

Recent Developments in Delaware Corporate Law

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Presentation Overview

- Board of Directors and Governance Issues
- Relations with Securityholders
- Business Combinations

Board of Directors and Governance

- Director Duties and Standards of Conduct
- Risk Management
- Executive Compensation

Board of Directors and Governance: Director Duties & Standards of Conduct

- Duty of Care
 - Duty to oversee the operations of the business
 - Obligation to inquire so as to obtain adequate information
 - Ability to rely upon competent management and experts
 - Actions taken in good faith on the basis of adequate information almost always will be sustained
 - “Inaction” claims require a showing of conscious disregard
 - Exculpation under DGCL Sec. 102(b)(7)

Board of Directors and Governance: Director Duties & Standards of Conduct

- Duty of Loyalty
 - Actions must be free of self-interest
 - Direct business or compensatory arrangements
 - Perpetuation claims
 - Interested Director Transactions
 - Ratification by informed shareholders
 - Approval by disinterested directors
 - Entire fairness
 - Intermediate Scrutiny and *Unocal* Standard
 - “Duty of Disclosure”

Board of Directors and Governance: Director Duties & Standards of Conduct – Recent Developments (Duty of Care)

- *In re Citigroup Shareholder Derivative Litigation*
 - Failing to oversee business
 - Conscious disregard for risks attendant to subprime mortgage market
 - Ignoring signs of worsening economy
 - Distinguished from *ALG*, which involved duty to protect against employees' fraudulent and criminal conduct
 - Plaintiff must show conscious disregard for known risks at a level that constitutes bad faith
 - Illustrates the difference between demonstrating bad faith actions as compared to inaction

Board of Directors and Governance: Director Duties & Standards of Conduct – Recent Developments(Duty of Loyalty)

- Evolution of “Duty of Disclosure” cases
 - Generally arise out of duty of loyalty
 - Negligent errors or nondisclosure can sound in duty of care
- Monetary damages are generally inadequate to remedy disclosure violations, so courts can award injunctive relief or order remedial disclosure
- *Dubroff v. Wren Holdings*
 - DGCL Sec. 228 Notice standard
 - Whatever the context, any time the board communicates with stockholders they must do so forthrightly and honestly
- *In re Transkaryotic Therapies, Inc.*
 - Negligent nondisclosure reflects a question of due care rather than implicating duty of loyalty

Recent Developments (Duty of Loyalty)

- Takeover Defenses and *Unocal/Unitrin* standard
 - Reasonable basis for believing a legitimate threat to the corporate enterprise based on good faith and reasonable information
 - Response must be proportionate to threat
- *Versata v. Selectica* (Del. Ch. Feb. 26, 2010)
 - Background
 - Longstanding and adversarial relationship between competitors
 - Board had carefully monitored NOL value and impact in consultation with advisory firm
 - Examination of alternatives
 - Versata's actions and apparent intent
 - Reloading plan
 - Effect of Rights Plan
 - Court determined
 - Legitimate threat to a valuable corporate asset
 - Response was reasonable in response to the threat at hand

Board of Directors & Governance: Executive Compensation

- Dodd-Frank Say-on-Pay and Say-When Initiatives
- Dodd-Frank Say-on-Golden-Parachutes Initiative
 - Limited applicability to golden parachute arrangements previously submitted in a say-on-pay proposal
 - Requires extensive disclosure regarding arrangements between the target's named executive officers and both the target and the acquiror
- Delaware law affords independent boards and compensation committees wide latitude in determining the amounts and types of compensation
 - *In re Walt Disney Co. Derivative Litigation* (Del. Ch. 2003)
 - *In re Citigroup Inc. Shareholder Derivative Litigation* (Del. Ch. February 24, 2009)

Relations with Securityholders

- Preferred Stockholder, Venture Capital and Private Equity Concerns
- Stockholder Control and Proxy Access Initiatives
- Segregation of Economic and Controlling Interests

Relations with Securityholders

- Preferred Stock Issues
 - Generally, preferences and protective provisions favoring preferred stockholders are in the nature of contract rights
 - Courts generally will impute fiduciary duties in protecting common holders, but often not preferred holders
 - *LC Capital Master Fund, Ltd., v. James* (Del. Ch. Mar. 8, 2010).
 - Chancery Ct. denied a preferred stockholder's motion to enjoin
 - Board approved a merger that would not trigger preferred stockholder approval
 - Deal consideration for preferred stockholders was less than liquidation preference
 - Merger resulted in consideration to common stockholders

Relations with Securityholders

- Preferred Stock Issues
 - *In re Trados, Inc., Stockholders Litigation* (Del. Ch. July 24, 2009)
 - Background
 - Long history of lackluster performance; private equity firm seeking liquidity and substantially controlled the board
 - Board adopts management incentive plan
 - Sale transaction in which preferred holders received \$52MM liquidation preference and management received \$8MM incentive payment
 - Common holders got nothing
 - Reasonable to infer that “this is the worst possible outcome for the common stockholders.”
 - Where the interests of the preferred and the common diverge, the board of directors may breach its fiduciary duty by improperly favoring the interests of the preferred holders over those of the common holders

Relations with Securityholders

- Shareholder Agreements
 - *Nemec v. Shrader*, Del. (Apr. 6, 2010)
 - Former Booz, Allen & Hamilton Stockholders
 - Officers Stock Rights Plan
 - Put/Call Rights
 - Purchase at \$162 per share
 - Imputed value >\$700 per share
 - Burden is to demonstrate that one party acted in an arbitrary or unreasonable manner which frustrated the fruits of the bargain the parties intended, *measured at the time they entered into the contract.*

