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After Akorn v. Fresenius, the first set of rulings that have ever enforced an MAE clause, four lawyers from Morgan Lewis explore the practical implications for those who negotiate and draft merger agreements and the litigators who fight for them in the courts. The lawyers are Troy Brown, a partner in the firm's Philadelphia office; Karen Abesamis, a partner in the Silicon Valley office; Su Jin Kim, a firm associate in the Philadelphia office; and Corey Mueller, a firm associate in San Francisco.

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Akorn

Practical Implications, M&A Drafting Tips, and Litigation Risk Management

By Troy Brown, Karen Abesamis, Su Jin Kim, and Corey Mueller

On December 7, 2018, the Delaware Supreme Court upheld a decision by the Delaware Chancery Court in *Akorn, Inc. v. Fresenius Kabi AG*, No. CV 2018-0300-JTL, 2018 WL 4719347 (Del. Ch. Oct. 1, 2018), aff'd, No. 535, 2018, 2018 WL 6427137 (Del. Dec. 7, 2018), affirming the right of Fresenius to walk away from a $4 billion acquisition because of the occurrence of a material adverse effect ("MAE"). The Chancery Court's decision in *Akorn* was the first of its kind to conclude that a buyer could terminate a merger agreement as a result of the occurrence of an MAE between signing and closing. This article examines the material facts and circumstances of *Akorn* and the key takeaways from the Chancery Court's opinion. Additionally, this article provides a series of drafting tips that M&A practitioners in both law and business should consider when negotiating and drafting acquisition agreements. In particular, the drafting tips set forth in this article focus on: (i) the importance and specificity required when crafting the definition of what constitutes a "material adverse effect"; (ii) the practical implications of the Chancery Court's distinction between "material adverse effect" and "in all material respects" qualifiers in the context of M&A representations and warranties; and (iii) practical considerations for practitioners when contemplating different "efforts" standards.

Despite careful and deliberate drafting, however, a buyer may find itself in a situation where it is contemplating terminating an agreement based on the existence of an alleged MAE. This may happen even if the parties to the deal have specified what constitutes an MAE or what level of efforts are required of the parties. While companies may take the *Akorn* decision to mean that Delaware courts are now more willing to find that an MAE has occurred, the opinion makes clear, in the litigation risk management context, how critical it is for a buyer to comply "in good faith" with all of its contractual obligations, even in the face of an MAE. In other words, to anticipate and mitigate the litigation risk that inevitably follows the invocation of an alleged MAE, the Chancery Court's decision does not now give remorseful buyers *carte blanche* to terminate deals they no longer find palatable. Post *Akorn*, establishing an MAE remains a heavy burden for a buyer to bear.

Background

Fresenius agreed to acquire Akorn pursuant to the terms of an agreement and plan of merger dated April 24, 2017 (the "Merger Agreement"). Fresenius's obligation to close the merger was conditioned upon standard closing conditions, including: (1) Akorn's representations and warranties having been true and correct both at signing and closing, except where the failure to be true and correct would not reasonably be expected to have a contractually defined MAE (or as the Chancery Court called it, a "General MAE"); (2) Akorn's compliance in all material respects with its regulatory obligations under the Merger Agreement (what the Chancery Court termed a "Regulatory MAE"); and (3) Akorn not having suffered a MAE.

Shortly after the execution of the Merger Agreement, Akorn's "business performance

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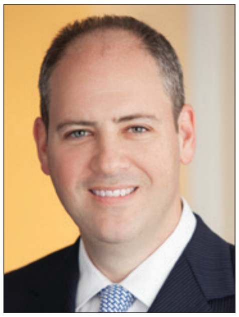

Troy Brown
Morgan Lewis

Karen Abesamis
Morgan Lewis

fell off a cliff." The Chancery Court's decision noted the following key facts: (1) Akorn's financial performance fell materially below its prior-year performance following signing despite Akorn having reaffirmed its financial projections to Fresenius on the date of the Merger Agreement; (2) in October and November 2017, Fresenius received letters from anonymous whistleblowers, alleging alarming and systemic regulatory compliance violations of Food and Drug Administration ("FDA") data integrity requirements including falsification of data; and (3) despite constant pressure by Fresenius and its counsel for answers, Akorn elected not to take affirmative action such as engaging its own investigative counsel, not to provide transparent answers and documents supporting its financial health and business integrity or to take affirmative actions to rectify its regulatory failings. At this point, Fresenius began consulting with its legal counsel regarding precedent deals gone bad, including prior attempts to terminate acquisitions. Despite the regulatory compliance concerns, Fresenius continued to proceed towards closing, including exploring alternative product launches on an accelerated basis to replace lost pipeline revenue. Akorn opted not to engage its own investigative counsel, but rather chose to rely on its deal counsel to "monitor Fresenius's investigation and head off any problems". As the Chancery Court notes, Akorn's deal counsel had never conducted a data integrity investigation for a pharmaceutical company and was not familiar with FDA rules and regulations. Fresenius on the other hand conducted its own investigation by engaging counsel who specializes in FDA enforcement and compliance matters. The results of such investigation once again identified serious data integrity violations. At the conclusion of its investigation and prior to terminating the Merger Agreement, Fresenius offered Akorn the choice of extending the outside date of the Merger Agreement until August 2018 to allow for additional time for Akorn to further investigate the data integrity issues, but Akorn declined. In light of the foregoing, Fresenius gave notice that it was terminating the Merger Agreement on April 22, 2018 pursuant to the termination provision of the Merger Agreement.

In upholding the validity of Fresenius's termination of the Merger Agreement, the Chancery Court held that Akorn had not satisfied its closing conditions set forth in the Merger Agreement. First, Akorn's representations regarding compliance with certain regulatory requirements were not true and correct, and "the magnitude of [such] inaccuracies would reasonably be expected to result in a MAE." Second, Akorn materially breached its obligations under the Merger Agreement as it was not operating in the ordinary course between signing and closing. Finally, the Chancery Court held Akorn had suffered a MAE.

Based on the Chancery Court's decision, set forth below are a few M&A drafting considerations as well as practical implications that practitioners should contemplate when negotiating and drafting acquisition agreements.

M&A Drafting Tips

Tailoring MAE Definitions

In reaching its decision that Akorn suffered an MAE, the Chancery Court's opinion focused extensively on the strict contractual terms set forth in the Merger Agreement, parsing in great detail the definition and exceptions to what constitutes a "Material Adverse Effect." As parties are typically averse to defining a specific test for materiality, the most common approach is to broadly define materiality and negotiate specific exclusions and carve-outs to such definition. In its analysis, the Chancery Court acknowledged such common practice and noted that such MAE definitions generally reveal four categories of risk: (i) systematic risks – risks that are "beyond the control of all parties" (e.g., economy-wide risks), (ii) indicator risks – any risk that "is not itself an adverse change, but rather evidence of such a change" (e.g., decline in stock price, credit rating downgrades, failure to meet financial projections, etc.), (iii) agreement risks – risks related to actions contemplated by the Merger Agreement and the public announcement of the transaction (e.g., potential employee flight), and (iv) business risks – risks "arising from the ordinary operations of the party's business" (e.g., risks associated with operating the business in the ordinary course). Often, a buyer assumes the first three categories of risk, with a seller bearing the business risks, under the notion that it is better situated to control and manage such risks.

Based on the foregoing, savvy practitioners will proceed cautiously when drafting MAEs, ensuring that both (1) the general statement of what constitutes a MAE and (2) the carve outs and exclusions of events that would otherwise give rise to an MAE are consistent with the business agreement between a buyer and seller. In particular, special consideration of the four risk categories should be explained to clients, with resulting modifications to the definition of MAE being tailored to the client's desired risk allocation.

Furthermore, practitioners should discuss with their clients the risks of relying on standard MAE provisions and should discuss whether the specific circumstances indicate a more tailored solution on a transaction-by-transaction basis, including considerations for any particular circumstances, events, and risks that may be anticipated in the context of each transaction and the industry of the parties. Bear in mind, the final terms of such definition and exclusions will inevitably be highly negotiated by both parties and their respective business and legal advisors.

Distinguishing "material adverse effect" from "in all material respects"

The Chancery Court also closely examined the closing conditions qualified by "in all material respects" and further parsed the application of such language in the context of representations or covenants as compared to a determination of whether an MAE has occurred.

The Chancery Court's opinion first looks at the common law application of "in all material respects" as well as the five-factor test set forth in the Restatement (Second) of Contracts. The Chancery Court ultimately determined it was more appropriate to apply the standard set forth in treatises for acquisition agreements and similar to the standard used in disclosure law, noting that in the M&A context an "in all material respects" qualifier is determined by whether such inaccuracy or breach "significantly alter[s] the 'total mix' of information." By comparison, a MAE qualifier will only be breached in the event a party can demonstrate durationally-significant quantitative and qualitative aspects. Ultimately, the Chancery Court did not establish a bright-line test to determine such quantitative and qualitative aspects.

Practitioners should carefully review each provision to determine the appropriate materiality qualification that should apply. Additionally, the Chancery Court also discussed the possibility of drafters using a dollar threshold rather than a MAE qualifier to determine the inaccuracy of a representation or warranty, although this approach bears its own risks as well. To the extent parties wish to utilize different materiality standards in different provisions, parties should do so cautiously, be specific, and ensure their intent has been properly reflected and synthesized throughout the acquisition agreement. The Chancery Court also determined that the double presence of the "in all material respects" qualification in the closing condition and the underlying covenants itself may be viewed as a single-materiality standard. Practitioners should proceed with caution.

Drafting Efforts Standards

As a condition to closing, the Merger Agreement provided that Akorn shall "use its… commercially reasonable efforts to carry on its business in all material respects in the ordinary course of business." In holding that Akorn failed to do so, the Chancery Court closely examined the "commercially reasonably efforts" qualifier. The Chancery Court analyzed the standards typically used by practitioners, including the commonly used standards from The ABA Committee on Mergers and Acquisitions, which sets forth a hierarchy among the various standards (e.g., "best efforts", "reasonable best efforts", "reasonable efforts", "commercially reasonable efforts", and "good faith efforts").

The Chancery Court also examined existing Delaware case law noting that by comparison there is little support in Delaware case law for common distinctions and hierarchy drawn by transactional lawyers. Furthermore, the Chancery Court noted that Delaware case law often does not distinguish between the various efforts standards and noted that even "best efforts" (which is generally considered to be the highest standard) requires some application of a reasonableness test and "it cannot mean everything possible under the sun."

