

## **Key Delaware Corporate and Commercial Decisions from 2009**

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During 2009, we highlighted approximately 250 decisions from the Delaware Chancery Court and the Delaware Supreme Court on the *Delaware Corporate and Commercial Litigation Blog*. From those decisions, we selected a number of key cases that we thought would be of the most wide-ranging interest and that could be highlighted in this short article. We recognize that many notable Delaware corporate decisions from 2009 have already been the subject of extensive scholarly commentary, and thus this short piece does not attempt to address those decisions in great detail. Copies of the complete decisions cited in this article are available at [www.delawarelitigation.com](http://www.delawarelitigation.com). The selection of these cases is necessarily subjective and though we attempted to list the “top five,” the last two cases were “tied for fifth place” which resulted in a total of six cases.

### **Delaware Supreme Court Addresses Appropriate Remedy in Short Form Merger Where Majority Violates Disclosure Duty**

*Berger v. Pubco Corp., et al.*, Del. Supr., No. 509, 2008 (July 9, 2009).

In a case of first impression, Justice Jacobs writing for the Delaware Supreme Court *en banc* resolved the differences between two Court of Chancery decisions addressing the appropriate remedy in a short form merger under 8 Del. C. § 253 where the controlling stockholder fails to disclose the facts material to an informed shareholder’s decision whether or not to elect the exclusive appraisal remedy available under section 253.

#### **The Remedy – No “Opt-in” or Escrow Requirement**

The Supreme Court was looking to select the remedy that “best effectuates the policies underlying the short form merger statute (Section 253) and the appraisal statute (Section 262) taking into account considerations of practicality of implementation and fairness to the litigants.” After a very detailed analysis, the decision came down to the two forms of “quasi-appraisal.” The Court noted that:

As between an opt in requirement that would potentially burden shareholders desiring to seek an appraisal recovery but would impose no burden on the corporation, and an opt out requirement that would impose a lesser burden on the shareholders but again no burden on the corporation, the latter alternative is superior and is the remedy that the trial court should have ordered.

In next holding that there was no requirement to deposit part of the merger consideration in escrow, the Court noted that:

The defendants-appellees argue that it is fair and equitable to require the minority shareholders to escrow some portion of the merger proceeds. Otherwise (defendants say), the shareholders would have it both ways: they could retain the merger proceeds they received and at the same time litigate to recover a higher amount—a dual benefit they would not have in an actual appraisal. It is true that the minority shareholders would enjoy that “dual benefit.” But, does that make it inequitable from the fiduciary’s standpoint? We

think not. No positive rule of law cited to us requires replicating the burdens imposed in an actual statutory appraisal. Indeed, our law allows the minority to enjoy that dual benefit in the related setting of a class action challenging a long form merger on fiduciary duty grounds. In that setting the shareholder class members may retain the merger proceeds and simultaneously pursue the class action remedy.

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The appraisal statute should be construed evenhandedly, not as a one-way street. Minority shareholders who fail to observe the appraisal statute's technical requirements risk forfeiting their statutory entitlement to recover the fair value of their shares. In fairness, majority stockholders that deprive their minority shareholders of material information should forfeit their statutory right to retain the merger proceeds payable to shareholders who, if fully informed, would have elected appraisal.

**Court of Chancery Addresses Application of Entire Fairness and Business Judgment Review of Merger Involving a Controlling Stockholder and a Third-Party Buyer**

*In re John Q. Hammons Hotels Inc. Shareholder Litigation*, No. 758-CC (Del. Ch. Oct. 2, 2009).

This dispute arose out of the merger involving John Q. Hammons Hotels (“JQH”) pursuant to which the holders of Class A common stock received \$24 per share in cash. Plaintiffs’ alleged that, among other things: (i) John Hammons, the controlling shareholder breached his fiduciary duty by negotiating benefits for himself that the minority stockholders did not receive; and (ii) the directors breached their fiduciary duties by permitting a deficient process and subsequent approval of the merger.

**Standard of Review – Entire Fairness or Business Judgment Rule**

The Court noted that the threshold issue was whether the Court should apply the entire fairness standard or the business judgment rule in reviewing the merger. Alleging the merger to be a “minority squeeze-out transaction,” plaintiffs contended that *Kahn v. Lynch Communication Systems Inc.*, 638 A.2d 1110 (Del. 1994), mandates that the Court apply the entire fairness standard of review. Defendants countered, alleging the business judgment standard of review was appropriate.

Hammons however, did not stand “on both sides of the transaction” and Hammons did not make the offer to the minority stockholders – an unrelated party, Elian, made the offer. Elian negotiated separately with the minority shareholders, who were represented by the “disinterested and independent special committee,” and Hammons, “who had a right to sell (or refuse to sell) his shares . . . .” Thus, regardless of any procedural protections in place for the minority shareholders, “*Lynch* does not mandate that the entire fairness standard of review apply notwithstanding any procedural protections that were used [i.e., the special committee or the approval of the majority of the minority shares voting.]”

