Insights: The Delaware Edition

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This issue focuses on important, developing areas of Delaware corporation law and deal litigation, including recent court decisions that underscore the importance of board actions in the face of activist pressure, significant developments in Delaware appraisal law and trends in deal litigation post-*Trulia*.

Activists at the Gate: Court of Chancery Weighs In on Claims Involving Activist Stockholders

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> See page 5 for key takeaways

Several recent decisions applying Delaware law offer helpful insight about the impact that activist investor involvement has on board decision-making leading to a transaction and how those decisions will be reviewed by the courts in any subsequent litigation. These cases demonstrate the importance of careful responses by boards of directors to satisfy their fiduciary duties in the face of activist pressure. Discussed below is a case addressing the implications of activism in the context of the *Corwin* doctrine[1] and three cases addressing the potential effect activist involvement can have on the judicial standard of review of a transaction.

Corwin and Activism

In *Morrison v. Berry*,[2] Vice Chancellor Sam Glasscock III dismissed an action challenging the sale of The Fresh Market to the private equity fund Apollo Management, L.P. The court observed the facts presented a fairly straightforward and "exemplary case" of the "utility" of the ratification doctrine set out in *Corwin*.[3] One aspect of the decision warrants particular focus: The court provides an example of a disclosure concerning activist pressure faced by Fresh Market that passed muster for *Corwin* purposes.

Fresh Market's founder, a then-board member and 10 percent stockholder, allegedly sought out a private equity buyer without the knowledge of the other members of the board and reached a preliminary agreement with Apollo to roll over his shares. After the agreement, Apollo made an unsolicited offer to acquire Fresh Market. The board formed a special committee, which recommended stockholders accept the offer, and a majority of the disinterested shares tendered. Among other challenges raised in the deal litigation that followed, the plaintiff alleged that an activist stockholder pressured the board to sell Fresh Market.

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[1] *See Corwin v. KKR Fin. Hldgs. LLC*, 125 A.3d 304 (Del. 2015). The *Corwin* doctrine, and its evolution, has been discussed at length in previous issues of this publication.

[2] *Morrison v. Berry*, C.A. No. 12808-VCG, 2017 WL 4317252 (Del. Ch. Sept. 28, 2017).

[3] *Id.* at *1.

On a motion to dismiss, the defendants argued that the *Corwin* ratification doctrine applied and required dismissal. For *Corwin* to apply, the stockholder vote approving the challenged transaction must be "fully informed,"[4] and in *Morrison*, one of the disclosure challenges asserted by the plaintiff targeted the activist issue. In particular, the plaintiff alleged "that the Schedule 14D-9 conceal[ed] the pressure on the Board from activist stockholders to sell the Company by failing to specifically mention a letter from Neuberger Berman, one of the Company's significant stockholders, expressing its view that the Board should consider selling the Company."[5] Even though the specifics of the letter were not disclosed, the court rejected the disclosure challenge. The court observed the board had disclosed "that the Company 'could become the subject of shareholder pressure and communications' if it didn't 'enhance efficiency,' and in fact already 'initiate[d] a comprehensive strategic review' and 'hir[ed] outside financial advisers' as recommended by Neuberger Berman."[6] The court found that this level of disclosure was adequate, which formed part of the court's ultimate decision to dismiss the case under *Corwin*.

Activist Pressure and the Judicial Standard of Review

Three recent cases involving allegations concerning activist stockholder pressure resulted in three different standards of review: business judgment, enhanced scrutiny and entire fairness. These cases, discussed below, demonstrate that there is no "one size fits all" approach to how a court will review board conduct and decision-making in response to activist involvement and that careful attention to facts, and reliance on advisors before making decisions, is crucial in these circumstances.

In August 2017, Chancellor Andre G. Bouchard applied the business judgment rule to dismiss a post-closing damages action that challenged a strategic stock-for-stock merger of equals in *In re MeadWestvaco Stockholders Litigation*.[7] In finding that the stockholder plaintiffs failed to plead a nonexculpated breach of fiduciary duty, the court observed that "[t]he thesis of the complaint is that the directors entered into the merger in bad faith in reaction to a threatened proxy contest by an activist investor."[8]

Shortly after the publication of an analyst note proposing a merger between MeadWestvaco Corporation and Rock-Tenn Company, "a well-known activist firm" Starboard Value LP began purchasing MeadWestvaco stock.[9] Over the next few months, Starboard pressed for changes that it claimed would "enhanc[e] the company's value," including a possible merger with Rock-Tenn.[10] Shortly before MeadWestvaco broke off merger negotiations, its board met with Starboard. In the following weeks, Starboard increased its ownership stake in the company and, signaling a proxy fight, announced it had signed an advisory agreement with a high-level industry player. MeadWestvaco resumed merger negotiations with Rock-Tenn, which ultimately resulted in the board's unanimous approval of the merger, which represented a 9.1 percent premium for MeadWestvaco shares. The transaction was approved by MeadWestvaco stockholders, with 98 percent of voting shares cast in favor of the transaction.

Stockholders sued post-closing for money damages, alleging breaches of fiduciary duty by the board in connection with the transaction. In light of MeadWestvaco's Section 102(b)(7) charter provision exculpating its directors from personal liability for any breach of the duty of care, the court found that the board's decision to approve the merger was presumptively governed by the business judgment rule, and thus a post-closing damages claim could survive a motion to dismiss only if the complaint alleged facts from which it could reasonably be inferred that either (1) a majority of the board was not both disinterested and independent, or (2) the board acted in bad faith.

[4] The court observed the applicability of *Corwin* to tender offers. *Id.* at *1 n.13.

[5] *Id.* at *3 (internal quotations omitted).

[6] *Id.* (alterations in original) (internal footnotes omitted) (quoting the company's 14D-9 and plaintiff's complaint).

[7] *In re MeadWestvaco Stockholders Litig.*, C.A. No. 10617-CB, 2017 WL 3526326 (Del. Ch. Aug. 17, 2017).

[8] *Id.* at *1.

[9] *Id.* at *2.

[10] *Id.* at *3.

Among other things, the plaintiffs argued that Starboard's presence was the "impetus" for the board's decision to engage in the negotiations with Rock-Tenn that led to the merger.[11] However, the court found the complaint "devoid of any allegations calling into question the disinterestedness or independence" of a majority of the MeadWestvaco board.[12] The court likewise found that the plaintiffs had failed to meet the "difficult standard" required to state a claim for bad faith.[13] To wit, the court observed that the plaintiffs' pleadings demonstrated the board's active engagement in the process and that there was no basis to infer the directors disregarded their duties or took any inexplicable actions based on Starboard's involvement. Rejecting the plaintiffs' theory that the merger price was "essentially inexplicable on any ground other than bad faith," the court observed that nowhere did the complaint suggest that "Starboard expressed any opposition to the merger price or believed that the MeadWestvaco directors left any additional value behind."[14]

A July 2017 decision by the Maryland Circuit Court applying Delaware law, *In re American Capital, Ltd. Shareholder Litigation*,[15] stands in contrast to *In re MeadWestvaco* and highlights facts that could lead a court to apply the entire fairness standard of review in cases involving activist pressure. Interestingly, this matter is one where the activist itself got swept into the deal litigation arising from the transaction that it had allegedly pressured the board to approve.

