DELAWARE M&A REVIEW
LESSONS FROM 2017 AND OUTLOOK FOR 2018

JANUARY 2018

Continuing trends observed in 2016 and 2017 saw a high volume of M&A market participation and shareholder activist campaigns. It also produced several significant legal decisions in key areas of Delaware corporate law whose ripple effects are sure to shape the considerations and actions of dealmakers in 2018 and beyond.

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Shareholder Activism

Shareholder activism continued to make headlines in 2017 with record amounts of capital spent targeting corporations, including Arconic, Procter & Gamble, ADP, General Motors, CSX Corporation, and Deckers Outdoor Corporation, among others. In some of these contests, activists pursued litigation. For example, Marcato Capital Management filed suit against the board of Deckers Outdoor Corporation in Delaware Chancery Court seeking to force the company to hold its annual shareholder meeting in December and eliminate expensive change-of-control "proxy penalties" in order to consider an alternative slate of director nominees. The board ultimately mooted the litigation by committing to hold its annual meeting as scheduled in December and deactivating the proxy penalties.

In *Sarissa Capital Domestic Fund LP v. Innoviva Inc.*,[1] the Chancery Court ordered pharmaceutical company Innoviva to add two nominees from Sarissa to the company's board of directors after concluding that an oral agreement to settle a proxy contest was binding and enforceable. In February 2017, Sarissa launched a proxy contest to replace three of Innoviva's seven directors at the company's annual meeting on April 20. The day before the annual meeting, the parties reached an oral agreement to settle the proxy contest in exchange for the appointment of two Sarissa nominees to the board. Later that day, Innoviva rescinded the oral agreement after learning that a large stockholder planned to vote for the board's directors, ensuring a win for the board nominees. In ordering specific performance of the oral agreement, the court found that Innoviva had entered into a binding agreement to settle a proxy contest launched by Sarissa and that Innoviva's attempts to renege on that agreement when it later learned it would win the proxy contest was "nothing but

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

misguided opportunism." As a result, the court ordered Innoviva to comply with its obligations under the settlement agreement and to seat two Sarissa designees on its board. The court's decision in *Sarissa* serves as an important reminder that a binding agreement can be formed even when the parties do not enter into a written agreement. Parties engaged in negotiations should take care not to inadvertently enter into a binding agreement by expressly indicating up front that oral business deals are contingent upon the parties forming a written agreement.

Appraisal Actions

Following high-profile appraisal decisions in 2016, the Chancery Court saw a notable increase in appraisal litigation during 2017. In two highly anticipated decisions, the Delaware Supreme Court made clear that the Chancery Court should afford significant weight to deal price when analyzing fair value for companies engaged in arm's-length mergers, but stopped short of imposing a presumption in favor of deal price. In *DFC Global Corporation v. Muirfield Value Partners L.P.*,[2] the high court found no basis for a presumption that deal price in open and arm's-length mergers equals fair value, but suggested that in conflict-free arm's-length mergers, the deal price is "the best evidence of fair value." It also noted that second guessing the value arrived upon by the collective views of the many sophisticated parties with a stake in the matter would be "hazardous." In remanding the case, the Supreme Court instructed the Chancery Court to reassess the weight it afforded the various factors potentially relevant to fair value. The Supreme Court also rejected the notion that the price paid by private equity or other non-strategic buyers was not entitled to such deference.

Consistent with the Supreme Court's decision in *DFC*, the Chancery Court in *In re Appraisal of PetSmart, Inc.*[3] deferred to the deal price in its appraisal evaluation because that price was negotiated following a robust auction process and was, therefore, the best indicator of the fair value of PetSmart's shares as of the closing of the merger. The court rejected the petitioners' analysis, which suggested a company value 45% greater than the deal price, finding the analysis was based on aggressive and unreliable management projections.

In *Dell Inc. v. Magnetar Global Event Driven Master Fund Ltd.*,[4] the Supreme Court similarly reversed the Chancery Court which had relied on a discounted cash flow analysis to produce an appraised value that was roughly 28% above the merger price. The Supreme Court determined that the lower court had abused its discretion by giving no weight to the deal price, particularly given that the trial court record suggested that the deal price deserved heavy, if not dispositive, weight.

