Clients&FriendsMemo

2017 Year in Review: Corporate Governance Litigation & Regulation

January 9, 2018

Delaware courts have recently issued decisions that have fundamentally altered corporate governance litigation. In 2016, the Court of Chancery changed the landscape for resolution of class actions on the basis of "disclosure-only" settlements, *i.e.*, settlements without any monetary payment to the class. In *In re Trulia, Inc. Stockholder Litig.*,[1] the Court of Chancery refused to approve such a settlement to the extent it provided a class-wide release unless the supplemental disclosure was "plainly material."[2] In 2015, the Delaware Supreme Court held in *Corwin v. KKR Fin. Holdings LLC*[3] that a transaction otherwise subject to *Revlon* review instead would be analyzed under the deferential business judgment rule if the transaction was approved by a majority of fully informed, uncoerced, disinterested stockholders. Confirming the far-reaching implications of *Corwin, in Singh v. Attenborough*,[4] the Delaware Supreme Court held that "dismissal is typically the result"[5] following *Corwin's* standard shifting, suggesting that the presumption is virtually irrefutable in that it can only be overcome by a showing of waste. The cumulative effect of these decisions has been to discourage pre-closing deal litigation (by making disclosure-based settlement much more difficult) and post-closing deal litigation (by making dismissal a near certainty where the procedural protections articulated in *Corwin* are in place).

In 2017, there was no shortage of significant decisions. Despite the decrease in deal litigation, the Court of Chancery's workload has remained sufficiently high that Delaware Supreme Court Chief Justice Leo E. Strine, Jr. requested the creation of two additional seats for new vice chancellors.[6] According to Chief Justice Strine, new filings in the Court of Chancery have increased 64% in the

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1 129 A.3d 884 (Del. Ch. 2016).

2 *Id.* at 898.

3 125 A.3d 304 (Del. 2015).

4 137 A.3d 151 (Del. 2016).

5 *Id.* at 152.

6 Tom McParland, *Strine Seeks to Bolster Bench Strength of Chancery Court*, DEL. BUS. CT. INSIDER (Nov. 2, 2017), http://www.law.com/delbizcourt/sites/delawarelawweekly/2017/11/02/strine-seeks-to-bolster-bench-strength-of-chancery-court/.

past decade. Creative plaintiffs' lawyers have adjusted to the new regime by increasingly shifting attention to other avenues of potential relief, including appraisal actions and mootness dismissals in Delaware, and disclosure litigation in federal courts and in state courts outside Delaware.

In this article, we discus significant judicial and regulatory developments in the following areas:

- **Mergers and Acquisitions:** Delaware courts issued numerous decisions applying *Corwin* to post-closing merger challenges; provided important guidance regarding the significance of the deal price in determining fair value in appraisal actions; and clarified the meaning of the contract term "commercially reasonable efforts." Outside Delaware, state and federal courts grappled with the application of *Trulia* to disclosure-only settlements.

- **Controlling Shareholders:** The Court of Chancery for the first time held that the *MFW* procedural safeguards (conditioning a transaction at the outset on approval by an empowered, independent special committee and a fully informed, uncoerced majority of minority stockholders) leads to the application of the business judgment rule for transactions in which a controlling shareholder is not on both sides of the proposed deal.

- **Embrace of Emerging Technology:** The Delaware Legislature authorized companies to use "blockchain technology" for share issuances and transfers.

- **Shareholder Activism:** Shareholder activists led successful campaigns to replace CEOs and/or board members at Procter & Gamble, CSX, and Buffalo Wild Wings. Activists also saw some setbacks in 2017, including losing a campaign for seats on the board of General Motors.

I. Mergers & Acquisitions

A. The Impact of Trulia Begins to Be Seen As Disclosure-Only Settlements Decline and Merger Litigation Migrates to Other Forums

In the aftermath of *Trulia* and *Corwin*, there has been a significant reduction in the volume of merger challenges filed in Delaware and a dramatic change in the resolution of these actions. Only 9% of merger transactions valued at over $100 million were challenged in Delaware in the first 10 months of 2017, compared to 34% in 2016 and 60% in 2015.[7] In 2017, there also was a surge in the rate of dismissals of such actions, which spiked to 89%, compared to 57% in 2016 and 55% in 2015. Perhaps reflecting *Trulia's* near extinguishment of disclosure-only settlements, 2017 saw a vastly increased rate of "mootness dismissals," in which defendants moot disclosure claims by voluntarily issuing supplemental disclosures, followed by plaintiffs' counsel seeking mootness fees that may be privately negotiated with defendants (without any release of claims). Only 22% of actions

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7 *See* Matthew D. Cain et al., *The Shifting Tides of Merger Litigation*, 71 VAND. L. REV. (forthcoming 2018) (manuscript at 6), http://scholarship.law.upenn.edu/faculty_scholarship/1728.

challenging such merger transactions were resolved using this method in 2016, but in 2017 mootness dismissals followed by fee applications occurred in 75% of deal litigation.[8]

Nationally, in 2017,[9] 85% of all public merger transactions valued at over $100 million faced litigation, higher than the 73% figure in 2016 but below the rate of 91% in 2014.[10] This rebound may reflect plaintiffs' counsel finding ways to adapt to *Trulia*, resulting in a shift of litigation to forums outside of Delaware, primarily to federal courts.[11] The increase in federal litigation may also reflect efforts by plaintiffs to avoid the effects of the increasing adoption by Delaware companies of forum selection bylaws designating Delaware as the exclusive forum for actions concerning fiduciary duty claims. The Court of Chancery in *Boilermakers*[12] held forum selection bylaws to be binding and enforceable and the Delaware Legislature recently amended the Delaware General Corporation Law ("DGCL") to make clear that such bylaws are permitted. Numerous courts outside Delaware, including courts in New York, Texas, California, Illinois, Ohio and Missouri, have enforced Delaware forum selection bylaws to dismiss fiduciary duty actions.[13] By bringing federal disclosure and control person claims under Sections 14 and 20(a) of the Securities Exchange Act of 1934 (the "Exchange Act"), plaintiffs can avoid forum selection bylaws mandating Delaware state courts as the required forum. According to NERA, the number of federal class actions challenging mergers rose from 30 in the first half of 2016 to 104 in the first half of 2017.[14] In the first ten months of 2017, 87% of merger transactions triggered challenges in federal court – a stark increase from 39% in 2016 and 20% in 2015.[15] Other states also saw a drop in litigation as merger challenges migrated to federal courts, with plaintiffs challenging 18% of mergers announced in 2017 in state courts outside Delaware, compared to 61% in 2016.[16]

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8 *Id. at 7, 25.*

9 *2017 figures come from a data set of transactions in the first ten months of the year. Id.*

10 *Id. at 6.*

11 *Id. at 24.*

12 Boilermakers Local 154 Ret. Fund v. Chevron Corp., 73 A.3d 934 (Del. Ch. 2013).

13 *See*, *e.g.*, *Hemg Inc. v. Aspen Univ.*, No. 650457/13, 2013 WL 5958388 (Sup. Ct. N.Y. Cty. Nov. 4, 2013); *In re MetroPCS Commc'ns, Inc.*, 391 S.W.3d 329 (Tex. Ct. App. – Dall. 2013); *Groen v. Safeway Inc.*, No. RG14716641 (Cal. Super. Ct. Alameda Cty. May 14, 2014); *Miller v. Beam, Inc.*, No. 2014 CH 00932 (Ill. Cir. Ct. Cook Cty., Mar. 5, 2014); *N. v. McNamara*, 47 F. Supp. 3d 635 (S.D. Ohio 2014); *Gawrych v. Monsanto Co.*, No. 16SL-CC04220 (Mo. Cir. Ct. St. Louis Cty. Dec. 12, 2016).

14 Stefan Boettrich & Svetlana Starykh, *Securities Class Actions: 2016 Full-Year Review & Mid-2017 Flash Update*, NERA ECON. CONSULTING (July 24, 2017), http://www.nera.com/publications/archive/2017/securities-class-actions--2016-full-year-review-and-mid-2017-fla.html.

15 *Cain*, *supra note 7, at 23*.

16 *Id.*

1. Courts in Indiana and Connecticut Followed *Trulia* in 2017

In *Bushansky v. Remy Int'l, Inc.,*[17] the United States District Court for the Southern District of Indiana, applying *Trulia* and the Seventh Circuit's 2016 decision *Hays v. Walgreen Co.* (*In re Walgreen Co. Stockholder Litig.)*,[18] rejected a disclosure-only settlement. In *Remy*, stockholders asserted that the directors of Remy International, Inc. violated Section 14(a) of the Exchange Act by causing a materially incomplete and misleading proxy statement to be filed with the SEC in connection with a proposed sale of Remy, a Delaware corporation, to BorgWarner Inc. The parties agreed to a disclosure-only settlement in which the defendants agreed to pay the plaintiffs' counsel up to $400,000 in fees and $15,000 in expenses and the defendants received class-wide releases. In rejecting the settlement, the Court found that the additional disclosures "fail[ed] to address a plainly material misrepresentation or omission and do not benefit the proposed class."[19]

In *Bushansky v. Phoenix Cos.*,[20] a Connecticut court followed *Trulia* but reached the opposite result in approving a disclosure-only settlement. In Phoenix, stockholders of Phoenix Companies, a Delaware corporation, sought to enjoin the acquisition of Phoenix by Nassau Reinsurance Group Holdings, L.P. on the grounds that the Phoenix directors breached their fiduciary duties by agreeing to the proposed transaction for insufficient consideration. The parties reached a disclosure-only settlement in which defendants agreed not to object to a fee award that did not exceed $340,000. The Court evaluated the "give"[21] and the "get"[22] in finding that the additional disclosures concerning information used by the company's consultants in their valuation were "plainly material"[23] and the releases appropriately tailored only to the alleged misconduct raised in the litigation.

