KEY DECISIONS OF 2015 IN DELAWARE CORPORATE LAW

Kathaleen S. McCormick and Daniel M. Kirshenbaum*

I. DEAL LITIGATION

A. *Corwin V. KKR Financial Holdings LLC*: The Effect Of An Uncoerced And Fully Informed Disinterested Stockholder Vote On The Standard Of Review In A Merger Without A Controlling Stockholder

In *Corwin v. KKR Financial Holdings LLC*,[1] the Delaware Supreme Court held that the business judgment rule is the appropriate standard of review in post-closing damages suits involving mergers that are not subject to the entire fairness standard, and which have been approved by a fully informed, uncoerced majority of the disinterested stockholders.

KKR involved the acquisition of KKR Financial Holdings LLC ("Holdings") by KKR & Co. L.P.'s ("KKR") in a stock-for-stock merger.[2] The stockholder plaintiffs filed suit challenging the merger, alleging, among other things, that KKR was a controlling stockholder of Holdings and that it breached its duty of loyalty to other stockholders by causing Holdings to enter into the merger agreement.[3] Although KKR owned less than 1% of Holdings' shares, the plaintiffs argued that KKR actually controlled Holdings' corporate conduct through a management agreement between Holdings and an affiliate of KKR, KKR Financial Advisors LLC ("Advisors") and, as such, the entire fairness standard of review should apply.[4]

The Court of Chancery dismissed the complaint, holding that a minority stockholder will not be considered a controlling stockholder "unless it exercises such formidable voting and managerial power that it, as a practical matter, is no differently situated than if it had majority voting control."[5] The Court of Chancery concluded that although the management agreement demonstrated that KKR controlled the day-to-day operations of Holdings, the complaint did not contain facts sufficient to support a reasonable inference that KKR controlled the Holdings board and was able to prevent the Holdings board from exercising its independent judgment when deciding whether or not to approve the merger agreement.[6]

---

* Ms. McCormick is a partner in Mr. Kirshenbaum is associated with the Corporate Counseling and Litigation Section of Young Conaway Stargatt & Taylor, LLP. The authors express their gratitude to members of their firm who assisted with this article, including Emily V. Burton, James M. Yoch, and Meryem Y. Dede.

1. 125 A.3d 304 (Del. 2015).

2. *Id.* at 306.

3. In re KKR Fin. Hldgs. LLC S'holder Litig., 101 A.3d 980, 990 (Del. Ch. 2014) (Bouchard, C.), *aff'd sub nom.* Corwin v. KKR Fin. Hldgs. LLC, 125 A.3d 304 (Del. Ch. 2015).

4. *Id.*

5. *Id.* at 993.

6. *Id.* at 995.

On appeal, the plaintiffs challenged the Court of Chancery's ruling that KKR was not a controlling stockholder.[7] The plaintiffs further contended that even if KKR was not a controlling stockholder and thus the entire fairness standard did not apply, the Court erred in not applying enhance scrutiny review under *Revlon* to the actions of the target directors.[8]

The Supreme Court affirmed. Respecting the Court of Chancery's ruling that KKR was not a controlling stockholder, the Supreme Court adopted the Court of Chancery's "well-reasoned opinion," and observed that "the Chancellor correctly applied the law and we see no reason to repeat his lucid analysis of the question."[9]

In rejecting the plaintiffs' argument that the Court of Chancery erred in not evaluating the actions of the target's board under *Revlon* and *Unocal*, the Court observed that *Revlon* and *Unocal* doctrines were intended to allow for pre-closing injunctive relief in merger transactions, not post-closing monetary relief.[10] In reaching this conclusion, the Supreme Court focused on the affect of a fully informed, uncoerced stockholder vote, explaining that where the entire fairness standard does not apply, it is the "long-standing policy" of Delaware law "to avoid the uncertainties and costs of judicial second-guessing when the disinterested stockholders have had the free and informed chance to decide on the economic measures of a transaction for themselves."[11] The Court reasoned that "there is little utility to having [judges] second-guess the determination of impartial decision-makers with more information (in the case of directors) or an actual economic stake in the outcome (in the case of informed, disinterested stockholders)."[12] The Supreme Court concluded that in such cases "the business judgment standard of review is the presumptively correct one and best facilitates wealth creation through the corporate form."[13] The Supreme Court also agreed with the Court of Chancery's view that *Gantler v. Stevens*,[14] a case in which the Supreme Court held that a stockholder vote can ratify certain transactions only when the vote is not statutorily required, stands for the limited question of whether the doctrine of "ratification" applies only to a voluntary stockholder vote.[15] *Gantler*, the Court observed, was not intended to overrule Delaware law giving "standard of review-invoking effect to a fully informed vote of the disinterested stockholders."[16]

---

7. *Corwin*, 125 A.3d at 308.

8. *Id.*

9. *Id.*

10. *Id.* at 312.

11. *Id.* at 312-13.

12. *Id.* at 313-14.

13. *Id.* at 313.

14. 965 A.2d 695 (Del. 2009).

15. 125 A.3d 304, 309-311 & n.20 (citing J. Travis Laster, *The Effect of Stockholder Approval on Enhanced Scrutiny*, 20 Wm. Mitchell L. Rev. 1443 (2014)).

16. *Corwin*, 125 A.3d at 309 n.19.

B. Controlling Stockholder Liability

In *In re Dole Food Co., Inc. Stockholder Litigation*,[17] the Court of Chancery held that a merger conditioned on both the approval of an independent special committee and the vote of the majority of minority stockholders was not entirely fair because the controlling stockholder undermined the special committee process.

Dole involved a controlling stockholder transaction in which David H. Murdock, the owner of approximately 40% of the common stock of Dole Food Company Inc. ("Dole"), purchased Dole's outstanding common stock for $13.50 per share.[18] Aspects of the process leading to the transaction led the Court to conclude that Murdock and Dole officers engaged in fraud that culminated in the $13.50 per share deal. For example, the Court held that, while Deutsche Bank AG ("Deutsche Bank") was acting as Dole's financial advisor in the strategic review process, it also held private discussions with Murdock about a freeze-out transaction in which Murdock would acquire Dole's outstanding common shares.[19] The Court observed that "Deutsche Bank should not have been secretly helping Murdock plan to acquire Dole" while it was simultaneously advising the board.[20] The Court also held that Dole's management publicly announced downward revisions to Dole's earnings estimates to depress the trading price of Dole's stock,[21] and opposed and ultimately thwarted an open-market share repurchase program that could result in a price appreciation potentially detrimental to a take-private transaction.[22] Notably, although the board formed an independent committee to consider Murdock's offer,[23] the Court held that Dole's controller and management were involved in the committee's affairs, by, among other measures, attempting to limit the scope of the committee's authority, retaining control over the terms of nondisclosure agreements with other potential bidders, and objecting to the committee's choice of advisors.[24] The Court also found that management provided false financial information to the committee, which left the committee uninformed when agreeing to the $13.50 per share price.[25]

Ultimately, the Court held that the merger was not entirely fair because it was not a product of fair dealing.[26] The Court explained that fraud by Dole's controlling stockholder and management "rendered useless and ineffective the highly commendable efforts of the [c]ommittee and its advisors to negotiate a fair transaction that they subjectively believed was

---

17. 2015 Del. Ch. LEXIS 223 (Del. Ch. Aug. 27, 2015) (Laster, V.C.).

18. *Id.* at *2.

19. *Id.* at *27.

20. *Id.* at *27.

21. *Id.* at *34-35.

22. *Id.* at *40.

23. *Id.*

24. *Id.* at *53-55.

25. *Id.* at *80.

26. *Id.* at *85.

in the best interests of Dole's stockholders."[27] The Court also raised an issue with the merger price, explaining that while $13.50 per share was within the range of reasonableness it was likely within the lower end of the range when accounting for management's fraud.[28] The Court therefore concluded that the plaintiffs were entitled under the circumstances "to a 'fairer' price."[29]

In addressing the issue of damages, the Court held that the controller and a Dole officer were personally liable to the plaintiffs for breaching their duty of loyalty.[30] The Court concluded that the resulting damages from their efforts to drive down the market price and their fraud during negotiations reduced the ultimate deal price by 16.9%, or $2.74 per share.[31]

In addition, as a combined entire fairness and appraisal proceeding, *Dole* also involved appraisal claimants seeking the fair value of their shares. But in its post-trial opinion, the Court declined to independently assess fair value, concluding that "the damages award potentially renders the appraisal claim moot."[32]

On February 10, 2016, the Court of Chancery approved a settlement agreement under which Murdock paid to the class plaintiffs and appraisal petitioners a sum equivalent to the damages (including interest) for which the Court of Chancery found the defendants liable in its post-trial opinion.[33]

C. Financial Advisor Liability

In *RBC Capital Markets, LLC v. Jervis*,[34] the Delaware Supreme Court affirmed several post-trial decisions by the Delaware Court of Chancery involving the liability of a banker for aiding and abetting breaches of the duty of care by a board of directors. Most significantly, the Supreme Court confirmed that RBC Capital Markets, LLC ("RBC") was liable to the shareholders of Rural Metro Corp. ("Rural") for nearly $76 million because RBC had aided and abetted

---

27. *Id.* at *85-86.

28. *Id.* at *112.

29. *Id.* at *124.

30. *Id.* at *127-29.

31. *Id.* at *155.

32. *Id.* at *156-57. The decision by the Court to forgo an independent analysis of fair value was premised on the petitioners' ability to obtain damages from the controller and management defendants. In concluding that the appraisal claims are "potentially … moot," the Court reasoned: "The appraisal proceeding could regain its relevance … if the appraisal claimants did not receive complete relief from Murdock, Carter, and DFC Holdings, at which point they would have reason to proceed against Dole. But because Dole is owned indirectly by Murdock through DFC Holdings, a separate remedy against Dole may not have incremental utility." *Id.* at *157. The Court further reasoned that the issue might be academic because the merger subsidiary is liable to the same degree as the controller under *In re Emerging Communications*, *Inc. Shareholders Litigation*, 2004 Del. Ch. LEXIS 70 (Del. Ch. May 3, 2004). This aspect of the Court's opinion—and the implicit message that the statutory right to demand appraisal could be left unresolved as moot—invites commentary beyond the scope of this article.

33. In re Dole Food Co., Inc. S'holder Litig., C.A. No. 8703-VCL (Del. Ch. Feb. 10, 2016) (ORDER) (Laster, V.C.).

34. 2015 Del. LEXIS 629 (Del. Nov. 30, 2015), *aff'g* In re Rural Metro Corp. S'holder Litig., 88 A.3d 54 (Del. Ch. 2014) (post-trial opinion concerning liability), 102 A.3d 205 (Del. Ch. 2014) (damages opinion).

the Rural board of directors' breach of fiduciary duty by interfering with and exploiting RBC's own interests in a 2011 sales process.[35] In so holding, the Supreme Court affirmed that the Rural board's *Revlon* duties had been triggered by the special committee's unauthorized decision to hire RBC to sell the company and that RBC knowingly aided and abetted the board's breach under *Revlon*.[36] The Delaware Supreme Court also affirmed the Court of Chancery's decision to reject RBC's efforts to claim settlement contribution from the defendants' adjudicated joint tortfeasors, who qualified for protection under Rural's 102(b)(7) exculpation from liability.[37]

RBC Capital arose from Rural's June 2011 merger with an affiliate of Warburg Pincus LLC ("Warburg").[38] Dissenting stockholders of Rural filed suit, alleging that the Rural board breached its fiduciary duties by (i) failing to conduct a reasonable sales process, and (ii) failing to disclose material information in Rural's definitive proxy statement.[39] The plaintiffs also alleged that the Rural board's financial advisors, RBC and Moelis & Company LLC ("Moelis"), aided and abetted the Rural board's breaches of fiduciary duties. The Rural directors and Moelis settled before trial.[40] Thus, RBC was the sole defendant at trial.

At trial, the plaintiffs proved the following: In December 2010, RBC was aware that both Rural and Emergency Medical Services Corporation ("EMS"), Rural's largest competitor, were interested in being acquired.[41] RBC saw an opportunity to use its position as a sell-side advisor for Rural to secure a buy-side role with other firms bidding for EMS. RBC pursued this opportunity and became Rural's sell-side financial advisor, but did not disclose its plans to use this position to procure financing work from the bidders for EMS.[42] RBC commenced the sales process on the instructions of one Rural director and without the full Rural board's approval. Soon after the sales process began, problems arose.[43] Because RBC had timed the Rural sales process to run in parallel with the EMS sales process, many of the financial sponsors who participated in the EMS process were conflicted from considering Rural due to confidentiality restrictions.[44] These conflicts ultimately resulted in Warburg being the only bidder for Rural. Based on these facts, the Court of Chancery held that the Rural board had breached its duty of care and that RBC had knowingly participated in such a breach.[45] On October 10, 2014, the Court of Chancery issued its opinion on damages.[46] In that opinion the Court determined that Rural was

35. 2015 Del. LEXIS 629, at *129-130.

36. *Id*. at *75-98.

37. *Id*. at *139-146.

38. *Id*. at *1.

39. *Id*. at *4.

40. *Id*. at *6.

41. *Id*. at *17.

42. *Id*. at *18-23.

43. *Id*. at *79.

44. *Id*. at *25.

45. *Id*. at *38-39.

46. 102 A.3d 205 (Del. Ch. 2014).

worth $21.42 per share at the time of its sale to Warburg.[47] As such, the plaintiffs were entitled to total damages of $91.3 million.[48] The Court allocated $75.8 million of liability to RBC, representing 83% of the total damages award.[49]

RBC appealed the decisions below on several grounds.[50] RBC challenged the Court of Chancery's determination that Rural's board breached its duty of care under *Revlon* scrutiny and violated their fiduciary duty of disclosure by making material misstatements and omissions in Rural's proxy statement.[51] RBC also challenged the Court of Chancery's imposition of aiding and abetting liability on RBC for the board's alleged breaches of fiduciary duties. RBC disputed the Court of Chancery's assessment of proximate cause on damages, the general calculation of damages, and appealed the Court of Chancery's application of the Delaware Uniform Contributions Among Tortfeasors Act ("DUCATA").[52]

The Delaware Supreme Court affirmed and held that the board breached their duty of care under enhanced *Revlon* scrutiny.[53] Since both parties agreed that *Revlon* applied at some point, the dispute only centered on when *Revlon* was triggered, either in December 2010 or a later time.[54] RBC's argument that business judgment review should apply to a search for strategic alternatives in December 2010 was rejected based on the Court of Chancery's finding that no exploration of strategic alternatives actually took place.[55] Communications within RBC indicated that RBC believed it had been hired to sell Rural in the December 2010 timeframe.[56] Even in light of some evidence that the board had not "completely abandoned" other alternatives, the record contained sufficient facts showing one director (Shackleton) and RBC "expanded their mandate into a sale" to support the Court of Chancery's holding, making reversal inappropriate.[57] The Court found that Shackleton, RBC, and "ostensibly the Special Committee" initiated a sale process in December 2010 that was later ratified by the Board in March 2011.[58] The Court invoked a policy argument for applying *Revlon*, arguing that applying business judgment review would give the Board the benefit of a deferential standard of review during the time when their lack of oversight allowed the Special Committee and RBC to engage in a "flawed and conflict-ridden sale process."[59]

---

47. 102 A.3d at 226.

48. *Id*. at 263.

49. *Id*.

50. 2015 Del. LEXIS 629, at *4.

51. *Id*.

52. *Id*.

53. *Id*. at *4-5.

54. *Id*. at *76.

55. *Id*. at *79.

56. *Id*. at *78-79.

57. *Id*. at *79.

58. *Id*. at *83.

59. *Id*.

The Court rejected all of RBC's arguments. Third parties can be held liable for aiding and abetting breaches of fiduciary duties only upon a showing of *scienter.* Therefore, in order to impose liability, the plaintiff must convince the trial court as a factual determination that the aider and abettor had "actual or constructive knowledge that their conduct was legally improper."[60] The Court noted that there was ample evidence that RBC had the requisite knowledge, explaining that "RBC knowingly induced the breach by exploiting its own conflicted interests to the detriment of Rural and by creating an informational vacuum."[61] Specifically, RBC failed to disclose to Rural's board that it was actively trying to leverage its engagement as Rural's advisor into a buy-side financing role for EMS.[62] RBC was found to have been aware of the board's lack of knowledge on valuation and financial analysis, and used that informational disadvantage for their own benefit. These failures by RBC resulted in a "poorly-timed sale at a price that was not the product of appropriate efforts to obtain the best value reasonably available[.]"[63] Rural's board was unaware of RBC's modifications to the relevant valuation analysis, their "back channel" communications with the buyer and an "eleventh-hour" attempt to secure some role in the buy-side financing business.[64] RBC's internal communications demonstrated "manifest intentionality" and evidenced their knowledge that Rural's board was operating with fragmented and misleading information.[65] Because there was ample evidence of RBC's knowledge, the *scienter* requirement was met, and the imposition of liability was appropriate.[66]

One of the most publicized aspects of the Court of Chancery's liability holding involved the characterization of the role of a financial advisor as that of a "gatekeeper."[67] While affirming the conclusions of the Court of Chancery, however, the Court explicitly rejected the "dictum" regarding the gatekeeper concept in a lengthy footnote.[68] The Court recognized that the financial advisor relationship is often contractual in nature, based upon an engagement letter negotiated at arms-length between sophisticated parties.[69] The Court held that absent substantial factual findings of *scienter*, a failure by a financial advisor to *prevent* a breach of the fiduciary duty of care by directors would not automatically give rise to an aiding and abetting claim.[70]

The Supreme Court also rejected RBC's challenge to the Court of Chancery's conclusion that Rural's exculpatory charter provision precluded contribution from the directors who breached their fiduciary duty.[71] Exculpation under

60. *Id.* at *110.

61. *Id.* at *111.

62. *Id.*

63. *Id.* at *112.

64. *Id.* at *68, *111.

65. *Id.* at *112-113.

66. *Id.*

67. *Id.* at *118-119 n.191.

68. *Id.* at *119.

69. *Id.*

70. *Id.*

71. *Id.* at *139-146.

102(b)(7) is inapplicable to third parties, the Supreme Court affirmed.[72] Application of an opposite rule could, according to the Court, "create a perverse incentive system wherein trusted advisors to directors could, for their own selfish motives, intentionally mislead a board only to hide behind their victim's liability shield when stockholders or the corporation seeks retribution for the wrongdoing."[73] Further, the Court of Chancery held that to lower their proportionate liability, third parties facing joint tortfeasor liability under DUCATA are required to prove that the directors would not have been exculpated. RBC challenged the effect of the interplay between 102(b)(7) and DUCATA. They argued that stockholders who voted for exculpation clauses should not be permitted to, effectively, shift monetary liability from fiduciaries who were "primarily liable" (though statutorily immunized under 102(b)(7)) to third parties who are neither fiduciaries nor immunized from liability.[74] This interpretation of DUCATA, they argued, caused financial advisors to shoulder a disproportionate risk of liability.[75] The Supreme Court held there was no error committed by the Court of Chancery in determining that RBC bore the burden of proving that Rural's directors would not have been exculpated, and but for the settlement of their claims, would have shared a common liability to the stockholder class.[76] Further, the two directors who were not exculpated were allocated liability under DUCATA.[77] The holding below did not violate principles of equity because the Court of Chancery found that RBC was responsible for a disproportionate amount of fault.[78] Moreover, even if RBC had acted in a grossly negligent way, they would not have been held liable as an aider and abettor.[79] Rather, the imposition of liability required *scienter*, a significantly difficult state of mind to prove.[80]

D. Pre-Trial Dismissal Of Independent Directors On The Basis Of Exculpatory Charter Provisions

As discussed in *Key Decisions of 2014 in Delaware Corporate and Alternative Entity Law*,[81] in 2015, the Delaware Supreme Court overruled the Court of Chancery's decision in *In re Cornerstone Therapeutics, Inc. Shareholder Litig.*, holding that even when the challenged transaction is subject to entire fairness review, exculpated claims against directors protected by exculpatory charter provisions may be resolved before trial, saving the directors the burden of litigation.[82]

---

72. *Id.* at *143.

