# Key Developments in Delaware Corporation Law in 2016

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01 / 30 / 17

This article is from Skadden's *2017 Insights.*


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Significant changes in Delaware merger litigation and settlement practice in 2016, as well as noteworthy case law developments and trends, will continue to affect merger parties and litigants in 2017 and beyond.

## *Trulia* and *Corwin* Shake Up Deal Litigation in Delaware and Across US

One of the biggest developments in Delaware corporation law in 2016 was the Delaware Court of Chancery's decision to upend its long-standing practice of approving disclosure-based deal litigation settlements. In *In re Trulia, Inc. Stockholder Litigation*, issued in January 2016, Chancellor Andre G. Bouchard fashioned a new standard for evaluating disclosure settlements — the "plainly material" standard — and expressed the Delaware courts' preference that disclosure claims be either litigated to a preliminary hearing or made moot by supplemental disclosures.

The decision sparked three observable trends in 2016: lower rates of deal litigation generally, a declining share of such litigation in the Delaware Court of Chancery relative to other states and courts, and decreased fee opportunities for plaintiffs' lawyers. Although the long-term implications are not yet fully clear, we anticipate that these trends will continue in 2017.

According to a report published in August 2016 by Cornerstone Research, an economic and financial consulting firm, stockholder plaintiffs filed lawsuits challenging 84 percent of M&A deals valued over $100 million in 2015, which dropped to 64 percent of such deals in the first half of 2016 after the *Trulia* decision was issued. Further, among deals that were litigated, plaintiffs sued in Delaware in 61 percent of cases during the first three quarters of 2015 but only in 26 percent of cases in the fourth quarter of 2015 and first half of 2016. The timing and magnitude of this shift strongly suggests that the plaintiffs' bar is responding to *Trulia* by filing fewer claims overall and avoiding the Delaware Court of Chancery much more often than previously (in some instances, in violation of a company's forum selection charter or bylaw provision). While some states have continued to approve disclosure-based settlements as in the past, other states have adopted Delaware's new, more stringent standards. Most notably, the U.S. Court of Appeals for the Seventh Circuit in *In re Walgreen Co. Stockholder Litig.* recently adopted the *Trulia* standard as well. It remains to be seen whether courts will continue to change their approach in these cases based on *Trulia*.

Disclosure-based settlements also have significantly declined post-*Trulia*, becoming virtually nonexistent in the Delaware courts. Instead, plaintiffs have seemed more inclined to challenge proposed transactions solely on disclosure grounds rather than bring broad claims for breach of fiduciary duty based on the merger price and process, in the hopes of a "mootness"-based resolution through supplemental disclosures. Plaintiffs' lawyers who have sought mootness fees have faced mixed but mostly negative results. For example, in 2016, the Court of Chancery decided several contested mootness fee applications in cases where the defendants issued supplemental disclosures designed to moot the disclosure claims. In each of those cases, the plaintiffs sought fee awards in the $275,000 to $350,000 range, but the court only granted amounts of $50,000 and $100,000, if any at all.

Meanwhile, as stockholder plaintiffs shift tactics in response to *Trulia*'s disfavor of disclosure-based settlements, the importance of disclosures as a matter of substantive corporation law has increased significantly following the Delaware Supreme Court's late-2015 decision in *Corwin v. KKR Financial Holdings LLC*. In its May 2016 opinion




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in *Singh v. Attenborough*, the Delaware Supreme Court reaffirmed the defendant-friendly *Corwin* rule, explaining that "[w]hen the business judgment rule standard of review is invoked because of a vote, dismissal is typically the result." The court clarified that when a fully informed stockholder vote makes *Corwin* applicable, the only remaining claim a plaintiff stockholder might have is under the "vestigial waste exception," which has "long had little real-world relevance." In the aftermath of *Corwin* and *Singh*, the Court of Chancery also issued a string of important rulings in challenges to already-closed mergers that had obtained majority approval from the target company's stockholders. In each of the *Volcano Corporation, Comstock, Larkin, OM Group, Inc.* and *Solera* cases, the Court of Chancery dismissed stockholders' claims for breach of fiduciary duty where the plaintiffs failed to state viable disclosure claims to undermine the effect of a disinterested stockholder vote or tender, and failed to allege that the transaction amounted to waste or was tainted by a conflicted controlling stockholder.