In *Stein v. UIL Holdings Corp.,*[24] another Connecticut court declined to approve a disclosure-only settlement, this time involving a Connecticut corporation. In *Stein*, stockholders of UIL Holdings Corp. challenged the acquisition of UIL by Iberdrola USA, Inc. on the grounds that the transaction was the result of an "utterly flawed sales process"[25] resulting in insufficient consideration, including because UIL's directors and financial advisor allegedly were conflicted and the registration statement filed by UIL contained material misstatements and omissions. The parties agreed to a

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[17] 262 F. Supp. 3d 742 (S.D. Ind. 2017).

[18] 832 F.3d 718, 723-24 (7th Cir. 2016).

[19] *Remy*, 262 F. Supp. 3d at 754.

[20] No. Xo8FSTCV156028891S, 2017 WL 1194768 (Conn. Super. Ct. Feb. 23, 2017).

[21] *Id.* at *3.

[22] *Id.*

[23] *In re Trulia*, 129 A.3d at 898.

[24] No. Xo8FSTCV156025536S, 2017 WL 1656891 (Conn. Super. Ct. Apr. 10, 2017).

[25] *Id.* at *1.

disclosure-only settlement in which the defendants agreed not to object to a fee award up to $425,000. While not expressly adopting *Trulia*, the court stated that it "does not believe that Connecticut would or should embrace a lesser standard than that suggested by the Delaware courts and the federal courts which have recently considered these types of settlements."[26] Primarily focusing on the overly broad scope of the release (which purported to release defendants "of virtually all claims the UIL former stockholders may have had against them or the 'released parties'"), the Court rejected the settlement, holding that "the settlement provides the defendants with too much by way of the release and the plaintiffs with too little by way of additional disclosure."[27]

2. Courts in New York and Florida Declined to Follow *Trulia*

Not all jurisdictions outside Delaware adopted *Trulia*. For instance, in *Gordon v. Verizon Commc'ns, Inc.*,[28] the New York Appellate Division, First Department declined to follow *Trulia* in reversing a lower court order and approving of a non-monetary settlement. In *Verizon*, Verizon stockholders sought to enjoin Verizon's $130 billion acquisition of Vodafone's 45% stake in Verizon Wireless on the grounds that Verizon's directors breached their fiduciary duties to Verizon shareholders by paying an exorbitant price for Vodafone's Verizon Wireless stock and filed a proxy statement that contained material omissions. The parties agreed to a settlement that included additional proxy statement disclosures, a covenant by Verizon to obtain a fairness opinion for any sale of more than 5% of its assets, and an agreement by Verizon not to oppose a fee award to plaintiffs' counsel of up to $2 million. In a pre-*Trulia* decision, the trial court cited Court of Chancery opinions requiring disclosures that "'materially enhance[d] the shareholder's knowledge about the merger,'"[29] and rejected the settlement, largely dismissing the additional disclosures as "trivial or obviously redundant."[30]

In reversing, the Appellate Division applied New York law because the settlement agreement included a New York choice of law provision. Although Verizon is a Delaware corporation, the court did not discuss the internal affairs doctrine (and Verizon does not have a Delaware forum selection bylaw). While the Appellate Division acknowledged that "the decisions of the Delaware courts provide some guidance on the issues presented on this appeal,"[31] it evaluated the settlement under a five factor test set forth in *Woodrow v. Colt Indus., Inc.* (*In re Colt Indus. S'holder Litig.)*,[32] which

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[26] *Id.* at *3.

[27] *Id.* at *2, *4.

[28] 46 N.Y.S.3d 557 (N.Y. App. Div. 1st Dep't 2017).

[29] *Gordon v Verizon Commc'ns, Inc.*, No. 653084/13, 2014 WL 7250212, at *7 (Sup Ct. NY Cty. Dec. 19, 2014) (citation omitted), *rev'd*, 46 N.Y.S.3d 557 (N.Y App. Div. 1st Dep't 2017).

[30] *Id.* at *3.

[31] *Gordon*, 46 N.Y.S.3d at 566.

[32] 553 N.Y.S.2d 138 (N.Y. App. Div. 1st Dep't 1990), *aff'd as modified*, 566 N.E.2d 1160 (N.Y. 1991).

includes the likelihood of success, the extent of support from the parties, the judgment of counsel, the presence of bargaining in good faith and the nature of the issues of law and fact.[33] After finding that these factors weighed in favor of approving the settlement, the Court considered two additional factors, including whether (1) the non-monetary relief is "in the best interests of all [stockholders]"[34] and (2) the settlement is in the best interest of the company. In contrast to *Trulia's* mandate that additional disclosures be "plainly material,"[35] the Appellate Division found that the additional factors also favored approval of the settlement because the disclosures provided "some additional benefit"[36] to stockholders. The Court also noted that the fairness opinion requirement was a corporate governance reform that would be sufficient by itself to warrant approval.

In *Delman v. Quality Distrib., Inc.*,[37] a Florida court disregarded *Trulia* in approving a disclosure-only settlement involving a Florida corporation. In *Delman*, stockholders sought to enjoin the sale of Quality Distribution Inc. to affiliates of Apax Partners on the basis of alleged fiduciary duty violations, including an alleged failure by members of management to disclose personal benefits flowing from the transaction.[38] The parties reached a disclosure-only settlement in which Quality Distribution agreed to pay $400,000 to plaintiffs' counsel.[39] In evaluating an objection to the settlement lodged by a law professor citing to *Trulia*, the court stated that the extent to which *Trulia* applied was a matter of first impression in Florida.[40] The court concluded that "*Trulia* is good law in Florida"[41] for the limited proposition that "a class action settlement should not be approved when the scope of the claims released exceeds the scope of the issues litigated in the case."[42] However, the Court then departed dramatically from *Trulia* by holding that "[e]ven if the court assumes the incremental disclosure is immaterial, it can still approve the settlement because that is the better choice among the alternatives."[43] The court explained that, unlike Delaware or federal courts, "the Florida court system does not provide for early stage 'out of hand' dismissal."[44]

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33 46 N.Y.S.3d at 566-67.

34 *Id.* at 568.

35 *In re Trulia*, 129 A.3d at 898.

36 *Gordon*, 46 N.Y.S.3d at 569.

37 No. 15-ca-005553, 2017 WL 2694490 (Fla. Cir. Ct. June 21, 2017).

38 *Id.* at *1.

39 *Id.*

40 *Id.* at *2.

41 *Id.* at *5.

42 Id.

43 *Id.* at *8.

44 *Id.*

Given the rejection or less than complete adoption of *Trulia* by certain state courts, plaintiffs are likely to continue to shop for forums that will be more receptive to approving disclosure-only settlements where plaintiffs' counsel conclude that is the likely path to resolution and a fee award. Companies can mitigate the risk of forum-shopping through the adoption, where permissible, of exclusive forum selection bylaws (including under Section 115 of the Delaware General Corporation Law, which authorizes Delaware corporations to designate Delaware as the exclusive forum for most shareholder suits).[45] In an effort to evade such bylaws, plaintiffs also likely will continue to refashion fiduciary and derivative claims into federal securities law disclosure claims that either must (for claims under the Exchange Act) or may (for claims under the Securities Act of 1933) be brought in federal courts.

B. 2017 Applications of Corwin to Post-Closing Merger Challenges

In 2017, the Court of Chancery applied *Corwin* in dismissing several post-closing merger challenges under the deferential business judgment rule standard of review where there was no controlling stockholder and the transaction was approved by a fully informed, uncoerced vote of disinterested stockholders. Delaware judges followed several 2016 Court of Chancery decisions[46] that made clear that the business judgment rule becomes "irrebuttable"[47] following a cleansing, standard-shifting vote under *Corwin*, requiring plaintiffs to plead the extremely difficult claim of waste to survive dismissal (an unlikely prospect given that it is difficult to believe that fully informed, disinterested, uncoerced stockholders would vote to approve a transaction constituting waste).[48] Plaintiffs, with limited success, sought to avoid *Corwin*'s potent effects by contending that stockholder votes were "coerced,"[49] *i.e.*, structured in a way that required stockholders to vote for a proposed transaction for reasons unrelated to the economic merits of the deal, or "uninformed,"[50] *i.e.*, based on inadequate disclosures.

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45 On January 5, 2018, the New Jersey Legislature followed Delaware's lead by passing Assembly Bill No. 2162, which, if enacted, permits New Jersey corporations to include exclusive forum provisions in their bylaws designating the federal and state courts in New Jersey as the exclusive forum for disputes relating to corporate "internal affairs."

