Potter Anderson & Corroon LLP

Recent Developments in Delaware Corporate Law

September 2009

Donald J. Wolfe, Jr. and **Michael K. Reilly** are partners and **Eve H. Ormerod** is an associate in the Wilmington, Delaware law firm of Potter Anderson & Corroon LLP. Portions of this article are drawn from materials prepared by other attorneys with Potter Anderson & Corroon LLP. The views expressed herein are those of the attorneys and may not be representative of the firm or its clients.

Introduction

During the late spring and summer of 2009, the Delaware courts rendered several decisions on topics of interest to corporate practitioners.

In July, the Court of Chancery issued two decisions implicating the reach and limitations of the Delaware Supreme Court's recent decision in *Lyondell Chemical Company v. Ryan*.[1] In *Wayne County Employees' Retirement System v. Corti*,[2] the Court of Chancery considered whether an allegedly conflicted board of directors failed to satisfy its *Revlon* duties, ultimately granting a motion to dismiss the claim and reiterating *Lyondell's* holding that *Revlon* does not require a target board to carry out a perfect process in a sale of control. By contrast, in *Louisiana Municipal Police Employees' Retirement System v. Fertitta,*[3] the Court of Chancery declined to dismiss a complaint challenging a proposed merger between the company and entities controlled by a controlling stockholder.

In a case entitled *In re Trados Inc. Shareholder Litigation*,[4] the Court of Chancery considered the diverging interests of common and preferred stockholders and found that directors may be found in breach of their duty of loyalty by favoring the interests of preferred stockholders over those of common stockholders.

In a matter of first impression brought before the Delaware Supreme Court in *Berger v. Pubco Corp.*,[5] the Court articulated a new quasi-appraisal remedy to address circumstances in which a controlling stockholder violates its disclosure obligations in a short form merger.

In *San Antonio Fire & Police Pension Fund v. Amylin Pharmaceuticals, Inc.*,[6] the Delaware Court of Chancery interpreted a "poison put" provision in a trust indenture, holding that, for purposes of the indenture's continuing director provision, a board of directors was permitted to "approve" as continuing directors persons nominated by dissident stockholders, even though the board opposed the election of the dissident slate.

Finally, in *Dubroff v. Wren Holdings, LLC,*[7] the Court of Chancery determined that a notice provided pursuant to Section 228(e) of the General Corporation Law

1 970 A.2d 235 (Del. 2009).

2 2009 Del. Ch. LEXIS 126 (Del. Ch. July 24, 2009).

3 2009 Del. Ch. LEXIS 144 (Del. Ch. July 28, 2009).

4 2009 Del. Ch. LEXIS 128 (Del. Ch. July 24, 2009).

5 2009 Del. LEXIS 345 (Del. July 9, 2009).

6 2009 Del. Ch. LEXIS 83 (Del. Ch. May 12, 2009).

7 2009 Del. Ch. LEXIS 89 (Del. Ch. May 22, 2009).

1313 North Market Street

P.O. Box 951

Wilmington, DE 19899-0951

(302) 984-6000

www.potteranderson.com

of the State of Delaware failed to provide appropriate disclosure to the non-consenting stockholders.

Each of these decisions is more fully examined below.

The Reach and Limitations of *Lyondell*

The Delaware Supreme Court's recent and widely-noted decision in *Lyondell* reversed the Court of Chancery's determination that a plaintiff had sufficiently stated a claim that directors had breached their duty of loyalty by failing to act in good faith in fulfilling their *Revlon* duties. Finding that, at best, plaintiffs' complaint asserted nothing more than a duty of care breach, the Supreme Court remanded the case to the Court of Chancery, directed dismissal on the grounds that the complaint failed to state a claim for bad faith conduct and that the Section 102(b)(7) provision in the defendant corporation's charter therefore exculpated the individual director defendants for monetary damages. In two ensuing decisions, the Court of Chancery was presented with the opportunity to consider the reach and limitations of *Lyondell*.

Wayne County Employees' Retirement System v. Corti, 2009 Del. Ch. LEXIS 126 (Del. Ch. July 24, 2009)

In *Corti*, the Court of Chancery considered a challenge to a transaction implicating a target board's *Revlon* duties, which included allegations that two conflicted directors controlled the sales process. The Court dismissed claims that the board of directors of Activision, Inc. ("Activision") failed to satisfy its *Revlon* duties by failing to conduct a market check prior to entering into an agreement that resulted in Vivendi S.A. ("Vivendi") obtaining majority control of the Activision voting stock. Chancellor Chandler reiterated *Lyondell's* holding that directors of Delaware corporations are not required to "carry out a perfect process in a sale of control"[8] and that there is "'no single blueprint that a board must follow to fulfill its duties.'"[9]

