Securities, Shareholder, and M&A Litigation Outlook

2020

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The Outlook for 2020

As we are finalizing this 2020 Outlook, the world is dealing with the COVID-19 pandemic. To all of our readers, we hope that you and your families, friends, and colleagues are safe. It will come as no surprise that the pandemic will present new and unique legal issues and challenges in many areas. In fact, we already are beginning to address issues arising from the pandemic, and it is only a question of "how" – rather than "if" – those issues will affect securities, shareholder, and M&A litigation. We will be assessing these challenges in real time.

In the meantime, the decisions in 2019 provide a window into what 2020 holds in store. Courts around the country issued a number of important decisions in 2019 that will affect how all corporate stakeholders – buyers and sellers, boards of directors, management, business partners, investors, and creditors – will structure their affairs, plan and execute transactions, and resolve disputes going forward.

While corporate governance decisions in 2019 covered the full range of transactional, governance, and dispute resolution issues, notable trends emerged in at least four key areas. *First*, several cases potentially revitalized *Caremark* oversight liability, highlighting that board members should carefully analyze whether they are adequately monitoring the most important risks faced by their companies. *Second*, Delaware courts continued to refine the seminal doctrines announced in *Dell* and *DFC* (appraisal actions), *M&F Worldwide* (controlling stockholder transactions), and *Corwin* (stockholder ratification). *Third*, numerous cases helped define the boundaries of a proper books and records claims, which will continue to be shaped in 2020. *Finally*, Delaware courts re-emphasized that Delaware corporate law favors contractual freedom and significantly limited the ability of parties to use concepts such as the implied covenant of good faith and fair dealing or "commercial reasonableness" to vary the terms of unambiguous written agreements. In the Executive Summary, we summarize the key developments in these areas and identify certain emerging trends that courts likely will address in the coming year.

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Executive Summary

New Life for *Caremark*

One of the most notable 2019 developments in Delaware law was the potential revitalization of what are commonly known as "*Caremark* claims" – assertions by stockholders that a company's board of directors failed to exercise proper oversight of the business and prevent the company from violating the law or otherwise incurring significant liabilities. Under *Caremark* and *Stone v. Ritter*, a stockholder plaintiff could plead a breach of fiduciary duty by showing that "(a) the directors utterly failed to implement any reporting or information system or controls; or (b) having implemented such a system or controls, consciously failed to monitor or oversee its operations." Over the years, courts frequently dismissed *Caremark* cases at the pleading stage, citing the maxim that such a claim was "possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment."

In *Marchand v. Barnhill*, however, the Delaware Supreme Court reversed the Court of Chancery's decision to dismiss a *Caremark* claim against Blue Bell Creamery arising from a listeria outbreak caused by contamination in the company's ice cream production facilities. The court determined that the plaintiff sufficiently alleged a *Caremark* claim because Blue Bell was a one-product company, food safety was mission critical to Blue Bell, and the complaint alleged that the company failed to implement procedures for the board to effectively oversee the company's most significant risk.

Relying on *Marchand*, the Court of Chancery denied a motion to dismiss Caremark claims in *In re Clovis Oncology, Inc. Deriv. Litig*. In *Clovis*, the Court of Chancery found that the company failed to implement procedures sufficient to allow the board of directors to (a) monitor the FDA approval process for the company's most promising cancer treatment, and (b) detect management misstatements regarding clinical trial results for that treatment.

In light of *Marchand* and *Clovis*, companies can no longer assume that *Caremark* claims will be routinely dismissed. Going forward, it will be important to monitor how courts interpret the three factors that led to the outcomes in *Marchand* and *Clovis* – both companies operated in highly regulated industries, both had small nondiversified product lines, and both sustained losses caused by mission critical risks. *Marchand* and *Clovis* raise questions regarding appropriate levels of board monitoring with respect to cybersecurity, particularly for financial institutions and technology businesses focused on the buying, selling, and utilization of data. Similarly, courts may hold boards at airline, hotel, and cruise companies to heightened monitoring duties relating to the coronavirus and other similar industry-threatening risks.

Continued Refinement of Key M&A Doctrine

In 2019, courts continued to refine and expand upon key doctrines impacting M&A deals and related litigations.

In *Dell Inc. v. Magnetar Global Event Driven Master Fund Ltd* and *DFC Global Corporation v. Muirfield Value Partners L.P*, the Delaware Supreme Court held that, when determining fair value in an appraisal action, courts must give significant weight to a merger price that was negotiated in an arms-length transaction following a robust shopping process. The court declined to create a formal presumption in favor of the deal price, however, and left the Court of Chancery with significant discretion to determine fair value based on the facts of each case.

In the *Verition Partners Master Fund Ltd.* appraisal case, the Court of Chancery determined the fair value was the target company's trading price immediately prior to the first public disclosure of the potential transaction. The Delaware Supreme Court reversed and held that, given the arms-length nature of the transaction and the extensive shopping process, the deal price minus any synergies arising from the transaction was the best indicator of fair value. *Verition Partners* confirms that stockholders will have significant difficulty in using discounted cash flow analyses, public company trading prices, or any other similar valuation metric when bringing appraisal actions to recover amounts in excess of the deal price.

In *Khan v. M & F Worldwide Corporation (MFW)*, the Delaware Supreme Court held that a controlling stockholder transaction would be subject to the business judgment rule (and not entire fairness review) if (a) the transaction was negotiated and approved by an independent special committee and (b) the deal was subject to approval by a "majority of the minority" vote. In *Olenik v. Lodzinski*, the Delaware Supreme Court held that these *MFW* procedures must be in place early in the process in order for the transaction to be evaluated under the business judgment rule. Specifically, the court held that the *MFW* procedures must be in place prior to any substantive economic discussions; putting the procedures in place prior to receiving a definitive proposal will not be sufficient.

And *In Corwin v. KKR Financial Holdings*, the Delaware Supreme Court held that a transaction subject to enhanced scrutiny under *Revlon* will instead be reviewed under the business judgment rule after it has been approved by a majority of fully informed stockholders. In *In re Towers Watson & Co. Stockholder Litigation*, a stockholder alleged that a merger transaction was subject to entire fairness review because Towers' CEO allegedly received and failed to disclose a compensation proposal in connection with his role as the CEO of the combined post-merger entity. The Court of Chancery concluded that the stockholder plaintiffs failed to show a true conflict (because the Towers board knew that its CEO was going to be the CEO of the combined entity and likely would receive increased compensation). Absent a true conflict, the business judgment rule applied without any need to analyze the *Corwin* doctrine.

