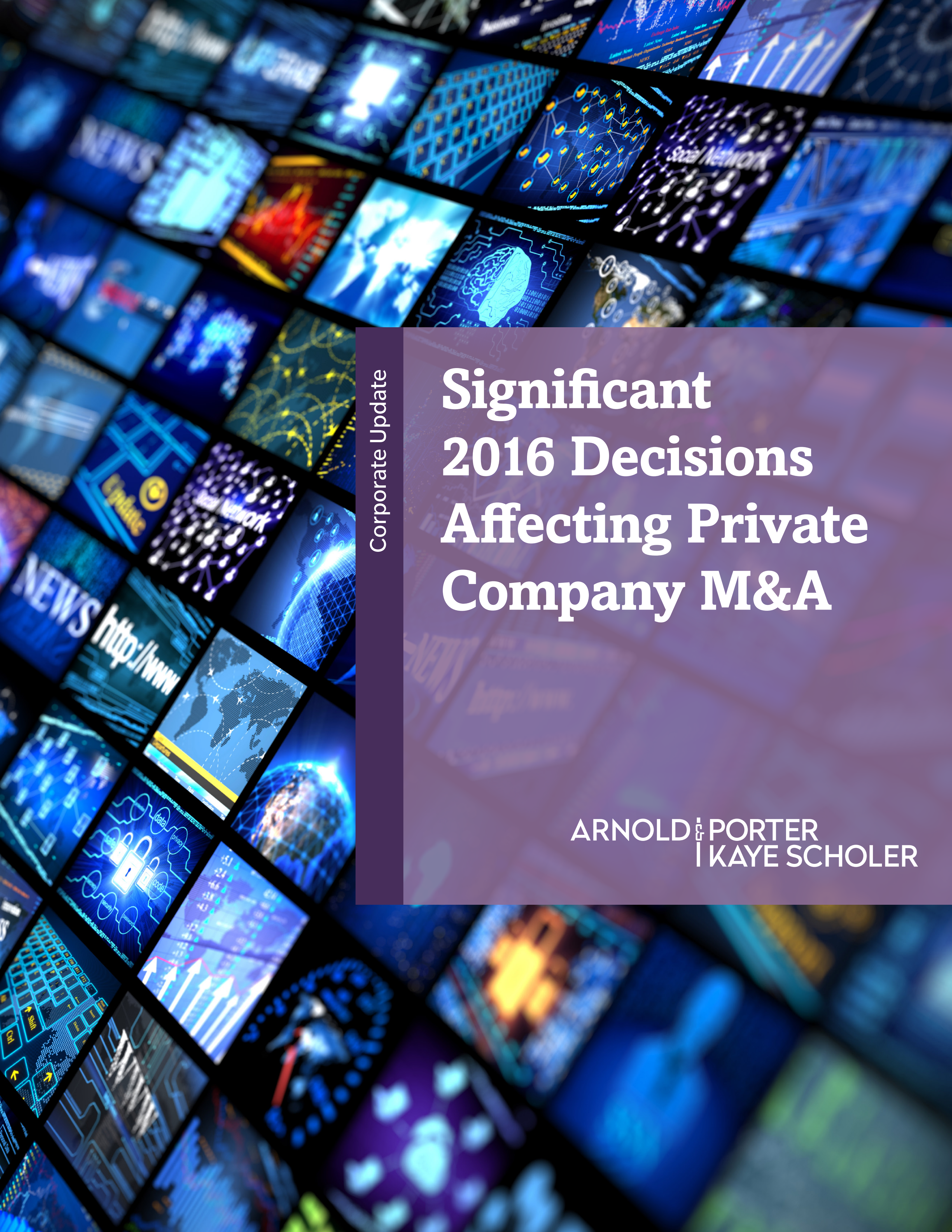

Corporate Update

Significant 2016 Decisions Affecting Private Company M&A

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Significant 2016 Decisions Affecting Private Company M&A

The following compilation is our third annual review of significant Delaware and New York court decisions relating to private M&A transactions and disputes. All decisions were issued in 2016 with the exception of *In re Vaalco*, which was issued at the end of 2015.

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1. *Hyatt v. Al Jazeera America Holdings II, LLC,* 2016 WL 1301743 (Del. Ch. Mar. 31, 2016)

Buyers should beware of sellers' ability to recoup litigation costs incurred in defense of indemnity claims under D&O advancement provisions of merger agreement.

As described in our *summer newsletter*, this decision stemmed from Al Jazeera's acquisition of Current Media LLC. Joel Hyatt and Albert Gore, Jr. were both former members and directors, and Hyatt was a former officer, of Current Media. Hyatt also served as the Members' Representative under the merger agreement, with the responsibility for dealing with indemnification claims on behalf of the members of Current Media. After Al Jazeera had made a number of indemnity claims under the merger agreement, all of which Hyatt rejected, Hyatt and Gore initiated an action (the Underlying Action) in the Delaware Court of Chancery in their capacities as Members' Representative and member, respectively, contending that Al Jazeera's claim certificates were improper and in breach of the merger agreement, and seeking release of the indemnity escrow funds. Al Jazeera counterclaimed, alleging in part that Hyatt, as Members' Representative, had breached the merger agreement by wrongfully rejecting Al Jazeera's valid claims for indemnification, including those arising from breaches of representations and warranties under the merger agreement, which led to losses for Al Jazeera.