[2] 172 A.3d 346 (Del. Aug. 1, 2017).

[3] C.A. No. 10782-VCS, 2017 WL 2303599 (Del. Ch. May 26, 2017).

[4] 2017 WL 6375829 (Del. Dec. 14, 2017).

Despite this clear trend toward using deal price in appraising M&A transactions, the Chancery Court issued two opinions in the past year that did not rely on the merger price as fair value, instead relying exclusively on a discounted cash flow analysis. In *In re Appraisal of SWS Group Inc.*,[5] the court used a discounted cash flow analysis because "the sale of SWS was undertaken in conditions that make the price thus derived unreliable as evidence of fair value." The court concluded that "certain structural limitations unique to SWS make the application of the merger price not the most reliable indicia of fair value," including that SWS was party to a credit agreement with its would-be acquirer under which the acquirer exercised a partial veto power over competing offers. Similarly, in *ACP Master, Ltd. v. Sprint Corp.*,[6] the court explicitly did not consider deal price while finding that the fair value for Clearwire Corporation on the date of the merger was $2.13 per share, less than half the merger price of $5 per share. *Sprint* presented a record of alleged misconduct by the bidder and the court suggested that the original deal price of $2.97 per share was not fair. The court, however, found that the ultimate purchase price of $5 per share obtained after a bidding war erupted between Sprint and Dish Network resulted in a price that exceeded fair value at the date of the merger. In both cases, neither party relied on deal price to demonstrate fair value.

Notably, in December 2017, Delaware's chancellor indicated during oral argument in *In re Appraisal of Solera Holdings Inc.* that he wanted a court-appointed expert to aid in the court's appraisal analysis. During the argument, the chancellor noted that he had been "decapitated" by the Supreme Court's reversal in *DFC* and that he did not "want to go through that again." It remains to be seen whether Chancellor Bouchard's decision to recruit an independent third-party expert will become prominent practice in appraisal actions going forward. The move has the potential to gain traction more broadly if it sufficiently addresses frustrations historically expressed by the Delaware courts over dueling litigant-hired experts, a process that has frequently resulted in widely disparate share price ranges. At the same time, given the trending emphasis on deal price as the best indicator of fair value in appraising transactions, courts may not be inclined to delegate valuation determinations to an independent expert in every case.

These decisions reaffirm the importance of deal price in appraisal cases, a fact companies on both sides of a deal should keep in mind through negotiations and deal closing. While *Dell* deliberately does not lay down a bright-line rule, it nevertheless gravitates towards deal price as the proper estimate of fair value, and *SWS* and *Sprint* are best seen as outliers resulting from specific evidence of flaws in the transaction process. Indeed, taken together, these cases demonstrate the importance of careful adherence to proper process, and suggest reduced risk that courts will reject deal prices absent structural impediments to or flaws in the negotiation and sale process. Companies assessing M&A transactions should continue to give due consideration to risks inherent in appraisal actions as a matter of course, in addition to the risk of class action litigation; however, adherence to appropriate process and robust negotiations should reduce the risk of both. Large shareholders, too, should take heed of the *Dell* decision before making the decision to dissent and seek appraisal, which can often be a timely and expensive process.

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

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

Application of the Business Judgment Rule in the Wake of *Corwin*

In late 2015, the Delaware Supreme Court handed down its landmark decision in *Corwin v. KKR Financial Holdings LLC*,[7] establishing the rule that the business judgment standard of review applies where a transaction "not subject to the entire fairness standard of review has been approved by a fully informed, uncoerced majority of the disinterested stockholders." Since then, Delaware courts have enforced *Corwin*'s high bar for plaintiff stockholders who pursue damages claims post-merger. In 2016, the Chancery Court dismissed multiple stockholder actions at the pleading stage where the court found that the stockholder approval vote was fully informed and the transaction did not involve a controller. Delaware courts continued to interpret and apply *Corwin* broadly in 2017.