73. *Id.*

74. *Id.* at *143-144.

75. *Id.* at *144.

76. *Id.*

77. *Id.* at *145.

78. *Id.*

79. *Id.*

80. *Id.*

81. 16 Del. L. Rev. 1, 65-68 (2016).

82. 115 A.3d 1173, 1176 (Del. 2015), *overrulling* 2014 Del. Ch. LEXIS 170 (Del. Ch. Sept. 10, 2014) (Glasscock, V.C.).

E. Appraisal Under 8 Del. C. § 262

1. Statutory Requirements For Pursuing Appraisal Concerning Continuous Stock Ownership And Share-Tracing

In *In re Appraisal of Dell Inc.*,[83] the Court of Chancery clarified the continuous ownership requirement of 8 *Del. C.* § 262(a) with respect to beneficial owners of stock.

Dell involved the going-private merger of Dell Inc. ("Dell") in which each publically held share of Dell would be converted into the right to receive $13.75 in cash.[84] Five institutions who were Dell stockholders (the "Funds") sought appraisal of their stock.[85] The Funds did not hold legal title to their stock but instead owned the stock indirectly through accounts at custodial banks.[86] The custodial banks were participating members of The Depository Trust Company ("DTC"), commonly known as Cede & Co. ("Cede"), which was the record owner of the stock.[87]

Under Section 262, the word "stockholder" means the record holders of stock—here, Cede—and one of the statutory requirements is that the stockholder pursuing appraisal must "continuously hold[] such shares through the effective date of the merger."[88] Thus, the statute required Cede to continuously hold its stock through the date of the merger in order for the Funds to pursue appraisal.

By operation of the custodial bank's internal protocol, however, and through no fault of the Funds, this did not occur. After the Funds caused Cede to demand appraisal, DTC moved a corresponding number of shares out of a fast automated securities transfer account, an electronic book entry system that tracks the number of shares of stock that each participant owns, by directing Dell's transfer agent to issue uniquely numbered certificates.[89] The transfer agent issued paper stock certificates in Cede's name for the shares owned beneficially by the Funds.[90] Because DTC does not act as a custodian of paper stock certificates for its participating members, however, DTC made arrangements to deliver the certificates to the custodial banks.[91] Pursuant to their internal procedures that required any certificates to be re-registered in the names of their own nominees, the custodial banks instructed Cede to authorize the shares to be re-titled in the names of their nominees.[92]

---

83. 2015 Del. Ch. LEXIS 184 (Del. Ch. July 13, 2015) (Laster, V.C.).

84. *Id.* at *9.

85. *Id.*

86. *Id.* at *10.

87. *Id.*

88. 8 Del. C. § 262(a).

89. *Id.*

90. *Id.* at *21.

91. *Id.*

92. *Id.* at *22.

Dell moved for summary judgment pursuant to 8 *Del. C.* § 262(a), arguing that the record holder (Cede) did not hold their shares continuously through the effective merger date so as to enable the Funds to continue to pursue appraisal, because the stock certificates were reissued in the name of the Funds, which therefore lost their rights to appraisal.

The Court granted Dell's motion. The Court observed that Delaware precedent is clear that "it is the record holder—not the beneficial owner—that is subject to the statutory requirements for showing entitlement to appraisal and demonstrating perfection of appraisal rights" under the statute.[93] As a result, the Court explained that the "re-titling of a certificated share after the demand but before the effective date [of the merger] violates the Continuous Holder Requirement by causing record ownership to change."[94] The Court held that the "record holder" of a company's shares is the party who is listed as the owner of those shares in the stock ledger maintained by the company or its transfer agent.[95] As such, the Court concluded that because the legal ownership of the Funds' shares changed from Cede to the custodial banks' nominees on Dell's records as maintained by the Transfer Agent, the Funds lost their appraisal rights.[96] The Court held inapposite the fact that the Funds were unaware of these transfers, explaining that the Funds "assumed the risk that [their] intermediaries might act contrary to their interests."[97]

While the Court bemoaned this result—commenting that "[w]ere it up to me, I would hold that the concept of a 'stockholder of record' includes the custodial banks and brokers on the DTC participant list"—it was bound by Delaware precedent, which as the Court noted, could only be changed by the Delaware Supreme Court.[98]

In another opinion clarifying the statutory requirements for demanding appraisal under 8 Del. C. § 262, *In re Appraisal of Ancestry.com, Inc.*,[99] the Court of Chancery explained that Section 262 does not require a stockholder who purchases shares of an acquired company after the record date of the transaction to demonstrate that the previous owners of the shares also refrained from voting in favor of the transaction.

Ancestry involved a cash-out transaction through which Permira Advisors ("Permira"), a private equity firm, acquired Ancestry.com ("Ancestry") for $32 per share.[100] The definitive proxy for the transaction was filed on November 30, 2012, indicating a record date of November 30 and a meeting date of December 27, 2012.[101] Merion Capital L.P. ("Merion") began purchasing shares of Ancestry on December 4, 2012, four days after the record date, and continued purchasing shares through December 17, 2012.[102] On December 12, 2012, Merion's portfolio manager notified Cede &

93. *Id.* at *28.

94. *Id.*

95. *Id.* at *27.

96. *Id.* at *28.

97. *Id.* at *32.

98. *Id.* at *78.

99. 2015 Del. Ch. LEXIS 2 (Del. Ch. Jan. 5, 2015) (Glasscock, V.C.).

100. *Id.* at *4.

101. *Id.*

102. *Id.* at *5.

Co. ("Cede"), the record owner of the shares, that it would be exercising its appraisal rights.[103] On December 18, 2012, Cede notified Ancestry that it was asserting appraisal rights with respect to the 1,255,000 shares beneficially owned by Merion.[104] Merion asserted in its petition that "it did not vote in favor of the merger."[105] Merion also asserted that "none of the petitioner's shares were voted in favor of the merger," but did not put forth any evidence to verify that those shares were not voted in favor of the merger by previous owners.[106]

Ancestry filed a motion for summary judgment asserting that Merion lacked standing to file a petition for appraisal. Ancestry argued that, pursuant to the 2007 amendment to Section 262(e), which allows a beneficial owner to file an appraisal petition in its own name, Merion was required to prove that it did not vote in favor of the merger.[107] Ancestry further argued that because Merion purchased its stock after the record date, Merion was required to prove that the previous owners of the shares did not vote in favor of the merger, which Merion was unable to prove.[108]

The Court rejected Ancestry's argument. The Court explained that while the 2007 amendment to Section 262(e) allowed beneficial owners of stock to file an appraisal petition in their own name, it did not amend the standing requirement of Section 262(a).[109] Pursuant to Section 262(a), a petitioner need only show that the *record holder* of the stock for which appraisal is sought: (1) held those shares on the date it filed a petition for appraisal; (2) continuously held those shares through the effective date of the merger; and (3) did not vote in favor of the merger with respect to those shares.[110] The Court added that even if the 2007 amendment to Section 262(a) extended the requirement that an appraisal petitioner not vote in favor of the merger to the *beneficial owner*, Merion met that requirement.[111] The Court held that it was irrelevant that Merion could not prove that the shares were not voted in favor of the merger by the previous owner, explaining that 262(a) "focuses on the actions of the *stockholder*, not on the shares."[112] The Court therefore denied Ancestry's summary judgment motion and held that Merion had standing to bring a petition for appraisal.

The Court of Chancery reached a similar conclusion in *Merion Capital LP v. BMC Software, Inc.*[113] In *Merion*, the petitioners, who were beneficial owners of BMC Software, Inc. ("BMC") shares, attempted to direct the record owner of those shares, Cede & Co. ("Cede"), to demand an appraisal.[114] When Cede refused, the petitioners withdrew their shares

103. *Id.*

104. *Id.*

105. *Id.*

106. *Id.*

107. *Id.* at *2.

108. *Id.* at *3.

109. *Id.* at *21.

110. 8 Del. C. § 262(a).

111. *Id.* at *24.

112. *Id.*

113. 2015 Del. Ch. LEXIS 3 (Del. Ch. Jan. 5, 2015) (Glasscock, V.C).

114. *Id.* at *4.

from the fungible mass at Cede and registered the shares with Computershare, BMC's transfer agent.[115] BMC argued that because the petitioners' shares were transferred from the fungible mass at Cede the petitioners were not able to say how those specific shares were voted in the merger and therefore the petitioners did not have standing to seek an appraisal.[116] The Court concluded that there is no such requirement under 8 Del. C. § 262.

2. Cases Addressing When Merger Price As Opposed To A Discounted Cash Flow Analysis Is A More Reliable Indicator Of Fair Value

Merion Capital v. BMC Software[117] capped a series of Court of Chancery opinions that looked to the merger price, resulting from an arm's-length, thorough and informed sales process, to determine the fair value in appraisal actions. *Merion Capital* followed similar rulings in *In re Appraisal of Ancestry.com, Inc.*,[118] *Merlin Partners LP v. AutoInfo, Inc.*,[119] and *LongPath Capital, LLC v. Ramtron International Corporation*.[120]

As discussed above, *Ancestry* involved a cash-out transaction in which Ancestry was acquired by Permira, a private equity firm, for $32 per share. Ancestry's board, consisting of six independent directors and three non-independent directors, began exploring strategic options in 2012.[121] Following a board presentation by Ancestry's financial advisory, Qatalyst Partners ("Qatalyst"), concerning Ancestry's growth prospects, the board authorized Qatalyst to engage in an auction process.[122] Ultimately, seven potential bidders submitted non-binding indications of interest, with the bids ranging from $30-$38 per share, and Ancestry invited the three highest bidders to engage in an extensive diligence process.[123] After conducting full diligence, Permira submitted a bid for $31 per share, eventually raising its bid to $32 per share.[124] Upon receiving a fairness opinion from Qatalyst, Ancestry's board approved the merger with Permira at $32 per share, which represented a 41% premium over the stock price.[125] No topping bids emerged during the two-month period between the announcement of the merger and the closing date, despite there being a fiduciary out clause in the merger agreement.[126]

---

115. *Id.* at *5.

116. *Id.* at *10 n.21.

117. 2015 Del. Ch. LEXIS 268 (Del. Ch. Oct. 21, 2015) (Glasscock, V.C.).

118. 2015 Del. Ch. LEXIS 21 (Del. Ch. Jan. 30, 2015) (Glasscock, V.C.).

119. 2015 Del. Ch. LEXIS 128 (Del. Ch. Apr. 30, 2015) (Noble, V.C.).

120. 2015 Del. Ch. LEXIS 177 (Del. Ch. June 30, 2015) (Parsons, V.C.).

121. *Ancestry*, 2015 Del. Ch. LEXIS 21, at *8.

122. *Id.* at *10.

123. *Id.* at *11.

124. *Id.* at *14.

125. *Id.* at *16.

126. *Id.* at *17.

The petitioners, who were beneficial owners of 1,415,000 Ancestry shares at the time of the merger date, filed an appraisal demand. Both parties' experts relied exclusively on a discounted cash flow ("DCF") analysis in reaching their respective conclusions about the fair value at the time of the merger.[127] The petitioners' expert relied on the average of two sets of management projections prepared in connection with the auction process in concluding that the fair value of Ancestry's stock was "at least" $42.81 per share.[128] In contrast, Ancestry's expert only relied on the more recent of the two sets of management projections, which he held were more accurate because they incorporated bidder feedback.[129] Based on that set of projections, Ancestry's expert concluded that the fair value of Ancestry's stock was $30.63 per share.[130]

The Court found each of the experts' approaches "less than fully persuasive," explaining that their approaches appeared to be "result-oriented riffs on the market price."[131] The Court therefore performed its own DCF analysis and arrived at a fair value of $31.79 per share.[132] The Court concluded, however, that because the reliability of the inputs and management projections were questionable and because Ancestry engaged in a robust sales process, the fair value of Ancestry's stock "was best represented by the market price."[133] The fact that the Court's DCF valuation was close to the market price gave the Court comfort that "no undetected factor skewed the sales process."[134]

Merlin involved the sale of AutoInfo, Inc. ("AutoInfo") to Comvest Partners ("Comvest"). AutoInfo was a non-asset based transportation services company that provided brokerage and contract carrier services through a network of independent sales agents.[135] In 2011, believing that its stock price was depressed, AutoInfo's board, a majority of whom were independent directors, retained Stephens, Inc. ("Stephens") to reach out to potential purchasers and run a sales process.[136]

In early 2012, Stephens contacted 164 potential acquirers.[137] Approximately seventy of those bidders signed non-disclosure agreements.[138] Ten bidders had submitted an indication of interest, with bids ranging from $.90-$1.36 per share.[139] Of those, three bidders submitted letters of intent and two others presented verbal valuation ranges.[140] The

127. *Id.* at *26.

128. *Id.* at *31.

129. *Id.* at *33.

130. *Id.* at *28.

131. *Id.* at *57.

132. *Id.* at *61.

133. *Id.* at *74.

134. *Id.*

135. *Merlin*, 2015 Del. Ch. LEXIS 128, at *1.

136. *Id.*

137. *Id.* at *9.

138. *Id.* at *9.

139. *Id.* at *10.

140. *Id.*

board formed a special committee to evaluate the bids.[141] The special committee consisted of three outside directors and proceeded to review the bids with the assistance of a legal advisor and a financial advisor.[142] Initially, the special committee recommended that the board pursue the $1.30 per share offer from HIG Capital ("HIG"),[143] but HIG eventually decided not to proceed with the transaction,[144] and the parties terminated their letter of intent and Stephens continued contacting potential acquirers.[145] By October 2012, four other parties submitted letters of intent or verbally indicated their interest.[146] Of the four, the highest offer of $1.26 per share came from Comvest Partners ("Comvest").[147] The special committee recommended to the board to pursue the Comvest offer and the board unanimously agreed.[148] The parties executed a letter of intent at $1.26 per share with a thirty-day exclusivity period.[149]

While conducting due diligence, Comvest discovered several potential issues with AutoInfo's business.[150] It also discovered the poor quality of AutoInfo's financials. Accordingly, Comvest lowered its bid to $0.96 per share.[151] The parties eventually reached an agreement at $1.05 per share.[152] On April 25, 2013, AutoInfo's stockholders approved the deal and the transaction closed on that day.[153] There were no topping bids between the deal's announcement and its closing.[154]

The petitioners, former stockholders of AutoInfo, demanded an appraisal of their shares. The petitioners' expert opined that AutoInfo's fair value was $2.60 per share.[155] In doing so, he placed equal weight on a DCF analysis based on AutoInfo management's projections and two comparable companies analyses in reaching his conclusion.[156] On the other

141. *Id.*

142. *Id.*

143. *Id.* at *11.

144. *Id.* at* 12.

145. *Id.*

146. *Id.*

147. *Id.*

148. *Id.*

149. *Id.*

150. *Id.* at *13.

151. *Id.*

152. *Id.* at *16.

153. *Id.* at *18.

154. *Id.*

155. *Id.* at *19.

156. *Id.*

hand, AutoInfo's expert opined that AutoInfo's fair value was $0.967 per share.[157] He rejected the idea that a DCF and comparable company analyses were accurate indicators of fair value based on the available data and instead concluded that the deal price, minus cost savings arising from the deal, was the best evidence of AutoInfo's fair value.[158]

The Court rejected the petitioners' expert's reliance on a DCF analysis.[159] The Court explained that while it will often give weight to management projections made in the ordinary course of business, such predictions "may be disregarded where the company's use of such projections was unprecedented, where the projections were created in anticipation of litigation, or where the projections were created for the purpose of obtaining benefits outside the company's normal course of business."[160] The Court observed that AutoInfo's management had never prepared projections in the normal course of business and only did so when prompted by Stephens in an effort to market the company to potential bidders.[161] The Court also noted that AutoInfo's management itself had doubts about its ability to accurately forecast the company's future performance, and that their projections were "indisputably optimistic."[162] The Court therefore concluded that if AutoInfo's management "could not have been trusted to produce credible projections in the ordinary course of business, the projections it created during the sales process deserve little deference."[163]

The Court also rejected the petitioners' expert's comparable analyses. The Court explained that "the utility of the comparable company approach depends on the similarity between the company the court is valuing and the companies used for comparison."[164] The Court held that the petitioners failed to show that the selected "comparables are truly comparable."[165] In so holding, the Court relied on the facts that "(i) all of the bids received by AutoInfo during the sales process implied market multiples well below [the petitioners' expert's], and (ii) AutoInfo ultimately sold, through a thorough sales process, at a price less than half of AutoInfo's comparable companies valuations."[166]

The Court agreed with AutoInfo's expert and held that the deal price was a reliable indication of AutoInfo's fair value at the time of the merger. The Court explained that "[w]here no comparable companies, comparable transactions, or reliable cash flow projections exist … the merger price may be the most reliable indicator of value."[167] The Court added, however, that "[t]he dependability of a transaction price is only as strong as the process by which it was negotiated."[168]

---

157. *Id.*

158. *Id.*

159. *Id.* at *22.

160. *Id.*

161. *Id.*

162. *Id.* at *23.

163. *Id.* at *23-24.

164. *Id.* at *25.

165. *Id.* at *32.

166. *Id.*

167. *Id.*

168. *Id.*

After thoroughly analyzing the sale process, the Court determined that "AutoInfo's process was comprehensive and nothing in the record suggests that the outcome would have been a merger price drastically below fair value."[169] As such, the Court concluded that "[p]lacing heavy weight on the [deal] price is justified in light of the absence of any other reliable valuation analysis."[170]

The Court did not agree with AutoInfo's expert, however, that the deal price should be adjusted downward to account for the portion of the price that was attributable to the actual consummation of the deal. The Court agreed that "in any appraisal action, the Court must value [the petitioners'] shares exclusive of any element of value arising from the accomplishment or expectation of the merger …."[171] The Court held, however, that the cost savings AutoInfo's expert attributed to the deal were speculative and that "the record did not establish that [Comvest] had based its bid on cost savings that [AutoInfo] could not have itself realized had it continued as a going concern."[172] The Court also supported its holding by explaining that "[a]llowing a near automatic reduction in price would reverse the burden that is on the party arguing that adjustments are warranted."[173] The Court therefore concluded that AutoInfo's fair value at the time of the merger was $1.05 per share, which was the deal price.[174]

LongPath Capital involved a hostile tender offer by Cypress Semiconductor Corporation ("Cypress") to acquire Ramtron International Corporation ("Ramtron"). After Ramtron's board rejected Cypress's offer of $2.48 per share, Cypress initiated a hostile tender offer at $2.68 per share.[175] Ramtron's board recommended that Ramtron's stockholders not tender their shares and reached out to over twenty potential buyers, without any success.[176] The parties eventually agreed on a transaction price of $3.10 per share and the merger was approved by a stockholder vote.[177]

The stockholder petitioner, LongPath Capital LLC ("LongPath") is an investment vehicle that began acquiring its shares in Ramtron approximately one month after the announcement of the merger.[178]

Both parties presented expert testimony regarding the fair value of Ramtron's stock at the time of the merger. The petitioner's expert opined that the fair value of Ramtron's stock was $4.96.[179] He reached this conclusion on a combination of a DCF analysis based on Ramtron management's projections, which he weighted at 80%, and a comparable transactions analysis of two comparable transactions, which he weighted at 20%.[180] Ramtron's expert opined that the fair

169. *Id.* at *41.