In an amended and supplemental complaint, Hyatt and Gore sought advancement of their litigation costs associated with defending the counterclaims in the Underlying Action, pursuant to D&O advancement provisions under the merger agreement. The merger agreement contained standard D&O indemnification and advancement provisions that obligated Al Jazeera to indemnify and advance fees and expenses to Current Media's former directors and officers, for a period of six years, to the same extent provided for under Current Media's Second Amended and Restated Operating Agreement (Operating Agreement). Hyatt and Gore conceded that their claims in the Underlying Action did not trigger advancement rights. However, they argued that Al Jazeera's counterclaims depended on Al Jazeera's contention that Hyatt and Gore, as directors and/or officers of Current Media, had caused the breaches of representations and warranties under the merger agreement. Hyatt and Gore argued that they had a financial interest in appearing and defending their actions as directors and/or officers, and it was this situation that triggered the D&O advancement rights under the merger agreement. Al Jazeera, on the other hand, argued that fee shifting provisions in the indemnification section of the merger agreement (obligating the nonprevailing party following a court judgment to pay the fees and expenses of the prevailing party) evidenced an intent by the parties to solely provide indemnification, and not D&O advancement, in any dispute relating to the indemnity escrow.

The court rejected Al Jazeera's argument that the fee shifting provision supplanted the D&O advancement provision because, according to the court, they involved different rights that served separate purposes. The court also rejected Al Jazeera's argument that advancement was not appropriate because Hyatt was sued in his capacity as Members' Representative and not as a former officer or director. The court held that Hyatt's rights in each capacity were preserved, noting that the parties could have, but chose not to, exempt Hyatt from the right to D&O advancement under the merger agreement.

The court then considered the scope of D&O advancement. The merger agreement entitled directors and officer to advancement to the extent they would have been entitled under the Operating Agreement. The Operating Agreement provided for mandatory indemnification in pending or threatened actions, suits or proceedings "by reason of the fact" that such person was an officer or director of Current Media, and indemnification included the right to advancement of reasonable expenses of the type entitled to be indemnified. Citing *Homestore, Inc. v. Tafeen,*[1] the court equated "by reason of the fact" to there being a "nexus or causal connection" between the underlying proceedings and the defendant's "official corporate capacity." According to the court, this nexus exists if "corporate powers were used or necessary for the commission of the alleged misconduct," which does not require any allegation of breach of fiduciary duty. On the other hand, no nexus exists "when the parties are litigating a specific and personal contractual obligation that does not involve the exercise of judgment, discretion or decision-making authority on behalf of the corporation."

The court analyzed whether the expenses could be advanced in connection with each of Al Jazeera's counterclaims. In finding that the requisite nexus existed with respect to Al Jazeera's indemnification claims alleging breaches by Current Media of various most-favored-nation provisions under contracts with third parties, the court wrote: "Although the Counterclaims appear on their face to merely implicate Hyatt's role as Members' Representative, the resolution of the validity of the [indemnification claims] in the Underlying Action, in part, necessarily requires Hyatt and Gore to defend their actions as former officers and directors, for which they are contractually entitled to advancement." On the other hand, the court found that Hyatt and Gore were not entitled to advancement with respect to a separate Al Jazeera claim that Current Media's former members agreed to indemnify Al Jazeera for 50 percent of the expenses it incurred with respect to termination of a specified agreement because that claim did not require Hyatt and Gore to defend actions taken in an officer or director capacity.

This decision serves as an important warning to buyers that D&O advancement provisions can be used by shareholders to circumvent their indemnification obligations under a merger agreement. Buyers who bring a court action to enforce an indemnification claim may find themselves in the position of funding the shareholders' litigation costs, which can, at a minimum, significantly alter the incentives and negotiating leverage in the litigation. Moreover, while the *Al Jazeera* decision focused on advancement rights, the logic could potentially be applicable in the context of D&O indemnification rights. This could potentially permit sellers to round-trip shareholder indemnification obligations under the merger agreement by claiming that they are indemnifiable losses for officers and directors under the merger agreement's D&O indemnification and advancement provisions.

Fortunately, the *Al Jazeera* court gave some clear guidance to buyers on how to address the risk. The court noted that the parties could have contractually exempted Hyatt from the right to D&O advancement under the merger agreement. Thus, the D&O indemnification and advancement section under the agreement could contain an exemption providing that such indemnification and advancement would not be available with respect to claims that relate to matters that are the subject of a buyer indemnification claim under the merger agreement. To be effective, the exemptive language should be included in both the merger agreement and any charter or other documents of the surviving corporation that contain D&O advancement and indemnification rights.

» Read the ruling.

» Read our summer newsletter.

2. ***FdG Logistics LLC v. A&R Logistics Holdings, Inc.***, 131 A.3d 842, 845 (Del. Ch. Feb. 23, 2016), *aff'd sub nom.* 148 A.3d 1171 (Del. 2016)

In order to foreclose a claim for fraudulent inducement, a nonreliance clause in an acquisition agreement must set forth an affirmative expression of nonreliance by the buyer, and not merely a disclaimer by the seller of what the seller was or was not representing.

This case arose from the sale of a trucking company (Company) by affiliates of FdG Associates LP, a private equity fund (Seller), to an affiliate of A&R Logistics Holdings Inc., a transportation and logistics company (Buyer). Seller initiated the action in order to recover a preclosing tax refund. Buyer responded with counterclaims for indemnification, violation of the Delaware Securities Act, common law fraud and unilateral mistake. This summary focuses on Buyer's fraud claim, which was based on extra-contractual statements made to Buyer before it entered into the merger agreement. In denying Seller's motion to dismiss the fraud claim, the court held that the merger agreement did not contain an affirmative disclaimer of reliance by Buyer that was sufficient to preclude Buyer from asserting a fraud claim based on representations outside the four corners of the merger agreement.

