2008

REVIEW OF DEVELOPMENTS

IN

DELAWARE CORPORATION LAW

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I. INTRODUCTION [1]

This review summarizes key case law and other developments in Delaware corporation law in 2007. The Delaware courts issued a number of decisions addressing statutory and fiduciary issues important—if not critical—to the corporate practitioner. The opinions in these cases provided guidance on a host of current corporate topics, including option backdating, private equity and other M&A transactions, "MACs" and "MAEs," and developing standards of review. For its part, the Delaware General Assembly fine tuned a few Delaware General Corporation Law provisions.[2]

Highlights in Delaware decisions included the following:

- Option Backdating and Spring-Loading – Chancellor Chandler issued the first important opinions relating to option backdating and spring-loaded options. In Ryan v. Gifford, the Chancellor held that a derivative complaint alleging the backdating of stock options awarded under a stockholder-approved option plan stated a claim for breach of the duty of loyalty. The option plan required an exercise price not less than fair market value on the date of grant. The court noted that a complaint relying on empirical data would state a claim if it showed: "1) specific instances of backdating; 2) violations of shareholder approved [option] plans or some other legal obligation; and 3) fraudulent disclosures regarding compliance with the plan." In Tyson Foods, the Chancellor refused to dismiss duty of loyalty claims against the seven-member Tyson Foods compensation committee for issuing spring-loaded stock options (those granted before the release of material information). The court concluded the claims implicated the duty of loyalty and bad faith conduct. Subsequent decisions, such as Brandin v. Deason, reveal the Delaware courts' interest in addressing the unsettled issues of law in this area.

- Private Equity Deals – A series of decisions in 2007 signaled closer scrutiny of private equity MBOs for compliance with Revlon obligations. The opinions in Netsmart, Lear and Topps each searchingly examined target board processes and management and banker conflicts in the underlying transactions, providing at least some guideposts for practitioners advising in future deals.

- Meeting Postponement-Merger – In Mercier v. Inter-Tel (Delaware), Vice Chancellor Strine permitted the postponement of a stockholder vote on a merger to allow the board to solicit additional affirmative votes to ensure approval. The transaction would not have secured the necessary votes without the postponement. Doctrinally, practitioners are left to muse whether the decision represents an outright retreat from, or a more nuanced

[1] J. Clayton Athey, Laina M. Herbert and Marcus E. Montejo, associates at Prickett, Jones & Elliott, P.A., contributed to the preparation of these materials.

[2] Appendix I lists cases in this summary that are on appeal to the Delaware Supreme Court. Appendix II summarizes the 2007 amendments to the General Corporation Law of the State of Delaware, 8 Del. C. §101 et seq. (the "DGCL"). Appendix III summarizes the Delaware Constitutional Amendment authorizing the Delaware Supreme Court to respond to certified questions of law from the SEC.

construction of, the Blasius "compelling justification" standard, applicable to board actions that affect the stockholder franchise.

- Doctrine of Independent Legal Significance – In Louisiana Municipal Police Employees' Retirement System v. Crawford, involving the proposed merger of Caremark RX, Inc. and CVS Corporation, the Chancellor ruled that a "special cash dividend" declared by Caremark prior to the merger and payable only upon closing of the merger was deemed to be additional cash merger consideration, thereby triggering appraisal rights to which stockholders would not have otherwise been entitled. Accordingly, the merger proxy materials failed to disclose the existence of appraisal rights as required by Section 262 of the DGCL and common law. The case is significant because it may be read as undermining the doctrine of "independent legal significance." The doctrine of independent legal significance holds that a transaction compliant with one provision of the DGCL may not be invalidated by the courts for failure to comply with another section of the DGCL. While the opinion can be read as eroding the doctrine, we tend to believe it is a product of bad facts.

- Appraisal Arbitrage? – In Transkaryotic Therapies, Chancellor Chandler held that purchasers after the merger record date—beneficial owners at the time of the merger—were entitled to seek appraisal so long as the total number of shares seeking appraisal did not exceed the total number of shares either voting no or abstaining. Some commentators have described the decision as inviting "appraisal arbitrage" by aggressive investors.

