a few things you should know about...

What's Happening in Delaware M&A – Summer 2016

What's Happening in Delaware M&A - Summer 2016: This edition of *A Few Things You Should Know* concerns recent updates in Delaware M&A Law. This update provides a summary of recent Delaware caselaw and statutory developments concerning mergers and acquisitions, including new cases regarding appraisal rights, fraud claims and fiduciary duty and deal process issues.

APPRAISAL ARBITRAGE

- **COURT MAKES INDEPENDENT DETERMINATION OF FAIR PRICE**
  In a highly publicized appraisal proceeding, the Delaware Court of Chancery determined that the "fair value" of Dell Inc. shares was 28% higher than the price paid by Michael Dell and Silver Lake in the 2013 management buyout of Dell (which at the time represented a 37% premium to the market price). Although the court did not find any glaring flaws in Dell's sale process, it identified three key factors that resulted in the process failing to produce "fair value": (1) Silver Lake's need to achieve a 20% IRR for its own investors, and the leverage Dell would support; (2) evidence that the market undervalued Dell's complex business; and (3) a lack of meaningful price competition pre-signing.
  - IMPACT: Some critics argue the decision will encourage further appraisal arbitrage and cause buyers (especially PE funds) to introduce appraisal closing conditions to public merger agreements in order to mitigate risk of additional costs post-closing.

- **WHEN IS A BENEFICIAL OWNER REALLY A "DISSENTING STOCKHOLDER"?**
  In the same *Dell* case, the Chancery Court denied the lead appraisal petitioner, T. Rowe Price, the right to seek appraisal due to evidence that T. Rowe Price had inadvertently instructed Cede & Co., via its custodian at Depository Trust Company (DTC), to vote in favor of the merger. Although T. Rowe Price publicly opposed the merger, it used an automated voting system through Institutional Shareholder Services Inc. (ISS) in which the default vote was set based on ISS's recommendation (in this case, in favor of the merger). The case settled, with Dell paying $25 million in exchange for T. Rowe Price not pursuing an appeal.
  - IMPACT: Case helps clarify when beneficial owners that hold shares through DTC (meaning Cede & Co. is the record owner) may be entitled to appraisal rights. Specifically, once a petitioner establishes a prima facie case that its shares are entitled to appraisal (e.g., simply by showing that Cede voted sufficient shares against the merger), the burden shifts to the company to show that Cede actually voted the underlying shares in favor of the merger.

- **DE LEGISLATURE TRIES TO CURTAIL APPETITE FOR APPRAISAL (AMENDMENTS TO DGCL 262)**
  In response to the recent rise in appraisal arbitrage, Delaware's legislature amended Section 262 of the DGCL in a manner that could significantly curb the number of appraisal actions. The two main changes: (1) set a floor on the number and value of shares seeking appraisal so that the court would dismiss public company appraisal proceedings unless at least 1% of the shares dissent, the value of the merger consideration for the dissenting shares exceeds $1 million, or the merger was a short-form merger pursuant to DGCL 253 or 267, and (2) allow the surviving company to prepay an amount of its choosing to dissenters, with interest then only accruing on the difference between the amount paid and the ultimately determined fair value of the shares, making the "interest play" aspect less attractive for hedge funds and other would-be appraisal arbitragers.
  - IMPACT: Amendments became effective on August 1, 2016. Critics have pointed out that the prepayment mechanism may have the opposite effect as intended, however, as hedge funds that receive such payments would be able to quickly redeploy capital to launch other appraisal proceedings.

FRAUD CLAIMS AND DISCLAIMERS OF RELIANCE

- **COURT OFFERS INSTRUCTIVE GUIDANCE ON POST-CLOSING CLAIMS FOR FRAUD**
  In *Prairie Capital, III L.P. v. Double E Holding Corp*. , a private equity buyer of a Prairie Capital portfolio company brought a post-closing suit for fraud based on books and records provided to the buyer that had allegedly been

falsified. The Chancery Court held, consistent with earlier decisions in Delaware (e.g., *Abry Partners V, L.P. v. F & W Acquisition LLC* , 891 A.2d 1032 (Del. Ch. 2006)), that a non-reliance provision in an acquisition agreement precludes a buyer from bringing a claim based on information provided outside the four corners of the agreement and limits the buyer's ability to bring a claim for fraud to a claim based on the breach of the representations and warranties made in the agreement. The court expanded its view of what language constitutes a non-reliance provision by finding that an affirmative statement that the buyer relied only on the representations and warranties in the agreement, along with a standard integration clause, functioned as an effective disclaimer of reliance. The provision doesn't have to be framed in the negative, or include "disclaim reliance" or other magic words, to disclaim reliance on extra-contractual statements. The court held that the provision also effectively barred claims for extra-contractual omissions, marking a split from the court's decision in *Transdigm Inc. v. Alcoa Global Fasteners, Inc.* , No. CIV.A. 7135-VCP, 2013 WL 2326881 (Del. Ch. May 29, 2013). The court further advised that a fraud carve-out in the exclusive remedy provision provides only that, in the case of fraud, the contractual indemnity framework does not limit the buyer's remedy. The carve-out does not expand the representations that the buyer can rely on to establish a claim for fraud. Finally, the court also found that the company's directors and officers could be found liable for the fraudulent contractual representations made by the company.

- IMPACT: This decision expands the language that will qualify as a disclaimer of reliance and makes it clear that, unless such a disclaimer includes a fraud carve-out, a buyer will be limited to basing a claim for fraud on the express representations and warranties included in the agreement. The opinion provides instructive guidance regarding several aspects of post-closing claims, including the requirements for proving fraud, the scope of representations and warranties as they relate to fraud claims, the need for fraud carve-outs in both the exclusive remedies and "no extra-contractual representations and warranties" provisions, the specificity required for noticing a claim, and the potential liability of officers, directors and sponsors for fraudulent statements made by the company.

