonable opportunity to do so." Importantly, though, such market check merely needs to be "effective," as opposed to "active." In essence, an effective market check is one whereby "interested bidders have a fair opportunity to present a higher-value alternative, and the board has the flexibility to eschew the original transaction and accept the higher-value deal." Of course, the latitude and freedom of stockholders to accept or reject their board's preferences must also be considered in determining the effectiveness and propriety of a market check.

Takeaways

1. The *C&J Energy* case is a clarification, if not a reiteration, of what *Revlon* requires of boards when selling companies, namely: (a) *Revlon* created no fiduciary duties in excess of the duties of loyalty and care, but simply requires that such fiduciary obligations be performed with the objective of maximizing the sale price of the enterprise when the company is put up for sale; (b) there is no judicially prescribed set of actions required to satisfy the heightened standard of review; and (c) *Revlon* is triggered only in a narrow set of circumstances and not merely because the target company is involved in a change of control transaction. Consequently, passive, yet effective, post-signing market checks are sufficient to satisfy *Revlon*, provided that stockholders are free to participate in an uncoerced vote on the transaction, the board is adequately informed as to both the deal and its company's value, and third-party bidders are posed only with reasonable obstacles in making a superior offer for the target company.

2. While *Revlon*, and cases like *QVC* and *Lyondell*, shed light on some of the ways a selling board may trigger the heightened standard of review, directors at target companies must take care to conscientiously consider whether the sales process of their company requires that they exercise their fiduciary duties with the goal of maximizing the sale price of the enterprise, even if a conventional change of control transaction is not involved. Despite the holding in *C&J Energy*, the borders of *Revlon*-land remain movable and arguably unclear. Indeed, the Delaware Supreme Court did not engage in a *Revlon* review of the C&J Energy-Nabors transaction, but assumed "for the sake of analysis" that the doctrine was "invoked," leaving largely unanswered the question of whether a deal departs from *Revlon*-land when contractual provisions dilute majority stockholder authority and grant the minority a right to share *pro rata* in any future sale of the company.

3. *C&J Energy* also touches on the notion that the Court of Chancery is a court of equity with broad discretion. Notwithstanding such latitude, it is inappropriate for the court to "blue-pencil" a contract and alter the rights of the parties to the agreement. Here, the Delaware Supreme Court noted that the Court of

Chancery's mandate that C&J Energy engage in a 30-day go-shop period and determination that such shopping would not constitute a breach of the Merger Agreement was not an appropriate exercise of equitable authority.

SEVERAL DECISIONS IN 2014 PROVIDED IMPORTANT GUIDELEINES ON STRUCTURING TRANSACTIONS

For transactional lawyers, many cases from 2014 provide guidance on planning, structuring and negotiating deals. These cases may also assist in either avoiding litigation or at least ensuring that the company and management are best positioned if the transaction is challenged.

BUSINESS JUDGMENT RULE GOVERNS RESPONSE TO BREACH OF NON-DISCLOSURE AGREEMENT

The Court of Chancery, in *In re Comverge, Inc. Shareholders Litigation*, 2014 WL 6686570 (Del. Ch. Nov. 25, 2014), issued guidance on dealing with, among other things, a breach of a non-disclosure agreement. The transaction at issue was relatively small (US$48 million) and involved a struggling target company, Comverge, facing a descending share price and a lack of available capital. Comverge and the acquiror, H.I.G. Capital, L.L.C., entered into a non-disclosure agreement, which contained a two-year standstill provision, whereby HIG agreed that it would not "acquire, agree to acquire, propose, seek or offer to acquire, or facilitate the acquisition or ownership of, any securities or assets of Comverge, any warrant or option to purchase such securities or assets, any security convertible into any such securities, or any other right to acquire such securities." Notwithstanding the foregoing provision, however, the NDA permitted HIG, as a public investor, to acquire Comverge securities in the public markets.

The Merger Agreement also provided for a 30-day go-shop, with a ten-day extension if Comverge benefited from a potentially superior proposal. Subsequent to the close of the go-shop period, the termination fee increased from US$1.026 million to US$1.93 million plus US$1.5 million in expenses. Finally, Comverge and an affiliate of HIG entered into a forbearance agreement, whereby the affiliate agreed not to exercise its rights under US$15 million of convertible notes it acquired from a third-party lender, Partners for Growth III, L.P., for a limited time. Pursuant to the Partners for Growth notes, HIG had the ability to block transactions alternative to the proposed Comverge-HIG deal.

In addition to alleging that the Comverge directors breached their fiduciary duties by failing to maximize the value of company, the plaintiffs contended that HIG aided and abetted alleged fiduciary violations at Comverge by "knowingly participat[ing]" in the breaches through its acquisition of the Partners for Growth Note in violation of the NDA, and then subsequently utilizing the blocking rights incorporated in the convertible notes.