Shaping the Boundaries of Section 220

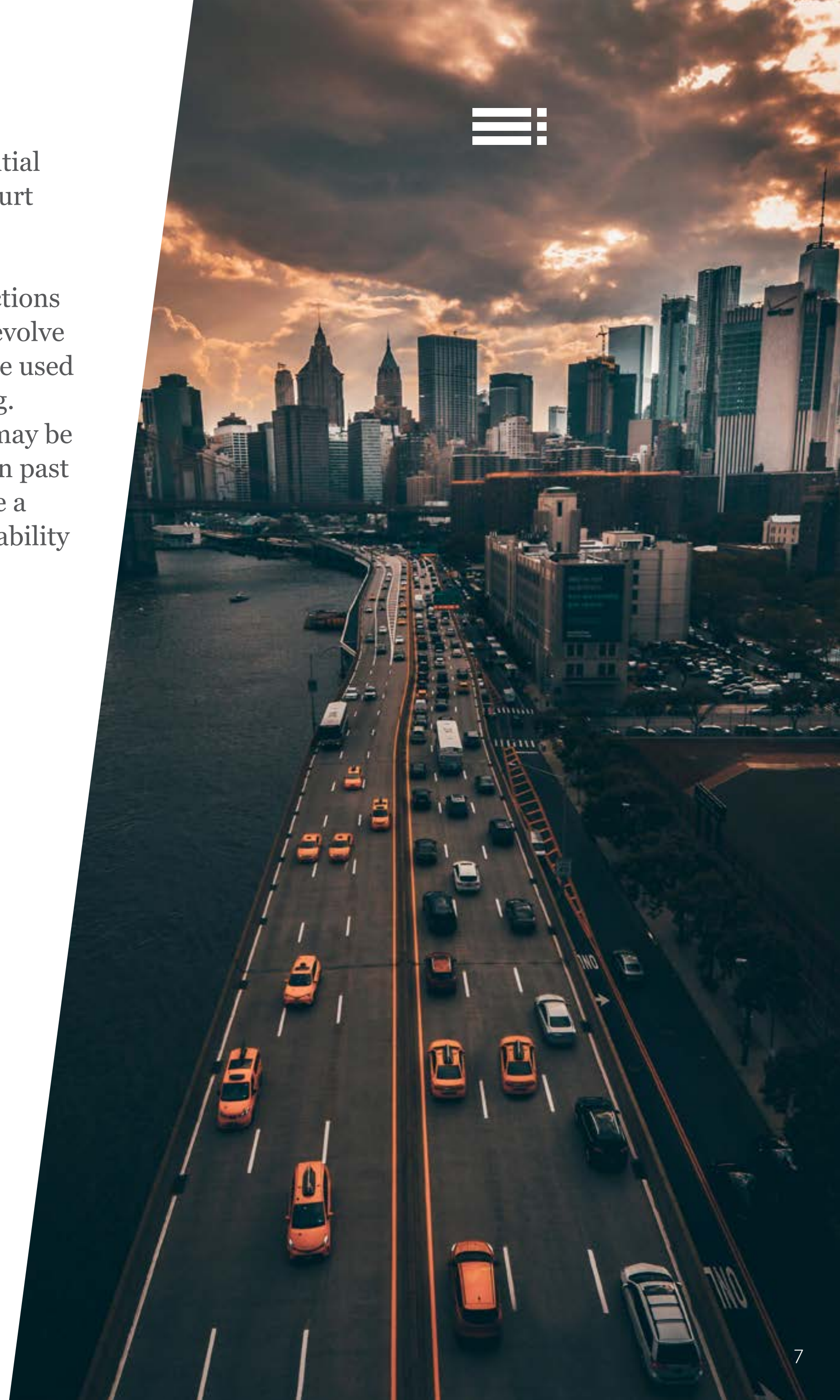
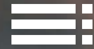
For several years, Delaware courts have encouraged stockholder plaintiffs to pursue books and records inspections under Section 220 of the Delaware General Corporation Law before bringing breach of fiduciary of duty claims, and in particular breach of fiduciary duty claims that allege "demand futility" without providing the court with the necessary particularized factual allegations. As a result of this push, the Delaware courts addressed a number of cases in 2019 that helped define the boundaries of Section 220 rights.

Several cases addressed attempts by stockholders to broaden the "proper purpose" for which stockholders could seek corporate books and records. For example, In *High River LP v. Occidental Petroleum Corp.*, the Delaware Court of Chancery rejected a Section 220 claim by an activist investor who sought books and records in order to communicate with other investors and wage a proxy contest against the incumbent management team. Similarly, in *Southeastern Pennsylvania Transportation Authority v. Facebook, Inc.*, the Court of Chancery rejected a stockholder's Section 220 claim to examine books and records in order to determine the factors that the board considered in setting management's compensation – the court found that the stockholder was simply second-guessing the board's business judgment and not investigating actionable misconduct.

A number of cases addressed the types of documents that fall within the scope of a valid Section 220 request. In *K24 Partners LLC v. Palantir Technologies, Inc.*, the Delaware Supreme Court determined that a company was required to produce board member emails in response to a Section 220 demand where traditional board materials (e.g., minutes and resolutions) were not sufficient to address the purpose of the demand. In *Schnatter v. Papa John's, International, Inc.*, the Court of Chancery ordered production of board member text messages in which the company founder alleged that the board improperly conspired to remove the founder. And in *Tiger v. Boast Apparel, Inc.*, the Delaware Supreme Court held that a company producing Section 220 records is not presumptively entitled to a confidentiality order.

Going forward, it will be important to monitor the Delaware Supreme Court's decision in the appeal of *Lebanon County Employees' Retirement Fund v. AmerisourceBergen, Inc.* In *AmerisourceBergen*, a stockholder sought books and records to investigate management misconduct relating to the company's opioid exposure. The company declined the request because, among other reasons, any possible claim relating to the company's opioid exposure was barred by the company's Section 102(b)(7) charter provision barring money damages claims for breach of the duty of care. The Court of Chancery rejected the company's position, holding that a stockholder seeking books and records to investigate management misconduct does not need to come forward with credible evidence of a viable claim, suggesting a potential conflict with other recent decisions by the Court of Chancery.

We expect the large volume of Section 220 actions to continue in 2020, as the law continues to evolve regarding how expansively Section 220 can be used to investigate potential corporate wrongdoing. Statistics from 2019 signal that Section 220 may be used to pursue *Caremark* claims more than in past years, which as discussed above appears to be a topic of renewed focus relating to potential liability for corporations and their boards.

Limitations on the Covenant of Good Faith and Fair Dealing

Delaware has long been viewed as a pro-contract state with courts willing to enforce the clear and unambiguous terms of written agreements negotiated by sophisticated corporate parties. Two 2019 cases reaffirmed that Delaware remains a pro-contract state and will enforce the plain meaning of written agreements even where the results may be perceived as harsh or unfair.

In *Vintage Rodeo Parent LLC v. Rent-A-Center Inc.*, a merger agreement allowed the parties to terminate the transaction if all closing conditions were not satisfied by a specified drop dead date. The Court of Chancery held that the seller did not waive its termination right by working with the buyer to obtain a required regulatory approval, and that the covenant of good faith and fair dealing and requirements of "commercial reasonableness" did not impose on the buyer any obligation to give the seller notice of the buyer's intent to exercise its termination right.

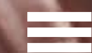
Similarly, in *Oxbow Carbon & Minerals Holdings, Inc. v. Crestview-Oxbow Acquisition, LLC,* the Delaware Supreme Court determined that the covenant of good faith and fair dealing did not give an LLC member the right to force an exit transaction that was not expressly contemplated by the operative LLC agreement. The court emphasized that the implied covenant was to be narrowly construed and applied only to fill genuine gaps in an agreement; it may not be used to adjust or rebalance the economic terms negotiated by the parties.

As the business and legal world comes to grips with the impacts of COVID-19, and we enter into a potentially prolonged period of economic downturn and distress, the interpretation of contract terms in commercial contracts and M&A agreements – such as *force majeure* and Material Adverse Effect (or Change) provisions – is certain to become increasingly important.

Caremark oversight liability

In re Clovis Oncology, Inc. Derivative Litigation,

C.A. No. 2017-0222 (Del. Ch. Oct. 1, 2019)



Why it is important

In *In re Clovis Oncology, Inc. Derivative Litigation*, the Court of Chancery denied a motion to dismiss a claim against the Clovis Oncology Board of Directors for breach of their duties of oversight – a so-called *Caremark* claim. This decision is the second of two recent decisions sustaining *Caremark* oversight claims, despite the fact that Delaware courts previously commented that a *Caremark* claim is the hardest type of claim to plead and to prove. *Clovis* demonstrates that boards of directors face potential liability for breaches of their duties of oversight where red flags dealing with "mission critical" issues have reached the board and been ignored.

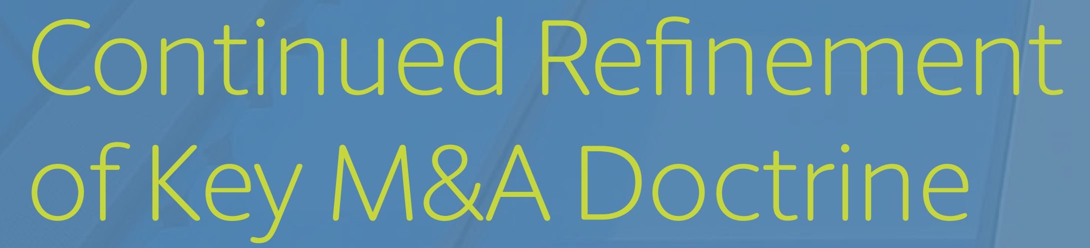
Summary

This matter arose from the plaintiffs' allegations that the directors of Clovis Oncology, Inc. (Clovis) breached their duties of loyalty by failing to properly oversee a drug trial related to Clovis' development of Rociletinib (Roci), a new lung cancer treatment. Clovis initiated a clinical trial for Roci, setting as a measure of success the percentage of patients whose tumors shrunk meaningfully. This measure of success is known as the objective response rate (ORR).

The plaintiffs alleged that Clovis misrepresented the ORR by including patient cases that had not been confirmed by subsequent radiological scans, in violation of the study parameters that had been agreed to with the FDA. The plaintiffs further allege that the Clovis board was aware of the improper calculation of the ORR as early as June 2014, over a year before Clovis disclosed the true ORR. The plaintiffs also alleged that the company had failed to report serious side effects of the drug.