The Court stated that the business judgment “would be the applicable standard of review if the transaction were (1) recommended by a disinterested and independent special committee, and (2) approved by stockholders in a non-waivable vote of the majority of all the minority

stockholders.” However, in order to invoke the business judgment standard, “it is paramount – indeed, necessary . . . – that there be robust procedural protections in place to ensure that the minority stockholders have sufficient bargaining power and the ability to make an informed choice of whether to accept the third-party’s offer for their shares.”

Here the Court found that the procedures in place (where the special committee could waive the vote of the minority stockholders and required the approval of only the majority of the *voting* minority shareholders), were not sufficient. Importantly, the Court stated that the minority vote serves as a complement to, and a check on, the special committee. It also noted that “[a]n effective special committee, unlike disaggregate stockholders who face a collective action problem, has bargaining power to extract the highest price available for the minority stockholders. The majority of the minority vote, however, provides the stockholders an important opportunity to approve or disapprove of the work of the special committee and to stop a transaction they believe is not in their best interests. Thus, to provide sufficient protection to the minority stockholders, the majority of the minority vote must be nonwaivable, even by the special committee.”

### **Chancery Court Determines Procedure for Payment of Attorneys' Fees In Advancement Case**

*Martinez v. Regions Financial Corp.*, No. 4128-VCP (Del. Ch. Sept. 9, 2009).

The Court of Chancery in this September 9 ruling issued a follow-up opinion to its August 6, 2009 decision regarding a dispute between plaintiff, Susan A. Martinez, and defendant, Regions Financial Corporation, wherein plaintiff sought to enforce a change of control agreement. In its August 6 decision, the Court had directed the parties to submit an appropriate form of order reflecting the Court’s rulings. *See Martinez v. Regions Fin’l Corp.*, No. 4128-VCP, 2009 WL 2413858, at \*15 (Del. Ch. Aug. 6, 2009), summarized on this blog [here](#). The parties, unfortunately, could not reach agreement so they went back to the Court for guidance on two issues: (i) whether a claim voluntarily withdrawn by plaintiff after defendant moved for summary judgment and filed its opening brief should be dismissed with or without prejudice; and (ii) what procedure should be followed for submission and payment of the plaintiff’s invoices for advancement and to the extent there are disputes about those invoices, how the dispute should be resolved.

### **Procedure for Payment of Attorneys’ Fees and Expenses Pursuant to Advancement Ruling**

Since the parties could not come to any agreement as to a form of order, the Court determined that the plaintiff must submit copies of invoices for fees and expenses incurred by plaintiff to defendant and file a notice of such submission with the Court. Defendant then has thirty days to make payment. If defendant disputes the reasonableness of any of the submitted invoices, defendant “shall (i) remit the undisputed amount plus prejudgment interest within thirty days of submission of the invoices to [defendant], (ii) advise [plaintiff] in writing with specificity of any and all disputes respecting the reasonableness of the invoices (“Objections”) within twenty days after the date the invoices were submitted to it, and (iii) simultaneously file those Objections with the Court” and the Court will schedule a telephone conference to resolve them

## **Delaware Chancery Court Requires Party to Submit to Terms of Forum Selection Clause Despite that Party Being a Non-Signatory; Based on Equitable Estoppel**

*Weygandt v. Weco, LLC*, Del. Ch., No. 4056-VCS (May 14, 2009).

### **Issue Presented**

The question in this case is whether a non-signatory defendant can be required to appear in a forum chosen in an agreement executed by an affiliate.

In this Chancery Court decision, the court determined that a party was subject to the personal jurisdiction of the Delaware courts based on a forum selection clause in an agreement that the party was not a signatory to, but which an affiliated party was a signatory to, based on equitable estoppel.

The court rejected the applicability to these facts of the general rule that “agreements that are part of the same transaction are construed together.” However, the court did find applicable the **equitable estoppel theory which many cases have applied to hold that a non-signatory was bound by a forum selection clause based on a three-part test. First, the forum selection clause must be valid. Second, the defendants need to be either third-party beneficiaries or “closely-related” to the relevant contract. Third, the claim must arise from the status of the defendant as closely-related to the agreement that contains the forum selection clause.**

The purpose of the third prong of the three-part test is that the agreement containing the forum selection clause must also be the agreement that gives rise to the substantive claims brought by or against a non-signatory in order for the forum selection clause to be enforceable against a non-signatory. (*See* footnotes 13 to 15 and 18.)

