Cooley

Keeping Up With M&A Case Law – Spotlight on Recent Delaware Decisions

July 21, 2023

The mergers & acquisitions market may wax and wane, but one thing in M&A is consistent from year to year: The Delaware courts issue opinions that impact M&A dealmaking. And this year is certainly no exception – Delaware courts continue to have plenty to say about M&A. While certainly not exhaustive (we were serious – the courts have been busy!), in this post we have summarized key takeaways from recent cases.

No *Corwin* for post-closing claims for injunctive relief

In *In re Edgio, Inc. Stockholders Litigation*(Del. Ch.; 5/23), the Delaware Court of Chancery issued a ruling regarding an unsettled question of Delaware corporate law – whether an uncoerced and fully informed vote of disinterested stockholders may ratify and defeat a post-closing claim seeking to enjoin certain governance measures and alleged entrenchment devices for the combined company negotiated as part of a transaction. The short answer: no. The longer answer: The court concluded that such a vote, often called "*Corwin* cleansing," does not apply to post-closing claims for injunctive relief.

The facts

Following a period of poor performance and speculation of activist interest, Limelight Network entered into a stock-for-stock combination with the owners of Edgecast to create Edgio. Limelight issued stock amounting to a 35% ownership stake of Edgio to College Parent (Edgecast's parent). In connection with the stock issuance, Limelight and College Parent entered into a stockholders' agreement obligating College Parent to:

a. Follow the Edgio board's recommendations regarding director nominations.
b. Vote in favor of the Edgio board's recommendations (or pro rata with all other stockholders) for nonroutine matters.
c. Refrain for two years from transferring newly acquired shares, except in limited circumstances, including Edgio board approval or in connection with a board-approved business combination.
d. Refrain for an additional year from transferring shares to a competitor or any known activist investor on the SharkWatch 50 list.

In exchange, College Parent was permitted to fill three of nine Edgio board seats. The stockholders' agreement was included in all disclosures in the registration statement and proxy statement, and Limelight's fully informed and disinterested stockholders voted overwhelmingly in favor of the share issuance in the combination. Following closing, the plaintiffs sought to enjoin the enforcement of the stockholders' agreement, asserting that the terms of the agreement established a 35% voting bloc designed to entrench – and to deter or defeat any activists' threats to – the existing board.

The ruling

The court held that the plaintiffs' allegations warranted a reasonably conceivable inference that the challenged terms of the stockholders' agreement were adopted as defensive measures against a perceived threat of investor activism, and that enhanced scrutiny under *Unocal* applied. Despite the thin allegations on the topic by plaintiffs (given the lack of board minutes and similar materials), the court found that the facts and circumstances surrounding the combination – and the defensive effect of the provisions of the stockholders' agreement –support this conclusion.

Further (and more "groundbreaking"), the court ruled that *Corwin* cleansing does not apply to post-closing claims seeking injunctive relief. The court noted that the express language of *Corwin* suggests its application is limited to post-closing damages claims only, which is further supported by the underlying policy rationale of ensuring that stockholders may make free and informed choices based on the economic merits of a proposed transaction.

Key takeaways

In many ways, this ruling creates more questions than answers. Going forward, parties should assume that stock-for-stock transactions that include post-closing covenants may be subject to more litigation risks: *Corwin* cleansing will not apply to requests to enjoin the enforcement of post-closing agreements, and *Unocal*'s enhanced scrutiny standard may apply to the judicial review of certain post-closing governance provisions, even if such governance provisions were included in the transaction that was approved by fully informed, uncoerced and disinterested stockholders.

Clarity on 'substantially all assets test' for stockholder approval

What makes a sale considered a sale of "substantially all assets" such that stockholder approval is required under Section 271 of the Delaware General Corporation Law? In the leading Delaware case on this issue from 1974, *Gimbel v. Signal Companies*, the Chancery Court said that the answer depended on "whether the sale of assets is quantitatively vital to the operation of the corporation and is out of the ordinary and substantially affects the existence and purpose of the corporation." This case-by-case standard has caused years of ambiguity – and corresponding reasoned legal opinions! Fortunately, a recent order from Chancellor Kathaleen Saint Jude McCormick in *Altieri v. Alexy* (Del. Ch.; 5/23) provides a helpful summary of the legal test. Perhaps the most useful part of the opinion is the chancellor's recitation of a number of Delaware cases in the "substantially all" space and notation of the distinguishing factors and key considerations.

The facts

The case involved a challenge to cybersecurity firm Mandiant's sale of its FireEye line of business. The plaintiff contended that the transaction involved substantially all of Mandiant's assets. From a quantitative perspective, the plaintiff's claim appeared to be fairly strong. In 2019 and 2020, the FireEye business accounted for 62% and 57%, respectively, of the company's overall revenue. In the sale, Mandiant retained its threat intelligence and cybersecurity software and services solutions business.