In light of the Chancery Court's seemingly deliberate lack of clarity in distinguishing between the various efforts standards, practitioners should carefully consider relevant factors and where appropriate be explicit in actions that are expected to be undertaken (e.g., listing such actions or expectations in a separate schedule). Failure to do so may result in undesirable and unintended outcomes based on existing Delaware case law that has effectively applied a similar reasonableness efforts standard across the various standards despite the parties' intent.

Information Access

Information rights between signing and closing are a standard right in merger agreements, however, in light of Akorn, buyers counsel would be best served to ensure that such information rights are broad and that the right to such information is not hamstringed by being limited to a specific purpose. In *Akorn*, the Chancery Court found that Fresenius had "bargained for a right of reasonable access to Akorn's officers,

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Morgan Lewis

Corey Mueller
Morgan Lewis

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employees, and information so that Fresenius could evaluate Akorn's contractual compliance and determine whether the conditions to closing were met." Fresenius relied on this broad informational access covenant to conduct its own investigation into the data integrity concerns and whistleblower letters. The Chancery Court determined Fresenius's actions to be proper as it continued to evaluate the transaction between signing and closing to determine whether to proceed with the transaction. Conversely, seller's counsel should be wary of granting broad information rights and where appropriate tailor such information rights, both as to extent and to purpose.

Sandbagging Clauses

Akorn also argued that Fresenius assumed the risk of any potential regulatory violations and signed the Merger Agreement anyways. In rejecting such an argument, the Chancery Court notes Fresenius explicitly bargained for representations on this matter and also examined Delaware case law, noting Delaware's continued pro-sandbagging position. Practitioners representing buyers should be explicit in drafting pro-sandbagging provisions but also be conscious of jurisdictional differences that may lead to unforeseen outcomes. Practitioners representing sellers will likely continue to push for an explicit anti-sandbagging provision.

Litigation Risk Management

How to Demonstrate an MAE Has Occurred

As Vice Chancellor Laster made clear, even after *Akorn*, "[a] buyer faces a heavy burden when it attempts to invoke a material adverse effect clause in order to avoid its obligation to close." [1] Indeed, Fresenius was well aware of the hurdles it would have to overcome before it could terminate the Merger Agreement. As of November 2017, even though Fresenius "regarded Akorn's disastrous performance as falling within a *businessperson's* understanding of what should qualify as a material adverse effect," its "*legal advisors* were not confident that they could prove to the satisfaction of a court applying Delaware law that Akorn had suffered a Material Adverse Effect . . . ." [2]

Nonetheless, Vice Chancellor Laster identified several ways in which a buyer can demonstrate that an MAE has occurred, thereby permitting it to terminate an agreement to acquire a target company. In fact, the Chancery Court determined there had been both a "General MAE" and misrepresentations regarding Akorn's compliance with regulatory requirements so severe as to "reasonably be expected to result in a Regulatory MAE." [3]

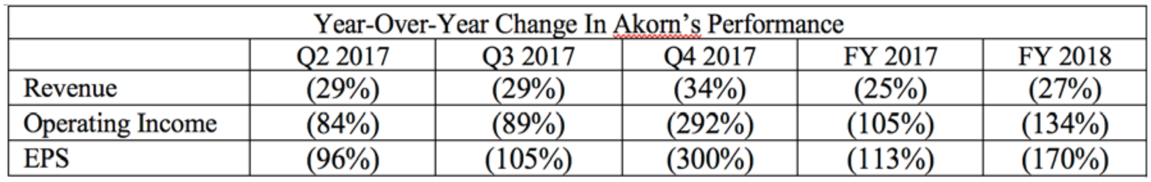
General MAE

Analyzing several different financial metrics, the Chancery Court found that "[t]he sudden and sustained drop in Akorn's business performance constituted a General MAE." [4] According to the Chancery Court, "[t]he important consideration . . . is whether there has been an adverse change in the target's business that is consequential to the company's long-term earnings power over a commercially reasonable period, which one would expect to be measured in years rather than months." [5] Accordingly, the Chancery Court rejected reliance on short-term results and instead utilized metrics viewed on a year-over-year basis to exclude cyclical or industry-related downturns that might skew quarterly analyses. In so doing, the Chancery Court followed *In re IBP Shareholders Litigation*, [6] which had involved a 64% drop in quarterly earnings that Justice Strine did not consider an MAE. This seemingly precipitous drop was due primarily to "widely known cycles in the meat industry, exacerbated by a harsh winter that also affected the buyer." [7] Once the target's performance was viewed over the course of a year, it was much more in line with expectations.

With these caveats in mind, the Chancery Court observed Akorn's financial performance, as measured by revenue, operating income, earnings per share ("EPS"), earnings before interest and taxes ("EBIT"), and earnings before interest, taxes, depreciation, and amortization ("EBITDA"), had sustained a dramatic downturn, not otherwise explainable by cyclicality in the market. See *Year-Over-Year Change In Akorn's Performance*.

In addition, after five years of continuous growth of EBIT and EBITDA, Akorn's

[1] *Akorn*, 2018 WL 4719347 at *53.
[2] *Id.* at *26 (emphasis added).
[3] *Id.* at *47.
[4] *Id.*
[5] Id. at *53 (quoting *Hexion v. Specialty Chemicals, Inc. v. Huntsman Corp.*, 965 A.2d 715, 738 (Del. Ch. Ct. 2008).
[6] 789 A.2d 14, 68 (Del. Ch. Ct. 2001).



Year-Over-Year Change In Akorn's Performance					
	Q2 2017	Q3 2017	Q4 2017	FY 2017	FY 2018
Revenue	(29%)	(29%)	(34%)	(25%)	(27%)
Operating Income	(84%)	(89%)	(292%)	(105%)	(134%)
EPS	(96%)	(105%)	(300%)	(113%)	(170%)

performance fell precipitously, as demonstrated by Fresenius's expert, Professor Daniel Fischel. "Akorn's EBITDA and EBIT grew each year from 2012 to 2016, but in 2017, fell by 55% and 62%, respectively."[8] See *Percentage Change in Akorn EBITDA from Prior Year - 2012-2017*

The Chancery Court considered these figures powerful evidence that an MAE had occurred because the dropoff in performance was "durationally significant. It has already persisted for a full year and shows no sign of abating," as Akorn faced stiff competition from multiple new entrants who competed with Akorn's top three products, and Akorn had lost a key contract that there was "no reason to believe" it would "recapture". [9] Finally, even the market believed that Akorn had lost substantial long-term value: "as of the date of termination, analysts' estimates for Akorn's 2018, 2019, and 2020 EBITDA were lower than their estimates at signing by 62.6%, 63.9%, and 66.9% respectively," compared with "11%, 15.3%, and 15%, respectively, for those years," for Akorn's industry peers. [10]

Vice Chancellor Laster also cautioned that determinations of whether an MAE has occurred should be made on a case-by-case basis, and parties should not view the metrics he cited as establishing any sort of bright-line thresholds: "These precedents do not foreclose the possibility that a buyer could show that percentage changes of a lesser magnitude constituted an MAE. Nor does it exclude the possibility that a buyer might fail to prove that percentage changes of a greater magnitude constituted an MAE." [11]

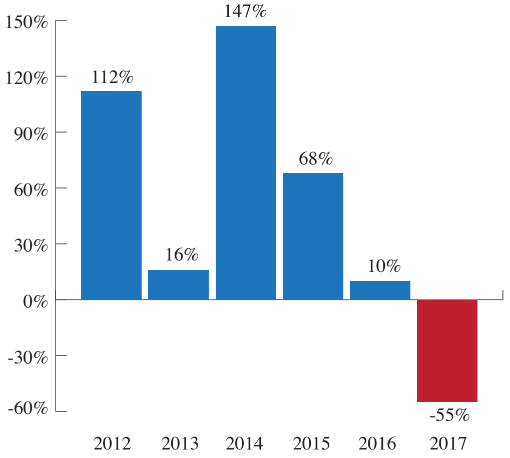
Regulatory MAE

Access to Information

One critical piece supporting Fresenius's ability to show the existence of a Regulatory MAE was its attorneys' access to Akorn's confidential information and documents, made available to Fresenius during its due diligence into Akorn. Fresenius had retained investigation counsel (Sidley Austin), separate and apart from its deal and litigation counsel, to conduct an investigation into multiple whistleblower allegations against Akorn. Before doing so, however, Fresenius's investigation counsel had to determine whether it was permitted to view such confidential documents:

> Sidley started its investigation by examining the materials on regulatory compliance that Akorn posted to the virtual data room. Before doing so, Sidley considered whether anything in the confidentiality agreement between Fresenius and Akorn prevented them from using the information. After reviewing the agreement, Sidley concluded that they were "Representatives" of Fresenius who could receive the "Evaluation Material" in the virtual data room without prior written consent from Akorn. The Sidley attorneys noted that the Evaluation Material could be used "solely

Percentage Change in Akorn EBITDA from Prior Year 2012-2017



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[7] *Akorn*, 2018 WL 4719347 at *61.
[8] *Id.* at *55.
[9] *Id.*
[10] *Id.*
[11] *Id.* at *53.

Akorn

continued

> for the purpose of evaluating, negotiating, and executing" a transaction. Sidley concluded that their investigation was part of the process of executing (i.e., carrying out) the transaction, and hence they could use the Evaluation Material in their investigation. I agree with that interpretation. [12]

The Chancery Court determined Fresenius's conduct was "proper, because buyers obtain informational rights so they can continue to evaluate the seller after signing and determine whether to close." [13]

In addition, counsel for Fresenius requested access to Akorn sites to conduct witness interviews and obtain further information and documents. Initially, Akorn proposed draft language for a common interest agreement between Akorn and Fresenius that the Chancery Court described as "a clever way to try to box in Fresenius and prevent them from using any information to evaluate Akorn's compliance with its representations." [14] Rejecting Akorn's attempts to limit how it could use this information, Fresenius prevailed in inserting an express provision that "either party shall be free to use or disclose the fact of, and any and all information learned or obtained during, the referenced investigation, including information exchanged hereunder, in any dispute between them." [15] This would be instrumental for Fresenius to prove that Akorn had breached its representations and warranties in the Merger Agreement that Akorn had complied with all regulatory requirements, and such breach constituted a Regulatory MAE.