The court dismissed claims regarding the board's decision not to sue HIG for breach of the NDA, observing that the NDA was ambiguous as to whether HIG's acquisition of Comverge's debt constituted a violation and the board acted reasonably and within its business judgment in deciding to focus on negotiating a go-shop period rather than risk a lawsuit. While the court took no issue with the go-shop period and the granting of a top-up option in the transaction, it refused to dismiss claims that the two-tiered termination fee structure was preclusive. In reaching that decision, the court intimated that if the lower of the termination fees were used, the total payable to HIG

would be 5.55 percent of the equity value of the deal and 5.2 percent of the enterprise value. If, however, the higher of the termination fees were used, the percentages were 7 percent of the equity value and 6.6 percent of the enterprise value. The court concluded that, even if it were to apply the 5.55 percent metric, such a percentage "tests the limits of what this court has found to within a reasonable range for termination fees."

DISPARATE TREATMENT OF BIDDERS PERMITTED

In *In re Novell, Inc. Shareholder Litigation*, 2014 WL 6686785 (Del. Ch. Nov. 25, 2014), the Court of Chancery approached the issue of target board preferences for bidders in sell-side auctions. Post-closing, the plaintiffs alleged that the board of directors of Novell "acted in bad faith by treating bidders differently for reasons other than pursuit of the best interests of the corporation and its stockholders."

Specifically, in 2010, Novell undertook a sales process in which it favored the eventual acquiror, Attachmate Corporation, to the disadvantage of another bidder, Symphony Technology Group. Some of the complained of conduct included: (i) a failure to provide Symphony with a draft non-disclosure agreement, despite Symphony's requests and delivery to all of the other bidders in the sell-side auction; (ii) placing teaming prohibitions on Symphony, restricting it from partnering with other bidders in the auction process; (iii) despite Symphony's early expression of interest, providing incomplete information with respect to the bidding process; (iv) not cooperating with due diligence requests and the disclosure of certain information to Attachmate but not to Symphony; and (v) granting Attachmate an exclusivity period, with multiple renewals.

The court suggested that the actions taken in favor of Attachmate were "questionable," or even "troubling," and might have been a breach of the duty of care, but held that the company's Section 102(b)(7) exculpatory provision limited liability for care claims. Because the plaintiffs failed to plead conflicts of interest to support a breach of the duty of loyalty, the remainder of the analysis centered on plaintiffs' bad faith claims with the court looking at the directors' true motives in favoring one bidder over another. Here, the defendants presented unrebutted evidence that the Novell board was concerned with Symphony's willingness and ability to close, a fear that did not encumber the Attachmate proposal in the opinion of the target board. Plaintiffs, on the other hand, supplied no factual basis supporting a finding of material conflicts held by any member of the Novell board, let alone a majority of the members of the board, other than a connection between one Novell director and indirect investors in Attachmate, the preferred bidder. Importantly, the court reaffirmed that "Delaware law does not require a board to treat all bidders equally."

OVERCOMING MUTUAL MISTAKE AS TO PRICE

The Court of Chancery's decision in *In re TIBCO Software Inc. Stockholders Litig.*, 2014 WL 6674444 (Del. Ch. Nov. 25, 2014), approached the issue of whether a target stockholder vote regarding a US$4.2 billion buyout should proceed despite a mutual mistake as to price.

TIBCO was to be acquired by Vista Equity Partners LLC, but a special committee of the target board provided its financial advisor with an erroneous capitalization table, reflecting an incorrect number of shares of TIBCO. The error led to 4.3 million unvested restricted shares being double-counted as outstanding award shares and as outstanding common shares throughout the entirety of the auction process. Vista won the auction with a US$24 per share bid, and using the flawed share count, the consideration offered suggested an equity value of US$4.244 billion and an enterprise value of approximately US$4.3 billion. If the correct share count had been utilized, the US$24 per share bid would have brought an equity value of approximately US$4.144 billion and an enterprise value of approximately US$4.2 billion, a difference of roughly US$100 million. Following discovery of the error by an employee at the target's financial advisor, the company publicly disclosed the mistake, but did not seek to renegotiate the per share price. A TIBCO stockholder sought to enjoin the stockholder vote and to have the Merger Agreement reformed to evidence a per-share consideration of US$24.58 (i.e., the bid price yielding the greater equity and enterprise values).

To make a successful claim for reformation in Delaware, a plaintiff "must show by clear and convincing evidence that the parties came to a specific prior understanding that differed materially from the written agreement." The Court of Chancery refused to grant a preliminary injunction on the grounds that the TIBCO stockholder

failed to show a reasonable probability that he could prove, by clear and convincing evidence, that there was an agreement between Vista and TIBCO for US$4.244 billion in aggregate equity value. While the stockholder-plaintiff could establish that Vista and TIBCO thought the merger would be consummated at an aggregate equity value of US$4.244 billion, he could not establish that the parties "specifically agreed" that the merger would be consummated for that price, effectively defeating the reformation claim. The court determined, rather, that the Merger Agreement reflected a meeting of the minds at US$24 per share, not US$24.58 per share. The court also refused to enjoin the merger because the plaintiff failed to demonstrate the existence of irreparable harm. The stockholder's claims concerned a "quantifiable sum of money (approximately US$100 million) that may be remedied by an award for damages."

