Del. Corporate Litigation: 2012 In Review

Law360, New York (January 11, 2013, 11:42 AM ET) -- Although the M&A market slowed its pace in 2012, the Delaware courts issued a number of notable corporate law opinions. Below, we highlight several case law developments that have practical implications for M&A practitioners and litigators preparing for what some anticipate will be a more active market in 2013.

Investment Banker Conflicts

2012 began where 2011 left off — with Delaware courts continuing to focus on banker-related conflicts and disclosure issues. For example, in In re El Paso Corp. Shareholder Litigation[1], Chancellor Leo E. Strine Jr. ultimately declined to enjoin the proposed sale of El Paso Corporation to Kinder Morgan Inc., despite finding that the plaintiffs had established a likelihood of succeeding on the merits of their claim that the merger was "tainted by disloyalty."

In reaching this decision, the chancellor examined "troubling" alleged conflicts of interest on the part of both El Paso's CEO and its financial adviser. El Paso's CEO, who was a key negotiator of the deal, was found to be conflicted because he and other members of El Paso's management were interested in purchasing one of El Paso's businesses after the merger with Kinder Morgan closed. This conflict was not disclosed to the board, and the court concluded that it may have affected the CEO's negotiations with Kinder Morgan.

The court also held that El Paso's financial adviser was conflicted because it owned 19 percent of Kinder Morgan (a $4 billion investment), and controlled two Kinder Morgan board seats. The firm's conflict was disclosed, but the lead banker's personal ownership of $340,000 of Kinder Morgan stock was not disclosed. The court found that efforts to address the conflict, including hiring a second financial adviser and establishing a "Chinese wall," were inadequate because the conflicted adviser continued to provide strategic advice.

Despite these findings, the court ultimately denied the motion for a preliminary injunction because El Paso stockholders could turn down the deal if they did not like the price and no rival bid existed. The possibility for a post-merger money damages case was, however, left open.[2]

The same day that El Paso was issued, Vice Chancellor Donald Parsons took a less sharp tone concerning banker issues in In re Micromet Inc. Shareholder Litigation.[3] In Micromet, the vice chancellor denied the shareholder plaintiffs' attempt to enjoin an all-cash negotiated tender offer for all the shares of Micromet Inc. a biopharmaceutical company, by Amgen Inc.

In addition to dismissing Revlon claims (discussed below), the court rejected the plaintiffs' disclosure claims regarding banker fees paid by Micromet over the past two years and the bankers' holdings in Amgen. The court noted that the financial advisors' position in Amgen was relatively small compared to its overall investment holdings, that its holdings in Amgen and Micromet were publicly available, and that the amount

of fees paid by Micromet was not shown to be material information to shareholders.

Revlon Duties

Also in Micromet, the court dismissed the plaintiffs' Revlon claims, explaining that Revlon duties attached not when Amgen made its first offer for Micromet, but when the Micromet board "resolved to enter into serious merger negotiations with Amgen and instructed [the financial advisor] to conduct a market check of other potential acquirors." The market check involved contacting seven potential strategic acquirors, and providing potential suitors with a "week-long" diligence period.

The court found the scope of the market check to be "adequate and consistent with the Board's well-informed understanding of the industry and Micromet's needs," and also rejected the plaintiffs' claim that the market check was "unreasonably short." Moreover, Amgen did not appear to enjoy any "informational advantages" as compared to the other potential acquirors.

By contrast, in In re Answers Corp. Shareholder Litigation[4], Vice Chancellor John Noble declined to dismiss a post-merger Revlon claim for money damages against Answers Corporations' board of directors, as well as aiding and abetting claims against Answers' acquiror, Summit Partners (a private equity firm). The court held that the plaintiffs had adequately pled a breach of the duty of loyalty claim against Answers' board, despite finding that a majority of the board was independent and disinterested as alleged. This holding came as a surprise to many, in part because Vice Chancellor Noble had previously denied a shareholder plaintiff's request to preliminarily enjoin the deal.

Vice Chancellor Noble held that the plaintiffs had alleged facts demonstrating that three Answers board members — the CEO and the two representatives of Redpoint Ventures, a 30 percent shareholder — were interested in the transaction. The court noted that although company managers are not typically interested simply because they will maintain their positions post-closing, "here, the Complaint allege[d] that [the CEO] would lose his job unless he completed a change of control transaction."

Vice Chancellor Noble also found adequate the plaintiffs' allegations that Redpoint's board representatives were interested because Redpoint needed the merger to achieve liquidity — a benefit unique to Redpoint. Further, the court found that the complaint adequately alleged bad faith by the four outside board members because those directors knew about the skewed interests of the other directors, and allowed the transaction to proceed on a fast timetable to serve their needs, despite learning from Answers' banker that better financial results would be reported that would cause its stock price to rise above the acquiror's offer.

