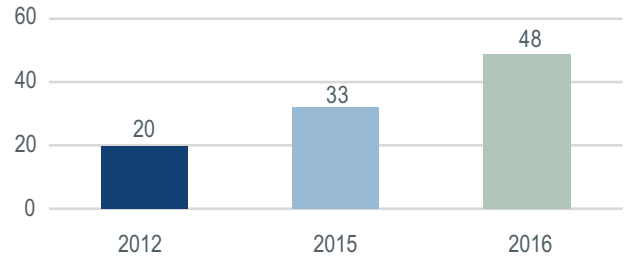
Fried Frank
M&A/PE QUARTERLY

A quarterly roundup of key M&A/PE developments

Summer 2017

The Evolving World of Delaware Appraisal

Number of Transactions Where Appraisal Was Sought



While other M&A-related litigation has decreased dramatically over the past couple of years based on the seminal *Corwin* and *Trulia* decisions, there has been a significant uptick in appraisal litigation (notwithstanding amendments to the appraisal statute in 2016 that eliminated de minimis appraisal cases). We note that, nonetheless, appraisal actions continue to be brought in a small minority of M&A transactions.

- **Appraisal results**. While the court has sometimes relied, solely or primarily, on the merger price, and sometimes on a DCF analysis, to determine appraised fair value, the court has almost invariably found fair value to be significantly above the merger price only in the case of affiliated transactions (*i.e.*, where an affiliated party stands on both sides of the transaction, such as in a controller take-private, majority stockholder squeeze-out, or management buyout). Our updated Delaware Appraisal Chart (with relevant information for all appraisal decisions issued since 2010) appears at the end of this M&A/PE Quarterly.

- ***PetSmart* and *SWS* decisions**. In our M&A/PE Briefings issued this past quarter (summarized below), we analyze the Court of Chancery's two most recent appraisal decisions: *PetSmart* (where the court relied on the merger price notwithstanding that (i) only financial sponsors, and no strategic buyers, submitted bids for the target company, and (ii) the target company experienced significantly improved post-signing financial performance); and *SWS* (where the court, for only the third time—based on our study of appraisal decisions since 2010—determined fair value to be *below* the merger price).

- **Pending Supreme Court appeals**. The Delaware Supreme Court is expected to rule shortly on the appeals of the *DFC Global* and *Dell* appraisal decisions. The Supreme Court may endorse the Court of Chancery's trend toward greater reliance on the merger price to determine fair value where there has been a robust sales process, may instead emphasize the statutory prescription that the court consider "all relevant factors" (and thus should consider a DCF analysis result, even when there has been a robust sales process), or may take some other approach.

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Inside

> *Clarification on Unavailability of* Corwin *Cleansing—"Coercion" and "Unrelated Acts"*—Saba Software, Liberty Broadband *and* Massey Energy
Page 2

> *Delaware Supreme Court, Reversing Chancery Court, Interprets Post-Closing Purchase Price Adjustment "True Up" Narrowly, Based on the Specific Factual Context—* Chicago Bridge v. Westinghouse
Page 5

> *Delaware Update*
Page 8

> *Fried Frank Briefings This Quarter*
Page 9

> *Delaware Appraisal Decisions - 2010-June 2017*
Page 13

M&A/Private Equity Partners

New York
Andrew J. Colosimo
Warren S. de Wied
Steven Epstein
Christopher Ewan
Arthur Fleischer, Jr.*
Andrea Gede-Lange
Randi Lally
Mark H. Lucas
Scott B. Luftglass
Philip Richter
Steven G. Scheinfeld
Robert C. Schwenkel
David L. Shaw
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Clarification on Unavailability of Corwin *Cleansing—"Coercion" and "Unrelated Acts"*—Saba Software, Liberty Broadband *and* Massey Energy

Under *Corwin*, if the stockholders approve a board action in a "fully informed" and "uncoerced" vote, the stockholder approval "cleanses" any breaches by the directors of their fiduciary duties in connection with the action. Since *Corwin* was decided in 2015, in every case where the defendants were seeking *Corwin* cleansing, the Delaware courts have found that the stockholder vote was fully informed and uncoerced—with the only exceptions being the recent decisions in *In re Saba Software Stockholder Litigation* (April 11, 2017), *Sciabacucchi v. Liberty Broadband Corporation and Charter Communications, Inc.* (May 31, 2017), and *In re Massey Energy Co. Derivative and Class Action Litigation* (May 4, 2017).

Key Points

- ***Corwin, Saba, Liberty* and *Massey* establish five categories under which *Corwin* "cleansing" may not be available:**
  - **Inadequate disclosure**—the stockholder vote was not "fully informed" (*Corwin*);
  - **"Affirmative coercion"**—stockholders were threatened with retribution of some type if they did not approve the proposed action (*Corwin*);
  - **"Situational coercion"**—due to a situation created by the board, the stockholders had no practical alternative but to vote for the proposed action (*Saba*);
  - **"Structural coercion"**—the stockholder vote to approve an action was tied to a stockholder vote on an unrelated action (*Liberty*); and
  - **"Unrelated acts"**—the defendants sought to cleanse breaches of fiduciary duty with respect to actions the directors took that were unrelated to the action that the stockholders approved (*Massey*).
- **These decisions do *not* appear to undercut the courts' general approach of broad applicability of *Corwin*.** Indeed, these decisions appear to *confirm* the trend of post-*Corwin* decisions that indicate that *Corwin* cleansing of non-controller stockholder-approved transactions is likely to be precluded only in unusual and egregious circumstances.
- **"Coerced" votes are likely to be rare.** "Affirmative coercion" occurs rarely. The concepts of "situational coercion" and "structural coercion" appear to have been developed in *Saba* and *Liberty* based on the unusual and egregious facts particular to those cases.
- **The concept of "unrelated acts" appears to be simply a commonsense clarification.** As explained by the court in *Massey*, the concept simply confirms that stockholder approval of one action will not cleanse every historical action by directors that led up to that action (although, we note, it does raise the issue of what the parameters will be with respect to *how* "related" an action must be to the stockholder-approved action for it to be included within the ambit of *Corwin* cleansing).