170. *Id.*

171. *Id.* at *49.

172. *Id.* at *51.

173. *Id.*

174. *Id.* at *53.

175. *LongPath*, 2015 Del. Ch. LEXIS 177, at *4.

176. *Id.* at *24.

177. *Id.* at *25.

178. *Id.* at *3.

179. *Id.* at *26.

180. *Id.*

value of Ramtron's stock at the time of the merger was $2.76 per share.[181] He used the deal price to arrive at his conclusion, reasoning that the merger was a result of a fair and competitive auction process and Ramtron management's projections were overly optimistic and unreliable.[182]

The Court agreed that in this instance a DCF analysis was an unreliable method to determine the fair value of Ramtron's stock. The Court explained that while the law favors valuations based on management projections "because management ordinarily has the best first-hand knowledge of a company's operations," those projections can be rejected entirely when they were prepared: "(1) outside of the ordinary course of business; (2) by a management team that never before had created long-term projections; (3) by a management team with a motive to alter the projections … and (4) when the possibility of litigation … probably affected the neutrality of the projections."[183] The Court held that Ramtron management's projections suffered from each one of these issues.[184] The Court supported its conclusion by noting that the projections relied upon by the petitioner's expert were created by relatively new employees who utilized new methodologies as a basis for their projections.[185] The Court also observed that the projections were only created after Cypress issued its initial offer and not in the ordinary course of business.[186] Finally, the Court pointed out that the projections suggested a dramatic turnaround in the company without an explanation of the underlying changes that would justify such an improvement, which according to the Court was a "red flag."[187]

The Court also rejected Ramtron's expert's comparable transactions approach. The Court explained that "[r]eliance on a comparable companies or comparable transactions approach is improper where the purported 'comparables' involve significantly different products or services than the company whose appraisal is at issue, or vastly different multiples."[188] The Court found that Clarke's analysis suffered from this flaw.[189] Additionally, the Court noted that the "dearth of data points" in Clarke's comparable transaction analyses "undermines reliability of the methodology."[190]

The Court therefore concluded that the merger price provided the best evidence of the fair value of Ramtron's stock at the time of the merger. The Court explained that "in the situation of a proper transactional process likely to have resulted in an accurate valuation of an acquired corporation, this Court has looked to the merger price as evidence of fair value and, on occasion, given that metric one-hundred percent weight."[191] The Court rejected the argument that a

181. *Id.*

182. *Id.* at *26-27.

183. *Id.* at *32-33.

184. *Id.* at *33.

185. *Id.* at *35.

186. *Id.*

187. *Id.* at *53.

188. *Id.* at *63-64.

189. *Id.* at *65.

190. *Id.*

191. *Id.* at *69.

multi-bidder auction is a prerequisite to finding that the merger price is a reliable indicator of fair value.[192] Instead, the Court held that "the process by which [Ramtron] was marketed to potential buyers was thorough, effective, and free from any spectre of self-interest or disloyalty" and therefore the price received from Cypress provided a reliable indication of fair value.[193] The Court likewise rejected the "real world" evidence asserted by the petitioner that it contended undermined the merger price as a reliable indicator of fair value, such as speculative remarks by Ramtron's CEO during negotiations with Cypress regarding what he believed to be the true value of Ramtron and an analyst price target that was admittedly based upon inconclusive models.[194]

Finally, because "it is inappropriate to include merger-specific value" in an appraisal action, the Court analyzed the portion of the merger price that was attributable to Cypress-specific synergies as opposed to Ramtron's value as a going concern.[195] The Court held that the net synergies were $0.03 per share.[196] The Court therefore concluded that the fair value of Ramtron's stock at the time of the merger was $3.07 per share.[197]

Merion Capital involved a going-private transaction in which BMC Software, Inc. ("BMC"), one of the world's largest software companies specializing in information technology management, was taken private by a consortium of investment firms, including Bain Capital, LLC, Golden Gate Private Equity, Inc., and Insight Venture Management, LLC (together, the "Buyer Group") for $46.25 per share.[198] In May 2012, Elliot Associates, L.P. and Elliot International, L.P. (together, "Elliot") took a 5.5% stake in BMC with the intent to urge the company to pursue a sale.[199] Elliot commenced a proxy contest in which it proposed a slate of four directors to be elected to BMC's board.[200] As part of a settlement with Elliot, BMC's board formed a strategic committee to explore all options that would create stockholder value, including a sale.[201]

After months of exploring different options and contacting potential strategic buyers, BMC received expressions of interest from three buyers, among them the Buyer Group.[202] While the Buyer Group had not submitted the highest bid, the board accepted the Buyer Group's offer, which included a 30-day go-shop period, after receiving a fairness opinion from its financial advisors, and recommended that BMC's stockholders approve the merger.[203] During the 30-day

192. *Id*. at *70.

193. *Id*. at *71.

194. *Id* at *88.

195. *Id*. at *83.

196. *Id*. at *86.

197. *Id*. at *89.

198. 2015 Del. Ch. LEXIS 268, at *2.

199. *Id*. at *23.

200. *Id*.

201. *Id*. at *24.

202. *Id*. at *27.

203. *Id*. at *29.

go-shop period, the board contacted both financial and strategic entities and waived any provisions pursuant to standstill agreements that would have prohibited a potential bidder from reengaging with BMC.[204] No alternative proposals were submitted, however, and the stockholders voted to approve the merger with the Buyer Group.[205]

The petitioners' expert witness relied exclusively on a DCF analysis based on BMC management's projections to reach the conclusion that the fair value of BMC's stock at the time of the merger was $67.08 per share.[206] He concluded that other methodologies, such as comparable companies and comparable transaction analyses, were not appropriate given the specific facts of the case.[207] BMC's expert witness also relied on the same DCF analysis but concluded that the fair value of BMC's stock was $37.88 per share.[208] BMC's expert held that management's projections were overly optimistic and therefore reduced the projections by 5%.[209] He supported this conclusion by performing a DCF analysis using projections derived from a collection of Wall Street analysts who followed BMC and a comparable companies analysis using trading multiples from selected publically-traded software companies.[210] The experts also used different discount rates, different long-term growth rates, and different excess cash values, among other things.[211]

In evaluating the issue, the Court undertook its own DCF analysis based on management projections without a 5% reduction.[212] The Court also used a supply side equity risk premium to calculate the discount rate, as was used by the petitioners' expert, instead of a historical equity risk premium.[213] After making other inputs and assumptions, the Court's DCF analysis resulted in a fair value per share price for BMC of $48.00.[214]

The Court also analyzed the sales process and concluded that BMC had conducted a robust, arm's-length sales process that was sufficiently structured to develop fair value of BMC.[215] The Court therefore held that the merger price of $46.25 per share was a relevant factor in determining the fair value of BMC at the time of the merger.[216]

The Court held that the merger price did not require any reduction for synergies in calculating fair value. The Court explained that a two-step analysis is required in determining whether to adjust the merger price to calculate fair

---

204. *Id.* at *30.

205. *Id.*

206. *Id.* at *31.

207. *Id.*

208. *Id.*

209. *Id.* at *34.

210. *Id.* at *32

211. *Id.* at *34-37.

212. *Id.* at *42.

213. *Id.* at *43.

214. *Id.* at *49.

215. *Id.* at *50.

216. *Id.* at *57.

value: "first, were synergies realized from the deal; and if so, were they captured by sellers in the deal price?"[217] The Court concluded that there was no evidence that either of these factors were present in the merger.[218]

In weighing all relevant factors, the Court concluded that the merger price of $46.25 per share was the best indicator of fair value of BMC's stock at the time of the merger.[219] In so concluding, the Court explained that it was concerned with the reliability of its DCF valuation because of the possibility that management's projections were overly optimistic.[220] The Court was also concerned about the discount rate used in its DCF analysis, "in light of a meaningful debate on the issue of using a supply side versus historical equity risk premium."[221]

In contrast to the trend of relying on merger consideration as an indicator of fair price, in *Owen v. Cannon*,[222] the Court awarded an appraisal petitioner approximately $16 million in post-trial damages, on management projections created in the ordinary course of business.

Owen involved a conflicted cash-out merger in which Nathan Owen ("Nathan"), formerly the largest stockholder of Energy Services Group ("ESG"), was cashed out for $19.95 per share by ESG's two other largest stockholders, Bryn Owen ("Bryn") and Lynn Cannon. The cash-out merger was the result of significant disagreements between Nathan, on the one hand, and Bryn and Cannon, on the other hand, regarding ESG's operations.[223] The merger was presented to Nathan at a specially noticed board meeting in May 2013.[224] At the special meeting, Bryn and Cannon voted in favor of the merger while Owen voted against it.[225] Bryn, Cannon, and Nathan were the only three board members.

The $19.95 per share price was determined by Grant Thornton, whom Bryn and Cannon engaged to prepare a set of five-year financial projections for the purpose of obtaining a credit facility to consummate the buy-out.[226]

After the May 2013 board meeting, Nathan brought claims in the Court of Chancery against Bryn and Cannon for breach of fiduciary duty in their capacities as directors and in their capacities as controlling stockholders and simultaneously sought an appraisal of his stock.[227]

Both parties' experts used a DCF analysis to arrive at their conclusions regarding the fair value of Nathan's shares at the time of the merger.[228] The dispute between the parties concerned which projections should be used as a basis for

217. *Id.* at *63.

218. *Id.*

219. *Id.* at *64-65.

220. *Id.* at *64.

221. *Id.* at *64-65.

222. 2015 Del. Ch. LEXIS 165 (Del. Ch. June 17, 2015) (Bouchard, C.).

223. *Id.* at *18-20.

224. *Id.* at *40.

225. *Id.* at *42.

226. *Id.* at *33.

227. *Id.* at *44.

228. *Id.* at *48-50.

the DCF analysis and what is the appropriate tax rate that should be used in the DCF analysis. Nathan's expert based her DCF analysis on the 2013 five-year projections prepared by Grant Thornton.[229] Nathan's expert also opined that it was appropriate to use a tax rate of 21.5% in any DCF analysis, which reflected ESG's Subchapter S status.[230] Nathan's expert concluded that the fair value of Nathan's stock at the time of the merger was $39.89 per share. ESG's expert, on the other hand, created his own set of ten-year projections, which were considerably lower than the 2013 projections prepared by Grant Thornton.[231] ESG's expert also argued that ESG's earnings should not be tax affected due to its status as a Subchapter S corporation.[232]

The Court agreed that a DCF analysis was the proper methodology to determine the fair value of Nathan's shares at the time of the merger, noting that the DCF methodology "has featured prominently in this Court because it 'is the approach that merits the greatest confidence' within the financial community.[233] Specifically, the Court sided with the opinion of Nathan's expert that the 2013 projections were the appropriate basis for a DCF analysis. The Court held that those projections were the product of a "deliberate, iterative process over a period of three years to create, update and revise multi-year projections" for ESG.[234] The Court was satisfied that the 2013 projections were properly adjusted to account for contemporaneous and anticipated business developments.[235] The Court also found fault with the ten-year projections created by ESG's expert, explaining that they were "not reflective of management's best estimates of future performance as of the [m]erger."[236] The Court added that "Delaware courts are generally skeptical of projections created by an expert during litigation," and that the projections created by ESG's expert were "tainted by hindsight bias."

In addressing the appropriate tax rate to use in the DCF analysis, the Court held that Nathan "was entitled to be paid for that which has been taken from him," which, the Court explained, included the tax advantage of being a stockholder in a Subchapter S corporation.[237] The Court therefore agreed with Nathan's expert that ESG's earnings should be tax affected to compensate Nathan's for his being deprived of his Subchapter S taxholder status.[238]

Based on these assumptions, the Court concluded that the fair value of Nathan's stock at the time of the merger was $31.94 per share.[239] The Court used this valuation in analyzing the entire fairness of the merger. The Court held

---

229. *Id.* at *48.

230. *Id.*

231. *Id.* at *50.

232. *Id.* at *51.

233. *Id.* at *47.

234. *Id.* at *53.

235. *Id.* at *55.

236. *Id.* at *61.

237. *Id.* at *67.

238. *Id.*

239. *Id.* at *85.

that the merger was not at a fair price nor was it the product of fair dealing.[240] The Court therefore awarded Nathan compensatory damages equal to the difference between the fair value of his stock at the time of the merger—$31.94 per share—less the price per share he actually received in the merger.[241]

3. Settlement Of Appraisal Demands With Non-Appearing Stockholders

In *Mannix v. PlasmaNet, Inc.*,[242] the Court of Chancery addressed whether it is appropriate for a surviving corporation to settle the appraisal demands of certain stockholders on terms that are not available to other stockholders who sought appraisal.

PlasmaNet involved the merger of PlasmaNet, Inc. ("PlasmaNet") and Free Lotto, Inc., with PlasmaNet being the surviving corporation. The petitioner sought appraisal of his 1,700 PlasmaNet shares.[243] Pursuant to 8 Del. C. § 262(f), PlasmaNet filed a verified list of forty-eight PlasmaNet stockholders who purported to exercise their appraisal rights.[244] However, several of those PlasmaNet stockholders failed to file an appraisal proceeding (the "Non-Appearing Dissenters").[245]

PlasmaNet entered into a settlement with the Non-Appearing Dissenters of all demands for appraisal.[246] Under the terms of the settlement, the Non-Appearing Dissenters were scheduled to receive a certain amount of equity in the surviving corporation.[247] Also pursuant to the settlement, the Non-Appearing Dissenters attested to their status as "accredited investors" as defined in the Securities Act of 1933.[248] PlasmaNet extended the same settlement offer to the petitioner, who rejected it, and also to all other PlasmaNet stockholders who properly demanded appraisal and who could attest to being an accredited investor.[249]

PlasmaNet moved to dismiss the Non-Appearing Dissenters from the proceeding. The petitioner argued, however, that the motion to dismiss should be rejected for two reasons. The petitioner first argued that the settlement with the Non-Appearing Dissenters was invalid because it was not available to all stockholders who demanded appraisal, namely, the ones who could not qualify as accredited investors.[250] The petitioner also argued that a settlement with only some of

240. *Id.* at *88-92.

241. *Id.* at *93.

242. 2015 Del. Ch. LEXIS 190 (Del. Ch. July 21, 2015) (Bouchard, C.).

243. *Id.* at *3.

244. *Id.*

245. *Id.*

246. *Id.*

247. *Id.* at *4

248. *Id.*

249. *Id.*

250. *Id.* at *6.

the PlasmaNet investors who demanded an appraisal "undermines the bedrock and fundamental principles of the appraisal statute by undercutting the economics of this appraisal proceeding."[251]

The Court rejected the petitioner's arguments. The Court explained that the concerns expressed in previous Delaware case law regarding the settlement of representative litigation do not apply in a case where the surviving corporation attempts to settle the appraisal demands of those stockholders who did not join the proceeding.[252] The Court compared this situation to a putative class action—where the defendant is readily permitted under the law to settle a class claim with non-representative class members—and held that "it logically follows that the surviving corporation after a merger may seek to settle the appraisal demands of non-appearing dissenters."[253] The Court also commented that the fact that the proposed settlement would undercut the economics of the appraisal proceeding does not make the settlement unjust.[254] The Court noted that to conclude otherwise "effectively would give the [p]etitioner a settlement hold-up right not envisioned by 8 Del. C. § 262(k), which is to be strictly construed, and would be contrary to the purpose of the Court-approval requirement of the appraisal statute."[255]

F. "Disclosure-Only" Settlements

"Disclosure-only" settlements refer to settlements of class action lawsuits challenging transactions involving public companies—typically mergers, acquisitions, recapitalizations, or other significant transactions—where the sole or primary benefit to the class achieved by the settlement is supplemental or corrected public disclosures. In addition to the agreement to provide supplemental or corrective disclosures, these settlements typically involve broad releases, extinguishing all claims against anyone involved in the challenged transaction (referred to as "intergalactic" releases by some Delaware judges),[256] and substantial fee awards to the plaintiffs, but no cash compensation for the class members. "Disclosure-only" settlements increased in popularity in the last decade.[257] Historically, the Court of Chancery has approved disclosure-only

251. *Id.*

252. *Id.* at *13.

253. *Id.* at *14.

254. *Id.* at *16.

255. *Id.*

256. Acevedo v. Aeroflex Holding Corp., C.A. No. 9730-VCL, at 62:17-63:6 (Del. Ch. July 8, 2015) (Laster, V.C.) (TRANSCRIPT) ("*Acevedo* 7/8/15 Tr.") ("The main component of these settlements are the following: First, the defendants, defined broadly to encompass anyone having anything to do with the transaction, get a broad class-wide release that extinguishes all claims against them. Not only all claims that were asserted in the litigation but all claims arising out of or relating to any of the facts an issues that were in the litigation or in the complaint or in the documents referenced in it. And it usually goes on much further than that. Since the complaint is based on a proxy statement ant the public filings related to the deal, that is a truly expansive scope of relief. Our Chief Justice has appropriately described those types of releases as 'intergalactic.'").

257. In re Trulia, Inc. S'holder Litig., 2016 Del. Ch. LEXIS 8, at *24 (Del. Ch. Jan. 22, 2016) (Bouchard, C.) ("In Delaware, the percentage of such cases settled solely on the basis of supplemental disclosures grew significant from 45.4% in 2005 to a high of 76% in 2012, and only recently has seen some decline." (citing Matthew D. Cain & Steven Davidoff Solomon, *Takeover Litigation in 2014* 2 (Jan. 14, 2016))). Many scholars and Delaware judges view the proliferation of "disclosure only" settlements as a symptom of a problem: the fast-filing of hastily prepare complaints challenging public transactions for the purpose of generating attorneys' fees.

continued on page 114

settlements, even where the additional information provided is not material or of significant value to the stockholders.[258] Some have concluded, however, that this historical practice in fact has a deleterious effect on the stockholder franchise.[259] In particular, some courts have addressed the agency conflict in these types of suits—whereby the motivations of counsel for a plaintiff class may be different from the interests of the class itself, as counsel has incentive to seek quick settlement, and thus quick profit.[260] In 2015, the Court diverged from its historical practice, rejecting numerous disclosure-only settlements, and signaling an intent to impose a more rigorous standard on such settlements moving forward.

