Potter Anderson & Corroon LLP

Recent Developments in Delaware Corporate Law – 2006

Michael D. Goldman and Michael K. Reilly practice in the Wilmington, Delaware law firm of Potter Anderson & Corroon LLP. The views or opinions expressed herein are those of the authors alone and do not necessarily represent the views or opinions of Potter Anderson & Corroon LLP or its clients.

Introduction

Over the course of the latter half of 2006, the Delaware courts rendered a number of notable decisions on topics of interest to corporate practitioners. In *Stone v. Ritter*, the Delaware Supreme Court confirmed the standard for duty of oversight claims, and definitively resolved the question whether directors of Delaware corporations owe an independent duty of good faith. In addition, the Court of Chancery explored a number of areas. It clarified certain issues relating to the use of "majority-of-the-minority" provisions and discussed the possibility of invoking the protections of the business judgment rule (absent a controlling stockholder) through the use of such a provision or a special committee in a case entitled *In re PNB Holding Co. Shareholders Litigation*. Fiduciary duties of directors of wholly-owned subsidiaries were examined and, as a matter of first impression, a claim for deepening insolvency was discussed in *Trenwick America Litigation Trust v. Ernst & Young, L.L.P.* Whether a merger agreement provision prevented an acquiring corporation from discussing a competing proposal with a third party was addressed in *Energy Partners, Ltd. v. Stone Energy Corp.* More recently, the Court of Chancery found, in *Esopus Creek Value L.P. v. Hauf*, that a Delaware corporation could not avoid a statutorily required stockholder vote on a sale of assets, even though the corporation was unable to solicit proxies under the federal securities laws. The Delaware courts also witnessed over the prior year a continued increase in litigations filed by hedge funds. Two decisions, *Highland Select Equity Fund, L.P. v. Motient Corporation* and *Accipiter Life Sciences Fund, L.P. v. Helfer*, provide a snapshot of such litigations. Most recently, the Delaware Court of Chancery rendered a significant decision in *Louisiana Municipal Police Employees' Retirement System v. Crawford*. In that decision, the Court treated a special dividend and a merger as an integrated transaction, notwithstanding the doctrine of independent legal significance, and as a result determined that stockholders of a target were entitled to appraisal rights under Delaware law. Each of the above-described decisions is discussed in more detail below.

I. Fiduciary Duties and the Duty of Good Faith

The *Disney* trial and the decisions that followed have been front and center on the national stage in recent years. Although the trial garnered attention for a number of reasons (some of which were wholly-unrelated to the merits of the case), corporate practitioners eagerly awaited clarity from the Delaware courts on, among other things, the question whether Delaware law recognized an independent duty of good faith. Despite the national attention, a lengthy trial and two voluminous opinions, the *Disney* saga ended without definitively addressing that issue.[1] It came as a surprise to most corporate practitioners, therefore, when the Delaware Supreme Court squarely answered that question in an unrelated decision entitled *Stone v. Ritter.*[2] In that case,

1313 North Market Street

P.O. Box 951

Wilmington, DE 19899-0951

(302) 984-6000

www.potteranderson.com

the Supreme Court confirmed, in an *en banc* decision, that the Court of Chancery's decision in *In re Caremark International Derivative Litigation*[3] sets forth the appropriate standard for a director oversight claim. In addition, the Supreme Court found that no separate and independent fiduciary duty of "good faith" existed under Delaware law, but rather that the duty of good faith was subsumed within the fiduciary duties of care and loyalty.

In *Stone v. Ritter*, the plaintiff-stockholders initiated derivative litigation on behalf of AmSouth Bancorporation ("AmSouth"), alleging that the directors were liable for failure to properly oversee the company's activities. AmSouth had become the subject of governmental investigation after it was discovered that certain AmSouth customers were involved in a "Ponzi" scheme. Various federal and state authorities examined whether, among other things, AmSouth employees had failed to properly file "Suspicious Activity Reports" as required by the Bank Secrecy Act and various anti-money-laundering regulations. In 2004, AmSouth and a wholly-owned subsidiary paid $40 million in fines and $10 million in civil penalties to resolve those investigations.[4]

Plaintiffs did not make a pre-suit demand upon AmSouth's board of directors before initiating their derivative action. The Court of Chancery held that plaintiffs had failed to adequately plead demand futility under Court of Chancery Rule 23.1.[5] Accordingly, the Court of Chancery dismissed the complaint.[6] Plaintiffs appealed, arguing that the complaint sufficiently pleaded that pre-suit demand was excused because the defendant-directors had breached their fiduciary duties by failing to implement adequate reporting, monitoring, and information controls to guard against the conduct giving rise to the loss.[7]

On appeal, the Supreme Court traced the evolution of director oversight liability claims, beginning with the Supreme Court's decision in *Graham v. Allis-Chalmers Manufacturing Co.*[8] In *Graham*, the Court held that "absent cause for suspicion there is no duty upon the directors to install and operate a corporate system of espionage to ferret out wrongdoing which they have no reason to suspect exists."[9] In *Caremark*, the Court of Chancery narrowly construed *Graham* "as standing for the proposition that, absent grounds to suspect deception, neither corporate boards nor senior officers can be charged with wrongdoing simply for assuming the integrity of employees and the honesty of their dealings on the company's behalf."[10] The *Caremark* decision held that "where a claim of directorial liability for corporate loss is predicated upon ignorance of liability creating activities within the corporation, as in *Graham* … 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."[11]

The Supreme Court determined that it would adopt the *Caremark* standard. First, it observed that the *Caremark* doctrine relies on the concept of a failure on the part of a board of directors to act in good faith,[12] consistent with the definition of bad faith enunciated in the Supreme Court's recent opinion in *In re Walt Disney Co. Derivative Litigation*.[13] In *Disney*, the Supreme Court stated that a failure to act in good faith requires conduct that "is qualitatively more culpable than gross negligence."[14] It identified three categories of conduct evidencing a failure to act in good faith, including "where the fiduciary intentionally fails to act in the face of a known duty to act, demonstrating a conscious disregard for his duties."[15] The *Stone v. Ritter* decision stated that such conduct "is fully consistent with the lack of good faith conduct that the *Caremark* court held was a 'necessary condition' for director oversight liability."[16]

The Court then addressed an issue that was expressly left open in *Disney* – *whether* a violation of the duty to act in good faith may serve as the basis for the direct imposition of liability.[17] In the past, practitioners, commentators, and Delaware courts have often referred to the "triad" of fiduciary duties, comprised of the duties of care, loyalty and good faith.[18] The *Stone v. Ritter* decision expressly holds, however, that there exists no separate fiduciary duty of good faith upon which liability may be predicated:

> The phraseology used in *Caremark* and that we employ here - describing the lack of good faith as a 'necessary condition to liability' - is deliberate. The purpose of that formulation is to communicate that a failure to act in good faith is not conduct that results, *ipso facto*, in the direct imposition of fiduciary liability. The failure to act in good faith may result in liability because the requirement to act in good faith 'is a subsidiary element[,]' i.e., a condition, 'of the fundamental duty of loyalty.' It follows that because a showing of bad faith conduct, in the sense described in *Disney* and *Caremark*, is essential to establish director oversight liability, the fiduciary duty violated by that conduct is the duty of loyalty.[19]

Thus, "although good faith may be described colloquially as part of a 'triad' of fiduciary duties that includes the duties of care and loyalty, the obligation to act in good faith does not establish an independent fiduciary duty that stands on the same footing as the duties of care and loyalty."[20] In the Court's view, only a breach of the duties of care and loyalty "may directly result in liability, whereas a failure to act in good faith may do so, but indirectly."[21] Furthermore, the Court noted that "the fiduciary duty of loyalty is not limited to cases involving a financial or other cognizable fiduciary conflict of interest. It also encompasses cases where the fiduciary fails to act in good faith."[22]

Consistent with the foregoing, the Court held that the standard articulated in *Caremark* sets forth the necessary conditions for director oversight liability: "(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 thus disabling themselves from being informed of risks or problems requiring their attention."[23] Under either scenario, plaintiffs must prove that the defendant-directors had knowledge of the fact that they were not discharging their fiduciary obligations: "Where directors fail to act in the face of a known duty to act, thereby demonstrating a conscious disregard for their responsibilities, they breach their duty of loyalty by failing to discharge that fiduciary obligation in good faith."[24] Moreover, the Court held that "in the absence of red flags, good faith in the context of oversight must be measured by the directors' actions 'to assure a reasonable information and reporting system exists' and not by second-guessing after the occurrence of employee conduct that results in an unintended adverse outcome."[25] The Court further noted that a claim that directors are subject to personal liability for employee failures is "possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment."[26]

Applying the foregoing principles to the facts before it, the Supreme Court held that to show that pre-suit demand was excused, plaintiffs needed to allege particularized facts "sufficient to show that the defendant directors [were] potentially personally liable for the failure of non-director bank employees to file" Suspicious Activity Reports.[27] Plaintiffs' derivative complaint incorporated by reference a KPMG report that refuted plaintiffs' "argument that the directors 'never took the necessary steps … to ensure that a reasonable [] compliance and reporting system existed.'"[28] To the contrary, that report reflected that the AmSouth directors "received and approved relevant policies and procedures, delegated to certain employees and departments the responsibility for filing [Suspicious Activity Reports] and monitoring compliance, and exercised oversight by relying on periodic reports from them."[29] Thus, plaintiffs' derivative complaint itself showed that the "directors not only discharged their oversight responsibility to establish an information and reporting system, but also proved that the system was designed to permit the directors to periodically monitor AmSouth's compliance" with applicable law.[30] Accordingly, the Supreme Court affirmed the Court of Chancery's dismissal of the complaint.