***Saba Software*: "Situational coercion" resulting from the board putting stockholders in a position of having to approve a transaction because it is the better of two bad alternatives.** The SEC had determined that, over several years, Saba Software, Inc. had engaged in fraud; and that, for several years thereafter, despite SEC orders to do so, and without explanation, the board had continuously failed to restate its financial statements to account for the fraud, as a result of which the company's stock was deregistered and, the plaintiffs alleged, the company was sold at a fire-sale price. The defendants asserted that any breaches of fiduciary duty in connection with entering into the $30 billion merger had been cleansed, under *Corwin*, by the stockholder

vote approving the merger. The court held, at the motion to dismiss stage, that the stockholder vote may have been neither "fully informed" nor "uncoerced." Vice Chancellor Slights acknowledged that there had been no "affirmative coercion"—that is, no "affirmative action by the fiduciary in connection with the vote that reflected some … promise of retribution that would place stockholders who rejected the proposal in a worse position than they occupied before the vote." However, the Vice Chancellor rejected the defendants' contention that only "affirmative coercion" would preclude *Corwin* cleansing. Rather, the Vice Chancellor stated, a coercive *situation* created by board action also would preclude *Corwin* cleansing.

The Saba stockholders may have faced "situational coercion," the court stated, as, based on the board's actions (*i.e.*, the fraud, followed by the board's continued and unexplained failure to restate the company's financial statements), the stockholders had only a "Hobson's choice" to "choose between keeping their recently deregistered, illiquid stock or accepting [the depressed] Merger price." The situation, created by the board, left the stockholders with "no practical alternative but to vote in favor of the Merger." The situation was coercive, the court explained, because the essence of "coercion" is putting stockholders in a position where their vote will necessarily be based on factors other than the economic merits of the action being voted on. *While* Saba *involved unusual and egregious facts that were central to the court's decision, a board should be attuned to the possibility of "situational coercion" where the stockholders have what could be viewed as a "Hobson's choice" between an unattractive proposed transaction and only an even more unattractive alternative*.

***Liberty*: "Structural coercion" resulting from the board's tying together two unrelated actions**. In *Liberty*, the stockholders had approved two proposed acquisitions (the "Acquisitions") that were conditioned in part on stockholder approval of an issuance of equity to and a proxy voting arrangement with the company's major stockholder (the "Equity Arrangements"). While the Equity Arrangements were used to partially finance the Acquisitions, they were "not integral" and were "extraneous" to the Acquisitions, according to the court, as the company "easily" could have financed the Acquisitions without them. By conditioning the Acquisitions on stockholder approval of the Equity Arrangements, the court reasoned, the board left the stockholders in a situation where, when they voted on the Equity Arrangements, they were not voting based on the merits of the Equity Arrangements but on the merits of the Acquisitions. In other words, to obtain the benefits of the Acquisitions, the stockholders had no practical choice but to approve the Equity Arrangements. While there was "nothing inherently nefarious" about the Equity Arrangements and "directors can act within their business judgment in the structuring of a transaction or the issuance of equity," Vice Chancellor Glasscock wrote, "[t]he threshold question here is, *assuming* that wrongdoing by the Defendants inheres in [the Equity Arrangements], is it nonetheless cleansed by the ratifying vote of the stockholders?" The Vice Chancellor concluded: "Under the unique circumstances here, I find the answer is no."

While the facts in Liberty *were "unique," a board should be attuned to the possibility of structural coercion where, due to action taken by the board to tie together two non-integral transactions, the stockholders have to approve the proposed transaction to obtain the benefit of the other transaction*—particularly if, as in *Liberty*, the proposed transaction involves benefits to an insider to the possible detriment of the other stockholders. Moreover, we note, there may not have been any vote required for the board to effect the Equity Arrangements—indicating that the vote was imposed for the purpose of obtaining *Corwin* cleansing of the unrelated action.

Open issue as to the parameters of "structural coercion." *Left for further judicial development is the issue as to when two actions are sufficiently related to be tied together by a board without a court considering the vote to have been structurally coerced*. If stockholders vote on two actions, is the second action *necessary* for the consummation of the first? If not, what is the basis on which the board determined to tie the two actions together? Notably, in *Liberty*, there was evidence that the Acquisitions could have been financed in any number of conventional ways, without the Equity Arrangements—thus, the Equity Arrangements were beneficial to a corporate insider but not necessarily beneficial to the corporation.

Vice Chancellor Glasscock wrote in *Liberty:*

> I understand that some method of financing is inherent in every transaction, and typically an informed [stockholder vote] in favor of the transaction ratifies the directors' actions with respect to financing. Certainly, if a deal cannot proceed absent adoption of a particular financing, an informed vote for such a transaction is cleansing with respect to the financing method chosen. The Complaint here alleges that the directors separately, and for reasons unrelated to the business interest of [the Company], chose to issue equity to an insider, then coerced acceptance of the inequitable issuance by tying it to approval of the underlying transaction.