DAY-TO-DAY MANAGER NOT A CONTROLLER DESPITE COMPANY'S "COMPLETE" RELIANCE

The Court of Chancery in *In re KKR Financial Holdings LLC Shareholder Litigation*, __ A.3d __, 2014 WL 5151285 (Del. Ch. Oct. 14, 2014), dismissed a purported class action by stockholders of KKR Financial Holdings LLC (KFN) challenging its acquisition by KKR & Co. L.P. (KKR) in a stock-for-stock merger, rejecting plaintiffs' novel claim that KKR, which held less than one percent of the shares of KFN stock, was a controlling stockholder of KFN because an affiliate of KKR managed the day-to-day business operations of KFN pursuant to a management agreement.

Although KFN was "completely reliant" on KKR's affiliate for its everyday management, the court found that plaintiffs' allegations did not support a reasonable inference that KKR controlled KFN's twelve-member board of directors such that those directors could not freely exercise their judgment in determining whether to approve and recommend to the stockholders a merger with KKR. The court held that business judgment review applied to the merger because a majority of the KFN board was disinterested and independent. The court also held 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 ruled that the merger "was approved by a majority of the shares held by disinterested stockholders of KFN in a vote that was fully informed."

DIRECTORS HOLDING 21.5 PERCENT INTEREST NOT CONSIDERED CONTROLLERS

Sanchez Energy Corporation, a publicly traded Delaware corporation, was established by certain members of the Sanchez family, including A.R. Sanchez Jr., a 16 percent stockholder, and A.R. Sanchez III, a 5.5 percent stockholder, both of whom served on the board of the company. The case of *In re Sanchez Energy Derivative Litigation*, 2014 WL 6673895 (Del. Ch. Nov. 25, 2014), arose from a transaction between Sanchez Resources, LLC, an affiliate of Sanchez Energy, Altpoint Capital Partners LLC, and Sanchez Energy, in which Sanchez Energy paid approximately US$77 million in cash and stock for rights to develop land and extract oil, subject to royalty payments. Of the US$77 million, US$62 million was scheduled to flow to Altpoint in order to buy out its equity interest in Sanchez Resources, and US$15 million was to be received by Sanchez Resources itself. Sanchez Energy additionally committed to constructing six oil wells on undeveloped property, a benefit of nearly US$22 million extending to Sanchez Resources, with royalties to be paid to Sanchez Resources on future revenues extracted from the same properties.

Plaintiffs filed a derivative action alleging breach of fiduciary duty as a result of the corporation's purchasing assets from Sanchez Resources, which was controlled by two members of Sanchez Energy's board. Problematically for the plaintiffs, however, the transaction was reviewed and approved by a Sanchez Energy audit committee, specifically empowered by the corporation's board of directors. The committee was composed of three disinterested directors, not including the Sanchez family members, and was assisted by a financial advisor. Nevertheless, the plaintiffs alleged that Sanchez Jr. and Sanchez III were controlling stockholders standing on both sides of the transaction, necessitating review of the transaction under the entire fairness standard and excusing demand as futile.

The court noted that a plaintiff may establish a defendant as a controlling stockholder "[w]hen [that] stockholder owns less than 50 percent of the corporation's outstanding stock" by alleging "domination by a minority shareholder through actual control of corporate conduct." In dismissing plaintiffs' claims, the court held that they failed to plead sufficient facts to support an inference that Sanchez Jr. and Sanchez III together were able to exercise actual control over the operations of Sanchez Energy and

exercise actual control over the terms of the transaction with Sanchez Resources and Altpoint. The court reiterated previous guidance on what constitutes control, stating that controlling stockholder cases "do not reveal any sort of linear, sliding-scale approach whereby a larger share percentage makes it substantially more likely that the court will find the stockholder was a controlling shareholder." Along those lines, *In re Sanchez Energy* reinforces the notion that "a large blockholder will not be considered a controlling stockholder unless they actually control the board's decision about the challenged transaction."

STOCKHOLDER HOLDING 33.7 PERCENT INTEREST NOT CONSIDERED A CONTROLLER

Crimson Exploration, Inc. was to be acquired in a stock-for-stock merger by Contango Oil & Gas Co. for a 7.7 percent premium. At the time of the merger, Oaktree Capital Management, L.P. and its affiliates held 33.7 percent of Crimson's outstanding stock, three directors on the Crimson board worked for Oaktree, and an affiliate of Oaktree held a significant portion of a Crimson term loan. The transaction was challenged by Crimson stockholders in *In re Crimson Exploration Inc. Stockholder Litigation*, 2014 WL 5449419 (Del. Ch. Oct. 24, 2014), who contended that entire fairness review applied because Oaktree and its affiliates were a controlling stockholder and received "significant side benefits not shared with the minority common stockholders."

In reaching the decision to dismiss the allegations, the court reiterated the well-settled Delaware principle that a majority stockholder – i.e., with more than 50 percent of the voting stock and therefore actual control – is treated as a controlling stockholder. Similar to the analysis in *In re Sanchez Energy*, the court in *Crimson* noted that a stockholder who "exercises control over the business affairs of the corporation" is deemed to be a controller, even if such stockholder holds less than a majority of the company's outstanding shares. The analysis in *Crimson* retraced a litany of controlling stockholder cases in Delaware, referencing a "scatter-plot" of holdings with incongruous results as to what percentage ownership makes a stockholder a controller.