And Fresenius unearthed damning evidence that Akorn had falsified results presented to the FDA, which were compounded by further misrepresentations made in a presentation given to the FDA, among other serious data integrity issues. As a result, the Chancery Court estimated the financial impact of Akorn's data integrity issues amounted to "approximately $900 million. . . . Using the equity value of $4.3 billion that is implied by the Merger Agreement, a valuation hit of $900 million represents a decline of 21%."[16]

Additional Proofs Fresenius Might Have Utilized

Here, though, the parties missed an opportunity to further frame the analysis for the Chancery Court, which observed that neither party contended with whether "remediation costs equal to approximately 20% of the target's standalone value would constitute" a Regulatory MAE: "It would have been helpful to have access to expert testimony or studies about the thresholds companies generally use when reporting material events, such as material acquisitions. It also would have been helpful to understand the thresholds that Fresenius and Akorn have used. No one addressed these issues." [17]

This left the Chancery Court to determine for itself whether an expense equal to 20% of the target's valuation would constitute an MAE, an unnerving prospect for litigants and one which they should seek to avoid. Relying on "external sources" as a "cross-check" on how a reasonable buyer would view the situation (while also acknowledging that they were "noisy" proxies), the Chancery Court concluded the proxies it selected, including comparisons to the largest losses in stock price in the Dow Jones Industrial Average's history, among others, supported the proposition that a 20% charge would be considered a Regulatory MAE by parties to an acquisition. [18]

Flexibility on Financial Metrics Used

Yet, in a footnote, the Chancery Court cautioned that the only reason it adopted revenue and profitability metrics to support its findings that a General MAE existed, versus "remediation costs" to conclude that a loss of 21% in Akorn's standalone value constituted a Regulatory MAE, was that is how the parties briefed the issues.[19] In another dispute, the Chancery Court might very well use different metrics.

Nonetheless, it went on to say that "[i]n the context of this case, the narrower focus for the Regulatory MAE makes sense and gives effect to the contract-driven requirement that there be a sufficient connection between the breach of the Regulatory Compliance Representations and the Regulatory MAE." [20] In a prior case, the Chancery Court had concluded that in "[i]

[12] *Id.* at *29; *see also id.* at *95 (rejecting Akorn's argument that "that Sidley accessed confidential Akorn materials in the virtual data room, . . . in breach of the confidentiality agreement.").

[13] *Id.* at *3.

[14] *Id.*

[15] *Id.* at *30.

[16] *Id.* at *74.

[17] *Id.* at *74.

n the context of a cash acquisition, the use of earnings per share is problematic," because it "is very much a function of the capital structure of a company, reflecting the effects of leverage."[21] Accordingly, in cash acquisitions, it is preferable to use EBITDA, which is not affected by leverage.

In *Akorn*, however, the Chancery Court examined EBITDA, EPS, and other operating and financial metrics. Thus, there is no one-size-fits-all approach, and a buyer should examine which analysis is most appropriate for its particular situation.

Adhering to Contractual Obligations in Good Faith in the Face of an MAE

Even if a buyer believes it has rock-solid support for the existence of an MAE that would justify terminating a merger agreement, it must be careful to adhere to all of its own contractual obligations so as not to undermine its legal position in the event of likely litigation. Indeed, in its opinion, the Chancery Court placed great emphasis on Fresenius' compliance with the Merger Agreement. Ultimately, though, the Court concluded that although "Fresenius technically breached its contractual obligation, . . . it was not a material breach sufficient to deprive Fresenius of its ability to exercise the termination rights on which it relied." [22]

The breach to which the Chancery Court referred was Fresenius's obligation to "'take all actions necessary' to secure antitrust clearance, which the Merger Agreement states shall require efforts that 'shall be unconditional and shall not be qualified in any manner.'"[23] Provisions like this are often dubbed "Hell-or-High-Water" clauses. The Chancery Court described Fresenius's non-material breach as follows: "*For approximately a week* in February 2018, Fresenius contemplated a path that could have constituted a material breach of the Hell-or-High-Water Covenant had Fresenius . . . [because it] nearly adopted an FTC strategy that it knew would delay approval by two months or more."[24] However, "because Fresenius changed course in approximately a week . . . , the breach was not material."[25]

Thus, in the year between signing the Merger Agreement and terminating it, Fresenius had diligently worked toward obtaining antitrust clearance, with the exception of one week in February 2018 when it briefly contemplated pursuing a strategy that would have delayed clearance by about two months. This was in contrast to the long-term problems plaguing Akorn that constituted a General MAE, as well as a Regulatory MAE. Thus, the Chancery Court easily determined that any breach by Fresenius was immaterial, despite Akorn's best attempts to paint Fresenius as having fabricated reasons for terminating the Merger Agreement after experience buyer's remorse.

Conclusion

When drafting a merger agreement, practitioners should revisit the guidance and distinctions set forth in the *Akorn* decision. The Chancery Court's decisions makes clear that words matter and parties should be explicit when drafting materiality and MAE provisions, and in particular ensuring such provisions have been tailored to the client's desired risk allocation. Further, Akorn affirms that the Chancery Court remains committed to honoring the language negotiated and agreed to by two parties in a contract.

And if, despite all due care in drafting a merger agreement, a deal falls apart, a buyer should use all of its informational, diligence, and expert tools at its disposal to demonstrate that an MAE has occurred while also adhering to its own contractual obligations.

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[18] *Id.* at *75-76. A 20% decline in stock price "would be the second largest single-day drop in the history of Dow Jones Industrial Average, exceeded only by Black Monday in 1987, when the market fell by 22.61%," (2) at least one study indicated that when a buyer asserts an MAE and firms renegotiate purchase prices, the adjusted purchase price is reduced by 15%, (3) parties generally use 10% and 20% as lower and upper bounds of collars in deals involving stock consideration, and (4) the magnitude of reverse termination fees (i.e., the amount a buyer agrees to pay the seller if the buyer cannot or does not complete an acquisition) was often far less than 20%.

[19] *Id.* at *74, n.740 ("No one should think that a General MAE is always evaluated using profitability metrics and an MAE tied to a representation is always evaluated relative to the entity's valuation.").

[20] *Id.*

[21] *Hexion*, 965 A.2d at 740.

[22] *Akorn*, 2018 WL 4719347 at *3.

[23] *Id.* at *46.

[24] *Id.* at *99 (emphasis added).

[25] *Id.* at *100.

The Delaware Courts

It's a very strong-arm tactic by plaintiff's lawyers. In that amended complaint, they named the general counsel for Fresh Market as a defendant. [T]his is another cautionary tale . . . Even when you're in-house, you're not safe.

WILLIAM LAFFERTY OF MORRIS, NICHOLS, ARSHT & TUNNELL

Editor's Note: The panelists on judicial developments in Delaware at this year's Tulane Corporate Institute were the following: William Lafferty (moderator) of Morris, Nichols, Arsht & Tunnell; The Honorable Kathaleen St. Jude McCormick, Vice Chancellor, Delaware Court of Chancery; Corinne Amato of Prickett, Jones & Elliott; Rudolf Koch of Richards Layton & Finger; Scott Luftglass of Fried Frank; and Melissa Sawyer of Sullivan & Cromwell. Herewith is a lightly edited transcript of their discussion.

Mr. Lafferty: I wanted to open things up about what is going on in a big-picture way in Delaware courts. I think in the wake of some of the developments in Delaware law over the last five years, developments like Trulia, Corwin, and MFW just to name a couple, the era of every deal being sued in Delaware really has ended. While some of those deals, full disclosure, strike suits, are getting filed now in the guise of federal securities claims in federal courts around the country, really very few of those are getting filed in the Delaware Chancery Court. Some get filed in the Delaware federal courts, but none of those cases really result in any real litigation, and at least one of the federal courts, ours in Delaware, has taken measures recently to try to put a stop to that racket as well. I won't get into that, really, but the court is trying to get a hold of these disclosure cases as well.

So you say to yourself, "Well, what do we have left in Delaware? We must be laying off lawyers. The judges must have a lot of free time on their hands." Well, that's just not been the case. What's happened is, we're actually going back to really litigating cases. Now the cases tend to focus on the hard ones. The post-closing litigations that involve either conflict transactions of some sort or a controlling stockholder. Post-closing damages cases are soon to be the norm these days. A lot of contractually-based claims, cases that tend to go to trial involving indemnifications, escrows, , fraud claims, and the like. And a lot of private company litigation to boot. Appraisal was big for at least the last four or five years, maybe even a little bit longer. That's slowed down. We're going to talk a little bit about that today.

The courts are seeing many more cases going to trial. Trials take a lot of time. It puts a lot of pressure on the judges. They're in court all day. They still have to write opinions. It's a real burden on them and they do a tremendous job managing it. What we've seen a lot of over the past 12 months has been what I put in the bucket of busted-deal litigation, That takes various forms and comes in various flavors.

You have the pre-closing cases where one side or the other has purported to terminate, and the other side may be seeking to enforce their rights under the agreement, à la Akorn/Fresenius last summer, and more recently the Vintage/Rent-A-Center case where there was an opinion on March 14. There are others like it coming down the pike. Boston Scientific is going to be tried next month.

Then there are the post-closing busted deal cases, like the Anthem/Cigna case, which just ended about a week ago. And I know Scott and I have the Sinclair/Tribune case that's winding its way through litigation. These things take a lot of time and effort and are just big pieces of work.

To continue my shameless plug for the Court of Chancery and how hard and how good the judges are, take the Akorn/Fresenius case. That case was filed in April of last year. It went to trial three days after Fourth of July. There were like 60 depositions, probably 10 experts, and the case was tried over a week. There was a post-trial briefing. The court rendered a decision in August, and we were up on appeal, and the Supreme Court affirmed it later in the fall. In the span of six months the case was litigated, tried, decided, and appealed, and ended.

Then, more recently, there is the Rent-A-Center case, which we filed a couple days before Christmas. There was a temporary restraining order hearing on New Year's Eve, and we had a trial in February. I argued that case post-trial on Monday before I came down here, and the court rendered its decision yesterday. That's incredible. You just don't get that kind of attention just anywhere. The judges work incredibly hard. I know Vice Chancellor McCormick had a recent experience just this past weekend where she got post-trial briefs on Saturday morning in a case and rendered a decision on Monday morning. I just want to commend the judges for all that they do. They really make litigating in the court a pleasure. Whether you win or lose, you know that you're going to get a fair shake, and you're going to get expert attention. With that shameless plug I'm going to turn it over to Rudy, who's going to talk a little bit about some of the Corwin updates that have happened over the past 12 months.