Buyer's fraud counterclaims involved assertions that after the merger closed, Buyer discovered an extensive series of illegal and improper activities that were concealed from it during premerger due diligence. These activities included matters such as falsification by truck drivers of hours-of-service logs, manipulation of scale tickets and time stamps, environmental spills, falsely reporting regular maintenance as capital expenditures and fraudulently charging customers for washes that were not performed. In analyzing Buyer's claims, Chancellor Bouchard listed the following elements of a fraud claim under Delaware: "(1) the defendant falsely represented or omitted facts that the defendant had a duty to disclose; (2) the defendant knew or believed that the representation was false or made the representation with a reckless indifference to the truth; (3) the defendant intended to induce the plaintiff to act or refrain from acting; (4) the plaintiff acted in justifiable reliance on the representation; and (5) the plaintiff was injured by its reliance."[2] Seller argued that Buyer could not establish justifiable reliance in light of Section 5.27 and 10.7 of the merger agreement.

Section 5.27 set forth a disclaimer by the Company of any representation or warranty outside of the merger agreement. It read as follows:

> "EXCEPT AS EXPRESSLY SET FORTH IN THIS ARTICLE 5, THE COMPANY MAKES NO REPRESENTATION OR WARRANTY, EXPRESS OR IMPLIED, AT LAW OR IN EQUITY AND ANY SUCH OTHER REPRESENTATIONS OR WARRANTIES ARE HEREBY EXPRESSLY DISCLAIMED INCLUDING ANY IMPLIED REPRESENTATION OR WARRANTY AS TO CONDITION, MERCHANTABILITY, SUITABILITY OR FITNESS FOR A PARTICULAR PURPOSE. NOTWITHSTANDING ANYTHING TO THE CONTRARY, (A) THE COMPANY SHALL NOT BE DEEMED TO MAKE TO BUYER ANY REPRESENTATION OR WARRANTY OTHER THAN AS EXPRESSLY MADE BY THE COMPANY IN THIS AGREEMENT AND (B) THE COMPANY MAKES NO REPRESENTATION OR WARRANTY TO BUYER WITH RESPECT TO (I) ANY PROJECTIONS, ESTIMATES OR BUDGETS HERETOFORE DELIVERED TO OR MADE AVAILABLE TO BUYER OR ITS COUNSEL, ACCOUNTANTS OR ADVISORS OF FUTURE REVENUES, EXPENSES OR EXPENDITURES OR FUTURE FINANCIAL RESULTS OF OPERATIONS OF THE COMPANY UNLESS ALSO EXPRESSLY INCLUDED IN THE REPRESENTATIONS AND WARRANTIES CONTAINED IN THIS ARTICLE 5, OR (II) EXCEPT AS EXPRESSLY COVERED BY A REPRESENTATION AND WARRANTY CONTAINED IN THIS ARTICLE 5, ANY OTHER INFORMATION OR DOCUMENTS (FINANCIAL OR OTHERWISE) MADE AVAILABLE TO BUYER OR ITS COUNSEL, ACCOUNTANTS OR ADVISORS WITH RESPECT TO THE COMPANY."

Section 10.7 set forth an integration clause that read as follows: "This Agreement, the Transaction Documents and the documents referred to herein and therein contain the entire agreement between the Parties and supersede any prior understandings, agreements or representations by or between the Parties, written or oral, which may have related to the subject matter hereof in any way."

In analyzing whether these two sections were sufficient to preclude justifiable reliance by Buyer, Chancellor Bouchard relied on the analysis of then-Vice Chancellor Strine in *Abry P'rs V, L.P. v. F&W Acquisition LLC*.[3] In *Abry*, Vice Chancellor Strine considered the need to strike a balance between the competing public policies of holding sophisticated parties to the terms of their contracts yet protecting against fraud. With regard to the former, Vice Chancellor Strine noted the problem of a party that has agreed to a clearly drafted integration clause that precludes reliance on representations outside the negotiated agreement, then brings a fraudulent inducement claim on the basis of representations outside the agreement. With regard to the public policy of protecting against fraud, Vice Chancellor Strine noted the problem of insulating a party from liability for a counterparty's reliance on fraudulent statements outside of the written agreement. Vice Chancellor Strine balanced these two competing public policies by only permitting fraud claims where the integration clauses contain a clear statement that the parties disclaim reliance on extra-contractual statements:

> "Murky integration clauses, or standard integration clauses without explicit antireliance representations, will not relieve a party of its oral and extra-contractual fraudulent representations. The integration clause must contain 'language that . . . can be said to add up to a clear antireliance clause by which the plaintiff has contractually promised that it did not rely upon statements outside of the contract's four corners in deciding to sign the contract.'"[4]

In *FdG Logistics*, Chancellor Bouchard then illustrated the type of clear nonreliance statement that is required by reference to two recent decisions. Chancellor Bouchard noted that in *Anvil Holding Corp. v. Iron Acquisitions Co.*,[5] the applicable purchase agreement language provides that neither the subject company nor any seller "makes any other express or implied representation or warranty with respect to the Company" and that the agreement "constitutes the entire Agreement among the Parties." Chancellor Bouchard noted that the *Anvil* court refused to dismiss the fraud claims because this language did not reflect a clear nonreliance promise by the Buyer. In other words, the nonreliance intent has to be clear, and the nonreliance statement must come from the Buyer.

