

Key Developments in Delaware Corporation Law in 2017

Contributing Partner

Edward B. Micheletti / Wilmington

Associate

Bonnie W. David / Wilmington

This article is from Skadden's 2018 *Insights*.

This memorandum is provided by Skadden, Arps, Slate, Meagher & Flom LLP and its affiliates for educational and informational purposes only and is not intended and should not be construed as legal advice. This memorandum is considered advertising under applicable state laws.

Four Times Square
New York, NY 10036
212.735.3000

Developments in appraisal law, the application of *Corwin v. KKR Financial Holdings LLC* in post-closing damages actions and the potential expansion of *Kahn v. M&F Worldwide Corporation (MFW)* — a case examining the standard of review in certain controlling stockholder transactions — were all significant in 2017, and likely will continue in the year ahead.

Notable Delaware Supreme Court Decisions on Appraisal Value

Appraisal law continued to be a major focus of the Delaware courts in 2017 and resulted in two significant Delaware Supreme Court decisions that indicate a transaction's merger price may be the best evidence of appraisal value.

First, in *DFC Global Corporation v. Muirfield Value Partners, L.P.*, the Delaware Supreme Court reversed and remanded the Court of Chancery's decision in appraisal proceedings in which it determined fair value by weighting one-third to the deal price, one-third to a discounted cash flow analysis and one-third to a comparable companies analysis. While the Supreme Court declined to create "a presumption that in certain cases involving arm's-length mergers, the price of the transaction giving rise to appraisal rights is the best estimate of fair value," it strongly suggested the deal price was the best indicator of fair value. Ultimately, the Supreme Court reversed because the Court of Chancery's one-third weight afforded to the merger price was not "explained" and thus the Supreme Court could not "discern the basis for this allocation." The court also did not follow the logic behind the Court of Chancery's conclusion that a "deal price resulting in a transaction won by a private equity buyer is not a reliable indicator of fair value."

In *Dell, Inc. v. Magnetar Global Event Driven Master Fund Ltd*, the Supreme Court issued an equally strong, if not stronger, decision emphasizing that, in appropriate circumstances, failing to give due weight to the deal price as the best evidence of appraisal value can result in reversal. The Supreme Court reversed and remanded the Court of Chancery's

exclusive reliance on a discounted cash flow analysis that resulted in an appraisal value 28 percent above the merger price, finding its decision was based on assumptions — including that the deal price was unreliable because the market was inefficient and the transaction was a management-led buyout — not grounded in "relevant, accepted financial principles." Although the Supreme Court reiterated its long-standing view that assigning "some mathematical weight to the deal price" is not required, it found that the deal price "deserved heavy, if not dispositive, weight" in this case. The *Dell* court also emphasized that statutory fair value does not require extraction of the "highest possible bid" or that a company "prove that the sale process is the most reliable evidence of its going concern value in order for the resulting deal price to be granted any weight."

How the Court of Chancery applies the Supreme Court decisions in *DFC* and *Dell* in future appraisal proceedings will be watched closely in 2018.

Standards of Review in Post-Closing Damages Actions

The number of merger cases seeking preliminary injunctive relief in Delaware has declined significantly since the Supreme Court's groundbreaking 2015 decision in *Corwin*, which requires dismissal of post-closing challenges to mergers approved by a fully informed, uncoerced stockholder vote (absent a conflicted controller), and the Court of Chancery's 2016 decision in *In re Trulia, Inc. Stockholder Litigation*, which held that disclosure-based settlements would not be approved unless the supplemental disclosures at issue in the settlement addressed a "plainly material" misrepresentation or

omission. Focus instead shifted to post-closing actions for money damages in a number of cases throughout 2017.

Corwin remains a viable option for defendants facing post-closing deal litigation, and the Delaware courts continue to dismiss challenges in circumstances where *Corwin* applies. For example, in *In re Merge Healthcare Inc. Stockholders Litigation*, the Court of Chancery rejected arguments that the chairman and 26 percent stockholder extracted personal benefits in the transaction and that the disclosures issued in connection with it were insufficient.

