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Delaware M&A Quarterly

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Summer 2018

Delaware Supreme Court Dicta Addresses "Sandbagging" in Delaware

In *Eagle Force Holdings, LLC* v. *Campbell*, the Delaware Supreme Court reversed and remanded the Court of Chancery's decision to dismiss the case for lack of personal jurisdiction over the defendant due to the lower court's finding that the contracts at issue—including their Delaware forum selection clauses that formed the basis for the court's jurisdiction over the defendant—were unenforceable. The case has been cited as being notable for M&A practitioners due to dicta in the Supreme Court majority opinion by Justice Valihura, as well as in a partial dissent by Chief Justice Strine, that discusses Delaware's position on "sandbagging." The particular sandbagging at issue in this litigation is where a buyer receives pre-signing (as opposed to post-signing but pre-closing) knowledge of a representation or warranty breach by the seller, but nonetheless proceeds with closing and seeks indemnification from the seller for the breach post-closing. In *Eagle Force*, the majority opinion acknowledged in a footnote the debate over whether such sandbagging is permitted in Delaware. The court sidestepped the defendant's argument that reliance is required in such situations, stating that the court "[had] not yet resolved this interesting question." Strine's partial dissent, also not binding, is more direct on the issue: "to the extent [plaintiff] is seeking damages because [defendant] supposedly made promises that were false, there is doubt that he can then turn around and sue because what he knew to be false remained so. Venerable Delaware law casts doubt on [plaintiff's] ability to do so . . . ." While it is unclear whether the agreement in *Eagle Force* contained a provision addressing the permissibility of sandbagging, parties should consider including in their agreement express language reflecting their intentions on the issues. Based on prior Delaware case law, such provisions are likely to be enforced by Delaware courts. For the *Eagle Force* decision, click here.

Stockholders of Parent-Target Not Entitled to Appraisal Rights in Merger Involving Transfer of Control

The Delaware Court of Chancery held that stockholders of Dr Pepper Snapple Group, Inc. were not entitled to appraisal of their shares in connection with a reverse triangular merger involving a subsidiary of Dr Pepper and the parent of Keurig Green Mountain, Inc. Because the transaction was structured so that Dr Pepper was not a "constituent corporation" in the merger and the public stockholders would retain their shares, the court found that the transaction did not satisfy the terms of Delaware's appraisal rights statute. While the decision by Chancellor Bouchard in *City of North Miami Beach General Employees' Retirement Plan* v. *Dr Pepper Snapple Group, Inc.* was notable because appraisal rights were denied even though Dr Pepper stockholders would transfer control of the company in what is effectively a mixed-consideration

deal, it is unlikely to prove meaningful from a precedent standpoint except in cases involving the uncommon acquisition structure used in the transaction. For more, click here.

Delaware Court Dismisses Misappropriation Claim Against Private Equity Firm for Investing in Competing Company

The Delaware Court of Chancery dismissed claims that a private equity firm and affiliated funds misappropriated trade secrets acquired from their portfolio company via their director designees and then misused the information by investing in a competitor. In *Alarm.Com Holdings, Inc.* v. *ABS Capital Partners Inc.*, Vice Chancellor Travis Laster held that no reasonable inference of misappropriation could be made, noting that multiple agreements between the company and the private equity firm, as well as provisions in the company's code of conduct and charter, specifically contemplated the possibility that the private equity firm would invest in competitors. The opinion highlights the importance of provisions that address potential conflicts of interest in situations where directors may sit on boards of competing companies, at least as protection against certain Delaware laws. For more, click here.

Delaware Court of Chancery Finds It "Reasonably Conceivable" That Two Minority Stockholders Form Control Group

In *In re Hansen Medical, Inc. Stockholders Litigation*, the Delaware Court of Chancery declined to grant defendants' motion to dismiss, finding that plaintiff stockholders had sufficiently pled a "reasonably conceivable" claim that two minority stockholders of Hansen Medical, Inc. constituted a control group and extracted a nonratable benefit from the company's acquisition by Auris Surgical Robotics, Inc. Therefore, the entire fairness standard would apply to the transaction. Vice Chancellor Montgomery-Reeves based her holding on allegations of a lengthy history of investment cooperation and coordination by the members of the control group and the fact that they entered into voting agreements and proxies with Auris. Additionally, the court cited the control group's decision to roll over their shares in the transaction, which constituted a nonratable benefit unavailable to other stockholders, as a basis for its holding. For more, click here.

Delaware Court of Chancery Holds that Director's Withholding of Consent to Correct Stock Issuances Amounts to Breach of Fiduciary Duty

In *CertiSign Holding Inc.* v. *Kulikovsky*, the Delaware Court of Chancery held that a director who refused for personal reasons to give his consent to the company's attempts to correct flaws in its capital structure breached his fiduciary duty of loyalty and owed damages to the corporation. Additionally, the court declined to validate under Section 205 of the Delaware General Corporation Law (the "DGCL") the alleged grant of certain stock options by the company. The options had not been validly granted under Section 157 of the DGCL. While Section 205 permits the court to validate technically flawed corporate acts, it did not do so in this instance because that record did not reflect a "meeting of the minds" on the part of the directors as to the quantities, terms, dates and recipients of the alleged option grants. For the opinion, click here.