In *In re Volcano Corp. Stockholder Litigation*,[8] the Delaware Supreme Court affirmed dismissal of a fiduciary duty action brought by plaintiffs (former public shareholders of Volcano Corporation) against individual Volcano directors and the Volcano board's financial advisor after the company was acquired by Philips Holdings USA in an all-cash merger. The Court held that stockholder acceptance of a first-step tender offer has the same cleansing effect under *Corwin* as a stockholder vote in favor of a long-form merger. Because Volcano's "fully informed, uncoerced, disinterested stockholders approved the Merger by tendering a majority" of the company's shares in the transaction, "the business judgment rule irrebuttably applie[d]." The Court's decision in *Volcano* rejected the notion that there is a distinction in the treatment of tender offers versus stockholder votes for the purposes of applying *Corwin*.

In *In re Merge Healthcare Inc. Stockholders Litigation*,[9] the Chancery Court dismissed another fiduciary duty claim brought by a class of stockholders alleging the company's directors breached their fiduciary duties in connection with the all-cash sale of the company to IBM. The approximately $1 billion transaction at issue was structured as a merger and was approved by 77% of the company's outstanding shares, including a majority of stockholders who were not associated with the company's purported controlling stockholder. In dismissing plaintiffs' claims, the court held that the business judgment rule afforded to directors involved in a change of control transaction that is approved by a majority of fully informed, disinterested stockholders applied to a merger, notwithstanding the presence of a target corporation controlling stockholder that was unaffiliated with the buyer. The court acknowledged that "the only transactions that are subject to entire fairness that cannot be cleansed by proper stockholder approval are those involving a controller stockholder," but noted that the mere presence of a controller does not trigger entire fairness per se. In the context of a transaction involving a controller, the primary concern is coercion, particularly where the "controller sits on both sides of the transaction, or is on only one side but competes with the common stockholders for consideration," in which case coercion is "deemed inherently present."

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[7] 125 A.3d 304 (Del. 2015).

[8] 156 A.3d 697 (Del. 2017).

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

As a result, *Merge Healthcare* extends the protections provided by *Corwin* to transactions involving a controlling stockholder absent coercion of the minority stockholders.

In a few decisions, however, Delaware courts determined that subsequent stockholder votes were not sufficient to apply the business judgment standard under *Corwin*. In *In re Saba Software*,[10] the Chancery Court declined to dismiss the action, holding the plaintiffs had adequately pled that a shareholder vote was coerced and not fully informed. Prior to the merger at issue, two former Saba directors had allegedly engaged in a fraudulent scheme to overstate pre-tax earnings by $70 million, and the company repeatedly failed to satisfy numerous Securities and Exchange Commission ("SEC") deadlines to restate its financial statements, resulting in a deregistration of Saba's stock by the SEC. Because of these events, Saba stockholders were "given a choice between keeping their recently-deregistered, illiquid stock or accepting the Merger price . . . consideration that was depressed by the Company's nearly contemporaneous failure once again to complete the restatement of its financials." In determining that the vote was coerced and not fully informed, the Chancery Court noted this choice, if the allegations were proven true, was "no real choice at all."

The court similarly found coercion existed in *Sciabacucchi v. Liberty Broadband Corporation.*[11] The stockholders had approved two proposed acquisitions that were conditioned in part on stockholder approval of an issuance of equity and a grant of a voting proxy to the company's major stockholder. The Chancery Court found that the vote was "structurally coerced" and therefore insufficient to cleanse board action and invoke business judgment review under *Corwin*. Although "inherent coercion" did not exist because the large stockholder did not control the company, the court determined that the vote was nevertheless structurally coerced as the stockholders were essentially forced to make "a simple choice: accept (disloyal) equity issuances to the Company's largest stockholder, and an agreement granting that stockholder greater voting power, or lose two beneficial transactions." The court did not accept the argument that the stock issuances constituted integral financing, finding it was "an insignificant part of the consideration" for the transactions.