46 *Larkin v. Shah*, C.A. No. 10918-VCS, 2016 WL 4485447, at *1 (Del. Ch. Aug. 25, 2016); *In re OM Grp., Inc. Stockholders Litig.*, C.A. No. 11216-VCS, 2016 WL 5929951, at *10 (Del. Ch. Oct. 12, 2016); *In re Volcano Corp. S'holder Litig.*, 143 A.3d 727, 738 (Del. Ch. 2016).

47 *Larkin*, 2016 WL 4485447, at *7.

48 *Singh*, 137 A.3d at 152 ("That is because the vestigial waste exception has long had little real-world relevance, because it has been understood that stockholders would be unlikely to approve a transaction that is wasteful.")

49 *See*, *e.g.*, *In re Cyan, Inc. Stockholders Litig.*, C.A. No. 11027-CB, 2017 WL 1956955, at *11 (Del. Ch. May 11, 2017).

50 *Id.* at *12.

1. The Court of Chancery Routinely Dismissed Challenges to Mergers Consummated after a Fully Informed, Uncoerced, Disinterested Stockholder Vote

In *In re Paramount Gold & Silver Corp. Stockholders Litig.*,[51] Paramount stockholders brought a post-closing challenge to a transaction entered into between Paramount and Coeur Mining, Inc., which involved the spin-off of Paramount's Nevada mining assets into a separate entity and a stock-for-stock merger of a subsidiary of Coeur into the post-spin-off Paramount.[52] Plaintiffs alleged that the directors of Paramount breached their fiduciary duties by allegedly including unreasonable deal protection devices in the merger agreement.[53] On the same day it entered into the merger agreement, Paramount entered into a royalty agreement whereby a wholly owned subsidiary of Coeur acquired a 0.7% royalty interest in a Mexican mining project in exchange for a $5.25 million payment.[54] The merger was approved by stockholders holding over 54% of Paramount's outstanding common stock, with approximately 97% of shares actually voted cast in favor of the transaction.[55] While not challenging the independence or the disinterest of the board, the plaintiffs contended the transaction should be reviewed under *Unocal* enhanced scrutiny due to the allegedly coercive effects of a $5 million termination fee in favor of Coeur in the merger agreement and the royalty agreement which, according to the plaintiffs, "effectively served as a second termination fee"[56] because any superior bidder allegedly would be required to buy out Coeur's $5.25 million royalty interest.[57] In dismissing the action, the Court applied the business judgment rule because it found that neither the termination fee (constituting between 2.72% and 3.42% of the merger consideration, which courts frequently have found to be within a reasonable range)[58] nor the royalty agreement (which was not contingent on the merger and the value of which would pass to another bidder) prevented a competitive bidding process.[59] Holding that the "transaction may only be attacked on the ground of waste,"[60] the Court dismissed the claim under *Corwin* because the plaintiffs had made no such assertion regarding the merger.

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51 C.A. No. 10499-CB, 2017 WL 1372659 (Del. Ch. Apr. 13, 2017).

52 *Id.* at *1.

53 *Id.*

54 *Id.*

55 *Id.* at *4.

56 *Id.* at *7.

57 *Id.* at *1.

58 See, e.g., In re Toys "R" Us, Inc. S'holder Litig., 877 A.2d 975, 1015-21 (Del. Ch. 2005); In re MONY Grp. Inc. S'holder Litig., 852 A.2d 9, 24 (Del. Ch. 2004).

59 *In re Paramount,* 2017 WL 1372659, at *7.

60 *Id.* at *14.

In *In re Cyan, Inc. Stockholders Litig.*,[61] stockholders commenced post-closing litigation to challenge the merger of Cyan and Ciena Corporation. Plaintiffs alleged that members of Cyan's board breached their fiduciary duties by approving the merger out of self-interest to bolster their indemnification rights relating to a pending securities litigation by partnering "Cyan with a company with 'deeper pockets,'"[62] and that defendants withheld material information that prevented plaintiffs from determining "whether to pursue their statutory appraisal rights."[63] The plaintiffs did not allege that the vote was coerced or that the merger failed to receive the approval of a disinterested majority of stockholders. Instead, plaintiffs alleged that the stockholder vote was not fully informed due to alleged disclosure violations in the proxy statement and other company filings. The Court rejected the plaintiffs' alleged disclosure deficiencies, holding that none of the alleged violations was material. Because the transaction had been approved by 98% of the stockholders voting in a fully informed, disinterested and uncoerced vote, and no allegations of waste had been made, the Court dismissed the case under *Corwin*.

In *In re Merge Healthcare Inc. S'holders Litig.*,[64] the Court of Chancery granted defendants' motion to dismiss a stockholder challenge to IBM's acquisition of Merge Healthcare Inc. The plaintiffs contended that the sales process suffered from multiple defects, and argued that the entire fairness standard of review should apply because a majority of the seller's board allegedly suffered from disabling conflicts of interest.[65] The Court dismissed the complaint because the merger was approved by 80% of Merge's stockholders in an uncoerced, fully informed vote and plaintiffs did not allege waste.[66]

In In re Solera Holdings, Inc. Stockholder Litig.,[67] the Court of Chancery dismissed a post-closing challenge to the acquisition of Solera by a private equity firm. Plaintiffs argued that the deal should be subject to review under *Revlon*.[68] In applying the business judgment rule instead, the Court reiterated *Corwin*'s explanation that "'*Revlon* was 'primarily designed to give stockholders and the Court of Chancery the tool of injunctive relief to address important M & A decisions in real time, before closing', and was not a tool designed with post-closing money damages claims in mind."[69] The Court also addressed the burden of proof for disclosure deficiencies in the context of *Corwin*'s

61 *In re Cyan, Inc.*, 2017 WL 1956955, at *1.

62 *Id.* at *1.

63 *Id.* at *6.

64 C.A. No. 11388-VCG, 2017 WL 395981 (Del. Ch. Jan. 30, 2017).

65 *Id.* at *5.

66 *Id.* at *13.

67 C.A No. 11524-CB, 2017 WL 57839 (Del. Ch. Jan. 5, 2017).

68 *Id.* at *6.

69 *Id.*

standard-shifting principles. The Court explained that "the plaintiff challenging the decision to approve a transaction must first identify a deficiency in the operative disclosure document, at which point the burden would fall to defendants to establish that the alleged deficiency fails as a matter of law in order to secure the cleansing effect of the vote."[70]

2. Court of Chancery Denied *Corwin*-Based Motions to Dismiss Based on Sufficient Allegations that the Vote Was Uninformed or Coerced

On two occasions in 2017, the Court of Chancery declined to dismiss post-closing claims under *Corwin* where the plaintiffs adequately alleged disclosure violations and/or structural coercion.

In *In re Saba Software*,[71] stockholders challenged the all-cash acquisition of Saba Software, Inc. by affiliates of Vector Capital Management, L.P. Saba had suffered through a troubled period preceding the merger, including the overstatement of pre-tax earnings by $70 million and repeated failures to satisfy numerous Securities and Exchange Commission ("SEC") deadlines to restate its financial statements, resulting in the deregistration of Saba's stock by the SEC.[72] Following a sales process, Vector presented an offer of $9 per share, representing a discount to Saba's average trading price over the prior two years.[73] Nonetheless, a majority of shareholders voted to approve the merger rather than hold deregistered stock.[74]

In finding that the vote lacked *Corwin*'s cleansing effect, the Court held that the vote was uninformed and coerced.[75] The Court found that the proxy statement omitted material information, including the factual circumstances surrounding the company's failure to file a restatement by the deadline set by the SEC.[76] The Court distinguished the claim from typically inadequate "tell me more"[77] demands, holding that the missing information was material to the stockholders' assessment of the likelihood that Saba would ever complete a restatement of its financials and evaluation of the credibility of management projections. The Court also faulted the proxy statement for failing to disclose post-deregistration options available to the company. Again noting that this type of information is not material "in a typical case,"[78] the Court held that stockholders needed the information to assess whether Saba would be a viable going concern without the merger. The

70 *Id.* at *8.

71 C.A No. 10697-VCS, 2017 WL 1201108 (Del. Ch. Apr. 11, 2017).

72 *Id.* at *1.

73 *Id.*

74 *Id.*

75 *Id.*

76 *Id.* at *13.

77 *Id.* at *9.

78 *Id.* at *13.