The court denied the defendants' motion to dismiss, finding that demand was excused and that the plaintiffs had adequately pleaded that the board members breached their duties of loyalty to the company through a failure of oversight of "mission critical" functions like the success of the Roci drug trial. For such "mission critical" issues, the court held that defendants will be liable if they (1) fail to implement any compliance system, or (2) choose to ignore obvious red flags showing deficiencies in that compliance system. The court found it "reasonable to infer" that the board understood the ORR metric and its significance given the extent of Clovis' reliance on the ORR when raising capital. As a result, the court concluded that the problems with the ORR reporting constituted a "red flag of noncompliance waived before the Board Defendants" that the board chose to ignore.

For a more detailed discussion of this case:



Continued Refinement of Key M&A Doctrine

FrontFour Capital Grp., LLC v. Taube,

C.A. No. 2019-0100-KSJM (Del. Ch. Mar. 22, 2019)

Why it is important

In *FrontFour Capital Grp., LLC v. Taube*, the Delaware Court of Chancery declined to order a curative shopping process despite finding that the sale process was tainted by conflicted insiders, failed to comply with the entire fairness test, and involved unreasonably preclusive deal protection measures. In so holding, the court reaffirmed that an injunction will not issue where it would strip an innocent third party (here, the buyer) of its contractual rights unless the third party aided and abetted the target's breach of fiduciary duty. To address the circumstances, however, the court ordered corrective disclosures regarding the conflicted sale process and third-party expressions of interest that were omitted from the proxy, and enjoined the stockholder vote pending such corrective disclosures.

Summary

Stockholders of Medley Capital Corporation, a business development corporation, challenged a proposed three-way merger involving Medley Capital Corporation, Medley Management, Inc., and Sierra Income Corporation. The court found that the Medley Capital stockholders had proven that Medley Capital's board – which included co-founders and majority owners Brook and Seth Taube – breached its fiduciary duties by entering into the proposed transaction. In particular, the court found that the Taube brothers had orchestrated the transaction by, among other things, stacking the special committee with board members beholden to them, depriving the special committee of information regarding other indications of interest, forcing an aggressive timeline with no compelling business reason, and insulating the deal from a post-signing market check by including preclusive deal protections, including a no-shop provision. The court, however, declined to permanently enjoin the merger because plaintiffs failed to show that the proposed buyer aided and abetted those breaches. Instead, the court ordered additional disclosures to the Medley Capital stockholders, and enjoined the stockholder vote pending such disclosures. Since that injunction, a second shareholder filed suit challenging the merger, alleging, among other things, that defendants failed to make the requisite corrective disclosures. The Court of Chancery has consolidated the two actions and permitted them to proceed.

For a more detailed discussion of this case:

Agiliance, Inc. v. Resolver SOAR, LLC,

No. 2018-0389-TMR (Del. Ch. Jan. 25, 2019)

Why it is important

The Court of Chancery's decision in *Agiliance, Inc. v. Resolver SOAR, LLC* further expounds Delaware law addressing the distinction between appointing an expert or an arbitrator to resolve disputes arising under a merger agreement. This decision follows another recent case on this topic – *Penton Business Media Holdings LLC v. Informa PLC*, Del. Ch., C.A. No. 2017-0487-VCL (Del. Ch. July 9, 2018) – featured in our Q3 2018 publication. Along with *Penton*, the *Agiliance* decision shines a light on the importance of carefully drafting dispute resolution procedures to clearly articulate the parties' intent regarding whether claims are subject to arbitration.

Summary

In a post-merger dispute concerning the calculation of the final networking capital amount, the court addressed whether the dispute resolution provision in the parties' purchase agreement called for arbitration or an expert determination. In addressing the issue on the seller's motion for summary judgment, the court stated that the determination hinges on the parties' intent, the best evidence of which is reflected in the agreement. After reviewing the relevant provision in the purchase agreement, which made several references to arbitration, including that any networking capital dispute "shall be submitted for arbitration," the court concluded that the language in the agreement evidenced the parties' intent to arbitrate the dispute.

For a more detailed discussion of this case:

Verition Partners Master Fund Ltd. v. Aruba Networks, Inc.,

No. 368, 2018 (Del. Apr. 17, 2019)

Why it is important

In *Verition Partners Master Fund Ltd. v. Aruba Networks, Inc.*, the Delaware Supreme Court reversed the Court of Chancery's reliance on an acquired company's pre-merger (or unaffected) share price in determining the fair value of the company's shares in an appraisal action. Reaffirming recent precedent giving significant weight to market-tested deal prices, the court held that the appropriate measure of fair value was the "deal-priceless-synergies." Together with the Delaware Supreme Court's recent appraisal decisions in *Dell, Inc. v. Magnetar Global Event Driven Master Fund Ltd., 177 A.3d 1* (Del. 2017) and *DFC Global Corporation v. Murfield Value Partners, L.P.*, (172 A.3d 346 (Del. 2017), *Aruba* completes a trilogy of decisions that are likely to have a strong deterrent effect on appraisal arbitrage, particularly in public deals, absent compelling reasons to believe the merger price is not a reliable indicator of value.

Summary

After PC-maker HP acquired Aruba – a network equipment firm – for US$24.67 per share, certain hedge funds purchased large amounts of Aruba's common stock and filed an appraisal action after the merger closed. Following extensive discovery and a trial, Vice Chancellor Laster rejected the valuation methodologies proposed by both sides and determined that Aruba's 30-day average unaffected market price of US$17.13 per share represented Aruba's fair value. On appeal, the Delaware Supreme Court reversed and remanded. The Delaware Supreme Court rejected the Court of Chancery's decision to rely exclusively on the stock price, finding that it was based on the erroneous premise that the deal-price-less-synergies figure incorporated reduced agency costs that would need to be estimated and subtracted from the company's share price. The Delaware Supreme Court directed the lower court to increase its valuation to US$19.10 per share on remand, reflecting the deal price minus estimated synergies.

For a more detailed discussion of this case:

Olenik v. Lodzinski,

No. 392, 2018 (Del. Apr. 5, 2019)

Why it is important

In *Olenik v. Lodzinski*, the Delaware Supreme Court reversed in part the dismissal of a challenge to a controlling shareholder transaction, finding that the Court of Chancery incorrectly applied the framework established by *Khan v. M & F Worldwide Corporation (MFW)*, 88 A.3d 635 (Del. 2014). Under the *MFW* framework, a controlling shareholder transaction may be subject to deferential review under the business judgment rule if it is conditioned from the outset of negotiations on (1) the approval of an independent, empowered special committee and (2) the approval of an informed, uncoerced vote of the majority-of-the-minority shareholders. The *Olenik* decision provides important guidance on when a transaction begins for purposes of the *MFW* framework. Previous decisions indicated that the *MFW* protections must be in place when "substantive economic discussions" began. In *Olenik*, the Delaware Supreme Court clarified that "exploratory discussions" regarding value and potential offers may constitute substantive economic discussions triggering the need for the *MFW* protections to be in place, even if no definitive proposal has been made.

Summary

Two companies, Earthstone Energy, Inc., and Bold Energy III LLC, entered into discussions regarding an all-stock "up-C" transaction. At the time of discussions and negotiations, EnCap Investments, L.P., a private equity firm, allegedly held controlling interests in both Earthstone and Bold. Following 10 months of preliminary discussions, Earthstone formed a special committee of the board to negotiate and approve the transaction. The special committee spent three months negotiating with Bold and ultimately approved the deal. A super majority of disinterested shareholders then approved the deal. An Earthstone shareholder brought claims against Earthstone, Bold, EnCap, and Earthstone management for breach of fiduciary duties and other related claims. The Court of Chancery dismissed the plaintiff's claims, applying the business judgment rule based on its conclusion that Earthstone complied with the *MFW* framework. The plaintiff appealed to the Delaware Supreme Court. The Delaware Supreme Court reversed in part and affirmed in part the decision of the Court of Chancery. The Delaware Supreme Court elaborated on its rulings under *MFW* and *Flood v. Synutra*, 195 A.3d 754 (Del. 2018) (summarized in our Q4 2018 Quarterly Corporate / M&A Decisions Update), clarifying what "up front" means for purposes of when the procedural protections of *MFW* must be in place to secure deferential business judgment review. The Delaware Supreme Court stated that the key is to have the protections in place "early in the process" and "before substantive economic negotiation [takes] place." The Delaware Supreme Court held that the Court of Chancery erred in finding that no substantive economic negotiations had taken place. A conflicted member of Earthstone management, who had led negotiations prior to the special committee being formed, had told the board that he was "negotiating" with EnCap and would make "an offer" prior to the formation of the special committee. Further discussions with EnCap, the trading of access to data rooms, and a number of valuation analyses convinced the Delaware Supreme Court that the plaintiff had sufficiently pleaded facts that demonstrated that *MFW*'s procedural protections were not in place "from the beginning." Additionally, claims in Earthstone's 10-K filing in 2017 belied claims by defendants that EnCap was no longer a controlling entity at the time of the merger. The Delaware Supreme Court affirmed the dismissal of the plaintiff's disclosure claims and remanded to the Court of Chancery for further proceedings on the fairness claims.