As to the acquiror, the court denied the motion to dismiss the aiding and abetting claims because, having obtained confidential information about Answers' value during the sales process, Summit Partners pushed Answers to conduct a quick (two-week) pre-deal market check to finish the sales process before the price of Answers' stock rose above the offer price.

Vice Chancellor Noble later denied the defendants' motions for re-argument[5], reiterating that the allegations in the complaint supported an inference that the disinterested directors "knowingly and completely failed to undertake" their duties to seek the highest value reasonably available for Answers' shareholders.

Standstill Agreements

Another "hot topic" in the Delaware Court of Chancery involved the use of "don't ask, don't waive" provisions in standstill agreements. In In re Complete Genomics Inc. Shareholder Litigation[6], Vice Chancellor Travis Laster compared "don't ask, don't waive" provisions, which effectively prevent bidders from privately requesting a waiver to make a topping bid, to no talk clauses that prohibit a target board from talking to

any other bidders, regardless of who initiates the discussion. The court explained that "[b]y agreeing to this provision, the Genomics board impermissibly limited its ongoing statutory and fiduciary obligations to properly evaluate a competing offer, disclose material information, and make a meaningful merger recommendation to its stockholders."

Chancellor Strine took a different view in In re Ancestry.com Inc. Shareholder Litigation [7], remarking that "don't ask, don't waive" provisions may be consistent with a director's Revlon duties. The court explained that there were no statutes or rulings of the court stating that such provisions are "per se" invalid, and the court was not "prepared to rule out that [the provisions] can't be used for value-maximizing purposes" so long as the purpose allows the "well-motivated seller to use it as a gavel" as part of a meaningful process.

Chancellor Strine also cautioned that board members employing "don't ask, don't waive" provisions need to remain informed about the potency of the provisions. The court ultimately enjoined the transaction at issue in the case because the board failed to disclose that topping bidders were foreclosed by a "don't ask, don't waive" provision, emphasizing that if the provisions are to be used, the electorate must be made aware of the provision's effect.

Vice Chancellor Parsons also commented on "don't ask, don't waive" provisions when approving a proposed settlement in In re Celera Corp. Shareholder Litigation (discussed further below).[8] Vice Chancellor Parsons noted that, although they may separately serve legitimate objectives, a "don't ask, don't waive" standstill combined with a no shop provision may be problematic because "don't ask, don't waive" standstills "block at least a handful of once-interested parties from informing the Board of their willingness to bid" while no solicitation provisions "block[ ] the Board from inquiring further into those parties' interest."

Controlling Shareholders and Control Premiums

As predicted, the Court of Chancery's decision in In re Southern Peru Copper Corp. Shareholder Litigation[9] was appealed. The Delaware Supreme Court affirmed the Court of Chancery's post-trial decision and final judgment awarding more than $2 billion in damages (including interest) and $304 million in attorneys' fees.[10]

As many will recall, in Southern Peru, Chancellor Strine held that Americas Mining Corporation, the subsidiary of Southern Copper Corporation's controlling shareholder, Grupo Mexico SAB de CV, breached its fiduciary duty of loyalty to Southern Peru and its minority stockholders by causing Southern Peru to acquire the controller's 99.15 percent interest in a Mexican mining company, Minera Mexico SA de CV, for an unfair price. The chancellor found that the evidence at trial established that the controlling shareholder extracted an unfair deal.

The defendants raised several issues on appeal — all of which were found to be without merit. For example, the Delaware Supreme Court held that the Chancellor did not commit error by declining to allocate the burden of proof for the entire fairness standard before trial began. The issue of who ultimately carried the burden was irrelevant, because the evidence of unfairness found by Chancellor Strine was overwhelming. The Delaware Supreme Court recognized, however, that the burden of proof should be assigned before trial if possible.

Vice Chancellor Sam Glasscock also commented on controlling shareholder transactions in In re Delphi Financial Group Shareholder Litigation.[11] In Delphi, Vice Chancellor Glasscock declined to enjoin the sale of Delphi Financial Group Inc. to Tokio Marine Holdings Inc. — despite finding that the plaintiff shareholders had demonstrated a likelihood of succeeding on the merits of their claims about Delphi's founder, chairman, CEO, and controlling shareholder, Robert Rosenkranz. The court held that the balance of equities weighed against an injunction because Delphi's shareholders should be permitted to decide whether to accept the premium deal, damages were available, and

no other bidder had emerged.

The plaintiffs claimed that Rosenkranz, who owned 13 percent of Delphi's outstanding stock but had 49.9 percent of the vote because of his ownership of high-vote Class B shares, negotiated on Delphi's behalf in order to secure a control premium for his stake. Ultimately, the parties agreed that Delphi's Class A shareholders would receive about $45 per share, while Rosenkranz would receive approximately $54 for his Class B shares.

