Insights:
The Delaware Edition

11 / 17 / 16

Contents

This issue focuses on important, developing areas of Delaware corporation law and deal litigation, including the continuing impact of *Trulia*, how to determine fair value in appraisal challenges and courts' recent application of *Corwin*.

Forward Momentum: *Trulia* Continues to Impact Resolution of Deal Litigation in Delaware and Beyond

Contributors

Edward B. Micheletti, Partner
Jenness E. Parker, Counsel
Bonnie W. David, Associate

> See page 5 for key takeaways

Throughout the second half of 2015, the Delaware Court of Chancery began questioning its long-standing practice of approving deal litigation settlements involving broad releases for defendants in exchange for disclosure (or other similar therapeutic) benefits and analyzed such proposed settlements with increased scrutiny. This culminated in Chancellor Andre G. Bouchard's widely anticipated decision in *In re Trulia, Inc. Stockholder Litigation*, C.A. No. 10020-CB (Del. Ch. Jan. 22, 2016), wherein the chancellor fashioned a new rule for evaluating disclosure settlements — the "plainly material" standard — and expressed a preference for disclosure claims to be either litigated or mooted.

As discussed in two earlier editions of *Insights: The Delaware Edition*, the Court of Chancery's decision in *Trulia* has had a clear impact on deal litigation, both in terms of litigation practice and increased scrutiny of disclosure-based settlements, with varied results in terms of approval.[1] This impact has continued throughout 2016, with the ripple effect leading to more contested mootness fee applications and decisions from the Delaware courts. It also has led to several interesting deal litigation settlement rulings from non-Delaware courts.

Mootness Fee Applications on the Rise

Since our last update in May 2016, plaintiffs and defendants appear to have taken seriously the Court of Chancery's view expressed in *Trulia* that disclosure-only settlements should be entered into only in circumstances involving plainly material supplemental disclosures. The court also expressed the view that one of the "preferred" ways to address disclosure claims was to "moot" them with supplemental, corrective disclosure.

[1] *See* Edward B. Micheletti, Jenness E. Parker & Bonnie W. David, "Court of Chancery Continues to Clarify Views of Disclosure-Based Deal Litigation Settlements," *Insights: The Delaware Edition*, May 19, 2016; Edward B. Micheletti, Jenness E. Parker & Bonnie W. David, "Delaware Courts Question Long-Standing Practice of Approving Disclosure-Based Deal Litigation Settlements," *Insights: The Delaware Edition*, Oct. 22, 2015.

Indeed, plaintiffs in many instances have begun to file complaints limited to disclosure claims — and in some instances, only a handful of disclosure claims — in the hope of having defendants moot such claims with supplemental disclosure. This, in turn, opens the door for plaintiffs to make an application for "mootness fees" for creating a disclosure "benefit." Sometimes, the parties are able to negotiate an agreed-upon mootness fee, while other times such fees are contested and require judicial resolution.

For example, on July 21, 2016, Chancellor Bouchard entertained a request for mootness fees in connection with stockholder class actions challenging the acquisition of Receptos, Inc. by Celgene Corp. Shortly after litigation was initiated, the parties entered into a memorandum of understanding to settle the litigation in exchange for supplemental disclosures. However, after the court issued its decision in *Trulia*, rather than seeking approval of the settlement, the plaintiffs dismissed the actions with prejudice as to the named plaintiffs only and sought a mootness fee award in the amount of $350,000, which the defendants opposed.

Evaluating the benefit conferred on stockholders by the supplemental disclosures, Chancellor Bouchard concluded that one aspect — an additional line of management projections reflecting management's estimated probability of success in obtaining certain regulatory approvals — provided "useful, but not material, information of some value." However, Chancellor Bouchard found that other disclosures were of the "'tell me more' variety that are not material" or added "nothing of meaningful value." Emphasizing that "plaintiffs should not expect to receive a fee in the neighborhood of $300,000 for supplemental disclosures in a post-*Trulia* world unless some of the supplemental information is material under the standards of Delaware law," Chancellor Bouchard nevertheless granted a fee award in the amount of $100,000.

The next day, Chancellor Bouchard addressed an application for mootness fees in an action arising out of JAB's acquisition of Keurig Green Mountain. *In re Keurig Green Mountain Inc. Stockholders Litig.*, C.A. No. 11815-CB (Del. Ch. July 22, 2016) (Transcript). Following announcement of the transaction, the plaintiffs moved for expedited discovery, arguing, among other things, that the proxy issued in connection with the transaction and the press release announcing the transaction were inconsistent with respect to their description of management's continuing role with the surviving entity. Chancellor Bouchard granted the motion, and defendants subsequently mooted the claim by providing supplemental disclosures clarifying that JAB may or may not retain existing management, but that management had not discussed its continuing role during negotiations. The plaintiffs dropped their case and sought $300,000 in mootness fees for this disclosure benefit.

Denying the request, Chancellor Bouchard applied a materiality standard and explained that the plaintiffs' "investigation and the supplemental disclosures confirmed that the proxy was correct in the first place in stating that management had no understanding regarding future employment," such that "these supplemental disclosures did not confer any benefit on the corporation because they did not correct a materially misleading disclosure in the original proxy, since there wasn't one, and because they did not provide new information to correct a material omission. Instead, the supplemental disclosures provided purely confirmatory information indicating that the proxy already was correct." As a result, Chancellor Bouchard declined to award any mootness fees to the plaintiffs' counsel.

In May 2016, Vice Chancellor Sam Glasscock III "struggled" over issues arising out of an application for mootness fees under similar circumstances. *See In re Xoom Corp. Stockholder Litig.*, C.A. No. 11263-VCG (Del. Ch. May 10, 2016) (TRANSCRIPT). The supplemental disclosures at issue in the case involved disclosures relating to the amount of fees received by Xoom's financial advisor from the acquirer in the two years prior to the merger; the value to Xoom of any potential recovery for a $30 million loss due to fraud; certain elements of the financial analysis performed by Xoom's financial advisor; and details about conversations regarding post-closing employment between Xoom's directors and the acquirer.

At oral argument, the vice chancellor remarked that "we are at a stage of the case law ... where our approach has fundamentally changed [after *Trulia*]," and noted that he did not "want to act precipitously or in a way that is going to produce incentives that [he has not had] at least attempted to suss out." He further noted that "what we've done in the past, I think everybody would agree, has not been a good system, and I want to do what I can [to not] create more problems going down the road." He acknowledged that the Court of Chancery is "responsible for creating a market here [for fees for mooted disclosure claims], and if we get it wrong, either wrongs against equity holders will go unremedied, or there will be way too much litigation, and that costs stockholders as well."