However, *Corwin* is not a “cure-all,” and the Delaware courts also have declined to apply *Corwin* where a vote was not fully informed or was coerced. For example, in *In re Saba Software, Inc. Stockholder Litigation*, the Court of Chancery declined based on material omissions in the proxy issued in connection with the transaction. Moreover, the Court of Chancery in *In re Massey Energy Company Derivative and Class Action Litigation* placed some limits on *Corwin*’s reach: Although *Corwin* is intended to avoid “judicial second-guessing” when fully informed, disinterested stockholders have freely determined the economic benefits of a transaction themselves, this policy does not apply where the conduct being challenged occurred well before the merger.

We anticipate further developments involving *Corwin* in 2018. One particular issue is whether enhanced scrutiny in the context of a sale of control under *Revlon*, or with respect to defensive measures under *Unocal*, should apply post-closing, regardless of the ratifying effect of a stockholder vote. In *In re Solera Holdings, Inc. Stockholder Litigation*, Chancellor Andre G. Bouchard dismissed a post-closing claim for money damages, referencing (among other reasons) the Delaware Supreme Court’s reasoning in *Corwin* that enhanced scrutiny was “primarily designed to give stockholders and the Court of Chancery the tool of injunctive relief to address important M&A

decisions in real time, before closing” and was not “designed with post-closing money damages claims in mind” On the other hand, in *In re Paramount Gold and Silver Corp. Stockholders Litigation*, the Court of Chancery, citing the Delaware Supreme Court’s 1995 decision in *In re Santa Fe Pacific Corporation Shareholder Litigation*, considered whether the presence of *Unocal* claims might preclude application of *Corwin*, even in a post-closing action for money damages. It ultimately dismissed the case under *Corwin* because the complaint failed to adequately allege an unreasonable deal protection device. More recently, in *Van Der Fluit v. Yates*, the Court of Chancery applied enhanced scrutiny under *Revlon* in a post-closing damages action after finding that alleged disclosure violations prevented a *Corwin*-based dismissal. It ultimately dismissed breach of fiduciary duty and aiding-and-abetting claims because the plaintiff failed to state any nonexculpated claims against the defendants.

The effect of a *Corwin* defense on a books-and-records request pursuant to Section 220 of the Delaware General Corporation Law also presents an area ripe for further development. For example, in *Lavin v. West Corporation*, the Court of Chancery held that a *Corwin* defense could not impede an otherwise properly supported demand for books and records.

It remains to be seen whether in 2018, the Delaware courts will offer further clarity on whether enhanced scrutiny under *Revlon* or *Unocal* remains a viable post-closing theory in deal litigations seeking money damages, and on *Corwin*’s implications in books-and-records actions.

Application of MFW to Reclassification Transactions

Case law addressing the standard of review in certain controlling stockholder transactions has continued to develop. In *In re Martha Stewart Living Omnimedia, Inc. Stockholder Litigation*, the Court of Chancery dismissed stockholder claims challenging Sequential Brands Group,

Inc.’s acquisition of Martha Stewart Living Omnimedia, Inc., a company controlled by Martha Stewart. The Court of Chancery found that application of the business judgment rule applied even in the context of third-party sales with a conflicted controller because the defendants had complied with the procedural protections outlined in the Delaware Supreme Court’s decision in *MFW*—namely, approval by an independent, disinterested and properly empowered special committee and a nonwaivable, fully informed and uncoerced vote of a majority of the minority stockholders.

In *IRA Trust FBO Bobbie Ahmed v. Crane*, the Court of Chancery applied the framework articulated in *MFW* to dismiss fiduciary duty claims brought in connection with a reclassification of shares of NRG Yield, Inc., a company controlled by NRG Energy, Inc. In that decision, which extended the application of *MFW* beyond a merger transaction, the Court of Chancery acknowledged that the reclassification was a conflicted transaction and thus presumptively subject to entire fairness review. It nevertheless applied the business judgment rule because, consistent with *MFW*, the transaction was approved by a disinterested special committee and a majority of the minority stockholders.

In so concluding, the court explained that there was no principled basis for determining that the *MFW* framework should apply to some transactions involving controlling stockholders but not others. The court added that the overall goal of the *MFW* framework is to provide a way for a controlled company to replicate an arm’s-length bargaining process and that encouraging the use of this approach protects minority stockholders in transactions involving controlling stockholders, regardless of structure.

Further development of *MFW* along these lines is anticipated in 2018, including the extension of *MFW* into transactions other than mergers that involve controlling stockholders.