Delphi's certificate of incorporation, however, provided that Class B share would be converted into Class A shares upon the sale of the company, preventing Rosenkranz from receiving a control premium. The special committee established by Delphi's board agreed to the differential for Class B shares because the premium to shareholders was well over market (about 76 percent), and it was clear that Rosenkranz would not agree to a higher price without receiving a premium. Thus, the deal was conditioned upon a charter amendment.

The court found that, because Delphi's shareholders "bought Delphi's stock with the understanding that the Charter structured the corporation in such a way that denied Rosenkranz a control premium," the plaintiffs were "likely to be able to demonstrate a trial" that Rosenkranz violated his duty to shareholders by negotiating for disparate consideration.

Shareholder Meetings

Vice Chancellor Glasscock also had an opportunity to discuss the interaction between Delaware and federal law regarding shareholder meetings. In Rich v. Fuqi International Inc.[12], the vice chancellor denied a motion for partial final judgment and a motion to certify the decision for interlocutory appeal in connection with a company's request to continue to suspend its annual stockholder meeting until it could provide audited financial statements to stockholders.

In this case, Fuqi International Inc. argued that it was caught between Delaware's annual meeting requirement and SEC Regulations 14A and 14C, which require publicly traded companies to distribute certain materials, including an annual report and audited financial results, in advance of annual meetings. Fuqi claimed that previous Delaware Court of Chancery case law did not govern the facts of the case because the SEC had subsequently promulgated a new rule governing the exemption requests from Rules 14A and 14C.

Vice Chancellor Glasscock rejected Fuqi's argument and held that "[t]he SEC release does not change a company's substantive obligations under federal securities law. Neither does it affect the principles and goals of SEC proxy rules, which are still to protect the stockholder franchise and provide accurate information to stockholders."

Lead Plaintiffs

Several notable opinions were issued by Vice Chancellor Laster in 2012 regarding the responsibilities of lead plaintiffs in shareholder litigation.

In LAMPERS v. Pyott[13], Vice Chancellor Laster declined to give collateral estoppel effect to a California federal court's dismissal of related derivative claims against defendant Allergan Inc. The court explained that under Delaware law, shareholder plaintiffs do not have authority to sue in the name of the corporation until there has been a finding of either demand excusal or wrongful refusal. Therefore, if a Rule 23.1 motion is granted, other shareholders are not precluded from bringing similar claims against the corporation.

Vice Chancellor Laster also found that the California plaintiffs were not adequate representatives of Allergan because they hastily filed a conclusory complaint in order to be first to the courthouse and reap legal fees. The court noted that "a fast-filing

stockholder with a nominal stake, who sues derivatively after the public announcement of a corporate trauma in an effort to shift the still-developing losses to the corporation's fiduciaries, but without first conducting a meaningful investigation, has not provided adequate representation."

Similarly, in South v. Baker[14], Vice Chancellor Laster chastised shareholder plaintiffs for failing to request books and records before filing their derivative claim. The court granted a motion to dismiss the plaintiffs' oversight claims against the board of Hecla Mining Company regarding damages the company allegedly suffered from mine safety violations and resulting federal securities actions. According to the court, the plaintiffs' claims lacked particularized facts supporting a reasonable inference that a majority of the board faced a substantial risk of liability.

In explaining the importance of investigating claims before filing suit, Vice Chancellor Laster emphasized that "[a] plaintiff who hurries to file a Caremark claim after the announcement of a corporate trauma behaves contrary to the interests of the corporation but consistent with the desires of the filing law firm to gain control of (or a role in) the litigation," which serves "the interests of the law firm, rather than those of the corporation on whose behalf the plaintiff ostensibly seeks to litigate."

Finally, in Steinhardt v. Howard-Anderson[15], Vice Chancellor Laster sanctioned a lead plaintiff in a shareholder class action for trading on information obtained through the litigation, in violation of a confidentiality order. The plaintiffs, including professional investor Michael Steinhardt and a former Steinhardt associate, Herb Chen, held 19 percent of Occam Networks Inc. before its acquisition by Calix Inc. After the merger was announced, they filed a class action against Occam's board for having approved the transaction.

In the course of the litigation, the defendants served discovery requests about any trading activities by the plaintiffs, which established that Steinhardt had been selling Calix stock while receiving detailed reports from Chen about the progress of the action. The discovery also established that Chen knew Steinhardt was short selling and warned him not to, but continued to provide him with information about the litigation.

Vice Chancellor Laster held that Steinhardt had violated his duties as a class representative, dismissed Steinhardt from the case with prejudice, and required him to report his trading to the SEC and disgorge $534,071 in profits. Although the court was troubled by Chen's activities, it concluded that his actions did not warrant an additional sanction.