The facts of the case are straightforward. In December 2007, Activision announced that it had entered into an agreement with Vivendi, pursuant to which Activision would combine its business with that of Vivendi Games, Inc., a subsidiary of Vivendi ("Vivendi Games"). The deal was structured as a two-step transaction – first, Vivendi acquired 52% of the Activision shares in connection with the contribution of the assets of Vivendi Games and the purchase of newly issued Activision shares. Second, Vivendi made a tender offer for up to 50% of the remaining Activision shares. The transaction originated from the efforts of two of Activision's executive officers and directors ("Kotick and Kelly"), who initiated discussions with Vivendi in late 2006. They informed the board of their ongoing discussions several months later, at which point the board authorized its nominating and corporate governance committee (the "Committee") to manage the process. In carrying out this charge, the Committee relied on Activision's financial and legal advisors, and on Kotick and Kelly, with whom the Committee vested negotiating authority. Prior to the stockholder vote, plaintiff filed its first complaint alleging disclosure violations and breaches of fiduciary duty. Plaintiff initially sought a preliminary injunction based on the alleged disclosure violations. The Court of Chancery denied that motion, finding that plaintiff "'failed…to establish the materiality of the alleged

8 2009 Del. Ch. LEXIS 126, at *51 (citing *Lyondell*, 970 A.2d at 243).

9 *Id.* at *33-34 (quoting *Lyondell*, 970 A.2d at 242-43).

[disclosure] omissions.'"[10] Thereafter, the stockholders voted to approved the combination and Vivendi acquired 52% of the outstanding shares of Activision.

Defendants subsequently moved to dismiss the complaint. Turning first to the viability of plaintiff's disclosure claims, the Court, citing *In re Transkaryotic Therapies, Inc.*,[11] observed that the appropriate course in a disclosure violation case is to address disclosure claims prior to the stockholder vote, rather than after the vote and the challenged transaction have occurred and "'the metaphorical merger eggs have been scrambled.'"[12] The Court noted that this was "consistent with this Court's explicit holding that a breach of the duty of disclosure leads to irreparable harm, or harm that cannot be remedied after the fact."[13]

With respect to the merits of plaintiff's disclosure claims, the Court ordered dismissal for the same reasons set forth in the Court's earlier opinion on plaintiff's motion for preliminary injunction. It held that the complaint failed to support any reasonable inference that the alleged omissions were material under Delaware law and that plaintiff had failed to state a claim for damages that were not barred by the Section 102(b)(7) provision in Activision's certificate of incorporation, stating that "[a] mere conclusory allegation that the alleged disclosure violations also constitute a violation of the duty of loyalty is not sufficient to survive a motion to dismiss, particularly in light of the holding that the complaint fails to otherwise state a non-exculpated claim against the Director Defendants for breach of fiduciary duty."[14]

Defendants also sought dismissal of the fiduciary duty claims leveled against the directors in connection with their approval of the sales process. In this regard, the complaint alleged that Kotick and Kelly were subject to a disabling conflict of interest and that they favored their personal interests over those of the Activision stockholders. The Court held that the complaint failed to state a claim that Kotick and Kelly were interested in the transaction or otherwise breached their fiduciary duty of loyalty. The Court reasoned that the fact that Kotick and Kelly did not have to pursue the transaction with Vivendi to retain their positions "significantly alleviate[d] the concern that [they] were acting out of an impermissible 'entrenchment' motive."[15] In addition, the Court observed that Kotick's and Kelly's employment agreements were approved by the Activision board and by each of the compensation and nominating and corporate governance committees. Importantly, plaintiff failed to plead facts to rebut the presumption that the members of such committees exercised their independent business judgment in that regard.

The complaint also asserted that the remaining directors (i) permitted Kotick and Kelly to dominate and control the negotiations in the face of an alleged conflict of interest, (ii) failed to conduct an independent market check, and (iii) failed to obtain a control premium in the

---

10 *Id.* at *23 (quoting *Wayne County Employees' Ret. Sys. v. Corti*, 954 A.2d 319, 331 (Del. Ch. 2008)).

11 954 A.2d 346 (Del. Ch. 2008).

12 *Id.* at 362 (quoting *McMillan v. Intercargo Corp.*, 768 A.2d 492, 500 (Del. Ch. 2000)).

13 *Corti*, 2009 Del. Ch. LEXIS 126, at *30 (citing *Transkaryotic*, 954 A.2d at 361 (finding that "once . . . irreparable harm has occurred – *i.e.*, when shareholders *have* voted without complete and accurate information – it is, by definition, too late to remedy the harm. If the Court could redress such an informational injury after the fact, then the harm, by definition, would not be irreparable, and injunctive relief would not be available in the first place.") (emphasis in original) (footnotes omitted)).