* * *

The following practice pointers can be drawn from the Delaware Supreme Court's decision in *Stone v. Ritter*:

- **Duty of Oversight Claims.** *Caremark* sets forth the appropriate standard for a director oversight claim. Under that standard, the failure to act in good faith is a necessary condition for director oversight liability, *i.e.*, the directors must know they are not discharging their fiduciary obligation. Thus, oversight liability results when directors either (i) utterly fail to implement any reporting or information system or controls, or (ii) having implemented such information systems and control, consciously fail to monitor or oversee its operations.

- **A Breach of the Duty of Loyalty.** If the directors have breached their duty of oversight, those directors would appear to have necessarily breached their duty of loyalty. As a result, a director may not be entitled to exculpation under Section 102(b)(7) of the General Corporation Law of the State of Delaware for such a breach.

- **Duty of Good Faith.** Delaware law does not recognize a separate and independent fiduciary duty of good faith. Rather, the duty of good faith is subsumed within the fiduciary duties of care and loyalty. Therefore, the failure to act in good faith alone does not result in liability.

- **Further Implications for Exculpation and Indemnification.** Even though the Court held that there is no independent duty of good faith, the failure of a director to act in good faith (standing alone) has ramifications under Delaware law. In particular, a director is not entitled to exculpation (under Section 102(b)(7) of the General Corporation Law of the State of Delaware) or indemnification (under Section 145 of the General Corporation Law of the State of Delaware) if the director has not acted in good faith.

II. "Majority-of-the-Minority" Provisions and the Business Judgment Rule

In a recent decision, captioned *In re PNB Holding Co. Shareholders Litigation*,[31] the Delaware Court of Chancery provided important guidance with respect to, among other things, the possibility of using (and the proper standard for calculating) a fully-informed, non-coerced vote of a majority of disinterested stockholders (a "majority-of-the-minority") in order to invoke the substantive protections of the business judgment rule outside of the context in which a controlling stockholder is on both sides of a merger transaction. In *PNB Holding*, the Court of Chancery found that, at least where a transaction was not conditioned on the approval of a "majority-of-the-minority," the vote required was a majority of *all* outstanding shares and not a majority of those shares present and voting. In addition, the Court found that the business judgment rule could be invoked, absent a controlling stockholder, through the use of a special committee or by obtaining as a mathematical matter (and regardless of whether the transaction was conditioned on such a vote) the approval of a "majority-of-the-minority" of the outstanding voting power.

The case involved PNB Holding Company, a Delaware corporation and bank holding company ("PNB"), headquartered in Livingston County, Illinois. Although initially a community bank confined to the town of Pontiac, PNB embarked on an expansion plan in the mid-1990s. After suffering initial setbacks, PNB eventually established a foothold in a nearby growing county and began to reap rewards from its expansion. Following that success, PNB's board considered other strategic alternatives, including the possibility of merging with a similar sized bank, acquiring smaller banks, converting to an S corporation, or continuing to operate under its current business plan.

Eventually, PNB's board decided to convert PNB to an S corporation. Because PNB had too many stockholders to qualify as an S corporation, however, PNB would need to engage in a transaction to reduce the number of stockholders. To accomplish that goal, PNB's board formed an S Corporation Conversion Committee (the "Committee"), which retained Prairie Capital Services, Inc. ("Prairie Capital"), an independent investment banker, to determine the "fair value" of PNB's capital stock.[32]

Based on Prairie Capital's advice, the Committee recommended, and PNB's board ultimately approved, a merger transaction to cash out a sufficient number of stockholders, at a price of $41.00 per share, in order to permit PNB to qualify as an S corporation (the "Merger").[33] Any stockholder who owned at least 2,000 shares of stock and was one of the largest 68 stockholders, as of May 2, 2003, would remain a stockholder of PNB, while all other stockholders would be cashed out. Importantly, all of the directors held a sufficient number of shares (either personally or through trusts) such that they would remain stockholders of PNB following the Merger.

The Merger was approved by 92.6% of the shares that were voted in person or by proxy at the meeting. Only 48.8% of the departing stockholders, however, voted in favor of the Merger.[34] Of the balance of the stockholders who were not eligible to remain as stockholders of PNB, 37.3% failed to return a proxy, 6.2% perfected a demand for appraisal rights, 4.3% voted against the Merger, and 3.4% abstained. Following consummation of the Merger, the number of stockholders of record was reduced from approximately 360 to 69. All of PNB's executive officers and directors, and certain of their family members, remained stockholders in PNB.

Several stockholders dissented from the Merger and perfected their appraisal rights, while several other stockholders accepted the Merger consideration, but commenced an action in the Delaware Court of Chancery alleging that PNB's directors breached their fiduciary duties by approving a merger that was unfair to the minority stockholders.[35] The actions were consolidated into an equitable/appraisal action, "rest[ing] on the notion that the $41.00 per share paid in the Merger was unfair."[36]

With respect to the equitable claim, the Court first considered the plaintiffs' contentions that the Merger was subject to the entire fairness standard of review. The plaintiffs argued that PNB's board should be "considered as a monolith and that given the board's voting power and board control, the Merger should be analyzed as if it were a squeeze-out merger proposed by a controlling stockholder."[37] In *Kahn v. Lynch Communications Systems, Inc.,*[38] the Delaware Supreme Court held that the entire fairness standard of review applied *ab initio* in certain special circumstances, *e.g.*, a negotiated going private transaction with a controlling stockholder or a merger of two companies under the common control of one controlling stockholder. In those circumstances in which a controlling stockholder is on both sides of a negotiated transaction, the Delaware Supreme Court has found that the approval of the transaction by disinterested directors (*e.g.*, by a special committee) or by a majority of disinterested stockholders would only shift the burden of proving entire fairness, but would not invoke the substantive protections of the business judgment rule.

In considering the plaintiffs' argument that the Merger should be subject to the rule of *Kahn v. Lynch*, the Court found that the officers and directors were not a "controlling stockholder group."[39] The Court noted that, under Delaware law, a controlling stockholder exists either where the stockholder (i) owns more than 50% of the voting power of the corporation, or (ii) exercises control over the business and affairs of the corporation.[40] Taken as a whole, the officers and directors owned only 33.5% of the voting power of the corporation. Furthermore, the evidence failed to show that the officers, directors, and their respective families operated as a unified controlling bloc.[41] Rather, Vice Chancellor Leo Strine, Jr. observed that there were no voting agreements in place between any of the members of the purportedly controlling block (consisting of directors, officers, spouses, children and parents), and that each individual "had the right to, and every incentive to, act in his or her own self-interest as a stockholder."[42] Importantly, of the approximately 20 people that comprised the "supposed controlling stockholder group," the largest block held by any one holder was 10.6%.[43] Thus, the Court reasoned as follows:

> Glomming share-owning directors together into one undifferentiated mass with a single hypothetical brain would result in an unprincipled Frankensteinian version of the already debatable 800-pound gorilla theory of the controlling stockholder that animates the *Lynch* line of reasoning.[44]

The Court, therefore, held that the facts of *PNB Holding* did not fit within the *Kahn v. Lynch* line of jurisprudence.

Although finding that the defendant directors were not controlling stockholders, the Court concluded that the defendant directors were subject to a conflict of interest that was sufficient to invoke the application of the entire fairness standard of review. Each of the defendant directors personally benefited to the extent that departing stockholders were underpaid.[45] Furthermore, each of the defendant directors had a material interest in the Merger, which had the effect of yielding an economic benefit that was not shared equally by all of the stockholders of the corporation.[46] In addition, and unlike in the context of determining whether a controlling stockholder group existed, the Court found that the family ties between the directors and the non-director stockholders were relevant. Importantly, several of the directors apparently transferred shares of PNB's stock to family members in order to ensure that they remained stockholders of PNB after the Merger. The Court found that fact to be "indicative of the importance they ascribed to continued ownership in" PNB.[47]

Having determined that the Merger was subject to the entire fairness standard of review, the Vice Chancellor addressed the potential "cleansing" effect of approval by (i) independent and disinterested directors (*e.g.,* a fully-functioning special committee), or (ii) a fully-informed, non-coerced vote of a "majority-of-the-minority." With respect to the former, Vice Chancellor Strine stated as follows:

> In my view, the rule of *Lynch* would not preclude business judgment rule protection for a merger of this kind so long as the transaction was approved by a board majority consisting of directors who would be cashed-out or a special committee of such directors negotiated and approved the transaction.[48]

Although the defendant directors created the Committee to investigate the feasibility of the conversion of PNB to an S corporation, the Committee was not comprised of disinterested directors. As a result, the Committee did not operate to invoke the substantive protections of the business judgment rule.

The Court also noted that the substantive protections of the business judgment rule could be invoked if the Merger was approved by a "majority-of-the-minority." The Court found, however, that PNB failed, as a mathematical matter, to obtain the approval of a vote of a "majority-of-the-minority." In that regard, the Court rejected the defendant directors' contention that only those stockholders who returned a proxy should be included in calculating whether a transaction had been approved by an informed, non-coerced "majority-of-the-minority." Clarifying a previously unresolved aspect of Delaware law, the Court held that Delaware law requires a vote of a majority of *all* of the minority shares entitled to vote.[49]

Equally important, Vice Chancellor Strine indicated that, outside of the *Kahn v. Lynch* context, the approval of a majority of the disinterested stockholders may be sufficient to invoke the protections of the business judgment rule, even if the challenged transaction is not subject to a non-waivable "majority-of-the-minority" condition. The Vice Chancellor stated as follows:

> Under Delaware law, however, the mere fact that an interested transaction was not made expressly subject to a non-waivable majority-of-the-minority vote condition has not made the attainment of so-called 'ratification effect' impossible. Rather, outside the *Lynch* context, proof that an informed, non-coerced majority of the disinterested stockholders approved an interested transaction has the effect of invoking business judgment rule protection for the transaction and, as a practical matter, insulating the transaction from revocation and its proponents from liability.[50]

The Court of Chancery ultimately concluded that the defendant directors failed to prove the entire fairness of the Merger. The Court awarded the appraisal claimants $52.34 per share and the claimants (who did not vote in favor of the Merger) damages in the amount of $11.34 per share (an amount representing the difference between the Merger consideration and the fair value). Claimants who voted in favor of the Merger were barred from recovery under the doctrine of acquiescence.[51] Claimants who accepted the Merger consideration but did not approve the Merger were not similarly barred.

