Delaware Supreme Court Clarifies Earlier Rulings, Chancery Court Stakes Out New Positions

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Contributing Partners

Paul J. Lockwood
Wilmington

Edward B. Micheletti
Wilmington

Associate

Lori W. Will
Wilmington

Four Times Square
New York, NY 10036
212.735.3000

skadden.com

Delaware courts tackled a number of issues of importance in 2015. The Delaware Supreme Court clarified prior inconsistent case law by reiterating that deference must be given to decisions made by disinterested directors. It also addressed the relatively new issue of financial advisor liability. Meanwhile, the Court of Chancery began to question the propriety of settlements that provide nonmonetary benefits in exchange for a broad release of claims. The courts undoubtedly will continue to shape these key areas of the law in the coming year, though how unresolved areas of law will be interpreted in 2016 remains to be seen, given the continued turnover in the courts.

The Courts

Since January 2014, four of the five justice positions on the Delaware Supreme Court have changed. The Court of Chancery also has experienced turnover, including Andre G. Bouchard becoming the chancellor of the court in May 2014. And with Vice Chancellor John W. Noble retiring in early 2016 and Vice Chancellor Tamika Montgomery-Reeves replacing Donald F. Parsons, Jr., Vice Chancellor J. Travis Laster (who joined the court in 2009) will be the longest-tenured member. Practitioners are watching closely to see how the relatively new members of these courts interpret Delaware law.

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Deference to the Board's Business Judgment

Two important Delaware Supreme Court decisions in 2015 clarified prior inconsistent case law and reinforced that Delaware law is deferential to the decisions of disinterested, well-informed boards that act in good faith. Both decisions address the importance of the standard of review applied by the Court of Chancery.

The first decision, *In re Cornerstone Therapeutics Inc. Stockholder Litigation*, resolved the uncertainty of whether breach of fiduciary duty claims against a board can be dismissed where entire fairness review — a heightened standard that typically requires defendants to prove the fairness of a deal's price and process — applies. The Court of Chancery, constrained by its reading of the Supreme Court's decision in *Emerald Partners v. Berlin*, applied entire fairness review at the pleadings stage to claims involving a controlling stockholder freeze-out merger. It found that directors could not prevail on a motion to dismiss, despite the fact that the claims against them were cleared under the company's exculpatory charter provision that shielded directors from personal liability for nonintentional breaches of fiduciary duty. On interlocutory appeal, the Supreme Court reversed, stating that "plaintiffs must plead a non-exculpated claim for breach of fiduciary duty against an independent director protected by an exculpatory charter provision, or that director will be entitled to be dismissed from the suit … regardless of the underlying standard of review for the transaction."

The Delaware Supreme Court's decision in *Corwin v. KKR Financial Holdings LLC* ended the debate that emerged after its 2009 *Gantler v. Stephens* opinion on what effect stockholder approval of a transaction should have on the standard of review applied to

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breach of fiduciary duty claims. The Court of Chancery rejected the plaintiffs' argument that KKR, which owned less than 1 percent of its merger counterparty, was a controlling stockholder due to a contractual arrangement whereby KKR managed the counterparty through an affiliate. The court found that entire fairness did not apply to the plaintiffs' post-closing damages claims regarding the stock-for-stock merger. In dismissing the plaintiffs' claims, the court held that the business judgment rule — a presumption that the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action was taken in the company's best interest — applied because "the transaction was approved by an independent board majority and by a fully informed, uncoerced stockholder vote."

On appeal, the plaintiffs argued that the Court of Chancery erred in deciding entire fairness review did not apply, and that *Revlon* review — which requires the court to assess whether the board undertook reasonable efforts to obtain the highest price realistically available in a sale of corporate control — should apply if entire fairness did not. In particular, the plaintiffs claimed that under the Supreme Court's decision in *Gantler*, a fully informed stockholder vote required by statute (as was the case in *KKR*) did not invoke the business judgment rule. The Supreme Court affirmed the lower court's decision that entire fairness was inapplicable and found that the plaintiffs' *Revlon* argument was not raised by the plaintiffs at the trial-court level. However, the Supreme Court noted, even if the applicability of *Revlon* was before it, the business judgment rule applied. The Supreme Court also made clear that *Gantler* should be read narrowly, as applying to stockholder ratification and not as affecting the standard of review applied to a transaction approved by informed, uncoerced stockholders that is not subject to entire fairness.

Uncertain Future of Disclosure-Based Settlements

Throughout 2015, the Court of Chancery chipped away at the long-standing practice of settling stockholder lawsuits for benefits such as supplemental disclosures in exchange for a broad release of claims against defendants. Vice Chancellor Laster first took a stance against disclosure-based settlements in *Acevedo v. Aeroflex Holding Corp.*, rejecting a settlement in which the parties had agreed to supplemental disclosures as well as a reduced termination fee and matching rights period for a broad release. Vice Chancellor Laster permitted the parties one of three options: reframe the case as a dismissal of disclosure claims due to mootness, narrow the settlement release to only Delaware fiduciary duty claims or have the defendants move to dismiss the case. (A motion to dismiss was later filed and granted.) In a subsequent decision, *In re Aruba Networks, Inc. Stockholder Litigation*, Vice Chancellor Laster also rejected a disclosure-based settlement due to "inadequate representation," where the court found the claims were unmeritorious when filed. The court, calling the practice of settling for only disclosures while providing a broad release of all claims a "systemic problem," also refused to certify the class and dismissed the cases filed by the named plaintiffs.

Other members of the Court of Chancery have expressed similar criticisms of disclosure-based settlements of stockholder deal cases. For example, Vice Chancellor Sam Glasscock III in *In re Riverbed Technology, Inc.* remarked that any weight given to the court's prior practice of approving settlements of disclosure claims for global releases would be "diminished or eliminated going forward," suggesting that settlement consideration of "small therapeutic value" warranted an equally narrow release. In *In re CareFusion Corporation Stockholders Litigation*, however, Vice Chancellor Noble took a more pragmatic approach in approving a disclosure-based settlement with broad releases: "When plaintiffs' counsel represent that they have seriously looked at other possible claims and can explain why they chose not to pursue them because of the merits and not because of sloth or short-term greed, approval of a global release may make much more sense."

Given the uncertainty over the future of disclosure-based settlements in Delaware, many are anticipating Chancellor Andre G. Bouchard's written decision on these issues in *In re Trulia, Inc. Stockholder Litigation*. In particular, Chancellor Bouchard is expected to address whether disclosures must be material to support a settlement and whether the scope of a release should include claims unknown at the time of settlement.

Development of Aider and Abettor Liability

In one of the most anticipated decisions of 2015, the Delaware Supreme Court in *RBC Capital Markets, LLC v. Jervis* (*Rural Metro*) affirmed the Court of Chancery's post-trial decision that a financial advisor was liable for aiding and abetting claims for $75.8 million in damages based on joint and several liability, in a case in which the director defendants had settled before trial. The Supreme Court made clear that its opinion should be confined to the "unusual facts" of the case and emphasized that a financial advisor must have acted with scienter to be found liable for aiding and abetting a breach of the board's fiduciary duty, making such claims "among the most difficult to prove." Notably, the Supreme Court rejected the Court of Chancery's view of financial advisors as "gatekeepers" in M&A transactions, explaining that such a standard would suggest that any failure by a financial advisor to prevent breaches of the board's duty of care could give rise to an aiding and abetting claim against the banker. Whether the Court of Chancery will limit the affirmance in *Rural Metro* to its facts or apply it more broadly to aiding and abetting claims against financial advisors will be closely watched in 2016.