Insights: The Delaware Edition

Skadden

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If you have any questions regarding the matters discussed in this memorandum, please contact the attorneys listed on the last page or call your regular Skadden contact.

This issue focuses on important, developing areas of Delaware corporation law and deal litigation, including recent trends involving the *Corwin* doctrine, the Delaware Supreme Court's decision reaffirming its view that deal price is a strong indicator of fair value and a court ruling that forum-selection provisions requiring that Securities Act claims be brought in federal courts are invalid under state law.

Examining *Corwin*: Latest Trends and Results

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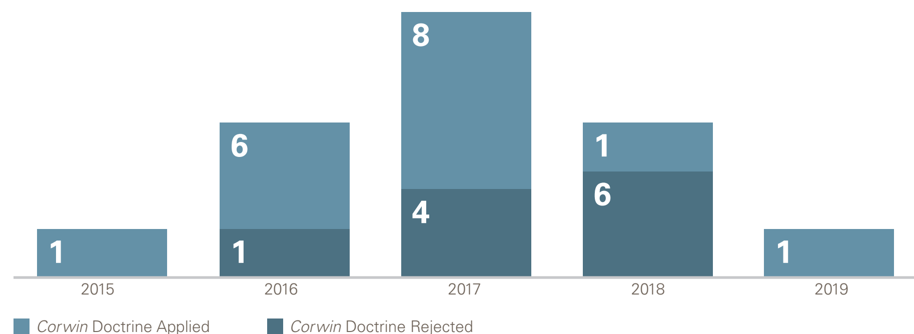
The Delaware Supreme Court's 2015 decision in *Corwin v. KKR Financial Holdings LLC*[1] fashioned a powerful defense in post-closing money damages cases for boards of directors by finding that business judgment deference applies where the challenged decision was approved by a majority of disinterested, fully informed and uncoerced stockholders, so long as there is no conflicted controlling stockholder present (the *Corwin* doctrine). The *Corwin* doctrine, in conjunction with other Delaware law developments during the same time period that made pre-closing injunctions in change of control transactions more difficult to secure (*C&J Energy Services, Inc. v. City of Miami General Employees' & Sanitation Employees' Retirement Trust*),[2] and raised the bar for disclosure settlements (*In re Trulia, Inc. Stockholder Litigation*),[3] was thought by some commentators to have swung the pendulum in defendants' favor. As the chart below demonstrates, the *Corwin* doctrine enjoyed a strong start resulting in many dismissals. That trend, however, reversed course in 2018.

Corwin Doctrine's Application by the Court of Chancery



[1] 125 A.3d 304 (Del. 2015).

[2] *See C & J Energy Servs., Inc. v. City of Miami General Emps.' & Sanitation Emps.' Ret. Trust*, 107 A.3d 1049 (Del. 2014).

[3] *See In re Trulia, Inc. Stockholder Litig.*, 129 A.3d 884 (Del. Ch. 2016).

Corwin Trends

The rise in cases where the Court of Chancery declined to apply the *Corwin* doctrine begs the question, why the change in fortune? The *Corwin* doctrine was applied only *once* by the Court of Chancery in 2018 to dismiss an action, and the court declined to apply the doctrine in six other cases. Four of the six decisions declining to invoke the doctrine found the disclosures issued in connection with the transaction insufficient for *Corwin* to apply.[4] The two remaining Court of Chancery decisions declining to invoke the doctrine in 2018 did so based on the pleading-stage presence of an alleged conflicted-controlling stockholder.[5] While each decision declining to invoke the *Corwin* doctrine turns on the unique facts presented, one potential reason for the changed dynamic in 2018 is that the plaintiffs' bar has recalibrated its approach and found increasing success by using documents obtained pursuant to Section 220 demands (or appraisal litigation or other discovery mechanisms) to defeat the application of the doctrine based on alleged inadequate disclosures (which have been the predominate basis for Delaware courts finding the doctrine inapplicable). Given the lack of meaningful pre-closing injunction risk to force corrective disclosures, boards and their advisors face a self-imposed burden to assess whether the disclosures issued will allow the *Corwin* doctrine to apply.

Analysis of Recent Decisions

A number of decisions in 2018 relied on Section 220 documents (such as board minutes or emails) obtained prior to the plenary action, and such documents played a role — or as the Supreme Court described in one case a "crucial" role — in avoiding dismissal under the *Corwin* doctrine. This seemingly was spurred on by a December 2017 decision, which contemplated the use of Section 220 to obtain company books and records to craft pleadings to defeat the *Corwin* doctrine at the pleading stage.[6]

Most interesting in 2018 are the two Delaware Supreme Court decisions regarding the *Corwin* doctrine. Previously, all appeals of dismissals pursuant to the doctrine resulted in short affirmances. However, in 2018 both *Corwin* doctrine appeals resulted in reversals by the Delaware Supreme Court for inadequate disclosures.