In *In re Massey Energy Co. Derivative & Class Action Litigation*,[12] the Chancery Court found that the stockholder vote on the merger did not operate to cleanse directors of liability for unrelated breaches of fiduciary duty. In *Massey*, former stockholders of Massey sought to pursue claims against Massey's former directors related to the company's failure to comply with mine safety regulations after Massey's merger with Alpha Natural Resources, Inc. in a cash and stock transaction. The Chancery Court dismissed the claim on standing grounds because plaintiffs ceased to be Massey stockholders after the merger. The Chancery Court also found that if the former Massey stockholders had standing, the directors could not rely on *Corwin* to cleanse them of liability. The stockholder vote only asked whether the stockholders wished to accept a specified amount of shares and cash in exchange for their Massey shares; it did not ask the Massey stockholders "in any direct or straightforward way to approve releasing defendants from any liability they may have to the

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

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

[12] 160 A.3d 484 (2017).

Company for the years of alleged mismanagement that preceded the sale process." In so doing, the court stated that there must be a "proximate relationship" between the subject of the vote and the claim to be cleansed and that "the policy underlying *Corwin* . . . was never intended to serve as a massive eraser, exonerating corporate fiduciaries for any and all of their actions or inactions preceding their decision to undertake a transaction for which stockholder approval is obtained."

As we look forward, parties to deal litigation should expect that Delaware courts will continue to give substantial deference to decisions made by informed, disinterested, noncoerced stockholders (and independent, impartial target boards) to approve merger transactions. Comprehensive pre-closing disclosures will likely suffice to cleanse transactions of post-closing damages claims in the majority of cases, but note that transactions involving allegations of controlling stockholders may complicate that analysis and efforts to shoehorn the cleansing of unrelated liability into a *Corwin* approval are not likely to be successful.

M&F Worldwide Extends Pathway to Business Judgment Review

In 2017, the Delaware Chancery Court extended the roadmap for corporate lawyers structuring going-private transactions involving controlling stockholders that was set forth in *Kahn v. M&F Worldwide*[13] to third-party transactions where the controller acts as a seller only, but is alleged to have received disparate consideration. In *In re Martha Stewart Living Omnimedia, Inc. Stockholder Litigation*,[14] former stockholders of Martha Stewart Living Omnimedia brought claims against the company's former controlling stockholder, Martha Stewart, alleging breaches of her fiduciary duties in connection with the sale of the company to a third-party buyer in 2015. The stockholders alleged that Stewart used her position as controlling stockholder to secure greater consideration for herself through side deals with the buyer. In dismissing the claims, the court held that the sale of the company satisfied the requirements of *M&F Worldwide* to invoke business judgment review. *Martha Stewart* demonstrates the importance of following the *M&F Worldwide* roadmap. Indeed, the court took particular note of the fact that the MSLO Board implemented protective measures *before* permitting negotiations between the buyer and Ms. Stewart.

In *NRG Yield v. Crane*,[15] the Delaware Chancery Court also applied business judgment review, under *M&F Worldwide*, to a corporate recapitalization proposed by a controller where the recapitalization would perpetuate its control and, in doing so, dismissed fiduciary duty claims against the directors who approved the recapitalization. Although the court concluded that the recapitalization was a conflicted controller transaction to which entire fairness review presumptively applied, because the transaction was subject from the outset to the approval of an independent committee of directors and a majority of the minority stockholders, business judgment review was the appropriate standard.

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[13] 88 A.3d 635 (Del. 2014).

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

[15] C.A. No. 12742-CB (Del. Ch. Dec. 11, 2017).