American Capital, Ltd. announced a plan to split up and spin off a majority of the company's assets into two public entities, each of which would be managed by the company. Shortly after the company filed a preliminary proxy statement in favor of the spin-off, activist investor Elliott Management Corporation announced that it had acquired an 8.4 percent economic interest in the company. Elliott launched a proxy solicitation against the spin-off, urged the board to undertake a strategic review process, and threatened to seek to replace the board. The board undertook a strategic review, during which Elliott's stake increased incrementally to 15.9 percent as a result of share buybacks. Following the strategic review, the board executed a merger agreement with Ares Capital Corporation, pursuant to which Ares would acquire the company for a mix of cash and stock. The board also signed a settlement agreement with Elliott, providing Elliott several concessions, including certain board seats if the merger did not close and reimbursement of up to $3 million of fees and expenses.

Stockholders filed suit challenging the transaction and later amended their complaint to add Elliott and certain of its affiliates as named defendants. Although the suit was filed prior to the transaction closing, the plaintiffs abandoned their efforts for injunctive relief. Post-closing, all defendants moved to dismiss the operative complaint, but claims against the board of directors for breach of fiduciary duty were settled shortly before the hearing on the motion. Elliott proceeded to a hearing on its motion to dismiss, which was denied. The court held the transaction was subject to entire fairness review because the plaintiffs had stated a claim that Elliott, despite owning only a 15.9 percent economic interest, controlled and/or dominated the board with respect to the Ares merger.[16] According to the court, the complaint alleged that "Elliott not only triggered the ultimate sale to Ares, but also had regular, detailed, and intimate knowledge of nearly every facet of the board's decision-making process."[17] The court further found

[11] *Id.* at *6.

[12] *Id.*

[13] *Id.* at *6-7.

[14] *Id.* at *9.

[15] Case No. 422598-V (Md. Cir. Ct. July 12, 2017).

[16] *See id.* at *29-31. In making this finding, the Maryland court distinguished a prior Delaware Court of Chancery decision in *In re Novell, Inc. S'holder Litig.*, C.A. No. 6032-VCN, 2013 WL 322560, at *12 (Del. Ch. Jan. 3, 2013) (finding that, standing alone, the "possible initiation of a proxy contest is not sufficient to establish domination and control, or to create a disqualifying interest" in a case where Elliott was agitating for a sale of a different company but only owned 7.1 percent of the company and had no representation on the board noting that inducing the board to consider the advisability of a sale, and "obtaining the desired response" is not sufficient to demonstrate control). The Maryland court found "the facts alleged are quite different than those outlined in *Novell*," including that *Novell* lacked allegations of actual undue influence on the board. *See In re American Capital*, Case No. 422598-V, at *31.

[17] *In re American Capital*, Case No. 422598-V, at *18.

that "[i]f the facts pleaded [we]re true, Elliott had access to the board, its advisors, and all deal information to an exquisite degree" and supported the inference that Elliott "acted as a *de facto* member" of the board.[18] The court also took issue with the board's reimbursement of Elliott's expenses as part of its settlement agreement, noting that there was no legitimate explanation given for the company compensating Elliott for "advising" it when it was already advised by two reputable investment banks.[19]

Finally, in March 2017, in *venBio Select Advisor LLC v. Goldenberg*,[20] Vice Chancellor J. Travis Laster applied enhanced scrutiny[21] and issued a temporary restraining order (TRO) blocking a "transformational transaction" entered in the midst of a proxy contest.[22] This time, the plaintiff was the activist stockholder itself. The nominal defendant, Immunomedics, Inc., a pharmaceutical company with a promising new cancer drug, was in a long-running process of identifying a partner for the licensing and distribution of its new drug. The company's largest stockholder, venBio, contended that the licensing process for the promising drug was taking too long and launched a proxy contest to replace the board in the upcoming annual meeting. VenBio announced in November 2016 its intent to nominate four directors for the company's board, which at the time had five seats. On February 9, 2017, a preliminary count of proxies submitted indicated that the venBio slate would likely defeat the incumbents.

On February 10, 2017, the board responded by, among other things, allegedly cutting short the ongoing process of finding a licensing and distribution partner, and announced the execution of a licensing agreement with one of the remaining bidders. venBio moved for a TRO to block the closing of the licensing transaction. According to venBio, the signing of the licensing agreement was an attempt by the incumbents to weaken venBio's proxy challenge. The court noted that Delaware case law teaches "that when incumbent directors act to affect the outcome of a proxy contest, they act against a specter of self-interest."[23] The court described the standard of review of such actions as falling between entire fairness and business judgment. The court granted the TRO, finding that the plaintiffs stated a colorable claim that the directors' self-interest in prevailing in the proxy contest tainted the licensing agreement decision. Thereafter, a settlement was reached between certain parties, and the matter is currently stayed.

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[18] *Id.* at *32.

[19] *Id.* at *32-33.

[20] C.A. No. 2017-0108-JTL (Mar. 9, 2017) (TRANSCRIPT).

[21] The decision did not explicitly indicate what specific line of enhanced scrutiny it was adopting; however, it appears that Vice Chancellor Laster applied *Unocal*, as the transcript decision does not expressly discuss the "compelling justification" standard of *Blasius*. *See id.* at 70-72 (citing *Mercier v. Inter-Tel (Delaware), Inc.*, 929 A.2d 786 (Del. Ch. 2007) (discussing overlap of *Blasius* and *Unocal*)).

[22] *Id.* at 60.

[23] *Id.* at 71.

Key Takeaways

- Board members faced with activist pressure need to be mindful at all pertinent times of their duties of care and loyalty owed to stockholders when taking steps to address or consider such pressure. There is no specific "road map" to be followed by a board when faced with a stockholder request to pursue a particular course of action. The board should be guided by its fiduciary duties.
- A board's decision as to whether to undertake any particular action should be based on the totality of information available and not solely in response to the demands of a particular stockholder. In other words, directors should inform themselves about requests received from activists but are not required to implement them.
- If, after receiving pressure from activist stockholders, a board determines to pursue a particular strategy or to enter into a transaction to sell the company, careful consideration of the company's disclosure obligations is appropriate, especially when the transaction structure permits the potential application of the *Corwin* defense to dismiss any post-closing litigation.
- Different standards of review can apply to board decisions that are made in the face of activist involvement. The facts and circumstances of each situation or transaction will dictate what standard of review will apply and how much leeway the court will have to "second guess" the board's process and decision-making. This underscores the importance for boards to retain and rely on knowledgeable and experienced legal and financial advisors during any process where activist involvement or pressure is occurring.
- The recent decisions discussed in this article underscore the importance of running a careful process when responding to proposals by activists. They demonstrate the need for boards to reach an independent determination regarding the merits of an activist's proposal for a company, recognizing that an activist stockholder is but one stockholder and the board's fiduciary duties run to all stockholders.