14 *Corti*, 2009 Del. Ch. LEXIS 126, at *31-32.

15 *Id.* at *37.

sale of control. With regard to the first claim, the Court found that the Committee did not abandon its role in the sale, noting that the Committee received regular status updates from financial and legal advisors and Kotick and Kelly, who were not, in fact, subject to a disabling self-interest. In connection with the latter two claims, the Court found that plaintiff's claims, although framed as purported breaches of the duty of loyalty, were not supported by the factual allegations of the complaint. To survive dismissal in light of the existence of an exculpatory charter provision, plaintiff was required to plead facts to support a claim that these director defendants failed to act in good faith. Relying on *Lyondell,* the Court reiterated that the "relevant question is whether the Director Defendants '*utterly failed to attempt* to obtain the best sale price.'"[16] The Court found that plaintiff's complaint failed to demonstrate that the defendants "knowingly and completely failed to undertake their responsibilities."[17] In so holding, the Court rejected plaintiff's argument that the director defendants "'failed to probe [] for alternatives,'" reasoning that "*Revlon* does not proscribe any specific steps that must be taken by a board before selling control of the corporation."[18] Plaintiff's argument that the board failed to secure a control premium was likewise held inadequate to support a claim for breach of the duty of loyalty. The Court concluded that plaintiff's allegation in this regard was, at best, an attack on the adequacy of the consideration, which is not reviewable under the business judgment rule. Accordingly, the Court dismissed plaintiff's fiduciary duty claims.

Finally, the Court dismissed as legally inadequate plaintiff's prayer for a declaratory judgment that two provisions in the combined company's charter were invalid and unenforceable. Section 8.3 of the charter purported to renounce certain corporate opportunities in favor of Vivendi, and Section 9.3 purported to relieve Vivendi and its affiliates, officers, and directors from liability for certain breaches of fiduciary duties, including the duty of loyalty, concerning agreements and contracts among Activision Blizzard and Vivendi and its affiliates. The Court declined to address the legal merits of these claims, holding instead that they were not ripe for judicial determination.

Although the Court of Chancery's decision in *Corti* comports with the Delaware Supreme Court's decision in *Lyondell*, independent lessons may be drawn from the case. First, it is noteworthy that the Court followed the holding in *Lyondell* despite the allegations that two of the directors were interested in the transaction and controlled the negotiations. Although the Court concluded that those directors were not conflicted, *Corti* lends credence to the conclusion that a board's decision will be afforded appropriate deference under the reasoning of *Lyondell* so long as a majority of its members are truly independent and disinterested, remain engaged in the sale process, and actively monitor the negotiations. Second, the Court's discussion of the disclosure violations underscores the willingness of the Court of Chancery to expedite both *Revlon* and disclosure cases to avoid the irreparable harm that may be imposed upon a plaintiff by the harshness of the post-transaction treatment of remedies imposed by *Lyondell* and recent disclosure case law. Indeed, in a prior decision considering the impact of *Lyondell* on a motion to expedite, the Court of Chancery found that the absence of a post-merger remedy will support a Court's decision to expedite proceedings

---

16 *Id.* at *52 (emphasis in original).

17 *Id.*

18 *Id.* at *53.

in the appropriate circumstances.[19] At the same time, it suggests that the failure to seek preliminary injunctive relief with respect to alleged disclosure violations may preclude the possibility of a remedy for any such violations in these situations in which any such remedy has been rendered impracticable by the consummation of the challenged transaction. Finally, the Court's discussion of the alleged failure to secure a control premium and the failure to secure protection for the minority stockholders emphasizes the Court's willingness to defer to the terms agreed to by an independent and disinterested board even in a sale of control situation.

Louisiana Municipal Police Employees' Retirement Sys. v. Fertitta, 2009 Del. Ch. LEXIS 144 (Del. Ch. July 28, 2009)

In an opinion rendered only a few days after *Corti*, the Court of Chancery refused to dismiss a case that contained an allegation that importantly distinguished it from the *Lyondell* decision— namely, the presence of a controlling stockholder. In *Fertitta*, the Court of Chancery addressed the fiduciary obligations of a board of directors and its controlling stockholder in connection with a proposed merger between the company and entities controlled by the controlling stockholder. In his final written opinion before leaving the bench, Vice Chancellor Lamb denied a motion to dismiss class action and derivative claims, noting that plaintiffs had adequately pled claims for breach of the duty of loyalty and grounds for demand excusal on a claim of waste with respect to an "abortive going-private transaction."[20]

Landry's Restaurants, Inc. ("Landry's") formed a special committee to assess an offer from Tilman J. Fertitta, Landry's Chairman, CEO, President and 39% stockholder ("Fertitta"). On June 16, 2008, Landry's entered into a $21 per share cash-out merger agreement with two entities controlled by Fertitta. The merger agreement contained, among other things, a reverse termination fee and a material adverse effect clause. Fertitta personally guaranteed the payment of the $24 million reverse termination fee in the event the entity he controlled failed to close the deal. Fertitta also entered into a debt commitment letter (the "June Debt Commitment Letter") with certain banks (the "Lending Banks") that contained a material adverse effect clause similar to that contained in the merger agreement.