Court found that the vote was coerced because the board presented stockholders with a Hobson's choice: "either to accept the $9 per share offered through the Merger or hold onto their illiquid stock with no real sense of when or if that circumstance might change."[79] Due to the lack of adequate disclosure surrounding the company's post-deregistration viability, "'situationally coercive factors'"[80] left "Saba stockholders staring into a black box . . . with no practical alternative but to vote in favor of the Merger."[81]

Absent any cleansing effect from the vote, the Court considered the plaintiffs' non-exculpated claims under *Revlon* for breach of the duty of loyalty and bad faith. The Court denied the directors' motion to dismiss because it found that plaintiffs adequately pled a breach of the duty of loyalty or bad faith by alleging the board "rushed the sales process, refused to consider alternatives to a sale, cashed-in significant, otherwise worthless equity awards before the Merger, directed its financial advisor to rely upon the most pessimistic projections when considering the fairness of the transaction and then rushed the stockholder vote after supplying inadequate disclosures regarding the circumstances surrounding the failure to complete the Restatement."[82] The Court also found that the plaintiffs adequately pled a breach of the duty of loyalty by allegations that the directors secured material benefits for themselves by negotiating cash compensation in exchange for equity grants.[83]

In *Sciabacucchi v. Liberty Broadband Corp.*,[84] the Court of Chancery again declined to find a cleansing effect from a stockholder vote that was "structurally coerced."[85] In *Sciabacucchi*, stockholders challenged a voting proxy agreement between Charter Communications, Inc. and its largest stockholder, Liberty Broadband Corporation, and two stock issuances worth $5 billion made by Charter to Liberty, allegedly as a part of the "financing" of Charter's $78.7 billion merger with Time Warner Cable and its purchase of Bright House Networks, LLC.[86] On the same day, stockholders (i) approved the share issuances and the voting agreement in a single vote by 86% of the stock not affiliated with Liberty, (ii) approved the merger with Time Warner Cable and

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79 *Id.* at *6.

80 *Id.* at *16 (citation omitted).

81 *Id.* at *15.

82 *Id.* at *20.

83 *Id.* at *22-23.

84 C.A No. 11418-VCG, 2017 WL 2352152 (Del. Ch. May 31, 2017).

85 *Id.* at *15.

86 *Id.* at *1, *24.

(iii) approved the purchase of Bright House.[87] Both third-party transactions were conditioned on Charter stockholders' approval of the share issuances to and voting agreement with Charter.[88]

The Court held that the vote was structurally coercive because stockholders were left with "a simple choice: accept (disloyal) equity issuances to the Company's largest stockholder, and an agreement granting that stockholder greater voting power, or lose two beneficial transactions."[89] The Court was unpersuaded by the claim that the stock issuances constituted integral financing, observing that the equity sale was "an insignificant part of the consideration"[90] for the third party transactions, thus rendering the insider financing "extrinsic"[91] to the transactions. Accordingly, the Court concluded that a reasonable inference was "that the Defendants obtained the [third party transactions], and then used the value of those transactions to obtain a favorable vote on extrinsic transactions—the Liberty Share Issuances and the Voting Proxy Agreement, transactions that allegedly transferred wealth and voting power to Liberty Broadband at stockholder expense."[92] Despite determining that *Corwin* did not apply to give cleansing effect to the stockholder vote, the Court held that the briefing was insufficient for a determination on the merits of defendant's motion to dismiss and ordered additional briefing on the motion, which remains pending.

Saba and *Sciabacucchi* provide early guidance from the Court of Chancery regarding how companies may avoid successful attempts by plaintiffs to evade standard-shifting under *Corwin* with allegations that a vote was uninformed or coercive. *Saba* reinforces well-established principles that require the disclosure of all material information in a proxy or similar filing, including a detailed summary of the background to the merger (which, per *Saba*, necessitates disclosure of any facts that would materially affect the standalone value of the seller), a fair summary of any analysis by a financial advisor, and disclosure of any financial advisor conflicts. Further, to ensure that *Corwin* applies, companies should review the structure of the transaction (and any corresponding stockholder vote) carefully to ensure they are providing stockholders the choice to vote for or against each transaction on its own merits, and not due to extraneous considerations.

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87 *Id.* at *21.

88 *Id.*

89 *Id.* at *22.

90 *Id.* at *23.

91 *Id.*

92 *Id.* at *24.

C. Appraisal Actions

1. Delaware Supreme Court Provides Important Guidance on Appraisal Calculations of Fair Value

The Delaware Supreme Court issued two high-profile decisions in 2017 that reestablished the primacy of the deal price in the calculation of fair value in appraisal litigations. In *DFC Glob. Corp. v. Muirfield Value Partners L.P.*[93] and *Dell Inc. v. Magnetar Glob. Event Driven Master Fund Ltd.,*[94] the Court reversed and remanded appraisal decisions by the Court of Chancery in which the lower court erroneously assigned insufficient weight to the final merger consideration in its determination of fair value. While the Delaware Supreme Court declined to establish a presumption equating fair value to the deal price, the decisions suggest that plaintiffs must plead strong evidence concerning material flaws in the sales process or an inefficient market in order to demonstrate an entitlement to a price higher than the merger consideration. The Court also provided important guidance clarifying that the deal price should not be deemed unreliable simply because a transaction was structured as a management-led buy out or the winning bidder is a private equity buyer.[95]

In *In re Appraisal of Dell Inc.,*[96] filed in connection with Michael Dell and private equity fund Silver Lake Partners' leveraged management buy out of Dell Inc., Vice Chancellor Laster determined a fair value of the company's shares to be nearly $7 billion above the transaction price based solely on a discounted cash flow analysis and without assigning any weight to the final merger consideration.[97] Despite stating that the special committee's process "easily would sail through if reviewed under enhanced scrutiny," the Court held that the final merger consideration was an unreliable indicator of fair value due to multiple factors, including a lack of strategic bidders, "investor myopia" focused on short-term profit, and the structure of the transaction as a management-led buy out.[98] Two months later, in *In re Appraisal of DFC Glob. Corp.*,[99] filed in connection with Lone Star Funds' leveraged buy out of DFC Glob. Corp, Chancellor Bouchard weighed the final merger consideration equally with a discounted cash flow analysis and a comparable companies analysis in determining fair value, similarly stating that merger consideration was not a wholly reliable indicator of fair value due to the buyer being a financial sponsor.

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[93] 172 A.3d 346 (Del. Aug. 1, 2017).

[94] No. 565, 2016, 2017 WL 6375829 (Del. Dec. 14, 2017).

[95] For an extended analysis of these opinions, *see* Joshua Apfelroth et al., *M&A Update: Delaware Supreme Court Emphasizes Deal Price in Appraisal Litigation*, CADWALADER, WICKERSHAM & TAFT LLP (Dec. 19, 2017), http://www.cadwalader.com/resources/clients-friends-memos/ma-update-delaware-supreme-court-emphasizes-deal-price-in-appraisal-litigation.

[96] C.A. No. 9322-VCL, 2016 WL 3186538 (Del. Ch. May 31, 2016).

[97] *Id.* at *51.

[98] *Id.* at *29, *34.

[99] C.A. No. 10107–CB, 2016 WL 3753123 (Del. Ch. Jul. 8, 2016), *rev'd*, 172 A.3d 346 (Del. 2017).

In August 2017, the Delaware Supreme Court unanimously reversed and remanded the Court of Chancery's decision in *DFC*.[100] The Court held that the best evidence of fair value was the merger consideration because it was the result of an open process with robust public information and easy access to non-public information.[101] Though the Court declined to create a judicial presumption in favor of the deal price, it made clear that the deal price should ordinarily be accorded significant weight: "the sale value resulting from a robust market check will often be the most reliable evidence of fair value, and that second-guessing the value arrived upon by the collective views of many sophisticated parties with a real stake in the matter is hazardous."[102] The Court also rejected a so-called "private equity carve out," a theory that suggests that the sale price in a transaction involving a private equity buyer is an unreliable indicator of fair value due to the buyer's focus on an internal rate of return.[103]

Four months later, on December 14, the Delaware Supreme Court unanimously reversed and remanded the Court of Chancery's decision in *Dell*.[104] The Court held that "the trial court erred in not assigning any mathematical weight to the deal price" because the record suggested "that the deal price deserved heavy, if not dispositive, weight."[105] The Court again declined to establish a presumption in favor of the deal price as a measure of fair value. The Court rejected the Court of Chancery's finding that "investor myopia" caused a valuation gap between fair value and the deal price because the evidence established an active trading market for Dell's shares, transparency regarding Dell's long-term strategy and no controlling stockholder.[106] The Court dismissed a "private equity carve out," holding that the absence of strategic bidders in the sales process was not a credible reason to disregard the deal price because there is "no rational connection between a buyer's status as a financial sponsor and the question of whether the deal price is a fair price."[107] The Court disagreed with the Court of Chancery's finding that the structure of the deal as a management-led buy out, in and of itself, provides a basis for not giving any weight to the deal price in the determination of fair value. According to the Court, Dell took steps to mitigate the likelihood of a "winner's curse," which "describes a theory that, in outbidding incumbent management to 'win' a deal, a buyer likely overpays for the company because management would presumably have paid

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[100] *DFC Glob.,* 172 A.3d at 348.

[101] *Id.* at 349.

[102] *Id.* at 366.

[103] *Id.* at 350.

[104] *Dell,* 2017 WL 6375829.

[105] *Id.* at *16.

[106] *Id.*

[107] *Id.* at *20.

more if the company were really worth it."[108] Dell "mitigated" the concern by allowing fair access to all necessary information to competing bidders.[109]

2. Court of Chancery Determines Fair Value Below the Deal Price in Synergy-Driven Transactions

The Court of Chancery also issued notable appraisal opinions in 2017, calculating fair values in two cases that were substantially below the merger consideration, confounding the "heads-I-win, tails-you-lose" approach adopted by many petitioners (believing an appraisal will result in a premium or the merger price). In reinforcing that merger-created value is excluded from fair valuation for purposes of an appraisal, these decisions provide guidance regarding the potential for fair valuations to undershoot the deal price in synergy-driven transactions.