For a more detailed discussion of this case:

In re Akorn Sec. Litig.,

240 F. Supp. 3d 802 (N.D. Ill. 2017)

Why it is important

In what may turn out to be a milestone decision in M&A federal shareholder litigation, Judge Thomas M. Durkin of the District of Illinois abrogated settlement agreements that would have resolved three shareholder suits against Akorn, Inc., and its board of directors based on additional disclosures made by Akorn in connection with its acquisition by competitor Fresenius Kabi AG, and ordered plaintiffs' counsel to return over US$320,000 in attorneys' fees. The court found that the additional disclosures made by Akorn as a result of the lawsuits contained "nothing of value" to Akorn's shareholders, and that the complaints therefore should have been dismissed. The ruling could result in significantly fewer shareholder class actions being filed in federal court challenging proxy statement disclosures relating to M&A transactions.

Summary

Plaintiffs sued Akorn and members of its board of directors seeking certain disclosures regarding Akorn's acquisition by competitor Fresenius Kabi AG. Akorn revised its proxy statement and issued a Form 8-K, and plaintiffs dismissed their lawsuits and settled for attorneys' fees. An Akorn investor moved to intervene to challenge the settlements and payment of attorneys' fees. The court denied the intervention motion, but it ordered briefing *sua sponte* on whether the settlements should be abrogated. Following briefing, the court abrogated the settlements, finding that the cases should have been "dismissed out of hand," that the extra disclosures Akorn had agreed to make "were worthless to investors," and that the court should exercise its "inherent authority to rectify the injustice that occurred as a result" of not immediately dismissing the plaintiffs' complaints.

For a more detailed discussion of this case:

Scottsdale Ins. Co. v. CSC Agility Platform, Inc.,

2019 U.S. Dist. LEXIS 62985 (C.D. Cal. Feb. 4, 2019)

Why it is important

Scottsdale Insurance Co. v. CSC Agility Platform, Inc. provides important guidance regarding disclosures in an insurance renewal questionnaire at the time of a potential acquisition. The U.S. District Court for the Central District of California held that Scottsdale was entitled to recover its payments under a business and management indemnity insurance policy, subject to a reservation of rights, because the insured failed to disclose in the insurance renewal questionnaire a transaction that was under "serious consideration" even though no formal offer had been made at the time.

Summary

Two companies, ServiceMesh and Computer Sciences, entered into a business partnership. During the course of this partnership, the parties began due diligence and discussed the possibility of an acquisition. In the midst of these conversations, ServiceMesh renewed its business and management indemnity insurance with its provider, Scottsdale, and reported that it was not contemplating any transactions in the next 12 months.

ServiceMesh was acquired by Computer Sciences three months after the policy went into effect. Subsequently, Computer Sciences brought suit against several employees of ServiceMesh for misrepresentations made as part of the acquisition. Scottsdale agreed to indemnify the individuals for the expenses related to defending the suit while reserving the right to deny coverage and recoup the expenses. After paying out the policy limit, Scottsdale brought suit to recover its costs.

The court found that Scottsdale was within its rights to deny coverage after determining that ServiceMesh's answer regarding the contemplated acquisition was a material misrepresentation based on their discussions with Computer Sciences. The court analyzed the plain meaning of the term "contemplate," noting that to contemplate "carries a connotation of serious consideration that goes beyond mere fleeting thoughts." However, the court also found that a formal offer was not necessary for a transition to be "contemplated." By holding that contemplation required "serious consideration," the court viewed as distinct every start-up's hopes of being acquired from situations like ServiceMesh's, in which ServiceMesh and Computer Sciences conducted several meetings as well as due diligence. The court also denied the defendant's cross motions to prevent Scottsdale from denying coverage based on theories of waiver and estoppel because of their subsequent knowledge of the transaction.

For a more detailed discussion of this case:

Sciabacucchi v. Salzberg et al.,

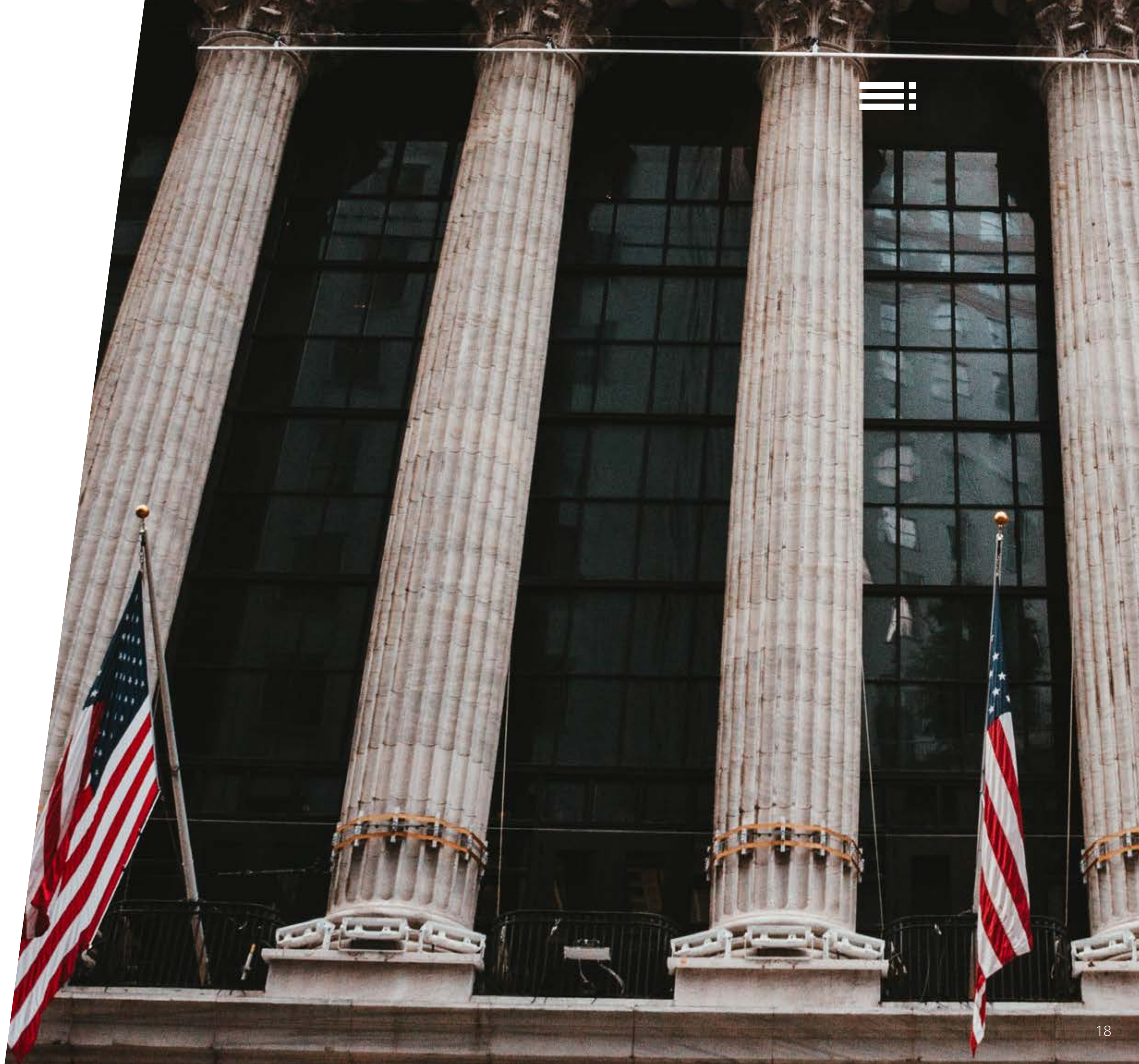
C.A. No. 2017-0931-JTL (Del. Ch. July 9, 2019)

Why it is important

We previously covered the Delaware Court of Chancery's decision in *Sciabacucchi v. Salzberg*, in which the court determined that forum selection clauses were invalid to the extent they required stockholders to bring claims under the Securities Act of 1933 only in federal forums. (See prior coverage here.) Based on this victory, the plaintiff sought a significant fee award of US$3 million. The court's decision to grant that request relied heavily on the value of the benefit conferred by the plaintiff's efforts – namely, eliminating federal forum selection clauses for 1933 Act claims – rather than the amount of time the plaintiff and the plaintiff's counsel invested. This case demonstrates that, even in cases involving non-monetary relief, companies may incur significant liabilities above and beyond the actual value of the plaintiff's attorneys' fees and expenses based on the court's valuation of the benefit achieved.

