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CLIENT ALERT

Delaware M&A and Shareholder Litigation Review – Lessons from 2019

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It has been another busy year for the Delaware courts, with opinions issued in a number of key areas. The Delaware Supreme Court confirmed that *Caremark* claims, although generally very difficult to maintain, can survive a motion to dismiss. Meanwhile, the Court of Chancery showed that there is still a high bar to establishing a material adverse effect that will permit termination of a merger agreement, and that justifications by buyers to walk away from binding contracts will be heavily scrutinized. The courts' decisions continued to clarify what information boards must disclose in order to ratify a third-party transaction under *Corwin*, what it means to be a "controlling stockholder," and when the *MFW* standard of review will apply to transactions with a controller. The courts also re-emphasized the importance of deal price in determining fair value in an appraisal action, and expanded the types of documents that may be available to stockholders in a books and records action. Finally, the courts addressed the enforceability of advance notice bylaws and analyzed several recurring issues in the context of post-closing disputes.

Chief Justice Strine's retirement in 2019 also marked the end of an era and resulted in some reshuffling on the Delaware courts. Justice Seitz was selected to replace Chief Justice Strine, and Vice Chancellor Montgomery-Reeves was elevated to become the first person of color and the third woman to serve on the Delaware Supreme Court. Earlier this month, her replacement, Paul Fioravanti Jr., was confirmed by the Delaware Senate as the newest Vice Chancellor of the Court of Chancery.

***Caremark* Pleading Burden**

Delaware courts have consistently held that stockholder derivative claims based on a board's failure to discharge its duty of oversight (also known as *Caremark* claims) are "possibly the most difficult theory" upon which a plaintiff can hope to prevail. Although such cases are commonly dismissed at the pleadings stage, in two separate cases in 2019, the plaintiffs were found to have alleged facts sufficient to overcome that high hurdle and survive a motion to dismiss.

In ***Marchand v. Barnhill***, the Delaware Supreme Court reversed the Court of Chancery's grant of a motion to dismiss a *Caremark* claim against the board and two executives of Blue Bell Creameries.[1] The lawsuit followed a listeria outbreak at Blue Bell in 2015, which caused the deaths of three customers, a total recall of its products, and a temporary shutdown of its manufacturing plants. Plaintiffs alleged that the directors and executives breached their duties of care and loyalty by knowingly disregarding contamination risks and failing to make a good faith effort to oversee the safety of the company's food-making operations. Disagreeing with the Court of Chancery, the Delaware Supreme Court held that the complaint sufficiently alleged particularized facts supporting a reasonable inference that the board failed to implement any system to monitor food safety, which is a central compliance issue for a company that only makes ice cream. The Delaware Supreme Court found that the directors' *Caremark* duties required them to make a "good faith effort to oversee the company's operations," which included establishing an "information and reporting system [that] is in concept and design adequate to assure the board that appropriate information will come to its attention in a timely manner." Here, the complaint alleged that the board had no committee overseeing food safety, no board-level process to address food safety issues, and no protocol by which the board was expected to be advised of food safety reports and developments. Thus, the Delaware Supreme Court concluded that there was a reasonable inference that the directors consciously failed to attempt to assure that a reasonable information and reporting system existed.

Several months later, the Court of Chancery, citing *Marchand*, denied a motion to dismiss a *Caremark* claim in ***In re Clovis Oncology Inc. Derivative Litigation***.[2] Following disclosures that one of Clovis's key cancer drugs could be less effective than previously thought, plaintiffs filed suit alleging, among other things, that the company's directors breached their fiduciary duties by failing to oversee clinical trials for the drug and allowing the company to issue misleading statements about the drug's efficacy. Vice Chancellor Slights found that the board had implemented an appropriate reporting system and controls, but that the complaint sufficiently alleged a failure to monitor the company's compliance. In particular, the court noted that, under *Marchand*, a board's oversight function "must be more rigorously exercised" when the company "operates in an environment where externally imposed regulations govern its 'mission critical' operations." Here, accepting the complaint's allegation that the drug was "Clovis' mission critical product," the court ruled that the

1 212 A.3d 805 (Del. 2019).

2 C.A. No. 2017-0222-JRS, 2019 WL 4850188 (Del. Ch. Oct. 1, 2019).

plaintiffs adequately alleged that the board ignored "red flags" that the company was not adhering to clinical trial protocols, thereby jeopardizing eventual FDA approval, and that management was not accurately reporting the trial results. The court did note that it was only a pleading level decision and that plaintiffs would have a higher burden at summary judgment to establish causation of any harm to Clovis.

Although these two decisions serve as an important reminder that *Caremark* claims may be permitted to proceed to discovery when supported by specific factual allegations, other cases from 2019 have generally reaffirmed that the high pleading hurdle facing plaintiffs is often insurmountable. For example, in ***Rojas v. Ellison***, a stockholder alleged that the directors of J.C. Penney had breached their fiduciary duties by consciously disregarding their responsibility to oversee J.C. Penney's compliance with state laws regulating price-comparison advertising.[3] In particular, the plaintiff alleged that the directors ignored a "red flag" in the form of a $50 million consumer class action settlement entered into by J.C. Penney, and that their failure to ensure that the company abided by the terms of that settlement resulted in additional civil litigation over its pricing practices. But the Court of Chancery dismissed the complaint because there was no evidence that the directors acted with "bad faith" by consciously allowing J.C. Penney to violate any laws. Rather, citing *Marchand*, the court found that the company had a board-level reporting system in place, including through the board's audit committee, to monitor compliance with laws and regulations. Chancellor Bouchard also found that the class action settlement was not the "proverbial red flag" evidencing ongoing illegal conduct because it was entered into "without any admission of liability, with an express acknowledgment that the [c]ompany was not then violating any . . . laws, and with a commitment to implement a program to ensure continued compliance with [relevant] laws going forward." Thus, because the board was actively taking steps to prevent any ongoing violations, no *Caremark* claim was adequately pleaded.