The rationale for the cases that have enforced forum selection clauses against non-signatory parties are based on the principle that a third-party beneficiary or closely-related party can not enjoy the benefits of an agreement without accepting its obligations. *See Capital Group Cos. v. Armour*, 2004 WL 2521295 (Del. Ch. Oct. 29, 2004). *See also* cases collected at footnote 17.

Importantly, it is not only third-party beneficiaries, but also parties who are “closely related” to the agreement at issue that are estopped from avoiding the obligations of an agreement from which they benefit. Thus, even if an agreement expressly disclaims any third-party beneficiaries, a “closely-related party” to the agreement can still be bound by its terms even if not a signatory. *See Capital Group*, 2004 WL 2521295, at \*6.

### **Foreseeability**

When a control person agrees to a forum, it is foreseeable that the entities controlled by that person which are involved in the deal will also be bound to that forum. *See* cases collected at footnote 25. **The rationale for binding such entities rests on the public policy that forum selection clauses “promote stable and dependable trade relations” and it would be inconsistent with that policy to allow entities through which one of the parties chooses to act, to escape the forum selection clause.** *See* cases collected at footnote 26.

If the purchaser of the business in this case was excused from buying the business because of fraud or falsity of representations and warranties, it would have no business reason or legal obligation to enter into the lease agreement which it needed only to operate the business. Thus, it was foreseeable that a dispute involving the purchase agreement and the lease agreements would have to be brought in Delaware because of the forum selection clause in the purchase agreement.

### Conclusion

Any contrary result would allow for duplicative and inefficient litigation in multiple forums and undermine the benefit of predictability that was provided to the purchaser by agreeing to a forum clause in the purchase agreement. Thus, the court found that the landlord was equitably estopped from asserting that the Delaware court lacked jurisdiction.

### **No Liability of Directors for Failing to Predict Subprime Debt Crisis**

In *In re Citigroup Shareholder Derivative Litigation*, 964 A.2d 106 (Del. Ch., 2009), the Court of Chancery issued the first detailed analysis of potential liability of directors under Delaware law for claims relating to a company suffering major losses resulting from substantial exposure to subprime debt.

The Court stated: “[a]lthough these claims are framed by plaintiffs as *Caremark* claims, plaintiffs’ theory essentially amounts to a claim that the director defendants should be personally liable to the Company because they failed to fully recognize the risk posed by subprime securities.” The burden was on the plaintiffs not only to show gross negligence but to rebut the presumption that the directors acted in an informed basis, in good faith and in the honest belief that the action was taken in the best interests of the company. In light of the “extremely high burden” placed on plaintiffs, the Court concluded that plaintiffs’ conclusory allegations (and thus their failure to plead particularized facts) were insufficient to state a *Caremark* claim thereby excusing demand. To the contrary, Citigroup had procedures and controls in place that were designed to monitor risk and the plaintiffs did not contest these standards. And even if there were warning signs, they are not evidence that the directors *consciously* disregarded their duties or otherwise acted in bad faith but may only be evidence that the directors made bad business decisions.

The Court did distinguish another 2009 Court of Chancery decision that *did* allow a *Caremark* “failure to monitor” claim to survive a motion to dismiss. That case was *American International Group, Inc. Consolidated Derivative Litigation*, 2009 WL 366613 (Del. Ch., Feb. 10, 2009) (“AIG case”). The AIG case was distinguishable from this Citigroup case, the court observed, in part because unlike the allegations against Citigroup, the defendant directors in the AIG case “allegedly failed to exercise reasonable oversight over pervasive *fraudulent* and *criminal* conduct.”

**Revlon Duties of Directors Clarified: When a Company is for Sale and When The Duties are Triggered**

The Delaware Supreme Court reversed the Court of Chancery's decision denying summary judgment for the directors of Lyondell Chemical Company ("Lyondell") as to the "Revlon" and "deal protection" claims and whether the directors of Lyondell acted in good faith in conducting the \$13 billion sale of Lyondell, in *Lyondell Chemical Company, et al. v. Ryan*, 970 A.2d 235 (Del. Supr. 2009).

The Supreme Court made clear that under *Revlon v. MacAndrews & Forbes Holdings, Inc.* 506 A.2d 173 (Del. 1986) duties arise not because a company is "in play" (such as in this case where there was a Schedule 13D filing), but rather when the company "embarks on a transaction – on its own initiative or in response to an unsolicited offer – that will result in a change of control." The Supreme Court further noted that "there are no legally prescribed steps that directors must follow to satisfy their *Revlon* duties" and that the Lyondell directors' failure to take any specific steps during the sale process could not have demonstrated a "conscious disregard of their duties." The Supreme Court reasoned that instead of questioning whether disinterested, independent directors did everything that they (arguably) should have done to obtain the best sale price, "the inquiry should have been whether those directors utterly failed to attempt to obtain the best sale price."

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