In *In re Appraisal of SWS Grp. Inc.*,[110] filed in connection with Hilltop Holdings, Inc.'s acquisition of SWS Group Inc., Vice Chancellor Glasscock determined a fair value $6.38 per share, a material discount to the $6.92 per share part-cash and part-stock merger consideration.[111] The Court assigned no weight to the merger consideration for several reasons. First, neither party in the litigation relied on the merger consideration in their calculation of fair value, with the stockholders contending that the sales process was "hopelessly flawed" and the defendants arguing that the deal price incorporates "large synergies inappropriate to statutory fair value."[112] In particular, Hilltop's internal projections suggested that the acquisition of SWS would derive much of its benefits from cost-savings rather than SWS's stand-alone performance. Second, the Court found the merger consideration to be unreliable due to a "problematic process," including the potential effect on the deal price from a credit agreement that in certain circumstances granted Hilltop a veto over competing offers.[113] Using its own discounted cash flow analysis, the Court held that the fair value was $6.38 per share. According to the Court, the decision was "not surprising" because the deal was a "synergies-driven transaction whereby the acquirer shared value arising from the merger with SWS."[114]

Similarly, in *ACP Master, Ltd. v. Sprint Corp.*,[115] filed in connection with Sprint's acquisition of Clearwire, Vice Chancellor Laster determined a fair value of $2.13 per share, less than half the

108 *Id.* at *23-24.

109 *Id.*

110 C.A. No. 10554-VCG, 2017 WL 2334852 (Del. Ch. May 30, 2017).

111 *Id.* at *1.

112 *Id.*

113 *Id.* at *10.

114 *Id.* at *18.

115 C.A No. 8508-VCL, 2017 WL 3421142 (Del. Ch. July 21, 2017).

merger consideration of $5.00 per share.[116] *ACP* arose from a July 2013 buy out of Clearwire by Sprint, its majority stockholder. Sprint initially offered $2.97 per share for the minority shares of Clearwire. Following a bidding war with DISH Network Corp. featuring several topping bids, Sprint and Clearwire agreed to a merger at $5.00 per share. A hedge fund and its affiliates sued, claiming that Sprint breached its fiduciary duties as controlling stockholder and also sought appraisal of their shares, contending that the fair value of the stock was $16.00 per share.

The Court first addressed the fiduciary claims under an entire fairness standard of review (discussed in more detail below), holding that the transaction met the standard despite "flaws" and "blemishes."[117] The Court next considered the appraisal claim, relying entirely on a discounted cash-flow analysis to determine a fair value of the stock at $2.13 per share, well under the merger consideration and substantially below even Sprint's initial offer. The Court entirely disregarded the deal price in its calculation for two reasons. First, neither party argued the merger consideration should be given any weight, which the court found "unsurprising, because the Clearwire-Sprint Merger involved a controlling stockholder."[118] Second, the deal price "provided an exaggerated picture of Clearwire's value because the transaction generated considerable synergies."[119] According to Sprint's projections, the value created from the merger ranged from $1.95 to $2.60 per share. The Court adopted Sprint's discounted cash flow valuation in full to reach a fair value of $2.13 per share.

D. Delaware Supreme Court Provides Guidance on What Constitutes "Commercially Reasonable Efforts"

For the first time, the Delaware Supreme Court considered the meaning of the murky contract term "commercially reasonable efforts" in *Williams Cos. v. Energy Transfer, Equity L.P.,*[120] affirming in a split decision the Court of Chancery's denial of injunctive relief to an aggrieved seller. In *Williams*, Energy Transfer Equity, L.P. ("ETE") agreed to acquire the assets of The Williams Companies ("Williams") in a two-step merger.[121] The merger was conditioned on the issuance of an opinion by ETE's legal counsel that the second step of the transaction – the transfer of Williams' assets to ETE in exchange for partnership units issued by a newly formed subsidiary of ETE – should be a tax-free exchange under Section 721(a) of the Internal Revenue Code. The merger agreement required the parties to use "commercially reasonable efforts" to obtain the tax opinion and to use "reasonable best efforts" to consummate the transaction.[122] Following a decline in the energy

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116 *Id.* at *1.

117 *Id.* at *29.

118 *Id.* at *30.

119 *Id.* at *31.

120 159 A.3d 264 (Del. 2017).

121 *Id.* at 266.

122 *Id.* at 267.

market that caused a corresponding decrease in the value of the assets held by both parties, ETE wished to avoid the transaction and raised "concerns," including to its counsel, that the IRS may view a portion of the merger consideration as payment for Williams' assets, rendering the second step a taxable transaction.[123] ETE's legal counsel then refused to provide the tax opinion required by the merger agreement, so ETE indicated that it would not close the merger.[124] Williams sued, seeking to enjoin ETE from terminating the merger agreement on the basis that ETE failed to discharge its obligation to "use commercially reasonable efforts" to obtain the tax opinion and "reasonable best efforts" to consummate the transaction.[125]

The Court of Chancery observed that the term "commercially reasonable efforts" was undefined in the merger agreement and that there is no case law clearly explaining the phrase.[126] Relying on *Hexion Specialty Chems., Inc. v. Huntsman Corp.*,[127] the Court held that "reasonable best efforts" comports with good faith, and that the term "reasonable best efforts" was similar to "commercially reasonable efforts."[128] The court concluded that ETE was obligated "to do those things objectively reasonable to produce the desired . . . Opinion."[129] The Court denied the injunction, holding that ETE did not breach its obligations because ETE's counsel reached its decision independently and in good faith, and Williams had not identified any commercially reasonable efforts, or objectively reasonable actions, that ETE could have taken to secure the opinion from its counsel. The Court distinguished *Hexion*, which held a purchaser breached its "reasonable best efforts" obligations by "actively and affirmatively" taking steps to torpedo a transaction, noting that there was nothing in the record to suggest that ETE had manipulated or hidden any information or otherwise caused or obstructed its counsel's ability to issue the tax opinion.[130]

In affirming, the Delaware Supreme Court identified several errors in the Court of Chancery's decision, providing important guidance concerning the meaning of the covenants. According to the Supreme Court, the Court of Chancery "took an unduly narrow view of *Hexion*" by appearing to require bad-faith actions, such as coercing or misleading its counsel, to breach the covenants to use "commercially reasonable efforts" or "reasonable best efforts."[131] Rather, the Court held that the covenants require the parties "to take all reasonable steps to solve problems and consummate

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[123] *Id.*

[124] *Id.*

[125] *Id.*

[126] *Id.* at 271.

[127] 965 A.2d 715 (Del. Ch. 2008).

[128] 159 A.3d at 271.

[129] *Id.*

[130] *Id. at 272.*

[131] *Id.*

the transaction."[132] The Court observed that the Court of Chancery "could have concluded that ETE did breach its covenants," including because ETE "did not direct [its counsel] to engage earlier or more fully with Williams' counsel, failed itself to negotiate the issue directly with Williams, failed to coordinate a response among the various players, went public with the information that [its counsel] had declined to issue the [tax opinion], and generally did not act like an enthusiastic partner in pursuit of consummation of the [Merger Agreement]."[133] Nonetheless, the Court affirmed the Chancery's decision because "the record is barren of any indication that the action or inaction of [ETE] . . . contributed materially to [its counsel]'s inability to issue the [tax opinion]."[134]

The Delaware Supreme Court appears to have determined that the phrases "commercially reasonable efforts" and "reasonable best efforts" are essentially the same, holding that the "provisions placed an affirmative obligation on the parties to take all reasonable steps to obtain the 721 opinion and otherwise complete the transaction." [135] In light of the Supreme Court's decision, future merger counterparties should consider defining terms like "commercially reasonable efforts" or "reasonable best efforts" to avoid uncertain judicial interpretation. For example, to avoid the risk that a party may manufacture the failure of a one-sided condition once a transaction is no longer in that party's best interests (like Williams accused ETE of doing with respect to the provision of a tax opinion), merger counterparties should consider specifying exactly what actions must be taken to satisfy an obligation or covenant.

E. Court of Chancery Finds "Viable" Caremark Claims but Dismisses Derivative Action Due to Lack of Standing Post-Merger

The Court of Chancery has stated that Caremark claims – fiduciary claims based on a board of directors' failure of oversight – are "possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment."[136] In *In re Massey Energy Co. Deriv. & Class Action Litig.*,[137] Chancellor Bouchard found that plaintiffs satisfied this difficult hurdle at the pleading stage where the complaint contained "excruciating detail [of] a web of specific facts from which it would be reasonable to infer at the pleading stage that Massey fiduciaries knowingly failed to discharge their duty to ensure that Massey complied with its legal obligations when it came to mine safety."[138] On April 5, 2010, an explosion at a coal mine owned by Massey Energy killed 29 workers, resulting in the deadliest mining disaster in the United States in 40 years.[139] Subsequent investigations

[132] *Id.* at 272.