Mr. Koch: Thanks, Bill. So, why are we talking about Corwin again? Corwin was decided in 2015. We had a panel on Corwin last year. That panel, folks may remember, asked the question of whether Corwin has gone too far. Some of the panelists argued quite enthusiastically, or vigorously, rather, that Corwin was going to kill deal litigation, and that it was going to lead to bad director behavior because you could just disclose away those behaviors. Fast forward 12 months. I told a very young colleague that I'd be speaking a bit about Corwin today, and he looked at me kind of funny and he said, "Why? Isn't Corwin dead?"

Well, no. It's alive, but the pendulum has swung. So what we want to talk about today is how the Supreme Court, the Delaware Supreme Court, seems to have recalibrated a bit what it means to be a fully informed vote to get a Corwin cleansing, among other issues.

To set the stage, Corwin was decided in 2015, and the Delaware Supreme Court essentially said, in a case that is not subject to an entire fairness review, if you have a fully informed, uncoerced vote of the stockholders, the business judgment rule will apply. Now, the purpose of the Corwin doctrine was, in those circumstances we don't want to second-guess the stockholders' decision to embrace a particular transaction.

What happens after Corwin's decided? Pretty predictable in Delaware, us defense lawyers started arguing for Corwin dismissal in most of our deal cases. We had a lot of very good early success, as well. Lots of cases got dismissed, and the doctrine itself was expanded in certain key ways. So now Corwin, we know, applies to 251(h) tender offers. The business judgment rule is going to be irrebuttable if Corwin applies. Even if entire fairness applies, so long as you do not have a controller sitting on both sides of a transaction, Corwin can apply. And it even applies to alleged aiders and abettors.

In the Comstock case, we asked the question: Was this case, decided in 2016, the high-water mark for Corwin? It involves some tricky disclosure issues, and the Chancery Court dismissed under Corwin saying that we don't require a play-by-play to be disclosed under Delaware law. Now, the Supreme Court did affirm, but it mentioned that it wasn't fully embracing the Chancery Court's decision, or the reasoning of its decision, at least, and it seemed to disagree with some of the reasoning with respect to two of the disclosures. So that's why we call this possibly the high-water mark.

More recently, we've seen some cases where the court is not applying Corwin in a couple areas. One, if the vote is coercive. Two, if the vote is not fully informed. And three, if there's potentially controlling stock. So let me take one minute on coercion, because I think this is pretty simple.

There are two key cases on coercion. The first case is the Saba case. This had some rather extreme facts. The company had overstated its earnings. It kept promising to send out a restatement and continuously failed to do so. Its stock had been relisted. And then the company decided to enter into a merger agreement. The court found that the forced timing and the fact that the company hadn't disclosed why it couldn't get a restatement out or what its alternative financing arrangements might be meant that the plaintiffs were looking at a black box, essentially. The court found that these issues contributed to what it called situationally coercive factors, meaning that some stockholders may have wrongfully been induced to vote in favor of the deal for reasons other than the economic merits of the transaction. I think that's the key issue when we're talking about coercion.

The second case we have in the slide deck on coercion is the Liberty Broadband case. Similar concept, slightly different issue. There, the stockholders were told that they had to vote in favor

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of the stock issuance that allegedly was unnecessary if they wanted to receive the benefits of the merger transaction. In that case, the court actually called it structurally coercive, not situationally coercive, and said when a vote is structured "so that considerations extraneous to the transaction [are] likely to influence the stockholder voters so that the court cannot determine that the vote represents a stockholder decision that the challenged transaction is in the corporate interest."

So those are the issues involving situational and structural coercion that we see sometimes come up.

So, let's move on to whether the vote's fully informed. I think that's really where the action is right now. Last year, right before this conference, the Berkman case was decided. That's the Diamond Resorts case. And as folks may recall, the Delaware Supreme Court overturned the Chancery Court's dismissal on Corwin grounds because in that case the founder and the chairman had actually said he was not in favor of the transaction because he thought the price was too low and it was a bad time to sell. All the company had disclosed, however, was that he abstained from voting in favor of the merger. So the Supreme Court reversed, saying it wasn't fully informed. They should have disclosed the reasons that this key director had expressed why he was not in favor of the merger.

If you look at that case alone, it's got some unique facts. I don't think that's necessarily representing any kind of a pendulum swing. But then comes the Fresh Market case. I represented the independent directors in the Fresh Market case, and I argued it below on appeal. Now there's an amended complaint, so I'll be a little bit cautious, but I want to spend a little bit of time on this case because I think it's important.

This is a case where the plaintiffs challenged Apollo's acquisition of Fresh Market, where Ray Berry was the founder, the former CEO and the chairman of the board. His son, Brett Berry, who was another former CEO of the company, rolled over their stock into the transaction. It was about 9.8 percent of the total equity of the company. Now, prior to filing their fiduciary claim, as the plaintiffs did in Berkman, the plaintiffs filed a Section 220 action, and they received minutes and at least one key email that they used to try to plead process claims and claims for disclosures to try to get around Corwin.

We moved to dismiss under Corwin and Section 102(b)(7). Now, this is what's interesting. The Chancery Court said this was an exemplary example of the futility of the ratification doctrine in Corwin. The court used the word "exemplary." We get up to the Supreme Court. The Supreme Court actually said there are "at least four material omissions in the disclosure document," and reversed the Chancery Court.

I want to drill down on some key takeaways. The four omissions are, first, that Ray Berry allegedly may have been less than forthcoming about his relationship with Apollo at the first initial meeting; the second was, more generally, that the board should have disclosed more information regarding Ray Berry's relationship with Apollo; the third was that the board did not disclose, or the company did not disclose, that Ray Berry had said he thought it was a good time to sell, and if there was no transaction he would consider selling all of his shares on the private market, or the public market; the fourth one was that the company started down the road of a partial disclosure and there was concern there may have been stockholder pressure. There already had been some activist pressure and they hadn't disclosed that as fulsomely as they should have.

We produced the long-form minutes, and there was a email from Ray Berry's counsel that was referenced extensively in the minutes. We ended up producing that email in the 220. The email said, prior to an auction starting, that Ray Berry had agreed with Apollo. It included the phrase, "as he did in October," that he would roll over his shares if Apollo was acquiring the company. The plaintiff's lawyers focused primarily on that phrase, "as he did in October," and they looked back at the October minutes. The October minutes didn't refer to Ray having agreed with Apollo, but it used slightly looser language. So the plaintiffs then said that Ray had not been forthcoming with the board in that October meeting, and they used the email as evidence of that. It also said in the email that Ray would consider selling his shares if the company didn't manage to do a merger transaction. That piece of the email also wasn't disclosed.

So, when I look at the key takeaways from here, one of the things that the Supreme Court did is, it really focused on the reasonable conceivability standard on the pleadings, and it said careful application of Corwin is important due to its potentially case-dispositive impact. Note that we have a slide showing that when the Supreme Court talked about the materiality standard, it did so fairly broadly. Now, it did cite to the standard that we're used to hearing, which is that there needs to be a substantial likelihood that a reasonable stockholder would find the omitted information important in deciding how to vote. But then the court went a little bit further and basically said that material information may be information that the investor would consider important, even if it's the type of information that would make a stockholder more likely to tender.

Now, the Chancery Court had actually found that Ray's alleged threat to sell his shares if the merger didn't go through was not material because that would have made it more likely, if it was disclosed, that shareholders would tender. I would submit that the Chancery Court got this one right, because if you go back to the fundamental purpose of Corwin, when the stockholders embrace a transaction on its terms, we're going to defer to that. Something that makes them more likely to embrace the transaction, I don't think should avoid Corwin cleansing. And if you think, Bill, about when we used to have all of these injunction cases when we always argued on disclosures that if something makes the deal seem more fair you shouldn't enjoin the transaction. The Chancery Court seemed to embrace that formulation. But now I think the Supreme Court is broadening the definition a bit when it comes to Corwin cleansing.

Ms. Amato: Just to give the counterpoint on that statement. If you're looking at disclosure in Corwin, disclosure in the context of Corwin, the question shouldn't have been whether or not the information would change the vote. The question is whether or not it would be material to stockholders in considering how to vote. It's not whether or not it would change the vote one way or the other. That goes back to Supreme Court decisions from the 1990s where they specifically said it's not that this information must change the vote, it's just that it's material to stockholders.

In the Berry situation, what you were dealing with was information that a reasonable stockholder would find material in figuring out what were the agreements or discussions or considerations going in that were driving this transaction. That is the material consideration for stockholders to think about when they're going to vote on a transaction.

Mr. Koch: Yeah. I would agree in part with that, but I still think if you go back to the fundamental purpose of the Corwin doctrine, which is not to second-guess a stockholder on a non-coerced and informed vote, but to accept the merits of the transaction, if there's something that tends to make the transaction more fair and make it more likely that more stockholders would have voted in favor of it, I don't see why you would say that omission should eradicate Corwin disclosure. But I understand [your point].

Ms. Amato: The key is an informed vote. The key is disclosure. The key is having the key information. Without that, I think it's hard to say that there is a valid vote.

Mr. Lafferty: Melissa, as somebody who drafts proxy statements and is involved in structuring deals, what do you make of all this? Do you take this Corwin doctrine into consideration when you're preparing a proxy statement or some other disclosure document?

Ms. Sawyer: Let me break that down into two pieces, because I react differently to it in the planning stages of the transaction when I'm talking to a board of directors about how to structure their meetings and the issues of the deal. I think in that phase, Corwin has not hit my radar as much. I don't think, for example, there was ever a circumstance where I said to directors, "You can be more relaxed about complying with your fiduciary duties because we're going to make sure you get business judgment rule here." I just can't imagine that. In the planning stages of the transaction, the ride up the curve with Corwin and then now the tightening of Corwin, I don't think it's really changed people's behavior that much.

What it has changed over time, in my view, is how people draft proxy statements. Proxy statements are getting longer and longer. Background-Of-The-Merger sections are regularly over 20 pages long. They look like data dumps from people's Outlook calendars. They're literally just chronologies of who went to which meeting on what date, and some basic information about what was discussed. I think that is a direct reaction to calls for more extensive disclosure. The problem that comes out of that is that quantity is not the same thing as quality. Sometimes what's lost in those lengthy chronologies is a true sense of what the board considered to be important. What were the drivers of the transaction?