- No Creditor Standing – In the North American Catholic case, the Delaware Supreme Court, affirming the Court of Chancery, held that individual creditors have no legal standing to maintain direct claims for breach of fiduciary duty against directors, irrespective of whether the corporation is operating in the zone of insolvency or is actually insolvent.

- National Law Firm Subject to Suit in Delaware for Providing Corporate Advice – The Court of Chancery held the Delaware long-arm statute conferred personal jurisdiction over a non-resident corporate lawyer and his national law firm for aiding and abetting claims arising out of their advice and services to a Delaware public corporation, its directors and its managers regarding matters of Delaware corporate law.

These groundbreaking developments, as well as more routine Delaware corporation law decisions, are summarized briefly in this review. The summaries are intended to be a practitioner's tool to identify developments in specific areas of corporation law. Opinions that address more than one issue are summarized in more than one section of this outline, though we have attempted to limit the discussion to the pertinent issue. Constraints of time and energy preclude lengthy expositions or analyses of the cases. The outline should serve only as a beginning point to further inquiry and analysis.

Attorneys at Prickett, Jones & Elliott, P.A. were involved in many of the cases discussed in this outline. The views expressed herein do not necessarily represent the views of the law firm or its clients. The authors have sought to describe the opinions objectively and any perceived failure to do so rests solely with them.

II. THE BOARD OF DIRECTORS AND GOVERNANCE ISSUES

A. Duty of Loyalty

In re Tyson Foods, Inc. Consol. S'holder Litig., 919 A.2d 563 (Del. Ch. 2007); 2007 WL 2351071 (Del. Ch.). Derivative action charging board members of Tyson Foods breached their fiduciary duties in connection with the issuance of "spring-loaded" stock options. Spring-loading is the practice of granting options to executives immediately before the release of material inside information that might reasonably be expected to drive the share price higher. Plaintiffs challenged option grants made between 1999 and 2003. Defendants moved to dismiss the breach of fiduciary duty claims arising out of spring-loading for failure to make a demand under Court of Chancery Rule 23.1 and failure to state a claim.

The court denied the motion to dismiss for failure to state a claim in principal part. 919 A.2d 563 (Del. Ch. 2007) (Tyson I). Defendants first contended that the statute of limitations barred breach of duty claims related to pre-2003 option grants, claiming that Tyson had accurately disclosed the grants in public filings such that the stockholders had been placed on notice of the spring-loaded grants. The court rejected that contention, finding that the statute was tolled under the doctrine of equitable tolling and fraudulent concealment. The court reasoned that stockholders were not required "to sift through a proxy statement and … a year's worth of press clippings" to uncover wrongdoing by those the stockholders assume are protecting their interests. Second, defendants contended that the complaint failed to assert allegations sufficient to suggest lack of independence or disabling interest on the part of the board or to create a reasonable doubt as to the exercise of business judgment. Since the directors were not recipients of the spring-loaded options and were not alleged to have lacked independence, defendants' motion turned on whether the complaint created a reasonable inference that the directors' decisions fell outside the protection of the business judgment rule because those decisions were made in bad faith and therefore constituted a breach of the duty of loyalty. Allegations that the directors used inside knowledge to enrich employees while avoiding shareholder-imposed restrictions on the options were sufficient to raise a doubt as to the application of the business judgment rule, the court found. The court offered guidance for properly pleading a "spring-loading" claim. To plead a claim for breach of loyalty arising out of spring-loading of options, the complaint must allege three elements: (1) the options were issued pursuant to a stockholder-approved plan; (2) the directors approving the options possessed material, non-public information soon to be released that would drive the stock price higher and (3) the directors acted with the intent to circumvent terms of the plan that restricted the exercise price of the options.