* * *

The following practice pointers can be drawn from the Court of Chancery's decision in *PNB Holding*:

- **Existence of a Controlling Stockholder.** A disparate group of directors who have a material conflict of interest with respect to a transaction will not necessarily be grouped together and treated as a controlling stockholder group. In addition, family members will not necessarily be grouped together for that purpose.[52] However, the grouping may still result in the invocation of the entire fairness test.

- **Invoking Business Judgment Rule Protection.** Outside of the *Kahn v. Lynch* context, a fully-informed vote of a "majority-of-the-minority," as a factual matter, and regardless of whether the merger transaction was conditioned on that vote, can invoke the protections of the business judgment rule and avoid entire fairness review. Similarly, the Court suggested that the negotiation and recommendation of a transaction by a committee of disinterested and independent directors should invoke the protections of the business judgment rule outside of the *Kahn v. Lynch* context.[53]

- **Majority of the Outstanding Minority.** For the first time, the Court directly answered the oft-debated question of whether a vote of a "majority-of-the-minority" should be a vote of a majority of the outstanding voting power of the minority stockholders or merely a

Potter Anderson & Corroon LLP

majority of voting power of the votes cast by the minority stockholders. The Court found that a vote of a "majority-of-the-minority" is effective to invoke the substantive protections of the business judgment rule (at least in the context at issue – *i.e.*, absent a controlling stockholder and a "majority-of-the-minority" condition) only if the challenged transaction is approved by a majority of the *outstanding* voting power of the minority stockholders.

- **Conditioning the Transaction.** Absent a controlling stockholder, a transaction need not be subject to a nonwaivable "majority-of-the-minority" condition in order to invoke the substantive protections of the business judgment rule, so long as the vote is obtained as a mathematical matter. Where there is a controlling stockholder, however, the transaction should be specifically conditioned upon the vote of a "majority-of-the-minority."
- **Adding Directors to Constitute a Special Committee.** Because all of the directors had a material conflict of interest with respect to the Merger, it appeared to have been impossible for PNB to have formed a committee of independent directors that could have operated to invoke the substantive protections of the business judgment rule. The Court suggested, however, that additional directors could have been added to PNB's board in order to form a special committee to protect the interests of the minority stockholders.[54]

III. Fiduciary Duties, Wholly-Owned Subsidiaries and Claims of Deepening Insolvency.

In *Trenwick America Litigation Trust v. Ernst & Young, L.L.P.*,[55] the Court of Chancery held that while directors of an insolvent Delaware corporation owe fiduciary duties to creditors of that corporation,[56] Delaware law does not recognize a claim for "deepening insolvency," a cause of action recognized in several federal courts.[57] The Court also explained the nature and scope of fiduciary duties between a parent corporation and its wholly-owned subsidiary.[58]

Beginning in 1998, Trenwick Group Inc., a public holding company (together with its successor, "Trenwick"), began to expand its insurance operations into international markets through the acquisition of various insurance companies. As part of its expansion, Trenwick reorganized its operating subsidiaries, transferring all of its United States operations and a portion of its debt to its wholly-owned subsidiary, Trenwick America Corporation ("Trenwick America"). Trenwick America became a primary and secondary guarantor of Trenwick's overall debt.[59] Both Trenwick and Trenwick America filed for bankruptcy protection in 2003, citing as the cause of insolvency, the claims made by their insureds (including the insureds of the acquired companies), which exceeded pre-acquisition estimates. Trenwick America's reorganization plan resulted in the creation of the plaintiff-Litigation Trust, which was assigned the potential claims and causes of action belonging to Trenwick America.

The Litigation Trust brought suit against the directors of Trenwick and Trenwick America, alleging various claims relating to the assignment to Trenwick America of Trenwick's debts and obligations, and the insolvency of Trenwick America.[60] The Litigation Trust also asserted a "deepening insolvency" claim, alleging that the restructuring exacerbated the financial difficulties of the company, to the detriment of Trenwick America's creditors. Defendants moved to dismiss the complaint.

The Court first addressed the Litigation Trust's claims against the directors of Trenwick. The Court noted that, as a result of the reorganization, the Litigation Trust was assigned only pre-petition derivative claims belonging to Trenwick America.[61] Therefore, the Litigation Trust lacked standing to pursue a claim against Trenwick directors other than one belonging to

Trenwick America. Accordingly, the Court reasoned that the Litigation Trust's claim "depends on the notion that the directors of a corporate parent – Trenwick – breached fiduciary duties to its wholly-owned subsidiary – Trenwick America."[62]

The Court held that the complaint failed to state a claim against Trenwick's directors. Under well-settled law, absent insolvency, a parent corporation does not owe fiduciary duties to a wholly-owned subsidiary or the subsidiary's creditors.[63] To the contrary, the Court explained:

> [T]he mere fact that the holding corporation caused its wholly-owned subsidiary to take on more debt to support the holding corporation's overall business strategy does not buttress a claim. Wholly-owned subsidiary corporations are expected to operate for the benefit of their parent corporations; that is why they are created. Parent corporations do not owe such subsidiaries fiduciary duties.[64]

Moreover, the Litigation Trust failed to plead facts sufficient to support an inference that the subsidiary was insolvent at the time of the challenged transactions. In fact, Trenwick America's financial statements indicated that following the restructuring, the company had a positive asset value in excess of $200 million.[65] Accordingly, the Litigation Trust failed to properly plead that Trenwick – much less Trenwick's directors – owed fiduciary duties to Trenwick America at the time of the challenged transactions.[66]

The Court also dismissed the Litigation Trust's claims against the directors of Trenwick America for failure to state a cognizable claim. The Litigation Trust argued that the directors of Trenwick America were conflicted because of their loyalty to their employer, Trenwick. The Court rejected that argument, holding that the directors of Trenwick America, a wholly-owned *solvent* subsidiary of Trenwick, were "obligated only to manage the affairs of [Trenwick America] in the best interest of [Trenwick] and its shareholders."[67] Absent an indication that they would be causing Trenwick America to violate legal duties owed to others, directors of Trenwick America were free to take actions to further Trenwick's business strategy. Furthermore, the Trenwick America directors were not obligated "to replicate the deliberative process of [Trenwick's] board when taking action in aid of [Trenwick's] acquisition strategies."[68]

In addition to dismissing the Litigation Trust's common law fiduciary duty claims, the Court also dismissed the Litigation Trust's claim against the directors of Trenwick America for "deepening insolvency" and held that Delaware law does not recognize a separate cause of action for "deepening insolvency."[69] Directors of Delaware corporations are under no obligation to dissolve and liquidate a corporation that is unable to meet its financial obligations. Rather, the board, in accordance with its fiduciary duties, may undertake a course of action designed to maximize the value of the firm. The Court observed that:

> [I]f the board of an insolvent corporation, acting with due diligence and good faith, pursues a business strategy that it believes will increase the corporation's value, but that also involves the incurrence of additional debt, it does not become a guarantor of that strategy's success. That the strategy results in continued insolvency and an even more insolvent entity does not in itself give rise to a cause of action. Rather, in such a scenario the directors are protected by the business judgment rule.[70]

"If simple failure gave rise to claims," the Court went on to say, "the deterrent to healthy risk taking by businesses would undermine the wealth-creating potential of capitalist endeavors."[71]

While rejecting the "deepening insolvency" theory of liability, the Court noted that directors of insolvent corporations are not free from responsibility, and remain subject to causes of action such as breach of fiduciary duty and fraud.[72] Such carefully designed causes of action balance "society's interest in promoting good-faith risk-taking and in preventing fiduciary misconduct."[73]

* * *

The following practice pointers can be drawn from the Court of Chancery's decision in *Trenwick*:

- **Fiduciary Duties and Wholly-Owned Subsidiaries.** Wholly-owned subsidiaries are expected to operate for the benefit of the parent corporation. As a result, directors of wholly-owned (solvent) subsidiaries owe fiduciary duties only to the parent corporation and its stockholders. In addition, a parent owes no fiduciary duties to a (solvent) wholly-owned subsidiary.

- **Fiduciary Duties in Insolvency.** If a wholly-owned subsidiary is insolvent, however, the creditors become the residual risk bearers and fiduciary duties will be owed to the creditors by both the parent and the directors of the wholly-owned subsidiary.

- **Deepening Insolvency.** Delaware courts will not recognize a claim for deepening insolvency. The recognition of such a claim would deter Delaware corporations from taking risks and thus undermine the purpose of corporations. Instead of discouraging risk-taking, a board should be encouraged to diligently pursue, in good faith, a business strategy that will maximize value. Even if the entity is insolvent, such risk taking should be encouraged.

IV. Interpreting Restrictions on an Acquirer in a Merger Agreement

In *Energy Partners Ltd. v. Stone Energy Corporation*,[74] the Court of Chancery interpreted a provision in a merger agreement which restricted the activities of an acquiring corporation prior to the consummation of a merger, and concluded that the provision at issue did not restrict the acquiring corporation from negotiating with a third party bidder. Both contract and fiduciary duty principles were utilized to construe the merger agreement.

At issue in *Stone Energy* was a proposed merger between Stone Energy Corporation ("Stone") and Energy Partners, Ltd. ("EPL") pursuant to which EPL would acquire Stone.[75] Importantly, the merger agreement provided for the payment of cash or stock to Stone's stockholders. Because of the stock issuance, the vote of EPL's stockholders was required to approve the merger agreement.