[133] *Id.* at 273.

[134] *Id.* at 274.

[135] *Id.* at 273.

[136] *In re Caremark Int'l Inc. Deriv. Litig.*, 698 A.2d 959, 967 (Del. Ch. 1996).

[137] 160 A.3d 484 (2017).

[138] *Id.* at 497.

[139] *Id.* at 491.

attributed blame to Massey's "knowingly flout[ing]," "ignoring" and "subverting" safety regulations and regulatory enforcement.[140] Multiple Massey employees, including its former CEO and Chairman, pled guilty or were convicted of criminal charges for their roles in the mine disaster.[141] Following these events, the company commenced a sales process, culminating in a merger agreement with Alpha Natural Resources, Inc.[142] Massey stockholders sought to enjoin the merger, which the Court of Chancery denied.[143] The transaction closed in June 2011.[144] The stockholder action was stayed for the next five years due to ongoing criminal investigations and Alpha's bankruptcy filing in 2015.[145] Following Alpha's emergence from bankruptcy, the Court considered motions to dismiss the then operative complaint, which included derivative and direct claims against the directors for breaching their fiduciary duties by "causing Massey to employ a deliberate and systematic business plan of willfully disregarding both internal and external safety regulations."[146]

The Court found that the complaint pled a "viable" claim that the directors breached their duty of oversight. According to the Court, the complaint provided "numerous detailed allegations" that Massey's officers and directors employed a systematic business plan to subvert safety regulations.[147] Nonetheless, the Court dismissed the derivative claims because the plaintiffs lacked standing following the extinguishment of their shares in the intervening merger.[148] Relying on the well-settled "continuous ownership rule" under Delaware law, the court held that standing to assert derivative claims requires stockholders to "hold shares not only at the time of the alleged wrong, but continuously thereafter throughout the litigation in order to have standing to maintain derivative claims."[149] Subject to limited exceptions, stockholders "lose standing when their status as stockholders of the company is terminated as a result of a merger."[150] Accordingly, the court dismissed the derivative claim because the Massey-Alpha merger terminated the plaintiffs' status as Massey stockholders. The plaintiffs also alleged a direct claim for "inseparable fraud" committed by directors who used an otherwise permissible merger to allegedly cover fraud.[151] The Court dismissed that claim as well, holding that the claim was derivative because the plaintiffs' challenge

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140 *Id.* at 492.

141 *Id.* at 495.

142 *Id.* at 487.

143 *Id.*

144 *Id.*

145 *Id.* at 495-96.

146 *Id.* at 487-88.

147 *Id.*

148 *Id.* at 488.

149 *Id.* at 497-98.

150 *Id.*

151 *Id.* at 498-99.

to the pre-merger conduct "boils down to a theory of mismanagement," rather than one involving fraudulent conduct that caused injury to any stockholder individually or separately from harm to the corporation.[152]

The Massey opinion reinforces the high standard required for plaintiffs to successfully plead and prevail on *Caremark* claims in Delaware. It also illustrates the rare circumstances in which the directors' conduct is egregious enough to render such a claim factually viable, but highlights that Delaware courts will rigidly enforce the standing requirements for direct or derivative stockholder litigation in addition to conducting a *Caremark* analysis.

F. Books and Records Demands

1. Court of Chancery Denied Corwin-Based Challenge to 220 Demand

In *Lavin v. West Corp.*,[153] the Delaware Court of Chancery held that a fully informed, uncoerced stockholder vote in favor of a merger does not preclude a stockholder's otherwise properly supported books and records demand under DGCL § 220 where the alleged purpose is to investigate supposed wrongdoing related to a merger. In *Lavin*, stockholder Mark Lavin served a demand on West Corporation to inspect its books and records to investigate his concerns about mismanagement and the disinterestedness of West's directors in a transaction pursuant to which the board allegedly chose a less-valuable sale of the whole company to preserve personal benefits to the directors and senior management over a more valuable piecemeal sale of the company.[154] The company opposed the Section 220 demand on the ground that, under *Corwin*, the stockholder vote cleansed any alleged breaches of fiduciary duty, permitting Lavin only to investigate claims for waste.[155] The Court rejected West's argument, holding that *Corwin* will not "stand as an impediment to an otherwise properly supported demand for inspection under Section 220."[156] According to the Court, "[a]ny contrary finding would invite defendants improperly to draw the court into adjudicating merits defenses to potential underlying claims in order to defeat otherwise properly supported Section 220 demands."[157]

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[152] *Id.* at 505.

[153] C.A. No. 2017-0547-JRS, 2017 WL 6728702 (Del. Ch. Dec. 29, 2017).

[154] *Id.* at *11-13.

[155] *Id.* at *1.

[156] *Id.*

[157] *Id.*

2. Court of Chancery Rules that Exculpatory Provision Does Not Bar 220 Demand Regarding Conflicts of Interest

In *Rodgers v. Cypress Semiconductor Corp.*,[158] Chancellor Bouchard ordered compliance with a books and records demand relating to a board member's alleged conflicts of interest pursuant to Section 220 of the DGCL, rejecting the argument that inspection was barred by an exculpatory provision in the corporation's certificate of incorporation. In late 2016, T.J. Rodgers, the former President and CEO of Cypress Semiconductor Corporation ("Cypress") and a Cypress stockholder, notified Cypress of his concerns that Ray Bingham, its new Executive Chairman, was also serving as founding partner of a private equity firm that was competing with Cypress for acquisition opportunities in the semiconductor industry.[159] Rodgers served a demand on Cypress under Section 220 seeking documents relating to Bingham's potential conflicts of interest, including documents relating to Bingham's employment with the private equity firm, the firm's affiliation with the Chinese government, the firm's intent to acquire other semiconductor-related entities, and Bingham's compliance with the company's Code of Business Conduct and Ethics.[160] The demand provided multiple purposes for the inspection, including to "[c]ommunicate with stockholders of the Company regarding . . . the composition of the Company's Board of Directors," to "[i]nvestigate possible mismanagement and breaches of fiduciary duty," and to "[e]valuate possible litigation or other corrective measures."[161]

Chancellor Bouchard rejected Cypress's argument that inspection was precluded by a Section 102(b)(7) exculpatory provision in the company's certificate of incorporation, which limits the personal liability of directors for monetary damages except for certain categories of misconduct, including breaches of the duty of loyalty and acts or omissions "not in good faith."[162] Citing the Court of Chancery's 2015 decision *Se. Penn. Transp. Auth. v. AbbVie Inc.*,[163] Cypress argued that, because the only alleged misconduct was attributable to a single board member, Rodgers could not demonstrate a credible basis to infer that a majority of the Cypress board breached a non-exculpated duty and, accordingly, his demand could serve no proper purpose. The Court found *AbbVie* distinguishable because, there, the stockholder's "sole motivation" in seeking documents was to initiate derivative litigation for breach of fiduciary duty.[164] In contrast, Rodgers sought the documents for multiple purposes, including communicating with stockholders and evaluating the suitability of the current members of the Cypress board. Thus, "it is irrelevant whether Rodgers has

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[158] C.A. No. 2017-0070-AGB, 2017 WL 1386621 (Del. Ch. Apr. 17, 2017).

[159] *Id.* at *2.

[160] *Id.*

[161] *Id.*

[162] Del. Code Ann. tit. 8, § 102(b)(7) (West 2006 & Supp. 2017).

[163] C.A. No. 10374-VCG, 2015 WL 1753033 (Del. Ch. Apr. 15, 2015), *aff'd*, 132 A.3d 1 (Del. 2016).

[164] *Rodgers*, 2017 WL 1380621, at *4.

established a credible basis to infer a non-exculpated breach of fiduciary duty by any of the other members of Cypress' board."[165]

When *AbbVie* was decided, some commentators questioned whether subsequent courts would treat the decision broadly or narrowly. A broad interpretation could have required a stockholder to allege a non-exculpated claim to access the books and records of a corporation that has adopted a Section 102(b)(7) provision, if even one of the stockholder's purposes for the inspection was to investigate potential derivative claims. *Rodgers* suggests that stockholders may still be entitled to the inspection of documents by establishing a proper purpose other than initiating derivative litigation.

II. Controlling Shareholders

A. Court of Chancery Holds that a Controlling Stockholder May Escape Entire Fairness Review in a Conflicted "One-Sided" Controller Transaction

In *In re Martha Stewart Living Omnimedia Inc. Stockholder Litig.*,[166] Vice Chancellor Slights dismissed a stockholder challenge to the sale of Martha Stewart Living Omnimedia, Inc. ("MSLO") to a third-party purchaser, Sequential Brands Group, Inc. ("Sequential"). The plaintiffs alleged that MSLO's controlling shareholder, Martha Stewart, improperly leveraged her position to secure greater consideration for herself through a series of "side deals," including a multi-million dollar employment agreement, the extension of her intellectual property rights, and an agreement to reimburse Stewart up to $4 million in expenses relating to the negotiations. According to the plaintiffs, Stewart engaged in a "conflicted" transaction and the entire fairness standard of review should apply.