Summary

In *Sciabacucchi v. Salzberg*, 2018 WL 6719718 (Del. Ch. Dec. 19, 2018), the Court of Chancery found in the plaintiff's favor and declared invalid any forum selection provision that purported to require a stockholder to bring a claim under the Securities Act of 1933 exclusively in a federal forum. As a result, the plaintiff sought a fee award of US$3 million for his and his counsel's work in invalidating those forum selection provisions. The defendants disagreed, arguing that the plaintiff should receive at most US$364,723 plus expenses. The court granted the plaintiff's request for US$3 million, relying in large part on the "significant and substantive result" that the plaintiff achieved in the litigation. The court noted that in past cases with significant impact on the state of the law – such as the cases challenging the viability of the "deadhand pill" in the late 1990s and the "deadhand proxy" in the early 2010s – similarly high fee awards were granted. The court then engaged in an analysis of counsel's time and effort to act as a cross-check on the fee award in order to avoid granting a windfall to the plaintiff and his counsel. While the fee award appeared slightly high on an hourly basis, the court noted that the litigation was taken on a contingency and counsel still bore the risk of receiving nothing depending on the outcome of the appeals process. The court concluded that under all elements in the applicable *Sugarland* framework, an award of US$3 million was reasonable.



Solera Holdings, Inc. v. XL Specialty Insurance Co. et al.,

No. 2018-0389-TMR (Del. Ch. Jan. 25, 2019)

Why it is important

In prior editions, we have highlighted a number of significant appraisal decisions issued by the Delaware courts over the past 18 months, including an appraisal action involving the combination of Solera Holdings, Inc. (Solera) and Vista Equity Partners (Vista). (See prior coverage here.) On July 31, 2019, the Delaware Superior Court addressed what appears to be an issue of first impression arising out of the Solera appraisal action – namely, whether Solera was entitled to recover its defense costs in the appraisal action under its directors' and officers' insurance policies. Based on the terms of the insurance policies as well as the nature of an appraisal action, the court denied the insurers' motion for summary judgment, finding that the appraisal action qualified as a covered "Securities Claim" because that term's definition was not limited to claims of wrongdoing.

Summary

Solera faced an appraisal action after it agreed to a business combination with an affiliate of Vista in March 2016. Solera notified its insurers but was denied coverage, and initiated this action as a result. The court, based on a plain reading of the insurance policy, concluded that a claim need not involve allegations of wrongdoing to constitute a "Securities Claim." The court also found that unless the policy specifically noted that interest on judgment would not be covered if the judgment itself was not covered, the listing of "pre-judgment interest" as a covered "Loss" requires the insurer to pay pre-judgment interest on a noncovered judgment.

For a more detailed discussion of this case:

In re Towers Watson & Co. Stockholder Litigation,

C.A. No. 2018-0132-KSJM (Del. Ch. July 25, 2019)

Why it is important

In *In re Towers Watson & Co. Stockholder Litigation*, the Delaware Court of Chancery dismissed shareholder claims that the CEO of Towers Watson & Co. (Towers) breached his fiduciary duties by failing to disclose a proposal regarding his postmerger compensation to the Towers board of directors, and that the Towers board breached its fiduciary duties by allowing the CEO to negotiate the transaction. The court held that the plaintiffs failed to rebut the application of the business judgment rule, which presumptively applied because the transaction was a "mostly stock-for-stock merger between widely-traded public entities and because the propriety of deal protection devices [was] not at issue." The decision is instructive because the court declined to reach whether shareholder ratification pursuant to the "recently fashionable Corwin doctrine" invoked the business judgment standard, instead holding that the CEO's alleged nondisclosure of a compensation proposal was insufficient to rebut the application of the business judgment rule because the board was aware of the CEO's post-merger employment, was kept apprised of the transaction, and because the proposal was just that – a proposal.

Summary

In re Towers arises out of the US$18 billion merger of equals between Towers and Willis Group Holdings plc (Willis). The transaction was unpopular with certain shareholders, who viewed the transaction as a windfall for Willis and not in Towers' interest. The terms of the transaction were revised, a supplemental proxy was filed, and the deal ultimately closed, but some Towers shareholders remained dissatisfied and brought suit. The shareholders alleged, among other things, that Towers' CEO, who served as Towers' lead negotiator, had a conflict of interest because he wanted to become the CEO of the joint, post-merger company, and that he had failed to disclose a proposal regarding the terms of his post-merger employment to the Towers board. Towers moved to dismiss, arguing that the business judgment rule applied to Towers' decision to enter into the transaction because the plaintiffs failed to rebut the application of the business judgment rule and, alternatively, that a fully informed stockholder vote invoked the business judgment rule under *Corwin*. The court held that dismissal was warranted because the plaintiffs failed to establish that a reasonable director would consider the compensation proposal to be significant when evaluating the merger.

For a more detailed discussion of this case:

Obasi Inv., Ltd. v. Tibet Pharmaceuticals, Inc.,

931 F.3d 179 (3d Cir. 2019)

Why it is important

In *Obasi Investment, Ltd. v. Tibet Pharmaceuticals, Inc.*, the U.S. Court of Appeals for the Third Circuit held that non-voting board observers do not share sufficiently similar powers and responsibilities with directors to impose liability on board observers under Section 11 of the Securities Act of 1933. The case provides helpful guidance to investors who are deciding between whether to seek a board observer seat or a director seat as part of their investment. The Third Circuit also held, as a matter of first impression, that the formal powers, rights, and duties of a position governs liability under Section 11, not the *de facto* power or influence an individual holding that position might wield.

Summary

Tibet Pharmaceuticals, Inc. (Tibet) is a holding company whose subsidiary, Yunnan Shangri-La Tibetan Pharmaceutical Group Ltd. (Yunnan), manufactured and sold traditional Tibetan medicines. Hayden Zou, an early investor in Tibet, approached L. McCarthy Downs III, a managing director at the investment bank Anderson & Strudwick (A&S), about raising capital for Tibet's operations through an initial public offering (IPO). In the IPO registration statement, Tibet listed Zou and Downs as non-voting board observers representing A&S, rather than directors of Tibet. The registration statement explained that although neither Zou nor Downs had any formal powers or duties, they may "significantly influence" board decisions.

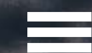
After the IPO, investors learned the IPO documents omitted material information about Yunnan's finances, including the fact that Yunnan defaulted on a loan from the Chinese government, which then froze Yunnan's assets. Soon after the IPO closed, the Chinese government auctioned off Yunnan's assets, leading NASDAQ to halt trading in Tibet stock, triggering a significant drop in the stock price. Shareholders sued Tibet, A&S, Zou, and Downs (among others) for violations of Section 11. The district court denied a motion for summary judgment by Zou and Downs, who argued they were not directors subject to liability under Section 11, in significant part because the registration statement noted that Zou and Downs could have "significant influence" over the outcome of board actions. The district court certified an interlocutory appeal on the question of Section 11 liability for board observers.

The Third Circuit ruled for Zou and Downs over a one-judge dissent, finding that the proper inquiry under Section 11 is whether a position formally has similar core powers and responsibilities to a board director. The court found that the formal functions of Zou and Downs differed from those of typical board directors because they (1) lacked voting power and thus the ability to control or direct the actions of the company; (2) were aligned with A&S' interests rather than with Tibet's; and (3) held terms that ended automatically, without a mechanism to vote them out. The court found that "realworld social dynamics of boardrooms" were not relevant. The dissenting judge argued that Zou and Downs were proper Section 11 defendants based largely on the same reasoning as the district court – namely, that the "significant influence" language in the disclosure statement raised a factual issue as to whether Zou and Downs exercised similar powers and control over Tibet as directors.