The court suggested that to reach plaintiffs' conclusion that Oaktree was a controlling stockholder, it would be required to "pile up questionable inferences," which it was loath to do. The court was "hesitant" to conclude that Oaktree was a controlling stockholder that actually exercised control over the Crimson board's decision to sell the company in the face of the facts that it held only 33.7 percent of the outstanding stock, was simply an outside investment fund, the majority of the Crimson board was unaffiliated with Oaktree, and the primary negotiators for the transaction were not employees of Oaktree.

The court continued, noting that entire fairness review is prompted not solely because a transacting company has a controlling stockholder, but because the controller engaged in a conflicted transaction, as well. The court identified two situations falling under the auspices of "conflicted controller transactions": "(a) transactions where the controller stands on both sides; and (b) transactions where the controller competes with the common stockholders for consideration." The court suggested that Delaware has identified three types of cases where the controller competes with the common for the consideration: "(1) the controller receives disparate consideration, which the board approves; (2) the controller receives a continuing stake in the surviving entity, whereas the minority is cashed out; and (3) the controller receives a unique benefit, despite nominal pro rata treatment of all stockholders." In *Crimson*, entire fairness review was not warranted because Oaktree stood on one side of the transaction and was not affiliated with the acquiror, and the plaintiffs failed to establish facts sufficient to support a reasonable inference that the investment fund received some benefit not shared with the common stockholders.

CEO HOLDING 17.3 PERCENT INTEREST DEEMED A CONTROLLER IN A GOING PRIVATE TRANSACTION

The Court of Chancery denied motions to dismiss breach of fiduciary duty claims against an alleged controlling stockholder in *In re Zhongpin Inc. Stockholders Litigation*, 2014 WL 46735457 (Del. Ch. Nov. 26, 2014), where the stockholder owned approximately 17.3 percent of the outstanding shares and was chairman of the company's board and CEO. The case arose from a going-private merger that represented the end of a sales process, which began with a proposal from the stockholder-CEO to acquire the outstanding shares of Zhongpin Inc. that he did not own for US$13.50 per share in cash. Plaintiffs alleged facts to support a "reasonably conceivable" inference that the stockholder-CEO controlled the company and that the transaction was polluted by unfair dealing and unfair price. With respect to the stockholder-CEO's status as a controller, the court looked to Zhongpin's 10-K, which demonstrated facts, in combination with other allegations in the complaint, that the alleged controlling stockholder "exercised significantly more power than would be expected of a CEO and 17 percent stockholder." The 10-K also provided that Zhu, the stockholder-CEO, "has significant influence over [Zhongpin's] management and affairs," including matters related to stockholder approvals for director elections, selection of senior management, mergers and acquisitions, and amendments to corporate by-laws. The court noted the practical import of Zhu's influence at Zhongpin by referencing: (1) a third-party bidder's offer for the outstanding stock of the company not owned by the stockholder-CEO, which was conditioned on Zhu's participation in the transaction as a rollover stockholder and his agreement to remain as the chairman of the board and CEO; and (2) the fact that the company received no bids during the go-shop period, thereby implying that "Zhu's grip on Zhongpin discouraged all potential acquirers from attempting to obtain control of the Company, just as the 10-K warned."

Although the *In re Zhongpin* case has only progressed beyond the motion to dismiss stage, it bolsters the suggestion that controlling-stockholder cases in Delaware are a "scatter-plot" of decisions without mechanical guidance as to what percentage ownership constitutes control. Here, a 17.3 percent stockholder-CEO may satisfy the requirement that a minority stockholder actually control the board's decision about the challenged transaction if he or she is to be labeled a controller. When read together with the holdings in *Sanchez Energy* and *Crimson*, the *Zhongpin* decision implies that, where an alleged controller has less than a majority of the outstanding stock, percentage ownership is given less weight in the reviewing court's analysis than the stockholder's actual ability to control corporate conduct.

THE INTERPLAY BETWEEN "ORDINARY COURSE OF BUSINESS" AND "MAE" PROVISIONS

On October 31, 2014, the Court of Chancery issued a memorandum opinion in *Cooper Tire & Rubber Co. v. Apollo (Mauritius) Holdings*, 2014 WL 5654305 (Del. Ch. Oct. 31, 2014), which confronted the relationship between "ordinary course of business" covenants, "material adverse effect" provisions, and labor unrest at facilities with ties to the transaction agreement.

The US$2.5 billion transaction at issue involved Apollo agreeing to purchase Cooper for US$35 per share. Subsequent to the merger announcement, labor unions at Cooper's Chinese joint venture went on strike, effectively preventing the joint venture from functioning at full capacity in the ordinary course of business. The minority partner at the Chinese joint venture, Chairman Che, used his position of authority over the workers to physically seize the facility, prohibiting the production of Cooper products on site and denying the merger parties access to both the facility and the joint venture's financial records.

