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Skadden Discusses Delaware Trends Affecting M&A and Corporate Litigation

By Edward Micheletti, Jenness Parker and Sarah Runnells Martin March 6, 2019

Comment

On February 20, 2019, Skadden held a webinar focused on a number of important developments in Delaware corporate law in 2018 and how such developments might affect M&A litigation in 2019. Specifically, the discussion focused on (i) the increasing importance of books and records demands and litigation under 8 Del. C. § 220, (ii) current trends in the stockholder ratification doctrines of Corwin[1] and MFW,[2] (iii) recent trends in appraisal litigation and (iv) a recent decision regarding forum selection clauses.

Below are high-level takeaways on each topic.

Books and Records Demands

Books and records demands are increasingly being used in the M&A litigation context, pre-closing, to seek information to bolster post-closing damages complaints and defeat Corwin defenses.

Given "the reality of today's world,"[3] courts have indicated that as part of a Section 220 demand, they may grant access to some limited amount of electronic records (including, but not limited to, emails), particularly when key discussions or determinations occur in an electronic format and are not formally documented in minutes or other board materials.

Keeping accurate formal corporate records remains important, and may defeat a request to inspect emails or other personal communications, such as text messages.

Corwin

While Corwin remains a very powerful defense tool, the trend (particularly in 2018) has been close judicial scrutiny regarding the adequacy of disclosures when a Corwin defense is raised. In the Court of Chancery, only one Corwin dismissal was successful in 2018, and the court found Corwin inappropriate in six other cases, in sharp contrast to prior years. Both times the Delaware Supreme Court addressed Corwin dismissals in 2018, the court reversed and remanded the cases after finding inadequate disclosures.

Because pre-closing injunctions challenging proxy disclosures are now rare, the burden to comply with disclosure obligations (and to ensure a defensible disclosure has issued to stockholders) has to be self-imposed before a stockholder vote, to best position a Corwin defense in post-closing litigation.

Delaware courts will assess disclosures when addressing a motion to dismiss under Corwin by placing documents produced pursuant to Section 220 side by side with the challenged disclosures, and analyzing whether the disclosures were "partial" or "elliptical" in nature, or otherwise misleading.

As the Delaware Supreme Court stated in Morrison v. Berry,[4] in rejecting a Corwin defense for discrepancies between disclosures and documents produced in a Section 220 action, such a scenario "offers a cautionary reminder to directors and the attorneys who help them craft their disclosures: 'partial and elliptical disclosures' cannot facilitate protection of the business judgment rule under the Corwin doctrine."[5]

MFW

MFW remains an important doctrine for transactions involving controlling stockholders that ordinarily invoke the entire fairness standard of review. When the MFW doctrine applies, the applicable standard of review is ratcheted down from entire fairness to the much more favorable business judgment standard of review.

Best practices still dictate that a controller's first communication contain the MFW "dual protections" — namely, that any merger be conditioned on both the (i) negotiation and approval by an independent, special committee with real bargaining power (the ability to say "no"), and (ii) a non-waivable majority of the minority stockholder vote.

However, MFW's dual protections may be established after initial discussions have occurred, as long as a potential transaction is expressly conditioned on the dual protections before economic negotiations begin.

Third-party transactions where the controlling stockholder receives a material benefit that is not shared with the minority may receive business judgment rule review if the dual protections are in place before the controller begins negotiating with the third party.

Appraisal

The 2017 Delaware Supreme Court opinions in DFC Global[6] and Dell, Inc.[7] heavily influenced Court of Chancery appraisal decisions in 2018.

Where a company is found to have a good sales process, Delaware courts will continue to consider a deal price (or deal price minus synergies) as a reliable (or most reliable) indicia of appraisal value.

In 2018, this resulted in all four appraisal decisions being at near or below the deal price (ranging from 2.5 percent above the deal price to 31 percent below the deal price).

As a result of these developments, we anticipate the number of appraisal actions to decrease from the higher levels of prior years. In addition, given the challenging climate for appraisal petitioners, it is also possible some currently pending appraisal actions where discovery has been obtained could "pivot" and abandon an appraisal action in favor of a plenary fiduciary duty action using the broad appraisal discovery to plead around a Corwin defense.

Respondent corporations can expect greater discovery into their deal process where they assert that deal price is the best indicia of fair value.

Practitioners are closely watching the Aruba appeal for further guidance regarding when market or trading price is an appropriate indicia of fair value.

Forum Selection Provisions

The Delaware Court of Chancery ruled in Sciabacucchi v. Salzberg[8] that Delaware corporations cannot regulate claims brought under the 1933 Act through forum selection bylaws or charter provisions because such claims do not relate to a corporation's "internal affairs" but relate instead to "external relationships."[9]

The court left open whether the same rationale would apply to 1934 Act claims.

In combination with the U.S. Supreme Court's Cyan decision,[10] this means that federal securities cases will continue to be brought in both federal and state courts.

Despite this ruling,[11] forum selection charter and bylaw provisions remain the most effective tool for requiring stockholders to file claims involving the internal affairs of a Delaware corporation (such as state law breach of fiduciary duty claims) in an exclusive (Delaware) forum.

ENDNOTES

1 Corwin v. KKR Fin. Holdings LLC, 125 A.3d 304 (Del. 2015).

2 Kahn v. M & F Worldwide Corp., 88 A.3d 635 (Del. 2014).

3 Schnatter v. Papa John's Int'l, Inc., 2019 WL 194634, at *16 (Del. Ch. Jan. 15, 2019); see also KT4 Partners LLC v. Palantir Techs. Inc., 2019 WL 347934, at *10 n.76 (Del. Jan. 29, 2019) (quoting Schnatter, 2019 WL 194634, at *16).

4 191 A.3d 268 (Del. 2018), as revised (July 27, 2018).

5 Id. at 272 (citation omitted).

6 DFC Glob. Corp. v. Muirfield Value Partners, L.P., 172 A.3d 346 (Del. 2017).

7 Dell, Inc. v. Magnetar Glob. Event Driven Master Fund Ltd, 177 A.3d 1 (Del. 2017).

8 2018 WL 6719718 (Del. Ch. Dec. 19, 2018).

9 Id. at *22.

10 Cyan, Inc. v. Beaver Cty. Emps. Ret. Fund, 138 S. Ct. 1061 (2018).

11 This ruling will likely be appealed. Defendants already attempted to appeal the ruling, but the appeal was refused by the Delaware Supreme Court as interlocutory since the Court of Chancery had not yet resolved plaintiff's request for legal fees. Salzberg v. Sciabacucchi, 2019 WL 549039 (Del. Feb. 12, 2019).

This post comes to us from Skadden, Arps, Slate, Meagher & Flom LLP. It is based on the firm's memorandum, "Delaware Corporation Law: Trends Impacting M&A and Corporate Litigation in 2019," dated February 28, 2019, and available here.