For a more detailed discussion of this case:

Sheldon v. Pinto Tech. Ventures,

L.P., 220 A.3d 245 (Del. 2019)



Why it is important

In *Sheldon v. Pinto Tech. Ventures, L.P.*, the Delaware Supreme Court affirmed the Court of Chancery's holding that a group of venture capital firms did not constitute a "control group" in connection with an alleged dilution scheme. As a result, the plaintiffs were barred from bringing direct claims against the venture capital firms. The decision reinforces important limitations on the liability of institutional investors who enter into governance agreements, such as voting agreements and investor rights agreements, by clarifying that such agreements, if unrelated to the challenged transaction, do not create a de facto control group.

Summary

Plaintiffs-appellants Jeffrey J. Sheldon and Andras Konya were minority investors in IDEV Technologies, Inc. (IDEV), owning 3.75 percent between them, while three venture capital firms – Pinto, RiverVest, and Bay City (the VC Firms) – owned a significant percentage of IDEV's remaining shares. The VC Firms were parties to a voting agreement that permitted them to appoint board members.

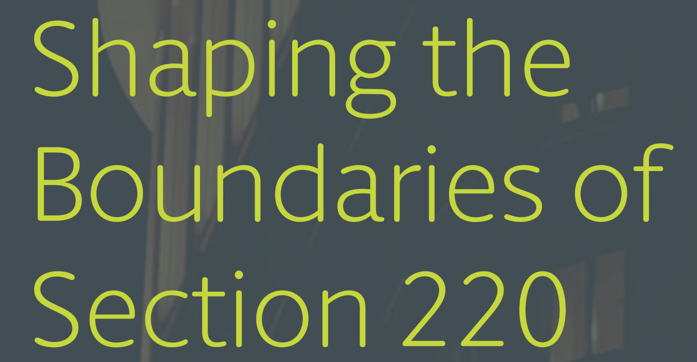
In July 2010, the VC Firms implemented a new financing effort, which involved converting preferred stock to common stock, issuing a new class of preferred stock, and eliminating certain rights held by stockholders, including Sheldon. The VC Firms gave Sheldon and Konya the opportunity to participate in the financing, but neither did. The Confidential Information Statement disclosed that the financing would "result in substantial dilution to Common Stockholders, and the dilution will be significantly increased as to Common Stockholders that do not participate . . . ."

Roughly three years later, Abbott Laboratories purchased IDEV for US$310 million. At the time of the sale, Sheldon and Konya owned just 0.012 percent of the company due to the fundraising and received a fraction of the proceeds they would have received based on their 2010 share ownership.

In their lawsuit, the plaintiffs alleged that the VC Firms constituted a control group and violated a fiduciary duty to the company by diluting shareholders' rights. The Court of Chancery found that the plaintiffs did not adequately plead a derivative claim because they did not make a demand on the board or allege demand futility and that they lost standing to file a derivative suit after Abbott Laboratories purchased IDEV. Although dilution claims are "classically derivative," the plaintiffs argued that their claims were partially direct under *Gentile*, which permits a plaintiff to bring a direct claim if a control group exists. The Court of Chancery rejected the plaintiffs' contention that the VC Firms constituted a control group, and therefore dismissed the plaintiffs' arguments because they did not make a demand on the board or allege demand futility and because they lost standing to bring a derivative suit after Abbott Laboratories acquired IDEV.

The Delaware Supreme Court affirmed, finding that the VC Firms were not connected in a "legally significant way," namely "by contract, common ownership, agreement, or other arrangement." The court rejected the plaintiffs' arguments that the VC Firms were a control group because, among other things, the VC Firms were parties to a voting agreement, had a history of investing together, and acquired enough stock to amend the Certificate of Incorporation. In particular, the court was not persuaded that the VC Firms' rights to appoint directors established domination or control or that a voting agreement among the VC Firms created a control group because the agreement did not require them to vote together nor did the voting agreement "bear on the [f]inancing or bind the [VC] Firms beyond selecting directors."

For a more detailed discussion of this case:



Shaping the Boundaries of Section 220

Tiger v. Boast Apparel, Inc.,

C.A. No. 2017-0776 (Del. Aug. 7, 2019)

Why it is important

In *Tiger v. Boast Apparel, Inc.*, the Delaware Supreme Court held that corporations responding to shareholder requests for the production of books and records under Section 220 of the Delaware General Corporation Law are not entitled to a presumption of confidentiality. The court found "that the targets of Section 220 demands will often be able to demonstrate that some degree of confidentiality is warranted where they are asked to produce nonpublic information," but held that an entitlement to a confidentiality order should not be presumed, and that orders requiring materials be kept confidential indefinitely should be "the exception."

Summary

Plaintiff Alex Tiger partnered with another investor, John Dowling, in 2010 to create Boast Investors, LLC—later converted to BAI Capital Holdings, Inc. (BAI)—in order to revive a 1970s era tennis apparel brand. Conflicts arose in the company when Dowling executed a series of actions that Tiger opposed, which resulted in Dowling gaining additional member units and amending the operating agreement. After these actions, Tiger made successive Section 220 requests for books and records. Both requests stalled after the parties could not reach an agreement on the scope of a confidentiality agreement that would govern the records Tiger requested.

After BAI sold substantially all of its assets against Tiger's consent, Tiger filed an action demanding access to the books and records he had sought in his earlier demands. BAI and Tiger again disagreed on what confidentiality restrictions should apply to the requested records. The Master in Chancery recommended an indefinite order that could be altered by the filing of a suit that was based on facts in the inspected materials, and the Court of Chancery adopted the recommendation, finding it was appropriate and that Tiger had not overcome the presumption in favor of confidentiality or shown the exigent circumstances required to justify limiting the confidentiality order's duration. Tiger appealed, and the Delaware Supreme Court held that, while the Court of Chancery's final judgment granting an indefinite confidentiality order to BAI was not an abuse of discretion, there was no presumption of confidentiality and no requirement to show exigent circumstances to avoid a confidentiality order of lengthy or indefinite duration. The court found that confidentiality orders instead should be evaluated using a balancing test that "weigh[s] the stockholder's legitimate interests in free communication against the corporation's legitimate interests in confidentiality," and that a court "must assess and compare benefits and harms when determining the initial degree and duration of confidentiality."

For a more detailed discussion of this case:

Southeastern Pennsylvania Transportation Authority et al. v. Facebook, Inc.,

No. 2018-0928-SG (Del. Ch. Mar. 14, 2019)

Why it is important

In *Southeastern Pennsylvania Transportation Authority et al. v. Facebook, Inc.*, the Delaware Court of Chancery denied a books and records request brought by Facebook stockholders, finding that the stockholders failed to show a "proper purpose" for the request under Section 220 of the Delaware General Corporation Law and that the limited records that Facebook already had produced were sufficient. The plaintiffs sought records following Facebook's revelation of systematic issues with its advertising metrics, disclosure of revenue growth deceleration, and a stock price drop characterized as the "biggest-ever one day loss in market value for a U.S.-listed company." After Facebook voluntarily produced certain board-level documents, the plaintiffs filed suit seeking documents concerning the extent to which the Facebook Board of Directors considered advertising revenue growth in its executive compensation decisions. The court found that the plaintiffs had failed to meet their minimal burden to show a "credible basis" to infer waste or mismanagement might have occurred, the "lowest possible burden of proof in Delaware law." The court found that the plaintiffs' theories impermissibly sought to challenge the company's business judgment regarding what factors to consider in setting executive compensation. This decision reinforces that, despite the low burden to obtain books and records under Section 220, Section 220 requests premised on mere second-guessing of board decision-making may be denied.

Summary

The plaintiffs, two institutional investors, sought records regarding how Facebook's Board of Directors determined executive compensation following Facebook's announcement that it had overstated certain advertising metrics, including the amount of time users spent watching video advertisements. The plaintiffs alleged that the announcement led to decreased Facebook revenue growth and a drop in the price of Facebook stock. The plaintiffs sought records from Facebook under Section 220 of the Delaware General Corporation Law, under which stockholders need to demonstrate a "proper purpose" for their request. Facebook provided certain materials but declined to produce others. The plaintiffs brought suit to compel additional disclosure.

The plaintiffs alleged that their request had four different purposes, but the court found that their primary purpose was to investigate possible breaches of fiduciary duty by Facebook's board in connection with the level of compensation they provided for Facebook executives. The court found that this was not a proper purpose because there were no allegations that the board was conflicted or had acted in bad faith, and the board's compensation decisions were therefore subject to the business judgment rule. The court found that in light of the business judgment rule and the Facebook charter's exculpatory provisions, alleged violations of the duty of care in connection with executive compensation would not be actionable, and therefore disclosure to investigate such violations was not proper. The court also held that further inspection was not "necessary and essential" to achieving the plaintiffs' stated purposes because Facebook already had produced sufficient information upon which to file a claim.

