May 16, 2017

Delaware Court of Chancery Dismisses Breach of Fiduciary Duty and Quasi-Appraisal Claims

Recently in *In re Cyan, Inc. Stockholders Litigation*, the Delaware Court of Chancery dismissed a fiduciary duty claim and a request for a quasi-appraisal remedy in connection with the acquisition of Cyan, Inc. by Ciena Corporation. Relying on principles of existing Delaware case law, the court held that the business judgment rule applied to the Cyan board's decision to approve the mostly stock-for-stock merger, a holding further reinforced under the doctrine set forth *in Corwin* v. *KKR Financial Holdings LLC* because Cyan shareholders had voted to approve the deal. The shareholders alleged numerous board conflicts (including that certain directors were conflicted due to their affiliations with shareholders that had liquidity needs different from other shareholders), but the court found each to be insufficient to rebut the business judgment rule. The court also denied shareholders' request for a quasi-appraisal remedy, finding that they had failed to adequately allege any material disclosure deficiencies.

Background

In May 2015, Cyan agreed to be acquired by Ciena in a merger transaction at an enterprise value of approximately $335 million, net of estimated cash. The consideration offered to Cyan stockholders consisted of 89% shares of Ciena common stock and 11% cash. Following the announcement of the merger, plaintiff stockholders sent a letter to counsel for the defendant Cyan directors requesting that the company supplement its proxy disclosures, which the company declined to do. The plaintiffs did not, however, seek to enjoin the stockholder vote on the merger, which closed in August 2015, after approval by the Cyan stockholders.

Beginning a little more than one year before the announcement of the merger, Cyan began exploring its strategic opportunities when a third party contacted the company's CFO expressing an interest in Cyan. Around this same time, management also informed the board that Cyan would only have sufficient cash to survive through the second quarter of 2015, and the board ultimately determined to raise additional capital through a convertible debt offering. Two management directors, an investment firm controlled by an outside director and Cyan's financial advisor in the merger participated in the debt offering. The convertible notes contained a "make-whole" provision under which, for a certain period, the noteholders could require the repurchase of their notes at 100% of the principal amount plus accrued and unpaid interest if a "Fundamental Change" occurred. During 2014 and the first quarter of 2015, however, the company began reporting continuous revenue growth, and in December 2014, the board formally hired a financial advisor to assist in a sale process, which led to Ciena acquiring the company.

Additionally, before the merger, a class action securities litigation was filed against Cyan asserting securities law violations in connection with the company's 2013 IPO. The Cyan directors, as well as several financial firms (including Cyan's financial advisor in the merger and other firms serving as underwriters in the IPO), were named as defendants in the securities litigation.

Almost one year after the close of the merger, plaintiffs filed an amended complaint asserting two claims: (i) that the Cyan board breached their fiduciary duties in connection with the approval of the merger, and (ii) that defendants withheld material information that prevented stockholders from determining "whether to pursue their statutory appraisal rights," and asking the court to award the remedy of quasi-appraisal. The defendants moved to dismiss the complaint.

Analysis

In granting the defendants' motion to dismiss, the Court of Chancery held as follows:

- *The business judgment rule applied to the board's decision to approve the merger because it consisted primarily of stock consideration and plaintiffs did not plead alternative applicable standards.* The court found that because the merger consideration consisted of 89% stock, heightened review under *Revlon* was inapplicable, and therefore, business judgment review presumptively applied. Plaintiffs also did not allege that the transaction triggered *Unocal* or that entire fairness review applied *ab initio*. Because Cyan's certificate of incorporation exculpated directors for breaches of the duty of care, plaintiffs were required to show that a majority of the defendants acted in bad faith or otherwise breached their duty of loyalty, which the court found that they failed to do. The court rejected each conflict of interest or instance of bad faith alleged by plaintiffs:

    - The evidence did not support plaintiffs' allegations that the defendants were motivated to secure a buyer with "deep pockets" to ensure they would be indemnified in connection with the securities litigation. Among other things, the directors were protected by D&O insurance and other avenues of recovery, Cyan's cash and cash equivalents as of the relevant time exceeded the total amount of damages that could result from the securities litigation and insufficient facts were pled that Ciena had "deeper pockets" than Cyan.