Ultimately, in a written decision issued August 4, 2016, Vice Chancellor Glasscock rejected the plaintiffs' counsel's request for $275,000 in fees and awarded $50,000 instead. Expressing a divergent view from Chancellor Bouchard in *Keurig*, Vice Chancellor Glasscock acknowledged that "[t]his Court in *Trulia* made clear that, to support a settlement and class-wide release based on disclosures only, the materiality of the disclosures to stockholders must be plain," but found that "[t]he mootness context, in my view, supports a different analysis" because "the individual Plaintiffs have surrendered only their *own* interests; the dismissal is to them only, not to the stockholder class. ... Therefore, a fee can be awarded if the disclosure provides some benefit to stockholders, whether or not material to the vote. In other words, a helpful disclosure may support a fee award in this context." Applying the factors set forth in *Sugarland Industries, Inc. v. Thomas*, Vice Chancellor Glasscock found that some of the disclosures at issue were "mildly helpful to stockholders" while others were "of minimal benefit." He noted that "[o]f the four disclosures that resulted from the litigation, those involving the banker conflict and post-Merger employment discussions are the most valuable," although "[n]one of the four is particularly strong."

Other State, Federal Courts Consider *Trulia*

After *Trulia*, a number of plaintiffs have pursued deal litigation outside of Delaware, sometimes in violation of a target company's charter or bylaws requiring stockholders to pursue such claims, if at all, solely in Delaware courts. In these cases, plaintiffs will sometimes request that defendants waive such "forum selection" charter and bylaw provisions with the goal of reaching a disclosure-based settlement in the non-Delaware forum. Defendants have met these requests with varying approaches, at times insisting on enforcing the charter or bylaw and at other times agreeing to waive it to pursue a disclosure-based settlement in the non-Delaware forum.

In circumstances where parties have entered into disclosure-based settlements outside of Delaware, some courts have relied on *Trulia* to reject the settlement. For example, on September 26, 2016, the Superior Court of New Jersey issued a ruling rejecting a disclosure-based settlement and awarding an objector to the settlement — Fordham Law professor Sean Griffith, a frequent objector in such cases — attorneys' fees in the amount of $88,274. *Vergiev v. Aguero*, No. L-2276-15 (N.J. Super. Ct. Law Div. Sept. 26, 2016).[2] In contrast, courts in other states have continued to approve disclosure settlements. *See, e.g., In re Sigma-Aldrich Corp. S'holder Litig.*, Case No. 1422-CC09684 (Mo. Cir. Ct. Aug. 19, 2015) (ORDER); *Murphy v. Synergetics USA Inc.*, Case No. 1511-CC00778 (Mo. Cir. Ct. July 29, 2016) (ORDER) (same).

In some cases, plaintiffs have responded by filing an action in federal district court, repackaging their state disclosure claims as federal disclosure violations, and sometimes adding breach of fiduciary duty claims attacking the board's process and the merger price as separate, additional counts. If the parties choose to go the settlement route, they do so with some amount of uncertainty, as some federal courts have recently rejected such settlements in line with the reasoning in *Trulia*.

For example, on August 10, 2016, the U.S. Court of Appeals for the 7th Circuit issued an opinion authored by Judge Richard Posner in which the court adopted the *Trulia* "plainly material" standard. *In re Walgreen Co. Stockholder Litig.*, No. 15-3799 (7th Cir. Aug. 10, 2016). The case involved a challenge to Walgreens' 2014 acquisition of Alliance Boots and addressed federal securities disclosure claims as well as claims for breach of fiduciary duty under state law. According to Judge Posner, "[w]ithin two weeks after Walgreens

[2] Notably, professor Griffith was awarded only $10,000 in fees for objecting in *In re Riverbed Technology, Inc.*, C.A. No. 10484-VCG (Del. Ch. Dec. 2, 2015), late last year.

filed a proxy statement seeking shareholder approval of the reorganization, the inevitable class action was filed, and 18 days later — less than a week before the shareholder vote — the parties agreed to settle the suit" based on additional disclosures. The settlement involved six categories of disclosures, including disclosures relating to the recent nomination of a certain director to the Walgreens board; the allocation of stock in the surviving company to two investment groups after the merger; the resignation of Walgreens' chief financial officer prior to the merger; additional risk factors the board considered in determining whether to approve the merger; the reason one director did not vote to approve the merger; and the background of the individual who had been appointed acting CEO of the surviving entity.

The district court approved the settlement and awarded $370,000 to plaintiffs in attorneys' fees. The Court of Appeals reversed, noting that "[t]he value of the disclosures in this case appears to have been nil. The $370,000 paid class counsel — pennies to Walgreens, amounting to 0.039 cents per share at the time of the merger — brought nothing of value for the shareholders, though it spared the new company having to defend itself against a meritless suit to void the shareholder vote." Echoing many of the sentiments expressed in *Trulia*, Judge Posner further remarked that "[t]he type of class action illustrated by this case — the class action that yields fees for class counsel and nothing for the class — is no better than a racket. It must end. No class action settlement that yields zero benefits for the class should be approved, and a class action that seeks only worthless benefits for the class should be dismissed out of hand."

Focusing on the district court's decision below, Judge Posner noted that the district court judge found the "supplemental disclosures *may have* mattered to a reasonable investor." He noted that "Delaware's Court of Chancery sees many more cases involving large transactions by public companies than the federal courts of our circuit do, and so we should heed the recent retraction by a judge of that court of the court's 'willingness in the past to approve disclosure settlements of marginal value and to routinely grant broad releases to defendants and six-figure fees to plaintiffs' counsel in the process.'" Instead, Judge Posner "endorsed" *Trulia*'s "clearer standard for the approval of such settlements," emphasizing that "the misrepresentation or omission that the supplemental disclosures correct must be 'plainly material.'"

Other Effects on Merger Litigation From *Trulia*

In addition to mootness fees, *Trulia* has impacted the development of merger litigation in Delaware beyond settlement practice. For example, after *Trulia*, defendants have been more resistant to voluntarily producing discovery on disclosure and other claims pre-close, given the reduced likelihood of settlement. Many times, a merger transaction will close with no discovery taking place. This development, in combination with the Delaware Supreme Court's decision in *Corwin v. KKR Fin. Holdings LLC*, 125 A.3d 304 (Del. 2015),[3] has prompted some plaintiffs to complain that Delaware courts should not stay discovery pending a dispositive motion because without discovery, plaintiffs cannot fairly assess whether a disclosure violation occurred, rendering the vote "uninformed" for *Corwin* purposes.

Vice Chancellor J. Travis Laster addressed this argument in a bench ruling on September 6, 2016, in *In re Columbia Pipeline Grp., Inc. Stockholder Litig.,* C.A. No. 12152-VCL (Del. Ch. Sept. 6, 2016) (TRANSCRIPT). In that case, plaintiff stockholders sought to challenge TransCanada's acquisition of Columbia Pipeline. Following the filing of the preliminary proxy, the plaintiffs amended their complaint to add disclosure claims. Following the filing of the final proxy, Columbia Pipeline stockholders voted overwhelmingly in favor of the transaction. The defendants subsequently moved to dismiss and to stay discovery pending resolution of the motions to dismiss, and the plaintiffs opposed the motion to stay discovery. Specifically, the plaintiffs

[3] In that case, the Delaware Supreme Court held that "the business judgment rule is invoked as the appropriate standard of review for a post-closing damages action when a merger that is not subject to the entire fairness standard of review has been approved by a fully informed, uncoerced majority of the disinterested stockholders."

argued that the combination of the Court of Chancery's crackdown on disclosure-based settlements post-*Trulia* and the Delaware Supreme Court's decision in *Corwin* has left stockholder plaintiffs facing a "brave new world" in which they have no means of discovery into disclosure claims. The plaintiffs thus advocated for a new rule in which defendants, when raising a *Corwin* defense, would be required to produce documents to "provide the basis" for the information disclosed in the proxy in order for plaintiffs to meaningfully be able to challenge it. Vice Chancellor Laster rejected this argument, holding that, notwithstanding any impact *Trulia* has had on stockholder plaintiffs' ability to obtain discovery, plaintiffs continue to bear the initial burden to plead facts, without discovery, making it reasonably conceivable that a disclosure violation occurred and the standard in *Corwin* should not apply.