Relations with Securityholders

- Vote-buying, Hedging and other issues segregating economic interest from control
 - Delaware has a longstanding hostility to segregating the voting right from the property right
 - Over-voting: voting by persons who were holders as of the record date but had sold their stock by the time of the vote
 - Under-voting: inability to vote the interests of shares one acquires after the record date
 - Hedging share ownership
 - 2009 Amendments to DGCL Sec. 213(a) – dual record dates for notice and voting
 - Proxy Mechanics Release (Rel. No. 34-62495, July 14, 2010)

Relations with Securityholders

- Vote-buying, Hedging and other issues segregate economic interest from control
 - *Parfi Holding A.B. v. Mirror Image Internet, Inc.* (Del. C Sept. 4, 2008, *aff'd* Del. Nov. 10, 2010)

Relations with Securityholders

- Proxy Access Requirements
 - Exchange Act Rule 14a-11
- Status of *Business Roundtable and U.S. Chamber of Commerce v. SEC*
- Other stockholder access initiatives
 - DGCL Sec. 112
 - Interplay between DGCL Sec. 112 and Exchange Act Rule 14a-8

Business Combinations

- Breaches of Fiduciary Duty
- Consummation Risk
- Controlled Company and Related Party Transactions
- Deal Protections
- Emergence of Tender Offers and Top-up Options

Business Combinations

- Breach of Fiduciary Duty
 - Emergence of “failure to disclose” as basis for fiduciary duty claims
 - Principle is that there is no adequate damages remedy for inaccurate disclosure
 - *Maric Capital Master Fund, Ltd., v. PLATO Learning, Inc.* Del. Ch. May 13, 2010)
 - Omission of free cash flow analysis was a material nondisclosure justifying injunction where DCF analysis was selectively removed from proxy statement
 - Court cited apparently misleading communications contained in proxy statement, as well as apparent collusion between management and acquiror
 - *Steamfitters Local Union 447 v. Walter* (Del. Ch. June 21, 2010)
 - No remedy awarded for omission of DCF analysis, but no such analysis had been performed nor relied upon
 - *Berger v. Pubco Corp.* (Del. 2009)
 - Deficient description of valuation methodology
 - Remedy: quasi-appraisal proceeding

Business Combinations

- *In re Dollar Thrifty Shareholder Litigation* (Del. Ch. Sept. 8, 2010)
 - Denial of injunction against Dollar-Thrifty/Hertz merger
 - Combination cash/stock transaction at \$41/share
 - Breakup fee, no-shop/fiduciary out, matching rights
 - Reverse termination fee for antitrust terminations
 - Avis activities
 - Cash/stock offer at \$46/share
 - No breakup fee or matching rights
 - No reverse termination fee
 - *Revlon* analysis

Business Combinations

- *In re Cogent Technologies Shareholder Litigation* (Del. Ch. Oct. 5, 2010)
 - All-cash deal valued at \$10.50/share
 - Two-step offer with top-up option
 - Lockup agreement with 39% stockholder terminable on change of board recommendation
 - Nonbinding expression of interest from “Company D” suggested a range of \$11-12/share
 - Board discounted possibility based on the risk Company D would not make a firm offer
 - Cogent had been perceived to be for sale for a considerable period of time
 - Court concluded board acted reasonably in approving deal and that protective measures were reasonable and not preclusive

Business Combinations

- Breaches of Fiduciary Duty
 - *Lyondell Chemical Corp. v. Ryan* (Del. Mar. 25, 2009)
 - Strategic combination following bear-hug acquisition and public announcement of interest
 - *Revlon* duties arise only when sale of control becomes inevitable
 - If directors are independent, duty of loyalty requires a knowing disregard of the directors' obligations, in this case, whether they "utterly failed to attempt to obtain the best sale price"
 - "Consummation Risk" and Impact on *Revlon* Duties
 - *In re Dollar Thrifty* (Del. Ch. Sept. 28, 2010)
 - *In re Cogent, Inc.* (Del. Ch. Oct. 5, 2010)

Business Combinations

- Controlled Company and Related Party Transactions
 - Acquisitions by controlling stockholders analyzed under the two-prong standard set forth in *In re Cox Communications Stockholder Derivative Litigation*, Del. Ch. June 6, 2005
 - Approval by a committee of independent directors
 - Tender offer includes a non-waivable majority-of-the-minority condition
 - *In re CNX Gas Corp Shareholders Litigation* (Del. Ch. May 25, 2010)
 - The sole independent director was not permitted to negotiate, but recommended a higher price, and ultimately declined to recommend in favor of the merger
 - More than 1/3 of the “float” was locked up in a prior transaction between the parent and T. Rowe Price

Business Combinations

- Deal Protections
 - Enforceability of no-shop arrangements
 - *NACCO Industries, Inc., v. Applica Inc.* (Del. Ch. Dec. 22, 2009)
 - Court refuses to dismiss damages claim even though target had previously paid a breakup fee
 - Suggested the appropriate remedy for breach would be expectation damages
 - Significant evidence of deliberate misconduct and intentional breach of both the no-shop and prompt notification provisions of the agreement

Business Combinations

- Tender Offers and Top-up Options
 - Structure involves the launch of a friendly tender offer
 - Often includes lockups of affiliate shares
 - Assuming minimum tender condition is met, “top-up” option permits acquiror to purchase from the target a number of shares sufficient to meet short-form merger requirement
 - *Olson v. ev3, Inc.* (Del. Ch. Feb. 21, 2011)

Questions?