The Supreme Court's decision in *Morrison v. Berry*[7] provides a potential roadmap for plaintiffs to attack the application of the *Corwin* doctrine based on disclosure issues. In *Morrison*, the plaintiff successfully used a "crucial" email produced in Section 220 litigation to raise a material disclosure claim. In reviewing the "crucial" email, the Delaware Supreme Court placed side-by-side in a chart the email and the relevant portion of the disclosure document and concluded the email demonstrated that the disclosure document contained a "material omission" regarding the company founder's agreement to roll over his equity interest. In reversing the Court of Chancery's dismissal under the *Corwin* doctrine, the Supreme Court emphasized the case "offers a cautionary reminder *to directors and the attorneys* who help them craft their disclosures: 'partial and elliptical disclosures' cannot facilitate the protection of the business judgment rule under the *Corwin* doctrine."[8] The case is now moving forward in the Court of Chancery.

Similarly, in *Appel v. Berkman*,[9] the Supreme Court reversed a dismissal under the *Corwin* doctrine because plaintiffs adequately pleaded that the stockholders' decision to accept a tender offer was not fully informed. Critical to this finding were board minutes

[4] *In re Xura, Inc., Stockholder Litig.*, 2018 WL 6498677 (Del. Ch. Dec. 10, 2018); *In re Tangoe, Inc. Stockholders Litig.*, 2018 WL 6074435 (Del. Ch. Nov. 20, 2018); *In re PLX Tech. Inc., Stockholders Litig.*, 2018 WL 747180 (Del. Ch. Feb. 6, 2018) (Order); *Kenneth Riche v. James C. Pappas, et al.*, C.A. No. 2018-0177-JTL (Del. Ch. Oct. 2, 2018) (TRANSCRIPT).

[5] *In re Hansen Med., Inc. Stockholders Litig.*, 2018 WL 3025525 (Del. Ch. June 18, 2018); *In re Tesla Motors, Inc. Stockholder Litig.*, 2018 WL 1560293 (Del. Ch. Mar. 28, 2018).

[6] *See Lavin v. West Corp.*, 2017 WL 6728702, at *9-10, 14 (Del. Ch. Dec. 29, 2017).

[7] 191 A.3d 268 (Del. 2018), *as revised* (July 27, 2018).

[8] *Id.* at 272 (emphasis added).

[9] 180 A.3d 1055 (Del. 2018).

produced pursuant to Section 220. The disclosure document omitted why the target company's chairman, founder and largest stockholder, whom the court described as "a 'key board member' if ever there were one," had abstained from supporting the merger. According to board minutes obtained pursuant to Section 220, this key board member abstained because he was disappointed with the price and management "for not having run the business in a manner that would command a higher price," and he did not think it was the right time to sell the company. Yet the disclosure document simply said that the chairman had abstained from the vote to approve the tender offer and had not yet determined whether to tender his shares, omitting his reasoning. The Supreme Court held that the failure to disclose the key board member's reason for abstaining, under the circumstances present in the case (including partial disclosures regarding the sale), rendered the disclosures issued "materially misleading."

In contrast, the two most recent *Corwin* dismissals do not appear to have involved books and records secured via Section 220. In *English v. Narang*,[10] the only case so far in 2019 to address *Corwin*, the Court of Chancery applied the *Corwin* doctrine and dismissed a stockholder challenge. Plaintiffs in *English* sought to avoid dismissal by arguing, among other things, that the disclosures issued in connection with the transaction were inadequate. In rejecting this argument, the court addressed various disclosure challenges regarding financial projections, post-closing employment arrangements and alleged financial advisor conflicts and relied heavily on the contents of the disclosure documents themselves to conclude that each alleged deficiency failed as a matter of law. For example, with respect to the alleged financial advisor conflicts, the court rejected the disclosure challenge because (1) the fees earned, (2) the contingency portion of the fees and (3) the past work performed by the financial advisors were fully disclosed. The *English* decision is currently on appeal. Similarly, in *In re Rouse Properties, Inc.*,[11] the only 2018 decision applying the *Corwin* doctrine to dismiss an action, the court rejected various disclosure challenges relying heavily on, among other things, the proxy statement's summary of the work the financial advisor performed, its potential conflicts and the projections it relied upon and rejected requests for greater "particulate detail."

Based on these rulings, one observation for the shift in results under the *Corwin* doctrine is the increased use of documents plaintiffs secure pursuant to Section 220 to plead disclosure claims. These cases show that accurate disclosure in connection with fundamental transactions is critical for deal planners and practitioners to secure the protections of the *Corwin* doctrine. The application of the *Corwin* doctrine can be defeated at the pleading stage through the use of documents obtained via Section 220 prior to a motion to dismiss, where such documents raise a material omission or create a material conflict with the disclosures issued in the transaction. Delaware courts will carefully review the challenged disclosures to determine whether a deficiency exists preventing the application of the *Corwin* doctrine, and directors and their counsel documenting the transaction must use care in ensuring that disclosures issued are consistent with corporate documents and communications. Given the lack of meaningful pre-vote injunction litigation after *C&J Energy* and *Trulia*, and now the Section 220 tactic plaintiffs have used to gain traction, companies, their boards and their advisors need to scrutinize disclosures closely for completeness and accuracy.