According to the Vice Chancellor, the Liberty directors chose to finance the Acquisitions with the Equity Arrangements even though, according to the plaintiffs, the Acquisitions could have been financed "in any number of ways." A plaintiff's pleading that a transaction could have been "easily" financed in other ways, the court stated, "if merely conclusory, might be unpersuasive to implicate coercion." In this case, however, the court wrote, "the contents and omissions of the definitive proxy statement are telling." According to the court, the pleadings and record indicated that the board did *not* determine that the Acquisitions "could be consummated only via the [Equity Arrangements]," and the directors "did not seek or receive a fairness opinion" relating to the issuance of equity to its major stockholder standing alone. Rather, "[w]hat the Complaint and proxy do disclose is that [the major stockholder] wished to make an additional equity investment in [the Company], and communicated that to the Defendant directors, who then structured the [Equity Arrangements]. These are the facts from which I must infer whether the [Equity Arrangements] are an integral part of the Acquisitions, or interested separate transactions for which the Defendant directors coerced stockholder approval…." "Fiduciaries 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." Otherwise, "fiduciaries could attach self-dealing riders to any transaction under consideration, and avoid being held to account by a favorable stockholder vote. That is not equity; it would represent, not a cleanse, but a white-wash."

Massey*: "Unrelated acts" to the stockholder-approved action are not cleansed under *Corwin. The plaintiffs challenged directors in connection with their approval of a merger that was allegedly necessitated by the directors' having breached their oversight duties over many years—which failure of oversight, according to several investigations, led to systematic, widespread violations of mining safety regulations, culminating in the worst mining disaster in the U.S. in forty years, with the loss of numerous lives and criminal convictions for the CEO and other Massey executives. The court granted the defendants' motion to dismiss the action based on standing issues (discussed below, under "Delaware Update")—but the decision is most notable for the court's discussion relating to *Corwin*. Chancellor Bouchard stated that, notwithstanding stockholder approval of the merger, the alleged breaches by directors of their fiduciary duties with respect to historic director actions that were "unrelated" and "extraneous" to the merger could not be "cleansed" under *Corwin*. According to the court, the director conduct about which the plaintiffs complained occurred well before and was not sufficiently proximately related to the merger. Chancellor Bouchard wrote that *Corwin* "was never intended to serve as a massive eraser, exonerating corporate fiduciaries for any and all of their actions or inactions preceding their decision to undertake a transaction for which stockholder approval is obtained."

* * * *

Delaware Supreme Court, Reversing Chancery Court, Interprets Post-Closing Purchase Price Adjustment "True Up" Narrowly, Based on the Specific Factual Context—Chicago Bridge v. Westinghouse

In *Chicago Bridge & Iron Company N.V. v. Westinghouse Electric Company LLC* (June 28, 2017), the Delaware Supreme Court interpreted a purchase agreement net working capital "true up" as a "narrow, subordinate, and cabined remedy." The buyer contended that the seller's post-closing net working capital calculations were flawed because the seller's historical accounting practices in preparing the target company's financial statements were not compliant with GAAP. The seller argued that, under the purchase agreement, the buyer's only remedy for breaches of representations and warranties had been a refusal to close (which the buyer had foregone)—and that, therefore, the buyer could not properly request that the dispute resolving auditor make a determination with respect to claims about GAAP compliance of the financial statements. The Supreme Court ordered that the Court of Chancery "enjoin [the buyer] from submitting to the [auditor] or continuing to pursue" the claims that were based on the historical accounting issues. The only claims that could be submitted and pursued, the Supreme Court held, were those "based on changes in facts and circumstances between the signing and closing."

As a result of the decision, the buyer's $2 billion claim with respect to the post-closing purchase price adjustment was reduced to less than $70 million. The Supreme Court emphasized that the decision was grounded in the *specific factual context* of the case. The first sentence of Chief Justice Strine's opinion reads: "In giving sensible life to a real-world contract, courts must read the specific provisions of the contract in light of the entire contract."

Key Points

- **The decision confirms that a provision requiring a "true up" at closing of net working capital for purposes of determining a purchase price adjustment will generally be considered to be a narrow remedy, relevant only to changes occurring between signing and closing—**and cannot be used as an end-run around purchase agreement provisions that limit liability for breaches of representations and warranties.

- **The decision underscores, however, that the specific language of a true up provision, the other provisions of the purchase agreement, and the overall context of the deal, will influence the court's interpretation of the breadth of the claims that can be made under the true up.**

Background. CB&I Stone & Webster, Inc. (the "Company"), a subsidiary of Chicago Bridge & Iron Co. (the "Seller"), had been building nuclear power plants, in partnership with Westinghouse Electric Company (the "Buyer"). As delays and cost overruns mounted, the relationship became "contentious." To resolve their differences, the Seller agreed to sell the Company to the Buyer, with the Buyer paying zero dollars as a purchase price but assuming all of the liabilities of the Company. (Cost overruns at these projects, in the billions of dollars, ultimately forced the Buyer into bankruptcy in March 2017—also threatening the financial viability of the Buyer's parent, Toshiba Corp.)

The Purchase Agreement provided as follows:

- **True Up.** The purchase price of zero was based on a target net working capital amount of $1.174 billion. The Agreement provided for a "True Up" at closing, and a post-closing purchase price adjustment to the extent that actual net working capital at closing varied from the target amount. The Seller was required to continue to run the Company in the ordinary course of business until closing.

- **Liability Bar.** The Agreement provided that the Buyer's sole remedy if the Seller breached its representations and warranties was to refuse to close; that the Seller would have no liability for monetary damages post-closing (the "Liability Bar"); and that the Buyer would indemnify the Seller for all post-closing claims or demands against, or liabilities of, the Company.

- **Dispute Resolution.** Any dispute over the post-closing purchase price adjustment was to be submitted to an independent auditor (the "Auditor")—who was to act "as an expert, and not as an arbitrator"; to issue a decision, in the form of a "brief written statement," within 30 days; and to rely on the parties' written submissions as the sole basis for its decisions.