Delaware Courts Continue to Define Appropriate Valuation Methodologies for Statutory Appraisal

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> See page 9 for implications

Statutory appraisal actions remain one of the most closely watched areas of Delaware corporate law, and there have been significant developments in Delaware appraisal law. Recently, the Delaware Supreme Court provided additional guidance on appropriate valuation methodologies as it reversed and remanded the Delaware Court of Chancery in *DFC Global Corporation v. Muirfield Value Partners, L.P., et al.*, C.A. No. 10107 (Del. Aug. 1, 2017). The Court of Chancery has issued two opinions in the past year that did not rely on the merger price as fair value. Notably, both decisions produced a fair value determination below the merger price. Two other opinions by the Court of Chancery issued in the past year continued a trend and relied on the merger price in determining fair value. Most recently, the Delaware Supreme Court heard oral argument in the appeal of *In re Appraisal of Dell Inc.*, C.A. No. 9322-VCL (Del. Ch. May 31, 2016), where the Court of Chancery gave no weight to deal price and relied on a discounted cash flow analysis to produce an appraised value that was roughly 28 percent above the merger price.

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. 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."

In re DFC Global

In its decision in *DFC Global Corporation v. Muirfield Value Partners, L.P., et al.*, C.A. No. 10107 (Del. Aug. 1, 2017), the Delaware Supreme Court reversed and remanded the fair value determination the Court of Chancery produced after giving equal weight to deal price, a comparable companies analysis and a discounted cash flow analysis. The decision contains several notable highlights:

- The Supreme Court considered and rejected DFC's argument on appeal that there should be a judicial presumption that the deal price is the best evidence of fair value when the transaction results from an open market check and contains other indicators of a competitive sale process. In doing so, the court expressly reaffirmed its prior holding in *Golden Telecom, Inc. v. Global GT LP*, 11 A.3d 214 (Del. 2010), that the Court of Chancery is given broad discretion to determine the fair value of a company's shares by considering "all relevant factors." However, the Supreme Court noted that this "refusal to craft a statutory presumption in favor of the deal price when certain conditions pertain" did not "in any way signal our ignorance to the economic reality that the sale value resulting from a robust market check will often be the most reliable evidence of fair value, and that second-guessing the value arrived upon by the collective views of many sophisticated parties with a real stake in the matter is hazardous."
- The Supreme Court concluded that the Court of Chancery's decision to give only one-third weight to deal price was not supported by the record based on the trial court's own findings that the deal price resulted from an open process,

was informed by robust public information as well as easy access to nonpublic information and included many parties with a profit motive that had a chance to submit a bid.

- The Supreme Court explicitly rejected the theory underlying one of the Court of Chancery's reasons (the so-called "private equity carve-out") for concluding that deal price should only be given one-third weight in determining fair value. Specifically, the Supreme Court stated that it did "not understand the logic of" a finding that deal price could not be given dispositive weight because the prevailing buyer was a financial buyer focused on achieving a certain internal rate of return. The Supreme Court concluded that "the private equity carve out that the Court of Chancery seemed to recognize, in which the deal price resulting in a transaction won by a private equity buyer is not a reliable indication of fair value, is not one grounded in economic literature or this record."

The Supreme Court also concluded that the Court of Chancery's decision to upwardly adjust the company's perpetuity growth rate following a motion for reargument was not supported by the record. The Supreme Court also held that the comparable companies analysis used was supported by the record and therefore the Court of Chancery was within its discretion in affording that analysis weight in determining fair value. Finally, the Supreme Court held that the Court of Chancery's decision to give equal one-third weight to each valuation method was not explained in a manner supported by the record, particularly in light of the Court of Chancery's findings regarding the robustness of the market check and the public information available about the company. The Supreme Court stated that on remand, the Court of Chancery "should reassess the weight [it] chooses to afford various factors potentially relevant to fair value."

Court of Chancery Employs Discounted Cash Flow Valuations

While many observers have focused on recent appraisal decisions that defer to the merger price, two cases in 2017 demonstrate that the Court of Chancery continues to rely on other methods of financial valuation, in particular, a discounted cash flow analysis, especially where neither party argues for the merger price as indicative of fair value.

In one recent decision, *In re Appraisal of SWS Group Inc.*, C.A. No. 10554-VCG (Del. Ch. May 30, 2017), the court determined the fair value of a small bank holding company. The court relied exclusively on a discounted cash flow analysis because "the sale of SWS was undertaken in conditions that make the price thus derived unreliable as evidence of fair value." Specifically, Vice Chancellor Sam Glasscock III concluded that "certain structural limitations unique to SWS make the application of the merger price not the most reliable indicia of fair value." In this regard, the vice chancellor highlighted that SWS was party to a credit agreement with its would-be acquirer under which the acquirer exercised a partial veto power over competing offers.

Notably, neither party relied on deal price to demonstrate fair value. Instead, the parties turned to traditional valuation methods. The petitioners presented a comparable companies valuation and a discounted cash flow analysis. The respondent presented solely a discounted cash flow analysis. After concluding that the comparable companies analysis was not reliable, the court turned to the competing discounted cash flow analyses. The parties' experts varied widely on fair value, providing "mirror image" valuations of 50 percent above and 50 percent below the deal price. The court chose one of the discounted cash flow analyses as its starting point before adjusting several inputs and assumptions to conclude that the fair value of SWS as of the merger date was $6.38 per share, lower than the merger consideration of $6.92 per share. The court noted that this result was not surprising, as the record before it suggested that the merger was a "synergies-driven transaction."

In another recent opinion, *ACP Master, Ltd. et al. v. Sprint Corp., et al.*, C.A. No. 8508-VCL (Del. Ch. July 21, 2017), the court determined the fair value of Clearwire Corporation using exclusively a discounted cash flow analysis. Like SWS, neither party argued in favor of deal price. The court explicitly did not consider deal price while finding that the transaction generated considerable synergies, estimated at $1.95 to $2.60 per share. The parties differed widely on the fair value of Clearwire, $16.08 per share vs. $2.13 per share. The court concluded that most of the difference was driven by the parties' choice of projections. After analyzing each set of projections, the court used the projections that were prepared by Clearwire's

management and determined that the fair value for Clearwire on the date of the merger was $2.13 per share, less than half the merger price of $5 per share.