[10] 2019 WL 1300855 (Del. Ch. Mar. 20, 2019).

[11] 2018 WL 1226015 (Del. Ch. Mar. 9, 2018).

Takeaways

- While *Corwin* remains a potentially powerful defense tool, the trend has been close judicial examination regarding the adequacy of disclosures when the *Corwin* doctrine is raised as a defense.
  - Only one Court of Chancery decision in 2018 invoked the *Corwin* doctrine to dismiss an action, and the *Corwin* doctrine was found not to apply in the six remaining cases where raised by defendants.
  - In both cases where the Delaware Supreme Court addressed dismissals under the *Corwin* doctrine in 2018, the court reversed and remanded the cases after finding inadequate disclosures.
- To best position a *Corwin* doctrine argument in post-closing litigation, companies, their boards and their advisors must pay attention to disclosure obligations before a stockholder vote because pre-closing challenges to disclosures seeking preliminary injunctive relief are now rare.
- Boards of directors should use particular care and consult with their legal counsel to ensure that material disclosures issued in connection with a transaction are supported by (and do not conflict with or omit material information from) contemporaneous corporate records.
- As the Delaware Supreme Court stated in *Morrison*, circumstances where disclosures conflict with or omit material information from contemporaneous corporate documents and communications offer "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."

Supreme Court Reinforces Deal Price Minus Synergies as 'Strong Indicator' of Fair Value

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> See page 7 for takeaways

The Delaware Supreme Court recently issued its highly anticipated decision in the *Verition Partners Master Fund Ltd. v. Aruba Networks, Inc.* appraisal action.[1] In a *per curiam* opinion, the Supreme Court reversed the Delaware Court of Chancery's determination that the fair value of Aruba Networks, Inc. (Aruba) was the company's 30-day average unaffected market price prior to announcement of its acquisition by Hewlett-Packard Company (HP) and directed the trial court to enter a final judgment for petitioners for the deal price minus synergies estimated by HP.

The opinion reinforces the Supreme Court's 2017 decisions in *Dell, Inc. v. Magnetar Global Event Driven Master Fund Ltd.*[2] and *DFC Global Corp. v. Muirfield Value Partners, L.P.*,[3] which, as the Supreme Court in Aruba explained, recognized that "when a public company with a deep trading market is sold at a substantial premium to the preannouncement price, after a process in which interested buyers all had a fair and viable opportunity to bid, the deal price is a strong indicator of fair value, as a matter of economic reality and theory."[4]

Background

In August 2014, HP approached Aruba, a public company, about a potential combination. Aruba hired professionals and began to shop the company. But no other strategic bidder was interested, and petitioners did not argue that any equity bidder could compete. After several months of negotiations, the Aruba board accepted HP's offer of $24.67 per share. News of the deal leaked two weeks later, causing Aruba's stock price to jump from $18.37 to $22.24. The next day, Aruba released quarterly results that beat analyst expectations. Its stock price rose by 9.7%, to just above the deal price.

Trial Court Decision

Citing the Delaware Supreme Court's decisions in *Dell* and *DFC*, the Court of Chancery determined that the fair value of Aruba was $17.13, the 30-day average unaffected market price, on the theory that "once Delaware law has embraced a traditional formulation of the efficient capital markets hypothesis," the unaffected market price provides a "direct route" to fair value for a company with certain attributes.[5] The trial court found that the deal price minus synergies was a "ceiling" on fair value, but declined to adopt this measure as fair value because it would need to back out theoretical reduced agency costs from the deal price, which, in the trial court's view, was subject to human error.[6]

[1] No. 368, 2018, slip op. (Del. Apr. 16, 2019) (*per curiam*) (*Aruba II*).

[2] 177 A.3d 1 (Del. 2017).

[3] 172 A.3d 346 (Del. 2017).

[4] No. 368, 2018, slip op. at 13.

[5] *Verition Partners Master Fund Ltd. v. Aruba Networks, Inc.*, C.A. No. 11448-VCL, slip op. at 6 (Del. Ch. Feb. 15, 2018).

[6] *Id.* at 87; *Aruba II*, No. 368, 2018, slip op. at 7.

Supreme Court Reversal

The Delaware Supreme Court reversed the Court of Chancery's decision, forcefully rejecting its sole reliance on the 30-day unaffected market price and deciding that the "price that HP paid could be seen as reflecting a better assessment of Aruba's going-concern value."[7]

Specifically, the Supreme Court rejected the trial court's view that *Dell* and *DFC* "compelled" reliance on the unaffected market price as the sole indicia of fair value because that view was not supported by "any reasonable reading of those decisions or grounded in any direct citation to them."[8] The court also observed that "the unaffected market price was a measurement from three to four months prior to the valuation date, a time period during which it is possible for new, material information relevant to a company's future earnings to emerge."[9] That was the situation in *Aruba*, where HP knew about Aruba's strong quarterly earnings before they were disclosed to the market. Procedurally, the Supreme Court also criticized Aruba for failing to argue market price as fair value until well after trial. Therefore, the court determined, "the extent to which the market price approximated fair value was never subjected to the crucible of pretrial discovery, expert depositions, cross-expert rebuttal, expert testimony at trial, and cross examination at trial."[10]