Delaware Lawmakers Expand Size of Court of Chancery

Both houses of the Delaware General Assembly have approved, and the governor has signed into law, legislation that increases the number of vice chancellors on the Court of Chancery from four to six (plus a chancellor). The expansion was a response to the court's increased caseload in recent years. The State Judicial Nominating Commission began taking applications for the two additional seats, with the deadline for applications set for July 20, 2018.

Proposed 2018 Amendments to the DGCL

The Delaware General Assembly has approved legislation proposing amendments for 2018 to the DGCL. The amendments, if signed by the governor, will be effective on August 1, 2018, except for (i) the amendments relating to ratification of defective corporate acts, which will be effective only as to such acts ratified or to be ratified pursuant to resolutions adopted by a board on or after August 1, 2018 and (ii) the amendments relating to Section 251(h) mergers, which shall be effective only with respect to a merger consummated pursuant to an agreement entered into on or after August 1, 2018. The proposed 2018 amendments to the DGCL relate to, among other things, the following:

- Application of the "market out" exception to the availability of appraisal rights to Section 251(h) mergers. As currently drafted, Section 262(b)(3) of the DGCL provides that appraisal rights are available for any "intermediate form" merger effected pursuant to Section 251(h) unless the offeror owns all of the stock of the target immediately prior to the merger; thus, stockholders of a target listed on a national securities exchange are entitled to appraisal rights in a Section 251(h) merger in which they receive only stock listed on a national securities exchange, even if they would not be entitled to appraisal rights in a comparable long-form merger (due to the "market-out" exception in Section 262(b)(1)-(2)). The proposed amendments would amend Section 262(b) to address this inconsistency and apply the "market-out" exception to Section 251(h) mergers.
- Clarification of information required in an appraisal statement in connection with "intermediate form" mergers. Currently, under Section 262(e) of the DGCL, surviving corporations must provide, upon request and subject to specified conditions, a statement to dissenting stockholders setting forth the aggregate number of shares that were not voted in favor of the merger or consolidation and as to which demands for appraisal have been received, and the aggregate number of holders of such shares. In Section 251(h) mergers, no shares are "voted" for the adoption of a merger agreement; therefore, the proposed amendments clarify that, instead of setting forth the shares not voted for the merger for which appraisal rights were demanded, the appraisal statement issued in connection with a Section 251(h) merger must set forth the relevant shares not purchased in the tender or exchange offer for which appraisal rights were demanded.
- Clarification of circumstances in which corporations can use Sections 204 and 205 to ratify defective corporate acts. The proposed amendments make several clarifying changes addressing availability of Sections 204 and 205 of the DGCL (relating to the ratification of corporate acts and stock), including the following:
    - Section 204 sets forth the requirements for ratification of defective corporate acts, which in some circumstances include a vote of the stockholders, with only "valid" stock entitled to vote on ratification. The amendments would clarify that Section 204 is still available where a corporation has no valid stock outstanding.
    - The proposed amendments clarify that where a stockholder vote is being sought for the ratification of a defective corporate act under Section 204 at a stockholder meeting, the notice required to be given to the holders of valid or putative stock as of the time of the defective corporate act may be given to the holders of valid stock or putative stock as of the record date for the defective corporate act if such act involved the establishment of a record date.
    - The proposed amendments clarify that any act or transaction within a corporation's power under subchapter II of the DGCL may be subject to ratification under Section 204. This amendment is proposed in response to the Court of Chancery's opinion in *Nguyen* v. *View,* which arguably adopted a more narrow reading of the statute, insofar as it suggested that an act or transaction may not be within the power of the corporation (and therefore not subject to ratification under Section 204) solely on the basis that it was not approved in accordance with the provisions of the DGCL or the corporation's organizational documents.

- The proposed amendments clarify that the failure of an act or transaction to be approved in compliance with the disclosure set forth in any proxy or consent solicitation statement may constitute a failure of authorization.
- Proposed amendments to Section 114 of the DGCL would allow nonstock corporations to ratify defective corporate acts under Sections 204 and 205.

- Other amendments. Other proposed technical amendments relate to the following issues: (i) requirements for distinguishing a corporation's name from those of a series of a limited liability company, (ii) the Delaware Attorney General's authority to revoke a corporation's charter and (iii) technical changes regarding the filing of certificates of revival for exempt corporations.

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M&A Markets

The following issues of M&A at a Glance, our monthly newsletter on trends in the M&A marketplace and the structural and legal issues that arise in M&A transactions, were published this quarter. Each issue can be accessed by clicking on the date of each publication below.

- April 2018
- May 2018
- June 2018

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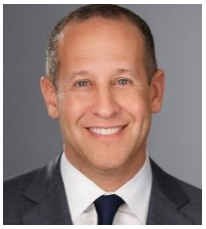

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