Court of Chancery Gives Full Weight to Deal Price When Sufficient Indicators of a Competitive Sales Process Are Present

While the Court of Chancery will turn to other valuation methods when the merger price is not a reliable indicator of fair value, decisions by the court highlight certain transactional scenarios when the court is likely to look to deal price as an exclusive, or at least presumptive, indicator of fair value.

In one recent decision, *In re Appraisal of Petsmart, Inc.*, C.A. No. 10782-VCS (Del. Ch. May 26, 2017), the court determined that the deal price was the most reliable indicator of fair value. The respondent argued that the merger price of $83 per share was fair value for the company, while the petitioners presented a fair value of $128.78 per share, a difference of $4.5 billion overall. The court began by examining the deal price of $83 per share. The court concluded that the process employed to sell the company, "while not perfect, came close enough to perfection to produce a reliable indicator of Petsmart's fair value." Specifically, Vice Chancellor Joseph R. Slights III highlighted that the sales process included "a robust pre-signing auction." After determining that deal price was a reliable indicator of fair value, the vice chancellor moved on to the parties' discounted cash flow analyses. Ultimately, the court concluded that a reliable discounted cash flow valuation could not be produced based on any of the projections in the record.

The court then considered whether the management projections could be adjusted to bring them more in line with the company's actual expected cash flows. To do so, Vice Chancellor Slights analyzed discounted cash flow analyses submitted by the parties that made adjustments to the management projections based on specific sensitivities the board of the company had directed its financial advisor to prepare. The court concluded that the financial advisor's sensitivities were reliable and found the valuations they produced to be confirmatory of deal price, but it did not adjust its view of fair value given the court's lack of confidence in the management projections underlying the sensitivities. Finally, the court considered if there was any other basis in the record to make further adjustments to the projections to arrive at a more reliable discounted cash flow analysis and found that no such basis existed. Therefore, the court concluded that deal price was the most reliable indicator of fair value at $83 per share.

In another important case, *Merion Capital L.P. and Merion Capital II L.P. v. Lender Processing Services, Inc.*, C.A. 9320-VCL (Del. Ch. Dec. 16, 2016), Vice Chancellor J. Travis Laster gave 100 percent weight to the deal price. The court first considered the initial merger consideration — the consideration contemplated when the deal was signed — of $33.25 per share. The court determined that this initial merger consideration was a reliable indicator of fair value based on several factors, including the existence of meaningful competition during the presigning phase, the presence of different types of bidders, the availability to all parties of adequate and reliable information about the company, and the lack of collusion or favoritism toward any particular bidders.

The court then analyzed the reliability of the final merger consideration — the actual consideration paid on the effective date of the merger — of $37.14 per share, which had risen due to an increase in the stock price of the acquirer. Vice Chancellor Laster concluded that the final merger consideration was a reliable indicator of fair value. Next, the court considered the parties' discounted cash flow analyses. After adopting the projections used by both parties' experts and making certain adjustments to the assumptions and inputs, the court arrived at a valuation of $38.67 per share.

Vice Chancellor Laster then discussed how he would weigh each valuation methodology. In doing so, he recounted a series of five cases in which the Court of Chancery gave exclusive weight to deal price and five others in which the court considered deal price but either did not rely on it or gave it limited weight. Concluding that this case was most similar to those in which the court gave exclusive reliance to deal price, because as in those cases the company ran a sales process that generated reliable evidence of fair value, the court accepted the deal price of $37.14 as the fair value of the company.

Implications

For directors and officers of companies involved in a sales process, there are a number of implications from recent developments in Delaware appraisal law:

- Delaware courts appear increasingly likely to use the merger price as the basis for a determination of fair value when a "proper transactional process" is used.
  - Both *Petsmart* and *Lender Processing* highlight the benefit in an appraisal proceeding of a robust and competitive presigning process, because the merger price can be an indicator of fair value.
  - The effects of a well-run and robust sales process are exemplified by the Delaware Supreme Court's reversal and remand in *DFC*. If the Court of Chancery makes findings that indicate that a strong process was used, these findings may "suggest that the deal price was the most reliable indication of fair value."
  - The Delaware Supreme Court will soon have another opportunity to weigh in on the effects of a well-run process when it issues its decision in the *Dell* appeal. The Court of Chancery had a positive view of the sales process used by the company but ultimately appraised the fair value of the company at a price higher than the deal price because, for several reasons, it concluded that deal price was not a reliable indicator of fair value.
- A determination that the merger price is not a reliable indicator of fair value does not necessarily result in fair value determinations higher than the merger price.
  - While typically a company might be concerned that reliance on a discounted cash flow valuation based on management projections may result in fair value determinations higher than the merger price, both of the Court of Chancery opinions this year that did not rely on the merger price demonstrate that this is not always true. In both *SWS* and *Sprint*, the Court of Chancery used a discounted cash flow valuation to arrive at a fair value lower than the deal price.
  - These fair value results indicate that methodology is not outcome determinative of fair value. Specifically, if there is evidence that the merger price included significant synergies or that other factors exist to doubt the reliability of the merger price, the court may accept that the fair value of the company is actually below the price paid in the merger.
- Recent cases also suggest that a petitioner's use of a "private equity carve-out" argument is unlikely to be persuasive or successful. Prior to the Delaware Supreme Court's decision in *DFC*, the Court of Chancery in *Petsmart* noted that "while it is true that private equity firms construct their bids with desired returns in mind, it does not follow that a private equity firm's final offer at the end of a robust and competitive auction cannot ultimately be the best indicator of fair value for the company." Then, in *DFC*, the Supreme Court stated that it did "not understand the logic of" the argument. The Supreme Court will soon have another opportunity to address this argument in the *Dell* appeal because one factor that caused the Court of Chancery to conclude that the deal price was not an indicator of fair value was the fact that the transaction was a management buyout.

Continuing Trends in M&A Disclosure Litigation

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> See page 13 for key takeaways

Over the past two years, the deal litigation landscape has changed dramatically. In early 2016, the Delaware Court of Chancery announced a new rule for evaluating disclosure-based settlements in deal litigation — the "plainly material" standard — and expressed a preference for disclosure claims either to be litigated or mooted, rather than settled. *In re Trulia, Inc. Stockholder Litigation*, C.A. No. 10020-CB (Del. Ch. Jan. 22, 2016). *Trulia* created a ripple effect across deal litigation in Delaware and beyond, with some interesting, and perhaps unforeseen, results.[1]

Disclosure-based settlements before the Court of Chancery are all but extinct. Litigation has not subsided in Delaware post-*Trulia* but has taken a different form. Instead of preclosing requests for injunctive relief, stockholder plaintiffs have focused instead on post-closing monetary damages and have increased their use of statutory relief, such as books and records and appraisal actions pursuant to 8 Del. C. §§ 220 and 262, to challenge transactions.