The second decision referenced by Chancellor Bouchard was the 2015 case, *Prairie Capital III, L.P. v. Double E Holdings Corp.*[6] In dismissing the buyer's fraud claim, the *Prairie* court found that the "exclusive representations" language reflected the necessary affirmative representation by the buyer that it had only relied on the representations and warranties in the purchase agreement. Moreover, the fact that the exclusive representations language was phrased in terms of buyer having relied only on the representations and warranties in the purchase agreement, as opposed to buyer not having relied on any representations and warranties other than those in the purchase agreement, did not render the antireliance language ineffectual. The *Prairie* court noted that "Delaware law does not require magic words."

In turning to the *FdG Logistics*' merger agreement, Chancellor Bouchard found that, similar to Anvil but unlike *Prairie*, there was not:

> "Any affirmative expression *by Buyer* of (1) specifically what it was relying on when it decided to enter the Merger Agreement or (2) that it . . . was not relying on any representations made outside of the Merger Agreement. Instead, Section 5.27 amounts to a disclaimer *by the selling company* . . . of what it was and was not representing and warranting. Moreover, the integration clause contained in Section 10.7 merely states in general terms that the Merger Agreement constitutes the entire agreement between the parties, and does not contain an unambiguous statement by Buyer disclaiming reliance on extra-contractual statements."

This sets forth an important drafting tip: for nonreliance language to be effective, the acquisition agreement must contain (i) an affirmative expression by the buyer (as opposed to merely a disclaimer by the seller), (ii) which specifies what the buyer was relying on, or that the buyer was not relying on representations outside the acquisition agreement. Chancellor Bouchard provided further gloss on what sort of specificity is required in a later decision, which is summarized next.

» Read the opinion.

3. ***IAC Search, LLC v. Conversant LLC***, 2016 WL 6995363 (Del. Ch. Nov. 30, 2016)

Consistent with his decision in FdG Logistics (summarized above), Chancellor Bouchard provides further guidance on what constitutes an effective nonreliance clause.

This decision, in relevant part, involves another ruling by Chancellor Bouchard on a motion to dismiss a fraudulent inducement claim by an aggrieved buyer. The case stemmed from the sale by ValueClick Inc. (Seller) of several subsidiaries to an affiliate of IAC/InterActiveCorp, a public media and internet conglomerate (Buyer). Buyer alleged that Seller provided false performance metrics regarding advertising revenue for one of the subsidiaries during the due diligence process.

In granting the motion to dismiss, Chancellor Bouchard reviewed Sections 3.31, 4.7 and 10.6 of the acquisition agreement. Section 3.31 set forth a disclaimer by Seller of making any extra-contractual representations and Section 10.6 contained a standard integration clause. Section 4.7 set forth the following acknowledgement by Buyer that Seller was not making any representation concerning due diligence information unless contained in an express representation and warranty in the acquisition agreement:

> "The Buyer is a sophisticated purchaser and has made its own independent investigation, review and analysis regarding the Transferred Group and the transactions contemplated hereby, which investigation, review and analysis were conducted by the Buyer together with expert advisors, including legal counsel, that it has engaged for such purpose. **The Buyer acknowledges that neither the Seller nor any of its Affiliates or Representatives is making, directly or indirectly, any representation or warranty with respect to any data rooms, management presentations, due diligence discussions, estimates, projections or forecasts involving the Transferred Group, including, without limitation, as contained in the Confidential Information Packet dated August 2013 and any other projections provided to Buyer, unless any such information is expressly included in a representation or warranty contained in Article III.** Nothing in this Section 4.7 is intended to modify or limit any of the representations or warranties of the Seller set forth in Article III."

Chancellor Bouchard found that this language "defines in precise terms from [Buyer's perspective] . . . the universe of information on which [Buyer] relied and did not rely when it entered into the Agreement through [Buyer's] express acknowledgement that [Seller] was making no representation about information provided during due diligence, except as otherwise provided in an express representation in the Agreement."

Chancellor Bouchard then addressed Buyer's attempt to distinguish the above language from the nonreliance language in *Abry*[7] because the above language does not also provide that Seller would not be liable to Buyer for statements made during due diligence. Chancellor Bouchard noted that although the absence of such "release" language "makes this case a closer call than *Abry*, the combined effect of [Section 4.7] and the integration clause in Section 10.6 of the Agreement nonetheless add up in my opinion to a clear antireliance clause to bar fraud claims based on extra-contractual statements made during due diligence."

This decision is noteworthy because the nonreliance language does not even contain the word "rely" or any of its derivatives, which presumably are viewed, using the lexicon of the *Abry* decision, as unnecessary "magic words." Rather, *IAC Search* indicates that Buyer merely needs to acknowledge the universe of representations that Seller is making. That, together with an integration clause, was all that Chancellor Bouchard required to find effective nonreliance language and dismiss Buyer's fraudulent inducement claim.

Notwithstanding this relatively low bar for establishing nonreliance, sellers would be better advised to take a fuller approach when drafting and include language such as the following:

- A specific "exclusive representations" section where buyer specifically acknowledges: (i) that it has conducted to its satisfaction an independent due diligence investigation of the target, (ii) that seller has relied solely on the results of its own independent due diligence investigation and any representations and warranties expressly set forth in the definitive acquisition agreement, and (iii) that buyer is not relying on any representations or warranties other than those expressly set forth in the definitive acquisition agreement; and
- An integration clause.