In ***McElrath v. Kalanick***, a stockholder alleged that the directors of Uber had breached their fiduciary duties by approving the acquisition of Otto, a company that produces self-driving vehicles.[4] After the acquisition, Google sued Uber, alleging that an employee had stolen trade secrets from Google's subsidiary Waymo and given them to Otto. The case resulted in Uber paying a $245 million settlement. The stockholder claimed that Uber's directors failed to adequately evaluate the risks of acquiring Otto and ignored warnings or "red flags" about the alleged misappropriation. The Court of Chancery dismissed the complaint, finding that even if the directors failed to sufficiently inform themselves of the due diligence findings, and instead relied on management's summaries of those issues, a "failure to follow best practices" or "[e]ven grossly negligent board action" is not enough to show the requisite non-exculpated breach of the duty of loyalty. As Vice Chancellor Glasscock noted, "there is a vast difference between an inadequate or flawed effort to carry out fiduciary

[3] C.A. No. 2018-0755-AGB, 2019 WL 3408812 (Del. Ch. July 29, 2019).

[4] C.A. No. 2017-0888-SG, 2019 WL 1430210 (Del. Ch. Apr. 1, 2019).

duties and a conscious disregard for those duties," which would be necessary to establish "bad faith" under a *Caremark* claim.[5]

The dismissal of *Caremark* claims in ***In re LendingClub Corp. Derivative Litigation*** highlights the importance of taking decisive remedial action once a problem is identified.[6] After a whistleblower reported potential misconduct by the CEO, the board conducted an internal investigation, self-reported the issues to the SEC and cooperated with its investigation, and secured terminations of multiple senior employees involved, among other remediation efforts. Stockholders then claimed that the directors "failed to take steps to maintain adequate internal controls necessary to prevent against the issuance of false and misleading statements" about adherence to certain policies that were violated. Plaintiffs also argued that the board "failed to monitor company operations" and thereby "disabled itself from being informed of problems requiring its attention." In dismissing the complaint, the Court of Chancery found an extensive record of board action, including implementation of a compliance program and reporting systems as well as appropriate board level action once the violations came to light. Indeed, Vice Chancellor McCormick noted that the complaint did not contain a "single fact that would demonstrate bad faith," as is required under *Caremark*.

***Corwin* and the Continued Importance of Disclosure**

The Delaware Supreme Court's 2015 decision in *Corwin v. KKR Financial Holdings LLC*—which applies the business judgment rule to arm's-length transactions that are subsequently ratified by a non-coerced, fully informed majority of disinterested stockholders—has served as a powerful defense for directors in post-closing money damages cases.[7] In 2019, the Delaware courts further refined the *Corwin* doctrine, examining, in particular, when disclosure deficiencies prevent application of the defense.

In ***English v. Narang***, the plaintiffs argued that the *Corwin* defense should not apply to their fiduciary duty claims because, among other reasons, the disclosures issued in connection with the transaction were inadequate.[8] Plaintiffs alleged that the board misrepresented the company's financial outlook by issuing projections that "understated the Company's upside and overstated certain risk factors;" failed to disclose "when, and the extent to which, discussions occurred regarding post-close employment opportunities for [] management;" and failed to disclose "potential conflicts of interest affecting [the] financial advisors," including that each financial advisor had previously performed work for the company. The Court of Chancery disagreed, finding that none of the complaint's allegations sufficed to show any

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5 The Court of Chancery's decision recently was affirmed by the Delaware Supreme Court. --- A.3d ---, 2020 WL 131371 (Del. Jan. 13, 2020). The Supreme Court found that the inference from the allegations in the complaint "show[ed] a functioning board that did more than rubberstamp the transaction" and agreed that the board's actions could not be characterized as an intentional dereliction of its duties. *Id*.

6 C.A. No. 12984-VCM, 2019 WL 5678578 (Del. Ch. Oct. 31, 2019).

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

8 C.A. No. 2018-0221-AGB, 2019 WL 1300855 (Del. Ch. Mar. 20, 2019).

materially misleading statements or omissions in the company's disclosures. Thus, because the stockholders were fully informed, Chancellor Bouchard applied the *Corwin* doctrine and dismissed the case.[9]

In contrast, in ***Chester County Employees' Retirement Fund v. KCG Holdings***, the Court of Chancery refused to apply the *Corwin* defense to dismiss the plaintiff's *Revlon* claims.[10] Even though stockholders voted to approve the transaction, Vice Chancellor McCormick determined that, if the allegations in the complaint were taken as true, the stockholders were not fully informed when they did so. Plaintiff alleged that multiple issues in connection with the transaction were not disclosed, including that (1) the company's longtime financial advisor had "secret dealings" with the buyer that "undermined" the board's ability to extract greater value, (2) the company's CEO, who was also tasked with negotiating the deal price, thought the price was too low but agreed to support the transaction after the compensation packages for him and his management team were increased, and (3) the circumstances leading to a downward revision by management of previous, more optimistic, financial projections for use in the fairness opinion. Because the court concluded that stockholders were not adequately informed about these issues, the subsequent vote did not "cleanse" the transaction and defendants' motions to dismiss were denied.