Key Takeaways

As the above discussion demonstrates, the impact of *Trulia* continues to have a ripple effect across deal litigation in Delaware and beyond. Disclosure-based settlements before the Court of Chancery have fallen out of favor. However, such settlements continue to obtain approval in some state and federal courts, while others have decided to follow *Trulia*. Whether the recent post-*Trulia* trends continue remains to be seen. What is certain, however, is that plaintiffs and defendants in deal litigation will continue to have to navigate the "brave new world" in which they find themselves post-*Trulia*.

Recent Opinions Highlight Different Appraisal Valuation Methods Employed in Merger Transactions by Delaware Courts

Contributors

Ronald N. Brown, III, Counsel

Keenan D. Lynch, Associate

There is a general perception that statutory appraisal challenges have been on the rise over the past several years. The Delaware Court of Chancery has issued a number of opinions during that time that use the merger price minus synergies as the best evidence of fair value. However, several notable opinions in 2016 have departed from this trend, relying instead on a discounted cash flow valuation derived from management projections and finding that the fair value for appraisal was significantly above the price paid by the acquirer in the transaction.

Background

Statutory appraisal under Section 262 of the Delaware General Corporation Law (DGCL) provides stockholders who dissent from a merger the ability to seek a judicial determination of the "fair value" of their shares on the "effective date," or the closing date of a merger.[1] In an appraisal action, fair value is determined "exclusive of any element of value arising from the accomplishment or expectation of the merger or consolidation," such as synergies, because the appraisal seeks to value the company on a "going concern" basis. In determining fair value, the Court of Chancery is required to take into account "all relevant factors."

Recent Trend Toward 'Merger Price Minus Synergies' Valuations

In a string of recent appraisal cases, the Court of Chancery held that in certain circumstances, the fair value of the dissenting stockholders' shares was best determined by the per-share merger price less any merger-related synergies rather than an analytical valuation method such as discounted cash flows. Last year, the Court of Chancery decided to defer to the merger price as the best indication of fair value in four separate appraisal cases. *Merion Capital LP v. BMC Software, Inc.*, C.A. No. 8900-VCG (Del. Ch. Oct. 21, 2015); *LongPath Capital, LLC v. Ramtron Int'l Corp.*, C.A. No. 8094-VCP (Del. Ch. June 30, 2015); *Merlin Partners LP v. AutoInfo, Inc.*, C.A. No. 8509-VCN (Del. Ch. Apr. 30, 2015); *In re Appraisal of Ancestry.com, Inc.*, C.A. No. 8173-VCG (Del. Ch. Jan. 30, 2015). These holdings were not legally novel; merger-price-based appraisal valuation has been used since at least the 2004 *Union Illinois 1195 Investment L.P.* opinion. 847 A.2d 340 (Del. Ch. 2004). And in an important 2010 ruling, the Delaware Supreme Court clarified that the use of merger price as evidence of fair value was permissible but not required. *Golden Telecom, Inc. v. Global GT LP*, 11 A.3d 214 (Del. 2010).

These cases suggest that the court is likely to apply a "merger price minus synergies" valuation if the sales process is thorough, effective and free from conflicts of interest. Additionally, the court has been more willing to defer to the merger price if the other evidence, such as the petitioners' expert valuation evidence, is seen as problematic. For example, the court has viewed discounted cash flow analyses as less persuasive than the merger price when the reliability of the projections, discount rates and other inputs to the financial analysis are effectively called into question.

Key 2016 Decisions That Rely on Discounted Cash Flow Valuations

While observers might have viewed recent decisions as ushering in a new deference to merger-price valuation in appraisal cases, three important cases

---

[1] On June 16, 2016, DGCL Section 262 was amended in two significant ways. First, the new statutory amendments institute a "de minimis threshold" of $1 million or 1 percent of the outstanding stock. Second, the statute was amended to permit the respondent corporation to prepay, in its discretion, some amount of consideration to the appraisal petitioners and thereby "cut off" the accrual of interest as to that amount. These amendments are further described in a March 16, 2016, client alert (available here).

in 2016 demonstrate that the court will utilize other financial analyses to determine fair value where it determines the merger price was not a reliable indicator.

In one recent decision, *In re ISN Software Corp. Appraisal Litigation*, C.A. No. 8388-VCG (Del. Ch. Aug. 11, 2016), the court determined the fair value of a closely held corporation whose controlling stockholder cashed out some, but not all, of the stock held by the minority stockholders. The court decided to rely exclusively on a discounted cash flow analysis because the method used by the controller to determine value was "unreliable," and neither historical sales of stock nor analyses of comparable companies and transactions provided reliable indicators of fair value. The parties' experts varied widely on the company's value, providing valuations ranging from $106 million to $820 million. The court chose one of the experts' discounted cash flow analysis as its starting point but adjusted several inputs and assumptions to conclude that ISN's fair value was $357 million — roughly 158 percent more per share than the merger consideration.

In another notable case, *In re Appraisal of DFC Global Corp.*, C.A. No. 10107-CB (Del. Ch. July 8, 2016), stockholders sought appraisal when the company was sold to a private equity buyer, alleging that the $9.50 per-share merger price was a discount to the company's fair value. Because of the differing assumptions and weighting in their discounted cash flow and comparable company analyses, the experts for the petitioners and the company diverged widely on the fair value of the company, calculating per-share values of $17.90 and $7.94, respectively. The company urged the court to consider the $9.50 per-share merger price as the most reliable evidence of fair value. The court was not persuaded that any of the proposed metrics to value the company were reliable, primarily because the merger "was negotiated and consummated during a period of significant company turmoil and regulatory uncertainty, calling into question the reliability of the transaction price as well as management's financial projections." The court concluded that the most reliable determinant of fair value of the company's shares was a blend of three "imperfect" techniques: a discounted cash flow model, a comparable company analysis and the transaction price. Giving each equal weight and making adjustments to the various inputs and assumptions, the court held that the fair value of the company was $10.21 per share.

One of the most noteworthy decisions rejecting use of the merger price as evidence of fair value came in *In re Appraisal of Dell Inc.*, C.A. No. 9322-VCL (Del. Ch. May 31, 2016). In the *Dell* case, Michael Dell, who founded and owned 15.7 percent of the company, teamed up in 2013 with private equity backer Silver Lake to take the company private. After an extensive sales process — which included competing bids from Carl Icahn and The Blackstone Group that ultimately pushed Silver Lake and Mr. Dell to enhance their offer — the company's public stock was acquired in a leveraged buyout (LBO) valued at $13.75 per share or roughly $25 billion. In the post-trial ruling, the Court of Chancery determined that the fair value of the company was $17.62 per share, or roughly 28 percent above the merger price.