Some state and federal courts outside of Delaware have adopted and applied the reasoning in *Trulia*, but a number of disclosure-based settlements involving companies incorporated under different state laws have found favor in other state courts, with some courts distancing themselves from *Trulia*. Also, since *Trulia*, many stockholder plaintiffs appear to be avoiding filing their disclosure claims as state law breach of fiduciary duty claims, instead filing claims relating to a proposed transaction in federal courts pursuant to federal securities laws in order to avoid forum selection bylaws requiring internal corporate state law claims (such as breach of fiduciary duty claims) to be filed in Delaware, and likely in the hopes of extracting higher mootness fee awards with less scrutiny. This proliferation of securities claims has inspired plaintiffs' attorneys to develop new tactics and craft some novel disclosure claims.

Certain State Courts Approve Disclosure-Based Settlements Over *Trulia*-Based Objections

Since *Trulia*, a number of litigants have pursued disclosure-based settlements in non-Delaware forums, with some involving companies incorporated outside of Delaware, where Delaware law did not apply. Several noteworthy decisions from state courts outside of Delaware have approved disclosure-based settlements, often over the objections of a dissenting stockholder seeking to rely on the *Trulia* decision as a basis for rejecting the settlements. In such cases, courts in other states have applied their own law to address arguments by objecting stockholders, as well as grapple with procedural obstacles, including whether such objectors formally must intervene in order to appeal the approval of a settlement.

For example, in *Gordon v. Verizon Communications, Inc.*, 148 A.D.3d 146 (N.Y. App. 2017), the New York Court of Appeals reversed the New York Supreme Court's rejection of a disclosure-based settlement of litigation challenging Verizon Communications, Inc.'s purchase of Vodafone Group

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[1] 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); Edward B. Micheletti, Jenness E. Parker & Bonnie W. David, "Forward Momentum: *Trulia* Continues to Impact Resolution of Deal Litigation in Delaware and Beyond," Insights: The Delaware Edition (Nov. 17, 2016).

PLC assets at an allegedly excessive price. The Supreme Court, "moved by the 'strong opposition to the proposed settlement voiced by the objectors [who appeared] at the fairness hearing,'" found that the supplemental disclosures "'individually and collectively fail[ed] to materially enhance the shareholders' knowledge about the merger' and that '[t]hey provide[d] no legally cognizable benefit to the shareholder class,'" and declined to approve the settlement.

The Court of Appeals reversed and ordered that the settlement be approved. At the outset, the court noted that "[a]lthough some commentators have opined that recent decisions, including *Trulia* ... may signal the extinction of 'disclosure-only' settlements ... this conclusion may be premature," and "recent commentators have called for courts to take a more balanced approach in evaluating non-monetary class action settlements."

Although Verizon is a Delaware corporation, the court found that New York, rather than Delaware, law applied, because the proposed settlement included a clause stating that it "'shall be governed by and construed in accordance with the laws of the State of New York.'" Applying New York law, the court analyzed the settlement under five factors set forth in *Matter of Colt Industries Shareholders Litigation*, 155 A.D.2d 154 (N.Y. Sup. Ct. 1990) — "the likelihood of success, the extent of support from the parties, the judgement of counsel, the presence of bargaining in good faith, and the nature of the issues of law and fact" — as well as "two additional criteria: whether the proposed settlement is in the best interests of the putative settlement class as a whole, and whether the settlement is in the best interest of the corporation." The court found that the settlement met this "enhanced standard" and remanded the case to the Supreme Court to determine an appropriate award of attorneys' fees.

In *Delman v. Quality Distribution, Inc., et al.*, Case No. 15-ca-005553 (June 21, 2017 Fla. Cir. Ct.), a Florida state court approved a disclosure-based settlement of litigation challenging the sale of Quality Distribution Inc., a Florida company, to certain funds advised by Apax Partners. Fordham School of Law professor Sean J. Griffith objected to the settlement, arguing that, for the reasons explained by the Delaware Court of Chancery in *Trulia*, the settlement should not be approved because "the underlying suit [was] meritless and the results obtained [in the settlement] [were] valueless. ..."

Noting that it was "a question of first impression" whether the reasoning in *Trulia* should apply under Florida law, the court found that it did not, and instead applied a "heightened scrutiny standard" under Florida law to approve the settlement. In doing so, the court observed that "first, the court must guard against a potentially overbroad release, and second, the court must scrutinize the transaction costs, including payments to class representative and fees to class counsel." The court found that the release in the settlement was "narrowly tailored to match the scope of issues litigated in the case, and pose[d] little risk of unintentionally barring any other claims the individual shareholders may have," and further noted that because "Florida courts have such a strong policy favoring resolution of cases by jury trial," "the consequence of simply refusing to approve the settlement would most likely be to require the case to proceed to jury trial over the course of a year or two." Although it approved the settlement, the court deferred its decision on plaintiff's counsel's application for attorneys' fees, instead instructing that a "true adversarial process" was required and suggesting that "[o]ne possible approach would be to retain independent counsel to protect the shareholders' interests. ..."

Following the court's ruling on settlement approval, the objector moved to intervene in the case for the limited purpose of preserving his rights to appeal the order approving the settlement. In his motion, the objector argued that it was an open question under Florida law whether an objector to a class action settlement must, in addition to filing an objection, intervene in order to become a party for purposes of appealing the approval of the settlement. Although arguing that intervention is not necessary under the U.S. Supreme Court case *Devlin v. Scardelletti*, 536 U.S. 1 (2002), the objector sought to intervene as a "belt-and-suspenders measure." The court reserved judgment on the motion to intervene, and the settlement approval is currently on appeal as a partial final judgment.

In *In re Journal Media Group, Inc. Shareholder Litigation*, Case No. 15-CV-9686 (July 24, 2017 Wis. Cir. Ct.), a Wisconsin state court also approved a disclosure-based settlement of litigation challenging Gannett's acquisition of Journal Media Group. In that case, an objector objected to the settlement for reasons similar to those expressed in *Trulia* and also sought to intervene in the case for the limited purpose of preserving his rights on appeal.

The court denied the objector's motion to intervene, both because it was untimely and because the objector failed to identify any "actual claims that he believe[d] that he ha[d] against th[e] merger." Rejecting the objector's argument that the scope of the release in the settlement was overbroad, the court explained that, under Wisconsin law, the objector was required, but failed, to identify the specific claims being released "to give the plaintiffs and the defendants the ability to assess whether or not the claims are legitimate or not ..." The court then approved the settlement as fair, reasonable and adequate, and awarded plaintiffs' counsel $425,000 in attorneys' fees.