The ruling

Chancellor McCormick noted that when evaluating quantitative metrics, no one factor is necessarily dispositive. Instead, the deal "must be viewed in terms of its overall effect on the corporation, and there is no necessary quantifying percentage." Applying this standard, she concluded that the FireEye sale did not constitute a sale of substantially all of Mandiant's assets, noting that Mandiant's public filings indicate that it had total balance sheet assets of approximately $3.2 billion as of December 2020, and $3.1 billion as of June 30, 2021 – and that the $1.2 billion sale price represented less than 40% of these assets. The chancellor also concluded that the FireEye assets did not meet the substantially all test from a qualitative perspective because, while the FireEye business was an important aspect of Mandiant, it was not shown to impact the "existence and purpose" of the company, which was and remains a cybersecurity company after the sale.

Key takeaways

The sale of a business line should not be considered a sale of substantially all the assets of a company, unless the sale involves the only substantial income-generating assets of the company and the company's retained business would constitute a stark departure from the company's historic business or a significant shift in overall business strategy. The court directs the seller to consider whether the sale "strikes a blow to the company's heart."

Potential for control not enough to apply entire fairness

A recent opinion by Vice Chancellor Sam Glasscock III in the ongoing litigation resulting from Oracle's 2016 acquisition of NetSuite offers helpful guidance in possible conflicted controller transactions.

The facts

Plaintiffs in *In re Oracle Corp. Derivative Litigation* (Del. Ch; 5/23) alleged that Oracle overpaid for NetSuite because Larry Ellison, founder, director, officer and 28% stockholder of Oracle, owned 47% of NetSuite when Oracle acquired NetSuite, and that Ellison was a conflicted controller. As a reminder on the legal standard, for a minority stockholder to be deemed a controller under Delaware law, they must "exercise such formidable voting and managerial power that, as a practical matter are no differently situated than if had voting majority control." As a result, the minority stockholder can either control the corporation's business and affairs in general or control the corporation for purposes of the transaction.

The ruling

Vice Chancellor Glasscock found that while Ellison had the potential to control Oracle in the transaction, he did not have actual control of Oracle through stock ownership and did not exercise actual control over the process. Ellison withdrew from Oracle's and NetSuite's consideration of the acquisition before the Oracle board's initial consideration of the acquisition, and the Oracle board empowered a special committee that oversaw the process. Despite Ellison's influence at Oracle as the face of the company, the court found no evidence of impact over the directors' decision-making and declined to find that Ellison was a conflicted controller simply because he was a "respected figure with a potential to assert influence over the directors." As a result, the court did not apply the higher entire fairness standard.

Key takeaways

The opinion outlines and praises the process run by Oracle, which could serve as a model for other transactions involving a potential controlling party. It included control by a special committee, recusal by Ellison on both sides and, importantly, obedience by Ellison to the rules of recusal approved by the Oracle special committee. Ellison was prohibited from discussing the transaction with anyone, and both the committee and Oracle employees were only able to participate in the negotiations at the direction of the committee – and after they were informed of Ellison's recusal.

Executive liable for tilting sale process and (along with buyer) failing to provide full disclosure

In *In re Mindbody, Inc., Stockholder Litigation* (Del. Ch.; 3/23), following a trial, Chancellor McCormick found that the former CEO of Mindbody violated his fiduciary duties under *Revlon* by tilting the process for selling Mindbody for personal reasons and failing to disclose in Mindbody's proxy statement the extent of his pre-deal involvement with the buyer, Vista Equity Partners. Vista also was found liable for aiding and abetting the CEO's breach of fiduciary duties because it failed to correct the proxy materials. This case offers lessons for boards and potential private equity buyers in the importance of designing and following fair and open sale processes and preparing fulsome proxy disclosures.

The facts

It's nearly impossible to succinctly summarize the facts of this case, but the key themes recited by the court are that the CEO pursued a sale for reasons that did not align with the stockholders' interests – including that he wanted to sell quickly, find a "good home" for his management team and obtain liquidity for his Mindbody holdings – and that he favored a sale to Vista at the expense of running a process designed to get the highest price for Mindbody. The court found that the CEO had contact with Vista prior to initiating a formal sale process that gave Vista a timing advantage over other potential buyers, and that the CEO continued to provide Vista a bidding advantage throughout the process through back-channel communications, thereby undermining a competitive bidding process. The court also found that the CEO's relationship and contacts with Vista prior to and during the process were not adequately disclosed.

The ruling

First, the court found that enhanced scrutiny under *Revlon* applied to the judicial review of the transaction, because the court found that the failure to adequately disclose the CEO's relationships and contacts with Vista negated *Corwin* cleansing. Applying *Revlon* to the CEO's actions, the court found that the CEO's conduct during the sale process was not reasonable and constituted a breach of his fiduciary duties. Further, the court found that the CEO failed to inform the Mindbody board of his conflicts and took steps to deprive the board of the information needed to employ a reasonable decision-making process. In addition, the court found that the CEO and Vista kept Mindbody's stockholders uninformed of their back-channel communications.