SUPREME COURT AFFIRMS APPLICATION OF BUSINESS JUDGMENT RULE WHEN MERGER APPROVED BY FULLY INFORMED STOCKHOLDER VOTE, LIABILITY OF FINANCIAL ADVISORS; COURT OF CHANCERY EXTENDS DECISIONS TO FULLY INFORMED TENDER OFFERS

- ### CASES REINFORCE IMPACT OF FULLY INFORMED, UNCOERCED STOCKHOLDER VOTE

  In two different recent decisions, the Delaware Supreme Court confirmed that when a merger is approved by a fully informed vote of the disinterested stockholders, the business judgment rule, not entire fairness, will apply to breach of fiduciary duty claims. In Corwin v. KKR Financial Holdings LLC , the court noted that although the KKR merger was a change of control transaction to which *Unocal* and *Revlon* would ordinarily apply, the primary purpose of *Unocal* and *Revlon* is to give stockholders the ability to enjoin a transaction prior to closing—they were not tools designed for bringing post-closing suits for money damages after stockholders have approved the transaction. In *Singh v. Attenborough (Zale)*, which concerned Signet's acquisition of Zale, the court then reaffirmed its analysis in *Corwin v. KKR* and further noted that such an informed stockholder vote can also result in the dismissal of post-closing damages claims against the directors and even its financial advisors. The *Zale* court noted that while plaintiffs could still hypothetically make a waste claim post-closing, such a claim would almost certainly fail where a transaction was approved by a fully informed, disinterested stockholder vote.

  - BE WARY: In Corwin v. KKR , the court made clear that the doctrine applies only to fully informed, uncoerced stockholder votes. If troubling facts regarding director behavior are not disclosed that would be material to a voting stockholder, the business judgment rule will not be invoked.

- ### DELAWARE SUPREME COURT CLARIFIES STANDARD FOR AIDING AND ABETTING LIABILITY; SENDS ANOTHER WARNING TO BANKERS

  Also in *Zale*, Chief Justice Strine clarified that it is not the case that an advisor can only be held liable if it aids and abets a non-exculpated breach of fiduciary duty. Delaware provides advisors with a high degree of insulation from liability by employing a defendant-friendly standard that requires plaintiffs to prove scienter and awards advisors an effective immunity from due-care liability; however, an advisor whose bad-faith actions cause the board to breach its situational fiduciary duties is liable for aiding and abetting (*RBC Capital Markets., LLC v. Jervis* , 129 A.3d 816 (Del.2015)). The

advisor is not absolved from liability because the board in good faith relied on misleading and incomplete advice tainted by the advisor's own knowing disloyalty. However, the standard of liability is scienter, a high threshold.

- IMPACT: On the one hand, the Zale decision may be viewed as a relief to financial advisors and other M&A gatekeepers who worried that RBC would expose them to additional liability. On the other hand, Chief Justice Strine made clear that financial advisors can still be liable for aiding and abetting a breach of duty of care even if the directors are exculpated for breaches of that duty; but the standard for liability requires exceptional circumstances, such as the bad faith behavior seen in RBC.

- **CORWIN AND ZALE DECISIONS EXTENDED TO TWO-STEP MERGERS**
  In *In re Volcano Corp*. Stockholder Litigation, the Delaware Court of Chancery dismissed claims against the board of directors of Volcano Corporation for breach of its fiduciary duties in approving a merger completed pursuant to Section 251(h) of the DGCL, and it dismissed claims against the company's financial advisor, Goldman, Sachs & Co., for aiding and abetting those breaches. The court reasoned that acceptance of a first-step tender offer by fully informed, independent stockholders is tantamount to a fully informed, disinterested stockholder vote on a merger for purposes of invoking the business judgment rule. Following the "cleansing effect" of the stockholder tender, the business judgment rule is irrebuttable, leaving the board of directors and financial advisors insulated from any claim other than one for corporate waste, a claim which, in the context of a fully informed stockholder-approved transaction, will almost certainly fail.
  - IMPACT: The Volcano decision provides directors and financial advisors with comfort that they will not be disadvantaged from a liability perspective if they choose to pursue a two-step merger rather than a stockholder vote. In either case, however, the ability to invoke the business judgment rule depends upon the stockholders being fully informed, meaning that they have received complete and accurate information regarding the proposed transaction, including any potential conflicts of interest.

NEW YORK COURT OF APPEALS ADOPTS MFW IN GOING-PRIVATE MERGERS

- **COURT ADOPTS MFW FACTORS TO INVOKE BUSINESS JUDGMENT RULE IN GOING-PRIVATE MERGER**
  In *In re Kenneth Cole Shareholder Litigation* , the issue before the court was which standard should be applied by courts reviewing a going-private merger. On May 5, 2016, the New York State Court of Appeals held that the business judgment rule should apply as long as the *In re MFW Shareholders Litigation* conditions are met—i.e., (1) the controller conditions the procession of the transaction on the approval of both a Special Committee and a majority of the minority stockholders; (2) the Special Committee is independent; (3) the Special Committee is empowered to freely select its own advisors and to say no definitively; (4) the Special Committee meets its duty of care in negotiating a fair price; (5) the vote of the minority is informed; and (6) there is no coercion of the minority). If these conditions are not met, the entire fairness standard should be applied.
  - IMPACT: New York has now expressly adopted the *MFW* factors as the standard for obtaining the protection of the business judgment rule, bringing the standard in New York in line with that in Delaware and discouraging plaintiffs from forum shopping in New York.

CONTACTS

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