In view of Chairman Che's stronghold on the facility, Apollo took the position that the labor strife and corresponding impact on the business at the Chinese joint venture constituted a breach of the ordinary course of business covenant in the Merger Agreement it had in place with Cooper. The agreement provided, in part, that "[Cooper] shall cause each of its Subsidiaries to, conduct its business in the ordinary course of business consistent with past practice…and shall, and shall cause each of its Subsidiaries to, use its commercially reasonable efforts to preserve intact its present business organization…." On the other hand, Cooper sought to compel specific performance of the Merger Agreement. As a counter to Apollo's position that Cooper ceased operating its Chinese joint venture in the ordinary course of business, Cooper argued that complications arising from the announcement of the merger were specifically carved out of the definition of an MAE in the Merger Agreement.

The court sided with Apollo and held that the seizure of Cooper's facilities at its Chinese joint venture was "unanticipated" and "prevented Cooper from complying with its contractual obligations necessary to close the merger." The rationale was that the MAE clause contained two subsections, one which shifted the risk of certain events, including the seizure of the joint venture facility, wholly onto Apollo, and another that stated that Apollo would only bear the risk of such an event if it would not "reasonably be expected to prevent or materially delay or impair the ability of [Cooper] to perform its obligations" pursuant to the transaction agreement. The court seized on the implications of the second subsection, noting the "logical operation of the definition of Material Adverse Effect shifts the risk of any carved-out event onto Apollo, *unless* that event prevents Cooper from complying with its obligations under the Merger Agreement."

Apollo, ultimately, was relieved of its obligations to close the merger, as the court concluded that Cooper breached its obligations under the ordinary course of business covenant. The court held that Chairman Che's physical seizure of the joint venture facility did not implicate Cooper's ability to "keep available the services of its…employees" or "maintain existing relations and goodwill with customers…partners, [or] suppliers," but, rather, disrupted Cooper's "ability to cause its subsidiary—an entity Cooper legally controlled with its 65 percent ownership interest—to operate in the ordinary course of business."

Takeaway

Two-part MAE provisions are common; one dealing with results of operations and financial conditions and the other dealing with the ability to perform the obligations imposed by the merger agreement itself. For labor disruption and other typical MAE carveouts, drafters should endeavor to negotiate language making clear that the carveout applies to both aspects of the MAE clause.

STOCKHOLDER BOOKS AND RECORDS DEMANDS: INSPECTION RIGHTS MAY BE BROADENING

The Delaware Supreme Court, in *Wal-Mart Stores, Inc. v. Indiana Electrical Workers Pension Trust Fund IBEW*, 2014 WL 3638848 (July 23, 2014), broadened the scope of stockholder books and records inspections made pursuant to Section 220 of the DGCL. Electrical Workers Pension Trust Fund IBEW, a stockholder of Wal-Mart, made a demand to inspect the books and records of the superstore following a *New York Times* report implicating bribery at a Mexican subsidiary of the company, Wal-Mex. The stockholder made a Section 220 demand with the purpose of investigating the bribery allegations.

The Court of Chancery, in its Final Order and Judgment, required Wal-Mart to produce documents to supplement the approximately 3,000 previously furnished for inspection, including documents privileged or protected by the work-product doctrine. Among the documents Wal-Mart was required to produce were: (1) officer-level

documents; (2) documents protected by the attorney-client privilege; (3) "documents spanning a seven-year period;" (4) disaster recovery tapes for data from two custodians to complement disaster tape recovery data voluntarily collected by the superstore for nine other custodians; and (5) documents "known to exist" by Wal-Mart's Office of General Counsel. The Court of Chancery found that the privileged and additional documents it required for production were "necessary and essential" to the stockholder's "proper purposes" of investigating potential mismanagement and alleged breaches of fiduciary duty by Wal-Mart and Wal-Mex executives in connection with bribery allegations.

In affirming the decision below, the Delaware Supreme Court reiterated that the proper standard to be applied in Section 220 actions is "necessary and essential" to achieve a "proper purpose." Furthermore, the court noted that documents are "necessary and essential" if they reach the "crux of the shareholder's purpose" and if that information "is unavailable from another source." The Delaware Supreme Court also noted that Delaware courts must circumscribe orders granting inspection "with rifled precision."

More notably, perhaps, the Delaware Supreme Court applied the *Garner* doctrine with respect to the production of documents protected by attorney-client privilege, stemming from *Garner v. Wolfinbarger,* 430 F.2d 10993 (5th Cir. 1970), a Fifth Circuit decision from 1970. As applied here, the *Garner* doctrine permits stockholders of a corporation to "invade the corporation's attorney-client privilege in order to prove fiduciary breaches by those in control of the corporation upon showing good cause." In applying *Garner* to Section 220, the Delaware Supreme Court noted that "the necessary and essential inquiry must precede any privilege inquiry because the necessary and essential inquiry is dispositive of the threshold question—the scope of document production to which the plaintiff is entitled under Section 220."