Section 6.2(e) of the merger agreement ("Section 6.2(e)") placed certain restrictions on EPL's actions prior to the consummation of the merger. That provision provided, in pertinent part, as follows:

> Except as expressly permitted or required by this Agreement, prior to the Effective Time, neither [EPL] nor any of its Subsidiaries, without the prior written consent of [Stone], shall:
>
> (e) knowingly take, or agree to commit to take, any action that would or would reasonably be expected to result in the failure of a condition set forth in Sections 8.1,

> 8.2, or 8.3 [conditions to consummation of the merger] … or that would reasonably be expected to materially impair the ability of [Stone], [EPL], Merger Sub, or the holders of Target Common Shares to consummate the Merger in accordance with the terms hereof or materially delay such consummation....[76]

Although the merger agreement contained a standard "no shop" provision restricting the activities of Stone, no reciprocal "no shop" provision restricted the activities of EPL. In addition, the merger agreement provided Stone, but not EPL, with the right to terminate the merger agreement if EPL's board changed its recommendation because of a "Third Party Acquisition Proposal."[77] Finally, the merger agreement provided for the payment by EPL of a termination fee if the EPL stockholders did not adopt the merger agreement because of a "Third Party Acquisition Proposal."[78]

Following the execution of the merger agreement, ATS, Inc. ("ATS"), an indirect wholly owned subsidiary of Woodside Petroleum Ltd. ("Woodside"), announced a hostile tender offer for EPL and, thereafter, formally launched the tender offer. As a result, a dispute erupted between EPL and Stone relating to whether Section 6.2(e) precluded EPL from having discussions with ATS and Woodside about a possible transaction.

EPL and ATS commenced separate actions in the Court of Chancery seeking declaratory relief as to the meaning of Section 6.2(e).[79] EPL argued that Section 6.2(e) could not be construed to be a "no shop" provision because EPL specifically refused to agree to a reciprocal "no shop" provision when it negotiated the merger agreement with Stone. EPL also argued that Section 6.2(e) did not apply to activities engaged in by EPL to develop, solicit, consider, communicate, exchange information about, negotiate, disclose, enter into or consummate potential or definitive strategic alternatives. If Section 6.2(e) operated to preclude such strategic alternative transactions, EPL argued that such a provision would then operate as a "no shop" provision and be invalid as a matter of Delaware law because it would prevent the EPL board from fulfilling its fiduciary duties.

By contrast, Stone argued that Section 6.2(e) operated as written, and did not restrict EPL's activities so long as any negotiations, recommendations or third party agreement did not materially delay or impair the merger.[80] Stone argued, therefore, that EPL was not unconditionally precluded from talking to third parties.[81]

In reaching its decision that Section 6.2(e) did not prevent EPL from exploring Third Party Acquisition Proposals, such as the ATS tender offer, the Court interpreted that provision in accordance with settled contract interpretation principles. Construing the contract as a whole and finding no ambiguity, the Court determined that Section 6.2(e) did not prevent EPL from investigating, negotiating or pursuing the ATS tender offer or any other Third Party Acquisition Proposal. In particular, the Court found that the preamble to Section 6.2, which contained the phrase "except as expressly permitted or required by this Agreement....," indicated that the entire merger agreement must be considered when construing the provisions of Section 6.2(e). The Court found that several other provisions of the merger agreement supported an interpretation of Section 6.2(e) that permitted EPL to pursue the ATS tender offer.

In particular, the merger agreement recognized that EPL might withdraw or modify its recommendation "in reference to a proposal conditioned upon the termination of the merger agreement and abandonment of the merger, *i.e.*, a Third Party Acquisition Proposal, such as the ATS Tender Offer."[82] In the event that EPL were to do so, the merger agreement provided Stone with a remedy – *i.e.*, to terminate the merger agreement and to collect a termination fee. Therefore, the Court concluded as follows:

> Taken together, these provisions are internally consistent with the plain reading of the Stone Merger Agreement. The provisions indicate that the parties contemplated that just such an event as the ATS Tender Offer might occur and that in reference to it, EPL's board, consistent with its fiduciary obligations, could investigate or pursue the Third Party Acquisition Proposal and potentially recommend against the Stone Merger. Under the plain language of the entire merger agreement, EPL is free to pursue Third Party Acquisition Proposals that qualify under the definition in 10.1(i). Nothing in the Stone Merger Agreement suggests that Section 6.2(e), as part of the provisions governing conduct of the business of the acquirer pending the merger, should be read to be inconsistent with the plain language of Sections 7.13(b) and 10.1(i) and the recognition implicit in those sections that EPL would have the ability to explore Third Party Acquisition Proposals and negotiate about them, if it determines that to be advisable.[83]

In addition, the Court found that, even if Section 6.2(e) was ambiguous, the relevant extrinsic evidence supported the same interpretation. The Court noted that the evidence showed that the parties did not discuss Section 6.2(e) in their negotiations. In addition, EPL had repeatedly refused to agree to a reciprocal "no shop" provision. As a result, the Court concluded that "construing Section 6.2(e) to preclude EPL from communicating or negotiating with ATS or the maker of any other Third Party Acquisition Proposal would be inconsistent with the extrinsic evidence and contrary to the parties' manifest intent."[84]

The Court also noted that the relevant Delaware fiduciary duty law supported a conclusion that Section 6.2(e) permitted EPL to pursue Third Party Acquisition Proposals. In particular, the Court found the reasoning of *Ace Ltd. v. Capital Re Corp.*[85] to be persuasive, and determined that the merger agreement provision should be construed consistently with the parties' understanding of the board's fiduciary duties. The Court reasoned as follows:

> In interpreting the ACE-Capital Re merger agreement, the Court recognized that the parties to the transaction were aware of the scope of the directors' fiduciary duties and, in effect, construed the provisions of the agreement consistent with those duties. This conclusion comports with the record established in this case in terms of the EPL-Stone merger.... Accordingly, the Court construes the Stone Merger Agreement, in general, and Section 6.2(e), in particular, as being consistent with that understanding and permitting EPL to explore Third Party Acquisition Proposals, as long as it does so in good faith.[86]

Finally, the Court concluded that the plaintiffs' claims that Section 6.2(e) was *per se* invalid were moot based on its interpretation of that provision.

* * *

The following practice pointers can be drawn from the Court of Chancery's decision in *Stone Energy*:

- **Fiduciary Duties of a Buyer's Boards.** Even a buyer's board must comply with its fiduciary duties following the execution of a merger agreement. In certain circumstances, such as when a buyer stockholder vote is required, a buyer's board should consider those ongoing fiduciary duties prior to approving a merger agreement.

- **Interpretation of Merger Agreements.** A Delaware court will apply settled contract interpretation principles when considering the terms of a merger agreement. Among other things, the court will read the contract as a whole and in accordance with its plain meaning. Even if the Court finds no ambiguity, it may consider the relevant extrinsic evidence to be persuasive.

- **Factoring in Fiduciary Duties.** Fiduciary duty principles may be important in determining the meaning of a provision in a merger agreement. If the evidence suggests that the parties were familiar with fiduciary duty principles when negotiating the merger agreement, the Court may construe the terms of the merger agreement in accordance with those principles.

V. State Law Franchise Rights and the Federal Securities Laws.

In recent years, some corporations have been in the difficult position of being unable to obtain audited financials and thus to satisfy federal law periodic reporting requirements. In those circumstances, a corporation is unable to solicit proxies under the federal securities laws and thus to hold a meeting of stockholders. That situation has led to a palpable tension between the federal securities laws and the requirements of Delaware law. For example, some Delaware corporations have been unable to hold annual elections or to call meetings of stockholders to consider extraordinary transactions, even when a vote is required by Delaware law. In 2005, the Court of Chancery found that a corporation's inability to solicit proxies under the federal securities laws did not excuse a Delaware corporation from holding an annual meeting to elect directors each year pursuant to Section 211 of the General Corporation Law of the State of Delaware.[87] In *Esopus Creek Value L.P. v. Hauf*,[88] the Court of Chancery extended the reasoning of that decision to transactions requiring a stockholder vote pursuant to Section 271 of the General Corporation Law of the State of Delaware ("Section 271").

Esopus Creek focused on the financial reporting difficulties of Metromedia International Group, Inc. ("Metromedia"). In particular, Metromedia's auditors had been unable to sign off on audited financials for several years. As a result, the company was unable to solicit proxies and thus had not held an annual meeting for three years.

In early 2006, Metromedia received an unsolicited offer for the sale of its 50.1% interest in Magticom, the Republic of Georgia's leading mobile telephony provider. Given that the sale of that asset would constitute a sale of all or substantially all of Metromedia's assets, Metromedia's board considered whether a sale was possible. Metromedia's counsel informed the board that a vote under Section 271 was impossible because Metromedia was not current on its periodic filings and therefore could not call a meeting or solicit proxies from its stockholders.

In light of that advice, the board decided to approve a plan to consummate the sale by employing certain procedures under the federal bankruptcy code. The plan involved the execution of an agreement to sell the assets, followed by the filing of a voluntary bankruptcy petition pursuant to which the company would seek bankruptcy approval for the sale, as well as approval of its plan of reorganization. Importantly, the relevant bankruptcy laws effectively required Metromedia to obtain the consent of the holders of at least two-thirds of its preferred stock. Therefore, Metromedia entered into voting and lock-up agreements with the holders of approximately 80% of its preferred shares. In connection with the negotiation of those voting and lock-up agreements, Metromedia agreed to provide the preferred stock with favorable treatment in the transaction.

Following public announcement of the proposed transaction, plaintiff common stockholders filed a motion to preliminarily enjoin Metromedia from executing the definitive agreement, absent a vote of Metromedia's common stockholders under Section 271. At oral argument, the defendants' counsel informed the Court that Metromedia had agreed to retreat from the bankruptcy plan and was amenable to a court order that would convene a meeting of stockholders to consider the proposed transaction. The parties agreed as follows: (i) any agreement entered into by Metromedia for the sale of the assets would be subject to a vote under Section 271, (ii) the directors would make a concerted effort to seek exemptive relief from the Securities and Exchange Commission (the "SEC"), in order to permit Metromedia to solicit proxies and to provide financial information to the stockholders, (iii) even if exemptive relief was not granted, Metromedia would distribute information required under Delaware law to ensure that the Section 271 vote was informed, and (iv) the company would take all necessary steps to encourage common stockholders to attend the Section 271 meeting and cast a vote on the proposed transaction.

