

January 23, 2015

Litigating Shareholder Derivative and Merger & Acquisition Claims:

Evolving Theories of Liability and Defenses

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Agenda

- **Litigation Related Bylaws**
 - Forum Selection Bylaws
 - Fee-Shifting Bylaws
- **Banker Conflicts of Interest**
 - Staple Financing
 - Conflicts of Interest for Contingency Advisors
- **Dead Hand Provisions in Debt Documents**

Forum Selection Bylaws

- Forum selection bylaws are board-adopted bylaws that designate an exclusive forum for intra-corporate litigation.
- *Boilermakers Local 154 Retirement Fund v. Chevron Corp.*, 73 A.3d 934 (Del. Ch. 2013).
 - The court held that forum selection clauses governing disputes pertaining to corporations' internal affairs are valid under Delaware statutory law.
- *City of Providence v. First Citizens Bancshares, Inc.*, 99 A.3d 229 (Del. Ch. 2014).
 - The court affirmed that board-adopted forum selection bylaws are valid, even when the chosen forum was not Delaware and the bylaw was adopted on the same day a merger transaction was approved.

Forum Selection Bylaws

- Potential advantages of adopting forum selection bylaws:
 - May reduce cost and disruption of multi-jurisdictional litigation.
 - May reduce forum shopping by plaintiffs.
- Concerns regarding forum selection bylaws:
 - Boards should consider proxy advisor and investor reaction to the adoption of forum selection bylaws.
 - Issues may arise if boards select a non-Delaware forum to settle Delaware internal corporate disputes.
 - Forum selection clauses may not be respected by courts outside Delaware.
 - Bylaws should give boards discretion to consent to an alternative forum.

Fee-Shifting Bylaws

- Fee-shifting bylaws impose attorney's fees on unsuccessful claimants in shareholder suits.
- Proponents contend that such provisions will deter frivolous litigation, and some argue that such provisions constitute self-interested director action.
- Opponents note that such provisions would make representative shareholder actions economically irrational, as the potential downside to any litigation will outweigh the proportional share of recovery any individual plaintiff could receive.

Fee-Shifting Bylaws

- *ATP Tour, Inc. v. Deutscher Tennis Bund*, 91 A.3d 554 (Del. 2013).
 - The Delaware Supreme Court held that Delaware law does not forbid “the enactment of fee-shifting bylaws. . . . Moreover, no principle of common law prohibits directors from enacting fee-shifting bylaws.” *Id.* at 558.
- The Delaware Bar Association proposed an amendment to the DGCL to limit the applicability of *ATP*, which the Delaware legislature has resolved to examine further.
- Sen. Richard Blumenthal (D-Conn.) asked the SEC to label fee-shifting provisions as “major risks” and refuse to permit registration statements to move forward for companies using fee-shifting provisions.

Banker Conflicts of Interest

- Staple Financing:
 - A prearranged financing package offered to potential bidders by the seller's investment banker.
- *In re Rural/Metro Corp.*, 88 A.3d 54 (Del. Ch. 2014).
 - The court found that the defendant advisor aided and abetted the breach of the duty of care because they, with improper motives, misled the directors into breaching their duty of care.
 - Commentators have noted that this decision, if upheld on appeal, could influence corporations' decisions to incorporate in Delaware or include a non-Delaware forum selection clause in their bylaws.

Banker Conflicts of Interest

- *In re Del Monte Foods Co. S'holders Litig.*, 25 A.3d 813, 818 (Del. Ch. 2011).
 - The court ruled that by “failing to provide the serious oversight that would have checked [the banker’s] misconduct, the directors breached their fiduciary duties.”
 - The court noted that “[a]lthough the blame for what took place appears ... to lie with [the banker], the buck stops with the Board.” *Id.* at 835.
- *In re El Paso Corp. S'holder Litig.*, 41 A.3d 432, 444 (Del. Ch. 2012).
 - The court ruled that plaintiffs had a reasonable probability of success in a shareholder litigation suit against El Paso Corporation in part due to the concealed financial interests of the company’s financial advisors.

Banker Conflicts of Interest

- Conflicts of Interest for Contingency Advisors:
 - Plaintiffs may allege that, because a portion of their compensation is contingent upon closing a transaction, financial advisors have a conflict due to an incentive to close the transaction.
- *In re Atheros Commc'ns, S'holder Litig.*, 2011 Del. Ch. LEXIS 36 (Del. Ch. Mar. 4, 2011).
 - Although Delaware courts routinely uphold contingent fees, the court required the disclosure of a financial advisor's contingency fee that was nearly 50 times the non-contingent fee.

Dead Hand Provisions in Debt Documents

- **Dead Hand Proxy Put**
 - A provision in a corporate debt agreement, pursuant to which there is an event of default and the corporate debt is accelerated if directors who were on the board at the time the debt agreement was signed are removed.
 - Proponents of dead hand provisions in debt documents contend that the provisions protect lenders from significant changes in the borrower's board that may affect debt repayment.
 - Opponents contend that the provisions do not have a legitimate business purpose and instead serve only to entrench the board.

Dead Hand Provisions in Debt Documents

- *Kallick v. SandRidge Energy, Inc.*, 68 A.3d 242 (Del. Ch. 2013).
 - The court noted that dead hand provisions in debt documents are dangerous because it is difficult to determine if the provision “was in fact sought by the third party creditors or willingly inserted by the incumbent management as a latent takeover and proxy contest defense.” *Id.* at 259.
 - The court held that absent a specific and substantial risk posed by a rival slate, an incumbent board that fails to approve the rival slate to avoid triggering the change of control put would likely breach its duties of loyalty.
- *Pontiac General Employees Retirement System v. Ballantine, C.A.* No. 9789-VCL (Del. Ch. Oct. 14, 2014).
 - The court declined to dismiss breach of fiduciary duty claims against the directors of Healthways, Inc. for entering into a credit facility that included a dead hand proxy put provision. The court further noted that a borrower’s board runs the risk of breaching their fiduciary duties if they accept a dead hand proxy put in a debt document without negotiating significant value in return.