Transactions With Controlling Stockholders

Challenges to transactions with controlling stockholders continued to be a focus of litigation in Delaware. Decisions over the past year have touched on a number of important issues, including when the defendant-friendly *MFW* standard of review can apply to such transactions and the circumstances under which minority stockholders are deemed to be "controllers" under Delaware law.

The Scope of MFW's Application to Controller Transactions

Since the seminal 2014 *MFW* decision, Delaware courts have applied the business judgment rule to a merger proposed by a controlling stockholder as long as two procedural safeguards are established "*ab initio*," or from the beginning: the merger is conditioned on the approval of an independent special committee and a majority vote by the minority stockholders.[11] In ***Olenik v. Lodzinski***, the Delaware Supreme Court further clarified when *MFW*'s "dual protections" must be put in place to qualify a take-private transaction for deferential business judgment review.[12] Minority stockholders challenged a merger between two companies with the same controlling stockholder, alleging that the controller conceived of the transaction and actively participated in negotiations before a special committee was established, thereby precluding

9 The Court of Chancery's decision was affirmed by the Delaware Supreme Court in a one-sentence slip order. 2019 WL 5681416 (Del. Nov. 1, 2019).

10 C.A. No. 2017-0421-KSJM, 2019 WL 2564093 (Del. Ch. June 21, 2019).

11 *Kahn v. M&F Worldwide Corp*., 88 A.3d 635 (Del. 2014). Willkie represented the special committee in the *MFW* matter.

12 208 A.3d 704 (Del. 2019).

application of *MFW*'s more favorable standard of review. The Court of Chancery dismissed the claims, finding that negotiations did not start until the acquirer sent an offer letter. The Delaware Supreme Court reversed. Applying the guidance it articulated in its 2018 *Synutra* decision,[13] the court found that the complaint pleaded facts "support[ing] a reasonable inference" that the controlled companies and the controlling stockholder had effectively engaged in "substantive economic negotiations" several months ***before*** the dual protections were in place, including by engaging in a joint exercise to value the two companies. As a result, the court held that the complaint "should not have been dismissed on *MFW* grounds." *Olenik* highlights the risks that deal participants face by engaging in merger-related activity—beyond truly "preliminary discussions"—ahead of putting *MFW*'s dual procedural protections in place.

In 2019, the Court of Chancery also extended, for the first time, the *MFW* framework to a board's decision on an executive compensation package for a controlling stockholder/CEO. ***Tornetta v. Musk*** dealt with Tesla's board approval of a compensation package for Elon Musk, which was potentially valued at up to $56 billion.[14] The plan was also "overwhelmingly approved" by a majority of disinterested stockholders who voted. Although Vice Chancellor Slights acknowledged that executive compensation decisions by a board are typically given great deference under Delaware law, the court nevertheless held that the entire fairness standard of review would apply when dealing with compensation of a controlling stockholder, unless the process was structured with the dual protections under *MFW* so as to nullify the potential for "coercive influence" by the controller. Returning to "first principles," the court wrote that "our law recognizes the relationship between a controlling stockholder and minority stockholders is fertile ground for potent coercion" even where no coercion is intended. As a result, the court could "discern no reason to think minority stockholders would feel any less coerced when voting against the controlling CEO's compensation plan than they would when voting to oppose a transformational transaction involving the controller" because "[i]n both instances, the minority stockholders would have reason to fear controller retribution [such as] forcing a squeeze-out or cutting dividends." Given the absence of a special committee, the court held that entire fairness, rather than business judgment, was the applicable standard of review, though plaintiffs bore the burden of showing the lack of fairness in light of the minority stockholder approval. Finding that the plaintiffs had met that burden at the pleading stage, "albeit just barely," the court denied defendants' motion to dismiss.

The Definition of "Control"

The Court of Chancery also had occasion to revisit the recurring question of when a less than 50% stockholder should be deemed a controller, and therefore become subject to fiduciary duties and the more rigorous judicial scrutiny that comes along with such status.

[13] *Flood v. Synutra Int'l, Inc.*, 195 A.3d 754 (Del. 2018).

[14] C.A. No. 2018-0408-JRS, 2019 WL 4566943 (Del. Ch. Sept. 20, 2019).

In ***FrontFour Capital Group v. Taube***, stockholders of Medley Capital Corporation, a publicly traded business development corporation ("BDC"), challenged a complex three-way merger involving Medley Capital's advisor, Medley Management, Inc., and a related BDC, Sierra Income Corporation.[15] Plaintiffs alleged that the Taube brothers, who founded and controlled Medley Management, orchestrated the transaction as a last ditch effort to bail Medley Management out of dire financial straits at the expense of Medley Capital's public stockholders. Although the Taube brothers owned just under 15% of Medley Capital's common stock, the Court of Chancery found, following a two-day preliminary injunction hearing that there was sufficient evidence showing that the Taube brothers actually dominated and controlled the board with respect to the transaction. That evidence included that a majority of the Medley Capital special committee were beholden to the brothers, that the committee allowed the brothers to dominate the process by setting the timeline and controlling the information flow, and that the committee otherwise failed to use its leverage to extract value for Medley Capital's stockholders. Applying entire fairness review, the court concluded that defendants had failed to meet their burden.