Where the *Wal-Mart* case appeared to be overly stockholder-friendly given the volume of documents subject to the court's order, late in 2014, the Delaware Supreme Court issued its opinion in *United Technologies Corp. v. Treppel*, No. 127, 2014 (Dec. 23, 2014), where it reversed and remanded a Court of Chancery determination that it lacked the statutory authority to impose, as a condition to producing books and records pursuant to Section 220, a requirement that any suits arising from the documents be filed only in a court within the State of Delaware. The Delaware Supreme Court held that Section 220(c) gives broad discretion to the Court of Chancery to "prescribe any limitations or conditions with reference to the inspection" and remanded the case to the trial court for a specific determination of whether the court should exercise its discretion and impose such a limitation. The Delaware Supreme Court noted that the following non-exhaustive factors could be considered in making such a determination: (i) the fact that plaintiff seeks to file claims arising out of the same conduct that was already the subject of derivative litigation in the Court of Chancery; (ii) the interest of United Technologies in obtaining consistent rulings; (iii) United Technologies' adoption of a forum selection bylaw; (iv) plaintiff's inability to articulate a reason for filing a suit in a forum other than Delaware; and (v) the importance of maintaining Section 220 actions as streamlined, summary proceedings, particular when companies can move to dismiss if a plaintiff files in an improper forum in violation of a forum selection bylaw.

STOCKHOLDER APPRAISAL PETITIONERS ARE SUBJECT TO BROAD DISCOVERY

In *In re Appraisal of Dole Food Company, Inc*., 2014 WL 6906134 (Dec. 9, 2014), two investment funds (Petitioners) bought substantial blocks of common stock in the Dole Food Company, Inc. (Dole) following the announcement of a cashout merger of Dole by the company's CEO, Chairman and controlling stockholder.

After the Petitioners filed an appraisal action, Dole sought discovery of any pre-litigation valuations/analysis of Dole prepared by Petitioners. The Petitioners objected to producing documents or providing testimony on the basis that the information would not lead to the discovery of admissible evidence. They argued that the pre-litigation valuations are opinions, not facts, and that the question of valuation in an appraisal proceedings is purely a matter for valuation experts.

In rejecting Petitioners' arguments, the Court of Chancery held that (i) it could consider all factors relating to fair value, including any valuation analyses prepared for non-litigation purposes, which would serve as a helpful "cross check" on litigation-driven figures by experts, (ii) lay witnesses (particularly when the Petitioners are investment funds) are competent to express their views of valuation, including the view they held contemporaneously about the value of the subject company, and (iii) non-expert evidence is useful to test the credibility of valuation inputs, in order to "temper…the adversarial hyperbole that inevitably influences an expert's opinion in [contested] valuation proceedings."

In addition to ordering Petitioners to respond to the requested discovery, the court also awarded the company is attorneys' fees and expenses pursuant to Court of Chancery Rule 37(b)(2). The court awarded fees because the lawyers for Petitioners instructed a 30(b)(6) witnesses not to answer when Rule 30(d)(1) permits a lawyer to instruct a deponent not to answer "only when necessary to preserve a privilege, to enforce a limitation on evidence directed by the Court, or to present a motion [for protective order.]" As Petitioners were aware of the deposition subjects when Dole noticed the Rule 30(b)(6) depositions and identified topics for question, they were required to obtain a limitation from the court before instructing the witnesses not to answer. The court determined that Petitioners' failure to provide the discovery was not "substantially justified."

IMPORTANT RULING ON USE OF SECTION 102(b)(7) EXCULPATORY PROVISIONS EXPECTED IN 2015

In *In re Cornerstone Therapeutics, Inc.*, C.A. No. 8922-VCG, 2014 WL 4784250 (Del. Ch. Sept. 26, 2014), the Court of Chancery certified for interlocutory appeal its decision to deny a motion to dismiss disinterested director defendants when the company has a Section 102(b)(7) provision exculpating such directors from liability. The court denied the motion to dismiss because the plaintiffs were challenging a transaction subject to entire fairness review *ab initio*.

The court held that interlocutory review was appropriate because its decision (i) determined a substantial issue as it could result in the dismissal of the director defendants from the litigation, (ii) established a legal rights in that it required the director defendants to be parties to the litigation, unable to assert their Section 102(b)(7) defense until after trial, and (iii) involved conflicting decisions of the Court of Chancery. The Delaware Supreme Court accepted the interlocutory appeal, which is currently pending. On December 23, 2014, the Court of Chancery, in *In re Zhongpin Inc. Stockholders Litigation*, 2014 WL 7335920 (Del. Ch. Dec. 23, 2014), certified another interlocutory appeal of a decision denying a motion to dismiss certain special committee defendants on the same basis as the *Cornerstone* case.

The Delaware Supreme Court's resolution of these interlocutory appeals will provide much needed clarity on the issue of whether, under an entire fairness standard of review, exculpation under 102(b)(7) can be employed to dismiss disinterested directors at the motion to dismiss stage, or whether they must await a full review of the entire fairness of the transaction, which necessitates either a trial or costly discovery and a summary judgment motion.