Aiding and Abetting/Advisor Liability

The Delaware Supreme Court's decision in *Corwin* also has a favorable impact on financial advisors facing claims of aiding and abetting liability. By heightening the standard of review applied to a claim that directors breached fiduciary duties to the business judgment rule, Delaware courts continued to narrow the scope of aiding and abetting liability in 2017. In a representative matter, *In re MeadWestvaco Stockholders Litigation*,[16] the Chancery Court dismissed fiduciary duty claims against the directors of MeadWestvaco and an aiding and abetting claim in connection with the company's stock-for-stock merger. The plaintiffs' breach of fiduciary duty claims rested solely on the allegation that the directors entered into the merger in bad faith in order to prevent a threatened proxy contest by an activist investor and, as a result, left behind $3 billion in value. Per *Corwin*, the court applied the business judgment rule and dismissed the breach of fiduciary claims. Because the fiduciary duty claims failed, the aiding and abetting claim was likewise dismissed. A similar outcome occurred in *In re Volcano Corp. Stockholder Litigation*, where an aiding and abetting claim against an advisor was likewise dismissed. The court determined that the advisor was protected from liability by the finding that the shareholder vote was fully informed and voluntary.

In light of this post-*Corwin* trajectory, once a transaction is approved by an uncoerced, fully informed vote of disinterested stockholders, advisors should be free of potential aiding and abetting liability based on an underlying breach by directors. Although disclosure of all material facts has always been important, these decisions underscore the need for adequate disclosures to ensure a "fully informed" shareholder vote. Advisors and their counsel should take care to ensure that any relevant facts—particularly conflicts—are disclosed to the Board and, when appropriate, shareholders.

Scope of Books and Records Demands

A number of decisions over the past year illustrate the nuanced requirements to prevail in an action pursuant to Section 220 of the Delaware General Corporation Law. In December 2016, the Chancery Court issued a ruling in *Dal Ben v. Outerwall Inc.*[17] that reinforced the notion that mere speculation of misconduct is not sufficient to state a proper purpose under Section 220. In that case, the plaintiff sought records to investigate potential breach of fiduciary duty for conflicts of interest in connection with the company's $1.6 billion acquisition of Apollo Global Management LLC based on management's pursuit of employment in the post-merger company. In finding the plaintiff failed to demonstrate a credible basis to infer wrongdoing, the court noted the credible basis standard is "a low burden, but it's a real one." Where the evidence provided by the plaintiff "amounts to little more than speculation and suspicion," the burden is not met.

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[16] 168 A.3d 675 (Del. Ch. 2017).

[17] C.A. No. 12763-CB (Del. Ch. Dec. 1, 2016).

In 2017, the Chancery Court continued to carefully examine evidence put forward by plaintiffs to meet their "credible basis" burden under Section 220. In February 2017, the Chancery Court in *Haque v. Tesla Motors, Inc.*[18] similarly denied a stockholder's Section 220 request, finding the stockholder had not stated a proper purpose because he had not demonstrated a credible basis from which the court could infer possible wrongdoing. In that case, the plaintiff made two demands for the inspection of Tesla's records for the stated purpose of investigating possible breaches of fiduciary duty and mismanagement by Tesla's officers and directors, including whether Tesla misrepresented production problems in order to hide low consumer demand for its vehicles. In addition to finding the plaintiff's theory "on its face, hard to fathom," the court determined that the plaintiff had failed to satisfy his burden of showing a credible basis to infer wrongdoing. According to the court, the plaintiff's arguments "reflect[ed] a basic misunderstanding of Tesla's complex manufacturing process" and the mathematical extrapolations presented lacked "support in evidence or in basic logic."

In its October 2017 decision in *The City of Cambridge Retirement System v. Universal Health Services, Inc.*,[19] the Chancery Court upheld a confidentiality agreement that conditioned production of documents pursuant to a Section 220 demand on plaintiff's agreement that a complaint in any subsequent litigation relying on certain documents provided in the Section 220 production be deemed to incorporate by reference *all* documents produced pursuant to the Section 220 demand. The court's decision derived in part from its concern that plaintiffs might unreasonably use a limited subset of documents produced in a Section 220 demand to support a complaint that would otherwise be untenable if examined under the full universe of documents obtained. *City of Cambridge* demonstrates the importance of insisting upon incorporation by reference provisions in the consensual response to a Section 220 demand, and highlights the willingness of the Chancery Court to impose such requirements, even over the objection of stockholders making the Section 220 demand.