In ***Reith v. Lichtenstein***, the Court of Chancery refused to dismiss a derivative complaint challenging the issuance of preferred stock and equity grants to a 35.62% stockholder, Steel Holdings, and its affiliated persons.[16] Although Vice Chancellor Zurn acknowledged that a 35.62% stake in the company was not enough, standing alone, to deem a stockholder to be a controller, the court nonetheless found that it was a "large enough block of stock to be the dominant force in any contested election." The court also noted the influence of Steel Holdings in determining the composition of the board and the fact that its affiliates served as the company's top executives, which the court found gave it "day-to-day managerial supremacy" over the company. Taken together, "the gestalt of Steel Holdings' stock ownership, influence over the board, and influence over management makes it reasonably conceivable that it exercised control over the Company's business affairs . . . such that it owed fiduciary duties." In light of that holding, the court determined that entire fairness review should apply to the challenged equity issuances.

In contrast, in ***In re Essendant, Inc. Stockholder Litigation***, the Court of Chancery found that the plaintiff's allegations fell short of establishing that an approximately 12% stockholder wielded the kind of influence that could justify a finding of controller status.[17] In particular, the court noted the absence of any facts revealing the common hallmarks of such control, including the power to nominate the company's directors, personal relationships with the directors, coercive contractual rights, or any other indicia of "outsized influence" in the board room. Indeed, the court observed that "it would have been difficult for [the stockholder] to achieve any of these markers of control because . . . two other entities held larger voting blocks."

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[15] C.A. No. 2019-0100-KSJM, 2019 WL 1313408 (Del. Ch. Mar. 11, 2019).

[16] C.A. No. 2018-0277-MTZ, 2019 WL 2714065 (Del. Ch. June 28, 2019).

[17] C.A. No. 2018-0789-JRS, 2019 WL 7290944 (Del. Ch. Dec. 30, 2019).

Controller's "Implied Consent" to Jurisdiction

Finally, in a decision that should be of particular relevance to non-U.S. companies, ***In re Pilgrim's Pride Corp. Derivative Litigation***, the Court of Chancery held that a foreign controlling stockholder "consented implicitly" to personal jurisdiction in Delaware by virtue of the company's adoption of an exclusive Delaware forum bylaw provision.[18] In this case, stockholders challenged the company's acquisition of one of its parent's other subsidiaries, alleging that the company did not engage in "true arm's-length bargaining" and that it paid too high a price. The parent, a Brazilian entity, moved to dismiss for lack of personal jurisdiction. Vice Chancellor Laster refused because the parent's designees on the board "comprised a majority of the directors who voted unanimously to adopt a forum selection provision in conjunction with an insider transaction and who selected the courts of this state for precisely the type of litigation in which Parent would be the principal defendant." Based on those facts, the court determined that the controlling stockholder "consented implicitly to the existence of personal jurisdiction in this state."

<u>Material Adverse Effects (MAEs) and Merger Termination</u>

As we noted last year, the Court of Chancery's 2018 landmark decision in ***Akorn, Inc. v. Fresenius Kabi AG***[19] marked the first time, under Delaware law, that a party's right to terminate a merger agreement based on the occurrence of a material adverse effect ("MAE") was upheld. The court found that Akorn's 86% year-over-year decline in EBITDA, as well as drastic declines in revenue, operating income, and earnings per share in five straight quarters since signing constituted a MAE because they were "durationally significant," with "no sign of abating." The court also found overwhelming evidence of widespread regulatory violations which were qualitatively and quantitatively material.[20] The court was clear that it was this unique set of facts that resulted in its unprecedented decision, but some speculated in the wake of the *Akorn* decision that the court might be willing to read MAE clauses and termination rights more broadly in future cases.

This past year, the Court of Chancery issued two significant decisions which make clear that it has not lowered the bar and still reviews termination rights strictly in accordance with the express terms of a merger agreement and the parties' negotiated rights thereunder. In ***Channel Medsystems, Inc. v. Boston Scientific Corp.***,[21] Boston Scientific sought to terminate a merger agreement to acquire Channel Medsystems based on alleged misrepresentations made by Channel Medsystems. After signing, it was discovered that the Vice President of Quality at Channel Medsystems had falsified expense reports and other documents as part of a fraudulent scheme in which he stole $2.6 million from the company, and some of those falsified documents had been submitted to the FDA. Under the merger agreement, Boston Scientific

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18 C.A. No. 2018-0058-JTL, 2019 WL 1224556 (Del. Ch. Mar. 15, 2019).

19 C.A. No. 2018-300-JTL, 2018 WL 4719347 (Del. Ch. Oct. 1, 2018).

20 The Delaware Supreme Court affirmed the decision on appeal. 2018 WL 6427137 (Del. Dec. 7, 2018).

21 C.A. No. 2018-0673-AGB, 2019 WL 6896462 (Del. Ch. Dec. 18, 2019).

had the right to terminate if any of the representations by Channel Medsystems in the agreement were inaccurate, such that they would reasonably be expected to have a MAE on Channel Medsystems.