THE IMPACT OF THE 2013 AMENDMENT ELIMINATING THE NEED FOR "TOP UP" OPTIONS

Prior to adoption of Section 251(h) of the DGCL, which became effective on August 1, 2013 (and was subsequently amended effective August 1, 2014), unless an acquirer could obtain 90 percent of the target's voting stock necessary to effectuate a short-form merger under Section 253 of the DGCL or negotiate for a "top-up" option to get to get to 90 percent, a back-end merger required a stockholder vote. Prior to Section 251(h)'s adoption, 23 percent of M&A deals involving public companies used the traditional two-step structure to close. In the year following its adoption, 34 percent of the M&A deals utilized the new Section 251(h) structure.

2014 AMENDMENTS TO THE DELAWARE GENERAL CORPORATION LAW AND ALTERNATIVE ENTITY STATUTES

2014 Amendments to the Delaware General Corporation Law

The following amendments became effective on August 1, 2014, except that the amendments relating to Section 251(h) only apply to merger agreements entered into on or after August 1, 2014:

§§ 103, 108, Incorporator Unavailability

Amendments accomplish two changes to address issues that arise when incorporator has become unavailable before completing statutory functions. Amendment to Section 103(a)(1) removed any limitation on the reason for the incorporator's unavailability. New Section 108(d) provides a mechanism for the incorporator's actions required by Section 108 to be taken in the event the incorporator is unavailable.

§§ 141, 228, Board and Stockholder Action by Written Consent with Future Effective Time

Amendments to Section 141(f) and section 228(c) permit board and stockholder actions by written consent to become effective at a future time that is no later than 60 days after the time of execution.

§ 218, Voting Trusts

Amendments to Section 218(a) and Section 218(b) provide that a voting trust agreement, or any amendment thereto, may be delivered to the corporation's principal place of business instead of its registered office.

§ 242, Permitting Limited Amendments to Certificate of Incorporation without Stockholder Approval

Amendments to Section 242 would authorize a corporation, by action of its board of directors, to amend its certificate of incorporation to change its name or to delete historical references to its incorporator, its initial board of directors or its initial subscribers for shares, or to provisions effecting changes to its stock, without the need to submit the amendment to a vote of stockholders. Amendments also eliminate requirement that the notice of the meeting at which an amendment to the certificate of incorporation is to be voted on contain a summary of the amendment when the notice constitutes a notice of internet availability of proxy materials the SEC's proxy rules.

§ 251, Eliminating Stockholder Votes in Certain Two-Step Mergers

Amendments to Section 251(h), which was adopted in 2013, make it easier for second-step mergers after tender offers to be finalized without stockholder approval. The amendments (i) eliminate the prohibition against a party to the merger agreement being an "interested stockholder," as defined in Section 203, (ii) clarify the timing and other requirements with respect to the back-end merger, and (iii) clarify that the merger agreement may either permit or require the merger to be effected under Section 251(h).

2014 Amendments to Delaware's Alternative Entity Statutes

The following amendments to the Delaware Limited Liability Company Act, *6 Del. C. § 18-101 et seq.* (the LLC Act), became effective on August 1, 2014:

§§ 18-104, 18-305, 17-104, 17-305, 15-403, Books and Records Requirement

Amendments require that each Delaware limited liability company and Delaware limited partnership maintain a current record of the name and last-known address of each member, manager and/or partner, as the case may be. Amendments also require entity to provide its

communication contact (i.e., the individual identified as the person authorized to received communications from the Delaware Secretary of State/Delaware registered agent) with the name, business address and business telephone number of a natural person who has access to the record(s) containing the name and last-known address or each member, manager and/or partner.

§§ 18-302, 18- 404, 17-302, 17-405, 15-407, Consents with Future Effective Dates

Unless a governing instrument provides otherwise, a member, partner, beneficial owner, manager or trustee may consent to an action prior to becoming a member, partner, beneficial owner, manager or trustee, respectively, so long as such consent is effective at a time when such person is a member, partner, beneficial owner, manager or trustee, respectively.

§§ 18-806, 17-806, Dissolution Revocation

Amendments permit additional ways by which dissolution of a Delaware limited liability company or a Delaware limited partnership may be revoked, including any way provided in an operating agreement and any other way permitted by law.

§ 3806, Default Vote of Trustees

When a governing instrument of a statutory trust is silent regarding the requisite number of trustees needed to approve an action on behalf of the trust, the default percentage is majority vote.

DELAWARE'S GUIDING PRINCIPLES REMAIN TRUE

These cases once again demonstrate that the Delaware courts are neither stockholder nor management biased. Delaware's guiding principles remain strict adherence to fiduciary duties, prompt enforcement of articles of incorporation, bylaws, and merger agreements, and the maximization of stockholder value. The business judgment rule remains alive and well for directors who reasonably inform themselves of important information, are free of economic or other disabling conflicts of interest, and whose only agenda is that of advancing the best interests of the corporation.

While the facts and legal analyses confronting directors are many times complex, the cases often boil down to the smell test. So long as independent directors can articulate why, in their best judgment, they acted as they did and believe those actions were in the best interest of the corporation, Delaware courts typically respect their decisions.

