



# CORPORATE ACCOUNTABILITY



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**REPORT**

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## Delaware Law

### Recent Delaware Cases Reflect Fluctuation In M&A, 'Poison Pill' Cases, Attorneys Note

**R**ecent Delaware corporate cases have reflected noticeable fluctuations in the number of cases related to issues such as mergers and acquisitions, "poison pills," and "poison puts," corporate law attorneys told BNA in recent interviews.

The issues addressed in these recent cases have been a "continuum, expansion, or clarification" of existing case law as applied to new sets of facts, Francis G.X. Pileggi, a partner at Fox Rothschild LLP in Wilmington, Del., told BNA Sept. 3.

"The Delaware courts are now seeing more of the types of cases—such as traditional fiduciary duty cases—that were prevalent prior to the financial crisis," Albert H. Manwaring, a partner at Pepper Hamilton LLP in Wilmington, Del., told BNA Sept. 9.

The economic downturn has not yet generated any new case law for Delaware, John F. Grossbauer, a partner at Potter Anderson & Corroon LLP in Wilmington, Del., told BNA Sept. 9. However, "there has been an increase in distressed situations among companies and boards. With many companies, pressing issues include determining when duties shift to creditors," he said.

There has also been an influx in litigation involving alternative entities—including limited liability companies—because they tend to be more subject to economic pressures and disputes during a recession, Edward M. McNally, a partner at Morris James LLP in Wilmington, Del., told BNA Sept. 4. "Conversely, the number of mergers and acquisitions cases has seen a decrease," he said.

**Recent Cases Generated by Variety of Factors.** A number of recent Delaware corporate cases involve fact patterns resulting from the financial crisis, Pileggi said. For example, cases such as *In re Trados Inc. Shareholder Litigation* reflect the difficulties the down economy has created with the sale of companies, he said (7 CARE 1031, 8/21/09).

During the economic downturn, many of the cases traditionally reviewed by Delaware courts—such as breach of fiduciary duty actions in connection to M&A or sale of a business—saw a decrease, Manwaring said. Recent cases have focused on challenges to excessive executive compensation by shareholders and *Caremark*

claims—or systematic and continuous failures by boards to properly monitor a company, he said.

In the landmark case of *In re Caremark Int'l Derivative Litigation*, 698 A.2d 959 (Del. Ch. 1996), the Delaware courts articulated the standard for assessing a director's potential personal liability for failing to act in good faith in their oversight responsibilities. The court concluded that only a "sustained or systematic failure of the board to exercise oversight—such as an utter failure to attempt to assure a reasonable information and reporting system exists—will establish the lack of good faith that is a necessary condition to liability."

"I do not think that these cases were very successful under Delaware's fiduciary duty laws," Manwaring said. "Cases that have actually been successful included allegations of fraud or outright acts of 'bad faith,'" he said.

The Delaware courts have also been working through the implications of the recently decided *Lyondell Chemical Co. v. Ryan* case, Grossbauer said (7 CARE 406, 4/3/09). "*Lyondell* set a very high standard regarding director duties and what constitutes bad faith. Now, the courts will likely see more injunctive proceedings," he said.

However, cases involving director and officer liability insurance are not likely to grow in number in the future because Delaware case history suggests that absent of a "true conflict," it is very difficult for disinterested directors to be held personally liable under Delaware law, Grossbauer said.

"After *Gantler v. Stephens*, I would have expected more director and officer liability cases would be filed by now—this is has not happened," Grossbauer said (7 CARE 170, 2/6/09). "To the extent a claim against an officer is a derivative one, the board is in charge of bringing the claim," he said. This is problematic if the board is uninterested, he said.

**Key Issues Include Poison 'Pulls,' 'Pills,' M&As.** With public companies, it is possible that the Delaware courts will continue to see litigation involving "poison put provisions"—as addressed in the *San Antonio Fire & Police Pension Fund v. Amylin Pharmaceuticals, Inc.* case, Grossbauer said. An issue for the courts regarding private entities that has been growing popular is class conflicts between preferred and common stockholders, he said.

"Interestingly, there has been a slight increase in lawsuits seeking to force boards to pull 'poison pills,' but none of those cases have gone to trial. As of now,

this seems to be an emerging focus, but there are no new decisions in this area,” McNally said.

In the near future, M&As will start to increase again, therefore impacting the number of M&A cases, Grossbauer said. “We are beginning to see more cases filed as a result of deals that are starting to happen now,” he said. “After *Lyondell*, plaintiffs will be pushing for more ‘injunctive aspects’ such as disclosures,” he said.

“There appears to be a growing focus on terms in merger agreements designed to protect the merger from being ‘broken apart.’ More agreements now contain provisions that essentially make these transactions ‘bullet-proof,’” McNally said.

An unusual occurrence over the recent years has been a steady amount—although not an increase—of litigation involving parties attempting to withdraw from transactions, McNally said.

Generally, the Delaware courts have supported stringent merger agreement terms, McNally said. “There is

a need for certainty and greater deal protections when the credit markets are in flux. This will likely hold true until the economy ‘settles down,’” he said.

**Proxy Access Issues Awaiting Federal Action.** There will likely be major cases associated with shareholder proxy access, but this will depend on what happens in the federal arena, Pileggi said. “The ultimate outcome will mostly depend on the SEC’s actions,” he said.

“I do not see anything occurring, in Delaware or anywhere else, in regards to shareholder proxy access until the related issues are resolved at the federal level,” McNally said.

“The proxy season is over, but I expect cases involving proxy fights and advanced notice bylaws will continue to surface,” Grossbauer said. Proxy access is likely to be a growing issue, he said.