However, aside from those issues, consistent with *Dell* and *DFC*, the court reaffirmed the "traditional Delaware view" that "the price a stock trades at in an efficient market is an important indicator of its economic value that should be given weight."[11] The Supreme Court explained that "*DFC* and *Dell* recognized that when a public company with a deep trading market is sold at a substantial premium to the preannouncement price, after a process in which interested buyers all had a fair and viable opportunity to bid, the deal price is a strong indicator of fair value, as a matter of economic reality and theory."[12] The court also emphasized the "long history of giving important weight to market-tested deal prices" in Delaware law.[13]

The Supreme Court then noted that the trial court itself concluded that the transaction involved "enormous synergies" and that the deal price operated as a ceiling.[14] But the Supreme Court rejected the trial court's "theory that it needed to make an additional deduction from the deal price for unspecified 'reduced agency costs'" as unsupported by the record or corporate finance literature.[15] The Supreme Court explained that "the Court of Chancery's belief that it had to deduct for agency costs ignores the reality that HP's synergies case likely already priced any agency cost reductions it may have expected," and indeed, the "record provides no reason to believe that those estimates omitted any other added value HP thought it could achieve because of the combination."[16]

To avoid "burden[ing] the parties with further proceedings," the Supreme Court simply "order[ed] that a final judgment be entered for the petitioners in the amount of $19.10" — Aruba's estimation of deal price less synergies — "plus any interest to which the petitioners are entitled."[17]

[7] *Aruba II*, No. 368, 2018, slip op. at 19.

[8] *Id.* at 13.

[9] *Id.* at 19.

[10] *Id.* at 21-22.

[11] *Id.* at 18.

[12] *Id.* at 13.

[13] *Id.*

[14] *Id.* at 25.

[15] *Id.* at 9.

[16] *Id.* at 11.

[17] *Id.* at 26.

Takeaways

- *Aruba* reaffirmed the Supreme Court's view that the deal price is a strong indicator of fair value when a public company has a deep trading market and was sold at a substantial premium in a process in which all interested buyers had a fair and viable opportunity to bid.
- Where a merger agreement allows for superior bids, a lack of other buyers does not signal a market failure.
- A court may potentially consider a strategic acquirer's calculation of synergies as the synergies estimate.
- While the unaffected market price of a company's stock in an efficient market may not result in the most reliable indicia of fair value, it remains "an important indicator of ... economic value that should be given weight."
- To ensure that any proposed valuation is considered by the court, litigants must advocate for and present evidence at trial in support of any valuation metric relied upon to prove fair value.

Supreme Court Provides Further Guidance on Demands to Inspect Electronic Communications

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> See page 11 for takeaways

Recently, Delaware corporations faced with demands for books and records under *8 Del. C.* § 220 have increasingly been forced to contend with demands for electronic communications, such as emails. Historically, the Delaware courts have mostly limited stockholder access to formal board-level documents, such as meeting minutes, board presentations and resolutions. The courts rarely required corporations to produce email. Electronic information was believed to be more in the nature of civil discovery, which is beyond the scope of a Section 220 request.

While electronic discovery is still rare in books and records cases, some recent decisions have required corporations to produce electronic information in addition to more traditional corporate books and records. In particular, courts have expanded the reach of Section 220 into electronic information when key decisions are made over email and are not formally documented in minutes or other board materials. This culminated in the Delaware Supreme Court's recent opinion in *KT4 Partners LLC v. Palantir Technologies Inc.*,[1] which suggests the importance of formality in record keeping as a defense to attempts by plaintiff stockholders to inspect emails and other electronic communications.

Background

Section 220 governs the "inspection of books and records" of Delaware corporations by stockholders and directors. The legal framework under Section 220 is settled: Stockholders of a Delaware corporation have a qualified right to inspect its books and records. Unlike directors, who have a "virtually unfettered" right to inspect books and records, stockholders may inspect books and records only if they show by a preponderance of the evidence that they have a "proper purpose." The courts have recognized that investigating wrongdoing or mismanagement is a proper purpose. If a stockholder seeks to investigate wrongdoing, it must present a "credible basis" from which the court can infer that wrongdoing may have occurred. If a stockholder satisfies this burden, the court will then allow the stockholder to inspect only the documents that are "essential and sufficient" to satisfy its stated purpose.

The Court of Chancery has stated that "books and records of the corporation" means "those [documents] that affect the corporation's rights, duties, and obligations."[2] The court has also explained that Section 220 demands are not the equivalent of civil discovery but instead are "a limited form of document production narrowly tailored to the express purposes of the shareholder."[3] Consistent with those observations, the court, when approving a Section 220 demand, has ordered the production of documents that "reflect the decision-making" of the corporation[4] and has noted that "[a] corporate record retains its character regardless of the medium used to create it."[5]

[1] No. 281, 2018, slip op. (Del. Jan. 29, 2019).

[2] *Chammas v. Navlink, Inc.*, C.A. No. 11265-VCN, slip op. at 21 (Del. Ch. Feb. 1, 2016).