It is also a good practice, and reasonably common, for sellers to include in the "exclusive representations" section, a buyer acknowledgement that seller is not making any representations regarding certain categories of information, such as projections. For added protection, sellers could also include an acknowledgement by buyer that seller may possess nonpublic information regarding the business being sold.[8]

But what approach should buyers take when confronted with sellers' arguments that they want robust nonreliance language so that the parties' obligations are captured within the four corners of the acquisition agreement? Try arguing for a fraud carve-out to the nonreliance language. Buyer's argument would be that buyer is ok specifying that *seller's* only representations are those confined to the acquisition agreement, but buyer is not ok giving a blanket waiver for seller's fraud. If seller commits fraud, and buyer can prove all of the elements of the claim (including reliance), then buyer should have a remedy.

» Read the opinion.

4. ***In re Baxter International Inc.***, C.A. No. 11609-CB (Del. Ch. Jan. 15, 2016)

The court held that the corporation could not use DGCL Section 205 to obtain an advisory opinion on what the correct voting standard was to amend its charter.

This decision involved an application by Baxter International Inc. under Section 205 of the Delaware General Corporation Law (Section 205) requesting an order validating a board resolution regarding the stockholder approval requirement for an amendment of Article SIXTH of its charter. Article SIXTH, which provided for a staggered board, contained language that prohibited any amendment "without the affirmative vote of at least two-thirds of the holders of all of the securities of the Corporation then entitled to vote on such change." A literal reading of this language suggests that the amendment should be on a per capita basis, i.e., that two-thirds of the stockholders must vote in favor of an amendment, which is an extraordinarily high standard for a public company like Baxter. Baxter took this interpretation in declassification proposals submitted to its stockholders in 2006, 2011 and 2013.

In September 2015, Baxter entered into a settlement agreement with the activist hedge fund Third Point, pursuant to which Baxter agreed, among other things, to take various steps to declassify its board. The steps included initiating the court proceeding under Section 205 in order to obtain a Court of Chancery determination that the amendment provisions for Article SIXTH should be on a per share basis and not a per capita basis. Section 205(a)(4) permits corporations to apply to the Court of Chancery for a determination regarding the validity of any corporate act or transaction. In connection with the settlement agreement with Third Point, Baxter's board of directors approved the following resolution: "FURTHER RESOLVED, the Board hereby determines that it is advisable and in the best interests of the Company and its stockholders that the Company count any stockholder votes on the proposed Charter Amendment on a per share basis, rather than on a per capita basis." In Baxter's Section 205 application, Baxter sought to have the Court of Chancery determine the validity of the board resolution, including the voting standard set forth in the resolution.

Chancellor Bouchard noted that he could determine the validity of the resolution under Section 205(a)(4) only if it was a corporate act or transaction. Chancellor Bouchard reasoned that a validation of the resolution under Section 205 "would only determine the validity of the resolution itself and not provide an opinion on its underlying contents." Chancellor Bouchard reasoned that Baxter was conflating the validity of the corporate act, the board resolution, with the correctness of statements made as part of the act. According to Chancellor Bouchard:

> "Section 205 does not empower the court to bless the legal validity of a future corporate act, nor does it authorize this court to opine on the substantive correctness of a legal position . . . Baxter asks me to bless the future vote counting process and asks me to do so because, in its view, it is the legally proper interpretation of the restrictive provision in the charter. Section 205, however, does not allow me to provide such relief merely because the request is wrapped up in a petition to validate a board resolution that was adopted in the past."

Chancellor Bouchard noted that the application was seeking an advisory opinion on an unripe issue. Chancellor Bouchard indicated, however, that if the charter amendment was submitted for a stockholder vote, and if the amendment was adopted by stockholders on a per share basis and not a per capita basis, Baxter would be in a better position to seek relief under Section 205.

Section 205 became effective in 2014 and thus has not been the subject of many court opinions. The Baxter decision provides important new interpretive guidance and makes clear that Section 205 cannot be used to obtain advisory opinions on the validity of future corporate acts.

» Read the oral argument.

5. ***Ambac Assurance Corp. v. Countrywide Home Loans, Inc.***, 27 N.Y.3d 616 (N.Y. June 9, 2016)

Under New York law, the common interest exception to the attorney-client privilege rule only applies to communications that relate to pending or anticipated litigation, not to general pre-closing communications between merger parties regarding legal issues.

This decision stemmed from litigation brought by Ambac Assurance Corporation, a monoline insurer, against Countrywide Home Loans Inc. for breach of contract and fraudulent misrepresentation in connection with Ambac's guarantee of payments under residential mortgage-backed securities of Countrywide. Ambac named Bank of America as a defendant as a result of its merger with Countrywide. During the discovery phase of litigation, Ambac challenged Bank of America's withholding of various communications that took place between Bank of America and Countrywide during the period between signing and closing of the merger. Bank of America claimed that the communications were privileged because they related to legal issues the merging parties needed to resolve in connection with closing of the merger, including filing disclosures, security regulatory approvals, reviewing contractual obligations to third parties, maintaining employee benefits plans and obtaining legal advice on tax matters. Ambac maintained that Bank of America and Countrywide waived the attorney-client privilege with respect to the communications because they were not affiliated entities at the time of disclosure and did not share a common legal interest in litigation or anticipated litigation.

The issue considered by the New York Court of Appeals was whether New York law should continue to take the narrow view that the common interest doctrine only applies with respect to legal advice in connection with pending or reasonably anticipated litigation or, alternatively, follow the federal courts that have "overwhelmingly rejected [a litigation] requirement."[9] As noted by the Court of Appeals, the attorney-client privilege "shields from disclosure any confidential communications between an attorney and his or her client made for the purpose of obtaining or facilitating legal advice in the course of a professional relationship."[10] Communications made in the presence of third parties are generally not privileged. One of the exceptions to this loss of privilege is the common interest doctrine. Where "two or more clients separately retain counsel to advise them on matters of common legal interest, the common interest exception allows them to shield from disclosure certain attorney-client communications that are revealed to one another for the purpose of furthering a common legal interest."[11] The doctrine, which originally applied to criminal codefendants and was extended to communications between parties in civil litigation, was first applied in New York courts in 1989.

