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Delaware Court of Chancery Finds Vote Coercive and Insufficient to Cleanse Board Action

In a recent decision in *Sciabacucchi* v. *Liberty Broadband Corporation*, Vice Chancellor Glasscock of the Delaware Court of Chancery held that a stockholder vote approving both stock issuances and the grant of a voting proxy to the company's largest stockholder was "structurally coerced" and therefore insufficient to cleanse board action and invoke business judgment review under *Corwin* v. *KKR Financial Holdings LLC*. The court determined that while "inherent coercion" did not exist because the large stockholder did not control the company, the vote was nevertheless structurally coerced as the stockholders were essentially forced to approve those transactions to avoid a detriment, and not due to the transactions themselves being beneficial to the corporation.

Background

The decision related to a pair of stock issuances that Charter Communications, Inc. made to its largest stockholder, Liberty Broadband Corporation, as a part of the financing of Charter's merger with Time Warner Cable ("TWC") and its purchase of Bright House Networks, LLC. Before the transactions with TWC and Bright House, Liberty Broadband owned approximately 26% of Charter. Pursuant to a stockholders agreement between Liberty Broadband and Charter, Liberty Broadband had the right to appoint four of 10 directors on the Charter board and also agreed to certain standstill provisions, including a prohibition on Liberty Broadband acquiring more than 35% of Charter's stock and a prohibition against it soliciting proxies.

In May 2015, Charter and TWC announced an agreement to merge for mixed stock and cash consideration that valued TWC at approximately $78.7 billion. Upon the closing of the merger, Liberty Broadband agreed to buy $4.3 billion of newly issued Charter shares (the "$4.3 Billion Share Issuance"). At the same time that Charter announced its merger with TWC, it also announced an agreement to acquire Bright House in exchange for payment to Advance/Newhouse (Bright House's owner) of a mix of cash and common and preferred partnership units exchangeable for Charter common stock at a later date. Importantly, Advance/Newhouse agreed to grant Liberty Broadband, in addition to certain other rights, a voting proxy in up to 6% of the Charter common stock that it would receive, effectively allowing Liberty Broadband to control approximately 25% of Charter stock post-transactions (the "Voting Proxy Agreement"). In addition, Liberty Broadband agreed to purchase $700 million of newly issued Charter shares (the "$700 Million Share Issuance" and together with the $4.3 Billion Share Issuance, the "Liberty Share Issuances").

The Charter board determined to recommend the transactions, including the Liberty Share Issuances and the Voting Proxy Agreement, to the stockholders. The merger with TWC and the acquisition of Bright

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House were conditioned upon Charter stockholders also approving the Liberty Share Issuances and the Voting Proxy Agreement. Moreover, Charter's certificate of incorporation also required that the Liberty Share Issuances and the Voting Proxy Agreement be approved by a majority of the disinterested outstanding shares of Charter common stock, which vote was separately obtained. The TWC and the Bright House transactions closed in May 2016.

After closing, plaintiff, a Charter stockholder, brought suit, alleging fiduciary duty breaches with respect to the Liberty Share Issuances and the Voting Proxy Agreement. Defendants moved to dismiss the claims.

Analysis

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

- *Liberty Broadband was not a controlling stockholder of Charter, and therefore there was no "inherent" coercion of the vote approving those transactions.* The defendants argued that the business judgment rule applied to the Liberty Share Issuances and the Voting Proxy Agreement under *Corwin* v. *KKR Financial Holdings LLC*, because there had been a fully informed, uncoerced vote of the majority of disinterested stock. Plaintiffs argued that the business judgment rule should not apply because Liberty Broadband controlled Charter, and as the court noted, "controller transactions are inherently coercive." Here, although the court observed that stockholders owning less than 50% of the voting power of a company may still qualify as a controller in certain circumstances, no such control existed here as evidenced by the following:
  - The restrictions on Liberty Broadband's actual control of Charter imposed by its stockholders agreement with the company (namely the 35% ownership limitation, its ability to only appoint four of 10 directors and the standstill provision) and the provision in Charter's certificate of incorporation requiring the approval of disinterested stockholders for certain transactions overcame any inference that Liberty Broadband exercised actual control over Charter.
  - Despite Liberty Broadband's letters to the SEC arguing that it exercised control over Charter for purposes of the Investment Company Act of 1940 (which would allow it to avoid registration as an investment advisor under that Act), the court found that no actual control existed for Delaware law purposes because of the "contractual handcuffs" of the stockholders agreement and the certificate of incorporation. The court distinguished other decisions where minority stockholders had been found to be controllers based on statements in SEC filings because the facts in those situations showed significant influence over company elections and operations by the stockholders.
  - Although the complaint alleged that a majority of the director defendants shared interests with Liberty Broadband and its controller, this was insufficient to show that Liberty Broadband exercised actual control over the board.

- *However, the vote approving the Liberty Share Issuances and the Voting Proxy Agreement was "structurally coerced" and thus business judgment review does not apply under* Corwin. Even where no inherent coercion exists, a stockholder vote may still be "structurally coerced" and therefore inadequate to cleanse the approved transaction under *Corwin*. Structural coercion exists when "the directors [create] a situation where a vote may be said to be in avoidance of a detriment created by the structure of the transaction the fiduciaries have created, rather than a free choice to accept or reject the proposition voted on." Here, the court found that approval of the Liberty Share Issuances and the Voting Proxy Agreement did not represent a free choice by the disinterested stockholders because they were forced to approve these transactions if they wanted to receive the benefit of the TWC and Bright House transactions—which all parties agreed were value enhancing. The court noted that the board did not determine that the Liberty Share Issuances and the Voting Proxy Agreement were necessary to, or that they were in the corporate interest independent of, the TWC and Bright House transactions. The fairness opinions issued in connection with the deal similarly did not specifically find that the Liberty Share Issuances and the Voting Proxy Agreement were fair to the disinterested stockholders. Moreover, nothing in the pleadings indicated that the Liberty Share Issuances were the only method of financing available. The court inferred from the complaint that the defendants secured the TWC and Bright House transactions, and then used the value of those transactions to obtain favorable votes on the Liberty Share Issuances and the Voting Proxy Agreement. Thus, the vote was structurally coerced and had no cleansing effect under *Corwin*. Vice Chancellor Glasscock writes that "[f]iduciaries cannot interlard such a vote with extraneous acts of self-dealing, and thereby use a vote driven by the net benefit of the transactions to cleanse their breach of duty."

In light of these holdings, the court reserved decision on the remaining grounds presented by defendant's motion to dismiss pending supplemental briefing.

Takeaways

Sciabacucchi and also the earlier *Saba* decision (see our memo here) reflect the courts' early guidelines on how companies can avoid issues of coercion in a stockholder vote. Although more detail may still be coming, to ensure that *Corwin* applies, companies should review transaction and vote structure to provide stockholders a "free choice" to vote each transaction up or down based on the transaction's own merits and not to avoid a detriment. Cross-conditioning and bundling matters that are not essential to the transaction being approved should be examined. Notwithstanding these decisions, it is important to remember that these structural issues affect the ability of boards to rely on the cleansing effect of the stockholder vote under *Corwin*, but failing to meet *Corwin*'s requirements does not necessarily mean that the board of directors will be found to have breached a fiduciary duty.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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