[3] *Paul v. China MediaExpress Holdings, Inc.*, C.A. No. 6570-VCP, slip op. at 14 (Del. Ch. Jan. 5, 2012).

[4] *Dobler v. Montgomery Cellular Holding, Co.*, C.A. Nos. 18105 & 18499, slip op. at 13-14 (Del. Ch. Oct. 19, 2001).

[5] *Amalgamated Bank v. Yahoo! Inc.*, 132 A.3d 752, 793 (Del. Ch. 2016).

While the Court of Chancery first considered the issue of allowing access to emails through Section 220 in the early 2000s,[6] recently stockholders have intensified demands to inspect emails of board members and senior officers. In addressing a demand to inspect email communications belonging to a corporation's board members and management, the Court of Chancery explained in *Chammas v. Navlink, Inc.* that "subjecting Section 220 proceedings to such broad requests, even by directors, runs contrary to the 'summary nature of a Section 220 proceeding.'"[7] However, the court did not entirely shut the door on emails, explaining that "any request for communications among corporate directors and officers must (1) state a proper purpose, (2) encompass communications constituting books and records of the corporation ... and (3) be sufficiently tailored to direct the Court to the specific books and records relevant to the [petitioner's] proper purpose."[8]

More recently, the Court of Chancery emphasized that there is no bright-line rule pertaining to the types of documents subject to inspection under Section 220. As the Court of Chancery held in *Schnatter v. Papa John's*, "[W]hen considering requests for information from personal accounts and devices in Section 220 proceedings, the court should apply its discretion on a case-by-case basis to balance the need for the information sought against the burdens of production and the availability of the information from other sources, as the statute contemplates."[9] The court went on to state that:

> The reality of today's world is that people communicate in many more ways than ever before, aided by technological advances that are convenient and efficient to use. Although some methods of communication (*e.g.*, text messages) present greater challenges for collection and review than others, and thus may impose more expense on the company to produce, the utility of Section 220 as a means of investigating mismanagement would be undermined if the court categorically were to rule out the need to produce communications in these formats.[10]

Delaware Supreme Court Clarifies When Electronic Communications Must Be Produced

On January 29, 2019, the Delaware Supreme Court issued its decision in *KT4 Partners*, clarifying when it is appropriate for stockholders to inspect emails or other electronic communications. The court stated that "if a company observes traditional formalities, such as documenting its actions through board minutes, resolutions, and official letters, it will likely be able to satisfy a § 220 petitioner's needs solely by producing those books and records."[11]

The Supreme Court reversed a decision of the Court of Chancery that limited a stockholder's inspection to formal board documents, holding that the lower court

[6] *E.g., Dobler*, C.A. Nos. 18105 & 18499, slip op. at 13-14.

[7] *Chammas*, C.A. No. 11265-VCN, slip op. at 21 (citation omitted).

[8] *Id.* at 21-22.

[9] *Schnatter v. Papa John's Int'l, Inc.*, C.A. No. 2018-0542-AGB, slip op. at 43 (Del. Ch. Jan. 15, 2019).

[10] *Id.* at 42.

[11] *KT4 Partners*, No. 281, 2018, slip op. at 4.

should have also allowed access to electronic communications. The plaintiff stockholder sought to inspect various categories of documents, including books and records related to amendments to an investors' rights agreement. The Court of Chancery held that the plaintiff had shown a proper purpose of investigating suspected wrongdoing related to those amendments but refused to order the corporation, Palantir, to produce email communications related to the amendments.

Palantir conceded that it conducted its business informally through email and lacked formal documents, such as meeting minutes. In light of these circumstances, the Supreme Court held that the Court of Chancery abused its discretion in refusing to allow plaintiff to inspect email communications relating to the amendments. The court reasoned that "[i]f the only documentary evidence of the board's and company's involvement in the amendments comes in the form of emails, then those emails must be produced."[12]

Importantly, the Supreme Court noted that corporations are not "defenseless" to requests for email and other electronic information. In doing so, the court reaffirmed the long-standing idea that, in connection with a Section 220 demand, a "corporation should not have to produce electronic documents" if it "has traditional, non-electronic documents sufficient to satisfy the petitioner's needs."[13]

[12] *Id.* at 35.
[13] *Id.* at 32.

Takeaways

Practitioners should closely monitor how the Court of Chancery interprets and applies *KT4 Partners*, particularly in the merger litigation context, in 2019. In the past, plaintiff stockholders challenging mergers often were able to obtain documents through expedited discovery in connection with motions for preliminary injunction. Following a series of recent decisions from the Delaware Supreme Court and the Court of Chancery,[14] and a decline in stockholder M&A injunction requests, plaintiff stockholders have had less success at obtaining pre-closing discovery through expedited proceedings. As a result, they have turned to Section 220, and the Delaware courts have approved that approach, largely on the theory that plaintiffs should have access to documents to help plead around dismissal arguments premised on the *Corwin* doctrine.[15] Many of these merger-related Section 220 demands include requests for electronic documents, and in certain cases, the courts have ordered such production.[16] The extent to which *KT4 Partners* will impact Section 220 demands in the merger context remains to be seen. Other takeaways from *KT4 Partners* and other notable cases include the following:

- Electronic communications may be considered books and records of the corporation if they affect the corporation's rights, duties and obligations or reflect the decision-making of the corporation.
- By properly documenting corporate activities, and mainly through formal books and records of decision-making, under the *KT4 Partners* decision, companies can reduce the risk of a stockholder obtaining access to email or text messages of directors and senior management.
- Directors and officers can observe corporate formalities by documenting decision-making in minutes, written consents, official letters, resolutions and formal board presentations.
- Additionally, because Delaware courts have viewed electronic communications to or from outside directors as corporate books and records, directors should consider using a company email address for all company business in order to avoid inspection of their personal devices and accounts by stockholders.
- Consult with your counsel to make sure that you establish the best protocol and practice to defend against stockholder demands to inspect emails and text messages.

[14] *C & J Energy Servs., Inc v. City of Miami General Emps'*., 107 A.3d 1049 (Del. 2014); *Corwin v. KKR Fin. Holdings LLC*, 125 A.3d 304 (Del. 2015); *In re Trulia, Inc. S'holder Litig.*, 129 A.3d 884 (Del. Ch. 2016).

[15] *E.g.*, *Lavin v. West Corp.*, C.A. No. 2017–0547–JRS, slip op. (Del. Ch. Dec. 29, 2017). For further discussion, see the first article in this edition, "Examining *Corwin*: Latest Trends and Results."

[16] *E.g.*, *Inter-Local Pension Fund GCC/IBT v. Calgon Carbon Corp.*, C.A. No. 2017-0910-MTZ, slip op. at 46-50 (Del. Ch. Jan. 25, 2019).

Charter-Based Forum-Selection Provisions Designed to Govern Claims Under the Securities Act Found Invalid

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> See page 14 for takeaways

In March 2018, the U.S. Supreme Court, in *Cyan, Inc. v. Beaver County Employees Retirement Fund*, 138 S. Ct. 1061 (2018), resolved a jurisprudential split among federal courts and held that certain federal securities claims may be brought in either state or federal court and that when brought in a state court, they cannot be removed to federal court. In the wake of that decision, companies have been attempting to adopt forum-selection provisions in their governing documents identifying an exclusive jurisdiction for federal securities claims. However, a recent Delaware court decision has found that such provisions are invalid under the Delaware General Corporation Law.

Specifically, Delaware's Court of Chancery ruled that charter-based forum-selection provisions that purport to require claims under the Securities Act of 1933 (the 1933 Act) to be brought solely in federal courts are invalid under Delaware law. The decision, *Sciabacucchi v. Salzberg*, C.A. No. 2017-0931-JTL (Del. Ch. Dec. 19, 2018), involved federal forum-selection provisions in the charters of nominal defendants Blue Apron Holdings, Roku and Stitch Fix. Stockholder plaintiff Sciabacucchi filed an action in the Court of Chancery seeking declaratory judgment that the companies' forum-selection provisions requiring stockholder-based federal securities claims to be brought exclusively in federal court are invalid. Vice Chancellor J. Travis Laster agreed with the plaintiff and held that because 1933 Act claims do not "arise out of the corporate contract and do[] not implicate the internal affairs of the corporation" but rather "arise[] from the investor's *purchase* of the shares," the constitutive documents of a Delaware corporation cannot bind a plaintiff to a particular forum.

The Forum-Selection Provisions at Issue

The Roku and Stitch Fix certificates of incorporation, which contained substantively identical provisions, provided that "[u]nless the Company consents in writing to the selection of an alternative forum, the federal district courts of the United States of America shall be the exclusive forum for the resolution of any complaint asserting a cause of action arising under the Securities Act of 1933. Any person or entity purchasing or otherwise acquiring any interest in any security of the Corporation shall be deemed to have notice of and consented to [this provision]." (alteration in original)

Blue Apron's certificate of incorporation was slightly different and provided that "the federal district courts of the United States of America shall, *to the fullest extent permitted by law*, be the sole and exclusive forum for the resolution of any complaint asserting a cause of action arising under the Securities Act of 1933." (emphasis in original)

Origins of the Corporate Forum-Selection Phenomenon, the *Boilermakers* Decision and the 2015 Amendments to the Delaware General Corporation Law

The court traced the history of the development of corporate forum-selection provisions arising from the then-increasing trend of strike suits against corporations, often filed in multiple jurisdictions, and the court's recommendation in *In re Revlon, Inc. Shareholder Litigation*, 990 A.2d 940 (Del. Ch. 2010), where it suggested that "if boards of directors and stockholders believe that a particular forum would provide an efficient

and value-promoting locus for dispute resolution, then corporations are free to respond with charter provisions selecting an exclusive forum for intra-entity disputes." The court noted that while only 16 publicly traded companies had charter- or bylaw-based forum-selection provisions prior to *Revlon*, by August 2014, 746 publicly traded companies had adopted such provisions.