The first 2015 decision rejecting a class action settlement was issued in *Acevedo v. Aeroflex Holding Corp.*[261] In Acevedo, the plaintiffs challenged a cash deal subject to enhanced scrutiny where it appeared that a potentially higher bidder was being excluded from the process.[262] The Court observed that the complaint stated colorable claims sufficient to warrant expedited proceedings. After expedited discovery, however, the Court found that there were no conflicts tainting the process that led to the ultimate deal, and that all incentives aligned with achieving the highest deal price.[263] The Court thus concluded that the additional disclosures revealing the lack of conflicts were insufficient to support the broad settlement release.[264] The plaintiffs' counsel had also negotiated for a reduction in some of the deal protections in the challenged merger agreement, which the Court concluded were not actual impediments to a competing bid, and thus was also of little value.[265]

---

continued from page 113

See, e.g., *Trulia*, 2016 Del. Ch. LEXIS 8, at *16. Defendants in such lawsuits are incentivized to settle to "achieve closing certainty" and minimize the expense and distraction of litigation, *id.* at *16, and thus settlements seem like a "necessary evil," *Acevedo* 7/8/15 Tr. at 64:304. Supplemental or corrective disclosures are the easiest "give" to be provided by defense groups, and thus a common way to settle such suits, *Trulia*, 2016 Del. Ch. LEXIS 8, at *18-19, though many question whether they provide "any identifiable much less quantifiable benefit to stockholders," *Acevedo* 7/8/15 Tr. at 65:2-4. The Court of Chancery is positioned to alleviate the perceived problems underlying disclosure-only settlements, because it has the obligation to review these settlements exercising its independent judgment to assure that the settlement is fair to absent class members. *Trulia*, 2016 Del. Ch. LEXIS 8, at *3.

258 *Trulia*, 2016 Del. Ch. LEXIS 8, at *23 (citing cases). *See also Acevedo* 7/8/15 Tr. at 62:12-15.

259. *Acevedo* 7/8/15 Tr. at 64:7-66:20 (observing that disclosure-only settlements contributed to the proliferation of M&A Litigation, fail to convey meaningful benefits to stockholders, undercut the credibility of the Litigation process, create disincentives for litigating meritorious claims, create blanket protections against potentially meaningful recovery, and undermine Delaware's reputation as the "honest broker in the legal realm").

260. *See e.g.*, In re Riverbed Technology, Inc. S'holders Litig., 2015 Del. Ch. LEXIS 241 (Sept. 17, 2015).

261. C.A. No. 9730-VCL (Del. Ch. July 8, 2015) (Laster, V.C.) (TRANSCRIPT).

262. *Acevedo* 7/8/15 Tr. at 78:15-19.

263. *Id.* at 73:19-22.

264. *Id.* at 73:7-16.

265. *Id.* at 71:8-72:10.

Given the deficiencies in the settlement, the Court refused to approve the settlement as presented by the parties, but offered alternative options. As one option, the Court invited the plaintiffs to reframe their motion as a mootness dismissal, as opposed to a settlement under Court of Chancery Rule 23 achieving mutual releases of the parties, but in which the plaintiffs' counsel could argue for (and likely obtain)[266] fees.[267] Alternatively, the Court recommended that the parties revise the proposed release to tailor it more pointedly to the claims investigated through the litigation.[268] As a final alternative, the Court welcomed the defendants to move to dismiss the action.[269] Ultimately the Court granted the defendants' motion to dismiss but retained jurisdiction to consider an application for attorneys' fees by plaintiff's counsel.[270]

In *In re Riverbed Technologies Stockholders Litigation*, the Court of Chancery approved a disclosure-only settlement, but decreased the attorney's fees sought by the plaintiffs' counsel.[271] In *Riverbed*, former stockholders of a corporation challenged a cash-out merger through a class action suit, initially seeking to enjoin the merger.[272] The Court expedited claims challenging the disclosure of potential conflicts of interest of a financial advisor to the corporation. Ten days later, the parties agreed to proposed settlement terms.[273]

Although it is rare for proposed settlements like that in *Riverbed* to draw objections, after the settlement was publically disclosed, Sean J. Griffith, a law school professor who has written about the difficulty of disclosure-only settlements bought stock in the company specifically to raise an objection.[274] Because the objector bought stock after the challenged transaction was announced, the plaintiffs argued that the objector lacked standing.[275] The Court rejected the argument, finding that despite having bought stock after the transaction and the settlement were announced, the professor nonetheless was a member of the class and therefore entitled to object.[276] In finding that the objector had standing, the Court dismissed concerns raised by the plaintiffs—that the Court's ruling would engender "'professional' objectors with nefarious strike-suit motives"—as something the Court can address by applying doctrines like unclean hands should the need arise.[277]

---

266. *Id.* at 75:18-21.

267. *Id.* at 74:5-17.

268. *Id.* at 74:18-75:2.

269. *Id.* at 75:3-17.

270. Acevedo v. Aeroflex Hldg. Corp., C.A. No. 9730-VCL (Del. Ch. Aug. 10, 2015) (ORDER).

271. In re Riverbed Tech., Inc. Stockholders Litig., 2015 Del. Ch. LEXIS 241 (Del. Ch. Sept. 17, 2015) (Glasscock, V.C.).

272. *Id.* at *3.

273. *Id.*

274. *Id.* at *5-6.

275. *Id.*

276. *Id.* The objector was Sean J. Griffith, one of the authors of *Confronting the Peppercorn Settlement in Merger Litigation: An Empirical Analysis and a Proposal for Reform*, 93 Tex. L. Rev. 557 (2015).

277. 2015 Del. Ch. LEXIS 241, at *8.

Before evaluating the fairness of the settlement, the Court canvased agency problems inherent in the settlement process, including the interests of class representatives and class counsel,[278] the interests of defendants,[279] and the lack of an adversary at the settlement approval phase.[280] The Court reiterated the need to balance "the value of all claims being compromised against the value of the benefit to be conferred on the Class by the settlement."[281] The Court approved the settlement, observing that the disclosures obtained—including that one of the financial advisors had existing engagements with the purchasers and their affiliates of a substantial nature—was "a positive result of small therapeutic value" but "not of great importance."[282] The Court noted: "the Plaintiffs have achieved for the class a peppercorn, a positive result of small therapeutic value to the Class which can support, in my view, a settlement*, but only where what is given up is of minimal value.*"[283]

The Court also warned of how similar suits may be treated in the future:

> I note first that, given the past practice of this Court in examining settlements of this type, the parties in good faith negotiated a remedy … with the reasonable expectation that the very broad, but hardly unprecedented, release negotiated in return would be approved by this Court. I note that this factor, while it bears some equitable weight here, will be diminished or eliminated going forward in light of this Memorandum Opinion and other decisions of this Court.[284]

The Court denied the plaintiffs' counsel's fee request of $500,000, although the defendants did not oppose the request, and instead awarded fees and costs of $330,000.[285] The plaintiffs' counsel argued that a number of mooted disclosures should be considered along with the disclosure by the financial institution.[286] The Court found the mooted disclosures to be evidence of "modest benefit," but noted that the mooted disclosures were the result of the company's

---

278. *Id.* at *9-10 ("A plaintiff's attorney may favor a quick settlement where the additional effort required to fully develop valuable claims on behalf of the class may not generate an additional fee as lucrative to the plaintiff's attorney as accepting a quick and moderate fee, then pursuing other interests.").

279. *Id.* at *9 ("the defendants' interest is largely subsumed within that of the successor entities' interests, which is commonly in the consummation of the deal and the termination of any further litigation threat … there is little incentive for the defendants to engage in further litigation threat even if the claims are weak … and every reason to go forward to obtain via settlement … the broadest release possible").

280. *Id.* at *13-14 ("In the class action arena, it falls on the Court to consider the fairness of [the settlement] exchange. The interests of the individual litigants and their counsel may not be fully aligned with the class ….").

281. *Id.* at *3 (quoting In re MCA, Inc. S'holders Litig., 598 A.2d 687, 691 (Del. Ch.1991)).

282. *Id.* at *18.

283. *Id.* (emphasis added).

284. *Id.* at *6 (citing In re Susser Hldgs. Corp. S'holder Litig., C.A. No. 9613-VCG (Del. Ch. Sept. 15, 2015) (Glasscock, V.C.) (TRANSCRIPT); *Acevedo* 7/8/15 Tr.; In re Intermune, Inc., S'holder Litig., C.A. No. 10086-VCN (Del. Ch. Jul. 8, 2015) (Noble, V.C.) (TRANSCRIPT)).

285. 2015 Del. Ch. LEXIS 241, at *22.

286. *Id.* at *6-7.

definitive proxy on the merger, and that the plaintiffs had filed their suit before even a preliminary proxy had been filed.[287] Ultimately, the Court awarded attorneys' fees of $200,000 for the supplemental disclosures as a direct result of litigation, $100,000 for the mooted disclosures, and almost $30,000 in costs.[288]

In *In re Aruba Networks, Inc. Stockholder Litigation*, the Court rejected a proposed settlement and dismissed the entire case with prejudice for inadequate representation by counsel.[289] *Aruba* involved a challenge to the acquisition of Aruba Networks by Hewlett-Packard Company.[290] The Court expressed doubts about the strength of the plaintiffs' claims early in the case, stating in the suit's scheduling order that plaintiffs' counsel should be prepared to explain "at oral argument why this matter should not be approached in the same manner as the Aeroflex case[,]" (thus referencing *Acevedo* discussed *supra*). The Court found several problems with the proposed settlement, and the litigation's process generally. First, the Court questioned whether the case had been meritorious when filed.[291] The suit was commenced before any proxy statement was filed, and thus the suit's only basis for relief was inadequate price, rather than any allegations of an ineffective process.[292] Second, although the plaintiffs had obtained discovery reflecting that the defendants' disclosures were materially inaccurate when made, the plaintiffs did not actively pursue remedies other than supplemental disclosures.[293] Third, and most importantly, the Court disapproved of the disparity between the broad release, although it carved out federal securities claims, and the benefit gained for the class.[294] The Court suggested that it would have supported a release of limited future claims, but could not agree to enter a settlement that had mild disclosure-only gains to the stockholder class, while giving the defendants a broad release from liability for all future derivative claims arising from the transaction.[295] Citing the same agency problems that earlier opinions discussed, the Court noted: "One thing we know is when people have a path to getting paid, behavior starts to reflect how one gets paid …. I am not saying anybody is consciously corrupt. The point is … we are all imperfect and subjectively limited humans."[296]

In early 2016, the Court of Chancery provided its clearest guidance yet as to the Court's changing reception of disclosure-only settlements. In *In re Trulia, Inc. Stockholder Litigation*, a stockholder class challenged the merger of Zillow, Inc. and Trulia, Inc., alleging breaches of fiduciary duties of Trulia's board in approving the proposed merger at an

---

287. *Id.*

288. *Id.* at *8.

289. C.A. No. 10765-VCL (Del. Ch. Oct. 9, 2015) (Laster, V.C.) (TRANSCRIPT).

290. *Id.* at 6-8.

291. *Id.* at 59.

292. *Id.*

293. *Id.* at 60:19-62:22.

294. *Id.* at 65:1-67:10.

295. *Id.*

296. *Id.* at 69:6, 69:18-23.

unfair exchange ratio.[297] After four months of discovery, the parties reached an agreement-in-principle to settle, detailed in a memorandum of understanding, and sought court approval of their proposed settlement.[298]

The Court rejected the settlement and, in doing so, signaled the Court's commitment to a harsher approach in evaluating disclosure-only settlements, affirming a new-found stance:

> [P]ractitioners should expect that disclosure settlements are likely to be met with continued disfavor in the future unless the supplemental disclosures address a *plainly material* misrepresentation or omission, and the subject matter of the proposed release is narrowly circumscribed to encompass nothing more than disclosure claims and fiduciary duty claims concerning the sale process, if the record shows that such claims have been investigated sufficiently.[299]

The Court further defined "plainly material," stating that "it should not be a close call that the supplemental information is material[.]"[300] In sum, after *Trulia*, practitioners should expect any settlements involving disclosure-only benefits to shareholders to be unsuccessful unless they both, 1) contain "narrowly circumscribed" releases, tailored to specific claims investigated in the litigation; and 2) the disclosures, themselves address "plainly material" misrepresentations or omissions.

The *Trulia* settlement did not meet this standard, the Court concluded. The Court held that Trulia's disclosures provided a "more-than-fair summary" of the information contained in its releases, and from the perspective of the Trulia's stockholders, "the 'get' in the form of the Supplemental Disclosures does not provide adequate consideration to warrant the 'give' of providing a release of claims to defendants and their affiliates in the form submitted or otherwise."[301] Importantly, the proposed settlement would release all "'unknown claims … arising under federal, state, foreign, statutory, regulatory, common law or other law or rule' held by any member of the proposed class relating in any conceivable way to the transaction."[302] The Court denied the settlement, holding that the supplemental disclosures had not been "material or even helpful to Trulia's stockholders."[303]

The Court also discussed the history and proliferation of disclosure-only suits at length, finding that "far too often such litigation serves no useful purpose for stockholders. Instead, it serves only to generate fees for certain lawyers

---

297. 2016 Del. Ch. LEXIS 8 (Del. Ch. Jan. 22, 2016) (Bouchard, C.). For earlier statements by Chancellor Bouchard on disclosure-only suits, see *In re TW Telecom, Inc. S'holders Litig.*, C.A. No. 9845-CB (Del. Ch. Aug. 20, 2015) (TRANSCRIPT), where the Chancellor questioned, but ultimately approved, a settlement containing broad releases of unknown claims for supplemental disclosures and a reduced matching rights period. The Chancellor stated, "So any time any member of the plaintiffs' bar walks in here to make one of these settlements, you better be ready to explain why things really matter in the real world. Not just some abstract 'more information is always better,' but why something really matters in the real world. Because I have a high degree of skepticism." The Chancellor reduced the requested fees to $150,00 (less than 40% of plaintiff's request).

298. *Id*. at *2.

299. *Id*. at *35 (emphasis added).

300. *Id*. at *35-36.

301. *Id*. at *59-60.

302. *Id*. at *10 (emphasis added).

303. *Id*. at *3.

who are regular players in the enterprise[.]"[304] Touching on agency concerns once again, the Court described how after striking an agreement-in-principle to settle, both plaintiffs and defendants "share the same interest in obtaining the Court's approval of the settlement[,]" and thus the litigation becomes "non-adversarial[.]"[305]

II. DERIVATIVE LITIGATION

A. Creditor Standing To Bring Derivative Claims

In *Quadrant Structured Products Company, LTD v. Vertin*,[306] the Court of Chancery provided further guidance concerning creditor standing to bring derivative claims on behalf of insolvent corporations.

Quadrant involved a motion for summary judgment filed by the board of Athilon Capital Corp. ("Athilon") seeking dismissal of derivative claims brought against them by the holder of Athilon's senior debt securities, Quadrant Structured Products Company, Ltd. ("Quadrant").[307] The board argued that Quadrant lacked standing to bring derivative claims on behalf of Athilon, contending that for a creditor to have derivative standing, the company on whose behalf the creditor sues must be insolvent at the time of suit and continuously thereafter.[308]

Acknowledging that the issue was one of "first impression," the Court denied the motion and held that there is no continuous insolvency requirement for creditors to have standing to bring derivative claims.[309] If a creditor can show that the company was insolvent at the date the suit was brought, a creditor has standing, so long as it remains a creditor, even if the company regains solvency during the pendency of the lawsuit.[310] In addition, the Court affirmed the use of the balance sheet test for determining whether a company is insolvent for the purpose of determining creditor standing.[311] In doing so, it rejected the argument that the "irretrievable insolvency" test (which is required for the appointment of a receiver) should be used to determine creditor standing to bring a derivative claim.[312]

The Court also provided guidance on the often murky issue of creditor standing to bring derivative claims.[313] In a thorough and clear review of the creditor derivative cases of the last decade,[314] the Court suggested that the actual

---

304. *Id.* at *16.

305. *Id.* at *19.

306. 115 A.3d 535 (Del. Ch. 2015) (Laster, V.C.).

307. *Id.* at 539.

308. *Id.*

309. *Id.* at 544, 548-556.

310. *Id.* at 548-556.

311. *Id.* at 556-561.

312. *Id.*

313. 102 A.3d 155, 177 (Del. Ch. 2014) (Laster, V.C.).

314. 115 A.3d at 545-556 (discussing the Delaware law concerning creditor standing to pursue derivative claims before and after N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92, 101 (Del. 2007)).

claims that creditors can successfully pursue are, as a practical matter, quite narrow—in essence breaches of the duty of loyalty through self-interested transactions and waste claims.[315]

B. Pleading Demand Futility

In *Delaware County Employees Retirement Fund v. Sanchez*,[316] the Delaware Supreme Court articulated the standard a plaintiff must meet when pleading demand excusal under *Aronson v. Lewis*[317] on the basis that the directors are not disinterested and independent. In reversing the Court of Chancery, the Supreme Court held that a trial court must consider all facts pled by the plaintiff regarding the directors' lack of disinterestedness and independence in their totality and draw all reasonable references in favor of the plaintiff.

Sanchez involved a transaction in which Sanchez Energy Corporation ("Sanchez Energy") purchased a partial working interest in 40,000 acres of undeveloped land from Sanchez Resources, LLC ("Sanchez Resources"), a private company whose equity was wholly owned by the family of A.R. Sanchez, Jr.[318] Members of the Sanchez family stood on both sides of the transaction—owning Sanchez Resources outright, and having a significant 21.5% stake in Sanchez Energy. Two Sanchez family members also sat on the Sanchez Energy board.[319] The other three board members acted as the audit committee, which was created for the purpose of evaluating and approving interested-party transactions between Sanchez Energy and Sanchez family members.[320] The independent audit committee members, assisted by a financial advisor, approved the transaction with Sanchez Resources.[321]

Stockholder plaintiffs filed a derivative action alleging a breach of fiduciary duty claim against all of the directors for approving the transaction. The plaintiffs did not make a pre-suit demand, arguing that such a demand was futile under the first prong of the *Aronson* test because two of the three members of the audit committee lacked independence from the Sanchez family.[322] In *Aronson*, the Supreme Court held that a plaintiff who has not made a demand on the board must plead allegations raising a reasonable doubt that "(1) the directors are disinterested and independent [or] (2) the challenged transaction was otherwise the product of a valid exercise of business judgment."[323] The plaintiff primarily based their argument on allegations that one of the audit committee members, Jackson, had donated to a Sanchez family member's political campaign and maintained a close friendship with the Sanchez patriarch "for more than five decades."[324] The plaintiff also noted that Jackson had several other business relationships with the Sanchez family.

315. 115 A.3d at 554.

316. 124 A.3d 1017 (Del. 2015), *aff'g* 2014 Del. Ch. LEXIS 239 (Del. Ch. Nov. 25, 2014) (Glasscock, V.C.).

317. 473 A.2d 805 (Del. 1984).

318. 2014 Del. Ch. LEXIS 239, at *6.

319. *Id.* at *3.

320. *Id.* at *7.

321. *Id.*

322. *Sanchez*, 2014 Del. Ch. LEXIS 239, at *8.

323. *Aronson*, 473 A.2d at 814.