Chancellor Bouchard agreed with Boston Scientific that the alleged fraudulent conduct rendered certain of the representations in the agreement inaccurate, including its representation that it was in material compliance with applicable design control requirements. But the court determined that Boston Scientific failed to prove that conduct would likely result in a MAE on Channel Medsystems. In so doing, the court reiterated the "heavy burden" for establishing a MAE. Relying on *Akorn*, the court conducted a fact-intensive inquiry that assessed both the qualitative and quantitative impact of the misrepresentations and concluded that Boston Scientific's qualitative concerns were based on little more than unsubstantiated speculation and its quantitative concerns were based on a model that was unreliable. As a result, Boston Scientific failed to prove that it was entitled to terminate the agreement. The court further determined that Boston Scientific had itself breached the obligation to use commercially reasonable efforts to consummate the merger, and instead "simply pulled the ripcord."[22]

In ***Vintage Rodeo Parent, LLC v. Rent-a-Center, Inc.***, the court once again assessed a termination provision in a merger agreement—this time concluding that termination was valid.[23] This case involved a transaction in which Vintage Capital would purchase Rent-A-Center for $1.37 billion. The merger agreement provided that each party had the unilateral right to extend the end date of December 17, 2018 by giving the other party written notice of its election to extend on or before December 17, 2018. If neither party elected to extend the end date, either party could terminate the merger agreement by delivering written notice as specified in the agreement. On December 18, Rent-A-Center delivered a notice of termination on the basis that Vintage did not exercise its right to extend the end date prior to the December 17 contractual deadline. Vintage disputed the termination notice, arguing that constructive notice of its intent to extend the end date had been provided through the conduct of the parties, and that Rent-A-Center had breached its implied covenant of good faith and fair dealing by affirmatively concealing its intent to terminate the merger if Vintage did not deliver written notice of extension. Following a two-day trial, Vice Chancellor Glasscock upheld termination, finding that the terms of the notice provision were "clear and unambiguous" and should be enforced. The court further determined that there was no implied duty to warn a counterparty of a mistake or oversight, and that an obligation to use commercially reasonable efforts to consummate a merger does not preclude exercise of an express right to terminate the merger agreement.

Advance Notice Bylaws

Advance notice bylaws require an activist stockholder to give notice to the company of its intention to nominate an alternative slate of director candidates to the board. Delaware courts routinely uphold and enforce these bylaw

[22] The decision is currently on appeal to the Delaware Supreme Court, No. 16, 2020.

[23] C.A. No. 2018-0927-SG, 2019 WL 1223026 (Del. Ch. Mar. 14, 2019).

provisions, explaining that they are "useful in permitting orderly stockholder meetings."[24] In recent years, many boards have adopted advance notice bylaws that require stockholders to submit certain information about their nominees upon a request by the board, sometimes in the form of a detailed questionnaire.

Saba Capital v. BlackRock Credit Allocation Income Trust involved the application of such a provision in the bylaws of two BlackRock closed-end investment funds.[25] The funds' bylaws require a stockholder to provide, within five business days, information that is "reasonably requested" by the boards to determine whether the stockholder's nominees satisfy director qualifications in the funds' bylaws. Saba Capital, a stockholder of the two BlackRock funds, provided timely notice of its intention to nominate a competing slate of candidates for election to the funds' boards. In response, the funds' boards sent Saba Capital a questionnaire seeking additional information about Saba Capital's nominees. When Saba Capital did not respond to the request within five business days, the funds declared that the nominations were invalid and that votes for Saba Capital's nominees would not be counted. However, the Court of Chancery issued a mandatory injunction requiring the funds to count votes for Saba Capital's nominees, holding that because some portion of the questionnaire sought information unrelated to whether the nominees satisfied the director qualifications in the funds' bylaws, the questionnaire was not "reasonably requested" and the boards could not enforce the five business day deadline.

On appeal, the Delaware Supreme Court reversed and held that Saba's nominations were invalid under the funds' bylaws.[26] The court held that because at least some of the questionnaire sought information related to director qualifications, the five business day deadline applied under the unambiguous language of the bylaws. The court stated that, if Saba Capital had objections to the scope of the questionnaire, it should have raised those objections with the funds before the deadline passed. The court further explained that it was "reluctant to hold that it is acceptable to simply let pass a clear and unambiguous deadline contained in an advance-notice bylaw," particularly where the bylaw had been adopted on a "clear day" and there was no evidence of any manipulative conduct by the funds. The court concluded that "[a] rule that would permit election-contest participants to ignore a clear deadline and then, without having raised any objection, proffer after-the-fact reasons for their non-compliance with it, would create uncertainty in the electoral setting" and frustrate the purpose of advance notice bylaws. The decision affirms that advance notice bylaws requiring stockholders to provide information about their nominees are a valid and effective way to ensure an orderly election process, and that stockholders wishing to nominate directors must pay very careful attention to any deadlines as they will be strictly enforced.

[24] *See, e.g.*, *Goggin v. Vermillion, Inc.*, C.A. No. 6465-VCN, 2011 WL 2347704, at *4 (Del. Ch. June 3, 2011).

[25] C.A. No. 2019-0416-MTZ, 2019 WL 2711281 (Del. Ch. June 27, 2019).

[26] --- A.3d ---, 2020 WL 131370 (Del. Jan. 13, 2020).

Post-Closing Disputes

This past year, the Court of Chancery also revisited several recurring issues that arise in the context of post-closing disputes. The decisions provide key insights and issues to consider for those drafting merger agreements and other transaction documents.

In ***Genuine Parts Co. v. Essendant, Inc.***, Essendant terminated its merger agreement with Genuine Parts Company ("GPC") to pursue another offer and paid the termination fee mandated by the merger agreement.[27] When GPC thereafter sued for breach of contract, Essendant moved to dismiss on the basis that GPC's acceptance of the termination fee precluded it from bringing suit. Vice Chancellor Slights held that under the clear and unambiguous terms of the merger agreement, the termination fee was not intended to be GPC's exclusive remedy and therefore denied the motion to dismiss. The court went on to explain that although GPC's acceptance of the fee may raise factual and legal issues for its damages claim, the terms of the merger agreement did not prevent it from pursuing a claim for any damages caused by the termination.