Settlement and Fee Awards

The year ended with the Delaware Supreme Court affirming in part and reversing in part the Delaware Court of Chancery's decision in In re Celera Corp. Shareholder Litigation.[16] In Celera, Vice Chancellor Parsons approved the settlement of litigation challenging a two-step merger transaction, overruling an objection, and awarded $1.3 million in attorneys' fees.

During briefing on a motion for a preliminary injunction, Celera Corporation had entered into a memorandum of understanding with the lead plaintiff, New Orleans Employees' Retirement System (NOERS), that contemplated a settlement for therapeutic benefits, including the modification of deal protection devices and additional disclosures, but no increase in the merger price.

Celera's largest shareholder had objected to the settlement because it believed the merger price was too low, and that NOERS — which had sold its Celera shares for a slight premium shortly after executing the Memorandum of Understanding, but before the deal closed through the second step short-form merger — was an inadequate class representative. The Court of Chancery found, however, that NOERS satisfied the adequacy of representation requirements of Rule 23, albeit barely, calling NOERS' decision to sell its shares "careless and cavalier."

Regarding attorneys' fees, the Court of Chancery applied the same valuation technique used last year in In re Compellent Technologies Inc. Shareholders Litigation[17], quantifying the value of modified deal protection provisions (including the reduction of a termination fee) based on the theoretical likelihood of a superior bid. Using this methodology, Vice Chancellor Parsons found that the value of a chance at a competing bid after the deal protections were modified was worth "approximately $1.6 million to $3 million." Ultimately, the court awarded $1.35 million in fees.

The objector appealed the Court of Chancery's certification of NOERS as lead plaintiff and its approval of the settlement without an opt-out right. The Delaware Supreme Court affirmed the Court of Chancery's ruling that the plaintiff was an adequate representative. But the Supreme Court found the Court of Chancery erred in denying the objector a discretionary opt-out right, based on the fact that the representative was "'barely' adequate," and the objector was a significant shareholder (holding an approximately 24.5 percent stake at the time the merger closed) prepared to prosecute a "supportable claim for substantial money damages."

Key Takeaways

Despite what some perceived to be a slower deal market in 2012, the cases discussed above are just a sample of the notable jurisprudence issued by the Delaware courts over the past year. In 2013, look for Delaware courts to resolve a number of open questions left by these decisions.

For instance, the courts may further refine what a board must disclose regarding investment banker conflicts. It is also fair to conclude that 2013 may see Delaware courts further address whether standstill agreements containing "don't ask, don't waive" provisions are consistent with a director's Revlon duties. The plaintiffs' bar should also stay tuned in during 2013 as the focus on the adequacy of shareholder plaintiffs may well continue.

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[1] 41 A.3d 432 (Del. Ch. 2012).

[2] The matter was ultimately settled. See In re El Paso. Corp. S'holder Litig., C.A. No. 6949-CS, at 37-40 (Del. Ch. Dec. 3, 2012) (TRANSCRIPT) (approving settlement for $110 million, of which $26 million would be paid to plaintiffs' legal fees and expenses).

[3] C.A. No. 7197-VCP (Del. Ch. Feb. 29, 2012).

[4] C.A. No. 6170-VCN (Del. Ch. Apr. 11, 2012).

[5] In re Answers Corp. S'holder Litig., C.A. No. 6170-VCN (Del. Ch. July 19, 2012).

[6] C.A. No. 7888-VCL (Del. Ch. Nov. 27, 2012) (TRANSCRIPT).

[7] C.A. No. 7988-CS (Del. Ch. Dec. 17, 2012) (TRANSCRIPT).

[8] C.A. No. 6304-VCP (Del. Ch. Mar. 23, 2012), rev'd on other grounds by, ---A.3d ---- (Del. 2012).

[9] 30 A.3d 60 (Del. Ch. Oct. 14, 2011, revised Dec. 20, 2011).

[10] Americas Mining Corp., et al. v. Theriault, 51 A.3d 1213 (Del. 2012).

[11] C.A. No. 7144-VCG (Del. Ch. Mar. 6, 2012).

[12] C.A. No. 5653-VCG (Del. Ch. Oct. 26, 2012).

[13] 46 A.3d 313 (Del Ch. 2012).

[14] --- A.3d ----, (Del. Ch. Sept. 25, 2012).

[15] C.A. No. 5878-VCL (Del. Ch. Jan. 6, 2012).

[16] C.A. No. 6304-VCP, (Del. Ch. Mar. 23, 2012), aff'd --- A.3d ----, at *7 (Del. Dec. 27, 2012, revised Jan. 2, 2012).

[17] C.A. No. 6084-VCL (Del. Ch. Dec. 9, 2011).

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