324. *Sanchez*, 2014 Del. Ch. LEXIS 239, at *16.

The Court of Chancery dismissed the complaint, finding the plaintiffs' allegations wholly insufficient bases upon which to reasonably infer that either Jackson or Garcia lacked independence from the Sanchez family.[325] In doing so, the Court of Chancery analyzed Jackson's friendship with the Sanchez family and his business relationships with the Sanchez family as two distinct issues, ultimately concluding that each one on its own did not support the inference that Jackson could not act independently of the Sanchez board members for the purpose of demand excusal.[326]

The Supreme Court disagreed with the Court of Chancery's approach. The Supreme Court explained that Delaware law "requires that all the pled facts regarding a director's relationship to the interested party be considered in full context in making the, admittedly imprecise, pleading stage determination of independence."[327] The Supreme Court added that the court is required to draw all inferences from those facts in favor of the plaintiff at the pleading stage.[328]

In applying that standard, the Supreme Court held that the plaintiffs had pled sufficient facts to show "that there is a reasonable doubt that Jackson can act impartially in a matter of economic importance to Sanchez personally."[329] The Supreme Court distinguished the facts of the case from the facts in *Beam v. Stewart*,[330]—a seminal case in which the Supreme Court held that allegations that the directors "moved in the same social circles, attended the same weddings, developed business relationships before joining the board, and described each other as 'friends,'" were insufficient to plead demand excusal—explaining that the plaintiffs "did not plead the kind of thin social-circle relationship" that was at issue in that case.[331] Instead, the Supreme Court concluded that the plaintiffs had pled facts regarding the economic relationship between Jackson and Sanchez "that buttress their contention that they are confidantes."[332]

C. Collateral Estoppel And *Res Judicata* Effect Of Dismissal Due To A Failure To Plead Demand Excusal

In *City of Providence v. Dimon*,[333] and *Asbestos Workers Local 42 Pension Fund v. Bammann*,[334] the Court of Chancery applied the full faith and credit doctrine and holding of *Pyott v. La. Municipal Police Employees' Retirement System*,[335] to dismiss claims previously dismissed in a prior New York actions for failure to plead demand futility.

---

325. *Id.* at *21.

326. *Id.*

327. 124 A.3d at 1022.

328. *Id.*

329. *Id.*

330. 845 A.2d 1040.

331. *Sanchez*, 124 A.3d at 1022.

332. *Id.*

333. 2015 Del. Ch. LEXIS 195 (Del. Ch. July 29, 2015) (Parsons, V.C.), *aff'd* 2016 Del. LEXIS 98 (Del. Feb. 25, 2016).

334. 2015 Del. Ch. LEXIS 142 (Del. Ch. May 21, 2015) (Glasscock, V.C.), *aff'd* 2016 Del. LEXIS 40 (Del. Jan. 28, 2016).

335. 74 A.3d 612, 615 (Del. 2013).

In *City of Providence*, the plaintiffs filed suit derivatively on behalf of JPMorgan Chase & Co. ("JPMorgan") seeking to hold the company's board and officers liable for over $2 billion lost through a series of settlements and consent orders relating to alleged violations of federal anti-money laundering statutes and regulations, some of which arose from the Maddoff Ponzi schemes.[336] In *Asbestos Workers*, the plaintiffs sued derivatively on behalf of JPMorgan, seeking to hold the company's board accountable for approximately $6.3 billion in damages caused in 2012 as a result of complex, high-risk trading by the Chief Investment Officer, nicknamed the "London whale."[337]

In both cases, the defendants moved to dismiss the lawsuit, arguing that principles of collateral estoppel and *res judicata* barred the claims because a prior lawsuit in New York federal and state courts arising out of the same series of transactions was dismissed for failure to plead demand futility.[338] In both cases, the Court of Chancery granted the defendants' dismissal motion, albeit under difference theories. In *City of Providence*, the Court concluded that because *res judicata* barred the Delaware litigation from proceeding forward, the Court need not analyze whether collateral estoppel likewise precluded the lawsuit.[339] In *Asbestos Workers*, the opposite result was reached—the Court dismissed the case under theories of collateral estoppel, and reasoned that the Court need not analyze whether *res judicata* precluded the lawsuit.[340]

In *City of Providence*, the Court observed that under Delaware law applying the *Full Faith and Credit Clause of the United States Constitution* and the Full Faith and Credit Act, "once a court of competent jurisdiction has issued a final judgment, a successive case is governed, under the full faith and credit doctrine, by the principles of collateral estoppel and res judicata rather than by demand futility law."[341] The Court applied New York law to analyze the *res judicata* argument. Under New York *res judicata* law, a party may not re-litigate a claim from a prior action between the same parties involving the same subject matter.[342] The Court also observed that, under New York law, "a later stockholder asserting derivative claims on behalf of a corporation is considered to be the 'same plaintiff' as a different stockholder asserting those claims on behalf of the corporation in a separate action."[343] Thus, the critical question in *City of Providence* was whether the prior action involved the same subject matter. New York applies a transactional analysis to this question, such that "once a claim is brought to a final conclusion, all other claims arising out of the same transaction or series of transactions are barred, even if based upon different theories or if seeking a different remedy."[344] The Court concluded that because the deferred prosecution agreement that was the focal point of the prior action was also the centerpiece of the settlements and consent orders challenged in the Delaware lawsuit, the transactional analysis was satisfied.[345] In reaching this conclusion,

336. 2015 Del. Ch. LEXIS 195, at *2.

337. 2015 Del. Ch. LEXIS 142, at *4-5.

338. *Id.*

339. 2015 Del. Ch. LEXIS 195, at *2-3.

340. 2015 Del. Ch. LEXIS 142, at *3-4.

341. *Id.* at *21 (citing Pyott v. La. Mun. Polic Emps.' Ret. Sys., 74 A.3d 612, 615 (Del. 2013)).

342. 2015 Del. Ch. LEXIS 195, at * 23. (citing In re Hunter, 826 N.E.2d 269, 274 (N.Y. 2005)).

343. *Id.*

344. *Id.* at *25 (citing *Hunter*, 827 N.E.2d at 274).

345. *Id.* at *25-30.

the Court rejected the plaintiff's argument that for *res judicata* to bar subsequent litigation, the "same evidence" must be needed to "support both claims," and the "facts essential to the second" must be "present in the first."[346]

In *Asbestos Workers*, the Court applied New York law in considering the elements of collateral estoppel. Under New York law, two requirements must be met before a party is barred from relitigating an issue on the basis of collateral estoppel: (1) "the party seeking the benefit of collateral estoppel must prove that the identical issue was necessarily decided in the prior actions and is decisive in the present action"; and (2) "the party to be precluded from relitigating an issue must have had a full and fair opportunity to contest the prior determination."[347] The Court also noted that under New York law "it is well-settled that collateral estoppel may be applied in the shareholder derivative context."[348] Because the plaintiffs had not argued that they lacked the opportunity to fully and fairly litigate the issues in the New York action, the "sole question" was whether the identical issues had been necessarily decided.[349] The Court held that collateral estoppel barred the plaintiffs' claims because the issue under consideration in the Delaware action was the "precise question" presented by the plaintiffs in the New York action.[350] In so concluding, the Court rejected the plaintiffs' argument that collateral estoppel did not apply because the controlling facts were more developed and pleaded more compellingly in the Delaware action than in the New York action.[351] The Court explained that this argument misapprehended the standard; rather "the underlying conduct is what is at issue, not whether the [c]omplaint raises additional facts, or a more compelling characterization of those facts, regarding the same conduct previously at large."[352]

The Delaware Supreme Court summarily affirmed both decisions.[353]

D. Common Law Defense Of Stockholder Ratification In Challenges To Non-Employee Director Compensation

Two 2015 decisions in derivative lawsuits challenging non-employee director compensation—*Calma v. Templeton*[354] and *Espinoza v. Zuckerberg*[355]—addressed whether particular stockholder conduct accomplishes ratification so as to shift the standard of review.

---

346. *Id.* at *34.

347. *Id.* at *47.

348. *Id.*

349. *Id.* at *49.

350. *Id.*

351. *Id.* at *53.

352. *Id.*

353. *Asbestos Workers*, 2016 Del. LEXIS 40 (Del. Jan. 28, 2016); *City of Providence*, 1026 Del. LEXIS 98 (Del. Feb. 25, 2016).

354. 114 A.3d 563 (Del. Ch. 2015) (Bouchard, C.).

355. 124 A.3d 47 (Del. Ch. 2015) (Bouchard, C.)

In *Calma*, the director defendants argued that stockholder approval of the compensation plan pursuant to which the challenged decisions were made constituted ratification sufficient to shift the standard of review.[356] The Court disagreed, concluding that "in obtaining omnibus approval of a Plan covering multiple and varied classes of beneficiaries, the Company did not seek or obtain stockholder approval of any action *bearing specifically on the magnitude of compensation to be paid to its non-employee directors*."[357] In reaching this conclusion, the Court contrasted the plan at issue in *Calma* with plans that placed meaningful limits on director compensation, and emphasized that a stockholder vote must approve the "specific decision of the board of directors" under scrutiny to have a standard-shifting effect.[358] The *Calma* decision is consistent with the Court of Chancery's 2012 decision in *Seinfeld v. Slager*,[359] and signaled that *Seinfeld* was not an aberration.

Whereas in *Calma*, the defendants argued that a stockholder vote of a compensation plan should be sufficient to ratify or provide insulating effect to issuances made pursuant to such a plan, in *Zuckerberg*, the defendants argued that the assent of a controlling stockholder to the compensation decisions at issue should suffice to invoke the business judgment rule. In rejecting this argument, the Delaware Court of Chancery resolved an issue of first impression, holding that a controlling stockholder's informal expression of assent was insufficient to ratify a board action so as to shift the standard of review from entire fairness to the business judgment rule.[360]

Zuckerberg involved derivative claims challenging the Facebook board's 2013 approval of compensation to its outside directors.[361] Given that a majority of the board were outside directors and were therefore conflicted regarding the compensation decision, the parties agreed that the entire-fairness standard would apply to the decision unless the defendants could successfully demonstrate that stockholder ratification entitled the board to the presumption of the business judgment rule.[362] The defendants, including Facebook's controlling stockholder and board chairman, Mark Zuckerberg, argued such ratification had occurred because Zuckerberg (in his capacity as Facebook's controlling stockholder) expressed his approval of the decision through his deposition and in an affidavit.[363] The plaintiff countered that Zuckerberg's informal expressions of assent were insufficient to constitute stockholder ratification under Delaware law, and that to have a standard-shifting impact, ratification must be accomplished pursuant to Section 228 of the Delaware General Corporation Law (the "DGCL") by a stockholder vote at a meeting or by written stockholder consent.[364]

On the defendants' motion for summary judgment, the Court ruled in favor of the plaintiff, concluding that a controlling stockholder may accomplish standard-shifting ratification only through formal stockholder action at a meeting or by written consent, and thus that the entire-fairness standard would be applied to the 2013 compensation decision.[365]

---

356. 114 A.3d at 569.

357. *Id.* (emphasis in original).

358. Id. at 586.

359. 2012 Del. Ch. LEXIS 139 (Del. Ch. June 29, 2012) (Glasscock, V.C.).

360. 124 A.3d at 49.

361. *Id.*

362. *Id.* at 49, 54.

363. *Id.* at 50, 54.

364. *Id.* at 54-55.

365. *Id.* at 49.

Among other grounds for its ruling, the Court cited policy goals that would be advanced by a rule requiring ratification to comply with the "formal mechanisms" set forth in the DGCL.[366] Specifically, the Court noted that requiring adherence to corporate formalities would promote transparency, enable minority stockholders to stay abreast of decision making, and limit the potential for ambiguity and misinterpretation of an act by which ratification is later claimed to have been accomplished.[367]

The Court also observed that the presence of a single controlling stockholder like Zuckerberg, as opposed to a control group, did not change the analysis.[368] Even though Zuckerberg "can outvote all other stockholders and thus has the power to effect any stockholder action he chooses," the Court explained, "he still must adhere to corporate formalities (and his fiduciary obligations) when doing so, because his rights as a stockholder are no greater than the rights of any other stockholder—he simply holds more voting power."[369]

III. CASES INVOLVING STOCKHOLDER RIGHTS

A. Removal Of Directors "Without Cause" Under 8 Del. C. § 141

In *In re VAALCO Energy, Inc. Consolidated Stockholder Litigation*,[370] the Court of Chancery held that a company without a classified board may not eliminate a stockholders' ability to remove directors without cause by operation of 8 *Del. C.* § 141(k).

In 2009, VAALCO Energy Inc. ("VAALCO") amended its corporate charter to de-classify its staggered board and establish a board elected annually, but left in place other charter and bylaw provisions limiting the removal of directors to "only for cause."[371] In 2015, in response to an activist investor's consent solicitation to remove members of VAALCO's board, VAALCO responded that its charter and bylaws precluded removal of directors without cause in between annual elections.[372] Stockholder plaintiffs filed a class action contending that under Section 141(k) of the Delaware General Corporation Law, stockholders have the right to remove directors without cause unless the company has a classified board or cumulative voting.[373] In a December 21, 2015 bench ruling, the Court of Chancery invalidated the removal for-cause limitations of VAALCO's charter and bylaws.[374]

---

366. *Id.* at 61.

367. *Id.* at 50, 55, 57, 64, 65.

368. *Id.* at 65.

369. *Id.*

370. C.A. No. 11775-VCL (Del. Ch. Dec. 21, 2015) (TRANSCRIPT) ("12/21/15 *VAALCO* Tr.").

371. Op. Br. in Opp. to Pls.' Mot. for Summary Judgment and in Support of Defs.' Mot. for Summary Judgment, In re VAALCO Energy, Inc. Cons. S'holder Litig., C.A. No. 11775-VCL, Dkt. No. 9 (Del. Ch. Dec. 14, 2015), at pp.1, 6-9.

372. *Id.* at pp. 10-13.

373. *Id.* at 1; Ver. Compl. for Breaches of Fiduciary Duties, In re VAALCO Energy, Inc. Cons. S'holder Litig., C.A. No. 11775-VCL, Dkt. No. 1 (Del. Ch. Dec. 7, 2015).

374. 12/21/15 *VAALCO* Tr. at 3:12-18.

This ruling is likely to be of interest to the many companies (at least 175)[375] with similar charter and bylaw provisions as those deemed invalid in *VAALCO*.

B. Inspection Of Books And Records Under 8 Del. C. § 220

1. The Proper Purpose Requirement

Under Section 220 of the Delaware General Corporation Law, to inspect books and records, a stockholder must state a "proper purpose,"[376] and is required to demonstrate that proper purpose, in any enforcement action, by a preponderance of the evidence.[377] A proper purpose is defined as one "reasonably related to such person's interest as a stockholder."[378] In two 2015 decisions—*Fuchs Family Trust v. Parker Drilling Co.*[379] and *Southpaw Credit Opportunity Master Fund LP v. Advanced Battery Techs.*[380]—the Court of Chancery clarified the proper purpose requirement and denied inspection demand where the plaintiff failed to state a proper purpose.

In *Fuchs*,[381] the Court denied a demand to inspect documents to investigate mismanagement where a federal court had dismissed with prejudice an action challenging the same allegedly wrongful acts. As in *City of Providence* and *Asbestos Workers*, discussed *supra* § I.B.3, the Court concluded that as a consequence of the Court's dismissal with prejudice of the prior federal action, collateral estoppel barred prosecution of the claims that the plaintiffs sought to investigate.

Fuchs arose from the 2010 disclosure by Parker Drilling Co. ("Parker") that the DOJ and SEC had requested information about the company's operations in Kazakhstan and Nigeria to investigate potential violations of the Foreign Corrupt Practices Act ("FCPA"), which prohibits the bribing of foreign officials.[382] Parker further disclosed that an internal investigation had revealed potential non-compliance with the FCPA.[383]

In response to the disclosures, stockholders filed derivative actions in Texas state and federal courts alleging that Parker's directors and executives had breached their fiduciary duties by failing to implement and maintain internal controls to ensure Parker remained legally compliant.[384] The Texas state courts dismissed the plaintiffs' petition (and an

---

375. *Id.* at 11:8-12.

376. 8 Del. C. § 220(b)(1).

377. Seinfeld v. Verixon Commc'ns, Inc., 909 A.2d 117, 121 (Del. 2006).

378. 8 Del. C. § 220(b).

379. 2015 Del. Ch. LEXIS 55 (Del. Ch. Mar. 4, 2015) (Noble, V.C.).

380. 2015 Del. Ch. LEXIS 54 (Del. Ch. Feb. 26, 2015) (Legrow, M.).

381. 2015 Del. Ch. LEXIS 55.

382. *Id.* at *2.

383. *Id.*

384. *Id.* at *3-4.

amended petition) without prejudice on the grounds that the plaintiffs failed to adequately plead demand futility.[385] The federal court dismissed the complaint with prejudice, a decision affirmed by the Fifth Circuit.[386]

Parker later entered into a deferred prosecution agreement with the DOJ and a civil settlement with the SEC (the "Settlement").[387] In its settlement papers, which were made public, Parker admitted that two Parker executives had used a lawyer obtained by Parker to channel $1.25 million in bribes to Nigerian officials.[388]

After the Settlement, the plaintiff sent a Section 220 inspection demand to the Parker board. Parker rejected the demand and asserted that the plaintiff had failed to state a proper purpose or credible basis for inspection.[389] The plaintiff subsequently narrowed its demand to include only documents sufficient to allow identification of two Parker executives, the outside law firm, and the lawyer involved for the stated purpose of assessing potential litigation or to demand Parker take action.[390] The action was tried on a paper record.[391]

The Court of Chancery ruled that the plaintiff's stated purpose of assessing potential litigation was not proper because any future derivative action brought by the plaintiff on this issue would be barred by collateral estoppel.[392] The Court held that the Texas federal court's dismissal with prejudice barred future action by this plaintiff because (1) in a derivative action, all stockholders are in privity with a shareholder plaintiff, making the Delaware 220 plaintiff in privity with the plaintiffs in the federal action; (2) both plaintiffs in the Delaware 220 action and the federal action alleged breaches of fiduciaries duties based on the same underlying actions by Parker and both advanced largely the same legal theories; and (3) the fact Parker had not publically admitted the bribery scheme prior to the federal court's ruling did not defeat the application of collateral estoppel because Parker's public admission was not material to the federal court's decision.[393] Given that collateral estoppel would bar all future derivative actions brought by the plaintiff in this context, the Court of Chancery held that investigating a claim was not a proper purpose for the plaintiff to demand inspection.[394]

In *Southpaw*,[395] the Court of Chancery concluded that the plaintiff's desire to conduct a risk assessment concerning the purchase of additional stock was not a proper purpose.

Southpaw involved a corporate defendant that was delisted from the NASDAQ in 2011.[396] The plaintiff, a hedge fund, purchased shares of the defendant's stock in March 2014, aware that the defendant was delisted but believing the

---

385. *Id.* at *4.

386. *Id.*

387. *Id.* at *5-6.

388. *Id.* at *6.

389. *Id.* at *7.

390. *Id.*

391. *Id.*

392. *Id* at *16-24.

393. *Id.* at *17-19.