The *Ambac* Court of Appeals noted that New York's existing formulation of the common interest doctrine "is limited to situations where the benefit and the necessity of shared communications are at their highest, and the potential for misuse is minimal." The Court of Appeals reasoned that the threat of mandatory disclosure where there was pending or threatened litigation may chill the parties' exchange of privileged information, but the same was not true with respect to information exchanged in commercial or other transactions. It noted Ambac's argument that, were the doctrine to apply in this case, it could permit Bank of America and Countrywide to shield disclosure that revealed that the merger was structured to conceal Countrywide's fraudulent dealings and leave victims without recourse. The Court of Appeals rejected Bank of America's argument that it would be anomalous to limit the common interest doctrine to pending or anticipated litigation when there is no such requirement for the attorney-client privilege. The Court of Appeals noted that the two do not need to be coextensive because the common interest doctrine is not itself an evidentiary privilege. The Court of Appeals also rejected Bank of America's view that it would be anomalous for the common interest doctrine to have a litigation requirement when such a requirement would not exist if the merging parties had simply hired a single attorney. Finally, the Court of Appeals declined Bank of America's request that New York law follow the trend in federal courts of rejecting the litigation requirement, noting that, according to one treatise, the common interest exception was "spreading like crabgrass" in unanticipated ways.[12]

The Court of Appeals' endorsement of a narrow construct of the common interest doctrine stands in contrast to jurisdictions like Delaware, which do not require that the disclosure be in connection with actual or reasonably anticipated litigation.[13] Moreover, the rule will not always be easy to plan around. For example, the parties may not

be able to select a more favorable governing evidentiary law because the issue will typically arise in connection with third-party litigation that is unrelated to the merger. As a result, a choice-of-law provision in a transaction agreement may not dictate which rules of evidence will determine whether the common interest doctrine applies. *Ambac* also does not provide any guidance as to when litigation is "reasonably anticipated," so deal participants may be at risk of wrongly determining that it is and wrongly assuming that the common interest doctrine would apply. The fact that public deals nowadays typically attract litigation does not mean that communications between deal parties in public deals are likely to benefit from the common interest doctrine. Public company deal litigation typically relates to matters such as fiduciary duties or proxy disclosure. Communications involving the types of matters that were at issue in *Ambac*, such as regulatory approvals and third-party consents, will not normally be the subject of deal litigation and thus not the type of communications for which the common interest doctrine would as a result apply.

So what can deal parties do where they are concerned about the potential waiver of privilege? If the parties wish to proceed down the path of sharing privileged information, they should contemporaneously document the basis for the privilege to apply, which may include entering into a common interest agreement that clearly references the pending or threatened litigation. Where parties prefer to avoid sharing privileged information, they could jointly hire new counsel to advise both parties with respect to the subject at issue. Another option sometimes employed is for the target company to simply provide nonprivileged information and have the acquiror draw its own legal judgments. In some instances, it may be possible for the information exchange to be delayed until after closing, when the parties will be affiliated and information sharing will not lead to a loss of privilege.

» Read the decision.

» Read our prior summary of the decision.

6. ***Huff Energy Fund, L.P. v. Gershen***, 2016 WL 5462958 (Del. Ch. Sept. 29, 2016)

The court held that a decision of a private company's board to dissolve does not implicate Revlon or Unocal scrutiny. The court also applied Corwin for the first time to a private company, and held that, even if some form of enhanced scrutiny were invoked, a fully informed stockholder approval cleansed the transaction, thereby irrebuttably reinstating the business-judgment rule.

This case deals with a challenge brought by The Huff Energy Fund LP, to the decision by the board of directors and stockholders of Longview Energy Company to dissolve Longview following a sale of a significant portion of its assets.

In connection with Huff Energy's investment in Longview in 2006, Huff Energy and Longview entered into a shareholders agreement which, among other things, provided Huff Energy with the right to designate two directors to Longview's board and required that a unanimous vote of the board was required for any act or omission that would have a material adverse effect on the rights of any shareholder set forth in the shareholder agreement. Following a failed merger with a Canadian company in 2011 and a failed attempt at selling Longview's assets held in Oklahoma in 2010 and California in 2014, Longview's board approved the sale of Longview's California assets in May 2015 followed by the dissolution of Longview over the abstention of the one Huff Energy director who was present for the vote. Longview's stockholders then approved the asset sale and plan of dissolution in June 2015.

Huff Energy sued the directors and Longview with respect to the approval of the plan of dissolution, claiming breach of the shareholder agreement and breach of fiduciary duty. In ruling on a motion to dismiss, the court dispensed with the breach-of-contract claim, first finding that the individual directors could not be sued for breach of the shareholder agreement as nonparties to the contract. The court then reviewed various provisions of the contract invoked by Huff Energy and determined that Huff Energy had failed to state a claim that the shareholder agreement was breached.