The outside director defendants thereafter filed a motion for judgment on the pleadings with respect to "nonqualified stock options," which unlike the incentive stock options could be issued by the compensation committee and made exercisable at any price. The outside directors' motion rested on the holding in the prior opinion that denied a motion to dismiss in part because the challenged stock options may have been issued "with the intent to circumvent otherwise valid shareholder-approved restrictions upon the exercise price of the options." Defendants accordingly maintained that the nonqualified stock options were not subject to such a restriction so that a judgment on the pleadings was appropriate. The court denied the motion for judgment on the pleadings. 2007 WL 2351071 (Del. Ch.). After further reviewing the allegations of the complaint, the court slightly altered the test announced in Tyson I, concluding that allegations of an implicit violation of a shareholder-approved stock option plan are not necessary for the court

to infer the decision to spring-load options lies beyond the bounds of business judgment. Instead, the court substituted a revised element that "where I may reasonably infer that a board of directors later concealed the true nature of a grant of stock options, I may further conclude that those options were not granted consistent with a fiduciary's duty of utmost loyalty."

Ryan v. Gifford, 918 A.2d 341 (Del. Ch. 2007). Stockholder derivative action asserting a variety of claims against members of the board and the compensation committee of Maxim Integrated Products, Inc. arising out of alleged backdating of stock options. Plaintiff alleged that defendants breached their duties of due care and loyalty by approving or accepting backdated stock options in clear violation of stockholder-approved stock option plans. Defendants moved to dismiss on multiple grounds, including failure to state a claim and failure to plead demand futility. Alternatively, defendants moved to stay in favor of prior pending litigation in California.

The court denied the motions, issuing a number of important rulings. First, with respect to the motion to stay, the court affirmed Delaware's compelling interest in resolving issues of first impression respecting the conduct of fiduciaries of Delaware corporations. Delaware courts had not addressed fundamental issues regarding stock option backdating, which are "of great importance to the law of corporations." Accordingly, the court declined to stay in favor of the California action. Denying the motion to dismiss in large part, the court held that a stockholder has no standing to maintain a derivative action challenging options issued prior to the date that he acquired shares in the corporation. The court rejected defendants' statute of limitations defense, finding that the statute was tolled under the doctrine of fraudulent concealment because there had been no disclosure of the alleged backdating. The court also imputed to the whole board the compensation committee's approval of the grants because the compensation committee comprised more than half of the whole board. Finally, the court suggested that the failure of option recipients to have exercised their options was not a complete defense to claims of unjust enrichment.

The court then assessed the application of the business judgment rule in light of the allegations of the complaint. At the pleading stage, the court held plaintiffs' allegations were sufficient to create a doubt as to the application of the business judgment rule because "a director who intentionally uses inside knowledge not available to shareholders in order to enrich employees while avoiding shareholder-imposed requirements cannot be said to be acting loyally and in good faith as a fiduciary." The court suggested a three-part test for determining the sufficiency of a pleading attacking spring-loaded options issued by a disinterested board. To raise the specter of bad faith in such a circumstance, the complaint should allege: (1) the options were issued pursuant to a plan approved by the stockholders; (2) the directors approving the options possessed material non-public information soon to be released that would impact the share price and (3) the issuing directors had the intent of circumventing the shareholder-approved restriction on the exercise price of the options.

In re infoUSA, Inc. S'holders Litig., 2007 WL 2419611 (Del. Ch.). Stockholder derivative action on behalf of infoUSA, Inc., alleging certain directors breached their fiduciary duties, wasted corporate assets and violated the DGCL largely to the benefit of the corporation's founder, CEO, director and 41% stockholder Vinod Gupta. Plaintiffs sought to void various self-dealing transactions between infoUSA and Gupta that were not approved by disinterested directors or a vote of disinterested stockholders pursuant to DGCL §144 and option grants awarded in violation of DGCL §157. Plaintiffs also sought to invalidate a standstill letter

agreement between infoUSA and Gupta whereby Gupta agreed not to acquire any additional infoUSA securities in exchange for infoUSA's agreement not to modify the stockholder rights plan to include Gupta. Defendants moved to dismiss for failure to make a demand under Rule 23.1 and for failure to state a claim.

In an opinion granting in part and denying in part defendants' motion to dismiss, the court concluded plaintiffs stated a claim for breach of the duty of loyalty. Plaintiffs' challenge to several related-party transactions, including allegations that Gupta obtained private jet travel, luxury cars and use of a yacht at corporate expense without board approval, stated a claim. The court explained that an "ideal complaint" would "separately address each challenged transaction; specifically mention whether the transaction was or was not approved by the board of directors (and provide the composition of the board); describe the purported consideration received by the company for the transaction, if known; and then conclude with an explanation of why transaction could not have been made in good faith."