After Hurricane Ike damaged several of Landry's restaurants, Fertitta, in a letter to the special committee, indicated that he believed the Lending Banks would refuse to finance the transaction because the hurricane damage and worsening economy amounted to a material adverse effect, and that Fertitta in turn could exercise his right to terminate. He also indicated that he believed that the Lending Banks nonetheless would be willing to provide financing at a reduced price of $17 per share. At the same time, Fertitta began accumulating shares of Landry's stock on the open market. Thereafter, Fertitta forwarded to the special committee a letter from one of the Lending Banks expressing doubt that the Fertitta entities would be able to satisfy the conditions to the June Debt Commitment Letter. The special committee did not deem the bank's letter to be a termination of the June Debt Commitment Letter, and asked Fertitta whether the entities could satisfy the conditions. In response,

19 *See Police & Fire Ret. Sys. of The City of Detroit v. Bernal*, 2009 Del. Ch. LEXIS 111, at *4-7 (Del. Ch. June 26, 2009) (granting expedited proceedings in connection with plaintiff's motion to enjoin certain provisions of a merger based on a sufficient likelihood of irreparable injury to the plaintiff, including the impossibility of "'unscrambl[ing] the eggs' by attempting to unwind the merger" post-completion).

20 *Fertitta*, 2009 Del. Ch. LEXIS 144, at *2.

Fertitta stated only that he was unable to obtain financing from other banks and formally demanded that the price be revised down to $17 per share. When the special committee countered with a $19 per share price, Landry's issued a press release that the buyout might be in jeopardy, causing a significant drop in the price of Landry's stock.

In October, Fertitta offered $13 per share, and the parties ultimately amended the merger agreement by lowering the acquisition price to $13.50 per share and reducing the reverse termination fee to $15 million. In addition, Fertitta and the Lending Banks agreed not to claim a material adverse effect as a result of any known events. Notably, Fertitta negotiated with the Lending Banks to provide for alternative financing that would allow Landry's to pay off certain senior notes in the event the merger did not close. Thereafter, Fertitta continued his open market purchases (pursuant to which he ultimately gained majority control of the company without paying a premium price). Landry's board did nothing to stop those purchases.

After the amendment to the merger agreement was finalized, the SEC requested that Landry's disclose certain information in the amended debt commitment letter, but the Lending Banks refused to allow Landry's to do so. Purportedly fearing that disclosure of the amended debt commitment letter would have risked the alternative financing commitment, Landry's responded by terminating the agreement, thereby waiving the $15 million reverse termination fee Fertitta would otherwise have to pay as a result of his inability to consummate the merger.

Plaintiff, a Landry's stockholder, filed a complaint asserting class claims against Fertitta for breach of fiduciary duty and against the Fertitta entities for aiding and abetting that breach. The complaint also asserted a class claim against Landry's directors for breach of fiduciary duty, and, in the alternative, a derivative claim for waste against Landry's board for failing to require Fertitta to pay the reverse termination fee. The defendants moved to dismiss the complaint on all counts for failure to state a claim upon which relief could be granted.

Defendants argued that the plaintiff had, at best, pled a claim for a breach of the duty of care, which was exculpated in Landry's certificate of incorporation pursuant to Section 102(b)(7), and cited to the Delaware Supreme Court's decision in *Lyondell*.[21] The Court of Chancery rejected defendants' argument that *Lyondell* applied, explaining that the plaintiffs in *Lyondell* had attempted to apply the *Caremark* standard for lack of good faith in the context of a sale of control transaction. In the present case, the Court found that applying *Lyondell* "misses entirely the gravamen of the plaintiff's claims," because the plaintiff was not alleging harm by "some sufficiently gross failure of process on the part of Landry's directors."[22] Instead, the plaintiff was simply claiming that Landry's board "knowingly preferred the interests of the majority stockholder to those of the corporation or the minority."[23]

In denying defendants' motion to dismiss, the Court pointed to three key facts that made it "impossible" to dismiss the complaint: (i) Fertitta's role in negotiating the refinancing commitment on behalf of Landry's; (ii) the board's "inexplicable impotence" in view of Fertitta's creeping takeover; and (iii) the board's termination of the merger agreement

21 970 A.2d 235.