Delaware corporations facing stockholder books and records demands should also be alert to circumstances that suggest a stockholder is merely lending his or her name to an opportunistic demand. In *Wilkinson v. A. Schulman, Inc.*,[20] the Chancery Court denied a request for books and records with a facially proper purpose based on the conclusion that the demand was a lawyer-driven effort by entrepreneurial plaintiffs' counsel. The stockholder testified that he was unaware of the details of the demand, or its purpose, and that he did not do anything to verify the factual allegations. It was also revealed that the stockholder served as a nominal plaintiff in seven other lawsuits for the same law firm that pursued the instant case. Companies should remain vigilant and actively involved in all aspects of the Section 220 demand process, and should not hesitate to push back appropriately when similar circumstances so warrant.

[18] C.A. No. 12651-VCS, 2017 WL 448594 (Del. Ch. Feb. 2, 2017).

[19] C.A. No. 2017-0322-SG, 2017 WL 4548460 (Del. Ch. Oct. 12, 2017).

[20] C.A. No. 2017-0138-JTL, 2017 WL 5289553 (Del. Ch. Nov. 13, 2017).

At the intersection of books and records demands and *Corwin*, the Delaware Chancery Court in *Lavin v. West Corp.*[21] declined to extend the *Corwin* ruling in the context of a properly supported Section 220 demand. In that case, a stockholder served a demand on West Corporation to inspect its books and records to investigate concerns related to mismanagement by West's directors in a merger transaction. The company opposed the Section 220 demand, arguing that, under *Corwin*, the stockholder vote cleansed any alleged breaches of fiduciary duty. The court rejected the company's argument, holding that *Corwin* will not "stand as an impediment to an otherwise properly supported demand for inspection under Section 220," and ruling that the approval of a merger by a vote of disinterested stockholders does not preclude a properly supported demand for inspection of books and records under Section 220 where the alleged purpose is to investigate alleged wrongdoing related to a merger. According to the court, "[a]ny contrary finding would invite defendants improperly to draw the court into adjudicating merits defenses to potential underlying claims in order to defeat otherwise properly supported Section 220 demands." The court noted, however, that any subsequent litigation challenging the shareholder vote would need to address the company's *Corwin* defense with facts supporting a reasonable inference that the shareholder vote was coerced or uninformed.

Preclusion Principles in Derivative Actions

In *In re Wal-Mart Stores, Inc. Delaware Derivative Litigation*,[22] plaintiffs-shareholders demanded access to Wal-Mart's books and records under Section 220 in an effort to strengthen their case, and "vigorously pursued the books-and-records litigation, which took three years to resolve." At the same time, other Wal-Mart shareholders who had commenced a parallel case in Arkansas did not seek Wal-Mart's books or records, or await the outcome of the Delaware action, and instead chose to proceed with their case. Before the Delaware plaintiffs had the chance to complete their Section 220 litigation and file an amended complaint, the federal district court in Arkansas dismissed the shareholders' action for failure to adequately plead demand futility. The Chancery Court subsequently dismissed the Delaware shareholders' claims on the ground that the Arkansas decision had a preclusive effect. On appeal, the shareholders argued that affirming the lower court's ruling could be the "death knell" of Section 220 actions, encouraging a race to the courthouse at the expense of proper discovery. The Delaware Supreme Court remanded the case, directing the Chancery Court to address whether, in a situation where dismissal by the federal court in Arkansas of a stockholder plaintiff's derivative action for failure to plead demand futility is held by the Chancery Court to preclude subsequent stockholders from pursuing derivative litigation, the subsequent stockholders' Due Process rights were violated. In evaluating that issue, the Chancery Court recommended limiting the preclusive effect of derivative lawsuit dismissals in other jurisdictions to protect due process rights. In formulating its recommendations, the court relied on "(1) the similarities between class action and derivative actions, (2) some of the realities of derivative litigation, and (3) public policy considerations." The Delaware Supreme Court is expected to respond to the Chancery Court's recommendation in 2018.