Even though the parties mutually agreed to those terms and the Court entered an ordered to that effect, the Court discussed the merits of the case in order to set the foundation for its order. The Court first examined whether the board's decision to pursue the proposed transaction under the federal bankruptcy law and to avoid a vote under Delaware law triggered "compelling justification" review under *Blasius*. The Court found that no such review was warranted for several reasons. First, the Court noted that the exacting *Blasius* standard of review was employed only sparingly when the matter to be voted on did not touch on issues of directorial control. The Court found that the board's decision to structure the transaction under the bankruptcy code was not motivated by entrenchment. Not only would the board cease to exist following the plan of reorganization, but also Metromedia had pledged that a stockholder meeting to elect directors would be held in December 2006. In addition, the Court found that the board's actions were not designed to thwart the will of the majority, as the evidence had suggested that approximately 44% of the company's stock supported the asset sale at the time of the Court's decision. Simply put, the decision to structure the transaction as a bankruptcy sale was caused by the practicable impossibility of soliciting proxies and holding a meeting under the federal securities laws, and not by some nefarious motive to ensure the consummation of the transaction over the opposition of stockholders.

Although finding that the *Blasius* standard of review did not apply to the proposed transaction, the Court concluded that the board's decision to structure the transaction as a bankruptcy sale was inequitable under *Schnell v. Chris-Craft Industries, Inc.*[89] The Court reached that conclusion because the bankruptcy plan was motivated by the single self-admitted purpose of avoiding a vote under Section 271. The Court stated, therefore, that it seemed to be "an abuse of the bankruptcy process for a robust and healthy company, encumbered by virtually no debt, to seek out of the vast and extraordinary relief a bankruptcy court is capable of providing."[90] The Court also found that the enfranchisement of the preferred stockholders, when they otherwise would not have had the ability to vote on the proposed transaction under the relevant certificate of designations, also suggested inequitable conduct by the board. Through that enfranchisement, the board "effectively granted the preferred stockholders substantial additional bargaining power to influence the company's disposition of its remaining assets."[91]

Finally, the Court found that the board's failure to explore exemptive relief with the SEC also supported a finding of inequitable conduct. The Court noted that the SEC has broad authority to grant exemptions of the federal securities laws, and that the SEC often granted exemptions in order to support important state law standards of corporate governance. The Court stated that the stockholder voting requirement under Section 271 is just such an important standard of corporate governance. It noted that Metromedia appeared to be a prime candidate for an exemption as it had asserted that it was unable to file audited financials because of certain disagreements with its outside auditor and that the resolution of those disagreements would not greatly affect the overall value of the stockholders' stake in Metromedia.

However, the Court recognized that it was possible that the SEC would not grant the exemption. Therefore, the Court ordered that a meeting be held and stockholders encouraged to attend, even if an exemption for proxies was not granted. Seemingly recognizing that such a meeting of the stockholders of a public company was a practical impossibility, the Court mentioned the possibility of invoking its equitable powers to appoint a receiver for the corporation if necessary.

* * *

The following practice pointers can be drawn from the Court of Chancery's decision in *Esopus Creek*:

- **Structuring Around a Stockholder Vote.** When a stockholder vote is required by Section 271, it may not be possible to structure around that vote by adopting a plan such as the one adopted in *Esopus Creek*. That is not to say that a Delaware corporation is precluded from taking advantage of the doctrine of independent legal significance to structure a transaction as something other than a "sale, lease or exchange." Rather, the decision should be read only as prohibiting a corporation from avoiding a stockholder vote when one is required by Section 271 because the transaction in fact is a "sale, lease or exchange" of "all or substantially all" of the corporation's assets.

- **SEC Exemptions.** Delaware corporations cannot avoid statutorily required stockholder votes even if they are unable to solicit proxies. Instead, such corporations should seek exemptions from the SEC and, in lieu of obtaining such an exemption, make all efforts possible to obtain any requisite stockholder vote by disseminating all material information and holding a meeting at which stockholders may attend in person. The Court's decision, and the reasoning set forth therein, may be persuasive in obtaining such an exemption from the SEC in the appropriate circumstances. Indeed, one could argue that the Court's decision is a (not so subtle) plea to the SEC to carefully consider any requests for an exemption and to take into account the corporate governance requirements imposed by state law.

- **The Receiver Option.** The Court's order may not be practical due to the difficult requirement of a quorum if proxies cannot be solicited. The Court left open the possibility that a receiver might be appointed if a corporation is unable to hold a meeting when one is required.

VI. Hedge Fund Litigation in Delaware

In recent years, hedge funds have become dominant players in corporate America. In addition to investing extraordinary amounts of capital, hedge funds have displayed an increasing appetite for direct confrontation with corporate boards when the hedge funds question the board's competence, its vision, or the speed with which that vision is accomplished. Not surprisingly, in recent years hedge funds increasingly have turned to the Delaware courts for redress for their concerns and several of those cases have resulted in decisions by the Delaware courts. Two of those decisions, *Highland Select Equity Fund, L.P. v. Motient Corporation*[92] and *Accipiter Life Sciences Fund, L.P. v. Helfer*,[93] are discussed below.

A. *Highland Select Equity Fund, L.P. v. Motient Corporation*

At issue in *Highland Select* was a hedge fund's use of a Section 220 books and records action against a corporation during a proxy contest. A stockholder may utilize books and records requests under Section 220 for a wide variety of reasons, including to investigate possible mismanagement in order to determine whether to bring derivative litigation or to commence a proxy contest. In fact, the Delaware courts have encouraged, for some time, the use of Section 220 demands by stockholders prior to asserting derivative actions against a corporation.[94] However, in recent years, some stockholders (including some hedge funds) have begun using sweeping (or, in some cases, repetitive) books and records requests under Section 220 that some corporations considered oppressive and/or unreasonable. In *Highland Select* the Court of Chancery considered such allegations against a hedge fund for the first time and sent a strong signal that it will not tolerate the aggressive use by hedge funds (or any other stockholder) of a books and records action under Delaware law as a "tool of oppression," particularly in the context of an ongoing proxy contest.[95]

At the center of the *Highland Select* case was Motient Corporation, a Delaware corporation ("Motient"), which provides two-way wireless mobile data services and nationwide internet services. Motient's primary assets are equity interests in two entities that operate and develop its services. Highland Select Equity Fund, L.P., a Delaware limited partnership ("Highland Select") is a hedge fund that was a stockholder of Motient.

Beginning in 2005, Highland Select began to express concerns about possible mismanagement at Motient. For example, Highland Select opposed a proposed transaction to combine Motient with the entities that owned its operating assets, asserting that the underlying Motient assets had been undervalued and that Motient's management may be motivated by self-dealing because of a potential conflict of interest of certain directors. In addition, Highland Select questioned certain consulting agreements that it believed were self-dealing transactions involving Motient's management. Highland Select also expressed concerns about Motient's recent disclosure of material weaknesses in its internal controls and the fact that it was at risk of being classified as an investment company under the Investment Company Act of 1940.[96]

Beginning in August 2005, Highland Select or its affiliates commenced a number of actions against Motient and its board, including a breach of fiduciary duty action in the Court of Chancery,[97] and an action filed in Texas seeking to rescind the sale of Motient Series A Preferred Stock to Highland Select. In response, Motient filed actions in the federal and state courts of Texas against Highland Select affiliates, claiming that the Highland Select director designee had breached his fiduciary duties and violated the securities laws. On February 14, 2006, the Highland Select director designee resigned from the Motient board and Highland Select announced a proxy contest to replace the Motient board with its own slate. Highland Select indicated that it was concerned about mismanagement at Motient and noted, in particular, concerns about material weaknesses in financial controls, certain disclosure inadequacies, a flawed April 2005 stock issuance and a failed roll-up transaction.

On April 12, 2006, Highland Select delivered a demand letter to Motient seeking to inspect Motient's books and records pursuant to Section 220. Highland Select's demand letter was 25 pages in length and contained 47 separate paragraphs of substantive demands. After

Motient rejected the demand letter (claiming that Highland Select failed to state a proper purpose and that the demand was "unreasonably broad and burdensome"),[98] Highland Select filed an action in the Court of Chancery pursuant to Section 220.

As the trial date approached for the Court to consider the Section 220 demand, Highland Select began a "dramatic series of revisions to its Section 220 demand."[99] Highland Select claimed in its brief that it had substantially narrowed the demand and then, on the eve of trial, it revised the demand again and cut down the 47 paragraphs of demands to 10 paragraphs. After reviewing a comparison of the demand letter, the Court stated that the revised demand, which only reduced the demands from 47 categories to 39 categories, "still suffers from the same overbreadth as its original letter."[100]

Following a one day trial, the Court of Chancery denied Highland Select's demand to inspect Motient's books and records. In its decision, the Court made several preliminary observations. First, the Court noted that a stockholder must make its demand for inspection in good faith, and that the demand will be examined by the Court for possible abuse. The Court stated that "[*r*]*ecent experience teaches that the potential for abuse is very much alive when the Section 220 demand is made – as this one is – in the context of an impending or ongoing proxy contest*."[101] The Court indicated that in the context of a proxy contest, where the plaintiff seeks to publicize certain information and the Court is asked to referee disputes about confidentiality, it is particularly important that the stockholder make a narrow request. In addition, the Court warned that Section 220 is not a means to circumvent the discovery process.