Another important trend in 2017 may be the interplay between *Trulia* and *Corwin*, which, in combination, could provide businesses relief from the previous status quo in which nearly every M&A transaction — even those with well-run processes and premium prices — attracted stockholder lawsuits. Overall, *Trulia* has led to a decrease in both deal litigation generally and injunction requests based on disclosure claims specifically. At the same time, the only path for plaintiffs to avoid a post-closing pleadings-stage dismissal under *Corwin* might be to cast doubt on the stockholders' "fully-informed" approval of the merger — by challenging the disclosures. This has proven difficult given that in most instances, without an injunction-based or settlement-based discovery record from which to draw, plaintiffs' claims are considered conclusory and fail to gain traction. It remains to be seen whether stockholder plaintiffs will experiment with new strategies and recalibrate, or if the trends of 2016 will lead to permanent changes in deal litigation practice. Additionally, several of the Court of Chancery's rulings applying *Corwin* have been appealed to the Delaware Supreme Court, and those cases may result in key opinions in 2017, along with new applications of the *Corwin* progeny in the Court of Chancery.

## Several 2016 Appraisal Decisions Depart From Previous 'Merger Price' Trend

In 2015, the Delaware Court of Chancery issued several important rulings in the appraisal context. In each of those cases, the court found that the fair value of the dissenting stockholders' shares was best determined by the per-share merger price (less any merger-related synergies). Several notable opinions in 2016 departed from this trend, finding that, in some cases, the fair value for appraisal was significantly above the price the acquirer paid in the transaction.

Most notably, in *In re Appraisal of Dell Inc.*, the Court of Chancery determined that the fair value of the company was roughly 28 percent above the merger price that Michael Dell and Silver Lake paid to take the company private in 2013. Vice Chancellor J. Travis Laster ultimately gave the merger price no weight in its fair value determination, instead relying entirely on a discounted cash flow valuation. This was 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.

Two appraisal cases following Dell also rejected the merger price as evidence of fair value. In the *ISN Software Corporation* case, the court used a discounted cash flow analysis to conclude that the company's fair value was roughly 158 percent greater than the merger consideration. The court relied exclusively on the discounted cash flows 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. In the *DFC Global Corporation* case, the court similarly declined to rely on the merger price 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 weighed a discounted cash flow model, a comparable company analysis and the merger price, and concluded that the fair value of the company was 7.47 percent greater than the merger price.

How the Delaware courts continue to resolve these appraisal issues — most notably, the question of whether "merger price" is the best evidence of fair value — is a ripe area for further development in the coming year. In particular, the respondent companies in the *Dell Inc.* and *DFC Global Corporation* cases have taken appeals to the Delaware Supreme Court. Those cases could bring significant developments to the increasingly important area of appraisal litigation.

## *Zynga* Adds to Case Law on Director Independence

The Delaware Supreme Court recently issued an important decision on the subject of director independence. In *Sandys v. Pincus*, a rare split decision reversing the Court of Chancery on a fundamental issue of corporation law, the Delaware Supreme Court held that certain directors of Zynga, Inc. were not independent because of personal and professional connections to Mark J. Pincus, the company's founder and controlling stockholder, and Reid Hoffman, an outside director. Specifically, the majority found that one of the three directors in question — Ellen Siminoff, an outside director — was not independent for purposes of considering the demand because she and her husband co-owned a private airplane with Pincus. The majority also found that directors William Gordon and John Doerr were not independent under Delaware law because their venture capital firm owned 9.2 percent of Zynga's equity and was invested in One Kings Lane (a company co-founded by Pincus' wife) and Shopkick, Inc. (another company where Hoffman is a director). The majority opinion determined that this "mutually beneficial ongoing business relationship ... might have a material effect on the parties' ability to act adversely toward each other."

One area to monitor is how the Court of Chancery responds to the *Sandys* opinion, and whether plaintiffs use the opinion as the basis for increased challenges to director independence, especially in companies with controlling stockholders.