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

[22] 167 A.3d 513 (Del. Ch. 2017).

Post-Closing Indemnification Issues

In October 2017, the Delaware Supreme Court affirmed the Chancery Court decision in *Friedman Fleischer & Lowe, LLC v. AccentCare, Inc*.,[23] holding that, in the post-closing indemnification context, where the term "claim" is used in an agreement but is otherwise not independently defined, "claim" means the filing of a lawsuit. AccentCare had purchased the common stock of a hospice provider company pursuant to a stock purchase agreement that included a provision providing AccentCare with certain indemnity rights against sellers and one that established that the representations and warranties made would only survive through the release date of December 22, 2012. Years later, in 2015, AccentCare made multiple demands for indemnification in connection with a settled legal action involving the hospice provider, and sellers ultimately filed suit to obtain release of the escrowed funds that AccentCare purported were owed to it in satisfaction of sellers' indemnification. The court denied AccentCare's indemnification claims, holding that AccentCare had an obligation to pursue its rights under the agreement by filing suit before the end of the survival period. Because it failed to do so, the indemnification claims were untimely. Pursuant to this decision, buyers should be aware that providing notice of an indemnification claim within the agreed-upon time period is not enough. Transaction planners should pay attention to the definition of "claim" in their contracts, or seek a tolling agreement, to prevent the statute of limitations from barring indemnity claims. In the absence of such protections, filing litigation to preserve indemnity claims may be necessary.

Post-Closing Purchase Price Adjustments

In another post-closing context, the Delaware Supreme Court reversed the Chancery Court's ruling in C*hicago Bridge & Iron Co. N.V. v. Westinghouse Electric Co. LLC*,[24] holding that the post-closing working capital true-up could not be used to circumvent the liability limitations agreed to in the transactions. In the case, Chicago Bridge sold its nuclear power plant subsidiary to Westinghouse for zero dollars in up-front consideration and, in return, was released from any further liabilities connected with the projects. The contract included a "liability bar" under which Westinghouse agreed that its remedy for breach of representations and warranties was to refuse to close and none of the seller's representations and warranties survived closing. It also provided that disputes over the post-closing adjustment were to be submitted to an independent auditor. Before the Chancery Court, Westinghouse successfully argued that, because the target's financials were not GAAP-compliant, Chicago Bridge owed it over $2 billion. The Delaware Supreme Court disagreed in 2017 and found that the buyer's GAAP compliance claims were not within the purview of the independent auditor. The court noted that the true-up process is a "narrow, subordinate, and cabined remedy" that is only intended to account for changes between signing and closing of the transaction. Thus, raising GAAP compliance claims in the true-up proceeding was an improper attempt to circumvent the contract's liability bar.

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[23] 173 A.3d 85 (Del. 2017).

[24] 166 A.3d 912, 915 (Del. 2017).

Reasonable Best Efforts Clauses in M&A Agreements

In *The Williams Companies, Inc. v. Energy Transfer Equity, L.P.*,[25] the Delaware Supreme Court held that a provision requiring the parties to "use [their] reasonable best efforts to . . . take . . . all actions . . . necessary" to complete the merger, not only prohibited the parties from preventing the merger, but also imposed an affirmative obligation to take all reasonable actions to complete the transaction. The Supreme Court further held that the alleged breaching party had the burden to prove that any alleged breach had not materially contributed to the failure of a condition to the merger. Notwithstanding these findings, the Supreme Court determined that the defendant had not breached its contractual obligation to use reasonable best efforts to obtain a tax opinion from its outside counsel stating that the merger should be treated by the Internal Revenue Service as a tax-free exchange. Rather, the Supreme Court found that the defendant's outside counsel had acted in good faith in making the determination that it could not deliver the tax opinion and, thus, there was no basis for finding the defendant in material breach of the reasonable best efforts requirement.