I think as transactional lawyers we need to resist the urge to just deliver a really long proxy statement. Before we even start drafting it and going through calendars we need to take a step back and think about the four or five key themes that we're trying to convey to the shareholders about the transaction. It's very hard to do. And the crazy thing about all of this is that the party that really bears the economic consequence of

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not doing the disclosure properly is the buyer, but they're the ones who are least likely to have access to the information about what actually transpired behind the scenes in the lead-up to the deal signing. There's a real asymmetry there.

I have seen some buyers reacting to that in how they deal with proxy statement review in the context of a deal. I'm aware of at least one financial sponsor, for example, that uses separate counsel to comment on proxy statements for them, separate from their deal counsel. That separate counsel has a rigorous checklist that they go through, unclouded by any of the background or the facts, because they weren't involved in the deal. They read the proxy statement with fresh eyes and essentially ask for more disclosure on a number of areas, based on the cases that have emerged in the last year.

Mr. Koch: In addition to what Melissa just said about asking what drives the transaction, I think there are two or three other takeaways from the specific disclosures of Corwin. In the Diamond Resorts case, you have a key director who was a former chairman and the founder of the company who expressed his views about why the company should sell. When you have a director who's a key director expressing his views about the transaction and the merits of the transaction, that may need to be disclosed. Traditionally we would take the view that a particular director's opinions would not have to be disclosed, but in Diamond and then also in Fresh Market, that wasn't the case. You had a very key director expressing his views to the rest of the board.

Mr. Lafferty: Rudy, I'm going to interrupt you once more, because I think Vice Chancellor McCormick would like to add something. And maybe even Scott Luftglass, too. I don't know.

Vice Chancellor McCormick: Yeah, I have a question for you, Melissa. This concept of new counsel reading the proxy with fresh eyes and going through a rigorous and robust checklist. How often is that happening?

Ms. Sawyer: I would say it's starting to happen more now. I've seen it a few times in the last year. I don't think it happened as often in the past. And it's not unhelpful. Having more people involved in drafting creates potential for delay, and too many cooks in the kitchen is not always a good thing, but I think it is a result of the case law. People are starting to focus on that element of the process more closely.

Mr. Koch: I think Scott Luftglass may be one of those cooks.

Mr. Luftglass: I do that for a number of private equity clients. What private equity clients want to understand is how to know from the white space in the draft, which the seller's counsel serves up, that there isn’t something there that's going to get crosswise with one of the vice chancellors in Delaware? It's a handful of topics that, frankly, you just need to go through and make sure you think about. What was the discussion of a pre-signing market price? What was the discussion around financial sponsors versus strategics? What was the discussion about management having a continuing role? Was there a discussion about a rollover? Those are the kinds of things that you have to really suss out.

I think the challenge, in part, is that proxy statements, which most of us here on the dais frequently draft, get longer and longer. They are prepared by outside counsel with the first line of input from the general counsel. The general counsel is then followed by individual directors. By the time you have a first draft that can pass muster at a meeting of the board of directors, it’s often 20, 25 single-spaced pages. When people are looking back over a year or a 10-month period, it's easy to actually miss things, not because anyone is trying to be nefarious, not because they're trying to hide something, just because it's eight months of their lives reduced to 20, 25 pages single-spaced, and sometimes things slip through the cracks. It’s also often the case that the more lawyers' eyes that are on these things, the more helpful it is, because various people have different roles over the chronology of a deal. Sometimes, as we all know, our clients silo off various pieces of the deals, and it's important to try to bring those together to get a good background section.

I would say, also, to Melissa's point, and I can't emphasize this enough: it really is critical that there's a narrative, that there's a story in the background section. So, is there a reason why the company considered selling itself rather than relying on its standalone plan and its prospects as an independent company? Is there a reason they reached out to a particular buyer? It's answering not only the question of whether this deal was the best deal available as a result of the market, but why do a deal now at all? That's the question, frankly, that I think a lot of these background sections omit, and that's where the plaintiffs' lawyers, frankly, could drive a truck through them, because they can put all kinds of allegations on the table about a need for liquidity, for a private equity sponsor on the sell side, or management needing to find some way to have an exit on a go-forward basis. If you don't answer that question about why sell now, that's where a lot of these questions really lead into litigation.

Vice Chancellor McCormick: Yeah. I don't envy the role you have in drafting these proxies from a thematic perspective, because the bottom line is that these deals are reached for multiple reasons by different constituencies and different people, and they often have a different view of what happened. I can only imagine that attempting to weave together a coherent story in a thematic way would be tricky.

Mr. Luftglass: You also have different incentives. I agree with the Vice Chancellor. There are buyers who say, "Look, I see these three different sets of projections, but after this company is sold, my investors are going to hold me to those projections and my investors are going to hold me to these synergy numbers. Yes, we have a deck among 20 different decks that show synergy numbers of one-and-a-half-X, and our base case was X, but if you put that one-and-a-half-X price into that deck in terms of synergies, it's going to be my investors on our road shows and our earnings calls who are going to be holding us to those numbers." So you really have an asymmetry of incentives among buyers, sellers, and sponsors on either side of the transaction in putting some of this information into the marketplace. It can be a very delicate dance.

Mr. Lafferty: Rudy, I want to turn back to Morrison v. Berry for a minute, because you had mentioned that there was an amended complaint filed, and I think it's really important for you to tell this audience what's in that amended complaint and who the new players are. I want to talk about that.

Mr. Koch: Yes. Following up on Vice Chancellor McCormick's comment about not envying the deal lawyers, we did get an amended complaint in the Fresh Market case. They brought in Apollo as an alleged aider and abettor. They brought in the investment banker. And then they also brought in the highly respected legal advisor [general counsel] as well. Focusing on the legal advisor, the theory effectively was, look, you were at all the meetings, you drafted the minutes, you also drafted the 14D-9. Therefore, you must have known that there were material omissions and inconsistencies between the long-form minutes and the 14D-9, and so we're going to bring you into the case as an alleged aider and abettor.

It's kind of scary. I think they were emboldened a bit by misreading part of the Supreme Court decision, because the Supreme Court said at the outset, this was a cautionary reminder to directors and the attorneys who help them draft their disclosures. The plaintiffs really ran with that sentence and argued that the legal counsel [general counsel] should be on the hook for the disclosures as well. Look, we've seen lawyers sued in similar circumstances, but I think what plaintiffs' lawyers were doing here is a new shift. I'm incredulous at these allegations. I think there should be a motion to dismiss. But I think the general counsel has to be aware, especially if there are allegations of troubling director behavior, that he or she may be in the plaintiffs' lawyers' sights in these types of cases.

Mr. Luftglass: Let's hope it's an aberration and not a shift.

Mr. Lafferty: I was going to say, Melissa, how does that make you feel, as a person drafting proxy statements?

Ms. Sawyer: I'm thinking about early retirement.

Mr. Lafferty: It's a very strong-arm tactic by plantiffs' lawyers. In that amended complaint, they named the general counsel for Fresh Market as a defendant. I'm not going to comment on whether there was any justification. I'm sure they have their reasons. But you are naming, now, an in-house lawyer who doesn't have necessarily the benefit of 102(b)(7). I guess that is an issue in the case. But this is another cautionary tale to those out there that are involved in drafting proxy statements. Even when you're in-house, you're not safe.

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Delaware Developments

31st Annual Corporate Law Institute
Tulane University Law School
March 15, 2019

Panelists:

The Honorable Kathaleen St. Jude McCormick
Vice Chancellor, Delaware Court of Chancery

William M. Lafferty (Moderator)
Morris, Nichols, Arsht & Tunnell LLP

Scott Luftglass
Fried, Frank, Harris, Shriver & Jacobson LLP

Corinne Amato
Prickett, Jones & Elliott, P.A.

Rudolf Koch
Richards Layton & Finger P.A.

Melissa Sawyer
Sullivan & Cromwell LLP

Delaware Developments

- What's Going On in the Delaware Courts?
- Post-Closing Fiduciary Litigation.
  - *Corwin* and Its Progeny.
  - *MFW*.
- Federal Forum Selection Bylaw: Sciabacucchi v. Salzberg.
- Section 203.
- Appraisal Update.
- Dual-Class Stock Structures.
- Derivative Update.

What's Going On in the Delaware Courts?

- Public company strike suits way down.
  - "Every deal draws a suit."
  - Not anymore: *Trulia*, *KKR*.
  - Posner: Stop the "racket".
- But "hard" cases and private company cases have increased.
  - Damages cases for conflicted board or controlling stockholder.
  - Post-closing claims. (indemnity, earn-out, fraud, etc.)
  - Private companies: bigger valuations, bigger cap tables.
  - Appraisal.
- Addition of two new Vice Chancellors:
  - Vice Chancellor Kathaleen St. Jude McCormick.
  - Vice Chancellor Morgan T. Zurn.

Post-Closing Fiduciary Litigation

Corwin Jurisprudence

- *Corwin v. KKR Fin. Holdings LLC*, 125 A.3d 304 (Del. 2015).
  - In the absence of a controlling stockholder, a fully informed, uncoerced vote of a majority of disinterested stockholders invokes business judgment rule review in cases in which the Revlon standard otherwise would apply.
  - "[W]hen a transaction is not subject to the entire fairness standard, the long-standing policy of our law has been to avoid the uncertainties and costs of judicial second- guessing when the disinterested stockholders have had the free and informed chance to decide on the economic merits of a transaction for themselves."

Corwin: Expanding Breadth

- Breadth of *Corwin* expanding since first decided.
  - Vast majority of cases suggest *Corwin* applies to ratify transactions subject to entire fairness review in the absence of a controlling stockholder on both sides.