Turning to the demand asserted by Highland Select, the Court found the demand to be "extraordinarily overbroad" and to have been made "despite the fact that [Highland Select] (or its affiliates) could have conducted full discovery into the very same questions of mismanagement in various other cases filed in Texas federal and state court.[102] In addition, the Court chided Highland Select for requesting expedited relief when Highland Select at the same time had "hamstrung Motient's efforts to defend itself" when it proffered a Rule 30(b)(6)[103] witness who was "so bound by attorney-client privilege, a self-serving lack of tenure in the plaintiff corporation, and a simple lack of knowledge, that his designation raises serious legal questions about Highland [Select]'s compliance with the rule."[104] In addition, the Court noted that necessity for expedited relief was largely of Highland Select's own making, given the fact that Highland Select had known almost every detail of the alleged mismanagement for months but waited until February to commence the proxy contest.

The Court concluded that "[t]hese facts describe a remarkable confluence of events that amount to an abuse of the Section 220 process, designed for some purpose other than to exercise Highland Select's legitimate rights as a stockholder."[105] The Court accused Highland Select of using the demand for an improper purpose, reasoning as follows:

> Highland [Select], from the beginning of this process, intended to file a proxy contest, and had all the information it needed to take that step, whether from public filings or from [Highland Select's designee's] long service as a Motient director. Highland [Select] thus appears to have maintained its books and records demand in large part because it has derived utility from the demand itself as a rhetorical platform. That is not the kind of compelling circumstance this court described in *Disney*, that would authorize the use of Section 220 as a way of publicizing concerns about mismanagement.[106]

The Court refused to "pick through the debris of the Section 220 demand in this state of disarray and to find the few documents that might be justified as necessary and essential to the plaintiff's demand."[107] Instead of a limited and discrete investigation into possible mismanagement, as contemplated by Section 220, Highland Select chose to assert a demand that was "broadly inconsistent with that statutory scheme."[108] Therefore, the Court denied the demand, dismissed the complaint and entered judgment in favor of Motient.

B. *Accipiter Life Sciences Fund, L.P. v. Helfer*

In *Accipiter Life Sciences Fund, L.P. v. Helfer*,[109] the Court of Chancery considered a claim by a hedge fund that a corporation "buried" the announcement of an annual meeting in a press release reporting the corporation's earnings and, as a result, caused the hedge fund to miss the deadline for nominating an opposing slate of directors. The Court denied the hedge fund's claims and, thus, put hedge funds on notice that the Court is unlikely to find that a sophisticated hedge fund was entitled to equitable relief for its own failure to properly monitor a corporation's public disclosures. Hedge funds often seek to run proxy contests or submit stockholder proposals in an effort to put pressure on a corporation to meet its demands. When submitting nominations or proposals, hedge funds must navigate a corporation's advanced notice bylaw provisions, which set forth deadlines for submissions. In order to meet the requisite deadline, it is often critical for stockholders to understand the mechanics of the advance notice bylaw provisions and to remain vigilant for announcements of an annual meeting date.

The facts of *Accipiter Life Sciences* are straightforward. LifePoint Hospitals, Inc., a Delaware corporation ("LifePoint"), had an advance notice bylaw requiring the board of directors to set a record date for the corporation's annual meeting. In prior years, LifePoint typically scheduled its meeting for mid-May. In recent years, however, that schedule was disrupted and LifePoint scheduled its annual meetings in 2004 and 2005 for mid-June and late June, respectively. LifePoint's advance notice bylaw provided that stockholders must submit their nominations or proposals not less than 90 days prior to the first anniversary of the preceding year's annual meeting. However, in the event that the annual meeting was advanced by more than 30 days or delayed by more than 60 days, stockholders must submit their nominations or proposals either no later than the 90th day prior to the annual meeting or the 10th day following the day on which public announcement of the date of such meeting is first made.

In early January 2006, LifePoint began preparing for its annual meeting and anticipated setting a meeting date of May 8, 2006. That plan changed when, on January 12, 2006, LifePoint received the first stockholder proposal in its history. In response, LifePoint's outside counsel suggested that LifePoint schedule an annual meeting in order to trigger the advance notice bylaw, thus requiring that all further stockholder proposals be submitted within ten days of that announcement. Intending to "identify the universe of stockholder proposals" sooner rather than later and with no knowledge of any stockholder's intent to nominate an opposing slate of directors, LifePoint decided to announce its annual meeting in an already drafted, and about to be published, press release announcing LifePoint's fourth quarter earnings.[110] On February 6, 2006, LifePoint issued a press release, which had a title that referred only to the fourth quarter earnings and which included eleven pages of text and financial results. However, in the seventh paragraph at the bottom of the first page of that release, LifePoint included a separate paragraph announcing that the date for the annual meeting of stockholders was set for May 8, 2006.

Accipiter Life Sciences Fund, L.P. ("Accipiter"), is a hedge fund and LifePoint stockholder that monitored the public filings of LifePoint. Accipiter's employees testified that they were awaiting the earnings press release and read it, but that they overlooked the paragraph announcing the annual meeting date. One of Accipiter's employees also admitted that, if he had seen the paragraph announcing the annual meeting, he would have known that Accipiter had ten days to submit nominations for a competing slate of directors.[111]

Unaware that a new meeting date had been set, Accipiter submitted a formal notice of nominations for a competing slate on March 31, 2006. LifePoint responded by stating that the notice was not timely because the new annual meeting date was set in the February 6 press release, triggering the ten day window under LifePoint's advance notice bylaw. In response, Accipiter filed suit in the Court of Chancery asserting, among other things, that the manner and form by which the meeting date was set was inequitable, even though LifePoint set the annual meeting date in accordance with Delaware law. Accipiter moved for summary judgment on its claim and requested the Court to order a new election of directors to the LifePoint board.

In examining the facts presented, the Court considered the standard of equitable behavior articulated in *Schnell v. Chris-Craft*.[112] In that case, the Delaware Supreme Court found that a corporation "may not take actions towards their stockholders which, though legally possible, are inequitable."[113] The Court noted, however, that its equitable power to set aside a corporate action must be used sparingly and a decision whether a particular act is inequitable must be decided on a case by case basis after a close examination of the relevant facts. The Court noted that it has been more likely in prior cases to invalidate the application of an advance notice bylaw under the *Schnell* standard where the corporation was acting "with the intent of influencing or precluding a proxy contest for control of the corporation."[114] The Court added, however, that intent is not a required element and the Court went on to describe certain cases in which extraordinary circumstances led to the invocation of the Court's equitable powers despite the absence of intent.[115]

With respect to the present case, however, the Court found that the "facts … fall far short of the types of inequity which our courts have found determinative in the past."[116] First, the Court noted that LifePoint did not know about Accipiter's intent to run a proxy contest at the time that the annual meeting date was announced. In addition, the Court determined that "LifePoint's actions did not … make the dissident's challenge extremely difficult or impossible."[117] Moreover, no new material facts arose after the nomination period ended. Finally, the Court found it important that, unlike in other cases, all Accipiter had to do "to preserve its rights was to read [LifePoint's] press release carefully and fully."[118] Although the Court found "some appeal" to the argument that LifePoint violated Delaware law by making "important corporate information more difficult to discover than was necessary," the Court found that the "troubling way" that LifePoint announced its annual meeting did not reach the standard required for equitable relief.[119] The Court concluded as follows:

> The reason this court grants the defendants' motion for summary judgment, therefore, is not that the court views LifePoint's method of disclosure with approbation, but that its equitable powers can only be roused under *Schnell* where compelling circumstances suggest that the company unfairly manipulated the voting process in such a serious way as to constitute an evident or grave incursion into the fabric of the corporate law. To rule in the plaintiff's favor here, where the record shows that Accipiter could easily have preserved its rights with reasonable diligence, would extend *Schnell* well beyond those limits and would threaten to involve the court in matters better understood as regulatory in nature.[120]

* * *

The following practice pointers can be drawn from the Court of Chancery's decisions in *Highland Select* and *Accipiter Life Sciences*:

- **Burdensome Books and Record Demands.** The Court of Chancery will neither participate in, nor tolerate, efforts by a stockholder to impose burdensome and expedited requests to inspect books and records on a corporation during a contest for corporate control. In such circumstances, a demand to inspect books and records must be narrowly focused. In circumstances where the Court believes a stockholder's efforts are simply an attempt to burden or otherwise oppress the corporation during such a time, the Court is willing to deny *in totality* a demand to inspect books and records.

- **Future Books and Record Demands.** One may reasonably expect to see a company rely in the future on this decision when rejecting a Section 220 demand by a stockholder that the company considers either overly broad or unnecessarily repetitive. However, it remains to be seen whether this decision will be read as an indication of a growing cynicism within the Delaware courts about the (ab)use of Section 220.

- **Notice of Annual Meetings.** The *Accipiter Life Sciences* case should not be read as an invitation for corporations to "bury" important information in press releases. However, the case does suggest that a corporation need not take extraordinary efforts, absent unusual circumstances, to highlight the setting of an annual meeting date in order to put stockholders on notice that the clock for nominations and proposals has commenced. The absence of such extraordinary efforts may, of course, have the unintended consequences of foreclosing an unforeseen proxy contest.

VII. The Doctrine of Independent Legal Significance and Appraisal Rights

In a decision with potentially far-reaching consequences for deal structuring, the Delaware Court of Chancery issued a preliminary injunction in *Louisiana Municipal Police Employees' Retirement System v. Crawford*,[121] and postponed for at least 20 days a vote of the stockholders of Caremark RX, Inc. on its proposed merger with CVS Corporation. Although the mere postponement of the vote appears to be unremarkable, the Court's decision merits attention because of the primary reason for the injunction – the Court treated a special dividend and a stock for stock merger as an integrated transaction and concluded that the Caremark stockholders were entitled to appraisal rights.