Impact of *Trulia* on Merger Litigation in Delaware and Federal Courts

In 2016, the Delaware Chancery Court ruled in *In re Trulia, Inc. Stockholder Litigation*[26] that it would no longer approve "disclosure-only" settlements absent certain conditions. The court refused to approve a disclosure-only settlement and held that supplemental disclosures supporting a proposed settlement must address material misrepresentations or omissions, and the release defendants obtain in return must be narrowly tailored to the claims relating to the disclosures. Following *Trulia*, 2017 saw a noticeable decline in the number of disclosure-only settlements in Delaware.

Although merger litigation declined in Delaware this past year, there was a marked increase in filings in other jurisdictions, particularly federal courts. According to Cornerstone Research's "Securities Class Action Filings: 2017 Midyear Assessment," federal filings of class actions involving merger transactions were at record high levels in 2017. For the first half of 2017, filings increased to 95, up from 57 during the same period in 2016. The response to *Trulia* in other jurisdictions has varied. In *In re Walgreen Co. Stockholder Litigation*,[27] the Seventh Circuit explicitly adopted *Trulia*'s reasoning in rejecting a disclosure-only settlement. The New Jersey Superior Court followed suit in *Vergiev v. Aguero*.[28] The court applied the *Trulia* standard and concluded the settlement could not be approved in light of the immateriality of the supplemental disclosures that were provided in exchange for a release of claims relating to the transaction. Courts in Connecticut and Indiana have similarly adopted the Chancery Court's *Trulia* analysis.

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[25] 159 A.3d 264 (Del. 2017).

[26] 129 A.3d 884 (Del. Ch. 2016).

[27] 832 F.3d 718 (7th Cir. 2016).

[28] No. L-2276-15 (N.J. Super. Ct. Law Div. Sept. 26, 2016).

In contrast, the New York Appellate Division reversed a lower court's rejection of a disclosure-only settlement in *Gordon v. Verizon Communications, Inc*.[29] The court there considered the concerns expressed by the Delaware Chancery Court in *Trulia* and in other cases, but nevertheless reversed the lower court's rejection of the settlement and remanded the case for the lower court to consider a fee award for the plaintiffs' counsel. A Florida court in *Delman v. Quality Distrib., Inc.*,[30] similarly declined to follow *Trulia* in approving a disclosure-only settlement concerning a Florida corporation. In approving the settlement, the court noted that, unlike Delaware or federal courts, "the Florida court system does not provide for early stage 'out of hand' dismissal."

Directors' Compensation

On December 13, 2017, the Delaware Supreme Court issued an important opinion, *In re Investors Bancorp, Inc. Stockholder Litigation*,[31] holding that stockholder challenges to certain types of director compensation awards will be governed by the fact-intensive "entire fairness" standard, rather than the more deferential "business judgment" rule. Specifically, *Investors Bancorp* held that even where stockholders have ratified director compensation awards, boards of directors will not be able to get the benefit of business judgment rule protection to a subsequent stockholder challenge unless (1) the stockholders approve the *specific director awards* or (2) the plan is self-executing (meaning the directors had no discretion in making the awards such as when the award is set pursuant to a predetermined formula).

Under *Investors Bancorp*, where directors exercise any discretion in granting themselves compensation, they must demonstrate that the compensation award was entirely fair to the company. This is so even if the stockholders approved the compensation plan in advance. The Delaware Supreme Court expressly rejected prior Delaware cases holding that directorial compensation plans that impose meaningful, director-specific limits on compensation should nevertheless be subject to business judgment review as long as informed stockholders had approved the plan. After *Investors Bancorp*, for business judgment review to attach, the board must be divested of discretion in awarding itself compensation.

This decision is significant in that it increases the risks of derivative litigation challenging director compensation. Although the precise ramifications of the Delaware Supreme Court's decision remain to be seen, *In re Investors Bancorp* will likely require Delaware corporations to conduct prompt, wholesale reviews of their future director compensation plans to guard against stockholder litigation challenging directorial compensation as unfair and excessive.

[29] 46 N.Y.S.3d 557 (N.Y. App. Div. 1st Dep't 2017).

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

[31] 2017 WL 6374741 (Del. Dec. 13, 2017), as revised (Dec. 19, 2017).

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