    - *In re Rouse Props., Inc.*, 2018 WL 1226015 (Del. Ch. Mar. 9, 2018) (Slights).
    - *van der Fluit v. Yates*, 2017 WL 5953514 (Del. Ch. Nov. 30, 2017) (Montgomery-Reeves).
    - *In re Columbia Pipeline Grp., Inc.*, 2017 WL 89838 (Del. Ch. Mar. 7, 2017) (Laster).
    - *In re Merge Healthcare Inc. S'holders Litig.*, 2017 WL 395981 (Del. Ch. Jan. 30, 2017) (Glasscock).
    - *Chester Cnty. Ret. Sys. v. Collins*, 2016 WL 7117924 (Del. Ch. Dec. 6, 2016) (Laster).
    - *Larkin v. Shah*, 2016 WL 4485447 (Del. Ch. Aug. 25, 2016) (Slights).
    - *City of Miami Gen. Emps. v. Comstock*, 2016 WL 4464156 (Del. Ch. Aug. 24, 2016) (Bouchard), aff 'd, 158 A.3d 885 (Del. 2017).
  - *Corwin* applies to transactions effected under Section 251(h).
    - *van der Fluit v. Yates*, 2017 WL 5953514 (Del. Ch. Nov. 30, 2017).
    - *In re Infoblox, Inc.*, 2017 WL 5046359 (Del. Ch. Nov. 2, 2017).
    - *In re Volcano Corp. S'holder Litig.*, 2016 WL 3626521 (Del. Ch. June 30, 2016).
  - *Corwin* applies in private company context.
    - *Huff Energy Fund, L.P. v. Gershen*, 2016 WL 5462958 (Del. Ch. Sept. 29, 2016).

City of Miami Gen. Emps. v. Comstock: *Corwin* High Water Mark?

- In March 2015, C&J Energy and Nabors merged with 97.6% of stockholder voting in favor of the transaction. Plaintiff sought post- closing damages from C&J's board arising from an allegedly conflicted sale process
- Plaintiff alleged five disclosure violations:
  - False information regarding estimates of Nabor's EBITDA;
  - CEO Jerry Comstock's threat to not pursue the deal unless the buyer guaranteed new employment contracts for him and management;
  - Financial advisor violated its conflicts policy by providing financing on the buy-side;
  - Comstock was personal friends with financial advisor for the special committee;
  - Not enough information about bidders who emerged during go-shop process.

City of Miami Gen. Emps. v. Comstock

- The Court of Chancery dismissed the action in August 2016.
- "Delaware law does not require disclosure of a play-by-play of negotiations leading to a transaction or of potential offers that a board has determined were not worth pursuing."
- In March 2017, the Delaware Supreme Court affirmed "largely on the basis" of the Court of Chancery's decision, noting it did not "fully embrace" the court's reasoning on two disclosure-related grounds.

Corwin Inapplicable in Several Recent Cases

- More recent cases denying motions to dismiss based on Corwin because of:
  - Coercion in the vote (*Saba*, *Liberty Broadband*);
  - Inadequate disclosures (*Appel*, Morrison, *Tangoe*, *Xura*, *Comverge*, *Van der Fluit*); and
  - Potential existence of a controller (*Tesla*).

Corwin: Coercion

- *Corwin* inapplicable *if*:
  - Vote Coerced.
    - *In re Saba Software, Inc.*, 2017 WL 1201108 (Del. Ch. Mar. 31, 2017).
      - Wrongful coercion existed where stockholders would hold delisted stock if deal voted down (because of company's failure to file restatements) and board did not disclose circumstances surrounding failure to file.
      - Not enough for an offer to be "too good to resist."
      - "Inequitable coercion" can exist when fiduciary fails to act where known duty to act.
    - *Sciabacucchi v. Liberty Broadband Corp.*, 2017 WL 2352152 (Del. Ch. May 31, 2017).
      - Wrongful coercion existed where stockholders were told underlying transaction would not be approved without approval of other matters.
      - A vote is "structurally coercive" if it is structured "so that considerations extraneous to the transaction likely influenced the stockholder-voters so that [the Court] cannot determine that the vote represents a stockholder decision that the challenged transaction is in the corporate interest."

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Corwin: Fully Informed Vote

- *Corwin* inapplicable if vote not fully informed:
  - *Appel v. Berkman*, 180 A.3d 1055 (Del. 2018) (finding stockholder vote not fully informed when proxy disclosed that founder/board chairman abstained from board vote recommending sale without explaining reason for abstention).
  - *Morrison v. Berry*, 191 A.3d 268 (Del. 2018) (holding that disclosure deficiencies related to, among other things, founder's unwillingness to partner with other bidders rendered Corwin inapplicable).
  - *In re Comverge, Inc. S'holders Litig.*, C.A. No. 7368-VCMR (Del. Ch. Oct. 31, 2016) (denying summary judgment because of factual questions as to whether disclosures were materially misleading).
  - *van der Fluit v. Yates*, 2017 WL 5953514 (Del. Ch. Nov. 30, 2017) (declining to dismiss claims because of failure to disclose identity of individuals who led sales outreach and possible involvement of two persons who received post-transaction employment and conversion of unvested options of target into options of acquiror).
  - *Corwin* **may** be inapplicable to deal protection measures.

Morrison v. Berry

- In March 2016, The Fresh Market announced that it had agreed to be acquired by Apollo, a private equity firm, and Plaintiff sought books and records pursuant to Section 220.
- Through the Section 220 litigation, Plaintiff uncovered documents that allegedly indicated the board was not forthcoming about an agreement between the founder, his son (a large stockholder), and Apollo in the company's federal securities filings recommending stockholders accept the tender offer.
- Post-closing, Plaintiff brought breach of fiduciary duties and aiding and abetting claims against the directors, the founder and his son.

- The Court of Chancery dismissed the action under Corwin.
- The Delaware Supreme Court reversed.
  - The company had failed to disclose "troubling facts regarding director behavior."
  - Plaintiff adequately alleged four material omissions and misrepresentations, including that the founder was initially dishonest to the board about the agreement with Apollo to roll over his and his son's equity stake.
- The materiality standard:
  - Information that is material "is any information that an investor would consider important. Such information could make a stockholder less likely to tender. But it also may be material if it is the sort of information that would make a stockholder more likely to tender, *or just information that a reasonable stockholder would generally want to know in making the decision, regardless of whether it actually sways a stockholder one way or the other*, as a single piece of information rarely drives a stockholder's vote."
- "[S]tockholders cannot possibly protect themselves when left to vote on an existential question in the life of a corporation based on materially incomplete or misleading information. Careful application of *Corwin* is important due to its potentially case-dispositive impact."

In re Xura, Inc. Stockholder Litigation

- Initially an appraisal action, a former shareholder of Xura brought a post- closing damages action
  - Through discovery in the appraisal action, plaintiff uncovered documents allegedly showing that CEO breached his fiduciary duties by directing Xura to consummate an undervalued transaction in order to ensure his future employment and to obtain a $25M deal-related payout.
- Defendants moved to dismiss the claims based on Corwin, and the Court denied the motion.
- Plaintiff adequately pled seven disclosure violations, rendering Corwin inapplicable because stockholders could not have cleansed conduct about which they did not know.

In re Tangoe, Inc. S'holders Litigation

- In the midst of a "storm" created by Tangoe's failed attempt to restate its financials and correct false filings with the SEC, and the subsequent delisting of its stock by

NASDAQ, the Tangoe board entered into an ill-advised take-private transaction.

- Directors created and issued alternative compensation that vested on an accelerated basis upon a change in control.
- Plaintiff alleged that the directors were incentivized to sell the company based on new compensation awards, not because a sale was in the best interests of stockholders.
- The court held that *Corwin* did not apply.
- A word of caution:
  - "One might discern from these findings . . . that directors simply cannot achieve business judgment rule deference when they make difficult decisions amid a "regulatory storm"[.] That would be a shallow reading of what has been said here. The business judgment rule protects directors in good times and in bad. But, to earn pleading-stage business judgment deference by invoking stockholder approval of a challenged transaction, the directors must demonstrate that they carefully and thoroughly explained all material aspects of the storm to stockholders—how the company sailed into the storm, how the company has been affected by the storm, what alternative courses the company can take to sail out of the storm and the bases for the board's recommendation that a sale of the company is the best course. Extraordinary transactions proposed to stockholders in the midst of extraordinary times must be explained with commensurate care. And, of course, in trying times, the directors must remain focused on the best interests of stockholders, not their own interests."

Corwin: Disclosure Issues

- How can plaintiffs raise disclosure claims post-close?
  - Discovery obtained in an appraisal proceeding.
  - Discovery obtained in other jurisdictions.
  - A books and records demand under Section 220.
- Use of 220 to demonstrate vote not fully informed:
  - *Lavin v. West Corporation*, 2017 WL 6728702 (Del. Ch. Dec. 29, 2017)
  - Plaintiff argued evidence from 220 supports an inference that the Board pursued a sale of the full company rather than a sale of business segments in order to provide large stockholders liquidity and trigger payments for directors.
  - Defendant argued vote of stockholders invoked *Corwin*, thus eliminating basis to bring 220 demand.
  - Court notes plaintiff has burden to plead some disclosure deficiency and states:
    - It "would be naïve to believe, in most instances, that the stockholder plaintiff will not face significant challenges to meet her pleading burden in anticipation of a *Corwin* defense if all she has in hand to prepare her complaint are the public filings of the company whose board of directors she proposed to sue . . . . It is precisely the reason this court should encourage stockholders, if feasible, to demand books and records before filing their complaints when they have a credible basis to suspect wrongdoing in connection with a stockholder-approved transaction and good reason to predict that a Corwin defense is forthcoming."

Corwin: Section 220

- *Inter-Local Pension Fund GCC/IBT v. Calgon Carbon Corp.*, 2019 WL 479082 (Del. Ch. Jan. 25, 2019).
  - The Court ordered production of electronic communications, including personal emails, to investigate the discussions between Calgon Carbon's management and third-parties to determine if management prioritized its own retention and compensation over the interests of Calgon's stockholders.
  - "When considering requests for information from personal accounts and devices in Section 220 proceedings, the court should apply its discretion on a case-by-case basis to balance the need for the information sought against the burdens of production and the availability of the information from other sources, as the statute contemplates. The core inquiry remains the same: whether the record is necessary and essential to the stockholder's investigation."
- Definite uptick in number of Section 220 demands in the wake of *Lavin*.

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continued

- Timing note: Can only bring suit if no reply within 5 business days of demand.
- Lose standing to bring 220 complaint if not brought before cash- out merger closes. *Weingarten v. Monster Worldwide, Inc.*, 2017 WL 752179 (Del. Ch. Feb. 27, 2017).

Corwin: Controlling Stockholder

- Corwin inapplicable if controlling stockholder:
  - *In re Tesla Motors, Inc. S'holders Litig.*, 2018 WL 1560293 (Del. Ch. Mar. 28, 2018).
    - Combo of well pled facts relating to Elon Musk's influence, and Tesla's and Musk's own acknowledgment of Musk's "outside influence," satisfies plaintiff's burden to plead that Musk's status as a Tesla controlling stockholder was reasonably conceivable.
- *But see In re Rouse Props., Inc.*, 2018 WL 1226015(Del. Ch. Mar. 9, 2018).
  - Plaintiff could not plead that target's 33.5% stockholder exercised the "managerial clout and retributive power to infer actual control" over special committee that negotiated merger with such stockholder and *Corwin* therefore applicable.