In 2013, then Chancellor and now Chief Justice Leo E. Strine issued a seminal decision in *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*, 73 A.3d 934 (Del. Ch. 2013), where he held that certain bylaw-based forum-selection provisions were valid because they related to *internal affairs* claims and emphasized that they concerned the rights of "stockholders *qua* stockholders." Chief Justice Strine also illustrated, by way of examples, causes of actions that a bylaw cannot regulate, such as a tort claim by a stockholder based on personal injury on the company's premises or a contract claim by a stockholder based on a commercial contract with the company. In deciding on the validity of the federal forum-selection provisions at issue here, Vice Chancellor Laster found the *Boilermakers* distinction between internal and external claims instructive because the DGCL provisions dealing with bylaws (*8 Del. C.* § 109(b)) and certificates of incorporation (*8 Del. C.* § 102(b)(1)) are largely parallel.

In 2015, Delaware's General Assembly codified the ruling in *Boilermakers* by enacting Section 115 to the DGCL, which provides: "The certificate of incorporation or the bylaws may require, consistent with applicable jurisdictional requirements, that any or all internal corporate claims shall be brought solely and exclusively in any or all of the courts in this State, and no provision of the certificate of incorporation or the bylaws may prohibit bringing such claims in the courts of this State." Internal corporate claims are further defined as "claims, including claims in the right of the corporation, (i) that are based upon a violation of a duty by a current or former director or officer or stockholder in such capacity, or (ii) as to which this title confers jurisdiction upon the Court of Chancery."

In applying the *Boilermakers* rationale to ascertain the validity of the federal forum-selection provisions at issue in *Sciabacucchi*, the court held that the forum-selection provisions concerned claims are "external" to the corporation and therefore invalid. In support of its conclusion that 1933 Act claims are external, the court provided the following reasons: (i) the nature of 1933 Act claims, which are based on a defective registration statement; (ii) the identity of possible defendants under a 1933 Act claim, which include broad categories of persons without regard to their director, officer or even employee status; (iii) the broad definition of "security" under the 1933 Act, which "could identify as few as fifty or as many as 369 different types of securities" of which shares are one type of security and shares of a Delaware corporation are merely one subset; and (iv) even where an investor purchases a share of stock, the predicate act for a 1933 Act claim is the purchase itself as opposed to stockholder status, and there exists no requirement of continuous ownership of shares.

Invalidity of the Forum-Selection Provisions Under First Principles

In addition to finding that the federal forum-selection provisions at issue were invalid under *Boilermakers*, the court found that application of first principles also supports the conclusion that Delaware cannot regulate claims external to a corporation, such as those under the 1933

Act. Specifically, the court looked to the fundamental concept of a "corporation," the "nature of its constitutive documents" and the plain language of *8 Del. C.* 102(b)(1). The court explained that the issuance of the corporate charter is a sovereign act and "[b]ecause the state of incorporation creates the corporation, the state has the power through its corporation law [here, the DGCL] to regulate the corporation's internal affairs." Therefore, "'there is no reason to believe that corporate governance documents, regulated by the law of the state of incorporation, can dictate mechanisms for bringing claims that do not concern corporate internal affairs, such as claims alleging fraud in connection with a securities sale'" (citation omitted). Accordingly, the state cannot assert authority over other types of claims because "the fact of incorporation is not a sufficient nexus to support applying the chartering state's law to external claims." Further, the court found that "consistent with the scope of what Delaware can regulate through the DGCL," the language of § 102(b)(1), which provides authority for a corporate charter to contain non-mandatory provisions, only governs "corporate management and the relations of stockholders *inter sese*."

Takeaways

- Under the *Sciabacucchi* decision, charter- or bylaw-based forum-selection clauses purporting to govern claims that are external to a corporation are invalid under Delaware law. The decision is still subject to an appeal, and a decision by the Delaware Supreme Court could provide further guidance to companies that have similar forum-selection provisions to the ones at issue in *Sciabacucchi*.
- While the *Sciabacucchi* decision focused on claims brought under the 1933 Act, it is possible that the same rationale might apply to claims under the 1934 Act as well.
- In combination with the U.S. Supreme Court's *Cyan* decision, the *Sciabacucchi* decision means that federal securities cases will continue to be brought in both federal and state courts.
- Nevertheless, 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 forum. Companies interested in adopting a forum-selection provision are encouraged to seek advice from their counsel before doing so.

Court of Chancery Rules That 'Commercially Reasonable Efforts' Obligation Does Not Imply a 'Duty to Warn'

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Recent Delaware decisions in *Williams Companies v. Energy Transfer Equity, L.P.*, and *Akorn, Inc. v. Fresenius Kabi AG*, examined contract provisions requiring "commercially reasonable efforts" and "reasonable best efforts" and concluded that these provisions imposed affirmative obligations on parties to "take all reasonable steps" to satisfy the subject contractual condition and to disclose the awareness of a "problem" and work together with the contractual counterparty to try to solve the perceived issue.[1] In *Vintage Rodeo Parent, LLC v. Rent-A-Center, Inc.*, C.A. No. 2018-0927-SG, the parties agreed to use "commercially reasonable efforts" to "consummate and make effective as promptly as practicable ... the transactions contemplated by" a merger agreement. The Delaware Court of Chancery analyzed whether the affirmative obligations articulated in *Williams* and *Akorn*, among other cases, also gave rise to a "duty to warn" after a party determined to terminate a merger agreement under a contractual right to do so. The Court of Chancery held that they did not.