394. *Id.* at *23.

395. 2015 Del. Ch. LEXIS 54.

396. *Id.* at *1.

stock was undervalued.[397] Thereafter, the plaintiff demanded to inspect records for the stated purposes of (1) assessing the risk of buying more shares of the defendant's stock and of maintaining its current holdings, and (2) to determine the actual value of its purchased shares.[398] When the parties could not settle the terms of the document inspection, the plaintiff filed a books and records action.[399]

The Court concluded that the plaintiff's risk assessment purpose was not a proper purpose, because the risk assessment purpose appeared to be an attempt by the plaintiff to obtain the information it would receive if the defendant was compliant with SEC regulations.[400] The Court concluded that because Section 220 is not to be used to give stockholders the power to enforce SEC regulations, the plaintiff's risk assessment purpose was not proper insofar as it aimed to achieve that end.[401]

The Court further concluded, however, that the plaintiff's valuation purpose was proper, regardless of the fact the plaintiff had purchased stock without knowledge of the stock's value or the defendant's financial health at the time.[402] The Court therefore decided that the plaintiff was entitled to inspect the books and records necessary and essential to valuing its stock with the defendant.[403]

2. The Credible Basis Standard

Where the stated purpose of an inspection demand is to investigate mismanagement, the stockholder must provide some evidence that suggests a credible basis from which such mismanagement can be inferred.[404] The credible basis standard is the lowest possible burden of proof under Delaware law, and "falls far short of requiring a stockholder to prove by a preponderance of the evidence that mismanagement or wrongdoing actually has occurred."[405] Two 2015 Section 220 decisions—*Oklahoma Firefighters Pension & Retirement System v. Citigroup Inc.*[406] and *Southeastern Pennsylvania*

---

397. *Id.* at *4-5.

398. *Id.* at *5.

399. *Id.* at *6.

400. *Id.* at *14-16.

401. *Id.* at *16-17, *31-33.

402. *Id.* at *17-20.

403. *Id.*

404. Southeastern Pa. Trans. Auth. v. AbbVie, Inc., 2015 Del. Ch. LEXIS 110, at *42 (Del. Ch. Apr. 15, 2015) (Glasscock, V.C.), *aff'd* No. 239, 2015 (Del. Jan. 20, 2016) (ORDER).

405. Okla. Firefighters Pension & Ret. Sys. v. Citigroup Inc., 2014 Del. Ch. LEXIS 189, at *18 (Del. Ch. Sept. 30, 2014) (LeGrow, M.), *aff'd* 2015 Del. Ch. LEXIS 199 (Apr. 24, 2015) (Noble, V.C.).

406. 2014 Del. Ch. LEXIS 189 (Del. Ch. Sept. 30, 2014) (LeGrow, M.), *aff'd* 2015 Del. Ch. LEXIS 119 (Del. Ch. Apr. 24, 2015) (Noble, V.C.).

Transportation Authority v. AbbVie, Inc.[407]—addressed whether a plaintiff had established a credible basis to infer mismanagement for the purpose of obtaining inspection.

In *Citigroup*, the plaintiff sought to inspect books and records for the purpose of investigating mismanagement and possible breaches of fiduciary duty in connection with fraud at Banamex, one of Citigroup's indirect wholly-owned foreign subsidiaries, and Citigroup's internal investigation of that fraud.[408] The plaintiff also demanded information concerning whether pre-suit demand would be excused in any action related to the events at Banamex.[409] In response to the plaintiff's demand, Citigroup asserted that no proper purpose had been stated because the plaintiff failed to meet the credible basis standard.[410]

The Court found that the plaintiff had established a credible basis for a possible breach of fiduciary duty in connection with the fraud at Banamex. The Court recognized that "the mere fact that wrongdoing occurred at a subsidiary is not a credible basis to infer mismanagement by the board or senior management of a parent company."[411] In this case, however, the Court found that a credible basis had been established with respect to the fraud at Banamex because of "[t]he scope of the fraud at the subsidiary [i.e., Banamex], the significance of the subsidiary to the parent company's profits, the public reports indicating that investigations uncovered deficiencies in internal controls, and the fact that one of the parent company's senior executives oversees the subsidiary and the parent company's board and its committees are responsible for overseeing the controls in question."[412] The finding of a credible basis fell well short of demonstrating that any wrongdoing actually occurred, but provided a basis for inspection of the company's books and records.[413] To that end, the Court observed that a stockholder is *not* required to provide specific and concrete evidence of wrongdoing to sustain a Section 220 demand.[414]

The Court also found that the plaintiff had established a credible basis to infer mismanagement in connection with the investigation into Banamex's regulatory compliance.[415] Although the Court observed that the consent orders alone would not have formed a credible basis, the Court cited in combination (1) the findings of various regulators underlying the consent orders; (2) the consent orders by which Citigroup undertook to improve its Bank Secrecy Act and anti-money laundering compliance and controls; and (3) the subpoenas issued in the wake of the regulators' findings and the consent orders.[416] The Court further noted that it would be improper to infer wrongdoing by Citigroup's directors simply because

---

407. 2015 Del. Ch. LEXIS 110 (Del. Ch. Apr. 15, 2015) (Glasscock, V.C.), *aff'd* No. 239, 2015 (Del. Jan. 20, 2016) (ORDER).

408. 2015 Del. Ch. LEXIS 189, at *2-9.

409. *Id.* at *3.

410. *Id.* at *13.

411. *Id.* at *18.

412. *Id.* at *19-20.

413. *Id.* at *20.

414. *Id.*

415. *Id.* at *21-22.

416. *Id.*

they had oversight over Banamex at the time the fraud occurred. However, the Court concluded that there was a credible basis to infer wrongdoing given that Banamex generates 10% of Citigroup's annual profits, the fraud was extensive enough to require Citigroup to restate its financials, Citigroup's CEO admitted there were multiple "telltale" signs that employees should have recognized and relayed to supervisors, Citigroup did not review its credit exposure after Standard & Poor's stopped rating an important company involved in the fraud, and the fraud involved a central component of Citigroup's business.[417]

In affirming the Master's report, the Court of Chancery focused on the fact the government-issued subpoenas were sent out quickly after Citigroup entered its consent orders, indicating to the Court that the government investigation was related, at least in part, to the events that occurred at Banamex.[418] The plaintiff therefore had a proper purpose to investigate the controls and compliance programs the board agreed to under the consent orders.[419]

In contrast, in *AbbVie*,[420] the Court denied the stockholders' inspection demand for failure to establish a credible basis to infer corporate wrongdoing in a rescinded corporate inversion.

In July 2014, AbbVie, Inc. ("AbbVie") entered into a formal agreement with the foreign entity Shire plc ("Shire") to undergo a corporate inversion that would significantly reduce AbbVie's corporate tax obligations.[421] In September 2014, the United States Treasury and Internal Revenue Service announced their intent to issue retroactive regulations to eliminate the tax benefits available from merger-based inversions.[422] In light of the regulatory changes, the AbbVie board reversed its favorable recommendation of the inversion agreement and terminated the proposed agreement.[423] AbbVie then paid Shire the break-up fee provided for in the proposed agreement.[424.]

The stockholder plaintiffs sought ten categories of documents for the stated purposes of investigating potential breaches of fiduciary duties, mismanagement, wrongdoing, and corporate waste by the AbbVie board and officers, demand futility,[425] and potential aiding and abetting by AbbVie's financial advisor in the inversion, J.P. Morgan.[426] AbbVie rejected the plaintiffs' demands for failure to state a proper purpose on the grounds that the plaintiffs failed to establish a credible basis.[427] AbbVie also argued that because its Certificate of Incorporation exculpated directors from liability for a

---

417. *Id.* at *7.

418. 2015 Del. Ch. LEXIS 119, at *17-19.

419. *Id.* at *19.

420. 2015 Del. Ch. LEXIS 110.

421. *Id.* at *4-6.

422. *Id.* at *27-28.

423. *Id.* at *30.

424. *Id.* at *31.

425. *Id.*

426. *Id.* at *31-32.

427. *Id.* at *33.

breach of duty of care pursuant to Section 102(b)(7) of the DGCL, investigating any such breach was futile and did not constitute a proper purpose.[428]

The Court of Chancery held, after a coordinated one-day trial,[429] that a plaintiff whose sole purpose is to assess a derivative action can only investigate non-exculpated corporate wrongdoing—i.e., breaches of the duty of loyalty, actions in bad faith, or corporate waste.[430] The Court held that a failed merger, without more, does not create a credible basis to infer corporate wrongdoing under *U.S. Die Casting & Developing Company v. Security First Corporation*.[431] The Court distinguished the facts of *U.S. Die-Casting*, which involved a suspicious failed merger and subsequent generous, gratuitous payments by the board, from AbbVie's payment of the break-up fee.[432] Likewise, contrary to the plaintiffs' suggestion, the amount of the break-up fee, on its own, could not establish a credible basis to infer bad faith.[433] Instead, the plaintiffs had to show that the risk of termination was so clear that the board's agreement to the break-up fee in the first place amounted to a willful and wrongful disregard of the corporation's interest.[434] Based upon the record before it, the Court determined that was not the case.[435] Given that the board had considered the political environment, which was hostile to inversion but appeared thoroughly gridlocked, in making its decision to go forward, there was no credible basis to infer bad faith.[436] The Court further held that because the deal would have created substantial value but for the changes in tax regulations, there was no credible basis to infer that paying the break-up fee constituted corporate waste.[437]

The Court also concluded that investigating the corporation's potential claims against a third party is not a proper purpose for a Section 220 demand in the absence of a credible basis to believe the directors could not adequately decide whether to pursue the company's claims.[438] The Court began by noting its holding in *Saito v. McKesson HBOC, Inc.*, that investigating potential claims against a defendant's third-party advisors was not a proper purpose.[439] The Court adopted that holding, though not categorically.[440] The Court held that any potential claims against J.P. Morgan were

---

428. *Id.* at *40.

429. *Id.* at *33.

430. *Id.* at *40.

431. *Id.* at *48.

432. *Id.*

433. *Id.* at *50.

434. *Id.* at *52.

435. *Id.* at *53-54.

436. *Id.* at *53.

437. *Id.* at *53-54.

438. *Id.* at *62-63.

439. *Id.* at *61 (citing *Saito*, 2001 Del. Ch. LEXIS 96, at *21 (Del. Ch. July 10, 2001), *aff'd in relevant part*, 806 A.2d 113 (Del. 2002)).

440. *Id.* at *62-63.

AbbVie's to vindicate, and that because the plaintiffs had failed to establish a credible basis to infer that the directors, who would be exculpated from personal liability for any underlying breach, could not make an informed decision whether or not to pursue claims against J.P. Morgan, the plaintiff had no proper purpose to investigate any aiding and abetting of a third-party advisor.[441]

3. The Necessary And Essential Requirement

In the context of a Section 220 action, once a stockholder has demonstrated a proper purpose, the stockholder is entitled only to "documents in the corporation's possession, custody or control, that are necessary to satisfy that proper purpose."[442] This restriction as to the scope of inspection, sometimes referred to as the "necessary and essential" requirement, was at issue in multiple 2015 decisions, including *In re Lululemon Athletica Inc. 220 Litigation*,[443] *Southpaw*,[444] and *Fuchs*.[445]

In *Lululemon*, the Court of Chancery denied the plaintiffs' request to inspect the personal e-mail accounts of the board members of lululemon athletica, inc. ("lululemon"), but granted inspection of necessary though privileged documents under Section 220 (*see* discussion *infra*). *Lululemon* arose from a motion to enforce an order from the Court of Chancery directing the defendant to produce documents related to potential mismanagement claims.[446] The defendant had already produced 195 documents, but the plaintiffs argued that the defendant should be required to search for and produce responsive emails from board members' non-company, personal e-mail accounts.[447]

In denying inspection of the board members' personal e-mail accounts, the Court observed that the plaintiffs had failed to show by a preponderance of the evidence that the non-company emails were necessary and essential to their proper purpose and therefore denied expanding of the scope of investigation.[448] The Court determined that the "crux" of the plaintiffs' proper purpose was to investigate whether any director had contacted lululemon to investigate possible insider trading.[449] However, any inquiries to that end would have ended up on the company's email server, which was

---

441. *Id.*

442. *Saito*, 806 A.2d at 115.

443. 2015 Del. Ch. LEXIS 127 (Del. Ch. Apr. 30, 2015) (Parsons, V.C.).

444. 2015 Del. Ch. LEXIS 54 (Del. Ch. Feb. 26, 2015) (Legrow, M.).

445. 2015 Del. Ch. LEXIS 55 (Del. Ch. Mar. 4, 2015) (Noble, V.C.).

446. 2015 Del. Ch. LEXIS 127, at *1. The plaintiffs alleged that, in December 2012, lululemon's then-Chairman of the Board of Directors, Dennis Wilson, entered into a trading plan (the "Trading Plan") wherein his broker was allowed to sell a capped number of his shares of common stock per month. On June 5, 2013, Wilson learned that lululemon's then-CEO planned to leave the company. On June 7, 2013, the entire board was informed of the news. On that same day, Wilson's broker sold over 600,000 shares of Wilson's stock, maxing out the monthly limit. A few days later, lululemon publically announced the then-CEO's resignation and the price of shares dropped. The *Wall Street Journal* emailed lululemon to confirm facts for a story on the June 7 sale. Individuals from Wilson's personal investment office and lululemon emailed one another to craft a coordinated response to the *Wall Street Journal* (the "WSJ Email Chain"). Later, lululemon's corporate secretary and in-house counsel responded to an email from one of lululemon's directors asking if the sale had conformed to the terms of the Trading Plan (the "Nicholas Email").

447. *Id.* at *7.

448. *Id.* at *21-22.

449. *Id.* at *23.

included in the original inspection order.[450] The Court held that though emails sent by directors on their personal email accounts might be "interesting" or "helpful" to the plaintiffs, they were not necessary and essential to the stated proper purpose, and therefore expanding the scope of investigation was unwarranted.[451]

Moreover, the Court noted that even if the documents were to fall within the plaintiffs' inspection right, it remained unclear whether the Court had the power to compel defendants to produce emails from non-company or personal email accounts under Section 220.[452] The Court reasoned that if the Court were to order production, it would require a careful review of the facts and circumstances of the case, with a particular focus on whether the documents were within the defendants' "possession, custody, or control."[453] However, because the Court found that the sought-after emails did not fall within the plaintiffs' inspection right, the Court did not need to resolve the issue and declined to undertake the necessary factual analysis on the record before it.[454]

In *Southpaw*, discussed *supra*, the Court rejected the defendant's argument that Chinese law precluded the removal of accounting records for a Chinese company's recordkeeping system.[455] The defendant's evidence of supposed illegality consisted solely of an uncertified translation of the Chinese law at issue and a law firm client alert, and thus failed to demonstrate that Chinese law precluded the defendant from complying with the inspection demand.[456] Further, the Court held that even if Chinese law did prohibit some means of inspection, the defendant had failed to show that all

---

450. *Id.*

451. *Id.* at *24.

452. *Id.* at *17.

453. *Id.* at *17.

454. *Id.* at *17-18. This issue came to a head in two 2016 cases which, though not the focus of this canvas of key 2015 decisions, nevertheless warrant mention. In *Chammas v. Navlink, Inc.*, 2016 Del. Ch. LEXIS 22, at *24 (Del. Ch. Feb. 1, 2016) (Noble, V.C.), the Court denied a board member's demand to inspect the private communications among directors, observing that "[w]hile directors' access to company books and records is broader than that of stockholders, the requested information itself must qualify as a book or record of the company before the Court will order its production." The Court observed that "subjecting Section 220 proceedings to such broad requests, even by directors, runs contrary to the 'summary nature of a Section 220 proceeding.' As such, any request for communications among corporate directors and officers must (1) state a proper purpose, (2) encompass communications constituting books and records of the corporation, i.e., those that affect the corporation's rights, duties, and obligations, and (3) be sufficiently tailored to direct the Court to the specific essential to the demand futility inquiry,' and assuming that such documents constitute books and records of the corporation." *Id.* at *26. In *Navlink*, the Court concluded that the plaintiff failed to establish the second or third requirement so as to be entitled to inspect private director communications. The Court nevertheless declined to impose a "blanket prohibition" on inspection of such communications. *Id.* The Court favorably cited the reasoning of *lululemon* in its analysis. *Id.* at *23-24 n.91. One day after the *Navlink* opinion, the Court of Chancery reached an opposite conclusion in *Amalgamated Bank v. Yahoo! Inc.*, 2015 Del. Ch. LEXIS 314 (Del. Ch. Feb. 2, 2016) (Laster, V.C.), permitting inspection of private communications among board members which might not be located on the company's server, and reasoning that "[t]hrough it jurisdiction over a corporation, a court can compel production of documents in the possession of officers, directors, and managing agents of the firm." *Id.* at *87 n.43 (citing cases). The *Yahoo* decision was vacated by stipulation of the parties on cross-appeal. *See* Stip. of Dismissal, No. 83, 2016, Docket No. 18 (Del. June 6, 2016).

455. 2015 Del. Ch. LEXIS 54, at *21-29.

456. *Id.* at *26.

means of inspection were prohibited.[457] Because the documents could legally be made available for inspection, even if only through unconventional and potentially inconvenient means, the Court concluded that the defendant was not excused from its Section 220 obligations.[458]

In *Fuchs*, discussed *supra*, the Court noted that the plaintiff had stated a proper purpose in seeking to assess its options with respect to making a demand that the board take action.[459] However, the Court determined that Parker's publically available settlement papers gave the plaintiff enough information about the Nigerian bribery scheme to pursue its contemplated course of action, without the plaintiff needing to learn the identities of the two executives accused of engaged in bribery, the law firm they used, and the implicated lawyer.[460] Because the requested information was not necessary and essential to the plaintiff making a demand on the Parker board, the Court denied the plaintiff's request and entered judgment for Parker.[461]

4. Inspection Of Privileged Documents

In a 2014 decision by the Delaware Supreme Court, *Wal-Mart Stores, Inc. v. Indiana Electrical Workers Pension Trust Fund IBEW* ("*Wal-Mart II*"),[462] the Supreme Court clarified that the standard set forth in *Garner v. Wolfinbarger*[463] for requiring production of privileged company information to company stockholders applied under Delaware law and in the Section 220 context. Applying the holdings of *Garner* and *Wal-Mart II*, in possibly one of the most publicized Section 220 issues of 2015, the Court of Chancery in *Lululemon* (*see* discussion *supra*),[464] granted inspection of necessary though privileged documents.

As discussed above, *Lululemon* arose from a motion to enforce an order from the Court of Chancery directing the defendant to produce documents related to potential mismanagement claims. The plaintiffs argued that in addition to the documents already produced by the defendant, the Court should order the defendant to produce two emails that had been withheld as privileged.[465]

The Court permitted inspection of the two emails, which the Court determined were privileged, but nonetheless must be produced because the plaintiffs had shown "good cause" to set aside privilege under the fiduciary exception to privilege established by *Garner* and *Wal-Mart II*.[466] The Court began by noting that the fiduciary exception to attorney-

457. *Id.* at *27-28.

458. *Id.* at *28-29.

459. 2015 Del. Ch. LEXIS 55, at *24-25.