Absent the special dividend, which would be declared by the Caremark board prior to the merger, the Caremark stockholders would not have been entitled to appraisal rights as a result of the stock for stock merger because of the "market out" exceptions of the appraisal statute, Section 262. In reaching the decision that the special dividend was effectively cash consideration to be paid to the Caremark stockholders as part of the proposed merger with CVS, the Court was persuaded by the fact that the payment of the special dividend was specifically conditioned on stockholder approval of the merger agreement and only became due after the effective time of the merger. The Court concluded that those "facts belie the claim that the special dividend has legal significance independent of the merger" and thus "the label 'special dividend' is simply cash consideration dressed up in a none-too-convincing disguise."

Although the Court's decision on the availability of appraisal rights may be surprising to some practitioners, it may be explained to some extent by the Court's apparent skepticism about the Caremark board's decision to continue to recommend the CVS/Caremark merger, despite the existence of a competing offer from Express Scripts, Inc. In particular, the Court stated that the Caremark stockholders "should not be denied their appraisal rights simply because their directors are willing to collude with a favored bidder to 'launder' a cash payment." Indeed, the Court found that it was CVS, not Caremark, that initially proposed the dividend in response to the Express Scripts offer. In the end, the Court determined to postpone, and did not indefinitely enjoin, the vote, finding that there was neither irreparable harm nor extraordinary inequity because the stockholders would have the opportunity to vote in a fully-informed manner on the CVS/Caremark merger, supported by the protection of the appraisal remedy.

The Court's skepticism about the Caremark board process is evidenced by its discussion of the personal benefits to be received by Caremark's officers and directors as a result of the CVS/Caremark merger. Those benefits included (i) cash payments payable to many of the directors and officers pursuant to certain change of control provisions in their employment agreements (even though the Caremark board insisted that the transaction did not constitute a "change of control" for purposes of *Revlon*), and (ii) structural and contractual protections from the liability that could result from the Caremark option backdating scandal. The Court noted that it was not clear that a third party bidder would offer those same benefits in a superior proposal.

The Court found the contractual liability protections to be particularly troubling. The surviving company agreed not only to contractually honor any grant of options by Caremark, but also, and most significantly, to indemnify all past and present directors of Caremark "to the fullest extent permitted by law." The Court found the indemnity agreement to be powerful because it provided the Caremark board, and particularly the independent directors, with indemnification rights that Caremark itself might not have been able to provide the directors – because the directors could be liable to Caremark under the reasoning of the recent *Tyson Foods* decision, which finds that directors risk potential personal liability for manipulating the grant date of options, even if they did not personally benefit from the manipulation. Therefore, the Caremark board was able to obtain indemnity protection from a third party – CVS – in the event that they were found to be liable in the backdating scandal.

As for deal protections, the Court again emphasized, as it did in *Toys "R" Us*, the context specific analysis required to determine the reasonableness of deal protections. Most interestingly, the Court rejected, with some emphasis, the contention that the Court should accept certain deal protections as *per se* reasonable simply because they are customary. In that regard, the Court refused to find that a 3% termination fee was *per se* valid, instead noting that the Court will consider a number of factors in determining the reasonableness of the fee, including "the overall size of the termination fee, as well as its percentage value; the benefit to the shareholders, including a premium (if any) that directors seek to protect; the absolute size of the transaction, as well as the relative size of the partners to the merger; the degree to which a counterparty found such protections to be crucial to the deal, bearing in mind differences in bargaining power; and the preclusive or coercive power of *all* deal protections included in a transaction, taken as a whole."

The Court also found that a postponement of the stockholder vote was necessary to provide the Caremark stockholders with additional disclosure relating to the contingent nature of the financial advisors' fee. That disclosure was misleading because it did not clearly state that the financial advisors were entitled to the fee only if the initial CVS/Caremark merger was approved. The Court concluded that knowledge of such financial incentives on the part of the financial advisors was material to the stockholder deliberations.

* * *

- **Implications for Deal Structuring.** The Court's treatment of the special dividend and the merger as an integrated transaction, notwithstanding the doctrine of independent legal significance, may lead practitioners to become more concerned that a Delaware court may focus on the substance, rather than the form, of corporate transactions. In our view, the decision should be read narrowly, however, as applicable to the unique facts of the case, including the fact that (i) the special dividend was contingent on and payable only in connection with closing of the merger and was viewed by the Court as a mechanism by which the directors were colluding with a bidder to favor a deal that arguably benefited the directors personally, and (ii) the availability of the appraisal remedy permitted the Court to merely postpone, and not completely enjoin, the vote.

- **Contingent Banker Fees.** The decision indicates that the Court remains focused on the contingent nature of financial advisor fees and strongly suggests that practitioners should remain vigilant when negotiating those fees in order to ensure that financial advisors are properly incentivized to advise a board or a committee thereof.

---

[1] *See, e.g.*, *In re Walt Disney Co. Deriv. Litig.*, 906 A.2d 27 (Del. 2006); *In re Walt Disney Co. Deriv. Litig.*, 907 A.2d 693 (Del. Ch. 2005).

[2] 911 A.2d 362 (Del. 2006).

[3] 698 A.2d 959, 971 (Del. Ch. 1996).

[4] *Stone v. Ritter*, 911 A.2d at 365.

[5] Court of Chancery Rule 23.1 provides, in part, that "[i]n a derivative action ... [t]he complaint shall [] allege with particularity the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors or comparable authority and the reasons for the plaintiff's failure to obtain the action or for not making the effort."

[6] *Stone v. Ritter*, 2006 WL 302558, at *1 (Del. Ch. Jan. 26, 2006). The Court of Chancery held that plaintiffs' complaint failed to plead particularized facts demonstrating that any problems "waived a 'red-flag' in the face of the board ... [or] facts suggesting a conscious decision to take no action in response to red flags." *Id.* at *2. The Court also noted that plaintiffs failed to plead "facts showing that the board ever was aware that AmSouth's internal controls were inadequate, that these inadequacies would result in illegal activity, and that the board chose to do nothing about problems it allegedly knew existed." *Id.*

[7] *Stone v. Ritter*, 911 A.2d at 364.

[8] 188 A.2d 125 (Del. 1963).

[9] *Id.* at 130.

[10] *Caremark*, 698 A.2d at 969. Moreover, the *Caremark* decision observed that "it is important that the board exercise a good faith judgment that the corporation's information and reporting system is in concept and design adequate to assure the board that appropriate information will come to its attention in a timely manner as a matter of ordinary operations, so that it may satisfy its responsibility." *Id.* at 970.

[11] *Id.* at 971.

[12] *Stone v Ritter*, 911 A.2d at 369.

[13] 906 A.2d 27 (Del. 2006).

[14] *Id.* at 66.

[15] *Id.* at 67. According to *Disney*, a failure to act in good faith may also be shown "where the fiduciary intentionally acts with a purpose other than that of advancing the best interests of the corporation, [and] where the fiduciary acts with the intent to violate applicable positive law." *Id.*

[16] The Court also noted that the *Disney* decision cited *Caremark* with approval. *Stone v. Ritter*, 911 A.2d at 369.

[17] *Disney*, 906 A.2d at 67 n.112.

[18] *See, e.g., Cede & Co. v. Technicolor, Inc.,* 634 A.2d 345, 361 (Del. 1993); Edward P. Welch, Andrew J. Turezyn & Robert S. Saunders, *Folk on the Delaware General Corporation Law*, § 141.2 at GCL-IV-24 (5th ed. 2006); David A. Drexler, Lewis S. Black, Jr. & A. Gilchrist Sparks, III, *Delaware Corporation Law and Practice*, §15.02 at 15-4 (2005).

[19] *Stone v. Ritter*, 911 A.2d at 369-70.

[20] *Id.* at 370.

[21] *Id.*

[22] *Id.* By way of example, the Court cited *Guttman v. Huang*, 823 A.2d 492 (Del. Ch. 2003), wherein the Court of Chancery recognized that "[a] director cannot act loyally towards the corporation unless she acts in the good faith belief that her actions are in the corporation's best interest." *Id.*

[23] *Stone v. Ritter*, 911 A.2d at 370.

[24] *Id.* (citations omitted).

[25] *Id.* at 373.

[26] *Id.* at 372 (quoting *Caremark,* 698 A.2d at 967).

[27] *Stone v. Ritter*, 911 A.2d at 372.

[28] *Id.*

[29] *Id.* at 373.

[30] *Id.* at 371-72.

[31] 2006 WL 2403999 (Del. Ch. Aug. 18, 2006).

[32] Prairie Capital determined that the fair value of PNB's outstanding shares was $40.74 per share.

[33] The merger consideration represented a 12% premium over PNB's book value and a 6% premium over market value.

[34] 2006 WL 2403999, at *8.

[35] Some of the stockholders who accepted the Merger consideration also voted in favor of the Merger.

[36] 2006 WL 2403999, at *8.

[37] *Id.*

[38] 638 A.2d 1110 (Del. 1994).

[39] 2006 WL 2403999, at *10.

[40] The Court noted that this "second test exists to allow the law to impose fiduciary obligations on stockholders who, although lacking a clear majority, have such formidable voting and managerial power that they, as a practical matter, are no differently situated than if they had majority voting control." *Id.* at *9.

[41] Plaintiffs maintained that the allegedly controlling group consisted of 20 individuals, all of whom were officers or directors of PNB, or were related to the officers or directors of PNB.

[42] 2006 WL 2403999, at *10.

[43] *Id.*

[44] *Id.*

[45] The Vice Chancellor noted that "the sixty-eight remaining stockholders of [PNB] would gain the advantages of being stockholders in an S corporation. Any upside in [PNB's] future would belong to [the remaining stockholders], exclusive of their departing brethren." *Id.* at *11 (internal citation omitted).

[46] Following the reclassification, the defendant directors would be entitled to approximately 42% of the annual dividends. *Id.* at *13.

[47] *Id.*

[48] *Id.* at *14 n.69.