In *Vintage*, after an expedited trial, the Court of Chancery held that defendant Rent-A-Center, Inc. (RAC) validly terminated its merger agreement with plaintiff Vintage. Vintage and RAC had agreed to a transaction whereby Vintage would acquire all of RAC's shares for $15.00 per share, which represented a 47% premium to the unaffected price. While the merger agreement contained an "End Date" of 11:59 p.m. on December 17, 2018, if the merger was still under regulatory review at that time, either party could elect to extend the End Date twice, in three-month increments, simply by "delivering written notice" to the other party prior to the End Date.

Through no fault of RAC, the merger was still in the middle of regulatory approval as December 17, 2018, approached, and it was clear that approval would not be obtained before the End Date. In early December, RAC's board of directors concluded that, because RAC's performance had improved, it was in the best interest of RAC and its stockholders to terminate the merger with Vintage if the opportunity arose. However, the RAC board expected Vintage to deliver written notice to extend the End Date and determined that RAC should therefore continue its efforts to consummate the merger. Thereafter, RAC management proceeded in a "business as usual" fashion with Vintage, including in their joint dealings with regulators, and no one informed Vintage of the RAC board's conclusion that it might terminate the agreement if the opportunity arose. When Vintage did not deliver notice to extend the End Date on December 17, 2018, RAC sprang into action, delivering written notice terminating the merger and issuing a press release five minutes later notifying the market of the termination. Vintage quickly filed litigation in Delaware alleging breach of contract, among other claims, and asked the Court of Chancery to order RAC to close the merger.

Vintage argued that RAC had breached its obligation to use "commercially reasonable efforts" to close the merger because RAC's "business as usual" conduct after RAC's board had decided it wanted to terminate the merger deceived Vintage, and RAC was obligated to give Vintage a "heads-up" that RAC was planning to terminate the merger. The court disagreed and found that RAC did nothing untoward. The court stated that "parties are assumed to have knowledge of their own contractual rights" under Delaware law. Unlike other Delaware cases, the evidence did not show that RAC was aware of any "problem" and failed to address it. There was no evidence that RAC knew that Vintage was unaware of, or mistaken about, its contractual rights.[2] To the contrary, the court

[1] *See Williams Companies v. Energy Transfer Equity, L.P.*, 159 A.3d 264, 273 (Del. 2017); *Akorn, Inc. v. Fresenius Kabi AG*, C.A. No. 2018-0300-JTL, slip op. at 225 (Del. Ch. Oct. 1, 2018), *aff'd*, 198 A.3d 724 (Del. 2018) (TABLE).

[2] The court also expressly declined to consider whether such inaction would have resulted in a breach of the commercially reasonable efforts provision.

found the opposite: RAC assumed Vintage would exercise its right to extend the End Date. According to the evidence at trial, "[i]t appear[ed] that Vintage simply forgot the End Date in the Merger Agreement — and its implications."

The court also rejected Vintage's argument that the parties' joint efforts to close the merger, which contemplated deadlines beyond the December 17, 2018, End Date, was evidence of deception sufficient to warrant ordering RAC to close the merger. The court noted that Vintage did not allege fraud and that RAC was merely doing what it was contractually required to do: take efforts to obtain regulatory approval and close the merger. The court also found legitimate business reasons for not informing Vintage of the RAC board's decision to terminate the merger if given an opportunity. For example, the court noted that such disclosure "could have upset its merger partner and complicated their relationship going forward" if Vintage had extended the End Date and the merger had closed.

Finally, the court also found that the "commercially reasonable efforts" provision did not imbue RAC with a "duty to warn" Vintage that RAC would terminate the merger agreement if given the opportunity. First, the court noted that such an "advance notice" provision was not in the relevant section of the merger agreement, though the merger agreement did require advance notice before exercising several other termination rights. The court stated that it "should refrain from writing a provision into a contract when the parties could have done so themselves, but chose not to." Second, the court held that there was no duty to warn here because "[c]ommercially reasonable efforts do not require that sophisticated parties remind one another of their contractual rights."

Succinctly summarizing its conclusion, the court stated that "[i]f an agreement to use commercially reasonable efforts to comply with obligations in a contract means that a party cannot exercise its bargained-for right to terminate that contract, that bargained-for right would be illusory." The court found that RAC validly terminated the agreement.

The *Vintage* case serves as a reminder that Delaware courts will give great weight to the express rights and obligations negotiated by sophisticated parties who act in good faith during the post-signing process. Following on the heels of the *Williams* opinion in the Delaware Supreme Court and the *Akorn* opinions in the Delaware Supreme Court and the Delaware Court of Chancery, the *Vintage* case adds to the recent slate of case law further refining what Delaware courts expect from sophisticated parties that agree to "reasonable" efforts provisions.

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