22 *Fertitta*, 2009 Del. Ch. LEXIS 144, at *30.

23 *Id.* at *30-31.

allowing Fertitta to avoid paying the reverse termination fee.[24] These facts, the Court observed, led to inferences that Fertitta used his influence as controlling stockholder and/or corporate officer to the detriment of minority stockholders, and that Landry's board willingly acquiesced to Fertitta as the controlling stockholder. The Court rejected defendants' argument that Fertitta was not a controlling stockholder (and therefore did not owe fiduciary duties with respect to the challenged actions). The Court concluded that Fertitta not only had actual control of Landry's, but that his negotiation of the refinancing commitment imposed fiduciary duties upon him, as he was acting either in his capacity as Landry's CEO or as its controlling stockholder. Moreover, at the time Landry's terminated the merger agreement, Fertitta was Landry's majority owner, thereby raising a presumption of control.

With respect to the claims against Landry's board, the Court determined that it was reasonable in the context of a motion to dismiss to infer a breach of the duty of loyalty from the board's failure to employ a poison pill to prevent Fertitta's acquisition of control without paying a premium through his purchases on the open market.[25] In connection with its decision to terminate the merger agreement, the board argued that disclosure of the amended debt commitment letter would have risked the financing commitment, forcing the company into bankruptcy. The Court determined that it was unreasonable to assume at the pleading stage that Fertitta would have allowed the company to be forced into bankruptcy rather than paying the termination fee, thereby raising a litigable question whether the board's decision to terminate and excuse Fertitta's performance constituted a rational exercise of business judgment.

Finally, the Court held that a failure to make a demand upon Landry's board was not fatal to the plaintiff's derivative claim, as the complaint raised a reasonable doubt that the challenged transaction was the product of a valid exercise of business judgment for the reasons discussed above.

The Court's decision in *Fertitta* demonstrates the context-specific importance of each particular transaction and the corresponding limitations of *Lyondell*. Although the Delaware Supreme Court's decision in *Lyondell* provides comfort that a decision by an unconflicted board of directors acting in good faith may be granted deference by a Delaware court, that same deference is unlikely to obtain where there is a controlling stockholder.

The Diverging Interests of Common and Preferred Stockholders

***In re Trados Inc. Shareholder Litigation*, 2009 Del. Ch. LEXIS 128 (Del. Ch. July 24, 2009)**

In *Trados*, the Court of Chancery denied a motion to dismiss plaintiff's claim that corporate directors breached their duty of loyalty by approving a merger in which the common stockholders received no consideration. The Court dismissed plaintiff's claim that two directors breached their duty of loyalty by agreeing to alter the company's revenue recognition practices to benefit the company's merger partner.

---

24 *Id*. at 23.

25 The Court specifically addressed the fact that while there was no *per se* duty to employ a poison pill, the board's failure to employ a pill, considered alongside other "suspect conduct," supported a reasonable inference at the motion to dismiss stage that the board breached its duty of loyalty in permitting the creeping takeover. *Id.* at *31-32 n.34.

Plaintiff brought a class action lawsuit challenging a merger in which Trados Incorporated ("Trados") became a wholly owned subsidiary of SDL, plc ("SDL"). In the merger, SDL paid $60 million in consideration, $52 million of which was distributed to Trados' preferred stockholders in partial satisfaction of their liquidation preference. The remaining consideration was distributed to Trados' executive officers under a bonus plan. Trados' common stockholders thus received no consideration in the merger. Plaintiff alleged that Trados' preferred stockholders were interested in exiting their investment in the company, and Trados' directors breached their duty of loyalty by favoring that interest over the interests of the common stockholders, in particular by approving a merger in which the common stockholders received no consideration for their interest at a time when there was no reason to sell the company.

Noting that it is possible for a director to breach his or her duty of loyalty by favoring the interests of preferred stockholders over those of common stockholders where those interests diverge, the Court ruled that plaintiff had sufficiently rebutted the presumptions of the business judgment rule for purposes of a Rule 12(b)(6) motion by alleging that four of Trados' seven directors were designated to the board by preferred stockholders, had employment or ownership relationships with such stockholders, and were dependent on preferred stockholders for their livelihood. The Court therefore refused to dismiss plaintiff's claim that the board improperly favored the interests of the preferred stockholders over the common stockholders.