The court ultimately gave the merger price no weight in its fair value determination, instead relying entirely on a discounted cash flow valuation. This is especially notable because the court's assessment of the sale process, led by the special committee of Dell's independent board of directors, was positive. The court found that the committee and its advisers "did many praiseworthy things" and that the process "easily would sail through" judicial review on a claim for breach of fiduciary duty.

Nevertheless, the court identified several factors that undermined the persuasiveness of using the merger price as evidence of fair value in the appraisal context. The court concluded that the original price generated by the presigning sales process — before the topping bids from Icahn and Blackstone — was less than fair value for several reasons:

- The use of an "LBO pricing model" meant that the price negotiations during the presigning phase were driven by the values financial sponsors were willing to pay, not the fair value of the company.
- Evidence suggested that there was a significant "valuation gap" driven by the market's short-term focus and the fact that the company's substantial long-term investments had yet to begin generating returns.
- There was no "meaningful pre-signing competition," which the court called "the

most powerful tool that a seller can use to extract a portion of the bidder's anticipated surplus."

The court noted that post-signing topping bids are exceedingly rare in LBO transactions. But two such bids materialized for Dell, and though the original buyer eventually succeeded, the merger price was increased as a result of the bidding war. However, the court rejected the notion that the increase in consideration post-signing was proof that Dell stockholders received fair value for their shares. Rather, the price bump "demonstrated only that the stockholders received an amount closer to the highest price that a bidder whose valuation was derived from and dependent on an LBO model was willing to pay." The court identified several other reasons it was not comforted by the post-signing go-shop competition:

- The size and complexity of the company meant that a successful topping bid "would have been unprecedented."
- In management buyout (MBO) go-shops such as the Dell deal, "incumbent management has the best insight into the Company's value, or at least is perceived to have an informational advantage."
- Mr. Dell was himself an asset to the company, so a competing bidder who did not have him as part of the buyout group would be bidding for a less valuable company.

Ultimately, the court concluded that the "sale process functioned imperfectly as a price discovery tool, both during the pre-signing and post-signing phases." The court found that the merger process was "sufficiently credible to exclude an outlier valuation" such as the $28.61 per-share value advanced by the petitioners. But "sufficient pricing anomalies and dis-incentives to bid existed to create the possibility that the sale process permitted an undervaluation of several dollars per share." Because the court found it "impossible to quantify the exact degree of the sale process mispricing," it gave no weight to the merger price and instead relied exclusively on a discounted cash flow methodology to derive a fair value of the company.

Implications

Appraisal will remain one of the most closely watched areas of Delaware corporate law, as the number of appraisal cases continues to increase and courts further address the issue of merger price as evidence of a company's fair value. For directors and officers of companies considering a sales process, there are a number of implications of the recent cases involving Delaware appraisal:

- Even a well-run sales process does not guarantee the use of the merger price as the basis for a determination of fair value.
  - Directors and officers who are well-motivated, independent, disinterested, informed and engaged during a sales process might not face serious allegations that they breached their fiduciary duties. Nevertheless, the merger still could be susceptible to an appraisal valuation higher than the merger price.
  - As best exemplified by the *Dell* case, depending on the circumstances of the transaction, the lack of a robust presigning market check can potentially diminish the company's ability to persuade the court that the merger price (minus merger synergies) constitutes the fair value for purposes of an appraisal. The post-signing go-shop in *Dell* was at least somewhat effective, and the sales process as a whole appeared to demonstrate that the directors discharged their fiduciary duties. Yet, in the appraisal context, the court nevertheless relied on a discounted cash flow analysis for fair value rather than the merger price.
  - The process considerations that affect appraisal litigation are not just an issue for the target and its directors. Because the surviving corporation ultimately

must pay any appraisal award, buyers may consider steps to minimize the risk of an appraisal case through the use of an appraisal-out condition or by structuring the transaction to avoid appraisal rights.

- Certain transaction dynamics and structures, including LBO/MBO transactions as in the *Dell* case, may involve particular risks in the appraisal context.
  - In certain contexts, the court may be less likely to adopt the merger price valuation framework in an appraisal action. If the court rejects the merger price in its determination of fair value, it likely will rely on a discounted cash flow and consider the projections and valuations used by the parties — including, for example, the internal rate of return calculations of an LBO sponsor or MBO group.
  - In *Dell*, the court identified certain issues that led to its decision not to use the merger price as evidence of fair value. For example, in the context of that case, the court described the advantage to a private equity buyer of having management on its side as being "endemic to MBO go-shops" and creating "a powerful disincentive for any competing bidder." The court also stated that "the claim that bargained-for price in an MBO represents fair value should be evaluated with greater thoroughness and care than, at the other end of the spectrum, a transaction with a strategic buyer in which management will not be retained."
- A discounted cash flow valuation based on management projections may result in fair value determinations higher than the merger price.
  - As in the recent cases described herein, Delaware courts will at times give significant weight to management's projections of future revenues and cash flows. In fact, the Delaware Supreme Court has cautioned that while Delaware law does not require it, "[w]e expect many companies will advocate the same company specific data in appraisal proceedings that they have previously advocated in proxy materials." *Golden Telecom, Inc.*, 11 A.3d at 219. In an appraisal case where the respondent company urges the court to use lower projections than were used in connection with the sale process, the Court of Chancery "can — and generally should — consider and weigh inconsistencies in data advocated by a company." *Id.*
  - Where the court adopts the projections used by management, it may use different inputs and assumptions than those used by the company or its advisors in their financial analysis of the fairness of the transaction — potentially resulting in a higher valuation for the appraisal petitioners than calculated by the company's financial advisors in their fairness opinions.

After *Corwin*, Court of Chancery Provides Additional Guidance on Application of Business Judgment Rule to Post-Closing Damages Claims

Contributors

Joseph O. Larkin, Counsel

Shaivlini Khemka, Associate

> See page 13 for key takeaways

As previously reported in *Insights: The Delaware Edition*, the Delaware Supreme Court's landmark decision in *Corwin v. KKR Financial Holdings LLC,* 125 A.3d 304 (Del. 2015) articulated a new defendant-friendly rule for post-closing damages actions for breaches of fiduciary duties. The Delaware Supreme Court held that 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," the deferential business judgment standard of review will apply, leaving only a claim for waste. The *Corwin* decision was followed shortly by an order in *Singh v. Attenborough*, 137 A.3d 151 (Del. 2016) (ORDER), in which the Supreme Court, applying *Corwin*, explained that "[w]hen the business judgment rule standard of review is invoked because of a vote, dismissal is typically the result ... because the vestigial waste exception has long had little real-world relevance, [and] because it has been understood that stockholders would be unlikely to approve a transaction that is wasteful."

As a practical matter, the *Corwin* case has created a high bar for plaintiff stockholders to pursue a post-closing damages claim. The Delaware Court of Chancery has now applied *Corwin* to dismiss a number of cases at the pleading stage, which are described below. In each case, the court found that (i) the stockholder vote approving the merger was fully informed, (ii) the transaction did not involve a controller, and (iii) under *Corwin*, plaintiffs' claims were subject to the business judgment rule standard of review.