Although plaintiffs' complaint fell far short of this model, it pointed to a collection of related-party transactions either blessed or passively noted by a conflicted board. The court found it significant that a report to the board had raised concerns about related-party transactions involving Gupta, but the directors approved SEC Form 10-Ks that concealed the nature of those transactions. These allegations gave rise to a reasonable inference of bad faith conduct.

The court also concluded plaintiffs' allegations that the board had created a sham special committee process to consider Gupta's going-private proposal stated a claim. Plaintiffs alleged that once the special committee began to search for potential acquirers, Gupta and other conflicted directors who did not serve on the special committee voted to disband the special committee. Although Gupta was unsuccessful in acquiring the corporation, the court concluded "this form of wasteful legerdemain . . . constitutes a violation of the duty of loyalty."

The court rejected plaintiffs' claim that a letter agreement exempting Gupta from the corporation's rights plan constituted a breach of duty. The court concluded the complaint failed to allege that the 1997 letter agreement had been adopted by a majority of interested directors or was beyond any reasonable business judgment.

Globis Partners, L.P. v. Plumtree Software, Inc., 2007 WL 4292024 (Del. Ch.). Stockholder class action alleging directors of Plumtree Software, Inc. breached their fiduciary duties in connection with their approval of a merger of Plumtree into BEA Systems, Inc. Plaintiff alleged defendants agreed to sell Plumtree for an unreasonably low price to reap certain personal benefits and to avoid personal liability from potential derivative litigation arising from allegations that Plumtree overcharged the federal government in breach of a sales contract. Defendants moved to dismiss the complaint arguing, inter alia, that plaintiff failed to plead facts showing director interest sufficient to overcome the business judgment rule.

In an opinion granting defendants' motion to dismiss, the court concluded plaintiff failed to plead with particularity that the individual defendants' fear of litigation based on the government contract problems caused them to approve the merger. In order to show that defendants were motivated by a fear of future litigation, the court explained that plaintiff would have to plead: (1) the individual defendants faced substantial liability in respect of the government overcharges, (2) the defendants approved the merger because of that liability and (3) the merger was merely pretextual and not entered into for any valid purpose. Plaintiff asserted that the individual defendants faced liability because they must have known of Plumtree's

misconduct in respect of the government contract, and if defendants did not know that Plumtree had overcharged the government, they were guilty of gross negligence. The court interpreted this assertion as attempting to allege a duty of oversight claim that did not satisfy the high pleading standard set forth in In re Caremark Int'l Inc. Derivative Litigation. Concluding that plaintiff failed to plead facts showing that defendants faced significant liability from the government overcharges, the court then found plaintiff failed to plead with the necessary particularity that defendants were motivated to approve the merger to avoid personal liability or that the merger was pretextual. The court also ruled plaintiff pled insufficient facts to support its allegations that the benefits the individual defendants received in the merger created any disabling interest that would limit application of the business judgment rule.

Crescent/Mach I P'ship, L.P. v. Turner, 2007 WL 1342263 (Del. Ch.). Consolidated appraisal and breach of fiduciary duty actions brought by minority shareholders of Dr Pepper Bottling Holdings, Inc. (Holdings) arising out of a 1999 cash-out merger. Plaintiffs alleged that the Chairman, CEO and 61.5% stockholder of Holdings (Turner), agreed to an unreasonably low merger price in exchange for side payments and other special consideration for himself, including employment with Holdings' successor. Plaintiffs alleged Turner breached his duty of loyalty to Holdings and its stockholders when he misled both his fellow directors and the board's investment banker by offering overly pessimistic assessments of Holdings' prospects and understating projections. Plaintiffs alleged Turner justified the merger price with financial projections showing that Holdings would experience 3% annual volume growth when he actually believed the corporation would experience 4% volume growth, a difference which may have increased the value of Holdings by as much as 15%.