In ***Shareholder Representative Services LLC v. RSI Holdco, LLC***, the court addressed the ownership of a target's pre-merger attorney client privilege for the first time since 2013.[28] RSI had acquired Radixx in September 2016 and the merger agreement provided that certain pre-merger privileged communications would not be transferred to the buyer and could not be used by the buyer. In July 2018, Radixx filed suit against RSI for breach of the merger agreement. In defense of its counterclaims, RSI sought access to approximately 1,200 privileged pre-merger emails between the seller and its counsel. RSI argued that despite the explicit provision in the merger agreement precluding such use, privilege over the emails had effectively been waived because no attempt was made to exclude or segregate these communications from RSI's servers. Vice Chancellor McCormick followed the guidance set forth by then-Chancellor Strine in *Great Hill Equity Partners IV, LP v. SIG Growth Equity Fund I, LLP*,[29] which established that although privilege over pre-merger communications ordinarily passes to the surviving corporation, parties may use their "contractual freedom . . . to exclude from the transferred assets the attorney-client communications they wish to retain as their own." Accordingly, the court concluded that the "broad contractual language" for which the sellers negotiated expressly bars RSI from using the privileged communications. As the court explained, allowing RSI to use the privileged communications would render the express language of the parties' agreement meaningless.

In ***Hill v. LW Buyer LLC***, the parties entered into a securities purchase agreement and a related escrow agreement to cover certain post-closing indemnification claims, including contingent tax liabilities.[30] Post-closing, LW Buyer discovered that Hill had failed to properly pay its taxes, leaving LW Buyer vulnerable to potential tax liabilities. Relying on the opinion

27 C.A. No. 2018-0730-JRS, 2019 WL 4257160 (Del. Ch. Sept. 9, 2019).

28 C.A. No. 2018-0517-KSJM, 2019 WL 2290916 (Del. Ch. May 29, 2019).

29 80 A.3d 155 (Del. Ch. 2013).

30 C.A. No. 2017-0591-MTZ, 2019 WL 3492165 (Del. Ch. July 31, 2019).

of an independent auditor, LW Buyer brought claims for indemnification of these potential tax liabilities. However, Vice Chancellor Zurn dismissed the claim on summary judgment as unripe because the term “taxes” was defined in the parties’ agreement to only cover “imposed, assessed or collected” taxes. In the absence of any liability having yet been assessed by any taxing authority for the unpaid amounts, the court concluded that LW Buyer had not yet suffered any indemnifiable losses. However, the court made clear that the claims were being dismissed without prejudice and that LW Buyer could pursue indemnification claims in the future for any tax liabilities that do materialize.

Kilcullen v. Spectro Scientific, Inc. also involved a dispute over money held in escrow pursuant to a stock purchase agreement as security for the seller’s indemnification obligations.[31] Post-closing, Spectro discovered that the seller sold and shipped products containing unlicensed software to third parties, contrary to the representations made by the seller in connection with the purchase agreement. Spectro settled the claims with the software’s licensor, Microsoft, and then sought indemnification from the seller. The seller moved to dismiss Spectro’s claims, arguing that they were outside the three-year statute of limitations for a breach of contract claim. Drawing a distinction based on the source of the alleged loss, Vice Chancellor McCormick dismissed as time-barred the buyer’s claims seeking recovery for losses resulting from the seller’s breach of the representations and warranties. The court reasoned that such claims are subject to a three-year statute of limitations that accrues on the day the transaction closes. However, the court also held that the indemnity arising from losses in connection with third-party claims did not accrue until the third-party claims are finally decided—that is, when damages are ascertainable. The court therefore declined to dismiss the buyer’s claims regarding losses resulting from the settlement with Microsoft.

Books and Records Actions Under DGCL § 220

Now all but required by the Delaware courts to meet heightened pleading standards, books and records demands under Section 220 of the DGCL are routinely made by stockholders before filing derivative or post-merger damages suits. In 2019, the Delaware courts issued several important decisions addressing the confidentiality of corporate records produced pursuant to Section 220, the availability of emails and text messages, the interplay between Section 220 and special litigation committee investigations, and other recurring issues in Section 220 practice.

Corporations producing books and records in response to demands under Section 220 typically seek to impose confidentiality restrictions on the productions. However, in ***Tiger v. Boast Apparel, Inc.***, the Delaware Supreme Court clarified that there is “no presumption of confidentiality in Section 220 productions,” abrogating a series of Court of Chancery decisions that had applied such a presumption.[32] Although the Court of Chancery “certainly has the power to impose reasonable confidentiality restrictions” and “targets of Section 220 demands will often be able to demonstrate that some degree of confidentiality is warranted where they are asked to produce nonpublic information,” the Supreme Court

[31] C.A. No. 2018-0429-KSJM, 2019 WL 3074569 (Del. Ch. July 15, 2019).

[32] 214 A.3d 933 (Del. 2019).

emphasized that such confidentiality must be justified. The Supreme Court also held that "an indefinite period of confidentiality should be the exception and not the rule," and "a party demanding Section 220 books and records need not show exigent circumstances for a court to grant something less than indefinite confidentiality." Thus, a court "must assess and compare benefits and harms when determining the initial degree and duration of confidentiality." Even so, the Supreme Court concluded that the confidentiality conditions imposed by the Court of Chancery in this case were reasonable under the circumstances.