The *Comstock* Decision

City of Miami General Employees v. Comstock, C.A. No. 9980-CB, 2016 WL 4464156 (Del. Ch. Aug. 24, 2016) involved a stockholder challenge to the merger between C&J Energy Services, Inc. (C&J) and a subsidiary of Nabors Industries Ltd. (Narbors). In November 2014, Vice Chancellor John W. Noble issued a preliminary injunction enjoining the merger until after C&J complied with a court-mandated, 30-day go-shop provision. In December 2014, the Supreme Court reversed that order. Subsequently, in March 2015, the transaction closed after receiving approval of approximately 97.6 percent of the shares of C&J stock that voted on the transaction. After closing, the plaintiff amended its complaint seeking post-closing damages for alleged breaches of fiduciary duties by C&J's board and its officers arising from any allegedly conflicted sales process. For the first time, the plaintiff also alleged disclosure claims.

Although the court noted that "plaintiff did not heed the preference under Delaware law for disclosure claims to be litigated before a stockholder vote so that if a disclosure violation exists, it can be remedied by curing the informational deficiencies, thus providing stockholders with the opportunity to make a fully informed decision," the court still considered the disclosure claims as part of its *Corwin* analysis. Specifically, the court stated that it was required to address the plaintiff's disclosure claims to determine the appropriate standard of review under *Corwin*. Ultimately, the court rejected the plaintiff's disclosure claims that, in essence, were the same "tell me more" type disclosures that the Delaware courts have consistently held are inadequate to state a colorable disclosure claim. In doing so, the court reiterated that "Delaware law does not require disclosure of a play-by-play of negotiations leading to a transaction or of potential offers that a board has determined were not worth pursuing" and that "quibbles with a financial advisor's work simply cannot be the basis of a disclosure claim."

With respect to the fiduciary duty claims, the plaintiff argued that entire fairness applied because: "(1) a majority of the C&J board was interested in the Nabors transaction because of their desire to obtain board seats in the surviving entity, and (2) that Comstock [the CEO and chairman of C&J,] tainted the process by which the board considered the transaction." The court rejected both arguments, holding that (i) "enticement of a future seat on the board of the company surviving a merger is not sufficient to disqualify that director from making a disinterested decision on the basis of financial interest," (ii) "Comstock's large [10 percent] equity position helped to align his interest with stockholders ... and there was no temptation for Comstock to tip the scales in favor of a transaction that would give him control of the combined entity," and (iii) in any event, the plaintiff failed to adequately allege the "type of duplicitous conduct" that Delaware courts have condemned. Because the plaintiff was unable to plead facts sufficient to invoke entire fairness review, the court held that the presumption of the business judgment rule applied under *Corwin* and dismissed the action. The court also dismissed claims against certain officers and aiding-and-abetting claims against the buyer and C&J's financial advisor.

The *Larkin* Decision

One day after *Comstock* was issued, Vice Chancellor Joseph R. Slights III provided additional guidance on *Corwin's* application in *Larkin v. Shah*, C.A. No. 10918-VCS, 2016 WL 4485447 (Del. Ch. Aug. 25, 2016). Larkin involved Teva Pharmaceuticals Industries, Ltd.'s (Teva) acquisition of Auspex Pharmaceuticals, Inc. (Auspex) in a $3.5 billion all-cash deal structured as a two-step medium form merger pursuant to Section 251(h) of the DGCL. The merger closed in May 2015 after stockholders owning 78 percent of Auspex's outstanding common stock (including 70 percent of shares not contractually bound to support the transaction) voted to approve the transaction in the first step of the two-step process. Former Auspex stockholders brought a post-closing damages action alleging that the Auspex board, several of whom were affiliated with different venture capital funds and were therefore alleged to be motivated to monetize their investments, breached their fiduciary duties by running a flawed sales process that ultimately led to an inadequate merger price.

The plaintiffs' "showcase theory" was that entire fairness applied to the transaction because "the venture capital funds ... controlled the Auspex board and, spurred by self-interest, caused the conflicted board to approve an ill-advised transaction with Teva at the expense of Auspex's other stockholders." Alternatively, the plaintiffs alleged that entire fairness applied because "a majority of the Auspex board labored under actual conflicts of interest throughout the process of negotiating and approving th[e] merger." After finding that the plaintiffs had failed to plead facts that the transaction involved a controlling stockholder, the court held that "[i]n the absence of a controlling stockholder that extracted personal benefits, the effect of disinterested stockholder approval of the merger is review under the irrebuttable business judgment rule, even if the transaction might otherwise have been subject to the entire fairness standard due to conflicts faced by individual directors." In reaching that conclusion, the court addressed the following overarching question: "[W]hat did *Corwin* mean by 'a transaction not subject to the entire fairness standard'?"

The court expressly rejected the plaintiffs' "rigorously literal reading" of *Corwin* that "*all* transactions subject to entire fairness for *any reason* cannot be cleansed under *Corwin*" (emphasis in original). Instead, the court agreed with the defendants that "the only transactions that are subject to entire fairness that cannot be cleansed by proper stockholder approval are those involving controlling stockholders." The court's decision was motivated by three primary reasons: (i) a plain reading of *Corwin* itself, along with supporting authority and underlying context, (ii) recent guidance from the Court of Chancery including Vice Chancellor Tamika Montgomery-Reeves' decision in *In re Volcano Corp. Stockholder Litigation*, 143 A.3d 727 (Del. Ch. 2016) (discussed below), and (iii) policy rationales that animate Delaware's controlling stockholder jurisprudence, namely, that "[c]oercion is deemed inherently present in controlling stockholder transactions of both the one-sided and two-sided variety, but not in transactions where the concerns justifying some form of heightened scrutiny derive solely from board-level conflicts and lapses of due care." The court dismissed the complaint in its entirety because the plaintiffs had not attempted to plead a waste claim.

The *Volcano* and *OM Group* Decisions

In *In re Volcano Corp. Stockholder Litigation*, Vice Chancellor Montgomery-Reeves rejected the plaintiffs' post-closing damages claims arising from the transaction between Volcano Corporation and Philips Holdings USA, finding that stockholder acceptance of a tender offer has the same cleansing effect under *Corwin* as stockholder approval pursuant to a traditional long-form merger. The court held that because Volcano's stockholders were fully informed as to all material facts regarding the merger, the plaintiffs were subject to an irrebuttable presumption under the business judgment rule.