Plaintiff Stockholders Still Prefer to Pursue Disclosure Claims in Federal Court

Another (perhaps unintended) consequence of *Trulia* is that many plaintiff stockholders have elected to pursue deal litigation involving Delaware companies under federal law, rather than Delaware law. In these cases, plaintiffs have repackaged claims once brought as state claims for breach of fiduciary duty as Sections 14(a) and 20(a) claims under the federal securities laws in an effort to avoid forum selection bylaws requiring internal corporate state law claims to be filed in Delaware. Notably, the shift away from state law fiduciary duty claims in favor of federal disclosure claims has resulted not in large numbers of disclosure-based settlements in federal court but in a raft of mootness fee applications.

As these types of federal securities disclosure cases proliferate, certain plaintiffs have injected some creativity into the typical mix of deal litigation disclosure claims. For example, one issue du jour is for plaintiff stockholders to request that the operative disclosure document reconcile the financial measures used in the company's projections that do not comply with generally accepted accounting principles (non-GAAP) with financial measures that do comply with them (GAAP). Many companies are opting to moot this claim with supplemental disclosure that provides a reconciliation. However, two recent cases strongly cast doubt on the viability of the claim.

In *Assad v. DigitalGlobe, Inc.*, No. 17-CV-01097-PAB-NYW, 2017 WL 3129700 (D. Colo. July 21, 2017), the U.S. District Court for the District of Colorado rejected a stockholder plaintiff's argument that a registration statement disseminated in connection with a motion to preliminarily enjoin a proposed merger of DigitalGlobe, Inc. and a subsidiary of MacDonald, Dettwiler and Associates Ltd. was materially misleading because it disclosed non-GAAP projections but did not reconcile those figures to GAAP financial metrics. In its ruling, the court rejected the notion that in all circumstances, "financial projections and their underlying financial information are material or must be disclosed." The court also rejected the plaintiff's argument that, as purportedly evidenced in a June 27, 2016, keynote address by Securities and Exchange Commission (SEC) Chair Mary Jo White, the SEC has "'heightened its scrutiny' of unreconciled, non-GAAP projections" by adopting Regulation G, which places certain conditions on the use of non-GAAP financial measures. In rejecting this argument, the Court observed that "such [non-GAAP] measures have been extensively used in financial disclosures even after Regulation G was finalized in 2003." Because the plaintiff could not show that the omission of GAAP measures "would take on actual significance to a shareholder in determining how to vote," and the non-GAAP projections were "recognized and specifically defined such that they ha[d] less potential to be misleading," the court concluded that the plaintiff had failed to show he was likely to succeed in proving that the non-GAAP financial measures were materially misleading.

Along these lines, in *Bushansky v. Remy Int'l, Inc.*, No. 115CV01343TWPTAB, 2017 WL 3530108 (S.D. Ind. Aug. 16, 2017), the U.S. District Court for the Southern District of Indiana declined to approve a disclosure-based settlement of federal securities claims challenging the disclosures disseminated in connection with a merger between Remy International, Inc. and BorgWarner Inc. An objector appeared to object to the settlement, asserting that the supplemental disclosures were not "plainly material" and provided no

real benefit to Remy stockholders. The court agreed with the objector, citing both *In re Walgreen Co. Stockholder Litig.*, 832 F.3d 718 (7th Cir. 2016) and *Trulia*, and concluding that the supplemental disclosures were not plainly material. Among other things, the court found that disclosures reconciling GAAP and non-GAAP financial measures were not material, rejecting the plaintiff's argument that such "reconciliation is important because Regulation G prohibits the use of non-GAAP financial measures, unless they are accompanied by a comparable GAAP accounting measure." Explaining that the projections disclosed in the proxy statement "'were not prepared with a view toward public disclosure [or] the published guidelines of the SEC regarding projections and the use of non-GAAP measures,'" the court found that Regulation G would not apply, and further, that the reconciled GAAP measures were not material information that needed to be disclosed.

More recently, on October 17, 2017, the SEC cast doubt on the viability of this theory. Specifically, the SEC updated its Compliance and Disclosure Interpretations to clarify that financial measures provided to a financial advisor are excluded from the definition of non-GAAP financial measures and therefore not subject to Regulation G, to the extent "the financial measures are included in forecasts provided to the financial advisor for the purpose of rendering an opinion that is materially related to the business combination transaction; and the forecasts are being disclosed in order to comply with Item 1015 of Regulation M-A or requirements under state or foreign law, including case law, regarding disclosure of the financial advisor's analyses or substantive work." "Non-GAAP Financial Measures," SEC.

Key Takeaways

As the above discussion demonstrates, deal litigation has continued to change and adapt to the post-*Trulia* world. The Delaware Court of Chancery has seen a significant drop in preclosing disclosure (or other breach of fiduciary duty) claims, which has resulted in a significant decrease in deal litigation in general. The cases that are being pursued are seeking money damages as opposed to injunctive relief. At the same time, the Court of Chancery has seen a significant increase in books and records and appraisal actions, as stockholder plaintiffs have turned to statutory remedies to seek relief related to transactions post-close. It is clear that there is significantly more preclosing deal litigation activity happening outside of Delaware. While disclosure-based settlements have obtained approval in some state courts outside of Delaware, construing their own state's laws, it appears that deal litigation-based disclosure claims under the federal securities laws have largely replaced state law disclosure claims for breach of fiduciary duty. Whether this trend of filing in the federal courts will continue, and whether new disclosure law theories will develop in those courts as they did for decades under Delaware law, remains to be seen.

Court of Chancery Confirms *MFW* Applies to Controlled-Company Sale With Disparate Consideration

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In 2014, the Delaware Supreme Court affirmed in *Kahn v. M&F Worldwide Corp.*, 88 A.3d 635 (*MFW II*), that the business judgment rule would apply to controlling stockholder "squeeze-out" mergers if the transaction is conditioned *ab initio* on the approval of both an empowered, independent special committee and a fully informed, uncoerced majority-of-the-minority vote. The decision, however, did not address whether the *MFW II* standard would operate to allow the business judgment rule to apply to the sale of a controlled company to an unaffiliated third party where the controller received disparate consideration or other "side deals."