In its post-trial opinion, the court concluded plaintiffs failed to prove Turner violated his fiduciary duties to Holdings and its stockholders. Based largely on Turner's own testimony, the court found that Turner believed the 3% volume projections were accurate and that he neither created nor adopted the 4% projections. The court concluded that the 3% projections were reasonable and realistic based on the information available to Holdings at the time. In a footnote, the court dispensed with plaintiffs' other allegations of fiduciary breaches by Turner involving side payments and self-dealing transactions. The court concluded those claims: (1) were developed too late and were not appropriate for trial, (2) may have been derivative, and not direct claims and (3) to the extent they were presented at trial were without merit because they were approved by two independent board members and, thus, subject to the business judgment rule.

Trenwick Am. Litig. Trust v. Ernst & Young, L.L.P., 906 A.2d 168 (Del. Ch. 2006), aff'd, 931 A.2d 438 (Del. 2007) (Order). Action by a litigation trust, formed in a bankruptcy reorganization of a wholly owned subsidiary of Trenwick Group, Inc., a publicly traded insurance holding company, against former directors of Trenwick Group and the subsidiary for breach of fiduciary duties, "deepening insolvency" and fraud. Plaintiff claimed defendants pursued an imprudent business strategy to acquire other insurers with underestimated claim exposures. Plaintiff asserted that the parent's former directors breached fiduciary duties owed to the subsidiary by overleveraging the subsidiary in a reorganization that made imprudent acquisitions. Plaintiff also asserted the former directors of the subsidiary breached their duty of care for not second-guessing the business judgment of the parent's former directors.

In an opinion granting defendants' motion to dismiss, which was summarily affirmed on appeal, the Court of Chancery held the complaint failed to state a claim for breach of fiduciary duty, that Delaware does not recognize the tort of "deepening insolvency" and that plaintiff

failed to plead fraud with particularity. Observing established Delaware law that a parent corporation owes no fiduciary duties to its wholly owned subsidiary, the court concluded a wholly owned subsidiary cannot breach its duty of care by acting with loyalty to implement the business strategy adopted by its parent's board. Thus, the court refused to permit a wholly owned subsidiary to assert claims for breach of fiduciary duty by its parent's directors under the guise that the parent's business decisions led to the ultimate bankruptcy of the subsidiary. The court also rejected the "deepening insolvency" claim, which is contrary to underlying principles of Delaware law.

In re Coca-Cola Enters., Inc. S'holders Litig., 2007 WL 3122370 (Del. Ch.). Derivative action by stockholders of Coca-Cola Enterprises, Inc. (CCE), the primary bottler and distributor of Coca-Cola products, against CCE's current and former directors and Coca-Cola Company (Coke) alleging breaches of fiduciary duty. Plaintiffs argued that since Coke spun-off CCE in 1986, CCE's directors and Coke have abused the relationship between the two entities and caused CCE to operate solely to benefit Coke, maximizing Coke's profits at the expense of CCE. Defendants moved to dismiss, arguing, inter alia, that the claims all related to a 1986 contract between CCE and Coke and were therefore barred by the doctrine of laches.

In an opinion dismissing the complaint as time-barred, the court found that all the alleged wrongs accrued in 1986 because they rationally flowed from the 1986 agreement. The court explained that because equity follows the law, absent unusual circumstances, a money damages claim for breach of fiduciary duties is subject to the analogous three-year limitations period of 10 Del. C. §8106. Finding no unusual circumstances that would toll the limitations beyond the analogous three-year statutory period, the court had no need to engage in a traditional laches analysis. Rather, Coke and CCE had publicly disclosed their agreements long ago in SEC filings, at which point plaintiffs knew or should have known the facts. The court further held that plaintiffs' duty of loyalty claim relating to a change in CCE's distribution arrangement with Walmart failed to state a claim. Plaintiffs failed to allege that any of the defendants stood on both sides of the transaction or would derive a personal financial benefit from the transaction.

B. Duty of Disclosure

In re Netsmart Tech., Inc. S'holders Litig., 924 A.2d 171 (Del. Ch. 2007). Stockholder action to enjoin a stockholder vote on a proposed merger of Netsmart Technologies, Inc. and two private equity firms. Plaintiffs alleged that Netsmart's directors breached their fiduciary duty to disclose all material information related to the merger as well as their fiduciary duties under Revlon. Plaintiffs' disclosure claims maintained that the proxy statement failed to disclose future cash projections relied on by Netsmart's financial advisor in rendering its fairness opinion. The defendants responded that the projections were not material because they were speculative and were not given to buyers.