For a more detailed discussion of this case:

High River LP v. Occidental Petroleum Corp.,

C.A. No. 2019-0403-JRS (Del. Ch. Nov. 14, 2019)

Why it is important

In *High River LP v. Occidental Petroleum Corp.*, the Delaware Court of Chancery rejected what it termed a "novel" demand by an activist shareholder for books and records related to a consummated merger transaction under Section 220 of the Delaware General Corporation Law, finding that the desire to gather information to assist in communicating with other shareholders about a potential proxy contest is not a proper purpose. The decision reiterated the Delaware courts' reluctance to approve Section 220 demands relating to corporate decisions "that are questionable, but not actionable."

Summary

Occidental Petroleum Corporation (Occidental) acquired Anadarko Petroleum Corporation (Anadarko) in May 2019 in a "merger of equals." Viewing the merger as ill-advised, activist investor Carl Icahn and affiliated entities (the Icahn Parties) began acquiring Occidental stock, with the goal of mounting a proxy fight to replace members of Occidental's board of directors with a new slate of directors proposed by the Icahn Parties. To help them win the proxy fight, the Icahn Parties demanded access to Occidental's books and records relating to the merger, Occidental's decision to be a buyer when market conditions seemed favorable for a seller, and provisions of Occidental's governing documents regarding the threshold for calling a special meeting of the stockholders. The Icahn Parties admitted that their primary purpose in seeking the documents was to support their potential proxy fight, rather than to investigate corporate wrongdoing or mismanagement. The Icahn Parties asked the court to recognize a new, or at least expanded, rule under Section 220 that would permit stockholders to inspect books and records relating to "questionable, but not actionable," board-level business decisions when the stockholder demonstrates that the purpose for the requests is in furtherance of "a potential, *bona fide* proxy contest."

The Delaware Court of Chancery rejected this request, finding that the Icahn Parties did not need access to Occidental's books and records to wage a proxy fight given the public information already available about the merger, and that disclosure was accordingly not "necessary, essential, and sufficient" for a "proper purpose." The court also found that the Section 220 demand was, in effect, a request for the court to "recognize a new, or at least expanded, rule that would allow a stockholder to inspect books and records relating to targeted, board-level business decisions that are questionable, but not actionable, when the stockholder states and then demonstrates that his purpose is to communicate with other stockholders in furtherance of a potential, bona fide proxy contest." Finding that the law on using Section 220 was "at best, murky," the court held that a "right case" might exist but had not been presented. The court also rejected the Icahn Parties' alternative ground for seeking Occidental records, finding that the Icahn Parties' disagreement with Occidental's decision to acquire Anadarko was insufficient to support an inference of corporate mismanagement or wrongdoing.

For a more detailed discussion of this case:

Bucks County Employees Retirement Fund v. CBS Corp.,

C.A. No. 2019-0820-JRS (Del. Ch. Nov. 25, 2019)

Why it is important

In another decision regarding a Section 220 demand for corporate books and records, the Court of Chancery held in *Bucks County Employees Retirement Fund v. CBS Corp.* that a pension fund that invested in CBS was entitled to obtain records related to CBS's planned (and now completed) merger with Viacom Inc., finding a credible basis to suspect actionable wrongdoing in light of the plaintiff's allegations that CBS was being improperly pressured by a controller who also controlled Viacom to merge with Viacom to its detriment. The decision affirms the principle that while a plaintiff must demonstrate a "credible basis" to infer that mismanagement, waste or wrongdoing "may" have occurred, "'[c]redible basis' is the lowest burden of proof known in our law," satisfied by a "[l]ow quantum of evidence."

Summary

Prior to their merger, CBS and Viacom were both controlled by Shari Redstone through a company she controls, National Amusements, Inc. (NAI). Redstone proposed that CBS merge with Viacom in 2016 and 2018, but special committees of CBS's board rejected the proposed merger as not in CBS's best interests on both occasions. In 2018, CBS's board took the extraordinary step of suing NAI to enjoin it and Redstone from forcing a merger. That litigation resulted in a settlement agreement in which CBS's board was restructured, several directors were replaced, and NAI and Redstone agreed that Redstone would not recommend a merger with Viacom for two years unless invited to do so by two-thirds of CBS's independent directors.

In 2019, a committee of the CBS board held a meeting to discuss "strategic possibilities for the company" attended by Redstone and CBS's chief legal officer. Afterwards, CBS's chief legal officer resigned, and CBS again began pursuing a merger with Viacom. The plaintiff, a pension fund invested in CBS, demanded CBS produce records pursuant to Section 220 of the Delaware General Corporation Law relating to the planned merger, and CBS largely refused. The plaintiff brought suit, alleging that there was a credible basis to infer that Redstone and NAI had violated the 2018 settlement and that CBS's directors and new CEO had breached their duties to CBS by recommending that CBS complete a merger with Viacom that was similar to the proposed Viacom merger CBS had rejected in 2016 and 2018. The Court of Chancery found that the plaintiff's allegations met the "credible basis" standard, which it described as "low," particularly since CBS did not seek approval of its unaffiliated stockholders for the proposed merger and did not "follow the *MFW* road map." The court approved some, but not all, of the plaintiff's requests for records, finding some unnecessary to achieve the plaintiff's purposes.

For a more detailed discussion of this case:

Limitations on the Covenant of Good Faith and Fair Dealing

Vintage Rodeo Parent LLC v. Rent-A-Center Inc.,

No. 2018-0928-SG (Del. Ch. Mar. 14, 2019)

Why it is important

Parties in M&A transactions often include provisions requiring formal notice to extend closing dates. The Court of Chancery's recent ruling in *Vintage Rodeo Parent LLC v. Rent-A-Center* Inc. illustrates that, where an agreement permits termination after a specified "end date" unless the period for closing is extended, failure to technically comply with the formal extension procedure in the agreement may result in harsh consequences.

Summary

Vintage Capital Management LLC owns and operates a chain of "rent-to-own" stores. In 2018, it entered into a merger agreement to acquire another rent-to-own store owner, Rent-A-Center Inc. Under the parties' agreement, either side could terminate the merger unilaterally if the transaction did not close within six months of signing, unless one or both parties served a formal notice extending the closing period, and other conditions were met. Unless terminated, the agreement required both parties to use "commercially reasonable efforts" to obtain FTC approval for the transaction and to close.

Following the signing, Vintage Capital and Rent-A-Center worked together to achieve FTC approval for their planned merger, but did not obtain that approval within the six-month closing period specified in the merger agreement. Rent-A-Center anticipated that Vintage Capital would exercise its right to unilaterally extend the closing period by sending an extension notice, but when Vintage Capital failed to do so, Rent-A-Center terminated the agreement. Vintage Capital sued, alleging that Rent-A-Center had waived Vintage Capital's obligation to send a formal notice extending the closing period by working together to continue to seek FTC approval for the merger. The court rejected this argument, finding that Rent-A-Center's conduct in jointly seeking FTC approval was consistent with Rent-A-Center's obligation under the agreement to use commercially reasonable efforts to close, and was not a waiver of the contractual provisions entitling Rent-A-Center to terminate the agreement if no formal extension notice was issued. The court found the agreement's termination and notice provisions clear and enforceable as written.

For a more detailed discussion of this case:

Oxbow Carbon & Minerals Holdings, Inc. v. Crestview-Oxbow Acquisition, LLC,

No. 2018-0389-TMR (Del. Ch. Jan. 25, 2019)

Why it is important

The Delaware Supreme Court's decision in *Oxbow Carbon & Minerals Holdings, Inc. v. Crestview-Oxbow Acquisition, LLC* reaffirms the court's reluctance to vary the plain language of sophisticated parties' bargains. In particular, the Delaware Supreme Court noted that a party could not rely on the implied covenant of good faith and fair dealing to force an exit transaction where the LLC agreement did not provide for such relief.

Summary

In 2007, Crestview Partners, L.P. and Load Line LLC (the Minority Members) invested in Oxbow. Oxbow's governing LLC Agreement afforded its members a "Put Right" following the seventh anniversary of their investment. If the put failed, the member could trigger an "Exit Sale" of all of Oxbow's assets. The Exit Sale was conditioned on a so-called "1.5x Clause," which permitted the Exit Sale only if all Oxbow members would receive at least 1.5 times their initial capital contribution to the LLC.