The Court of Chancery ruled in favor of the Buyer, reasoning that the mandatory dispute resolution provision in the Purchase Agreement meant that all disputed issues relating to the post-closing adjustment were to be submitted to the Auditor. The Supreme Court reversed, finding that the lower court decision—which would have permitted a "wide-ranging" challenge to the Company's historical financial statements—was inconsistent with (i) the Liability Bar provision of the Purchase Agreement; (ii) the structure of the True Up, which reflected that it was a "narrow," "confined" remedy that related to the period between signing and closing; and (iii) the general tenor of the deal and other terms of the Purchase Agreement, which indicated an intention to provide a "clean break" for the Seller.

Discussion

The Supreme Court viewed the True Up as a narrow remedy that could not be used as, in effect, an end run around the Liability Bar. In the Supreme Court's view, the Buyer's claims were, "in essence, claims that [the Seller] breached the Purchase Agreement's representations and warranties…." The claims "therefore are foreclosed by the Liability Bar," the Supreme Court held. The Court of Chancery decision, the Supreme Court wrote, by "reading the True Up as unlimited in scope and as allowing [the Buyer] to challenge the historical accounting practices used in the represented financials, … rendered meaningless the Purchase Agreement's Liability Bar." The Buyer's sole remedy if the financial statements were not GAAP-compliant was to refuse to close, the Supreme Court stated—which the Buyer had chosen not to do.

The Supreme Court confirmed that the main role of a true up, as a general matter, is to account for changes in the target company's business between signing and closing. The Supreme Court rejected the Court of Chancery's interpretation of the True Up as "providing [the Buyer] with a wide-ranging, uncabined right to challenge any accounting principle used by [the Seller]." Rather, the Supreme Court wrote, the True Up, "[w]hen viewed in proper context, … is an important, but narrow, subordinate, and cabined remedy available to address any developments affecting Stone's working capital that occurred in the period between signing and closing." The Supreme Court reviewed that generally the purpose of a true up is to "maintain the underlying economics of the parties' bargain"—in this case, to ensure that the Seller would continue to operate the Company "as though it were still its own business, but without worrying that pursuing normal construction operations would benefit [the Buyer] to [the Seller's] own detriment"; to protect the Buyer against the Seller or the Company "suddenly shift[ing] course in how it chose to treat [the Company] from an accounting perspective"; and to protect the Buyer against "end[ing] up worse off than it was at signing" if "[the Seller] didn't follow through with the construction program or if the Buyer and the utilities paid a bunch of their bills…."

The Supreme Court viewed the language of the True Up as supporting the view that it could not be used to challenged past accounting practices. The Supreme Court noted that the True Up "emphasizes that net working capital should be determined in a manner consistent with GAAP, consistently applied by the seller in preparation of the company's financial statements." Other pertinent language in the agreement also requires consistency with past practices and with "the basic idea that the True Up is used to set a Final Purchase Price based on developments after the initial price of zero was set." Thus, the Court concluded, "the True Up was tailored to address issues that might come up if [the Seller] tried to change accounting practices midway through the transaction or if it stopped work on the projects, rather than continue to invest as expected [and as required by

the covenant to run the business in the ordinary course until closing]." The parties expectation, according to the Court, was that, "at closing, [the Buyer] would get [the Company] and [almost certainly would] have to make a payment to [the Seller], [under the True Up,] to account, for example, for the expectation that [the Seller] would make substantial capital expenditures before closing so [the Company]'s construction projects could continue."

The Supreme Court viewed the limited role of the Auditor as confirming the narrow role of the True Up. Moreover, the Court noted, the structure of the dispute settlement provision confirmed that the True Up was to have a "subordinate and confined purpose." The settlement procedure required a brief written statement by the Auditor, issued within the "expedited timeframe" of 30 days, with reliance only on the parties' written submissions. The Court stated:

> [T]he reason parties can hazard having an expert decide disputes in this blinkered, rapid manner is because when considering claims under the True Up, the expert is addressing a confined period of time between signing and closing using the same accounting principles that were the subject of due diligence and contractual representations and warranties, and thus formed the foundation for the parties' agreement to sign up and close the transaction.

The Supreme Court viewed the overall context of the deal as supporting its interpretation of the True Up as a narrow remedy. "The basic business relationship between parties must be understood to give sensible life to any contract," the Chief Justice wrote. The zero purchase price, assumption of all liabilities by the Buyer, Liability Bar, and other provisions of the Purchase Agreement, and the genesis of the deal as a resolution of the various differences between the parties in running the construction projects, indicated an intent to provide the Seller with a "clean break," the Supreme Court wrote. The "essence of the deal" was that "[the Seller] would deliver [the Company] to [the Buyer] for zero dollars up front consideration and, in return, would be released from any further liabilities connected with the projects." Not only would the Buyer indemnify the Seller against future liabilities, the Court wrote, but closing was contingent on the Seller receiving releases from the utility company that would operate the plants when they were completed. The Court concluded: "The key provisions of the Purchase Agreement show and the business context they highlight demonstrates, [the Buyer]'s view that the Purchase Agreement gave it a free license to re-trade the core common basis of the exchange is beyond strained; it involves a rewriting of the contract embodying that exchange." Moreover, the Court noted, the accounting practices about which the Buyer complained were known to the Buyer prior to its entering into the Purchase Agreement and were reflected in the very financial statements on which the Buyer relied when deciding to enter into the deal.

Justice Strine characterized "the sum total of [the Buyer's] logic" to be as follows:

> Based on challenges to large items included in the [Seller's] financials that [the Seller] represented were GAAP compliant, which [the Buyer] knew about before closing, and which [the Buyer] did not use as a basis not to close, [the Buyer] now says that it should keep [the Company], which it got for zero dollars, and be paid by [the Seller] over $2 billion for taking it!