In an opinion granting plaintiffs' motion for a preliminary injunction, the court held that the board's failure to disclose the cash flow projections relied on by its financial advisor rendered disclosures to Netsmart's stockholders materially incomplete. The court also held that the board likely breached its Revlon duties and, therefore, the description of the sales process in the proxy statement was materially misleading. The omitted financial information was material because the proxy statement clearly stated that the cash flow analysis performed by Netsmart's financial advisor in rendering its fairness opinion covered a period ending December 31, 2011, and that 82-86% of Netsmart's present value was attributable to a terminal value calculated from

the 2011 projected EBITDA. To remedy the proxy's misleading description of the sales process, the court directed that at least the court's opinion be disclosed so Netsmart's stockholders were provided with a "fuller, more balanced description of the board's actions."

In re Topps Co. S'holders Litig., 926 A.2d 58 (Del. Ch. 2007). Action by disgruntled stockholders and a competing bidder to enjoin the proposed going-private cash merger between Topps and a private equity firm led by Michael Eisner. Plaintiffs alleged, inter alia, that Topps's directors breached their fiduciary duty of disclosure and their duties under Revlon to obtain the highest price reasonably available to them.

In an opinion granting a preliminary injunction, the court held the proxy statement contained material omissions and misstatements in violation of defendants' duty of disclosure. The court found the proxy statement omitted material information about representations that Eisner had made to Topps's management about retaining senior management and key employees if his firm's bid were successful. The court found that rather than disclosing these representations, the proxy statement created a misleading impression that the managers were given no assurances about their future with the corporation. The court also found defendants failed to disclose that the corporation's financial advisor made substantial revisions to its analysis which had the effect of making the Eisner bid appear substantially more attractive. Additionally, the court concluded that the proxy statement contained several material misstatements and omissions about the competing bidder and the seriousness of its bid. In light of these disclosure violations, the court entered an injunction until the defendants issued corrective disclosure and satisfied their fiduciary duties under Revlon.

Globis Partners, L.P. v. Plumtree Software, Inc., 2007 WL 4292024 (Del. Ch.). Stockholder class action alleging directors of Plumtree Software, Inc. breached their fiduciary duties in connection with their approval of a merger of Plumtree into BEA Systems, Inc. Plaintiff alleged defendants breached their fiduciary duties by failing to disclose adequate information in the merger proxy statement. Plaintiff also asserted defendants agreed to sell Plumtree for an unreasonably low price to reap certain personal benefits and to avoid personal liability from potential derivative litigation. Defendants moved to dismiss the complaint, arguing that plaintiff failed to plead sufficient facts to overcome the business judgment rule and that the disclosure allegations failed to state a claim and were exculpated pursuant to a DGCL §102(b)(7) charter provision.

In an opinion granting defendants' motion to dismiss, the Court of Chancery held the complaint failed to state a claim for breach of the duty of disclosure. The court rejected plaintiff's claim that the discussion of the analyses conducted by Plumtree's financial advisor, as described in the proxy statement, were inadequate. The omission of a discount rate discussion in one of the financial analyses was not a per se disclosure violation and did not alter the total mix of information. Nor was the proxy required to explain why different sets of companies were used in the comparable companies and comparable transactions analyses. The information was inferred because one analysis involved ongoing public companies while the other included acquired companies. The failure to disclose the financial advisor's actual fee in light of the disclosure that the fee was "customary" and partially contingent was not material absent an allegation it was exhorbitant or otherwise improper. The court rejected plaintiff's claim challenging the omission of Plumtree's projections of future performance, noting plaintiff failed to allege the corporation possessed reliable projections. The court further concluded that alleged omissions about the background of the merger—such as why the board had formed a special

mergers and acquisitions committee and the identities of third parties contacted as potential merger partners—were not material. The court determined Plumtree's exculpatory charter provision under DGCL §102(b)(7) provided an alternative basis for dismissing plaintiff's disclosure claims. Because plaintiff sought only money damages for its disclosure claims, and plaintiff failed to demonstrate that defendants withheld information from stockholders in bad faith, the omissions would only amount to violations of the defendant directors' duty of care. As the §102(b)(7) provision exonerated the directors from breaches of their duty of care, defendants could not be held liable.

