BUSINESS LAW TODAY

Key Delaware Corporate and Commercial Decisions from 2014

Francis G.X. Pileggi

About the Authors:

Francis G.X. Pileggi is the member-in-charge of the Wilmington, Delaware, office of Eckert Seamans Cherin & Mellott, LLC. He summarizes the corporate and commercial decisions of Delaware courts at www.delawarelitigation.com.

DELAWARE INSIDER Recent trends in Delaware business law

In this article, we review the top five decisions from the Delaware courts in the last year.

1. *C&J Energy Services, Inc. v. City of Miami General Employees' and Sanitation Employees' Retirement Trust,* Del. Supr., No. 655/657, 2014 (Dec. 19, 2014).

This Delaware Supreme Court opinion is noteworthy because it clarifies the version of fiduciary duties known as the *Revlon* standard that apply to a board of directors when they are selling their company, or when they are selling a change in control.

The Revlon *Standard*

The Delaware Supreme Court determined that the Court of Chancery based its ruling on "an erroneous understanding of what *Revlon* requires." Delaware's high court emphasized that "*Revlon* made clear that when a board engages in a change of control transaction, it must not take actions inconsistent with achieving the highest immediate value reasonably attainable." However, the court also emphasized that *Revlon* does not require a board to set aside its own view of what is best for the company's stockholders, nor does it require an auction in every instance.

Importantly, the Delaware Supreme Court underscored that: "There is no single blueprint that a board must follow to fulfill its duties" when the company is for sale, and a court applying the enhanced scrutiny under *Revlon* must determine "whether the

BUSINESS LAW TODAY HOME

DOWNLOAD A PDF OF THIS ARTICLE

DOWNLOAD A PDF OF THIS ISSUE

ABA BUSINESS LAW SECTION

THE LAST LAUGH

"Yes, it does take quite a bit of self-discipline, but I'm finally getting used to working from home."

SECTION NEWS

Summer Time Reading: The Business Lawyer
Content Corner: Content for Free
Free Non-CLE Webinar 6/25: Bank of America, N.A. v. Caulkett and the Future of Lien Stripping
Using the World's Best Checklist – Forming LLCs: Free CLE in Two Days 6/25
Free Non-CLE Webinar Tomorrow 6/23: "PLSAs, SEPs and PAEs: The Antitrust/IP Acronyms You Should Know and Understand"
All News

SECTION EVENTS

directors made a reasonable decision, not a perfect decision." In order for a market check to be effective, an act of solicitation is not needed "so long as interested bidders have a fair opportunity to present a higher-value alternative, and the board has the flexibility to eschew the original transaction and accept the higher-value deal." Moreover, the court stated that the "ability of the stockholders themselves to freely accept or reject the board's preferred course of action is also of great importance in this context."

2. *ATP Tour, Inc. v. Deutscher Tennis Bund*, Del. Supr., No. 534, 2013 (May 8, 2014).

The Delaware Supreme Court decided certified questions of law from the District of Delaware regarding whether it was consistent with Delaware law for a bylaw provision to provide for shifting attorneys' fees to an unsuccessful plaintiff pursuing intra-corporate litigation. Short answer: such a bylaw provision is generally enforceable subject to equitable exceptions – at least for non-stock corporations which is the type involved in this case. This opinion has generated copious commentary among academics and others. Legislation addressing the issues in this opinion is expected to be considered in the Delaware Legislature during its 2015 session that ends in June.

The plaintiff in this case is a Delaware non-stock membership corporation. The bylaws, to which members agreed to be bound, were allowed to be amended from time to time and include a provision that requires members who unsuccessfully sue the corporation to pay reasonable attorneys' fees incurred in that litigation. Several of the members sued the corporation and its board in the United States District Court for the District of Delaware alleging both federal antitrust claims and Delaware fiduciary duty claims. The District Court certified those questions to the Delaware Supreme Court.

The Delaware Supreme Court observed that DGCL Sections 114 and 109(b) provide that the provisions of the DGCL apply to non-stock corporations and all references to the stockholders of a corporation are deemed to apply to members of a non-stock corporation. Other general principles that have broad application and should be of interest to most corporate and commercial litigators include the following:

- Bylaws of a corporation are presumed to be valid. In order to be facially valid, the bylaw must be authorized by the DGCL, be consistent with the Certificate of Incorporation, and must not be otherwise prohibited. *See* footnotes 12 to 14.
- Delaware law allows parties to modify the American Rule by contract to obligate the losing party to pay the attorneys' fees of the prevailing party. Corporate bylaws are treated as contracts among shareholders and, therefore, the fee-shifting bylaw is facially valid under Delaware law. It is not necessary for the corporate charter to specifically or implicitly authorize such a provision.
- Whether or not a particular bylaw is enforceable, however, must be based on the facts and circumstances in a particular matter. For example, the court referred to several cases where

amendments to bylaws were deemed unenforceable based on the principle, well-established in Delaware law, that "inequitable action does not become permissible simply because it is legally possible." *See Schnell v. Chris-Craft Industries*, 285 A.2d 437, 439 (Del. 1971).

- Finally, the court found that members joining before the bylaw provision was adopted are still subject to its provisions. The DGCL allows a board to amend or repeal bylaws through its directors and if such an amendment is made, the stockholders will be bound by those bylaw amendments adopted unilaterally by the board.