Controlling Stockholders

- Over past several years, Court of Chancery has addressed whether a less-than- majority stockholder may be a controlling stockholder.
- Two recent decisions are noteworthy.
- *Basho Techs. Holdco B, LLC v. Georgetown Basho Investors, LLC*, 2018 WL 3326693 (Del. Ch. July 6, 2018).
  - Court finds that a less-than-majority stockholder is a controlling stockholder for purposes of a decision to approve a new round of financing, in part because the stockholder used its *contractual* rights to cut off access to other sources of financing.
    - "Lest sensitive readers fear that this decision signals heightened risk for venture capital firms who exercise their consent rights over equity financings, I reiterate that a finding of control requires a fact-specific analysis of multiple factors. If Georgetown only had exercised its consent right, that fact alone would not have supported a finding of control. The plaintiffs proved that Georgetown and Davenport did far more."
- *In re Tesla Motors, Inc. S'holder Litig.*, 2018 WL 1560293 (Del. Ch. Mar. 28, 2018).
  - Court found sufficient facts pled that Elon Musk acted as a controlling stockholder with respect to the acquisition of SolarCity Corporation by Tesla, and therefore denied a motion to dismiss under Corwin.
  - Although Musk owned only 22.1% of Tesla's stock, the Court found it reasonably conceivable Musk actually dominated and controlled Tesla with respect to the specific transaction.
- Key factors in Court's opinion:
  - Musk previously forced out the founder and then-CEO.
  - Tesla had some high votes in its bylaws that could have provided Musk holdup value.
  - Musk brought the transaction to the board three times, led the discussion of the acquisition, and engaged the advisors for the acquisition.
  - Musk had strong connections with the members of the Tesla Board and a majority of Tesla's Board was "interested" in the Acquisition.
  - Tesla acknowledged Musk's significant influence at Tesla in Tesla's public filings.
- Refinements of *MFW*
  - *In re MFW*: In either a public company or private company controlling stockholder squeeze out, business judgment rule applies if the controlling stockholder conditions the deal "from the get-go" on both a fully functioning independent committee and the affirmative, fully informed vote of a majority of the outstanding shares held by independent stockholders.
  - What does it mean to have the dual protections in place "from the get-go"?
- *In re Synutra Int'l, Inc. S'holder Litig.*
  - Supreme Court held *MFW* applied where the board considered a "preliminary non-binding proposal" that did not condition a potential transaction on the dual procedural protections because a follow-up letter, sent before the board had substantively evaluated the proposal, reaffirmed its initial offer and expressly conditioned the transaction on the approval of the special committee and a majority of the

minority stockholders.

- In dissent, Justice Valihura argued that the dual protections should be included in the controller's initial formal written proposal in order for MFW to apply.

- *Olenik v. Lodzinski*, 2018 WL 3493092 (Del. Ch. July 20, 2018)
  - Court of Chancery held that the *MFW* protections need not be in place before exploratory discussions between the parties, so long as they are in place at the outset of negotiations (which typically begin when a proposal is made by one party that, if accepted, would constitute a binding agreement).
  - *Olenik* is still in the appeals process.

Federal Forum Selection Bylaws

Sciabacucchi v. Salzberg, 2018 WL 6719718 (Del. Ch. Dec. 19, 2018).

- Blue Apron, Stitch Fix and Roku had provisions in their IPO charters mandating that claims based on the Securities Act be filed in federal court.
- The Court of Chancery held that such provisions were invalid because they attempted to regulate "external claims" – *i.e.*, claims not related to the corporation's internal governance and the relationships among or between the corporation and its officers, directors and stockholders.
- The Supreme Court dismissed Blue Apron's appeal, concluding the judgment was not final and appealable until the Court of Chancery ruled on an outstanding motion for attorneys' fees.

Section 203

- Section 203 is Delaware's anti-takeover statute.
- If a person acquires beneficial ownership of 15% or more of the target company's stock without board approval (i.e., becomes an "interested stockholder"), he is generally restricted from engaging in business combinations with target company for three years.
- Person A may be attributed beneficial ownership of stock owned by Person B if Person A and Person B have an "agreement arrangement or understanding" for the purpose of "acquiring, holding, or voting" Person B's stock.
- Generally prohibits "business combinations" with an "interested stockholder" (generally a holder of 15% or more of a corporation's voting stock) for a period of three years following the time at which the stockholder became an interested stockholder, unless:
  - Prior to the time the interested stockholder became such, the board of directors approved the business combination or the transaction that resulted in the stockholder becoming an interested stockholder.
  - After the time the interested stockholder became such, the business combination is approved by the board and by stockholders at a meeting by 2/3 vote of the voting stock which is not owned by an interested stockholder.
- A "business combination" is broadly defined to include:
  - Mergers and consolidations with or caused by an interested stockholder;
  - Transactions resulting in the issuance of stock of the corporation to the interested stockholder or any increase in the proportionate share of any class or series of stock owned by such interested stockholder;
  - Dispositions of 10% or more of a corporation's assets to or with an interested stockholder; or
  - The receipt by the interested stockholder of the benefit of loans, advances, guarantees, pledges or other financial benefits provided by or through the corporation.
- Importantly, transactions that do not involve the interested stockholder, such as a sale of the corporation to a third party where the interested stockholder does not receive a benefit that is different from the other stockholders, are not business combinations and, thus, are not subject to the restrictions of Section 203.

- ***Interested stockholder***
  - The direct or indirect owner of 15% or more of the voting stock of a corporation (as well as any affiliate or associate of such an owner).
  - An affiliate or associate of a corporation who was, within the prior three years, the owner of 15% or more of the corporation's voting stock.

- ***Determining ownership***. For purposes of calculating ownership under Section 203, a person is considered to be the owner of stock:

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- That it beneficially owns;
- That it has the right to acquire or vote; or
- ***With respect to which it has an agreement, arrangement or understanding for the purposes of acquiring, holding, voting or disposing of such stock.***

What constitutes an agreement, arrangement or understanding for purposes of acquiring, holding, voting or disposing of stock?

In re ArthroCare Corp. S'holder Litigation

- Action arose out of a cash-out merger in which Smith & Nephew, Inc. acquired 100% of the common stock of ArthroCare.
- One Equity Partners LLC, a subsidiary of JPMorgan Chase & Co., owned more than 15% of the outstanding voting stock of ArthroCare before the merger with S&N.
- Plaintiffs alleged that S&N entered into an "agreement, arrangement or understanding" with JPM for the purpose of acquiring all outstanding shares of ArthroCare's voting stock when it hired JPM as its financial advisor for the acquisition and agreed that JPM's banking subsidiary would underwrite the term loan, the proceeds, of which would be used for the acquisition.
- Plaintiffs claimed that by virtue of this "agreement, arrangement or understanding" with JPM, an affiliate of One Equity, S&N became an "Owner" of One Equity's 15.2% stake in ArthroCare's voting stock and thus an "Interested Stockholder" under Section 203.

Plaintiffs' alternative Section 203 theory:

- Before the ArthroCare board approved the merger agreement, One Equity agreed to enter into a voting agreement with S&N (although not until after the S&N Board approved the deal) whereby it "irrevocably and unconditionally" agreed to vote its ArthroCare stock in favor of the merger with S&N.
- Plaintiffs claimed that the voting agreement constituted an "agreement, arrangement or understanding" whereby S&N became the "Owner" of One Equity's position in ArthroCare and thus an "Interested Stockholder" under Section 203, and argued that the merger required the approval of 2/3 of all outstanding shares other than the shares owned by S&N as a result of its agreements, arrangements and understandings with JPM and/or One Equity. The merger did not receive such 2/3 vote.

- After the Court scheduled a pre-closing expedited trial on the Section 203 claim, the parties settled, with S&N paying $12 million on behalf of all defendants. At the settlement hearing, the Court characterized the Section 203 claim as "seemingly quite strong," but noted:
  - "Importantly, however, I do not think this claim would likely have resulted in money for the class. It probably would have resulted in relief in terms of the voting requirement or in the [3 year] moratorium that applies under 203."
  - It is not clear from the transcript whether the Court was referring to one or both of the plaintiffs' 203 theories when it referred to the strength of the Section 203 claim.

Greenway v. KCG Holdings, Inc.

- Action arose out of cash-out merger in which Virtu Financial acquired 100% of the common stock of KCG Holdings.
- Prior to the merger, Jefferies owned approximately 24.5% of KCG. Plaintiff alleged that Virtu became an "interested stockholder" because it had discussions with Jefferies before engaging, and ultimately agreeing to a deal, with the KCG board.
- Plaintiff filed a motion for a preliminary injunction and motion to expedite. The Court granted the plaintiff's request for expedited proceedings on the Section 203 claim, but largely denied the remainder of the motion.
- After expedited discovery, but before the injunction hearing, KCG filed an amended and supplemental proxy containing additional disclosures and subjecting the merger to the 2/3 disinterested vote requirement in Section 203, and the parties thereafter agreed to a stipulation withdrawing plaintiff's motion for a preliminary injunction.
- The 2/3 disinterested approval was achieved, but the case is proceeding post-closing. Defendants' motions to dismiss are pending.

In re USG Corp. Stockholder Litigation

- Action arose out of acquisition of USG by Knauf. Prior to the merger, Berkshire Hathaway owned over 30% of USG's common stock. Plaintiff alleged that Knauf became an interested stockholder because it had engaged in discussions, and allegedly coordinated a proxy contest that led to the defeat of 4 USG backed directors, with Berkshire (specifically Warren Buffett) before reaching an acquisition agreement with the USG board.

- Plaintiff sought a preliminary injunction against the merger closing until the defendants complied with Section 203. After expedited discovery and a preliminary injunction hearing, Vice Chancellor Glasscock denied the motion, finding that Berkshire and Knauf did not have an "agreement, arrangement or understanding" for purposes of Section 203.

Section 203
Key Takeaways/Advice:

- Focus on Section 203 early and often throughout process.
- Consider obtaining/providing board approval for Section 203 purposes before transaction is fully negotiated if circumstances warrant.
- Structure initial proposal to avoid or postpone Section 203 issues.

Appraisal Update

Verition Partners Master Fund Ltd. v. Aruba Networks, Inc.