The Delaware Court of Chancery recently addressed this open issue in *In re Martha Stewart Living Omnimedia, Inc. Shareholder Litigation*, C.A. No. 11202-VCS (Del. Ch. Aug. 18, 2017). In that case, the court confirmed, in an alternative holding,[1] that the business judgment standard of review can apply at the pleadings stage to a litigation challenging a controlled-company sale to a third party if the transaction is subject to the protections proscribed in *MFW II*, even when the controller received disparate consideration for its shares.[2] The Court of Chancery analogized the "disparate consideration scenario" to a squeeze-out transaction, stating: "[t]he conflicts inherent in the disparate consideration scenario are no more or less present or worrisome than in the scenario where the controller stands on both sides of the transaction."[3] Thus, it continued, "[t]he need to incentivize fiduciaries to act in the best interests of minority stockholders ... is equally important in one-sided and two-sided conflicted controller transactions," and "[i]n both instances, the key is to ensure that all involved in the transaction, on both sides, appreciate from the outset that the terms of the deal will be negotiated and approved by a special committee free of the controller's influence and that a majority of the minority stockholders will have the final say on whether the deal will go forward."[4] However, the court cautioned that "strict compliance with the transactional road map laid out in [*MFW II*] is required for the controlling stockholder to earn pleadings-stage business judgment deference when it is well-pled that the controller, as seller, engaged in a conflicted transaction by wrongfully diverting to herself merger consideration that otherwise would have been paid to all stockholders."[5]

The Court of Chancery highlighted one important distinction to the *MFW II* opinion — timing. It stated that the threshold date for implementing *MFW II*'s procedural protections derives from "the point where the controlling stockholder actually sits down with an acquirer to negotiate for additional consideration."[6] In *MFW II*, which involved a controlling stockholder squeeze-out merger, the Delaware Supreme Court required the merger to be "conditioned *ab initio*" on the required structural protections.[7] In contrast, the *Martha Stewart* court

[1] In addition to applying *MFW II*, the Court of Chancery held that the controller's alleged "side deals" did not siphon consideration from the minority stockholders; therefore, the controller did not "stand on both sides" of the transaction, and the transaction was not subject to entire fairness review on that basis. *Martha Stewart Living Omnimedia*, Slip op. at 31, 36-38.

[2] Slip op. at 50.

[3] *Id.* at 48.

[4] *Id.*

[5] *Id.*

[6] *Id.* at 52.

[7] *MFW II*, 88 A.3d at 644.

held that, in controlled-company sales to third parties, the protections need not be in place until "the moment the controller and third party begin to negotiate the controller's side deals."[8]

In its opinion, the Court of Chancery acknowledged two pre-*MFW II* cases that arguably foreshadowed this decision.[9] In the first, *In re John Q. Hammons Hotels Inc. Shareholder Litigation*, the court, while finding the requirements not met, held that the business judgment standard of review may apply to a controlled-company sale to a third party that was (1) recommended by a disinterested and independent special committee, and (2) approved by a majority in a nonwaivable vote of all minority shares.[10] The second, S*outheastern Pennsylvania Transportation Authority v. Volgenau*, applied the business judgment standard and granted summary judgment to all defendants in litigation challenging a controlled-company sale to a third party where the controller received disparate consideration because the transaction was subject to the "robust procedural protections" identified in *John Q. Hammons*.[11] However, the *Martha Stewart Living Omnimedia* opinion noted that these pre-*MFW II* cases did not address when the protections needed to be in place and whether the business judgment standard of review could be conferred at the pleadings stage.[12]

Continuing the themes articulated by the Delaware Supreme Court in *MFW II* and *Corwin v. KKR Financial Holdings LLC*, 125 A.3d 304 (Del. 2015), *Martha Stewart Living Omnimedia* extends the body of recent Delaware case law deferring to the decisions made by independent directors and informed stockholders, and incentivizing controlling stockholders and directors to insist on procedural protections that allow the parties to mimic arm's-length bargaining. The decision also provides a road map for transactional attorneys seeking to comply with *MFW II*'s requirements outside of the traditional squeeze-out setting.

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8 *Id.* at 52-53.

9 *Id.* at 45-46.

10 C.A. No. 758-CC, slip op. at 3, 29 (Del. Ch. Oct. 2, 2009).

11 C.A. No. 6354-VCN, slip op. at 2 (Del. Ch. Aug. 5, 2013), *aff'd*, 91 A.3d 562 (Del. 2014) (TABLE).

12 *Martha Stewart Living Omnimedia*, slip op. at 46-47.

Court of Chancery Addresses the Effect of *Corwin* and *Garner* in the Section 220 Context

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> See page 18 for key takeaways

Since its issuance in 2015, the Delaware Supreme Court's decision in *Corwin v. KKR Financial Holdings LLC*[1] has been routinely applied, in appropriate circumstances, to dismiss post-closing deal litigation. However, *Corwin*'s applicability remained untested in certain areas, such as stockholder demands to inspect books and records under 8 Del. C. § 220 relating to transactions to which *Corwin* could arguably apply. Recently, in *Salberg v. Genworth Financial, Inc.*,[2] the Delaware Court of Chancery answered the question of *Corwin*'s applicability in such demands in the context of discussing the *Garner* doctrine, which is based on a 1970 U.S. Court of Appeals for the Fifth Circuit case[3] and permits a stockholder plaintiff to obtain privileged documents in certain circumstances under a showing of good cause.

Garner's Applicability in Section 220 Matters

The *Garner* doctrine is a judicial recognition that when "the corporation is in suit against its stockholders on charges of acting inimically to stockholder interests, protection of those interests as well as those of the corporation and of the public require that the availability of the privilege be subject to the right of the stockholders to show 'good cause' why the privilege should not apply."[4] Although certain Delaware cases over the years[5] have touched on *Garner*, it was not officially adopted by the Delaware Supreme Court until 2014 in *Wal-Mart Stores, Inc. v. Indiana Elec. Workers Pension Trust Fund IBEW*.[6] In *Wal-Mart*, a case affirming the Court of Chancery's decision that Wal-Mart had to produce books and records pursuant to a Section 220 demand, the Delaware Supreme Court held that *Garner* could apply in both plenary actions and Section 220 actions and identified numerous factors that could be established to demonstrate the requisite "good cause" to set aside the attorney-client privilege, including:

[1] 125 A.3d 304 (Del. 2015). *Corwin* dictates that the business judgment presumption will apply to a transaction that was approved by the fully informed, uncoerced vote of a majority of disinterested stockholders. Cases applying *Corwin* to dismiss post-closing stockholder merger litigation include, among others, *In re MeadWestvaco Stockholders Litig.*, C.A. No. 10617-CB (Del. Ch. Aug. 17, 2017); *In re Solera Holdings, Inc. Stockholder Litig.*, C.A. No. 11524-CB (Del. Ch. Jan. 5, 2017); and *In re Merge Healthcare Inc. Stockholders Litig.*, C.A. No. 11388-VCG (Del. Ch. Jan. 30, 2017).

[2] C.A. No. 2017-0018-JRS, 2017 WL 3499807 (Del. Ch. July 27, 2017).

[3] *Garner v. Wolfinbarger*, 430 F.2d 1093 (5th Cir. 1970).

[4] *Salberg*, 2017 WL 3499807, at *4 (quoting *Grimes v. DSC Commcn's Corp.*, 724 A.2d 561, 568 (Del. Ch. 1998).