Practice Points

- It should be kept in mind that a court's interpretation of a contract provision will be influenced not only by the language of the provision and the contract as a whole, but also the overall history and context of the deal. Clarity in drafting is key, as unambiguous language will be applied as written.

- Although most of the issues in *Chicago Bridge* arose because of the Liability Bar in the purchase agreement, the decision is a reminder of the need to draft a true up with clarity and precision. Based on *Chicago Bridge,* parties should consider stating whether a closing true up is intended to cover only changes occurring in the business between signing and closing (and, if so, which changes). Attaching hypothetical examples can be helpful.

- Parties should be mindful that the timeframe and other parameters set forth for a settlement process may influence the court's view of the breadth of a settlement dispute provision purporting to cover "all" disputes. Parties should consider stating wheather the structure of the settlement process is or is not reflective of the parties' intent with respect to the substantive breadth of the true up.

* * * *

Delaware Update

Court held claims asserted against directors before the company was acquired by a third party were extinguished in the acquisition—*Massey Energy Co. Litigation* (May 4, 2017)**.**

The former stockholder-plaintiffs asserted "Caremark-type" claims that the Massey Energy directors had failed to exert proper oversight over the company's operations, resulting in a mining explosion that claimed numerous lives, which then led to the company's sale. The court found, consistent with long-established law, that these "otherwise valid" Caremark-type claims of breach of the directors' oversight duty, made before Massey merged with a third party acquiror, "passed" to the acquiror in the merger. The plaintiffs therefore could no longer satisfy the requirement that they had "continuously owned" the claims and, thus, they could no longer bring them. The court rejected the plaintiffs' contentions that they qualified for an exception to the continuous ownership rule based on the merger having been effected (a) for the purpose of depriving stockholders of standing to bring a derivative action or (b) as a mere reorganization which did not affect the plaintiffs' ownership interest in the business. The court also rejected the plaintiffs' argument that they could bring "inseparable fraud" claims.

Court held stockholder approval of director compensation with specific sub-limits resulted in business judgment review—*In re Investors Bancorp, Inc. Stockholder Litigation* (April 5, 2017).

The Court of Chancery dismissed the plaintiffs' claims challenging large equity incentive awards to the company's non-employee directors. Due to directors' self-interest in director compensation awards, if such awards are challenged, they are generally subject to the stringent entire fairness standard of judicial review; however, if such awards are ratified by stockholders in an informed, disinterested vote, then business judgment review should apply. In the 2015 *Calma v. Templeton* decision, the court held that stockholder ratification of an equity incentive plan with only "generic limits" would not constitute ratification sufficient to invoke business judgment review of the challenged grants by directors to themselves under the plan. By contrast, in *Investors Bancorp*, the stockholders' approval of the equity incentive plan was sufficient to invoke business judgment review because the plan included meaningful, specific sub-limits for non-employee directors. The court upheld the awards, finding that, although they were large in relation to the company's peer group, they were within the plans specified sub-limits and the plaintiffs had not established that they were so exorbitant as to constitute waste.

Court held that bylaws requiring supermajority stockholder approval to remove directors (of non-classified boards) are invalid—*Frechter v. Zier* (Jan. 24, 2017, Transcript).

The Court of Chancery held that DGCL Section 141(k) "unambiguously" confers a right of a majority of the outstanding shares to remove directors and that any provision to the contrary in a company's bylaws is unlawful. Vice Chancellor Glasscock noted that a supermajority vote requirement to remove directors *is* valid if included in a *certificate of incorporation* (as DGCL Section 102(b)(4) permits such a requirement in a charter). The court noted the 2015 *Vaalco* decision, where the court invalidated provisions of Vaalco's charter and bylaws that provided that directors could be removed only for cause because, under Section 141(k), it is only when there is a classified board (which Vaalco's was not) that a charter may provide for removal of directors only for cause.

Court enjoined stockholder meeting due to required additional disclosure relating to banker's fees—*Vento v. Currey* (March 22, 2017).

The Court of Chancery enjoined for five days the company's stockholder meeting on a proposed acquisition and required that the acquiring company make additional disclosure relating to fees payable to its financial advisor for participating in the acquisition financing. The acquiror had disclosed in its registration statement the *advisory fees* that were payable to the banker and had disclosed that "additional fees" would be payable relating to the banker's participation in the acquisition financing. The court found that additional disclosure was required relating to the "additional fees." Given that the court recently, as a general matter, has not exhibited a strict attitude toward disclosure of details relating to banker fees, it should be kept in mind that some detail may be required when the banker is receiving "additional fees" separate from the primary fees described.

Delaware State Bar approved a proposed amendment to the DGCL relating to the dating of stockholder written consents.

Among the proposed amendments to the Delaware General Corporation Law—that, in March 2017, were approved and recommended by the Corporate Council of the Corporation Law Section of the Delaware State Bar Association and introduced to the Delaware General Assembly—is an amendment to DGCL Section 228 (which permits action to be taken by stockholders by written consent in lieu of a meeting). The amendment is intended to remove any uncertainty as to whether a written stockholder consent must bear the date of signature of the stockholder executing the consent to be effective. Section 228(c) currently provides that a written consent will not be effective to take corporate action unless delivered "within 60 days of the earliest *dated* consent" (emphasis added) to take such action. Based on this provision, a number of Delaware judicial decisions have called into question the validity of consents that were not individually dated by the stockholders when executed. Under the proposed amendment, Section 228(c) will continue to provide a 60-day period for the delivery of consents representing a sufficient number of shares for action to be taken, but will provide that the 60-day period is measured based on the first date that a consent is *delivered* to the corporation. The amendment, if enacted, will be effective for written consents as to which the record date for determining which stockholders are entitled to vote is on or after August 1, 2017.