ABOUT US

DLA PIPER WORLDWIDE

DLA Piper is a global law firm with 4,200 lawyers in more than 30 countries throughout the Americas, Asia Pacific, Europe and the Middle East, positioning us to help companies with their legal needs anywhere in the world.

Our Corporate and Securities group, with 250 lawyers in the US and 550 worldwide, represents clients pursuing sophisticated transactions. We advise on public and private equity and debt securities offerings, mergers and acquisitions and reorganizations. In addition to offering comprehensive transactional services, we advise on corporate governance, IT, tax, compensation and technology issues. Learn more at dlapiper.com.

DLA PIPER IN DELAWARE

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

The corporate lawyers in DLA Piper's Delaware office represent corporations, boards of directors, individual officers and directors, special board committees and large investors. In addition to counseling on corporate and governance issues, this practice involves advising on deal structure and compliance with fiduciary duties as well as representation in the Delaware courts.

The litigation aspect of the corporate practice covers class actions and derivative breach of fiduciary claims, corporate control disputes, merger and acquisition litigation, actions involving the interpretation of charter provisions and bylaws, actions by directors and/or officers seeking advancement and/or indemnification, stockholder appraisal actions, stockholder requests for books and records, internal corporate investigations, litigation arising out of transactions involving subsidiaries, tender offers, asset sales, capital restructurings, stockholder meetings and votes, dissolutions, corporate reporting and compliance programs and other matters involving corporate governance and the Delaware General Corporation Law.

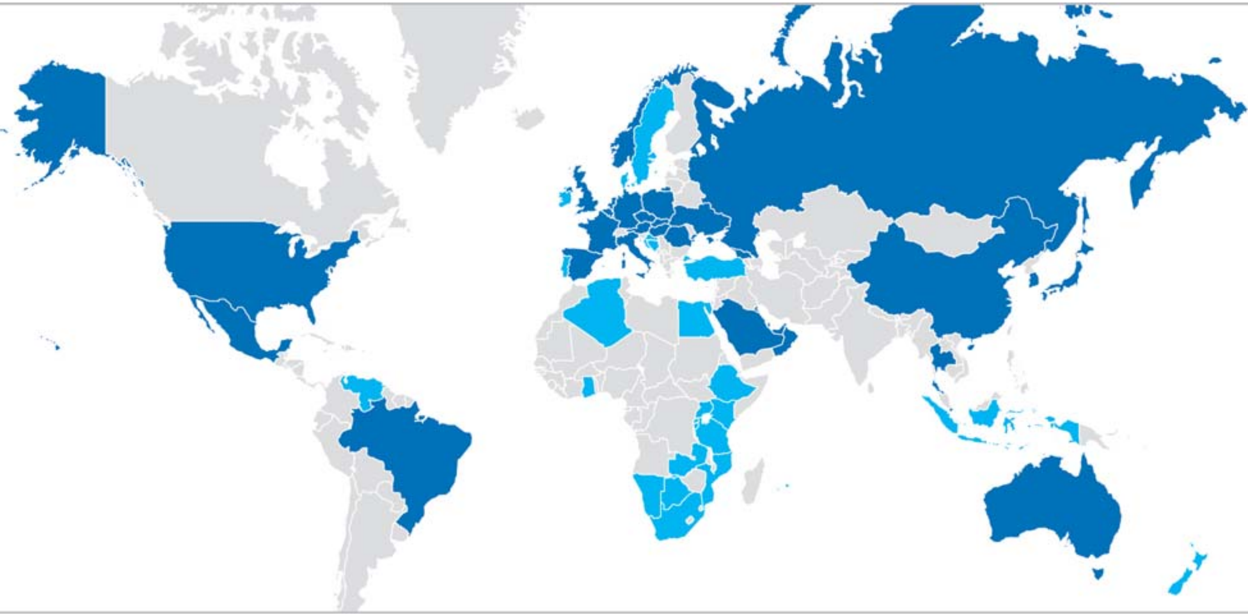
Also resident in DLA Piper's Wilmington office is a former two-term governor and nine-term congressman of Delaware, whose extensive state and federal experience provides understanding of a wide array of issues faced by businesses that are either incorporated in Delaware or deal with Delaware entities.

OUR PRIVATE EQUITY PRACTICE

DLA Piper's integrated, experienced teams represent private equity funds as well as their principals, management teams, institutional investors, financing sources and portfolio companies in all types of transactions and industries. Our clients range from emerging managers to "unfunded" sponsors, to traditional sponsors managing billions of dollars in committed capital. Along with providing legal services, we introduce clients to the opportunities, relationships and insights afforded by our global platform. We are proud to have been ranked #1 globally for total private equity and venture capital deal volume in 2011 and again in 2012 by Dow Jones Private Equity Analyst.

OUR M&A PRACTICE

Our Mergers and Acquisitions group acts each year as counsel on a large number of mergers and acquisitions transactions. In 2014, for the fourth consecutive year, DLA Piper retained its number one ranking globally for overall deal volume, according to mergermarket's league tables for legal advisors. In 2013 alone, that publication noted, we handled 385 transactions valued at approximately US$31 billion. We are consistently ranked among the top US firms in number of announced and completed deals.



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