The court then reviewed the breach-of-fiduciary-duty claims. The court began by explaining that in analyzing a breach-of-fiduciary-duty claim, the directors are presumed to have acted with loyalty and care. A plaintiff must rebut that presumption by pleading facts demonstrating "a majority of the director defendants have a financial interest in the transaction or were dominated or controlled by a materially interested director."[14] If the shareholder plaintiff fails to rebut the presumption, then the business-judgment rule applies, protecting the directors' decision so long as the decision can be attributed to a rational business purpose. The court reviewed Huff Energy's allegations that the CEO and COO, both of whom were also members of the board, were receiving change-in-control benefits pursuant to pre-existing employment agreements, that certain directors had former and then-current business relationships with the CEO and that the CEO's animosity towards Huff Energy led the CEO to act out of self-interest. The court found none of these allegations were sufficient an interest to rebut the business-judgment rule.

The court then evaluated Huff Energy's claim that the adoption of a plan of dissolution constituted a "final stage" transaction, which triggered enhanced scrutiny under *Revlon*.[15] The court explained that where *Revlon* concerns are present, "the defendant fiduciaries bear the burden of proving that they 'act[ed] reasonably to seek the transaction offering the best value reasonably available to the stockholders'."[16] The court, however, found that the adoption of the plan of dissolution "in no way implicates the policy concerns expressed in *Revlon* that trigger . . . enhanced scrutiny." The court explained that the adoption of a plan of dissolution does not constitute a "final stage" transaction because a corporation's existence continues for a period of at least three years, during which time the board would maintain control of Longview's remaining assets and retain a duty to act in the best interest of Longview's stockholders and creditors.

The court similarly dismissed Huff Energy's alternative claim that the plan of dissolution invoked enhanced scrutiny under *Unocal* as an unreasonable defensive measure adopted by the board touching on issues of control. In *Unocal*, the Delaware Supreme Court recognized that "[w]hen a board addresses a pending takeover bid," there is an "omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders."[17] Huff Energy, however, failed to cite any case indicating that either "(1) the adoption or filing of a certificate of dissolution or (2) the board's 'perception' that a shareholder posed a threat to any individual director's 'power' over the corporation implicates the 'omnipresent specter' lingering in those instances where *Unocal* scrutiny has been invoked." The court found that the adoption of a plan of dissolution "avoids any specter of entrenchment given that such action invariably results in winding up of the company's operations, payments of its debts and liquidation of its assets."

Finally, applying *Corwin*[18] and its progeny to a private company for the first time, the court found that even if Huff Energy had pled facts allowing an inference that some form of enhanced scrutiny applied to the adoption of the plan of dissolution, the Longview stockholders had a fully informed, uncoerced vote, which cleansed the transaction, irrebuttably reinstating the business-judgment rule. The court, quoting *Corwin,* stated "Delaware corporate law has long been reluctant to second-guess the judgment of a disinterested stockholder majority that determines that a transaction with a party other than a controlling stockholder is in their best interests."[19]

The *Corwin* decision has been well received among company-side M&A practitioners because it has helped to extinguish claims that continue post-merger. The application of *Corwin* to private deals is likely to be viewed as a welcome development.

» Read the decision.

7. ***In re ISN Software Corp. Appraisal Litigation***, 2016 WL 4275388 (Del. Ch. Aug. 11, 2016)

The court held that the most reliable method to value a company, whose stock was not traded publicly and lacked historical sales that were reliable indicators of fair value, and for which no comparable company evaluations existed, was the discounted cash flow (DCF) method.

This case deals with the fair value determination of the stock of ISN Software Corp., a privately held Delaware corporation, following a merger through which the controlling stockholder cashed out some, but not all, of the stock held by the minority stockholders of ISN. The merger was effected in January 2013 through a merger of ISN with its wholly owned subsidiary. ISN did not engage a financial advisor or an investment bank in connection with the merger and did not obtain a fairness opinion. The merger consideration entitled certain minority stockholders the right to receive $38,317 per share. The controlling stockholder determined that price using a third-party valuation created in 2011, which he theoretically adjusted based on his expectations of the Company's outlook at that time. Following the merger, two stockholders demanded appraisal of all of their shares of ISN stock.

At trial in the appraisal action, ISN and the two petitioners each proffered experts with what the Vice Chancellor determined was an "alarmingly" wide valuation for ISN ranging from $106 million, or $29,360 per share, to $820 million, or $230,000 per share. No expert relied on the valuation used by the controlling stockholder in the merger. Each of the experts relied on various valuation methods, weighting each as they saw fit, to determine the fair value of ISN as of the date of the merger, including discounted cash flow (DCF), guideline public companies (GPC), direct capitalization of cash flow (DCCF) and prior transactions.

The Vice Chancellor reviewed each method and decided to rely exclusively on a DCF valuation. The Vice Chancellor found the GPC method less reliable than a DCF to determine fair value because ISN had no public competitors and ISN's industry included various and divergent companies. The Vice Chancellor found the DCCF method inappropriate because it assumes a company will grow in perpetuity at a long-term growth rate and is an appropriate valuation tool when a company has reached steady state or where no other feasible valuation methods exist, none of which was true for ISN. Finally, the Vice Chancellor found that the two prior transactions were not reliable methods of valuation. The circumstances under which they arose made them unlikely to have generated fair value in return for the shares and the consideration for each transaction was complex, different and difficult to value.

The Vice Chancellor then reviewed the DCF method, which estimates the fair value of a company by discounting to present value the sum of the company's future cash flows over a projection period plus a termination value, representing the company's remaining cash flows in perpetuity. The three experts used different projection periods of five, six and 10 years, reflecting disagreement regarding the remaining length of time for ISN's growth stage. After reviewing ISN's current stage in its life cycle, the length of time remaining in that stage and the reliability of available projections to estimate future cash flow, the Vice Chancellor found the use of a five-year projection period appropriate, deeming it a standard period and typical for a DCF valuation. Using ISN's expert's DCF model as a framework, the Vice Chancellor then adjusted the model to reflect his conclusions as to certain other key assumptions and inputs, resulting in the conclusion of the value of ISN as of the date of the merger to be approximately $357 million, or $98,783 per share.

