Skadden

Key Delaware Corporation Law Developments

Contributing Partners

Cliff C. Gardner / Wilmington

Edward B. Micheletti / Wilmington

Associate

Art Bookout / Wilmington

The Delaware courts issued a number of significant decisions in 2018 that are likely to have ripple effects throughout 2019. Among them were a series of cases that further developed the parameters of the *Corwin* and *MFW* doctrines, a case of first impression invalidating a forum selection provision that sought to require Securities Act claims to be brought in federal court, the first-ever Delaware case approving the termination of a merger because of a material adverse effect (MAE), and the finding of "fair value" in an appraisal proceeding based on the unaffected market price of a company's stock.

Corwin's Nuances Grow

The Delaware Supreme Court's 2015 decision in *Corwin v. KKR Financial Holdings LLC* granted a potentially powerful litigation tool to corporate directors and officers — irrebuttable business judgment deference to decisions approved by a majority of disinterested, fully informed and uncoerced stockholders (the so-called *Corwin* doctrine). Among the questions left unanswered was how the Delaware courts would measure whether stockholder approval was "fully informed." The Delaware Supreme Court and Court of Chancery addressed that question in a series of opinions in 2018, holding in several notable instances that disclosures fell short of fully informing stockholders, thereby rendering the *Corwin* doctrine unavailable.

In *Appel v. Berkman*, the Supreme Court reversed a pleading-stage dismissal under the *Corwin* doctrine because a plaintiff adequately pleaded that the stockholders' decision to accept a tender offer was not "fully informed." According to the court, the recommendation statement omitted why the target company's chairman, who also was its founder and largest stockholder, had abstained from supporting merger discussions. The chairman, whom the court described as "a 'key board member' if ever there were one," had been disappointed in the price and the sale process run by management, and he did not think it was the right time to sell the company. Yet the recommendation statement said only that the chairman had abstained from the vote to approve the tender offer and had not yet determined whether to tender his shares. The court opined that "[i]t is inherent in the very idea of a fiduciary relationship that the stockholders that the directors serve are entitled to give weight to their fiduciaries' opinions about important business matters."

Similarly, in *Morrison v. Berry*, the Supreme Court reversed the Court of Chancery's dismissal under *Corwin* based on "'partial and elliptical disclosures' [that] do not satisfy *Corwin*." The action arose from the acquisition of The Fresh Market (TFM) by an entity owned by Apollo Management, L.P. through a two-step tender offer and merger. In its ruling, the court held that the proxy misrepresented the agreement allegedly reached between Apollo and TFM's founder and his son, as well as the founder's alleged preference to only deal with Apollo and his threat to sell his shares.

In *In re Tangoe, Inc. Stockholders Litigation*, the Court of Chancery denied a motion to dismiss under *Corwin* because the target company, which had been in the midst of a "regulatory storm" for some time, had failed to disclose when

This article is from Skadden's *2019 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

long-awaited audited financial statements and financial restatements would become available. The court noted that the company had been providing only "sporadic and qualified" financial information to its stockholders, had failed to file multiple Form 10 documents with the Securities and Exchange Commission, and had not provided stockholders with a quality of earnings report it had commissioned. The court also held that information about the restatement process was material "because the delisting depressed the amount potential acquirers were willing to pay for Tangoe and stockholders needed to understand whether the delisting was likely to continue or whether the Company had a legitimate prospect of completing the Restatement and regaining its listed status with NASDAQ."

These cases illustrate how full and complete disclosure in connection with a fundamental transaction can be highly case-specific, how *Corwin* can be defeated at the pleadings stage without any finding that the underlying alleged facts are actually true, and that the court will carefully review the challenged disclosures to determine whether a shortcoming exists that will prevent application of the *Corwin* doctrine. In 2019, we will be watching for further developments in Delaware disclosure law as it applies to this doctrine.

Clarification of *Ab Initio* Under *MFW*

In the 2014 case *Kahn v. M & F Worldwide Corp.* (*MFW*), the Delaware Supreme Court held that the business judgment rule could apply to so-called "squeeze out" mergers, in which a controlling stockholder uses an entity it controls to cash out or otherwise eliminate the minority stockholders in another entity it controls. Prior to *MFW*, this type of transaction would be subject to Delaware's most stringent "entire fairness" standard. Under the *MFW* doctrine, however, the business judgment rule will instead apply if, broadly speaking, the transaction (1) was approved by a well-functioning, independent special committee of directors and (2) received approval from a fully informed, uncoerced majority of the minority shares. Critically, these two procedural protections must be irrevocably put in place *ab initio*, or "from the beginning."

In *Flood v. Synutra International, Inc.*, the Supreme Court clarified that, for purposes of *MFW*, "from the beginning" means "before the start of substantive economic negotiations." This line of demarcation serves "to have both the controller and the Special Committee bargain under the pressures exerted on both of them by these [procedural] protections." Thus, "so long as the controller conditions its offer on the key protections at the germination stage of the Special Committee process, when it is selecting its advisors, establishing its method of proceeding, beginning its due diligence, and has not commenced substantive economic negotiations with the controller, the purpose of the pre-condition requirement of *MFW* is satisfied." We anticipate that 2019 will further illuminate when "substantive economic negotiations" begin — a topic of spirited debate among the academic community and Delaware law practitioners.