3. *Wal-Mart Stores, Inc. v. Indiana Electrical Workers Pension Trust Fund IBEW*, Del. Supr., No. 614, 2013 (July 23, 2014).

This Delaware Supreme Court en banc opinion requires Wal-Mart to produce documents about an alleged bribery scandal involving their Mexican subsidiary. Even though the initial focus of this case was on DGCL Section 220 and what documents a stockholder of Wal-Mart could demand, the most noteworthy aspect of this decision is that for the first time the Delaware Supreme Court directly addressed and recognized an exception to the general rule that documents protected by the attorney/client privilege do not need to be produced. It is referred to as the Garner exception after a case of that name from the Fifth Circuit.

In this case, the Delaware high court ruled that the well-established attorney/client privilege does not apply to bar production, or the privilege is subject to an exception, if a stockholder needs the otherwise inaccessible information to sue a director for breach of fiduciary duty. A similar analysis was applied to documents otherwise protected by the work-product doctrine.

4. *Kahn v. M&F Worldwide Corp.*, Del. Supr., No. 334, 2013 (March 14, 2014).

The Delaware Supreme Court affirmed the Court of Chancery's decision granting summary judgment to the defendants under the business judgment standard of review (and not the entire fairness standard) where the controlling stockholder, MacAndrews & Forbes, conditioned its offer upon the MFW Board agreeing, *ab initio*, to two procedural protections: approval by both a special committee and by a majority of the minority stockholders.

The Supreme Court noted that "[f]or the combination of an effective committee process and majority-of-the-minority vote to qualify (jointly) for business judgment review, each of these protections must be effective singly to warrant a burden shift." The Supreme Court reviewed the record and found that the defendants "have successfully established a record of independent committee effectiveness and process that warranted a grant of summary judgment entitling them to a burden shift prior to trial." The Supreme Court also found that the majority-of-the-minority vote was "fully informed and not coerced. That is, the Defendants also established a pretrial majority-of-the-minority vote record that constitutes an independent and alternative basis for shifting the burden of persuasion to the Plaintiffs."

Mergers and Acquisitions
Spring 2015

Nonprofit Organizations
First Quarter, 2015

Private Equity and Venture Capital
April 2015

Taxation
June 2015

All Newsletters

OTHER NEWSLETTERS

Miscellaneous IT Related Legal News (MIRLN) 17 May - 6 June 2015 (v18.08)

- Archive
- Contact Us
- Disclaimer
- Editorial Board
- In The Know
- Guidelines for Authors

The money quote from the opinion:

> To summarize our holding, in controller buyouts, the business judgment standard of review will be applied if and only if: (i) the controller conditions the procession of the transaction on the approval of both a Special Committee and a majority of the minority stockholders; (ii) the Special Committee is independent; (iii) the Special Committee is empowered to freely select its own advisors and to say no definitively; (iv) the Special Committee meets its duty of care in negotiating a fair price; (v) the vote of the minority is informed; and (vi) there is no coercion of the minority.

5. *In Re Rural Metro Corporation Stockholder Litigation*, C.A. No. 6350-VCL (Del. Ch. Mar. 7, 2014).

The Court of Chancery found RBC Capital Markets LLC liable for aiding and abetting the breach of fiduciary duties of directors by advising simultaneously Rural/Metro Corp. on the value of the company in connection with a sale to Warburg Pincus LLC, while other bankers at RBC were pitching their services to Warburg in an effort to gain fees by helping Warburg finance the same deal. In a subsequent opinion, substantial damages were assessed against RBC. Substantial damages were imposed in a subsequent decision.

Highlights of the Court's Decision:

- When determining whether corporate fiduciaries have breached their duties, Delaware corporate law distinguishes between the standard of conduct (which is defined by the duties of care and loyalty) and standard of review for director decision-making (business judgment rule, enhanced scrutiny and entire fairness).
- Enhanced scrutiny review adopted by the Delaware Supreme Court in *Unocal* and *Revlon* applies to "specific, recurring and readily indemnifiable situations involving potential conflicts of interest where the realities of the decision-making context can subtly undermine the decisions of even independent and disinterested directors."
- Enhanced scrutiny requires that the fiduciaries "bear the burden of persuasion to show that their motivations were proper and not selfish," and that "their actions were reasonable in relation to their legitimate objective."
- To satisfy the enhanced scrutiny test in the M&A context, defendant directors must establish: (i) the reasonableness of "the decision-making process employed by the directors, including the information on which the directors based their decision," and (ii) "the reasonableness of the directors' action in light of the circumstances then existing."
- Here the board approved the sale of Rural to Warburg for cash which triggers the enhanced scrutiny standard. When a stockholder sues a director alleging breach of fiduciary duty in connection with a decision that is subject to enhanced scrutiny, the burden of proof shifts to the defendant directors to satisfy its requirements. However, when the plaintiffs are alleging an aiding and abetting claim, the burden remains with the plaintiffs.
- The presence of an exculpatory provision does not eliminate the underlying duty of care or the potential for fiduciaries to breach that duty. Directors whose actions fail to pass muster under the applicable standard of review have breached their fiduciary duties, even though they are not liable

for damages when exculpation applies under 8 Del. C. §102(b)(7). That exculpation protection, however, does not apply to those who are liable for aiding and abetting a breach of fiduciary duty.