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Fried Frank Briefings This Quarter

Please click on a title below to see the full Fried Frank Briefing.

Appraisal Decision Relies Solely on Merger Price Where Sales Process Was Reliable and Projections for DCF Analysis Were Not—And Suggests Likelihood of Even Broader Reliance on Merger Price Going Forward—*PetSmart*

- The decision reaffirms the Delaware Court of Chancery's recent trend of increased reliance on the merger price to determine appraised "fair value" when the sales process involved "meaningful competition" and the target company projections available for a DCF analysis were unreliable. (In the appraisal decision issued the day after *PetSmart*—*SWS*, discussed below—the court did *not* rely on the merger price—but *SWS* was based on "unique facts," including that the buyer had a veto right over competing bids.)
- Moreover, in our view, the court's discussion in the opinion suggests that the court may be more likely than in the past to rely on the merger price where there has been a sales process involving "meaningful competition," *even if* the company projections available for a DCF analysis were reliable.
- The sales process undertaken by PetSmart (which is detailed in our Briefing) provides a roadmap for a sales process that maximizes the likelihood of judicial reliance on the merger price to determine appraised "fair value."
- Notably, the court relied on the merger price notwithstanding that (i) only financial sponsors submitted bids for the target company (as strategic buyers were solicited for bids); (ii) the most likely strategic bidder—the company's main competitor—was not contacted (as the board had a reasoned basis for not having done so); and (iii) the target company experienced improved post-signing financial performance—to the point that it declared an $800 million dividend at year-end after the closing, representing a 38% return on equity invested.
- Also of note is that the court expressly rejected the contention (which was made by the petitioners in the case and had been suggested by the court itself in prior recent decisions) that a financial buyer's price, which is based on an "LBO pricing model," cannot reflect "fair value" for appraisal purposes.

Are Below-the-Merger-Price Appraisal Results Likely to Become More Common?—The Critical Misconception Relating to the *SWS* Decision

- In this decision—for only the third time (based on our study of appraisal decisions since 2010)—the Court of Chancery determined appraised "fair value" to be *below* the merger price (7.8% below the value of the merger consideration at closing, which was about 19% below the value of the merger consideration at the time the merger agreement was announced and the hedge-fund petitioners decided to acquire shares). In the two other cases (*Gearrald v. JustCare* (2012) and *Longpath v. Ramtron* (2015)), there were unusual facts and, in one of them (*Ramtron*), the fair value determination was only nominally below the merger price.

- A number of commentators have suggested, based on *SWS*, that below-the-merger-price appraisal results will now become more common. Their conclusion follows from what we believe to be a *misconception* that, in *SWS*, in determining fair value, the court "excluded" the value of merger synergies based on the statutory requirement that "value arising from the merger itself" must be excluded. That conclusion, in our view, (i) may overstate the significance of the court's brief statement that the below-the-merger-price DCF result was "not surprising" given that there were significant expected synergies, and (ii) conflates (a) the effect of the statutory requirement to exclude value arising from the merger itself when the court relies on the merger price to determine fair value with (b) its effect when (as in *SWS*) the court relies on a DCF analysis. We believe that *SWS* does *not* reflect a new judicial approach to the treatment of merger synergies in determining fair value—whether the court relies on the merger price (where the court could, but has almost invariably not, made adjustments based on the statutory requirement to exclude value arising from the merger itself) *or* a DCF analysis (where, based on the methodology itself, merger synergies are always excluded).

- We note that below-the-merger-price appraisal results *conceivably may become more common*, as: (i) the court just reached this result in *SWS*; (ii) the Delaware courts have transformed the law in several other areas to reduce M&A-related litigation and the volume of appraisal litigation has been increasing; (iii) there are readily available tools for reaching a below-the-merger-price result—such a, when the merger price is relied on, the statutory requirement to exclude any value arising from the merger itself; and, when a DCF analysis is relied on, the fact that the DCF methodology is susceptible of highly variable results; (iv) a DCF analysis can serve as confirmation of a below-the-merger-price result because the methodology excludes the value of merger synergies; and (v) Vice Chancellor Laster, in a recent decision (*Lender Processing*), appeared to encourage respondent companies to establish an appropriate record to support, and then to argue for, a downward adjustment to the merger price to exclude the value of merger synergies (albeit without offering guidance as to which type of "merger synergies" would be properly excludable or what type of record would overcome the court's previous reluctance to make such adjustments).

- We note that, on the other hand, the following factors *militate against below-the-merger-price results becoming more common*: (i) the court did not appear to intend in *SWS* to announce a major shift in its treatment of merger synergies in appraisal cases; (ii) contrary to much of the commentary on *SWS*, the court did *not* act affirmatively to exclude the value of merger synergies, resulting in fair value below the merger price (but simply pointed out that a below-the- merger-price DCF result could be explained by the fact that that methodology excludes the value of merger synergies); (iii) the court has reached a below-the-merger-price result only twice before (in the context of unusual facts and, the adjustment in one of these cases was only nominal)—notwithstanding that there are significant merger synergies expected in many deals; and (iv) finally, and most critically, a move toward below-the-merger-

price results would be inconsistent with the court's strong recent emphasis on the merger price as the best proxy for fair value when there has been a robust sales process (even though that approach does not appear to fulfill the statutory mandate that value arising from the merger itself be excluded).

- Final resolution of this issue will depend on the intervention of the Delaware Supreme Court, which has not recently spoken on appraisal issues (but, as noted, is currently considering the appeals of two appraisal cases).