460. *Id.* at * 24.

461. *Id.* at *24-26.

462. 95 A.3d 1264 (Del. 2014).

463. 430 F.2d 1093 (5th Cir. 1970).

464. 2015 Del. Ch. LEXIS 127 (Del. Ch. Apr. 30, 2015) (Parsons, V.C.).

465. *Id.* at *7, 11.

466. *Id.* at *25-51.

client privilege is "narrow, exacting, and intended to be very difficult to satisfy."[467] In determining that the plaintiffs had shown good cause to set aside privilege, the Court analyzed and balanced the six factors set forth in *Garner*.[468] The Court concluded that the factors weighed in favor of setting aside privilege because the plaintiffs were seeking a limited number of documents, the plaintiffs were substantial stockholders, the emails did not involve trade secrets, and the alleged wrongdoing was a criminal act.[469] Moreover, the Court concluded that the plaintiffs' claims were obviously colorable, and the emails related to the underlying events giving rise to the litigation, rather than the litigation itself, making it more appropriate to set aside privilege.[470] The Court further concluded that the documents were essential to the plaintiffs' proper purpose in investigating potential *Brophy* and mismanagement claims and were unavailable from other sources.[471] Taken together, the Court concluded that the plaintiffs had carried their burden in showing good cause to set aside privilege and ordered the defendant to produce the WSJ Email Chain and Nicholas Email for inspection.[472]

5. Conditions On Inspection

Section 220 vests the Court of Chancery with the discretion to prescribe "limitations or conditions" to inspection, including requiring the inspecting party to sign a confidentiality agreement as a condition to inspection.[473] The Court of Chancery's exercise of this discretion was been heavily litigated in and around 2015.[474]

The Court of Chancery explored this issue in *Southpaw*, discussed *supra*, determining that because the defendant, though a public company, was not compliant with SEC information reporting requirements, it should be considered a private company for the purposes of assessing the necessity of a confidentiality agreement as a condition to plaintiff's

---

467. *Id.* at *37 (quoting *Wal-Mart II*, 95 A.3d at 1278).

468. *Id.* at *37-49.

469. *Id.* at *49-50.

470. *Id.* at *39.

471. *Id.* at *42-43.

472. *Id.* at *49-51.

473. 8 *Del. C.* § 220 (c).

474. *See, e.g.*, United Techs. Corp. v. Treppel, 109 A.3d 553 (Del. 2014) (Strine, C.J.) (remanding Court of Chancery decision and directing court to exercise care in determining whether to condition inspection on the imposition of a forum selection clause); Quantum Tech. P'rs IV, L.P. v. Ploom, Inc., 2014 Del. Ch. LEXIS 78 (Del. Ch. May 14, 2014) (FINAL REPORT) (Legrow, M.) (adjudicating disputes over the appropriate confidentiality restrictions to govern inspection); Ravenswood Inv. Co., L.P. v. Winmill & Co. Inc., 2014 Del. Ch. LEXIS 93 (Del. Ch. May 30, 2014) (Noble, V.C.) (holding that a company may not condition access to its books and records on an agreement forbidding the recipient from trading in its stock); Ravenswood Inv. Co., L.P. v. Winmill & Co. Inc., 2014 Del. Ch. LEXIS 272 (Del. Ch. Dec. 31, 2014) (Noble, V.C.) (requiring documents produced to the plaintiff to be maintained as confidential for a period of one or three years, depending on the information, and rejecting the defendants' arguments to lengthen that period of time); Amalgamated Bank v. Yahoo! Inc., 2016 Del. Ch. LEXIS 314, at *95 (Del. Ch. Feb. 2, 2016) (Laster, V.C.) (imposing condition to inspection that all documents produced as for inspection be incorporated by reference in any complaint concerning the same alleged wrongdoing the plaintiffs sought to investigate in the inspection).

inspection of the defendant's books and records.[475] The Court, noting that there is good reason to err on the side of imposing confidentiality agreements, concluded that the nature of the defendant's records, which it considers confidential, made a confidentiality agreement appropriate.[476]

However, the Court in *Southpaw* declined to include in the confidentiality agreement a restriction on the plaintiff's ability to trade shares of the defendant's stock on the basis of the books and records it inspects. The Court adopted in *Southpaw* a position similar to that taken in *Ravenswood Investment Co., L.P. v. Winmill & Co.*,[477] that for a "corporation to condition access" to stock valuation information "on an agreement not to trade—would inappropriately frustrate this fundamental stockholder right."[478] The Court also declined to require the defendant to publically disclose the books and records it provided through inspection so as to avoid potential implicit trading restrictions on the Plaintiff under SEC Regulation FD, holding that the potential federal legal obligations of the parties resulting from a Section 220 inspection are for the parties, not Delaware courts, to discern and resolve.[479]

6. Procedural Considerations

In *Fuchs*, discussed *supra*, the Court of Chancery discussed the procedural impropriety of expanding inspection demands on the eve of trial.[480] There, eight days prior to trial, the plaintiff attempted to broaden the scope of its inspection request.[481] The plaintiff issued a supplemental inspection demand requesting any report prepared by Parker's board or any Parker committee related to Parker's legal violations in Nigeria, as well as all the documents relied on by the Parker board and committees regarding Parker's FCPA non-compliance.[482]

The Court of Chancery held that allowing the plaintiff to broaden its inspection request eight days prior to trial would substantially impair Parker's right to receive and properly consider an inspection demand prior to litigation, and thus rejected the plaintiff's attempt to do so.[483] The plaintiff's inspection demands were thus limited to the documents it sought in its original complaint.[484]

---

475. 2015 Del. Ch. LEXIS 54, at *29-38.

476. *Id.* at *29-33.

477. 2014 Del. Ch. LEXIS 93 (Del. Ch. May 30, 2014) (Noble, V.C.).

478. *Id.* at *35 (quoting *Ravenswood*, 2014 Del. Ch. LEXIS 93, at *12).

479. *Id.* at *37 (citing *Ravenswood*, 2014 Del. Ch. LEXIS 93, at *12-13. Although 2016 decisions are not the focus of this article, in the first quarter of 2016, the Court of Chancery imposed a condition at the request of a corporate defendant that it described as an "issue of first impression" in *Amalgamated Bank v. Yahoo! Inc.*, 2016 Del. Ch. LEXIS 314, at *95 (Del. Ch. Feb. 2, 2016) (Laster, V.C.). Specifically, the Court conditioned "any further production on [the plaintiff] incorporating by reference into any derivative action complaint that it files the full scope of the documents that Yahoo has produced or will produce in response to the Demand (the 'Incorporation Condition')." *Id.*

480. 2015 Del. Ch. LEXIS 55, at *12-16.

481. *Id.*

482. *Id.*

483. *Id.*

484. *Id.*

IV. ADVANCEMENT UNDER 8 Del. C. § 145

A. Issues Of First Impression—Claims For Equitable Contribution For Advancement From Third-Parties And The Status Of Advancement Claims In The Context Of A Delaware Receivership

The Court of Chancery decided a significant number of advancement cases in 2015, two of which—*Konstantino v. AngioScore, Inc.*[485] and *Andrikopoulos v. Silicon Valley Innovation Company, LLC*[486]—resolved issues of first impression.

In *Konstantino*, the Court of Chancery entered judgment for the defendant on its third-party claim of equitable contribution for advancement. There, the Court of Chancery had granted advancement to the plaintiff from a former employer, AngioScore, Inc. ("AngioScore"), in connection with claims for usurpation of a corporate opportunity brought against him by AngioScore.[487] AngioScore then sought equitable contribution from the plaintiff's then-current employers, the "third-party defendants," who benefited from the acts of fiduciary breach and who also owed the plaintiff advancement obligations.[488] On the third-party defendants' motion to dismiss, the Court recognized that the standard for equitable contribution set forth in *Chamison v. HealthTrust, Inc.* applied in the advancement context.[489] *Chamison* held that "[t]o seek contribution from another insurer, the one seeking contribution must show that the other insurer's liability is concurrent, benefits the same insured, and insures the same risk."[490] *Chamison*, and a later case applying this standard, *Levy v. HLI Operating Co., Inc.*,[491] both involved indemnification. Although the Court had previously applied the *Chamison* standard in determining allocation among related entities in the context of advancement claims,[492] the Court's decision denying dismissal in *Konstantino* was the first time the Court squarely addressed the viability of an equitable contribution claim in the advancement context between unrelated third-parties.

In a later bench ruling in *Konstantino*, the Court granted AngioScore summary judgment on its claims for equitable contribution from the third-party defendants, holding that the third-party defendants were 50% liable for advancement

---

485. 2015 Del. Ch. LEXIS 251 (Del. Ch. Oct. 2, 2015) (Bouchard, C.) (denying third-party defendants' motion to dismiss claims for equitable contribution); C.A. No. 9681-CB (Del. Ch. Nov. 9, 2015) (TRANSCRIPT) ("*AngioScore* 11/9/15 Tr.") (Bouchard, C.) (entering summary judgment for defendant on its third-party claims for equitable contribution).

486. 120 A.3d 19 (Del. Ch. 2015) (Parsons, V.C.).

487. 2015 Del. Ch. LEXIS 251, at *2. The Court has granted discovery into the plaintiff's other sources of entitlement to advancement in a prior ruling. C.A. No. 9681-CB, at 120:11:24 (Del. Ch. Aug. 6, 2014) (TRANSCRIPT) (Bouchard, C.) (entering summary judgment for defendant and staying discovery on third-party defendants except to permit the defendant to discovery any "documents that contain an obligation to advance or indemnify" the plaintiff).

488. 2015 Del. Ch. LEXIS 251, at *2.

489. *Id.* at *33 (discussing *Chamison*, 735 A.2d 912, 926 (Del. Ch. 1999), *aff'd*, 748 A.2d 407 (Del. 2000)).

490. *Chamison*, 735 A.2d at 926.

491. 924 A.2d 210, 220 (Del. Ch. 2007).

492. *See* Sodano v. Am. Stock Exchange LLC, 2008 Del. Ch. LEXIS 92, at *58-59 n.84 (Del. Ch. Apr. 25, 2008) (Strine, V.C.).

to *Konstantino*.[493] The Court cited to no authorities that "provide any meaningful guidance in determining the appropriate allocations among the sources of advancement that are available to [the plaintiff]," and thus the Court established a 50/50 split between AngioScore and the third-party defendants.[494] The Court's order, however, was limited to going-forward payments.[495] Although AngioScore had paid around $11.7 million in advancement before it obtained summary judgment, the Court declined to obligate the third-party defendants to retroactively "advance" half of that amount by paying AngioScore damages.[496] Instead, "[g]iven the fluid nature of the situation," the Court ordered that the third-party defendants would be liable for 100% percent of the plaintiff's advancement expenses going forward until such time as it has paid out an amount equivalent to what AngioScore incurred to date[.]"[497]

In *Silicon Valley*, the Court of Chancery resolved the "previously unanswered" question of whether, in the context of a receivership estate under Delaware law, advancement claims are administrative expenses warranting priority or unsecured creditor claims to be paid pro rata with the other unsecured creditors.[498] Section 298 of the Delaware General Corporation Law provides that, before making distributions in a receivership, the Court shall give priority to (i) "reasonable compensation to the receiver," (ii) "the costs and expenses incurred in and about the execution of such receiver's … trust," and (iii) "the costs of the proceedings in the Court."[499] In contending that their advancement claims warranted priority under Section 298, the plaintiffs argued that "advancement is a cost of bringing a lawsuit against a former officer with advancement rights."[500] They further argued that Delaware policy favoring advancement also favors giving priority to advancement claims. The plaintiffs also argued that a receivership is distinguishable from bankruptcy, and thus the analogous bankruptcy standards under which advancement claims would be treated as unsecured claims should not apply.[501]

The Court held that advancement claims are not afforded priority in a receivership before the Court of Chancery. In rejecting the plaintiffs' arguments, the Court noted its "broad discretion in the receivership context,"[502] and identified four reasons for treating advancement obligations as unsecured claims. First, the Court observed that Delaware's pro-advancement policy was offset by policies in play during the winding up of a corporation where "there is no long-term horizon" and "the focus is on winding up the entity's affairs."[503] Under these circumstances, "the relevant importance of the policy justification of advancement as an inducement to attract qualified individuals to manage the company is

493. *AngioScore* 11/9/15 Tr. at 117:12-21.

494. *Id*.

495. *Id*. at 117:21-24.

496. *Id*. at 117:21-24.

497. *Id*. at 118:15-22.

498. 120 A.3d at 20.

499. 8 Del. C. § 298.

500. *Id*.

501. 120 A.3d at 22-23 (citing 11 U.S.C. § 503(b)(1)(A)).

502. 120 A.3d at 25.

503. *Id*.

diminished."[504] The Court further observed that granting administrative priority to advancement claims "seriously could undermine, if not entirely eliminate the ability of companies in receivership to pursue claims against former management."[505] Second, the Court held that because advancement claims are contractual in nature, they should be placed on par with similar contractual claims.[506] Third, the Court observed that advancement claimants typically may recover expenses through director and officer insurance policies, which provide a better market solution for obtaining fees from an insolvent entity.[507] Fourth, and finally, the Court expressed concerns about "becoming embroiled in time-consuming, line-item accounting disputes" necessitated by distinguishing between priorities and "super-priorities" of unsecured creditors versus the receiver and other professional who administer the entity in receivership.[508]

B. Clarification Concerning The "By Reason Of The Fact" Standard

In addition to resolving issues of first impression in 2015, the Court also added clarity to issues commonly litigated in the advancement and indemnification context, including the "by reason of the fact" requirement. To be entitled to indemnification or advancement under 8 *Del. C.* § 145, a plaintiff must demonstrate that the claims for which he seeks advancement were brought "by reason of the fact" that the plaintiffs acted in his or her official capacity. Three cases in 2015 addressed this standard: *Mooney v. Echo Therapeutics, Inc.*,[509] *Charney v. American Apparel, Inc.*,[510] and *Lieberman v. Electrolytic Ozone, Inc.*[511]

Mooney involved the common scenario present in *Konstantino* (discussed *supra*)—litigation arising between a corporate officer and his or her former employer after a corporate officer left the corporate defendant to work for a competitor. In these circumstances, companies often attempt to avoid advancement in connection with the litigation by relying on *Cochran v. Stifel Financial Corp.*[512] and *Weaver v. ZeniMax Media, Inc.*,[513] which hold that advancement will be denied when the underlying claims are in the nature of an employment dispute based on personal obligations to the corporation.

In *Mooney*, the Court of Chancery concluded that the defendant entities may not avoid advancement obligations by pleading claims designed to implicate the covered person's personal, as opposed to official, capacity. There, the plaintiff

---

504. *Id.*

505. *Id.*

506. *Id.* at 26.

507. *Id.* & n.31 (citing William D. Johnston et al., *Bankruptcy: The Game-Changer for Directors & Officers Who May Face Claims by Shareholders of Others*, Sec. Lit. Report, Dec.-Jan. 2010, at 3-4).

508. 120 A.3d at 26.

509. 2015 Del. Ch. LEXIS 146 (Del. Ch. May 28, 2015) (Parsons, V.C.).

510. 2015 Del. Ch. LEXIS 238 (Del. Ch. Sept. 11, 2015) (Bouchard, C.).

511. 2015 Del. Ch. LEXIS 231 (Del. Ch. Aug. 31, 2015) (Noble, V.C.).

512. 2000 Del. Ch. LEXIS 179 (Del. Ch. Dec. 13, 2000) (Strine, V.C.), *aff'd in part, rev'd in part*, 809 A.2d 555 (Del. 2002).

513. 2004 Del. Ch. LEXIS 10 (Del. Ch. Jan. 30, 2004) (Noble, V.C.).

sought advancement in part for defending against counterclaims and affirmative defenses asserted by his former employer in an employment dispute against the former employer.[514] The counterclaims all implicated the plaintiff's conduct when serving as an officer of the company.[515] Relying on *Cochran* and *Weaver*, the defendant argued that the misconduct at issue was undertaken in the plaintiff's personal capacity.[516] The defendant even amended its counterclaims to target misconduct allegedly undertaken in the plaintiff's personal capacity in a "deliberate[]" and "conscious effort" to bolster this defense and "avoid triggering [the plaintiff's] advancement rights."[517] The Court of Chancery rejected the defendant's argument, distinguishing and eschewing the defendant's reliance on *Cochran* and *Weaver*, which the Court observed were "authored over a decade ago," in favor of the more recent rule espoused in *Paolino v. Mace Security International*,[518] namely: that the presumption at the advancement stage favors advancement, and that any claim for which a corporation seeks to avoid advancement based on a capacity defense "must *clearly* involve a specific and limited contractual obligation without any nexus or causal connection to official duties."[519]

The Court concluded that the defendant failed to demonstrate that the underlying counterclaims, even as amended, had *no* causal connection to the plaintiff's official duties. This result, the Court observed, is consistent with the policy behind advancement. The Court explained that:

> Deferring resolution of less clear-cut disputes to the indemnification stage helps avoid excessive litigation over advancement. In addition to saddling the parties with unnecessary costs, litigation-related delays over advancement threaten to undermine the summary nature of the proceedings envisioned by 8 *Del. C.* § 145, as well as the policy of providing prompt reimbursement to present and former directors and officers who have had to incur attorneys' fees and related expenses.[520]

Different results based on different facts were reached in the next two 2015 cases addressing the "by reason of the fact" standard—*Lieberman*[521] and *Charney*.[522] As in *Mooney*, *Lieberman* involved a legal proceeding arising after a corporate officer left his employment to work for a competitor. And, as in *Mooney*, the defendant entity sought to avoid advancement obligations by arguing that the alleged misconduct was undertaken in the person's personal, not official, capacity. Unlike in *Mooney*, however, the claims at issue in *Lieberman* arose "*solely* from alleged post-termination breaches of personal obligations under [the governing agreements] …."[523] The Court placed significant weight on this fact in denying

514. 2015 Del. Ch. LEXIS 146, at *13-14.

515. *Id.* at *20.

516. *Id.* at *23.

517. *Id.* at *18, *22.

518. 985 A.2d 392, 408 (Del. Ch. 2009).

519. 2015 Del. Ch. LEXIS 146, at *25-26 (quoting *Paolino*, 985 A.2d at 407) (emphasis in *Mooney*).

520. *Id.* at *23-24.

521. 2015 Del. Ch. LEXIS 231.

522. 2015 Del. Ch. LEXIS 238.