- Citing extensively to *Dell* and *DFC*, the Court of Chancery found that the most persuasive evidence of fair value was the company's 30-day unaffected market price.
    - Deal the result of an arm's-length transaction involving a publicly traded company without a controlling stockholder.
    - Deal price also contained synergies, and thus "logically exceeded fair value."
    - Petitioner failed to identify a bidder who would pay a higher price, and thus lack of competition cuts against the petitioner.
    - Although occasionally there were misaligned incentives among Aruba's advisors, "[t]he issue in an appraisal is not whether a negotiator has extracted the highest possible bid. Rather, the key inquiry is whether the dissenters got fair value and were not exploited."
- No weight to deal price because of difficulties in calculating synergies.
    - "[M]y deal-price-less-synergies figure is likely tainted by human error. Estimating synergies requires exercises of human judgment analogous to those involved in crafting a discounted cash flow valuation. The Delaware Supreme Court's preference for market indications over discounted cash flow valuations counsels in favor of preferring market indications over the similarly judgment-laden exercise of backing out synergies."
- No weight to DCF.
    - Noted "the hazards that always come when a law-trained judge is forced to make a point estimate of fair value based on widely divergent partisan expert testimony."
- 30-day unaffected market price best evidence of fair value.
    - The court held that when there is a sufficient market, the unaffected market price provides "a direct route to the same end point," as backing out synergies and reduced agency cost from the deal price, and that Aruba Networks' unaffected market price provides "the best evidence of its going concern value."
    - Explicitly declined to adopt a bright-line rule, but found market price to be best evidence of fair value under the circumstances.

Aruba – Issues on Appeal

- Argument on appeal scheduled for March 27, 2019.
- Reliance on unaffected market price.
    - Petitioners argue that unaffected market price failed to reflect material non-public information and therefore was not the product of the type of efficient market identified in *Dell* and *DFC*.
        - ECM Hypothesis accounts for "informational efficiency" of publicly available information and does not imply "fundamental" efficiency.
        - By holding any premium offer is non-exploitive and thus "fair," the decision eviscerates appraisal for publicly traded corporations.
    - Aruba argues that the financial principles recognized in *Dell* and *DFC* support market price.
        - Market price is the best indicator of value.
        - Petitioners failed to establish that the non-public information undermined its reliability in this case.

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- Use of "deal-price-minus-synergies" as an effective check on unaffected market price.
  - Petitioners claim that the Court erred in using a "deal-price-minus-synergies" calculation to effectively check the reliability of unaffected market price due to issues in the sales process and the lack of evidence supporting the Court's synergies calculation.
  - In response, Aruba notes that the Court actually declined to rely on this calculation.
- Rejection of the petitioners' DCF analysis.
  - Petitioners challenge the Court's rejection of their DCF analysis solely because it deviated from deal price and market price.
  - Aruba responds that, if market price and deal price are deemed reliable indicators, it was appropriate to disregard a DCF analysis that significantly deviated from such values under *Dell* and *DFC*.

Aruba – Amicus Briefs

- An amicus brief submitted by seven law and finance professors supports the reversal of *Aruba* and argues against reliance on unaffected market price.
  - Unaffected market price fails to reflect "fair value" under Section 262 because it:
    - Only accounts for "informational efficiency" of publicly available information and does not imply "fundamental" efficiency.
    - Does not factor in interim developments between signing and closing.
    - Includes implied minority discount.
  - Citing recent studies for the propositions that there is no evidence that the threat of appraisal causes bidders to lower prices up front and that stronger appraisal remedies actually lead to increased deal premia, they argue that relying on unaffected market price is harmful to stockholders.
- Two other law professors have filed their own amicus brief in support of the Court of Chancery's decision and reliance on market price.
  - In the absence of fraud or conflicts that provide substantial reason to doubt the fairness of market price, market price is a more reliable indicator of fair value than "a DCF analysis commissioned by a self-interested litigant" even if market price does not fully reflect non-public information.
    - Markets are wiser than experts as reflected by mutual fund experts underperforming the relevant benchmark market average.
    - Scant evidence of implied minority discounts for publicly traded stocks, particularly without a controller.
  - These professors refute the conclusion derived by the other amici curiae professors from recent studies and assert that a general reliance on unaffected market price would still leave room for appraisal to benefit stockholders in the most concerning cases.

Blueblade Capital Opportunities LLC v. Norcraft Cos., Inc.

- Fortune Brands Home & Security, Inc. acquired Norcraft in an all-cash merger at a price of $25.50 per share.
- The Court declined to defer to deal price, instead using a DCF analysis to find fair value at $26.16 per share—approximately 2.6% more than the deal price.
- The Court noted that "significant flaws" in the merger process undermined the reliability of the deal price as an indicator of Norcraft's fair value.
  - There was no pre-signing market check, Norcraft's lead negotiator was focused on securing benefits for himself, and the deal's go-shop provision was rendered ineffective "by a clutch of deal-protection measures."
- The Court concluded that, given the unreliability of the deal price and the lack of evidence addressing whether Norcraft's unaffected trading price was probative of Norcraft's fair value, DCF analysis was the best method to determine fair value.

In re Appraisal of Solera Holdings, Inc.

- Vista Equity Partners ("Vista") acquired Solera Holdings, Inc. ("Solera") in an arm's-length, all-cash merger at a price of $55.85 per share.
- The Court deferred to deal price, less synergies, finding a fair value of $53.95 per share—approximately 3.4% less than the deal price.
- The Court noted that the sale process "was characterized by many objective indicia of reliability," with the process directed by an independent special committee and

“was conducted against the backdrop of an efficient and well-functioning market for Solera's stock.”

- The Court concluded that the deal price was the most reliable evidence of fair value and, after adjusting for synergies, was deserving of “sole and dispositive weight in determining the fair value” of Solera.

Dual-Class Stock Structures

- Vast majority of U.S. public companies (~90%) have a “one share, one vote” capital structure.
- In companies with dual-class share structures, owners of “high vote” stock have voting control that is disproportionate to their equity interest.
  - Owners of common stock receive limited voting rights (1 vote or no votes per share).
  - Owners of “high-vote” stock receive more than 1 vote per share.
- Most common in **founder-led** companies. Advocates argue that this structure:
  - Allows founders who are instrumental in a company’s success to maintain long term control.
  - Provides public investors with an opportunity to participate in the company’s growth.
- Dual-class and multi-class stock structures have existed for more than 100 years, but gained popularity in the last 15 years after a wave of high-profile IPOs of technology companies.
- Between 2012 and 2016, companies with dual-class structures have announced recapitalizations through creation and issuance of a new class of non-voting stock.
  - Typically initiated at the request of controller.
- Shares of non-voting stock are issued in a dividend to holders of both classes of stock.
- Proponents argue that recapitalizations preserve founder/controller-led approach.
  - Non-voting shares can be used as currency for employee compensation and M&A transactions.
  - Controller/founder can sell non-voting shares without further dilution of control.
- Opponents argue that issuance of non-voting stock leads to further entrenchment of controller.

Litigation Outcomes

- Stockholders sued to enjoin issuances of non-voting stock, alleging that proposed transactions entrenched controllers and diluted public investors without sufficient compensation
- Claims against **Zillow** (Washington corporation) were dismissed with prejudice
- **Google** (Delaware corporation) and **Under Armour** (Maryland corporation) negotiated settlements that permitted the issuance of the non-voting stock
  - Google: dividend of $522M to all Class A & B, paid in Class C/cash (value determined by average difference between trading price of Class A & C during 1st trading year)
    - Plaintiffs received $9.0M in attorneys’ fees and expenses
  - Under Armour: dividend of $59.0M to all Class A & B, paid in Class C/cash and additional concessions (amendment to founder’s non-compete allowing termination for cause if founder does not devote necessary time; board review of acquisitions using >5% non-voting stock)
    - Plaintiffs received $2.3M for attorneys’ fees and expenses
- **Facebook** and **IAC** (both Delaware corporations) abandoned plans to issue non-voting stock
  - Facebook (2017): plaintiffs received $67.M for attorneys’ fees and expenses.
  - IAC (2017): plaintiffs received $9.25M for attorneys’ fees and expenses.

Other Efforts to Stem Use of Low or No Vote Stock Classes

- Stockholders were not the only ones leading the fight against low/no vote stock
- In 2017, two major indices announced that they would no longer add/list companies with low vote stock classes after months-long consultations with users and other stakeholders
  - **S&P Dow Jones** announced that the S&P Composite 1500 and component indices will no longer admit companies with low/no vote stock classes
    - Does not include S&P Global BMI or S&P Global BMI
  - **FTSE Russell** announced plans to exclude companies with low/no vote stock classes
    - Companies seeking inclusion in FTSE Russell’s indices need to have at least 5% of voting rights held by unrestricted public stockholders

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    (reviewed on annual basis)
  - But, in October 2018, MCSI announced it would not delist/restrict companies with low/no vote stock
- In October 2018, **CII** petitioned **ICE** (parent company of **NYSE**) and **NASDAQ** to require companies with dual class share structures to revert to a traditional one-share/one-vote structure no more than seven years after the IPO date

Derivative Developments

Know Your Director Conflicts: *Oracle*

- *In re Oracle Deriv. Litig.*, C.A. No. 2017-SG (Del. Ch. Mar. 19, 2018)
- Plaintiff challenged an acquisition by Oracle of NetSuite, a company in which Larry Ellison, Oracle's co-founder/largest blockholder/director, retained a significant ownership interest
- Plaintiff pled facts demonstrating substantial business ties among Ellison and Oracle directors sufficient to raise reasonable doubt that a majority of the board that would have considered a demand would be capable of bringing its business judgment to bear, thus excusing demand.

Know Your Director Conflicts: *Fitbit*

- In re Fitbit, Inc. S'holder Deriv. Litig., 2018 WL 6587159, at *1 (Del. Ch. Dec. 14, 2018).
- Plaintiffs alleged directors and CFO of Fitbit breached their fiduciary duties by using insider knowledge that Fitbit's proprietary "PurePulse" technology did not perform as represented by the Company to structure IPO and Secondary Offering to personally profit from the sale of the Company's stock.
- Court of Chancery found that plaintiffs had pled facts raising a reasonable doubt that a majority of the demand board could impartially consider plaintiffs' insider trading and breach of fiduciary duty claims as they faced a substantial likelihood of liability.

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E-mail: info@themandajournal.com

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