The Court nonetheless dismissed plaintiff's additional claim that two Trados directors, who were also executives at the company, breached their duty of loyalty by "agreeing 'to manipulate Trados' ordinary business practices to benefit SDL by artificially increasing its post-merger revenue.'"[26] The Court held that plaintiff had not sufficiently alleged that the purported revenue shifting harmed Trados or its stockholders or resulted from any breach by defendants. In addition, the Court held that the claim failed because plaintiff had not alleged facts that reasonably suggested that the two directors received a material personal benefit as a result of the alleged revenue shifting.

The Court's decision in *Trados* is a reminder not only that the interests or lack of independence of directors must be considered when determining the appropriate process for a particular board decision, but that such conflicts can come in a variety of forms. As a result, any such analysis should include an examination of not only any direct financial benefit or detriment that would be bestowed upon or incurred by any director as a result of any particular transaction, but also any relationship that the director may have that would suggest that the director's independence with respect to a particular decision may be tainted. When the interests of common stockholders and preferred stockholders are implicated, and their respective interests diverge, the analysis necessarily becomes more complex and practitioners should proceed with caution.

Quasi-Appraisal Remedy for Disclosure Violations in a Short Form Merger

***Berger v. Pubco Corp.*, 2009 Del. LEXIS 345 (Del. July 9, 2009)**

In a matter of first impression, the Delaware Supreme Court determined in *Berger v. Pubco*

26 *Trados*, 2009 Del. Ch. LEXIS 128, at *40.

the question of an appropriate remedy for a "short form" merger under Section 253 of the General Corporation Law of the State of Delaware where a corporation's minority stockholders are cashed out without being advised by the controlling stockholder of information material to a stockholder's decision whether to seek appraisal.

In the decision from which the appeal was taken, the Court of Chancery determined that the controlling stockholder had breached his disclosure duty in connection with a short form merger by (i) sending the minority stockholders an outdated copy of the appraisal statute, and (ii) failing to disclose the method by which defendant set the merger consideration, which the Court considered to be a material fact relevant to the decision to accept the merger consideration or seek appraisal. Based on these disclosure violations, the lower court awarded a quasi-appraisal remedy under *Gilliland v. Motorola*.[27] Pursuant to that remedy, minority stockholders were required to "opt in" to the appraisal proceeding and to escrow a portion of the merger proceeds they received pending a final decision on valuation. While the Supreme Court found that the trial court correctly determined that the controlling stockholder violated its duty of disclosure, the Court held that the lower court erred as a matter of law in ordering a *Gilliland*-style remedy.

In its opinion, the Supreme Court determined that the appropriate remedy for a breach of the duty of disclosure in a short form merger is the following:

- The minority stockholders are entitled to supplemental disclosures enabling them to make a fully informed decision on whether to participate in the appraisal proceeding.
- Those who decide to participate in the appraisal proceeding would be entitled to seek recovery of the difference between the fair value of their shares and the merger consideration without having to establish the controlling stockholders' personal liability for breach of fiduciary duty.
- The process should proceed on an "opt out" rather than an "opt-in" basis, so that minority stockholders will automatically become members of a class. The Court found that the "opt-out" procedure was no more burdensome to the corporation, but less burdensome to the minority stockholders. Moreover, such a procedure avoids the risk of forfeiture to the benefit of the minority stockholders victimized by the controlling stockholder's failure to disclose.
- Minority stockholders should not be obligated to escrow a portion of the merger proceeds they received. While this means that the minority stockholders would enjoy a "dual benefit" by retaining the merger proceedings at the same time that they litigate to recover a higher amount, the Court did not find such a result inequitable. The Court analogized the situation to the law allowing the minority stockholders to enjoy the dual benefit in a stockholders class action challenging a long form merger on fiduciary duty grounds. The Court also invoked principles of fairness to ensure that the appraisal statute is applied evenhandedly. "Minority shareholders who fail to observe the appraisal statute's technical requirements risk forfeiting their statutory entitlement to recover the fair value of their shares. In fairness, majority stockholders that deprive their minority shareholders of material information should forfeit their statutory right to retain the merger proceeds payable to shareholders who, if fully informed, would have elected appraisal."[28]

27 873 A.2d 305 (Del. Ch. 2005).

28 *Pubco*, 2009 Del. LEXIS 345, at *32-33.

Finally, the Court qualified its holding by noting that in some circumstances, such as where the only disclosure violation is the delivery of an incomplete copy of the appraisal statute, the *Gilliland*-style remedy might be deemed more appropriate.

The Court's decision in *Pubco* underscores the importance of disclosure in the context of short form mergers. Practitioners should ensure that all material information is properly disclosed and all formalities strictly followed. The remedy for violations of those disclosure obligations could be burdensome.

Continuing Director Provisions in Debt Instruments.