Potential Liability for PE Firms and Directors When Preferred Stock Held by a Controller-Sponsor Is Redeemed by a Non-Independent Board—*Hsu v. ODN* and Practice Points

- This is the second decision by the Court of Chancery in recent years that highlights the potential liability for the directors of a portfolio company, and the private equity sponsor-controller, when the company redeems preferred stock held by the sponsor. At the pleading stage, the court declined to dismiss the plaintiff's claims of breach of fiduciary duty by the directors, and aiding and abetting by the sponsor, in connection with the company's redemptions. Rather than effecting a "de facto liquidation" of the company at "seemingly fire-sale prices" and "stockpiling cash," the court wrote, the board "could have grown [the company's] business, gradually redeemed all of the preferred stock, and then generated returns for its common stockholders." The court also held that the directors, who, according to the court, were conflicted and were involved in the various steps underlying the redemptions, were not shielded from liability by having abstained from voting on the redemptions.

- In our view, the key distinguishing features in *Hsu* that underlay the court's decision were that the court deemed the preferred stockholder to be a controller; the court viewed the board as meaningfully influenced by the controller and not independent and disinterested; and, critically, the board apparently neither engaged in an adequate process to consider the interests of the common stockholders nor established a contemporaneous record indicating the bases for its actions.

- In the Briefing, we offer related practice points, including certain terms that should be included in preferred stock to mitigate the risk of breach of fiduciary duties when the preferred stock is redeemed. We also discuss the possibility of alternative investment structures that potentially could limit or eliminate fiduciary duties to the non-sponsor investors.

Court of Chancery Notes Uncertainty Whether *Unocal* Heightened Scrutiny Applies in *Corwin* Stockholder-Approved Transactions—*Paramount Gold & Silver*

- The court rejected the plaintiff-shareholders' primary claim that a royalty fee and termination fee should be considered, in combination, as an unreasonable deal protection device.

- The decision is most notable for the court's noting that there is an open issue as to whether, in a post-closing action, *Corwin* would "cleanse" a defensive action that might be found to be unreasonable under the *Unocal* standard of review—that is, whether a post-closing challenge to deal protection devices under *Unocal* would or would not survive if *Corwin* were applicable.

- The decision also highlights that, in post-closing non-controller actions, even when *Corwin* is not applicable (for example, if the transaction was not approved by stockholders in a fully informed, uncoerced vote or if *Corwin* does not apply when *Unocal* does), business judgment review generally will be applicable in any event—under *Cornerstone*—unless the plaintiff meets the high bar for pleading a valid claim of breach of the duty of loyalty or bad faith.

Unusual Facts Preclude "Cleansing" of Stockholder-Approved Merger, But the Power of *Corwin* Continues—*Saba Software*

- See the discussion above under *Clarification of Unavailability of Corwin Cleansing*.
- In the Briefing, we analyze the decision (including the court's dismissal of certain claims relating to the target company's financial advisor and to a cash-out of directors' equity awards) and offer related practice points.

Delaware Supreme Court Applies "Entire Fairness" to An MLP Conflict Transaction and A Lower Bar to "Bad Faith" Claims—But Decision Is Likely to Have Limited Impact—*Brinckerhoff v. Enbridge Energy*

- An MLP investor challenged a $1.2 billion transaction between the MLP and its parent corporation involving the repurchase by the MLP of an asset it had previously sold to the parent–with the repurchase at a significantly higher price despite strong indications that the value of the asset had declined, and without the general partner or its banker having considered the earlier sale as a comparable transaction.
- The Supreme Court applied a standard to the general partner's approval of the transaction that the Court characterized as "equivalent to entire fairness." Importantly, however, this ruling was based on the Court's interpretation of the particular, atypical language in the Enbridge limited partnership agreement.
- The Supreme Court also "changed course" from previous holdings in connection with the pleading standard for bad faith by a general partner (in the context of the availability of exculpation); raised questions about whether an LPA's conclusive presumption of good faith based on reliance on a fairness opinion could be undermined due to the timing of and substantive weaknesses in the opinion; stated that equitable remedies (such as reformation or rescission of the challenged transaction) could be available to redress general partner breaches made while acting in good faith; and made other important holdings.
- Importantly, however, as all of these flowed from the Court's imposition of an entire fairness-like standard and/or from the Court's finding, based on that standard, that a valid claim of breach by the general partner had been made, in our view, *the rulings are not likely to impact MLPs that operate under more typical LPAs* (where such a standard would not be imposed and it would be much more difficult for a plaintiff to state a valid claim of breach).
- Nonetheless, the decision underscores the importance of the particular language of the LPA at issue to the judicial result in MLP cases generally. Based on *Brinckerhoff*, MLPs operating under older-form LPAs without a state-of-the-art "safe harbor" for conflict transactions may want to consider amending the LPA to add a safe harbor, if possible. If it is not possible to add a safe harbor, then the existing provisions should be reviewed and a transaction structured to comply with the standards set forth in the agreement.
- Furthermore, the case highlights that disputes over MLP conflicted transactions have became more common, and there are circumstances under which a general partner can have liability. Indeed, after *Enbridge*, in *Morris v. Spectra Energy* (June 27, 2017), relating to the $3 billion joint venture between Spectra Energy Corp. and Phillips 66 Co. in DCP Midstream LLC, Vice Chancellor Glasscock ruled that an allegation that the $1 billion purchase price paid by the MLP's general partner undervalued assets acquired from the MLP by $500 million conceivably supported an inference of "subjective bad faith" by the general partner—notwithstanding that the general partner had availed itself of a safe harbor that the court acknowledged provided "(at least) a rebuttable presumption of good faith." Importantly, however, the general partner, at the time it relied on a banker's fairness opinion in accordance with the safe harbor, had already entered into an agreement with a third party to sell the assets, at a price substantially greater than the price being paid to the MLP. Thus, as in other cases in recent years, the court ruled against the general partner based on evidence that it likely did not in fact have the subjective belief upon which the safe harbor was premised.