In so holding, Vice Chancellor Montgomery-Reeves rejected the plaintiffs' attempt to distinguish tender offers from stockholder votes for purposes of application of the *Corwin* analysis. Specifically, the vice chancellor rejected the following two arguments: (i) tender offers differ from statutorily required stockholder votes "based on 'the lack of any explicit role in the [DGCL] for a target board of directors responding to a tender offer'" (citation omitted) (alteration in original), and (ii) "a first-step tender offer in a two-step merger is arguably more coercive than a stockholder vote in a one-step merger." With respect to the first argument, the court explained that the target board, even in the case of two-step mergers, is obligated to adopt a resolution approving the merger agreement and declaring its advisability. Further, "in recommending that its stockholders tender their shares in connection with a [two-step] merger, the target corporation's board has the same disclosure obligations as it would in any other communication with those stockholders." With respect to the coercion argument, the court noted that the requirements under Section 251(h) alleviate any such coercion because the first-step tender offer must be for all of the company's outstanding stock, the second-step merger must be effected as soon as practicable after the first-step tender offer, the same consideration must be paid in both the first- and second-steps, and appraisal rights are available in two-step mergers. Additionally, the court reiterated *Corwin*'s concerns about judicial second-guessing of economic decisions made by disinterested and fully informed stockholders and noted that the *Corwin* decision itself uses the terms "approve" and "vote" interchangeably.

Most recently, Vice Chancellor Slights applied *Corwin* in *In re OM Group, Inc. Stockholders Litigation*, C.A. No. 11216-VCS, 2016 WL 5929951 (Del. Ch. Oct. 12, 2016). The *OM Group* litigation arose from a merger between OM Group, Inc. (OM) and Apollo Global Management, LLC (Apollo). The plaintiffs brought a post-closing rescissionary damages action for alleged breaches of fiduciary duties by OM's board of directors and an aiding-and-abetting claim against OM's merger partner, Apollo. The aiding-and-abetting claims were voluntarily dismissed. The plaintiffs argued that the stockholder vote should be disregarded because it was "the product of OM's incomplete and misleading public disclosures ... regarding a director conflict, the extent to which the OM Board appreciated and managed the banker conflicts and material details of an indication of interest received by the OM Board during the post-signing go-shop."

Applying *Corwin*, Vice Chancellor Slights dismissed the complaint "because a majority of fully informed, uncoerced, disinterested stockholders voted to approve the merger and [p]laintiffs [did] not allege that the transaction amounted to waste." In so holding, the court noted that the complaint alleged "no facts from which one could infer that a majority of the OM Board was interested in the transaction or that the OM Board labored under the influence of a controller." Further, upon analyzing the plaintiffs' disclosure claims, the court found that there was "no material omission and no materially misleading partial disclosure" regarding indications of interest from an alternate bidder; there were "no facts from which [the court could] reasonably infer that the omitted facts relating to [an OM director's] connection to Apollo reflect an actual conflict or are otherwise material"; and that "[t]he OM stockholders were fully apprised of [OM's financial advisor's] past work with Apollo and of the contingent nature of its engagement by the OM Board."[1]

[1] In one recent decision, *In re Comverge Shareholders Litigation*, C.A. No. 7368-VMCR (Del. Ch. Oct. 31, 2016), Vice Chancellor Montgomery-Reeves stopped short of entering summary judgment for the defendants under *Corwin* because the court found that some of the plaintiffs' disclosure claims presented a mix of factual issues and questions of law that required further development before they may be decided as a matter of law. It bears mentioning, however, that the court had denied a motion to dismiss on the plaintiffs' claims almost a year before the Supreme Court issued its decision in *Corwin*.

Key Takeaways

The Court of Chancery's recent string of decisions applying *Corwin* have some important takeaways for practitioners and parties to deal litigation.

- Delaware courts will continue to defer to the decisions of independent and disinterested target company boards, and of disinterested, noncoerced and fully informed stockholders, to approve transactions. In fact, as of the date of this article, all the cases where the Court of Chancery applied the *Corwin* analysis have resulted in dismissals.
- The law underlying *Corwin* continues to develop. For example, one interesting issue emerging from these recent decisions is the perception that the Court of Chancery appeared to take a broader view of *Corwin* in *Larkin* than in other cases, such as *Comstock*.

  In *Larkin,* Vice Chancellor Slights interpreted *Corwin* to hold that "[i]n the absence of a controlling stockholder that extracted personal benefits, the effect of disinterested stockholder approval of the merger is review under the ***irrebuttable*** business judgment rule, ***even if the transaction might otherwise have been subject to the entire fairness standard due to conflicts faced by individual directors***" (emphasis added). In reaching that conclusion, the court read *Corwin* to hold that "the only transactions that are subject to entire fairness that cannot be cleansed by proper stockholder approval are those involving a controlling stockholder." The *Larkin* court's formulation of *Corwin* seems to place a higher barrier to plaintiffs in post-closing merger litigation than in other recent cases such as *Comstock*. Because the case law is still evolving, it remains worthwhile to monitor closely how the Court of Chancery applies *Corwin* to noncontroller transactions going forward.
- While *Comstock* suggests that disclosure claims may be considered post-closing as part of the *Corwin* analysis, other recent decisions from the Court of Chancery (*see Nguyen v. Barrett*, C.A. No. 11511-VCG, 2016 WL 5404095 (Del. Ch. Sept. 28, 2016) and *In re Columbia Pipeline Group Stockholder Litigation*, C.A. No. 12152-VCL (Del. Ch. May 25, 2016) (TRANSCRIPT)) strongly indicate that disclosure claims should be brought before the stockholder vote when the purported harm of an uninformed vote may still be remedied. Accordingly, stockholder plaintiffs may not be able to seek tactical gain by deferring disclosure claims until after stockholders vote and the disclosures can no longer be supplemented.

Two Court of Chancery Deal Litigation Decisions Provide Helpful Guidance

Contributors

Amy C. Huffman, Associate

Lauren N. Rosenello, Associate

***Chelsea Therapeutics*: Post-Closing Bad Faith Claim a 'Rare Bird' in Delaware Absent Allegations of Self-Interestedness or Lack of Independence**

In *In re Chelsea Therapeutics International LTD Stockholders Litigation*, Vice Chancellor Sam Glasscock III of the Delaware Court of Chancery dismissed claims that Chelsea Therapeutics International Ltd.'s (Chelsea) board of directors acted in bad faith by selling Chelsea to Lundbeck A/S (Lundbeck) at an amount substantially below its standalone value. Specifically at issue were the board's instructions to its financial advisor to ignore one set of financial projections in opining on the fairness of the sale, as well as the board's choice to disregard a second set of projections before recommending the transaction to Chelsea's stockholders. The plaintiffs did not otherwise challenge the board members' interests or independence but rather argued that such actions were "inconceivable as anything other than actions against the interests of the stockholders" and therefore must constitute bad faith. In dismissing the claims, the court noted that bad faith was a "rare bird," further highlighting the difficulty stockholders of Delaware corporations face in bringing post-closing bad faith claims against otherwise unconflicted boards.

Background

Chelsea researched and developed a drug called Northera, which treated symptomatic neurogenic orthostatic hypotension (NOH). Prior to Northera's Food and Drug Administration (FDA) approval, a market check had yielded no potential buyers. Following Northera's approval, several potential buyers expressed a renewed interest in Chelsea, including Lundbeck. When negotiating the transaction, the Chelsea board had been reviewing and relying upon three sets of projections for the company. The "Base Case" assumed one possible application for Northera — the treatment of NOH. The "Adjusted Base Case" made the same assumption but reflected higher net sales due to an increase in Chelsea's sales force. The "No-Midodrone Projections" assumed a hypothetical scenario where Northera's competitor, Midodrone, would be removed from the market. None of the projections reflected results of a study that Chelsea had commissioned that analyzed potential revenue streams from applications of Northera that were not yet FDA approved.