***San Antonio Fire & Police Pension Fund v. Amylin Pharms., Inc.*, 2009 Del. Ch. LEXIS 83 (Del. Ch. May 12, 2009).**

In *Amylin*, the Court of Chancery interpreted certain so-called "poison put" provisions in an indenture and held that, for purposes of the indenture's continuing director provision, a corporate board of directors was permitted to "approve" as continuing directors persons nominated by dissident stockholders (so as to prevent triggering a default under the indenture), even though the board was at the same time opposing the election of the dissident slates in its communications with stockholders. The "poison put" provisions at issue were contained in a trust indenture ("Indenture") governing publicly traded notes issued by, and a syndicated credit agreement ("Credit Agreement") entered into by, defendant Amylin Pharmaceuticals, Inc. ("Amylin"). The trust indenture governing Amylin's 3.00% convertible senior notes due 2014 (the "2007 Notes") provided note-holders the right to demand redemption of any or all of their notes at face value upon the occurrence of certain events, including a Fundamental Change, defined within the Indenture as "any time the Continuing Directors do not constitute a majority of the Company's Board of Directors."[29] Section 11.01 of the Indenture defined "Continuing Directors" as those directors who, on the issue date, constituted the board of directors or any new directors whose nomination or election was approved by at least a majority of the directors still in office who were directors on the issue date or whose nomination or election was previously so approved. The Credit Agreement at issue also provided that an event of default would occur thereunder if "Continuing Directors" failed to constitute a majority of the members of Amylin's Board, but contained a much more strict definition of "Continuing Directors."

On January 28, 2009, Icahn Partners LP and affiliates ("Icahn"), an 8.8% stockholder, notified Amylin of its intention to nominate a slate of five directors to Amylin's twelve-person board. The following day, Eastbourne Capital Management, L.L.C. ("Eastbourne"), a 12.5% stockholder, notified Amylin of its intention to nominate its own five-person slate. Because the election of more than five of the dissidents' nominees would trigger the "Continuing Directors" provisions, Eastbourne sent Amylin a letter on February 1, 2009 asking the Amylin board to act to prevent the provisions from being triggered. Specifically, Eastbourne asked the board to compile an approved slate of directors that would include a "significant number" of the nominees from each of Eastbourne's and Icahn's slates.

Amylin and the banks that were parties to the Credit Agreement reached agreement on a waiver of the Credit Agreement covenant, mooting that issue. Thus, the Court considered

29 *Amylin*, 2009 Del. Ch. LEXIS 83, at *5.

the central issue in this case to be whether or not the Amylin board had both the power and the right under the Indenture to approve the stockholder nominees as "Continuing Directors." Because the Indenture was a contract between Amylin and The Bank of New York Mellon Trust Co. (the Trustee for the 2007 Notes), the Court determined that the question was one of contractual interpretation based on New York law pursuant to a choice of law provision contained in the Indenture. The Court sided with Amylin's definition of "approve," finding that it means to "give formal sanction to; to confirm authoritatively."[30] This definition gives the board the power to approve a slate of nominees for the purposes of the Indenture without simultaneously endorsing them, allowing the board to avoid triggering the provision even as it recommends and endorses its own opposing slate. After determining that the board had the power to approve the slate, the Court turned to the issue of whether the board properly exercised the right to do so. The Court found that the central question was whether approval by the board comported with the company's implied covenant of good faith and fair dealing inherent in all contracts. Citing *Hills Stores Co. v. Bozic*,[31] the Court noted that the board had the right to approve stockholder nominees if the board determined in good faith that the election of one or more of the dissident nominees would not be materially adverse to the interests of the corporation or its stockholders. The Court noted that the parties had not introduced any evidence regarding the board's deliberations with respect to the decision to approve the stockholder-nominated slate, but determined this issue to be unripe since the dissident parties reduced the size of their respective slates so that a majority of the board would remain "Continuing Directors."

The Court also addressed whether the Amylin board had breached its duty of care by approving the Indenture, insofar as it contained the "Continuing Directors" provisions. The Court found that the board had approved the issuance of the Notes under the Indenture only after retaining "highly-qualified counsel" and seeking advice from Amylin's management and investment bankers regarding the terms of the agreement.[32] The Court found that these actions did not constitute "the sort of conduct generally imagined when considering the concept of gross negligence" (which is the standard of conduct applicable to claims of the breach of the duty of care), ultimately concluding that the board did not breach its duty of care when it approved the issuance of the Notes under the Indenture.[33] The Court noted however that, because of the potentially significant adverse effects of the inclusion of such provisions, counsel advising boards considering debt instruments containing such provisions should "highlight" them to the board, because of the board's "continuing duties to the stockholders to protect their interests."[34]

It is unclear how the *Amylin* decision may affect the future negotiation of change of control

---

30 *Id.* at *25-26. The plaintiffs argued that "approve" was synonymous with "endorse" or "recommend." The Court found the plaintiffs' definition to be far too restrictive, causing grave concerns for the stockholder franchise. The Court stated that it would allow such an "eviscerating" provision if the board produced, at a minimum, "evidence that the board believed in good faith that, in accepting such a provision, it was obtaining in return extraordinarily valuable economic benefits for the corporation that would not otherwise be available to it." *Id.* at 28.