Buyer liable for aiding and abetting breaches of fiduciary duties and disclosure failures

A recent decision by the Delaware Chancery Court in *In re Columbia Pipeline Group, Merger Litigation* (Del. Ch.; 6/23) follows in *Mindbody*'s footsteps by finding a buyer in a merger transaction liable for aiding and abetting breaches of fiduciary duties. Vice Chancellor J. Travis Laster found that the buyer, TC Energy Corp. (TransCanada), was liable because it knowingly participated in breaches of fiduciary duties by executives and the board of the seller, Columbia Pipeline Group, that occurred during the sale process. The court also found TransCanada liable for aiding and abetting Columbia's failure of the duty of candor or disclosure because the proxy statement did not accurately disclose the interactions between the parties – and that some of the interactions violated the standstill agreement in place between the parties.

The facts

Like *Mindbody*, the facts in this case are extensive, so we focus on the important facts for understanding the finding of

TransCanada's liability. The lead of TransCanada's deal team developed a back channel with Columbia's chief financial officer (CFO), who along with Columbia's CEO, ran the deal process for Columbia. TransCanada communicated with Columbia's deal team directly multiple times in violation of the standstill agreed to in the nondisclosure agreement and gained insider insight regarding deal timing, motivations of the management team and preferred sale price.

After TransCanada and Columbia verbally agreed to a deal at $26 per share (90% in cash, 10% in stock), the deal leaked, and TransCanada reneged on the price, lowering its bid to $25.50 per share. It also demanded that Columbia accept the revised offer within three days or it would announce publicly that the negotiations were dead. The standstill prohibited TransCanada from threatening to make the parties' discussions public unless required by law. Finally, the proxy statement did not disclose all the interactions between TransCanada and Columbia or the violations of the standstill.

The ruling

TransCanada was found liable for knowingly participating in Columbia's management and board breaches of fiduciary duty that took place in the sale process. This requires a finding that TransCanada had knowledge that the fiduciary was breaching a duty and that TransCanada culpably participated in the breach. The court found that TransCanada had knowledge of the breaches because of the behavior of Columbia's CEO and CFO during the negotiations – including sharing information freely, not using sources of leverage and ignoring the standstill – and because TransCanada had knowledge that both Columbia's CEO and CFO had personal interests in getting the deal done. TransCanada culpably participated in the breach by exploiting the management team's conflicts of interests, with the decisive moment being when TransCanada reneged on the handshake deal price, lowered its bid and threatened to go public that a deal was off, in violation of the standstill.

The court found that TransCanada only took this step because its team knew that the Columbia CEO and CFO were wedded to the deal. The court emphasized that the totality of the circumstances matter, that TransCanada did not engage in an isolated breach, and that TransCanada would not have been found liable without the final renegotiation of the price. The court awarded $1.00 per share based on the lost value of the deal before it was renegotiated (and because of the increase in TransCanada's stock price between signing and closing, increasing the value of the stock consideration). The court also found that TransCanada knowingly permitted the sell-side fiduciaries to issue a misleading proxy statement that failed to disclose the defective sale process. Under principles of equity, the court awarded $0.50 per share for breaches of the duty of disclosure, which equates to 1.96% of equity value.

Key takeaways

This opinion serves as a cautionary tale for buyers who want to move quickly and exploit relationships with their sell-side counterparts. The key fact in this case that led to the buyer's liability appears to be the threat by the buyer to violate the standstill, accompanied by the reduction in its bid price – all done with knowledge of the motivations of the sell-side negotiation team. Buyers should be respectful of the seller board's process and avoid nonsanctioned communications. Disclosure of all communications in the process (including any back-channel communications between the parties) is equally important to receiving judicial protections, and buyers should take a proactive role in their review of the disclosures to make sure the background section is complete.Keep in mind that theseller's counsel is likely to be unaware of nonsanctioned communications that should be disclosed.

Exclusive forum clause in merger agreement does not convey jurisdiction

In a recent letter ruling in *D. Jackson Milhollan v. Live Ventures, Inc.*, (Del. Ch.; 4/23), Vice Chancellor Paul Fioravanti found that the Delaware Chancery Court did not have jurisdiction to consider the plaintiff's complaint relating to an alleged breach of a merger agreement, despite the forum selection provision of the merger agreement.

The facts

The case arose out of the buyer's alleged failure to make timely payment of the balance of an indemnity holdback to the target's former stockholders. The plaintiff cited the merger agreement's exclusive forum clause as the basis for the Chancery Court's jurisdiction. A plain reading of the clause at issue might lead one to this conclusion: Section 11.12 of the merger agreement provides that any claims, actions and proceedings that arise from or relate to the merger agreement "shall be heard and determined exclusively in the Court of Chancery of Delaware," and that the parties submit to the exclusive jurisdiction of the court.

The ruling

The court held that the forum selection clause of the merger agreement could not confer subject matter jurisdiction onto a court. The Chancery Court has subject matter jurisdiction over cases involving equitable rights or requesting an equitable remedy when there is no adequate remedy at law. Because this case asserts a breach of contract and claims money damages, the court held that it did not have subject matter jurisdiction.

Key takeaways

This case serves as a reminder that parties cannot convey subject matter jurisdiction onto a court, and that parties must closely review the forum selection provisions of transaction agreements to confirm they comply with jurisdiction standards.

Contributors

Barbara Borden
Bio

Brian French
Bio

Sarah Lightdale
Bio