The Court first determined that the transaction did not involve a controller conflict, which exists where, for example: (1) a parent acquires a subsidiary or (2) the controller exploits its position to divert consideration from minority stockholders to itself. In the Court's analysis, the Martha Stewart transaction did not fit either scenario. Stewart was only on the sell-side and did not have a relationship with the buyer. And the Court explained that, to plead a conflict in a "one-sided" controller transaction, the plaintiffs must establish that the controller "extract[ed] different consideration or derive[d] some unique benefit from the transaction not shared with the common stockholders."[167] The Court held that the plaintiffs had failed to plead facts supporting the inference that Stewart received different or unfair consideration in the transaction. Stewart received the same per share consideration that all other stockholders received. The Court also found that

[165] *Id.* at *5.

[166] C.A. No. 11202-VCS, 2017 WL 3568089 (Del. Ch. Aug. 18, 2017).

[167] *Id.* at *11.

the side deals did not "divert" consideration from the minority shareholders. The Court found it significant that it was Sequential, not Stewart, that initiated the negotiations for the side deals to ensure that Stewart would remain involved with the company. According to the Court, "[i]t was entirely proper for Sequential to pay, and for Stewart to accept, extra consideration (just as MSLO had paid before the Merger) to secure the immeasurable value" of "Martha Stewart's time, energy and talent to the keep the brand alive and thriving."[168]

The Court next held that, even if Stewart had engaged in a "one-sided" conflicted transaction, the transaction would be subject to review under the deferential business judgment rule standard pursuant to the framework set forth in *In re MFW S'holders Litig*.[169] In *MFW*, the Delaware Supreme Court held that the level of scrutiny applied to a transaction involving a controlling stockholder on both sides of the transaction changes from entire fairness review to the business judgment rule when the transaction was conditioned at the outset on the approval of (i) an empowered, independent special committee and (2) a fully informed majority vote of non-controlling shareholders.[170] Vice Chancellor Slights held that *MFW* applied to conflicted one-sided controller transactions, and applied to the Omnimedia deal because "the dual procedural protective measures deployed . . . followed the *M & F Worldwide* road map with precision."[171] In so finding, the Court rejected an argument made by the plaintiffs that the business judgment rule could not apply because the procedural protections were not in place when the merger negotiations commenced. The Court held that, in a one-sided controller transaction, the pivotal moment for the imposition of the procedural protections is before the controller begins negotiations with the purchaser, not before the companies commence discussions. According to the Court, "[i]f the procedural protections are implemented before that time, then all actors, and most importantly the controlling stockholder, enter those negotiations aware that both the Special Committee and the majority of the minority stockholders will have the final say on whether the deal, with the controller's extra consideration, will be approved."[172]

The Court also rejected conclusory allegations by plaintiffs that the special committee members were beholden to Stewart due to prior business relationships, and pointed to the facts that the special committee met frequently, rejected proposals for MSLO and convinced Sequential to increase its offer to rebut plaintiffs' allegations that the special committee was ineffective. Likewise, the Court rejected plaintiffs' contention that the vote was ineffective because the minority stockholders were uninformed. Interestingly, the Court observed that plaintiffs may have had more

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168 *Id.* at *13.

169 67 A.3d 496, 499 (Del. Ch. 2013), *aff'd sub nom. Kahn v. M & F Worldwide Corp.*, 88 A.3d 635 (Del. 2014).

170 *Id.* at 502.

171 2017 WL 3568089, at *2.

172 *Id.* at *19.

success had they argued that the vote was coercive, suggesting another potential limitation on *MFW*.

The decision in *In re Martha Stewart* is notable in several respects. *First*, in holding that Stewart did not extract consideration from Sequential that should have gone to MSLO stockholders, the Court refused to credit allegations in the complaint that were contradicted by the proxy statement, bringing it in line with several recent Delaware decisions that have rejected after-the-fact litigation positions contradicted by contemporaneous emails or other written material.[173] *Second*, the opinion provides a roadmap for structuring the sale of a controlled company to a third party where the buyer wishes to negotiate separate arrangements with a controlling stockholder: form and empower an independent special committee before the beginning of any substantive discussions between the controller and the buyer, and ensure the transaction is conditioned on approval by the committee and a majority of the minority stockholders in a fully informed, uncoerced vote. *Third*, the opinion continues the recent trend in Delaware case law deferring to the decisions of independent directors and providing a cleansing effect to the uncoerced, fully informed vote of stockholders. *Fourth*, the decision shows that not all disparate consideration paid to a controlling shareholder creates a material conflict with minority stockholders. *Fifth*, courts require factual allegations of undisclosed, material conflicts on the part of committee members or financial advisors in order for such conflicts to render the Committee not independent or ineffective.

B. Alleged Misconduct in Squeeze-Out Merger May Be Cleansed by Later Competitive Bidding Process

In *ACP Master*,[174] Vice Chancellor Laster held in a post-trial opinion that a controller cash-out merger was "entirely fair" and appraised the fair value at less than half the deal price.[175] As discussed above, *ACP* concerned a July 2013 buy out of Clearwire by Sprint, its majority stockholder. Sprint initially offered $2.97 per share for the minority shares of Clearwire. Following a bidding war with DISH Network Corp. featuring several topping bids, Sprint and Clearwire agreed to a merger at $5.00 per share. A hedge fund and its affiliates sued, claiming that Sprint breached its fiduciary duties as controlling stockholder and also sought appraisal of their shares, contending that the fair value of the stock was $16.00 per share.

The Court addressed the fiduciary claims under the entire fairness standard of review, which places the burden on the defendant to "establish 'to the court's satisfaction that the transaction was the product of both fair dealing and fair price.'"[176] The Court found "an array of misconduct" in

[173] *See*, *e.g.*, *Pell v. Kill*, 135 A.3d 764 (Del. Ch. 2016); *Fox v. CDX Holdings Inc., C.A.* No. 8031-VCL 2015 WL 4571398 (Del. Ch. July 28, 2015), *aff'd*, 141 A.3d 1037 (Del. 2016); *In re El Paso Pipeline Partners*, *L.P. Deriv. Litig.*, C.A. No. 7141-VCL, 2015 WL 1815846 (Del. Ch. Apr. 20, 2015).

[174] 2017 WL 3421142, at *1.

[175] *Id.*

[176] *Id.* at *17 (citation omitted).

connection with Sprint's initial offer, including an undisclosed side deal where Sprint's parent, Softbank, agreed to expand its business relationship with Clearwire's second-largest stockholder, Intel, by launching Intel-based phones in three new countries in exchange for Intel's support of the transaction.[177] The Court also noted interference with Clearwire's business in an effort to depress the valuation and retributive threats to Clearwire's minority stockholders to engage in "substantial dilution" should the merger fail – and noted that if Sprint had obtained stockholder approval at the original price of $2.97 per share, its "acts of unfair dealing would have resulted in a finding of unfairness and a damages award in the form of a fairer price."[178] However, the Court held that the subsequent bidding war "changed the landscape so substantially as to render immaterial the instances of unfair dealing that took place during the first phase."[179] According to the Court, "[a]fter DISH intervened and the merger consideration was raised to $5.00 per share, the relevance, materiality and effectiveness of [the misconduct] faded."[180] Thus, the Court held that the transaction met the entire fairness standard despite a record reflecting "flaws," "blemishes," and a "deal process [that] was far from perfect."[181]

In addition to illustrating the potential pitfalls for plaintiffs opting for appraisal, *ACP* demonstrates that the entire fairness standard, although exacting for defendants to meet, is not insurmountable. Even in the face of a flawed deal process, defendants may be able to establish "entire fairness" if they provide sufficient evidence as to the reasonableness of the ultimate transaction price. As Vice Chancellor Laster noted, "[t]he fair price aspect can be 'the predominant consideration in the unitary entire fairness inquiry.'"[182]

III. Updates to Delaware Law

A. "Blockchain" Amendments to the DGCL Now In Effect

Effective August 1, 2017, Delaware authorized companies to use "blockchain technology," information technology that incorporates distributed ledgers and smart contracts, for corporate recordkeeping, including share issuances and transfers.[183] In a distributed ledger, there is a single record of transactions among multiple parties that do not require reconciliation or a trusted intermediary to verify and process the transactions. Smart contracts are automated "if/then" software programs that execute automatically upon a triggering event. Delaware now allows for

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177 *Id.* at *6.

178 *Id.* at *20.

179 Id.

180 *Id.* at *26.

181 *Id.* at *29-30.

182 *Id.* at *27 (citation omitted).

183 Cindy L. Dole & Doneld G. Shelkey, *Delaware Blockchain Law Goes Into Effect*, NAT'L LAW REV. (Aug. 11, 2017), https://www.natlawreview.com/article/delaware-blockchain-law-goes-effect.

these automated processes in certain contexts, including the creation and maintenance of stock ledgers. As amended, Delaware General Corporation Law ("DGCL") § 224 provides that corporate records administered by or on behalf of a Delaware corporation may be kept on "one or more electronic networks or databases (including one or more distributed electronic networks or databases)."[184] DGCL § 219 expressly extends that authorization to stock ledgers.[185]

To date, three other states in addition to Delaware—Arizona, Nevada, and Vermont—have passed laws addressing the commercial use of blockchain, e-contract, and e-signature technologies. In 2018, it is likely that other states will follow suit to various degrees, indicating a growing momentum toward the use of blockchain for more than simply maintaining bitcoin ecosystems. As states develop their own rules, there may be an outcry for a national standard to avoid inter-state inconsistencies and confusion. Delaware's experience using blockchain technology for various corporate governance functions such as maintaining stock ledgers and managing UCC filings, as well as for monitoring non-compliant activities and reducing audit burdens, will likely be viewed as a test case by other jurisdictions as well as federally and internationally.