BY TINA CHI

### Review of Recent Key Delaware Corporation Law Cases—Third Quarter 2009

Topic	Case Name (Case Citation cite of CARE story)	Holding
Attorneys’ Fees	<i>Loral Space &amp; Communications Inc. v. Highland Crusader Offshore Partners L.P.</i> (7 CARE 977, 8/7/09) Del., No. 623, 2008, 7/23/09	The Chancery Court correctly awarded fees and expenses to a law firm that represented shareholders who were challenging a preferred stock transaction. The decision properly took into account the results achieved, time and effort made by the firm, complexity of the issues, the firm’s work on a contingency fee basis, and firm’s overall ability. The class counsel created a direct, “hugely substantial benefit” as a result of the litigation.
Directors’ Fiduciary Duties	<i>Amazon.com Inc. v. Hoffman</i> (7 CARE 857, 7/10/09) Del. Ch., C.A. No. 2239-VCN, 6/30/08	Amazon.com Inc. unsuccessfully argued that the Basis Technology Corp. directors breached their fiduciary duties by engaging in a concerted effort to avoid triggering Amazon’s anti-dilution rights an agreement to invest in the preferred shares of Basis. The shares were not issued for less than fair value, and thus, did not have had a “dilutive effect,” so there was no breach of fiduciary duty.
Directors’ Fiduciary Duties	<i>Latesco L.P. v. Wayport Inc.</i> (7 CARE 1008, 8/14/09) Del. Ch., C.A. No. 4167-VCL, 7/24/09	A minority shareholder—and former insider in a telecommunications firm who sold his stock to the company—and several insiders were allowed to proceed with claims for breach of the duty of loyalty and fraud because the stock sales fell outside a right-of-first-refusal agreement. Transactions were made outside the confines of such an agreement, so insiders had the normal fiduciary duty not to engage in transactions with stockholders while in the possession of material information unavailable to sellers. The defendants’ liability was evaluated under the normal standard of fraud—which may include a fiduciary’s duty to speak in purchasing or selling stock—as applied to transactions between corporate insiders and minority stockholders.

## Review of Recent Key Delaware Corporation Law Cases—Third Quarter 2009 – Continued

Topic	Case Name (Case Citation cite of CARE story)	Holding
<b>Indemnification</b>	<i>Stockman v. Heartland Industrial Partners LP and Stepp v. Heartland Industrial Partners LP</i> (7 CARE 976, 8/7/09) Del. Ch., C.A. No. 4427-VCS, 7/14/09	Two former officers of Collins & Aikman Corp. successfully sued for advancement of legal fees and indemnification from C&A's majority investor, Heartland Industrial Partners LP, for expenses arising from civil and criminal proceedings against them stemming from their C&A service. The officers' claims were governed by Heartland's partnership agreement, which provides for indemnification of and advancement to, among others, officers and directors of its portfolio companies. The agreement's language made advancement mandatory. It did not clearly require an indemnitee to plead and demonstrate good faith, lawfulness, and a lack of scienter where, as in this case, the indemnitee was successful in the underlying proceeding.
<b>Mergers and Acquisitions</b>	<i>In re National City Corp. Shareholders Litigation</i> (7 CARE 1030, 8/21/09) Del. Ch., Civil Action No. 4123-CC, 7/31/09	The court approved a settlement of litigation challenging the merger of National City Corp. with PNC Financial Services Group Inc. where the defendants provided additional disclosures, but no changes were made to the financial terms of the transaction. The plaintiffs sought to enjoin the merger in its early stages, alleging that the members of NCC's board of directors breached the fiduciary duties they owed to NCC's shareholders. Plaintiffs also alleged that PNC aided and abetted those breaches. The parties eventually negotiated an agreement, subject to court approval, by which the claims relating to the merger would be released. The plaintiffs' fiduciary duty claims lacked probability of success on the merits, and the disclosures were an "exceedingly modest benefit" to the shareholder class, so the settlement was deemed fair and reasonable and valid.
<b>Mergers and Acquisitions</b>	<i>Police and Fire Retirement System of City of Detroit v. Bernal</i> (7 CARE 856, 7/10/09) Del. Ch., Civil Action No. 4663-CC, 6/26/09	Shareholders were granted a hearing in their case alleging that the Data Domain board breached fiduciary duties by agreeing to deal protection measures in a merger agreement with NetApp Inc. that deterred other bidders. The plaintiffs claimed the merger agreement contained a number of deal protection mechanisms and a voting agreement that favored the merger with NetApp. The court said the plaintiffs established a sufficient likelihood of irreparable injury, and the only realistic remedy for certain breaches of fiduciary duty in connection with a sale of control transaction was probably injunctive relief.
<b>Shareholder Derivative Litigation</b>	<i>In re Trados Inc. Shareholder Litigation</i> (7 CARE 1031, 8/21/09) Del. Ch., Civil Action No. 1512-C, 7/24/09	The court partially rejected a motion to dismiss claims brought by a former Trados Inc. common stockholder regarding a transaction that provided Trados' preferred stockholders with \$52 million, but gave nothing to the company's common stockholders. The plaintiff alleged the preferred stockholders embarked on a plan to sell Trados in 2004 in order to "exit" their investments. The plaintiff alleged enough facts "to demonstrate that at least a majority of the members of Trados' seven member board were unable to exercise independent and disinterested business judgment in deciding whether to approve the merger." The common stockholders would have been able to receive some consideration for their Trados shares at some point in the future, had the merger not occurred.