523. *Id.* at *15-16 (emphasis added).

the plaintiff advancement. Similar facts were present in *Charney*, where the Court also denied advancement. There, the Court concluded that the plaintiff had not met the "by reason of the fact" requirement because the alleged misconduct lacked the "causal connection" between the claims in the underlying proceeding and the plaintiff's official capacity.[524] The misconduct at issue in *Charney*—violation of a standstill agreement—took place after the plaintiff's "suspension as an officer and resignation as a director" in connection with a "privately discussed … potential takeover" of the defendant entity.[525] The Court held that the plaintiff's status "as the founder and past leader" of the corporation "may have made his violations of the Standstill Agreement more damaging, but that former status was not necessary for the violations themselves."[526]

In *Charney*, the Court also interpreted a broadly worded agreement that mandated advancement for events or occurrences "related to the fact" to be the equivalent of the statutory "by reason of the fact" language, rejecting plaintiff's argument that the "related to" language demanded a broader scope.[527] Delaware law construes the statutory "by reason of the fact" requirement to be met "if there is a nexus or causal connection between" the underlying proceeding and a party's official capacity.[528] The plaintiff argued that the choice of the phrase "related to the fact" suggests a broader scope of advancement than "by reason of the fact"—if the latter demands a causal nexus, the former requires a more attenuated "but for" connection.[529] The Court rejected this argument, first and foremost, on the ground it would lead to "absurd results to which no reasonable person would have agreed."[530] The Court also concluded that "to construe 'related to the fact' more broadly than 'by reason of the fact' as used in Section 145, would render the indemnification provision in the Indemnification Agreement invalid under Delaware law."[531] The Court observed that the weight of Delaware case law supports the proposition that contractual advancement provisions must comply with the requirements of Section 145 and may not exceed the powers as circumscribed under Section 145.[532] Thus, in *Charney*, the Court made clear that the "by reason of the fact" statutory provision is a mandatory requirement in any corporation's advancement agreement that cannot be expanded.

C. Advancement For Claims Or Actions Initiated By The Advancement Claimant

Two 2015 Court of Chancery decisions—*Mooney*[533] and *In re Genelux Corp.*[534]—addressed another commonly disputed advancement issue of when a person is entitled to advancement in connection with claims or actions initiated

---

524. 2015 Del. Ch. LEXIS 238, at *47-57.

525. *Id*. at *49.

526. *Id*. at *53-54.

527. *Id*. at *33-47.

528. *Id*. at *35 (quoting Homestore, Inc. v. Tafeen, 888 A.2d 204, 214 (Del. 2005)).

529. *Id*. at *34.

530. *Id*.

531. *Id*. at *41.

532. *Id*. at *41-42 (discussing cases).

533. 2015 Del. Ch. LEXIS 146.

534. 2015 Del. Ch. LEXIS 269 (Del. Ch. Oct. 22, 2015) (Parsons, V.C.).

by that person. As the Court observed, "[w]hen a corporation provides for broad, mandatory advancement[,] … an individual's entitlement to advancement often depends on whether the expenses in question were incurred in 'defending' the litigation."[535] The Court in *Mooney* denied the plaintiff advancement in connection with a second, separate lawsuit commenced by the plaintiff, which the Court concluded was "neither compulsory nor would it defeat or offset any affirmative claim of [the former employer]."[536] In reaching this conclusion, the Court was mindful that "[i]f the term defending were construed more broadly, advancement would have the potential to become an unfettered license enabling disgruntled former officers and directors to litigate at the Company's expense."[537]

In the second case of 2015 addressing the question of entitlement to advancement for affirmative conduct, *Genelux*,[538] the former CEO of Genelux Corp. sought advancement in connection with a proceeding in which he moved to intervene. Although Genelux had not named the plaintiff as a defendant in the underlying proceeding, which the plaintiff alleged was a conscious effort to avoid triggering his advancement rights, the underlying proceeding directly implicated the plaintiff's rights—namely, the validity of Genelux shares issued to plaintiff as well as plaintiff's right to elect directors to the Genelux board.[539] The Court thus held that were it to rule in favor of Genelux in the underlying proceeding, the plaintiff "could be barred on collateral estoppel grounds from arguing that he had discharged his fiduciary duties properly in connection with the challenged actions."[540] For these reasons and others, the Court concluded that the plaintiff's intervention in the underlying proceed "is akin to a compulsory counterclaim in that it was 'necessarily part of the same dispute'" and therefore subject to advancement.[541]

D. Disputes Concerning The Scope Or Reasonableness Of Demanded Advancement Amounts Determined After A Finding Of Entitlement To Advancement

Increasingly, the Court of Chancery is first determining the issue of entitlement to advancement and only later dealing with disputes concerning the scope of that advancement.[542] Two 2015 Court of Chancery decisions reflecting this trend arose in the context of a challenge concerning the scope or reasonableness of the demanded advancement amounts: *Konstantino v. AngioScore, Inc.*[543] and *Holley v. Nipro Diagnostics, Inc.*[544]

---

535. 2015 Del. Ch. LEXIS 146, at *13-14.

536. *Id.* at *35.

537. *Id.* at *34.

538. 2015 Del. Ch. LEXIS 269.

539. *Id.* at *11.

540. *Id.* at *12.

541. *Id.* at *12.

542. *See, e.g.*, Danenberg v. Fitracks, Inc., 58 A.3d 991 (Del. Ch. 2012); Konstantino v. AngioScore, *Inc.*, C.A. No. 9681-CB (Del. Ch. Aug. 15, 2014) (ORDER); Holley v. Nipro Diagnostics, Inc., C.A. No. 9679-VCP (Del. Ch. Mar. 13, 2015) (ORDER).

543. C.A. No. 9681-CB (Del. Ch. Feb. 16, 2015) (TRANSCRIPT) (Bouchard, C.) ("*AngioScore* 2/16/15 Tr.").

544. 2015 Del. Ch. LEXIS 212 (Del. Ch. Aug. 14, 2015) (Parsons, V.C.).

In both *Konstantino* and *Holley*, the Court resolved the question of whether expenses incurred in connection with both claims subject to advancement and claims not subject to advancement should be advanced in their entirety, by applying the rule of *Danenberg v. Fitracks*.[545] *Holley* involved objections to expenses incurred in connection with both a proceeding subject to advancement as well as a proceeding not subject to advancement; *Konstantino* involved the same objections, as well as objections to expenses incurred in the defense of a party entitled to advancement as well as a co-defendant who is not entitled to advancement.[546] In both cases, the Court employed a similar inquiry that erred on the side of granting advancement, asking, essentially, whether the expenses would have been incurred in connection with the covered persons or proceeding even if the persons or proceeding not covered "did not exist."[547] In *Holley*, the Court held that "if the work was useful for both sets of claims, then the fees will be advanced in whole."[548] In *Konstantino*, the Court held that "if something was a matter that [the plaintiff] would undertake as an effort in his own defense, then he would receive 100 percent advancement for those amounts, even if another defendant might benefit from that work."[549] The Court in *Holley* observed that "the Court generally will not determine at the advancement stage whether fee requests relate to covered claims or excluded claims, unless such discerning review can be done realistically without significant burden on the Court," and further directed that such disputes are more easily resolved at the indemnification stage.[550]

E. Effect Of Representations In A Form Of Undertaking Executed In Connection With An Advancement Demand

Lastly, the Court of Chancery's decision resolving an advancement dispute in *Blankenship v. Alpha Appalachia Holdings, Inc.*,[551] is notable, in part due to its length. In *Blankenship*, a defendant entity attempted to cease paying advancement amounts after its former director and officer was indicted in a criminal proceeding.[552] The corporate defendant

545. 58 A.3d at 997-98.

546. *AngioScore* 2/16/15 Tr. at 12:23-13:3, 23:1-3.

547. 2015 Del. Ch. LEXIS 212, at *7 (articulating the inquiry as "whether [the disputed] fees would have been incurred if the [proceeding that was not subject to advancement] did not exist").

548. 2015 Del. Ch. LEXIS 212, at *3.

549. *AngioScore* 2/16/15 Tr. at 87:23-88:4 (applying Paragraph 2 of *Konstantino v. AngioScore, Inc.*, C.A. No. 9681-CB (Del. Ch. Aug. 15, 2014) (ORDER) and discussing *Danenberg v. Fitracks, Inc.*, 58 A.3d 991 (Del. Ch. 2012)); *see also Konstantino*, 2/16/15 Tr. at 88:8-16 ("But the intent of this order is that if Dr. Konstantino could use the work for his own defense and it was in his counsel's judgment something that could be used for his defense, if it had some collateral benefit to another party, or even if it had an obvious other benefit that was duplicative for another party, it doesn't matter, he gets 100 percent advancement for that. That was the intent.").

550. 2015 Del. Ch. LEXIS 212, at *3-4. The Court echoed these sentiments in *Mooney* in determining entitlement to advancement, directing that if "the fee requests relate to *both* advanceable claims and non-advanceable claims, *i.e.*, the work is useful for both types of claims, that work is entirely advanceable if it would have been done independently of the existence of the non-advancement claims." 2015 Del. Ch. LEXIS 146, at *17 (citing *Danenberg*, 58 A.3d at 997-98 (noting that the nature of the advancement right counsels against granular review of each and every charge); *Paolino v. Mace Sec. Int'l*, 985 A.2d 392, 408 (Del. Ch. 2009); *AngioScore* 2/16/15 Tr. at 10-12 (concluding that fees need not be apportioned among co-defendants if the legal work would have been done regardless of the existence of co-defendants)).

551. 2015 Del. Ch. LEXIS 145 (Del. Ch. May 28, 2015) (Bouchard, C.).

552. *Id.* at *19.

based this decision on unusual language in the former officer and director's undertaking executed in connection with his advancement demands, which provided: "It is my understanding that Massey will indemnify me and/or advance on my behalf the fees and costs associated with this representation, contingent upon the following factual representations and undertakings… I had no reasonable cause to believe that my conduct was ever unlawful."[553] The corporate defendant argued that this contractual contingency permitted the corporation to cease advancement if the representations were found to be untrue.[554] The plaintiff argued that the representations need only be true when advancement commenced, and served as assurances only to the defendant corporation.[555] The Court of Chancery agreed with the plaintiff, and found that a plain reading of the undertaking provided no basis upon which to deny advancement to the plaintiff.[556]

V. JUDICIAL RATIFICATION UNDER 8 Del. C. § 205

Sections 204 and 205 of the DGCL became effective on April 1, 2014, providing for the first time a path for corporations to ratify void or voidable corporate acts.[557] Section 204 provides a means for a board to remedy such acts.[558] Section 205 authorizes judicial ratification to accomplish these ends when the board cannot, such as in situations when the board's status is questionable.[559] More than a hundred corporations took advantage of Section 204 within the first year of its existence.

In *In re Numoda Corp. Shareholders Litigation*, the Court of Chancery's first written opinion interpreting Section 205,[560] the Court carefully analyzed what constitutes an "act" subject to ratification under Section 205.[561]

Numoda concerned the ratification of invalid stock theoretically issued at multiple points in time by Numoda Corporation ("Numoda Corp.") and Numoda Technologies, Inc. ("Numoda Tech.").[562] Both corporations were primarily

---

553. *Id.* at *13.

554. *Id.* at *41-42.

555. *Id.* at *42.

556. *Id.* at *42-60. Careful analysis should be given to the unusual facts in *Blankenship* before applying its holdings to other cases. *See, e.g.*, Thompson v. ORIX USA Corp., C.A. No. 11746-CB (Dec. 8, 2015) (Bouchard, C.) (TRANSCRIPT), at 28:11-21 (observing that *Blankenship* raised an unusual set of circumstances that might preclude it from analogizing to other advancement cases).

557. 8 Del. C. §§ 204, 205.

558. 8 Del. C. § 204.

559. 8 Del. C. § 205.

560. In 2014, the Court of Chancery issued two bench rulings interpreting Section 205. *See* In re Trupanion, Inc., C.A. No. 9496-VCP (Del. Ch. Apr. 28, 2014) (ORDER AND TRANSCRIPT) (approving ratification pursuant to Section 205) and In re Cheniere Energy, Inc. S'holders Litig., C.A. No. 9710-VCL (Del. Ch. Jul. 10, 2014) (TRANSCRIPT) (addressing the procedural interplay between Section 205 and traditional stockholder actions).

561. 2015 Del. Ch. LEXIS 30 (Del. Ch. Jan. 30, 2015) (Noble, V.C.); *see also* Boris v. Schaheen, 2013 Del. Ch. LEXIS 292, at *1 (Del. Ch. Dec. 2, 2013) (Noble, V.C.) (reciting background facts concerning 2015 Del. Ch. LEXIS 30).

562. *Id.* at *2-3.

controlled by three siblings Ann S. Boris ("Ann"), John A. Boris ("John"), and Mary S. Schaheen ("Mary"), who served on both boards at various times.[563] Both corporations followed very informal corporate governance practices, which often failed to comply with the DGCL's requirements.[564] On November 9, 2012, John and Ann purported to act by written consent to remove Mary from the boards of both corporations and to elect themselves to both boards.[565] Mary challenged the validity of the written consents; John and Ann responded by filing a Section 225 Action (the "225 Action") seeking confirmation of the validity of the written consents.[566] In the 225 Action, the Court found that the written consent with respect to Numoda Corp. was valid, because much of the stock that Numoda Corp. had purported to issue to Mary was void.[567] The Court found that the written consent with respect to Numoda Tech. was invalid because Numoda Tech. had never validly issued any stock.[568]

Numoda was the consolidation of multiple cases filed after the resolution of the 225 Action seeking to validate or to obtain declaratory judgement with respect to the various invalid attempts to issue and return stock of Numoda Corp. and Numoda Tech. at issue in the 225 Action.[569] The primary factor assessed by the Court in determining whether to ratify each purported stock issuance or return was whether "the moving parties have provided sufficient evidence of a corporate act for the Court to confirm fairly and with reasonable certainty."[570]

Before delving into the validity of the individual acts at issue, the Court considered what powers were conferred by Sections 204 and 205. At a high level, it concluded that "[t]he legislation … empowers the Court to grant an equitable remedy for corporate acts that once would have been void at law and unreachable by equity."[571] Guided by the legislative synopsis for Sections 204 and 205, the Court reasoned that the statute permitted the Court "to act even in situations where corporate formalities are barely recognizable[,]" but that "[t]he Court cannot determine the validity of a defective corporate act without an underlying corporate act to analyze."[572] Under this metric, "[e]ven an *ultra vires* act can be a corporate act[,]" but "[o]ur law would fall into disarray if it recognized, for example, every conversational agreement of two of three directors as a corporate act."[573] The Court therefore explained that it "looks to organizational documents, official minutes, duly adopted resolutions, and a stock ledger, for example, for evidence of corporate acts."[574]

563. *Id.*

564. *Id.* at *4; *Boris*, 2013 Del. Ch. LEXIS 292, at *4-5.

565. *Boris*, 2013 Del. Ch. LEIXS 292, at *1.

566. *Boris*, 2013 Del. Ch. LEXIS 292.

567. *Id.* at *31-39, *64.

568. *Id.* at *2-3.

569. 2015 Del. Ch. LEXIS 30, at *17.

570. 2015 Del. Ch. LEXIS 30, at *1.

571. *Id.* at *25.

572. *Id.* at *28-29.

573. *Id.* at *31-32.

574. *Id.* at *32.

Applying this rule to the purported acts at issue in *Numoda*, the Court first concluded that there was sufficient evidence of a corporate act attempting to grant stock to third parties in 2004 where there were defective stock certificates for the putative stock, unsigned board minutes of a meeting concerning the issuance, and where the parties had reached an agreement to attempt to ratify the stock (although that ratification was itself ineffective).[575] Second, the Court concluded that testimony by various parties and sundry documents reflecting Mary holding 400,000 Numoda Corp. shares were insufficient to prove that some corporate act occurred because Mary could not establish when any board approved an issuance of these 400,000 shares to her.[576] Third, in contrast, the Court found that Mary had shown that a corporate act purporting to issue her 5,750,000 Numoda Corp. shares had occurred where Ann and Mary met to discuss board business and directed the issuance of the shares at that time.[577] Fourth, the Court also found sufficient evidence of a corporate act purporting to issue 5,100,000 shares of Numoda Corp. stock to a third-party where a defective stock certificate was issued and there was a later, abet, invalid attempt to ratify the initial issuance.[578] Fifth, and finally, the Court found that, although the parties had generally believed and acted as though Numoda Tech. had been or would be spun off from Numoda Corp., there was no defective corporate act by Numoda Tech. purporting to effect the spin-off in the absence of completed stock certificates or evidence of Numoda Tech. board meetings.[579] After determining that there was no underlying corporate act to ratify with respect to the spin-off, the Court separately noted that the various equitable factors set forth in Section 205(d) did not convince the Court that a different outcome was appropriate.[580]

Based on the various ratifications effected in *Numoda*, the Court found that the outcome of the 225 Action should be reversed because the retroactive ratification of various stock issuances by Numoda Corp. diluted Ann and John's stockholdings such that Ann and John's written consent removing Mary from the Numoda Corp. board was invalid.[581]

The Court of Chancery's decision in *In re Genelux*,[582] resolved an issue of first impression, holding that Section 205 of the DGCL, which permits the Court of Chancery to "[d]etermine the validity of any corporate act or transaction and any stock, rights or options to acquire stocks,"[583] can only be used to validate defective corporate actions, not to declare an action invalid.

Genelux involved a contested annual election of directors, which hinged on whether certain shares of stock were issued validly or lacked consideration when issued.[584] The plaintiffs, the corporation and one of its founders, sought to

---

575. *Id.* at *36.

576. *Id.* at *37.

577. *Id.* at *38.

578. *Id.* at *41.

579. *Id.*

580. *Id.* at *42.

581. *Id.* at *53-54.

582. 126 A.3d 644 (Del. Ch. 2015).

583. 8 Del. C. § 205(a)(4).

584. 126 A.3d at 647.

set aside the intervenor's election of two directors by having the Court declare stock issued to the intervenor invalid.[585] The plaintiffs contended that inherent within the Court's power to "determine the validity" of "any stock" lies the power to deem such stock invalid.[586] The defendants and intervenor disagreed, arguing that "viewing that phrase in a vacuum ignores the overall structure of the statute, which makes clear that the relief available under Section 205 is the validation of presumed defective and otherwise incurable acts (which the Court can then grant or deny), not the invalidation of acts presumed for years by a company or a stockholder to be valid."[587] Because the Court viewed both the plaintiffs' and the defendants' interpretation of Section 205 as reasonable, the Court deemed Section 205 ambiguous, and looked to outside sources to discern the statute's meaning.

The Court concluded that outside sources supported the interpretation of Section 205 preferred by the defendants—that "Section 205 was intended to be a remedial statutes designed in conjunction with Section 204, to cure otherwise incurable defective corporate acts, not a statute to be used to launch a challenge to stock issuances on grounds already available through the assertion of plenary-type claims …."[588] This reading is supported by the legislative history of Sections 204 and 205, which makes clear that the legislative intent behind Section 205 was to abrogate the draconian effects of prior Delaware case law that made acts void under law incurable in equity.[589] The Court further deemed this conclusion consistent with several provisions of Section 205, including factors in Section 205(d) concerning "whether the company believed the act was valid and treated it that way" and "whether validating the act would cause harm that the act itself originally would not have cause," among others.[590]

While a similar claim might be made in a Section 225 case, there are limits to who might pursue a Section 225 claim, so *Genelux* sets forth a meaningful limitation as to the scope of relief available under Delaware law.[591]

---

585. *Id.*

586. *Id.* at 666.

587. *Id.*

588. *Id.* at 668.

589. *Id.* at 667 (discussing STAAR Surgical Co. v. Waggoner, 588 A.2d 1130 (Del. 1991) and Blades v. Wisehart, 2010 Del. Ch. LEXIS 227 (Del. Ch. Nov. 17, 2010)).

590. *Id.* at 668.

591. *Id.* at 669.