As adoption spreads, various state cybersecurity and data protection laws also will need to be re-examined to determine whether they are compatible with blockchain's open-records approach. While having a decentralized and public data repository may be less subject to attack and manipulation, it has implications for consumer privacy, particularly in the financial services and health care sectors.

B. Amendments to DGCL Simplify Mergers Between Delaware and Non-Delaware Corporations

Recent amendments to Delaware law that came into effect in 2017, including DGCL §§ 252, 253, 254, 256, 258, 263, 264 and 267,[186] sought to bring consistency to the types of foreign entities with which Delaware corporations are permitted to merge or consolidate. As amended, mergers with foreign entities will be permitted if the foreign jurisdiction does not "prohibit" the merger. This uniform standard replaces various previous standards with minor variations in language requiring the merger to be "permitted" or that the foreign statute "not forbid" the merger. The revised language is intended to be permissive and to be consistent across all types of legal entities.

In addition, the amendments to DGCL §§ 254, 263 and 264 make clear that mergers with foreign entities of the types covered by such sections (joint stock or other association, partnership and

[184] Del. Code Ann. tit. 8, § 224 (West 2006 & Supp. 2017).

[185] Del. Code Ann. tit. 8, § 219 (West 2006 & Supp. 2017).

[186] S.B. 69, 149th Gen. Assemb. (Del. 2017).

limited liability companies) are now expressly permitted, whereas the previous statutory language only allowed such mergers if the non-Delaware jurisdiction also permitted them.

Many of the newly enacted amendments clean up statutory language and bring technical consistency to provisions, with little practical impact on litigation trends in Delaware. Substantively, the foreign entity provisions eased requirements for mergers between Delaware corporations and non-Delaware entities by removing a potential deal obstacle.

IV. Shareholder Activism

A. Developments in Shareholder Activism

In 2017, activist shareholders deployed record amounts of capital to target some of the world's largest companies. Lazard reports that activist investors deployed $45 billion in the first three quarters of 2017, nearly double the amount deployed in all of 2016.[187] Large campaigns drove this growth, with a 66% spike in campaigns targeting companies with a market capitalization of $10 billion or greater, and a 70% increase in campaigns for companies with a market capitalization of at least $5 billion.[188] While a rise in settlements caused fewer campaigns to proceed all the way through an election, activists successfully obtained at least one seat in 50% of campaigns that went to a vote.[189]

In what has been called the most expensive proxy campaign in history, Nelson Peltz ultimately won a seat on the board of Procter & Gamble after his fund, Trian Fund Management LP, spent $25 million against the $100 million spent by P & G. Initially, Peltz appeared to have narrowly lost his bid following the company's declaration of victory after the annual meeting on October 10. A recount performed by an independent inspector, however, declared Peltz the winner by just 43,000 votes – a margin of 0.0016% – over Ernest Zedillo, a former president of Mexico.[190]

In other contested matters, activists pursued litigation to achieve their goals. For example, Marcato Capital Management, which reported a 8.4% stake in Deckers Outdoors Corporation, filed suit against the board in Delaware Chancery Court seeking to defuse "proxy penalties" embedded within compensation plans and a debt facility that would be triggered upon a change in the majority

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[187] LAZARD, REVIEW OF SHAREHOLDER ACTIVISM – 3Q 2017 at 1 (Oct. 2017), https://www.lazard.com/media/450309/lazard-review-of-shareholder-activism-q3-2017-final.pdf.

[188] Liz Moyer, *Activist Hedge Funds Target Bigger and Bigger US Cos. in Year of the 'Super Campaign'*, CNBC (Aug. 9, 2017), https://www.cnbc.com/2017/08/09/activist-hedge-funds-target-big-companies-in-year-of-super-campaign.html.

[189] LAZARD, *supra* note 181, at 8.

[190] Daniel Faber, *Procter & Gamble Challenges Activist Peltz on Proxy Vote Recount, Sources Say*, CNBC (Nov. 22, 2017), https://www.cnbc.com/2017/11/22/procter-gamble-challenges-activist-peltz-on-proxy-vote-recount.html; Andrew Ross Sorkin, *DealBook Briefing: Peltz Gets His Seat on Proctor & Gamble's Board*, N.Y. TIMES (Dec. 15, 2017), https://www.nytimes.com/2017/12/15/business/dealbook/rupert-murdoch-fox.html.

of the composition of the board by "unapproved" directors. Additionally, Marcato sought an order fixing the date of the annual shareholder meeting.[191] The board ultimately mooted the litigation by disabling the proxy penalties and committing to hold its annual meeting as scheduled on December 14.

Notable Shareholder Activism Campaigns in 2017

Target	Activist and Stake	Outcome
Buffalo Wild Wings	Marcato Capital Management (9.9%)[192]	Marcato won three of the company's nine board seats.
CSX Corp.	Mantle Ridge LP (4.9%)	Activist and company reached a deal to appoint new CEO, and to appoint the new CEO and four Mantle Ridge candidates to the board.
Deckers Outdoor Corp.	Marcato Capital Management (8.4%)	Shareholders re-elected incumbent board.
Proctor & Gamble	Trian Partners (1.5%)	Trian won a board seat following a recount.
ADP	Pershing Square Capital Management (8.3%)[193]	Shareholders rejected Pershing Square's bid for three ADP board seats.
Whole Foods	Jana Partners LLC (8.8%)	Company named five new independent directors before announcing sale to Amazon.
Arconic	Elliot Management Corp. (13.2%)	Company agreed to appoint three Elliott candidates to board and replace CEO.
Hain Celestial	Engaged Capital (9.9%)	Company agreed to nominate six new directors to the board, three incumbents retired.

191 Verified Complaint, *Marcato Int'l Master Fund, Ltd. v. Gibbons*, No. 2017-0751 (Del. Ch. Oct. 23, 2017).

192 Cadwalader, Wickersham & Taft LLP represented Marcato in its contests with Deckers and Buffalo Wild Wings, along with related litigation against Deckers.

193 Cadwalader, Wickersham & Taft LLP represented Pershing Square in this matter.

Target	Activist and Stake	Outcome
General Motors	Greenlight Capital (3.6%)	Shareholders rejected Greenlight Capital's bid for three board seats and proposal for a stock split.

B. Court of Chancery Enforces Oral Agreement to Settle Proxy Contest

In *Sarissa Cap. Domestic Fund LP v. Innoviva, Inc.*,[194] Vice Chancellor Slights concluded that an oral agreement to settle a proxy contest was binding and enforceable.[195] In February 2017, Sarissa Capital launched a proxy contest to elect three directors to Innoviva, Inc.'s board of directors at the company's April 20 annual meeting.[196] The day before the annual meeting, Innoviva orally extended a settlement offer to Sarissa to name two directors to the board; Sarissa accepted, and the parties began drafting a written settlement agreement.[197] Later that day, upon learning that a large stockholder planned to vote for the incumbent slate, Innoviva rescinded its settlement offer.[198] The annual meeting was held on April 20 as scheduled, and stockholders re-elected all six incumbent directors. Sarissa filed suit in the Court of Chancery seeking enforcement of the oral settlement agreement, and the Court held a one-day trial on July 27.[199] On December 8, after considering evidence concerning the board's state of mind and intent to be bound by a settlement offer, the absence of language in draft settlement agreements providing that an agreement would become effective only upon execution of a written agreement, and the interactions between the parties, the Court concluded that the parties had entered into a binding oral agreement and ordered Innoviva to appoint two Sarissa nominees to its board of directors.[200]

The *Sarissa* case offers several lessons for companies and activists. *First*, it is a timely reminder that a writing is not necessary to form a binding agreement. Courts will look at the conduct of parties to determine whether an oral agreement exists, including prior draft agreements, the interaction between the parties, and evidence of the directors' state of mind. *Second*, parties should exercise caution to ensure that their agents do not inadvertently enter an oral agreement.

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194 C.A. No. 2017-0309, 2017 WL 6209597 (Del. Ch. Dec. 8, 2017).

195 *Id.* at *1. For an extended analysis of the case, *see* Joshua Apfelroth et al., *M & A Update: Del. Court of Chancery Enforces Oral Agreement to Settle Proxy Contest*, CADWALADER, WICKERSHAM & TAFT LLP (Dec. 27, 2017), http://www.cadwalader.com/resources/clients-friends-memos/ma-update-delaware-court-of-chancery-enforces-oral-agreement-to-settle-proxy-contest.

196 *Id.* at *1.

197 *Id.* at *2.

198 *Id.* at *3.

199 *Id.*

200 *Id.*

Third, parties should continually evaluate settlement options rather than delaying negotiations until the last minute.

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