[5] *See, e.g.*, *Grimes*, 724 A.2d at 568; *Lee v. Engle*, 1995 WL 761222 (Del. Ch. Dec. 15, 1995) ("Although not a binding case, this court adopted and consistently has followed *Garner v. Wolfinbarger* ..."); *In re Information Mgmt. Services, Inc.*, C.A. No. 8168-VCL, 2013 WL 4772670, at *14 (Del. Ch. Sept. 5, 2013) ("[E]quity historically has imposed other limitations on a stockholder plaintiff's ability to obtain corporate documents in a derivative action, even after the stockholder gains standing to sue on behalf of the corporation. For example, a stockholder seeking to penetrate the corporation's privilege had to show good cause under *Garner v. Wolfinbarger*, 430 F.2d 1093 (5th Cir. 1970).)."

[6] 95 A.3d 1264 (Del. 2014).

> 1) the number of shareholders and the percentage of stock they represent; 2) the bona fides of the shareholders; 3) the nature of the shareholders' claim and whether it is obviously colorable; 4) the apparent necessity or desirability of the shareholders having the information and the availability of it from other sources; 5) whether, if the shareholders' claim is of wrongful action by the corporation, it is of action criminal, or illegal but not criminal, or of doubtful legality; 6) whether the communication is of advice concerning the litigation itself; 7) the extent to which the communication is identified versus the extent to which shareholders are blindly fishing; and 8) the risk of revelation of trade secrets or other information in whose confidentiality the corporation has an interest for independent reasons.[7]

Shortly after *Wal-Mart* was decided, the Court of Chancery had an opportunity to apply *Garner* in *In re LuluLemon Athletica Inc. 220 Litigation*. In that case, the court found that the plaintiffs demonstrated good cause to access privileged documents in a Section 220 action. In doing so, the court considered several of *Garner*'s factors, including whether the plaintiffs' claims were obviously colorable; whether the communications were necessary and unavailable from other sources; whether the alleged wrongdoing constituted a criminal act; and whether the communications at issue related to advice concerning the current litigation at issue. In considering the last factor regarding whether the communications related to advice about the pending litigation, the court noted that "[t]his aspect of the analysis is not applied rigidly ... and depends of the specific facts of the case."[8]

Salberg: The Interplay of *Corwin, Garner* and Section 220

Enter *Salberg*. Stockholder plaintiffs had filed derivative claims against Genworth's board, alleging that the directors failed to oversee systemic fraud in connection with the company's insurance lines. After the derivative action was filed, Genworth announced it was being acquired by China Oceanwide — a transaction that, if completed, would eliminate the plaintiffs' standing to pursue their derivative claims. The same stockholders represented by the same counsel as in the derivative action then made a Section 220 demand seeking documents regarding whether the Genworth board considered the value of the derivative claims when evaluating the merger. This Section 220 demand was clearly targeting evidence that would help the stockholders argue that post-merger derivative standing should be preserved under the test discussed in *In re Primedia Inc. Shareholders Litigation*.[9] Genworth produced documents in response to the demand, many of which were redacted on privilege grounds.

The plaintiffs argued that they were entitled to the documents that Genworth withheld or redacted on the basis of privilege under *Garner*. In evaluating whether the plaintiffs had satisfied the *Garner* factors and demonstrated "good cause" to obtain privileged documents, the court emphasized three factors that have "particular significance": 1) the colorability of the claim; 2) the extent to which there is an identified privileged communication versus merely fishing for one; and 3) the necessity or desirability of stockholders having the information and its availability from other sources. The court also reiterated what it recognized in *LuluLemon* — that whether the privileged communication being sought relates to advice concerning the litigation itself is also an important factor in the *Garner* analysis.[10]

In reviewing these factors, the court first held that the plaintiffs had stated a colorable claim, and in doing so, made important statements regarding *Corwin* in the Section 220 context. The defendants argued that any breach of fiduciary duty claims challenging the merger that extinguished the plaintiffs' derivative standing would be dismissed under *Corwin*. However, the court declined to apply *Corwin* when determining whether the plaintiffs had stated a colorable claim, holding that the "colorability"

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[7] *Wal-Mart*, 95 A.3d at 1278-80.

[8] *In re LuluLemon Athletica Inc. 220 Litig.*, C.A. No. 9039-VCP, 2015 WL 1957196, at *13 (Del. Ch. Apr. 30, 2015).

[9] 67 A.3d 455 (Del. Ch. 2013) (discussing situations where a stockholder of an acquired corporation can challenge the fairness of the merger by which their standing to sue was extinguished).

[10] *Salberg*, 2017 WL 3499807, at *5.

of a plaintiff's claim for purposes of *Garner* must be assessed under the applicable Section 220 standard — whether there is a "credible basis" to suspect wrongdoing.[11]

The court then went on to consider the nature of the privileged advice in deciding whether privilege should be waived. While the litigation the privileged communications related to was not the litigation directly before the court — *i.e.*, the Section 220 action — but the pending derivative action, the court refused to take a "talismanic" approach to that *Garner* factor. Rather, the court observed that the plaintiffs and their counsel were the same in both actions, and that they initiated the Section 220 action to get privileged documents they would not have been able to obtain in the derivative action. Thus, the court found that the case did not warrant production of privileged communications under *Garner*. In doing so, the court noted that "[p]laintiffs cannot achieve via Section 220 what they could not achieve via discovery in the Derivative Action."[12]

[11] *Id.* at *5-7 (noting "[t]o be clear, the strength of Plaintiffs' claims in the Derivative Action as measured against Chancery Rule 12(b)(6) or Rule 23.1 standards is not at issue here. The question is whether Plaintiffs have articulated a credible basis from which the Court may infer possible mismanagement or wrongdoing in connection with the Genworth board's evaluation of the derivative claims during the negotiation of the merger.").

[12] *Id.* at *7. However, it is not clear that, had the plaintiffs not been party to a derivative action, the court would have found that *Garner* had been satisfied.

Key Takeaways

The court in *Salberg* appears to have answered in the negative — at least in the *Garner* context — whether *Corwin*'s business judgment presumptions will apply in determining whether claims are colorable for purposes of a Section 220 demand. Rather, it appears that when considering whether a plaintiff has stated a "proper purpose" to warrant inspection, the court will maintain adherence to the "credible basis" standard and not read *Corwin*'s business judgment presumption into Section 220's standards.

However, it remains to be seen whether *Corwin* will be inapplicable in every Section 220 demand under the reasoning of *Salberg*. *Salberg* was not a case where a plaintiff was seeking documents in order to directly challenge a merger transaction; rather, stockholders sought to evaluate whether a merger properly valued their pre-existing derivative claims for purposes of maintaining derivative standing. It is unclear if *Corwin* would even properly apply in such a situation, whether in the Section 220 context or in a plenary action. Thus, it is possible that *Corwin* might still have a place in evaluating whether a stockholder has stated a proper purpose to bring a Section 220 demand for the purpose of asserting a direct fiduciary challenge to a stockholder-approved merger.

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Special thanks to **Stephen F. Arcano** and **Richard J. Grossman**

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