Securities Act Claims Cannot Be Governed by Forum Selection Provisions

In a seminal 2013 decision, *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*, the Court of Chancery upheld the validity of a provision in Chevron's bylaws requiring "internal corporate claims" — *i.e.*, those claims subject to the internal affairs doctrine, such as claims for breach of fiduciary duty — to be litigated in Delaware courts. This decision was subsequently codified at 8 Del. C. § 115, which expressly allows forum selection provisions to be included in the certificate of incorporation or the bylaws of a Delaware corporation. In the years since, corporations, practitioners, scholars and the media all questioned how far the forum selection provision could extend. In December 2018, the Court of Chancery provided an answer.

In *Sciabacucchi v. Salzberg*, the Court of Chancery invalidated a forum selection provision that required any claims under the Securities Act of 1933 to be brought in federal court. Earlier in 2018, the U.S. Supreme Court confirmed in *Cyan, Inc. v. Beaver County Employees Retirement Fund* that state courts have concurrent jurisdiction with federal courts over Securities Act claims. Relying on the *Cyan* decision as well as language in *Boilermakers* emphasizing the limited scope of a forum selection provision for a Delaware company, the Court of Chancery invalidated the provision because federal law, not Delaware law, created the Securities Act claim. The court stated that the "state of incorporation cannot use corporate law to regulate the corporation's external relationships" and that a forum selection provision in a company's certificate of incorporation or bylaws cannot govern Securities Act claims "because the provision would not be addressing 'the rights and powers of the plaintiff-stockholder as a *stockholder*.'" (For more, see our December 21, 2018, client alert "Delaware Court of Chancery Invalidates Forum Selection Provisions Regulating Claims Under the Securities Act of 1933.")

The *Sciabacucchi* decision is likely to be appealed, and the outcome of that appeal will be closely watched for its potential implications for future forum selection cases.

Delaware Allows First-Ever Termination of a Merger Because of an MAE

Delaware's first judicial finding of an MAE in a merger transaction, *Akorn, Inc. v. Fresenius Kabi AG*, went from filing to affirmance on appeal in less than eight months. The case began in April 2018, when Akorn filed its complaint seeking a declaratory judgment that Fresenius could not terminate the parties' merger agreement. The Court of Chancery held that Fresenius, the acquirer, could validly terminate the merger agreement with Akorn, the seller, because of the presence of two separate and independent MAEs. First, it found that Akorn's business "fell off a cliff" right after the merger agreement was approved by stockholders, and that this decline continued for a "durationally significant" period of time (five quarters), showed "no sign of abating" and could not be attributed to general industry decline or other MAE exceptions in the merger agreement.

The court also found "overwhelming evidence of widespread regulatory violations and pervasive compliance problems at Akorn" in violation of various covenants in the merger agreement. When evaluating whether the regulatory violations and compliance problems here "would reasonably be expected to result in an MAE," the court stated that it "must consider [the] 'quantitative and qualitative aspects.'" It then proceeded to find the violations both qualitatively and quantitatively material, finding for the latter that the violations would require approximately $900 million to remediate, equating to roughly 21 percent of the total equity value implied by the merger agreement. The court concluded that a remediation cost of 20 percent of the total equity value "would reasonably be expected to result in an MAE." The court made clear that the facts presented did not produce a picture of a buyer simply experiencing buyer's remorse, concluding that the buyer acted properly and in response to serious issues at Akorn. (For more, see our October 19, 2018, client alert "Analyzing *Akorn*: Delaware's First M&A Termination Under Material Adverse Effect.")

In December 2018, the Delaware Supreme Court affirmed the Court of Chancery's judgment because it found that the "record adequately supports" the Court of Chancery's findings on both MAE points. (For more, see our December 21, 2018, client alert "Delaware Supreme Court Affirms *Akorn*.") Whether *Akorn* establishes any "thresholds" buyers must clear in order to prove an MAE or merely provides data points on an evolving landscape remains to be seen.

The *Aruba* Appeal

Appraisal law has been a significant focus of the Delaware courts over the past several years. In 2019, the Delaware Supreme Court is poised to issue a ruling in the appeal *Verition Partners Master Fund Ltd. v. Aruba Networks, Inc.*, an appraisal action where the Court of Chancery held after trial that Aruba Networks' most recent 30-day average unaffected market price was the best evidence of "fair value," even though that price was more than 30 percent below the merger price. The court reasoned that its use of unaffected market price was consistent with other recent noteworthy Delaware Supreme Court appraisal decisions — such as *DFC* and *Dell* — where the driving valuation argument was that the merger price (as opposed to an expert-driven valuation analysis) was the best evidence of appraisal value.

Companies, practitioners, scholars and the media are closely watching the case, and the Supreme Court's decision is one of the most highly anticipated Delaware opinions of 2019.

Click here for a full list of Delaware-related litigation articles authored by Skadden attorneys in the last year.