There have been a relatively large number of appraisal decisions recently dealing with public deals. *In re ISN Software* provides useful guidance with respect to appraisal valuations of private companies. The decision indicates that Delaware courts are likely to place heavy, if not exclusive, reliance on the DCF valuation methodology.

» Read the opinion.

8. ***In re Vaalco Energy, Inc. Stockholder Litigation***, C.A. No. 11775-VCL (Del. Ch. Dec. 21, 2015)

The Court of Chancery finds that certificate and bylaw provisions providing that directors may be removed only for cause are invalid unless the corporation's board is classified or the corporation has cumulative voting.

In a consent solicitation by an activist stockholder of Vaalco Energy Inc., the stockholder sought to remove four directors from the Vaalco Board. At the time of the consent solicitation, Vaalco's board was not classified; its stockholders had previously voted to declassify the board of directors and the certificate and bylaws had then been amended to remove the classification provision. The certificate of incorporation and bylaws also had typical provisions for a corporation with a classified board, providing that directors could only be removed for cause. The stockholders had not been given an opportunity to vote on the removal provision when they voted on the amendment to declassify the board, and the certificate and bylaws at the time of the consent solicitation still provided that directors could be removed only for cause. Vaalco asserted that the directors could not be removed without cause.

In this transcript ruling, the Chancery Court granted the plaintiff's motion for summary judgment, invalidating the provisions of Vaalco Energy's certificate of incorporation and bylaws providing that members of its board of directors could only be removed for cause. The court held that the default rule under Section 141(k) of the DGCL for removal of directors is that directors "may be removed, with or without cause." The statute provides only two exceptions: directors may be removed "only for cause" in corporations that either (1) have a board classified pursuant to Section 141(d) of the DGCL (a staggered board) or (2) provide for cumulative voting pursuant to Section 214 of the DGCL. Plaintiffs argued that Section 141(d) permits a classified board to "be divided into 1, 2 or 3 classes," and that a single-class board would be classified for purposes of Section 141(k), permitting removal only for cause. Without deciding whether there might be a "single-class classified board," Vice Chancellor Laster held that Vaalco had never established that its board was classified. Accordingly, the court ruled that Vaalco's removal provisions in its certificate of incorporation and bylaw providing for removal "only for cause" were in direct conflict with Section 141(k), and therefore invalid.

Defendants had argued that 175 public companies had similar provisions on removal without cause while not having either a classified board or cumulative voting. Immediately after this ruling, the plaintiff began sending letters to those companies and filing lawsuits against some of them. Many companies have declassified their boards in recent years and while Vaalco makes it clear that any lingering "removal only for cause" provisions are invalid in the absence of a classified board or cumulative voting, it is worth reviewing certificates of incorporation and bylaws where declassification has been effected to confirm that the removal provisions have also been appropriately amended to return to the default "with or without cause," in order to avoid a "hold up" lawsuit. Similarly, private corporations should also be aware that such for-cause removal provisions cannot be relied on in defense against dissident stockholders.

» Read the transcript.

1. 888 A.2d 2014 (Del. 2005).
2. *FdG Logistics,* 131 A.3d at 857 (citing *DCV Hldgs., Inc. v. ConAgra, Inc.,* 889 A.2d 954, 958 (Del. 2005)).
3. 891 A.2d 1032 (Del. Ch. 2006).
4. *Abry*, 891 A.2d at 1058-59.
5. 2013 WL 2249655 (Del. Ch. May 17, 2013).
6. 2015 WL 7461807 (Del. Ch. Nov. 24, 2015); see also our summary of that decision.
7. *Abry Partners V LP v. F&W Acquisition LLC*, 891 A.2d 1032 (Del. Ch. 2006).
8. See, e.g., *Haney v. Blackhawk Network Holdings*, C.A. No. 10851-VCN (Del. Ch. Feb. 26, 2016), where the court refused to dismiss a seller fraud claim against a buyer that was based on seller's allegation that the buyer withheld certain information that it had concerning a material agreement that the acquired business was in the process of negotiating, which resulted in a significant economic benefit to the buyer.
9. *See our prior summary of the decision* (citing decision of Appellate Division, 124 AD3d 129, 134 (1st Dept. 2014)).
10. *Id.* (quoting New York CPLR §4503[a][1]).
11. *Id.*
12. *Id.* (quoting Wright & Graham §5493 [2015 Supp]).
13. See, e.g., *American Legacy Foundation v. Lorillard Tobacco Co.*, 2004 WL 2521289, at *6 (Del. Ch. 2004) (citing D.R.E. 502(b)(3)).
14. Citing *Orman v. Cullman*, 794 A.2d 5, 22 (Del. Ch. 2002).
15. *Revlon v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 174 (Del. 1986).
16. Citing *In re Rural Metro Corp.*, 88 A.3d 54, 83 (Del. Ch. 2014), *aff'd sub nom. RBC Capital Markets, LLC v. Jervis,* 129 A.3d 816 (Del 2015).
17. *Unocal Corp. v. Mesa Petr. Co.*, 493 A.2d 946, 954 (Del. 1985).
18. *Corwin v. KKR Financial Holdings LLC*, 125 A.3d 304 (Del. 2015).
19. *Id.* at 306-308.

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