Immediately after the transaction was announced, the plaintiffs sought a preliminary injunction to prevent the transaction from closing. The plaintiffs alleged, among other things, that the proxy was deficient because it omitted the No-Midodrone Projections and the results of the study analyzing potential uses for Northera. Although these projections were not disclosed, the proxy did disclose that the board had considered the No-Midodrone Projections and concluded they were too speculative and, thus, instructed the financial advisor not to take them into account. The court denied the injunction, finding that the projections and study were highly speculative and therefore the existing disclosures were sufficient.

The plaintiffs subsequently pursued a post-closing action for damages where they renewed their arguments regarding the purported disclosure violations and additionally claimed that Chelsea's directors had breached their duty of loyalty by knowingly selling the company at a price substantially below its standalone value. The bad faith allegations mirrored the disclosure violations — specifically, that the directors had improperly instructed their financial advisors to exclude the No-Midodrone Projections when opining on the fairness of the transaction, and that the directors themselves had ignored the commissioned study when evaluating the company's value, which indicated a higher value for the company. The plaintiffs argued that excluding these projections allowed the financial advisor to determine the transaction was fair when it was not and allowed the directors to recommend an inadequate price. The plaintiffs argued that there was no conceivable basis on which it was in the interest of the stockholders for the board and its financial advisors to exclude these projections, and that the directors, despite their independence and disinterestedness, "must have" acted in bad faith.

Court's Analysis

Based on the record created at the preliminary injunction hearing, the court rejected the plaintiff's disclosure violations, holding that the board did not have a duty to disclose the No-Midodrone Projections or results of the study (and their implications for value) due to their speculative nature.

In dismissing the bad faith claim on its merits, the court declined to reach the issue of whether a fully informed stockholder vote could cleanse bad faith board action under the holdings of *Corwin v. KKR Financial Holdings LLC*. Similarly, the court did not decide whether *Corwin* could apply in the context of a tender offer.

Rather, in its analysis, the court compared a bad faith claim to waste and noted that "like waste, [bad faith] is a rara avis." The court explained that to state a bad faith claim, a plaintiff must plead either an "extreme set of facts" to show that "disinterested directors were intentionally disregarding their duties" or that "the decision under attack is so far beyond the bounds of reasonable judgment that it seems essentially inexplicable on any ground other than bad faith." The court further noted that the plaintiffs relied "on the most difficult path to overcome dismissal of a claim based on bad faith: that the action complained of is otherwise inexplicable, so that bad faith — a motive other than the interest of the [c]ompany — *must* be at work."

The court found that, contrary to the plaintiffs' allegations, it was readily explicable that the board would exclude such highly speculative projections. The court reasoned that there were no assurances that Midodrone would be taken off the market or that Northera would be proven capable of treating additional conditions and then approved by the FDA for those uses. The court also noted that if the omitted projections would have reflected a realistic valuation, another bidder would have likely emerged throughout the 20-month-long sales process. Thus, the plaintiffs failed to plead facts that demonstrated the directors' decision to disregard the projections was so egregious that it was reasonably conceivable the board acted in bad faith.

In re Books-A-Million, Inc. Stockholders Litigation: Delaware Court of Chancery Applies '*MFW*' Framework to Going-Private Transaction and Dismisses Claims on Motion to Dismiss

In his recent *Books-A-Million* opinion, Vice Chancellor J. Travis Laster of the Delaware Court of Chancery clarified the obligations of controlling stockholders in going-private transactions under the "*MFW*" framework. Noting that compliance with the *MFW* framework can be tested on a motion to dismiss, the court dismissed breach of fiduciary duty claims against the Books-A-Million board of directors and its controlling stockholders.

Background

Following an inquiry from a third party (identified in the proxy as Party Y), the controlling family stockholders (the Anderson Family) of Books-A-Million, Inc. (BAM) made a proposal to acquire the remaining minority shares for $2.75 per share, a 65 percent premium over the average closing price for the past 90 days. The proposal contemplated the formation of a special committee of independent directors with its own financial and legal advisers. The proposal also stated that the Anderson Family would not move forward with the transaction unless it was approved by a special committee and that any agreement would need to include a nonwaivable majority of the minority condition. The Anderson Family expressly stated that it was only interested in purchasing BAM's minority shares and would not sell its shares to a third party.

In response to the Anderson Family proposal, the board formed a special committee (the Special Committee) consisting of the three BAM directors not affiliated with the Anderson

Family. Shortly after retaining counsel, one member of the Special Committee, Ronald G. Bruno, disclosed that, even though he qualified as an independent director under Nasdaq rules, he had certain social and civic ties to the Anderson Family that may otherwise call his independence into question. The Special Committee and its counsel met later that same day (without Bruno in attendance) and determined that it would be preferable if Bruno did not serve on the Special Committee to avoid any possible challenges to its independence. Bruno resigned that same day and the Special Committee retained Houlihan Lokey to serve as its financial advisor.

In light of the Anderson Family's plan to finance its proposal using the company's existing credit facility, the Special Committee decided to evaluate alternative transaction structures. Houlihan Lokey also contacted three other entities despite the Anderson Family's expressed intention not to sell any of their shares. Ultimately, only Party Y submitted an indication of interest at a price of $4.21 per share, conditioned on due diligence and other matters. Party Y also rejected the idea of making a minority investment, indicating that it was only interested in purchasing a controlling stake.

Recognizing that there was no viable path forward with Party Y, the BAM board determined to continue negotiations with the Anderson Family only. After several rounds of negotiations, the Anderson Family and the Special Committee agreed on $3.25 a share, with the Anderson Family maintaining a right to terminate the transaction if 10 percent or more of the minority stockholders sought to exercise their appraisal rights. On July 13, 2015, Houlihan Lokey delivered an opinion that the $3.25 per share contemplated by the family's proposal was fair to minority stockholders from a financial point of view. The Special Committee and Bruno attended Houlihan Lokey's presentation, and Bruno was subsequently excused during the Special Committee's deliberations. The Special Committee members then deliberated and voted to recommend the Anderson Family's offer to the full board.

The merger consideration valued the company's minority interest at $21 million. The merger was financed through borrowings under the company's credit facilities, and the company's three top executives entered into rollover agreements. On October 22, 2105, BAM filed its definitive proxy statement, and the Anderson Family's proposed buyout was submitted to BAM's stockholders on December 8, 2015. Approximately 66.3 percent of the shares not affiliated with the Anderson Family or any Section 16 BAM officer approved the merger. The transaction closed on December 10, 2015.

Stockholder Litigation and Court's Analysis

Following announcement of the transaction, the minority stockholders filed suit for breach of fiduciary duty against (i) the two members of the Special Committee, (ii) Bruno, as the resigned Special Committee member who later voted in favor of the transaction, (iii) the Anderson Family's two board representatives, and (iv) the three members of BAM's executive management who entered into the rollover agreements.