[49] The Court reasoned that such a standard is in line with the vote required to approve a merger under Delaware law. *Id.* at *15 ("a vote of a 'majority of the outstanding stock of the corporation entitled to vote' is required for merger approval, and a failure to cast a ballot is a *de facto* no vote") (citing 8 *Del. C.* § 251)). The Court also commented that a contrary holding required "an untenable assumption that those who did not return a proxy were members of a 'silent affirmative majority of the minority.'" *Id.*

[50] *Id.* at *14 (internal citations omitted). Note, however, that the Vice Chancellor also recognized that with respect to going private transactions with controlling stockholders, there may be compelling justifications for requiring that a transaction be subject to an express, non-waivable condition that the "majority-of-the-minority" approve the transaction.

[51] 2006 WL 2403999, at *21. *See Clements v. Rogers*, 790 A.2d 1222 (Del. Ch. 2001). Vice Chancellor Strine observed that, ordinarily, "[a]cceptance of the merger consideration is simply an abandonment of the appraisal right…." 2006 WL 2403999, at *22.

[52] The Court noted, in particular, that "the idea that children and parents always see eye-to-eye is not a premise of our law. One can have a healthy family relationship and still feel free to vote one's stock differently than a parent. Absent some reason to believe that the vote would work a serious injury on the close relative – for example, a vote that would ask a child to unseat her CEO father in favor of another director candidate, knowing that the loss of his seat would mean the loss of his job – the mere fact that relatives both own stock means little. Rather, what is critical is whether there is a reason to believe that the familial relationship, coupled with other important facts, is so thick that the stockholders should be treated as essentially a voting group." *Id.* at *11 (citation omitted).

[53] *See also In re Western Nat'l Corp. S'holders Litig.*, 2000 WL 710192 (Del. Ch. May 22, 2000) (finding that the business judgment rule standard of review applied to a transaction approved by a well-functioning independent special committee in the absence of a controlling stockholder).

[54] 2006 WL 2403999, at *14 ("But the PNB board all suffered the same conflict and made no attempt to add directors representing the stockholders to be cashed-out.").

[55] 906 A.2d 168 (Del. Ch. 2006). The Court of Chancery's decision has been appealed, *Trenwick Am. Litig. Trust v. Billet*, No. 495, 2006 (Del. filed Sept. 14, 2006).

[56] *See, e.g., Prod. Res. Group, L.L.C. v. NCT Group, Inc.*, 863 A.2d 772, 791 (Del. Ch. 2004) ("When a firm has reached the point of insolvency, it is settled that under Delaware law, the firm's directors are said to owe fiduciary duties to the company's creditors.").

[57] *Trenwick*, 906 A.2d at 204; *see Official Comm. of Unsec. Creditors v. R.F. Lafferty &Co.*, 267 F.3d 340, 354 (3d Cir. 2001); *see also Smith v. Arthur Anderson LLP*, 421 F.3d 989, 1004 (9th Cir. 2005) (agreeing "with the Third Circuit's observation in *Lafferty* that 'prolonging an insolvent corporation's life through bad debt may' dissipate corporate assets and thereby harm the value of corporate property.").

[58] *Trenwick*, 906 A.2d at 192.

[59] *Id.* at 168.

[60] The Litigation Trust also advanced a host of claims against third party advisors to Trenwick, which the Court dismissed. *Id.* at 175.

[61] *Id.* at 189-90.

[62] *Id*. at 191.

[63] *Id.*

[64] *Trenwick*, 906 A.2d at 174.

[65] *Id*. at 172.

[66] The Court noted additional problems with the claim, including the existence of an exculpatory charter provision pursuant to 8 *Del. C.* § 102(b)(7), and the corporate separateness of Trenwick. "[T]he Litigation Trust may not assert claims on behalf of Trenwick America against the Trenwick board of directors without piercing Trenwick's veil in some manner. ... Delaware law does not blithely ignore corporate formalities and the Litigation Trust has not explained how the Trenwick directors, as opposed to Trenwick, can be deemed to be a 'controlling stockholder' group that owes fiduciary duties to a subsidiary." *Id.* at 194.

[67] *Id.* at 200 (citation omitted).

[68] *Id.* at 174.

[69] *Id.* at 205. The Litigation Trust alleged, among other things, that the Trenwick America directors "fraudulently concealed the true nature and extent of [Trenwick America's] financial problems by expanding the amount of debt undertaken by [Trenwick America]," and that such directors "prolonged the corporate life of [Trenwick America] and increased its insolvency, until [Trenwick America] was forced to file for bankruptcy...." *Id.* at 204.

[70] *Id.* at 205. The Court also stated that "the business judgment rule protects the directors of solvent, barely solvent, and insolvent corporations, and the creditors of an insolvent firm have no greater rights to challenge a disinterested, good faith business decision than the stockholders of a solvent firm." *Id.* at 195 n.75.

[71] *Id*. at 218.

[72] *Id.* The Court dismissed the Litigation Trust's fraud-based claims. *Id*. at 208-12.

[73] *Id.*

[74] 2006 WL 2947483 (Del. Ch. Oct. 11, 2006).

[75] The merger agreement was entered into after Stone had terminated a merger agreement with Plains Exploration and Production Company ("Plains"). Following an offer by EPL, Stone's board reached the conclusion that the merger agreement with Plains should be terminated in accordance with the fiduciary-out provision of that agreement. EPL agreed to pay the $43.5 million termination fee under the merger agreement on behalf of Stone. Stone and EPL used the Plains merger agreement as a starting point for their negotiations.

[76] 2006 WL 29473483, at *2.

[77] *Id.* at *3.

[78] *Id.*

[79] The Court consolidated the separate actions.

[80] Stone also argued that the absence of a reciprocal "no shop" provision was intended to provide Stone with "deal certainty." The parties had stipulated, however, that (i) neither side commented or mentioned Section 6.2(e) in the merger agreement in their negotiations with each other, and (ii) neither side discussed or negotiated Section 6.2(e) in the Plains Merger Agreement.

[81] Before interpreting the merger agreement, the Court first considered whether the matter was justiciable (*i.e.*, whether there was a genuine and substantial controversy that was ripe). In reaching the conclusion that there was a justiciable dispute concerning whether EPL could explore Third Party Acquisition Proposals, the Court found that the controversy was substantial because Stone had argued that (i) a breach of Section 6.2(e) should result in significant actual damages (given that the merger agreement involved consideration in the billions of dollars), and (ii) it should not be limited to its termination fee.

[82] 2006 WL 2947483, at *14.

[83] *Id.*

[84] *Id.* at *15.

[85] 747 A.2d 95 (Del. Ch. 1999).

[86] 2006 WL 2947483, at *16.

[87] *New Castle Partners, L.P. v. Vesta Insurance Group, Inc.*, 887 A.2d 975 (Del. Ch. 2005), *aff'd*, 906 A.2d 807 (Del. 2005) (Table).

[88] 2006 WL 3499526 (Del. Ch. Nov. 29, 2006).

[89] 285 A.2d 437, 439 (Del. 1971).

[90] *Esopus Creek*, 2006 WL 3499526, at *7.

[91] *Id.* at *8.

[92] 906 A.2d 156 (Del. Ch. 2006).

[93] 905 A.2d 115 (Del. Ch. 2006).

[94] *See Scattered Corp. v. Chicago Stock Exch.*, 701 A.2d 70, 78 (Del. 1997); *Rales v. Blasband*, 634 A.2d 927, 935 n. 10 (Del. 1993); *Disney v. Walt Disney Co.*, 857 A.2d 444, 448 (Del. Ch. 2004).

[95] *Highland Select*, 906 A.2d at 157.

[96] In light of those concerns, Highland Select requested, through its then director designee on the Motient board, that Motient's audit committee conduct an investigation. Motient's board ordered the audit committee to conduct an investigation with the assistance of independent counsel and later generated a report that purportedly exonerated the Motient board of any wrongdoing. Highland Select's designee on the Motient board, who subsequently resigned, was never given a copy of that report.

[97] The Delaware breach of fiduciary duty action later was dismissed for failure to state demand futility under Chancery Court Rule 23.1.

[98] *Highland Select*, at 906 A.2d at 161.

[99] *Id.* at 163.

[100] *Id.*

[101] *Id.* at 164 (emphasis added).

[102] *Id.* at 165.

[103] Chancery Court Rule 30(b)(6) permits a litigant to name an entity as a deponent. The entity so named is required to designate one or more persons, who consent to testify on behalf of the entity, and to set forth the matters on which the person will testify. The rule requires the person so designated to "testify as to matters known or reasonably available to" the entity. Ch. Ct. Rule 30(b)(6).

[104] *Highland Select*, 906 A.2d at 166.

[105] *Id.* at 167.

[106] *Id.* at 167-68. Motient argued that the Section 220 demand was made for an improper purpose, *i.e.*, "as a vehicle through which to attack Motient's management in preparation for the proxy contest, with little regard for whether it receives any information or not." *Id.* at 164.

[107] *Id.* at 168.

[108] *Id.*

[109] 905 A.2d 115 (Del. Ch. 2006).

[110] *Id.* at 118.

[111] The Court found it important that Accipiter did not challenge the ten day window and thus concluded that Accipiter could have complied with that deadline if its employees had noticed the paragraph announcing the meeting date.

[112] 285 A.2d 437 (Del. 1971).

[113] *Accipiter Life Sciences*, 905 A.2d at 124.

[114] *Id.* at 125.

[115] *See, e.g., Linton v. Everett*, 1997 WL 441189, at *10 (Del. Ch. July 31, 1997) (finding the application of an advance notice bylaw to be inequitable where the corporation had not held an annual meeting for three years and then announced a meeting triggering a ten day window for nominations, and where the stockholders did not actually receive the notice until three days before the window closed).

[116] *Accipiter Life Sciences*, 905 A.2d at 126.

[117] *Id.* at 127.

[118] *Id.*

[119] *Id.*

[120] *Id.* at 10.

[121] 2007 WL 582510 (Del. Ch. Feb. 23, 2007).