Delaware Appraisal Decisions - 2010-June 2017

Date	Case	Appraisal amount is Higher/Equal/ Lower than merger price – If higher, premium over merger price	Estimated additional premium over merger price represented by statutory interest	Number of years from merger closing to appraisal decision	Sales process included market check with competitive bidding	Valuation methodology solely or primarily used by court
NON-AFFILIATED TRANSACTIONS						
5/30/17	In re SWS Group	Lower (-7.8%)	11.7%	2.4	Yes – but buyer (a substantial creditor) had veto right over competing bids	DCF
5/26/17	In re PetSmart	Equal	11.6%	2.2	Yes	Merger Price
12/16/16	Merion v. Lender Processing	Equal	10.4%	2.9	Yes	Merger Price
9/14/16 7/8/16	In re DFC Global	Higher 8.4%	12.5%	2.2	Yes – but court found unusual, extreme business uncertainty (due to industry-wide regulatory overhaul) undermined sale process	Merger price/DCF/ Comparables (1/3 each)
10/21/15 1/5/15	Merion v. BMC Software	Equal	11%	2.1	Yes	Merger price
6/30/15	Longpath v. Randron	Equal	13.7%	2.6	Yes	Merger price (minus 0.01% adjustment for synergies)
4/26/15	Merlin v. AutoInfo	Equal	10.5%	2.0	Yes	Merger price
1/30/15	In re Ancestry	Equal	11%	2.1	Yes	Merger price
11/1/13 5/19/14 2/12/15	Huff v. CKx	Equal	12.7%	2.3	*	Merger price
7/8/13	Merion v. 3M Cogent	Higher 8.5%	14.3%	2.6	*	DCF
3/18/13	IQ v. Am. Commcl. Lines	Higher 15.6%	13.7%	2.3	*	DCF
4/30/12	Gearrald v. Just Care	Lower (-14.4%)	11.7%	2.6	*	DCF

Date	Case	Appraisal amount is Higher/Equal/ Lower than merger price – If higher, premium over merger price	Estimated additional premium over merger price represented by statutory interest	Number of years from merger closing to appraisal decision	Sales process included market check with competitive bidding	Valuation methodology solely or primarily used by court
AFFILIATED TRANSACTIONS**						
11/10/16	Dunmire v. F&M Bancorp	Higher 10.7%	12.2%	2.1	No	DCF
8/11/16	In re ISN Software	Higher 258%	70.1%	3.6	No	DCF
5/31/16	In re Dell	Higher 26%	17.4%	2.6	Yes – but major shareholder (founder-CEO) had developed and was critical to company's turnaround plan, and was a net acquirer of shares; also, go-shop utility was limited by size and complexity of company; plus other aggravating factors also undermined sales process	DCF
6/17/15	Owen v. Cannon	Higher 60%	17.6%	2.1	No	DCF
6/25/14 5/12/14	Laidler v. Hesco	Higher 86.6%	24.7%	2.5	No	DCCF
6/28/13	Towerview v. Cox	Higher 19.8%	26.9%	3.9	Weak process	DCF
7/18/12	In re Orchard Entp.	Higher 127.8%	36.1%	2.0	***	DCF
4/23/10	Global v. Golden Telecom	Higher 19.5%	14.7%	2.2	Weak process	DCF
2/15/10	In re Sunbelt	Higher 148.8%	213.8%	12.4	No	DCF

* In these cases, the court did not address the strength of the sale process. We note that in each case the court conducted a DCF analysis that yielded an appraisal result that was within 10-15% of the merger price.

** Transactions in which a controller or majority stockholder stands on both sides of the transaction or similar transactions – such as a controller take-private, majority stockholder squeeze-out of minority stockholders, or management buyout.

*** This case is not relevant, as the amount of the appraisal award depended almost entirely on the court's holding that the liquidation preference on the company's preferred stock was not triggered by the merger.

Fried Frank M&A/PE *Round-Up*

Fried Frank's M&A practice advises clients on some of the largest and most complex US and global deals, providing counsel to a full spectrum of companies on sophisticated transactions that are often multi-jurisdictional and, in some cases, transformational. With over eighty attorneys in four offices, our team has deep experience advising public and private companies, special committees, audit committees, and boards of directors in complex negotiated and contested situations, including negotiated mergers, hostile takeovers and takeover defense, proxy contests, financial adviser representations, and restructuring transactions.

Highlights of our 2017 second quarter work include representations of:

Knight Transportation, Inc.

Counsel to Knight Transportation, Inc. in a definitive agreement under which Knight Transportation, Inc. will merge with Swift Transportation Company in an all – stock transaction valued at US$6b.

Sinclair Broadcast Group

Counsel to Sinclair Broadcast Group in its definitive agreement to acquire Tribune Media Company for an aggregate price of US$3.9b, plus the assumption of US$3.0b in net debt.

Coach, Inc.

Counsel to Coach, Inc. in its definitive agreement to acquire Kate Spade & Company for US$2.4b.

Yellow Wood Partners

Counsel to Yellow Wood Partners in the US$1.4b sale of its portfolio company PDC Brands to CVC Capital Partners.

Goldman Sachs

Counsel to Goldman Sachs, as part of an investor consortium, in its investment in Outcome Health.

AEA Investors

Counsel to AEA Investors in its recapitalization of National Carwash Solutions.

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Fried Frank M&A/PE Quarterlies for 2016 / 2017

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