31 769 A.2d 88 (Del. Ch. 2000).

32 *Id.* at *38.

33 *Id.*

34 *Id.* at *39-40.

provisions in indentures and other debt instruments.[35] What is clear, however, is that practitioners should ensure that boards of directors are fully informed about such provisions when approving such arrangements and that they consider, in their good faith business judgment, the scope of such provisions and the extent to which they could impose constraints that implicate the best interests of the corporation going forward.

Disclosure Violation in Connection With a Section 228 Notice

***Dubroff v. Wren Holdings, LLC,* 2009 Del. Ch. LEXIS 89 (Del. Ch. May 22, 2009)**

Plaintiffs, former minority stockholders, brought a purported class action against defendants, the corporation, and various former directors and stockholders, alleging breaches of fiduciary duties based on the dilution of the plaintiffs' stock upon recapitalization of the corporation.

Among other rulings, the Court (i) held that plaintiffs' claims were derivative rather than direct, given plaintiffs' failure to plead sufficiently that several stockholders were a "control group," and (ii) refused to dismiss a challenge to the sufficiency of a notice delivered pursuant to Section 228(e) of the General Corporation Law of the State of Delaware ("Section 228(e) notice"). The transaction at issue was a recapitalization whereby certain stockholders converted their preferred debt into preferred stock via "written consent of the holders of a majority of the Company's stock."[36] As a result, the stockholders increased their ownership of the corporation while diluting the ownership of the minority stockholders.

The Court first considered plaintiffs' claim for breach of fiduciary duty in connection with the dilution of their equity, noting that this was a claim for corporate overpayment. Although such claims are typically derivative, the Court explained that there is a species of corporate overpayment claim that is both derivative and direct where "a corporation issues more shares to its controlling shareholder and dilutes the minority shareholders' equity."[37] Because the corporation was subsequently merged into another corporation in which plaintiffs owned no stock, they lacked the requisite derivative standing. Plaintiffs, however, sought to pursue a direct claim alleging that the three stockholders collectively acted as a controlling stockholder even though none was individually a majority stockholder. The Court recognized the viability of a "control group" theory for fiduciary duty purposes, but nonetheless dismissed plaintiffs' claims with prejudice, because plaintiffs failed to allege facts establishing that the defendants were "connected in some legally significant way" so as to constitute a "control group."[38] Plaintiffs' mere allegations of "parallel interests" among the defendants were held insufficient.[39]

Plaintiffs also asserted disclosure claims in connection with the approval of the recapitalization by written consent. The Court agreed with plaintiffs that the Section 228(e)

---

35 *Amylin* is not the first time that the Delaware courts have considered a change of control provision in an indenture. *See Law Debenture Trust Co. of New York, as Indenture Trustee for KCS Energy, Inc. 7 1/8% Senior Notes Due 2012 v. Petrohawk Energy Corp.*, 2007 Del. Ch. LEXIS 113 (Del. Ch. Aug. 1, 2007).

36 *Dubroff*, 2009 Del. Ch. LEXIS 89, at *3.

37 *Id.* at *8.

38 *Id.* at *12, 16.

39 *Id.* at *12.

notice was insufficient because "material facts—who benefited from the [r]ecapitalization and what benefits . . . they achieve[d]—were omitted."[40] Noting that Delaware courts have not passed upon the level of disclosure required under Section 228(e), the Court found that regardless of the level of disclosure required, the complaint contained facts allowing "the Court to infer reasonably that the board deliberately omitted material information with the goal of misleading the [p]laintiffs and other shareholders about the [d]efendants' material financial interest in, and benefit conferred by, the [r]ecapitalization not shared with other shareholders."[41] The motion to dismiss this claim was therefore denied.

Although the reach of the *Dubroff* decision is not yet clear, practitioners should be mindful of its holding when considering the form of notice provided pursuant to Section 228(e). One could argue that *Dubroff* should be limited to its facts as a classic case of failing to provide complete disclosure and should only apply to those situations.[42] Until further guidance is provided by the Delaware courts, however, the holding counsels caution.

40 *Id.* at *24.

41 *Id.* at *25-26.

42 *See Malone v. Brincat*, 722 A.2d 5, 10 (Del. 1998).