    - The court rejected plaintiffs' argument that two directors were interested because they were affiliated with Cyan's two largest stockholders that desired the merger so as to "cash out." The court cited prior Delaware case law rejecting a similar argument that a stockholder was interested because he received liquidity benefits that were not shared equally with the rest of the stockholders, and noted that "[g]enerally speaking, a fiduciary's financial interest in a transaction as a stockholder (such as receiving liquidity value for her shares) does not establish a disabling conflict of interest when the transaction treats all stockholders equally . . . ."

    - Similarly, the court rejected plaintiffs' allegations that three directors who held Cyan convertible notes were interested because they were motivated to ensure a transaction so they would receive the make-whole payment or to have the notes tied to a more financially secure company. The court pointed out that each of those directors also held a significant amount of Cyan stock, and therefore were motivated to maximize the exchange ratio in the merger. Even if their desire to maximize the exchange ratio was outweighed by their desire to trigger the make-whole payment, these allegations concerned only three directors and did not show that a majority of the board faced a disabling conflict.

- The board's refusal to supplement the proxy at plaintiffs' request shortly before the stockholder meeting did not amount to bad faith because none of plaintiff's disclosure allegations had merit.

- *Because a majority of the fully informed stockholders of Cyan approved the merger, plaintiffs' breach of fiduciary duty claims must also be dismissed under Corwin.* Pursuant to *Corwin* and its progeny, absent a showing of waste, when a transaction not subject to entire fairness is approved by a fully informed, uncoerced vote of the disinterested stockholders, the business judgment rule applies. Here, whether *Corwin* applied depended upon whether the shareholder vote approving the Cyan-Ciena merger was fully informed. While the complaint listed approximately 20 disclosure deficiencies, the court determined that none amounted to a material deficiency. Therefore, under *Corwin*, the business judgment rule applied to the merger, thereby serving as an additional basis supporting the dismissal of plaintiffs' fiduciary duty claim.

- *The court denied plaintiffs' request for a quasi-appraisal remedy because they failed to identify any material disclosure deficiencies or to allege any other non-exculpated breach of fiduciary duty that would serve to underlie their request for such a remedy.* Under Delaware law, "quasi-appraisal" is a remedy that measures damages based on the money equivalent of what a stockholder would have received in an appraisal. Different causes of action can give rise to the quasi-appraisal remedy, including when a fiduciary breaches its duty of disclosure in connection with a transaction that requires a stockholder vote. Plaintiffs alleged that they were entitled to a quasi-appraisal remedy because defendants deprived stockholders of "sufficient information to determine whether to pursue their statutory appraisal rights." Here, as discussed above, the court found that plaintiffs' disclosure allegations lacked merit, and therefore, their request for quasi-appraisal based on these allegations must also be dismissed. Moreover, the court found that the cause of action underlying the remedy sought was an alleged breach of fiduciary duty and, as discussed above, plaintiffs failed to plead a non-exculpated claim for breach of fiduciary duty. In an attempt to circumvent the exculpatory provision in Cyan's certificate of incorporation, plaintiffs styled their request for quasi-appraisal as being based on the "frustration of the statutory right of appraisal, not breach of fiduciary duty." The court rejected plaintiffs' attempt to do so, noting that a cause of action for "frustration of the statutory right of appraisal" does not exist in Delaware.

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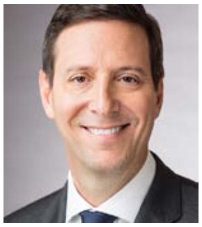

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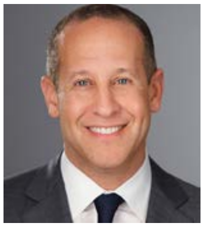

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