Several years later, the Minority Members sought to exercise their Put Right and trigger an Exit Sale. However, the valuation of the sale was less than required for certain subsequently admitted members (the Small Holders) to receive 1.5 times their capital contribution. The Small Holders therefore sought a declaratory judgment blocking the Exit Sale.

Although the contract required that sale proceeds be allocated pro rata to the members, the Court of Chancery applied the implied covenant of good faith and fair dealing to read a "Top-Off" provision into the LLC Agreement so that the Small Holders could not block the transaction. The Delaware Supreme Court reversed, emphasizing that the implied covenant is an exceedingly rare remedy unavailable to alter the parties' bargain as to foreseeable circumstances.

For a more detailed discussion of this case:

Securities, Shareholder, and M&A Litigation practice overview

At Hogan Lovells, we guide companies – and their officers and directors – through all types of disputes that arise with their investors, shareholders, and transactional partners. Working with our market-leading corporate and regulatory colleagues, we get involved early in a dispute, helping companies avoid costly and protracted litigation or, if litigation is inevitable, obtaining favorable outcomes at the earliest possible stage through aggressive investigation, discovery, and advocacy. No other firm has the breadth and depth of practice and industry expertise that Hogan Lovells offers, and we leverage that to provide the best representation possible in these disputes. We bring our extensive experience to bear in all industries, focusing on the following areas:

1. Corporate governance litigation;
2. Private company M&A disputes;
3. Public company M&A litigation;
4. Federal securities litigation; and
5. Investment fund disputes and litigation.

Corporate Governance Litigation

Shareholders frequently challenge decisions made by the board of directors at both public and private companies; our role is to advise, and when necessary defend, companies and their directors against these challenges. We have successfully done so in a wide array of contexts, including M&A transactions, dissolutions, recapitalization plans, compensation awards, by-law amendments, and voting rights agreements.

We also are frequently involved early in corporate transactions to help clients navigate the conflicts of interest – and other potential pitfalls – that often later give rise to shareholder litigation. We represent special committees of the board in investigating shareholders' allegations of misconduct. And when shareholders make books and records demands on a company under Section 220 of the Delaware General Corporations Law, or similar state laws, prior to filing litigation, we have significant experience in successfully limiting or opposing inappropriate demands.

Private Company M&A Disputes

Disputes between the buyer and the seller in private company M&A transactions arise in several predictable areas:

- Purchase price disputes in which one party (usually the buyer) seeks to renegotiate the deal price through the use of a post-closing price adjustment provision;
- Earn-out disputes in which the parties disagree about whether deferred portions of the purchase price are payable based on the target's post-closing performance; and
- Indemnification disputes where one party (usually the buyer) seeks indemnification for breach of representations and warranties in the purchase agreement.

In collaboration with our corporate colleagues specializing in private M&A, our team reviews transaction documents during negotiations to help craft the most favorable terms for our client. If a dispute does later arise, we have substantial experience litigating the complex accounting and contract issues that arise in these disputes to obtain the best results for our clients, whether in arbitration or in court.

Public Company M&A Litigation

Recent data reflects that, in more than 90 percent of public company M&A transactions, lawsuits are filed by shareholders that purport to challenge the transactions; in transactions in excess of US$100 million that number is over 95 percent. Working together with our M&A group, we advise directors on relevant litigation issues prior to the M&A announcement and aggressively defend the predictable suit when filed, aiming to prevent plaintiffs and their lawyers from disrupting transactions that the board has found to be in the best interest of the company and its stockholders. We also have experience representing companies when faced with tender offers or proxy battles that can arise in conjunction with announced M&A transactions.

Federal Securities Litigation

We have deep experience representing public companies and their officers and directors in all types of securities litigation in courts across the United States. We have successfully defended clients in cases involving initial and secondary offerings alleging violations of Sections 11 and 12 of the '33 Act and fraud claims under Section 10(b) of the '34 Act. We defend companies in proxy litigation and short-swing trading cases. Underwriters and auditors also rely on us to defend them, and our attorneys have won victories for all of the major accounting firms and the leading investment banks.

Investment Fund Disputes and Litigation

We have represented funds of all types – private equity, venture capital, distressed debt, REITs, and investment management companies – in disputes at the portfolio company and fund level. These disputes have run the gamut, involving any of the following:

- investor complaints by limited partners and shareholders;
- board disputes and/or contests for board control;
- corporate governance rights or creditor rights, both in and out of bankruptcy;
- allegations of alter ego and veil piercing;
- minority shareholder rights when the funds are not in a control position; and
- damages claims when an investment suffers loss or when a portfolio company or fund is threatened with such claims.

Private equity funds are repeat players in private M&A and corporate governance disputes, and so are we, having developed significant experience representing fund sponsors in these disputes. The sponsors can also have unique disputes with their own minority partners or investors, whether over capital calls, investor rights, or management decisions under the terms of the fund documents, and we advise and represent funds in these disputes.

Notable cases and victories

We are a **team of experienced trial attorneys** that are focused on achieving our clients' key business objectives. We are proud of our trial record, and this year is no different. Notably, in 2019, our team tried a case to judgment, obtaining a **complete defense verdict** on behalf of a **public aerospace and defense company** and its officers. To add to this victory, we also obtained an **award of attorneys' fees** for the plaintiffs' discovery misconduct.

In another notable victory, we obtained a pre-discovery **summary judgment** ruling entitling our client to recover a contractual earnout payment in a **private M&A case** in New York state court. Upon the buyer's appeal of the decision, the New York Appellate Division, First Department **unanimously affirmed the trial court's decision**, entitling our clients to recover **US$70 million in earnout payments**.

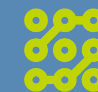
In the last several years, it has become increasingly common to resolve public M&A cases through so-called "mootness fee" settlements. We have experience navigating these waters, but stand apart from many firms in that we also have **challenged plaintiffs' fees applications** on the grounds that certain state laws – including New York – preclude mootness fees prior to class certification as impermissible fee shifting.

In **federal securities class actions**, we have experience attacking deficient pleadings under the **Private Securities Litigation Reform Act**. Over the last 12 months, our team has won **pleading-stage dismissals** of securities class actions filed against public companies in the life sciences, sporting goods, and consumer retail industry sectors. In particular, we prevailed on a motion to dismiss a complaint alleging securities fraud based on news articles reporting the use of racist language and #MeToo allegations. The court granted the motion to dismiss, finding that the company's code of ethics did not set forth factual representations that investors actually relied on, and that Items 303 and 503 of Regulation S-K did not create a duty to disclose unproven allegations of wrongdoing.

Our team has vast experience on the defense side, but we can also act as plaintiffs' counsel to protect the rights of our clients. For example, we **successfully defeated a motion to dismiss** in federal court challenging the standing of our client, a **minority investor** pursuing claims against a controller for **self-dealing** breach of fiduciary duty and misappropriation of trade secrets.

We are actively litigating a number of large cases across a broad array of industries, such as:

In a contest for corporate control, we are currently contesting a board of directors election pursuant to Delaware General Corporate Law Section 225 in the Delaware Court of Chancery;



On behalf of a start-up technology company, we are currently defending a breach of fiduciary duty and other claims brought in Delaware Court of Chancery;

On behalf of a public sports manufacturing company founder and chairman, we are defending multiple securities class actions and derivative suits alleging securities fraud and breach of fiduciary duty claims, as well as coordinating related regulatory investigations;

On behalf of a public REIT, we are defending shareholder lawsuits alleging breach of fiduciary duty and disclosure claims in connection with a merger transaction;

On behalf of a privately held energy company, we are defending multiple actions filed by limited partners in Texas state court involving breach of fiduciary duty and breach of the underlying investment agreement.

These examples represent just a sample of our team's experience and successes in 2019, and we are poised to help our clients tackle the new challenges already presented in 2020.

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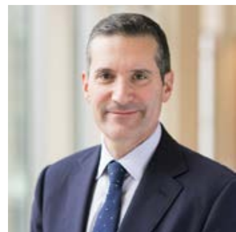

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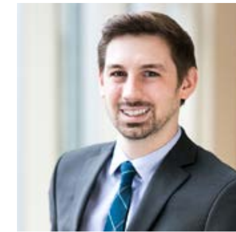

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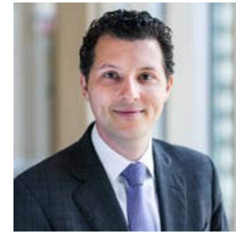

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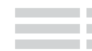

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