In ***KT4 Partners LLC v. Palantir Techs. Inc.***, the Delaware Supreme Court confirmed that emails and text messages may be available as part of a books and records demand in limited circumstances.[33] KT4 sought to inspect certain emails from Palantir relating to an investors' rights agreement, arguing that the emails were necessary to its investigative purpose and that Palantir's formal board-level materials were not sufficient. The Court of Chancery denied the request, but the Supreme Court reversed, holding that Section 220 "must be interpreted in light of companies' actual and evolving record-keeping and communication practices." The court explained that if a company "decides to conduct formal corporate business largely through informal electronic communications," rather than through formal minutes and resolutions, "it cannot use its own choice of medium to keep shareholders in the dark about the substantive information to which Section 220 entitles them." But it added that "[i]f a corporation has traditional, non-electronic documents sufficient to satisfy the petitioner's needs, the corporation should not have to produce electronic documents."[34]

In another high-profile decision in 2019, ***Schnatter v. Papa John's International, Inc.***, Chancellor Bouchard ordered production of text messages and emails in a Section 220 action brought by the founder of the Papa John's pizza chain, John Schnatter.[35] The court found that "[a]lthough some methods of communication (*e.g.*, text messages) present greater challenges for collection and review than others, and thus may impose more expense on the company to produce, the utility of Section 220 as a means of investigating mismanagement would be undermined if the court categorically were to rule out the need to produce communications in these formats."

In ***In re Oracle Corporation Derivative Litigation***, the Court of Chancery found that documents gathered by a company's special litigation committee ("SLC") may constitute corporate books and records for purposes of a Section 220 demand.[36] A derivative suit against Oracle regarding the company's purchase of NetSuite, Inc. was stayed while an SLC conducted an investigation. During that investigation, the SLC collected 1.4 million documents and interviewed numerous witnesses, and the SLC ultimately concluded that it was in the corporate interest for the stockholder-plaintiff to pursue the

33 203 A.3d 738 (Del. 2019).

34 Equally important, in *Palantir*, the Delaware Supreme Court warned that "the Court of Chancery must be cautious about limiting the jurisdiction in which a petitioner can use in litigation the books and records it receives from a § 220 action," and reversed the Court of Chancery's imposition of a restriction that any follow-on litigation using books and records produced in response to the demand be brought in Delaware irrespective of whether potential defendants consented to jurisdiction in Delaware.

35 C.A. No. 2018-0542-AGB, 2019 WL 194634 (Del. Ch. Jan. 15, 2019).

36 C.A. No. 2017-0337-SG, 2019 WL 6522297 (Del. Ch. Dec. 4, 2019).

claim. The stockholder-plaintiff then made a demand under Section 220 for all documents obtained or reviewed related to the SLC's decision. In a virtually unprecedented decision, given the unique circumstances of the case, the court held that "privileged communications given by Oracle to the SLC, *and* relied upon by the SLC in concluding that litigation by the lead plaintiff is in the corporate interest, must be produced to the Lead Plaintiff" because "it would be . . . *against* Oracle's best interests to allow the Lead Plaintiff to proceed with the litigation asset stripped of all value created by the SLC." At the same time, the court made clear that communications between the SLC and its counsel were protected by the attorney-client privilege.

In ***High River Limited Partnership v. Occidental Petroleum Corp.***, the Court of Chancery declined a stockholder's invitation to hold that a books and records demand in aid of a proxy contest constitutes a proper purpose under Section 220.[37] After Occidental agreed to an allegedly bad deal with Anadarko, entities affiliated with Carl Icahn mounted a proxy challenge and made a Section 220 demand for information that might support the proxy contest. The court observed that Delaware law on whether stockholders have an inspection right in these circumstances "is, at best, murky." Although the court said that it "might endorse a rule that would allow a stockholder to receive books and records relating to questionable, but not actionable, board-level decisions so that he could communicate with other stockholders in aid of the potential proxy contest" in the right case, the sought-after records in this case were not "necessary and essential" for the proxy contest because documents sufficient to support the proxy contest were already available, given that the transactions at issue were highly publicized and plaintiffs had enough information to file their preliminary proxy materials. Therefore, any additional documents made available through the Section 220 demand would not be necessary or essential.[38]

In ***CHC Investments, LLC v. FirstSun Capital Bancorp***, the court granted FirstSun's motion to dismiss CHC's Section 220 complaint in light of the fact that CHC had already filed a plenary action in the same court regarding the same subject matter.[39] CHC conceded that its demands were "all designed to give [it] the information necessary to investigate the claims asserted in the Plenary Action." Criticizing the strategy as "[i]nherently contradictory" and a "sue first, ask questions later" approach, Vice Chancellor McCormick explained that "using Section 220 inspections to investigate pending plenary claims undermines well-established discovery law." Thus, the court noted that it would not permit a Section 220 complaint filed after plenary claims on the same subject were initiated unless there were "special circumstances" present, such as where the complaint was dismissed without prejudice with leave to amend.

[37] C.A. No. 2019-0403, 2019 WL 6040285 (Del. Ch. Nov. 14, 2019).

[38] The decision is currently on appeal to the Delaware Supreme Court, No. 483, 2019. Oral argument in the case is scheduled for February 5, 2020.

[39] C.A. No. 2018-0610-KSJM, 2019 WL 328414 (Del. Ch. Jan. 24, 2019).