In reviewing the plaintiffs' challenges to the BAM transaction, the court first noted that "compliance with the *M&F Worldwide* structure can be tested on a motion to dismiss." Citing *Swomley v. Schlecht*,[1] the court stated that "[i]f the defendants have described their adherence to the elements identified in *M&F Worldwide* 'in a public way suitable for judicial notice, such as board resolutions and a proxy statement,' then the court will apply the business judgment rule at the motion to dismiss stage unless the plaintiff has 'pled facts sufficient to call into question the existence of those elements.'"

The court then turned to the plaintiffs' specific allegations and held that they "do not support a reasonably conceivable inference that any of the *M&F Worldwide* conditions were not met," and therefore the business judgment rule would apply. Taking each of the *MFW* elements in turn, Vice Chancellor Laster concluded as follows:

- **The Anderson Family conditioned the transaction *ab initio* upon the approval of an independent and empowered Special Committee and a nonwaivable majority of the minority stockholder vote**. In so finding, the court rejected the plaintiffs' argument that the Anderson Family's 2015

[1] 2014 WL 4470947, at *20 (Del. Ch. Aug. 27, 2014) (TRANSCRIPT), *aff'd* 128 A.3d 992 (Del. 2015) (TABLE).

proposal was a continuation of a prior offer made by the Anderson Family in 2012, which did not contain these minority protections. The complaint acknowledged that a special committee had previously rejected the 2012 offer, thereby terminating it.

- **The Special Committee was independent.** The plaintiffs mounted two separate collateral attacks on the Special Committee's independence. First, the plaintiffs alleged that Bruno was not independent from the Anderson Family and that he tainted the Special Committee's independence by sitting in on Houlihan Lokey's July 13, 2015, fairness opinion presentation. The court found, however, that Bruno's early resignation from the Special Committee was a "commendable step for Bruno and the Committee to take," and therefore, no decision needed to be made regarding his independence. The court so held notwithstanding Bruno's presence during Houlihan Lokey's presentation. Specifically, the court stated that "[u]nder different circumstances, the participation of a director whose independence was compromised might be problematic," but "the allegations of the Complaint do not support a reasonably conceivable inference that having Bruno present solely for Houlihan Lokey's fairness presentation prevents the Merger from meeting this element of the *M&F Worldwide* test."

  Second, the plaintiffs alleged that the Special Committee acted in bad faith by refusing to continue negotiations with Party Y, which had previously offered up to $4.21 per share of BAM. The court first paused to consider whether a "good faith" requirement even existed under *MFW* and ultimately concluded that a pleading of "subjective bad faith is a theoretically viable means of attacking the *M&F Worldwide* framework." Relying heavily on *Mendel v. Carroll*,[2] however, the vice chancellor rejected the plaintiffs' arguments holding that there could be no finding of bad faith where (i) the Anderson Family had no obligation to sell its controlling stake, and (ii) the Anderson Family did not overreach or exploit the minority in making its proposal. Under those circumstances, the court stated that "[u]nder the rule of *Mendel*, the Committee could not have acted loyally by deploying corporate power against the Anderson Family to facilitate a third party deal."

- **The Special Committee was empowered to select its own advisers and say no definitively.** Citing the proxy and BAM's board resolutions, the court found that the Special Committee was granted the requisite authority to select its own advisers and further that the BAM board committed not to proceed with the transaction without a favorable recommendation from the Special Committee.

- **The Special Committee fulfilled its duty of care in negotiating a fair price.** After noting that the standard of conduct for the duty of care remains gross negligence on a motion to dismiss, the court held that the Special Committee had fulfilled its duty by meeting 33 times over five months, seeking alternative buyers, considering alternative structures, rejecting the Anderson Family's initial offer, negotiating over noneconomic terms and ultimately obtaining a sale price 20 percent higher than the Anderson Family's initial offer.

- **The minority was informed and its vote was not coerced.** The plaintiffs did not assert any disclosure claims and did not otherwise allege that the vote was coerced. Accordingly, the court found that the fifth and sixth *MFW* requirements were satisfied.

After determining that the transaction satisfied the elements of *MFW*, the court applied the business judgment rule and dismissed all causes of action with prejudice.

---

[2] 651 A.2d 297 (Del. Ch. 1994).

Implications

Chelsea Therapeutics and *Books-A-Million* add to a recent body of Delaware jurisprudence that narrows the path for plaintiffs to successfully pursue a post-closing damages case and indicate that courts are willing to dismiss lawsuits at the pleading stage.

Specifically, *Chelsea Therapeutics* indicates that when a company's charter includes an exculpatory provision and there are no allegations of extreme facts, Delaware courts appear willing to dismiss conclusory bad faith claims when unaccompanied by specific allegations of interestedness or lack of independence.

Chelsea Therapeutics also confirms that plaintiffs continue to focus on disclosure of management projections and that there is no per se rule regarding their disclosure. Although the court determined that the specific omitted projections were not material, it also focused on their highly speculative characteristics and noted that such speculative nature was disclosed in the proxy. Accordingly, if a board is considering disclosing management projections, it should carefully determine whether the projections were actually relied upon and, if they were not, why they were not. If the board ultimately chooses not to rely on certain projections, strong consideration should be given as to whether the rationale for that decision should be documented and disclosed.

The *Books-A-Million* opinion confirms that Delaware courts are willing to apply the deferential business judgment rule where controlling stockholders seeking to take a company private heed the advice set forth by the Delaware Supreme Court in *Kahn v. M&F Worldwide Corp.*, 88 A.3d 645 (Del. 2014). However, *Books-A-Million* suggests that controlling stockholders would be well advised to make even their initial offers conditioned upon both the approval of an independent and empowered special committee and nonwaivable majority of the minority vote.

Books-A-Million also confirms that Delaware courts will consider application of the *MFW* framework on a motion to dismiss provided that the transaction documents sufficiently describe the transaction's compliance with each of the six *MFW* elements. Specifically, documents subject to judicial notice, including proxy statements and board resolutions, should be reviewed not only for compliance with state and federal disclosure laws but also for their descriptions of the company's and interested parties' adherence to the elements identified in *M&F Worldwide*.

Contacts

Litigation

Paul J. Lockwood
302.651.3210
paul.lockwood@skadden.com

Edward B. Micheletti*
302.651.3220
edward.micheletti@skadden.com

Robert S. Saunders
302.651.3170
rob.saunders@skadden.com

Jennifer C. Voss
302.651.3230
jennifer.voss@skadden.com

Edward P. Welch
302 651 3060
edward.welch@skadden.com

Mergers & Acquisitions

Steven J. Daniels
302.651.3240
steven.daniels@skadden.com

Allison L. Land
302.651.3180
allison.land@skadden.com

Robert B. Pincus
302.651.3090
bob.pincus@skadden.com

Corporate Restructuring

Mark S. Chehi
302.651.3160
mark.chehi@skadden.com

Anthony W. Clark
302.651.3080
anthony.clark@skadden.com

*Editor

Special thanks to **Stephen F. Arcano**

One Rodney Square / 920 N. King Street / Wilmington, Delaware 19801 / 302.651.3000

Four Times Square / New York, NY 10036 / 212.735.3000