Appraisal Actions

After important guidance from the Delaware Supreme Court in the *Dell* and *DFC Global* decisions,[40] holding that deal price should have heavy, if not dispositive, weight in an appraisal analysis, the Court of Chancery continued to clarify the circumstances under which courts should deviate from deal price. Generally, this has resulted in determinations that fair value was either at or below the deal price. These decisions are expected to further reduce the volume of appraisal arbitrage litigation in Delaware.

In ***Verition Partners Master Fund Ltd. v. Aruba Networks, Inc*.**, the Delaware Supreme Court reversed the Court of Chancery's controversial 2018 ruling setting fair value at the "thirty-day average unaffected market price," or $17.13, which was 30% lower than the $24.67 deal price.[41] In that decision, Vice Chancellor Laster acknowledged the precedent finding that deal price holds "substantial probative value" when a widely-held, publicly-traded company is sold in an arm's-length transaction, but decided that difficulties in quantifying and deducting synergies—specifically, "reduced agency costs" arising out of the merger—made the "deal price minus synergies" measure a less reliable indicator of fair value. On appeal, the Supreme Court reversed, finding that the Court of Chancery's concerns about "reduced agency costs" were unsupported by the record because, among other things, the buyer's "synergies case likely already price any agency cost reductions it may have expected." Further, while the Delaware Supreme Court stated that estimating synergies may inherently involve "imprecision," the calculation was "no more [imprecise] than other valuation methods." Finding that the record created a reliable estimate of deal price minus synergies that the Court of Chancery should have followed, the court directed that judgment be entered for the petitioners awarding them $19.10 per share, which was about 20% below the deal price. Thus, although successful on appeal, the stockholder petitioners ultimately secured a pyrrhic victory.

Two other appraisal actions this year confirmed that the Court of Chancery will defer to deal price as the most persuasive indicator of fair value where there are "objective indicia of deal price fairness." In ***In re Appraisal of Columbia Pipeline Group, Inc.***, the court identified six such indicia: (1) the merger was conducted at arm's-length with a third party, (2) the board had no conflicts of interest, (3) the buyer conducted extensive due diligence that included confidential insights about the company's value, (4) a pre-signing market check was held and other potential buyers were contacted, (5) the seller extracted multiple price increases during the negotiations, and (6) no other bidders emerged during the post-signing market check.[42] In ***In re Appraisal of Stillwater Mining Co.***, the court's decision to rely on deal price was based on similar factors.[43] In both cases, the petitioners attempted to point out flaws with the sale process, but the court

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40 *Dell, Inc. v. Magnetar Global Event Driven Master Fund Ltd.*, 177 A.3d 1 (Del. 2017); *DFC Global Corp. v. Muirfield Value Partners, L.P.*, 172 A.3d 346 (Del. 2017).

41 210 A.3d 128 (Del. 2019).

42 Cons. C.A. No. 12736-VCL, 2019 WL 3778370 (Del. Ch. Aug. 12, 2019).

43 Cons. C.A. No. 2017-0385-JTL, 2019 WL 3943851 (Del. Ch. Aug. 21, 2019).

determined that even though the sale process in each case was "not perfect," the facts as a whole supported a finding that the deal price was a reliable indicator of fair value.[44]

However, in ***In re Appraisal of Jarden Corp.***, the Court of Chancery declined to adopt "deal price less synergies" as the appropriate calculation where deficiencies in the sales process undermined its reliability as an indicator of fair value.[45] Specifically, Vice Chancellor Slights found that the sales process "left much to be desired," because Jarden's lead negotiator acted with "little to no oversight by the Board" and there was no pre- or post-signing market check on the negotiated price. Moreover, the evidence regarding synergies was conflicting, and the parties agreed that backing out synergies would be "especially difficult in this case." Instead, after considering all relevant factors, the court determined that Jarden's unaffected market price of $48.31, which was about 18% less than the $59.21 deal price, was a more reliable indicator of fair value. That holding was based on, among other things, "unrebutted expert testimony" about the efficiency of the market, the fact that Jarden was widely-held and heavily-traded, share prices in Jarden's own pre-transaction buyback program, and the lack of credible evidence that any material information bearing on Jarden's fair value was withheld from the market. The court also performed a discounted cash flow analysis as a "reality check" on fair value. Although the parties' DCF analyses "yielded results that were solar systems apart," the court utilized the most credible components of each to perform its own DCF valuation, which provided comfort that its analysis was "grounded in reality."[46]

Finally, in ***Manti Holdings, LLC v. Authentix Acquisition Company, Inc.***, the Court of Chancery held that sophisticated stockholders could contractually limit or waive their appraisal rights as long as the waiver was clear and unambiguous, and the stockholders were fully informed and represented by counsel at the time they signed the agreement.[47] The petitioners had argued that the waiver was unenforceable as a matter of law because it was inconsistent with DGCL § 262. Vice Chancellor Glasscock disagreed and upheld the waiver. The Court reasoned that the statute neither explicitly prohibits contractual modification or waiver of appraisal rights, nor requires a party to exercise its appraisal rights. Therefore, appraisal rights are merely an available stockholder remedy, not a mandatory one.

[44] The decision is currently on appeal to the Delaware Supreme Court, No. 427, 2019.

[45] C.A. No. 12456-VCS, 2019 WL 3244085 (Del. Ch. July 19, 2019).

[46] The decision is currently on appeal to the Delaware Supreme Court, No. 454, 2019.

[47] C.A. No. 2017-0887 SG, 2019 WL 3814453 (Del. Ch. Aug 14, 2019).

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