Mercier v. Inter-Tel (Delaware), Inc., 929 A.2d 786 (Del. Ch. 2007). Stockholder class action alleging directors of Inter-Tel breached their fiduciary duties by manipulating the corporate machinery and making inadequate disclosure in connection with a proposed cash-out merger of Inter-Tel. The proxy ballot contained two provisions: one to approve the merger and one authorizing the board to postpone or adjourn the special meeting of stockholders to permit the corporation to seek additional votes in favor of the merger. On the morning of the special meeting, proxy ballots were running overwhelmingly against the merger and against the proposal to authorize adjournment or postponement. Defendants rescheduled the meeting, stating stockholders needed additional time to consider recent information. After setting a new record date and disseminating a proxy supplement with additional information, the merger was approved. Plaintiffs argued the last-minute postponement violated the defendants' fiduciary duties under Blasius and the proxy supplement violated defendants' duty of disclosure.

In an opinion denying plaintiffs' motion for a preliminary injunction, the court concluded plaintiffs failed to establish a reasonable probability of success on their disclosure claims. Plaintiffs argued the proxy supplement failed to disclose that, at the time the defendants voted to reschedule the special meeting (i.e., the morning of the original meeting date), a majority of Inter-Tel's outstanding stock had submitted votes against both the merger and the proposal to authorize postponement or adjournment of the special meeting. Despite criticizing the "coy nature" of the press release rescheduling the special meeting, the court concluded that reasonable stockholders realized the merger would not have been approved on the original meeting date. Similarly, the court rejected plaintiffs' contention that, in setting a new record date, defendants sought to enable arbitrageurs to purchase shares of Inter-Tel stock that could be voted at the new special meeting. The court reasoned that the ability of hedge funds and arbitrageurs to buy and vote stock due to the change in record date was obvious to any reasonable investor. Furthermore, the court noted that the key issue was the merits of the merger, not how the vote had been running prior to the original meeting date or that the new record date would facilitate voting by arbitrageurs. Finally, the court also noted that Inter-Tel's former chairman and its largest stockholder, who had been running a proxy contest against the merger and in favor of a recapitalization proposal, had made arguments about these issues in his campaign against the merger.

Sample v. Morgan, 914 A.2d 647 (Del. Ch. 2007). Stockholder derivative action, alleging, inter alia, directors of Randall Bearings, Inc. breached their fiduciary duties by failing to disclose in a proxy statement material facts in connection with an incentive stock plan and charter amendment presented for stockholder approval. Plaintiff alleged the material facts omitted from the proxy statement included the origin of the incentive stock plan—purportedly the brainchild of strategy sessions between the CEO and the corporation's outside counsel on how to secure a control block for the inside directors. Moreover, the proxy did not disclose that

as a result of another agreement with Randall's largest stockholder simultaneously approved by the directors, the stockholders were authorizing an issuance to management of the only equity the corporation could issue for the next five years. Defendants moved to dismiss, arguing that the terms of the incentive plan were fully disclosed to the stockholders, and the stockholders' fully informed approval of the incentive plan constituted ratification and extinguished any breach of fiduciary duty claims.

In an opinion denying the defendants' motion to dismiss, the court held the proxy statement disclosure concerning the incentive stock plan and charter amendment was materially misleading. The court was particularly troubled by the size of the incentive stock plan—one-third of the corporation's voting power and more than twice the size of a typical incentive stock plan—and allegations that, from its inception, all the shares authorized under the incentive plan were to be allocated to three inside directors. Most striking was the failure to disclose that, at the time the board approved the incentive stock plan, it also entered into an agreement with a significant stockholder preventing the corporation from issuing shares other than the incentive stock shares for the next five years.

In re Lear Corp. S'holder Litig., 926 A.2d 94 (Del. Ch. 2007). Stockholder action alleging directors of Lear breached their duty of disclosure and failed to satisfy their duty to obtain the highest value reasonably available under Revlon in connection with the proposed going-private merger of Lear with an entity controlled by Carl Icahn.

In an opinion granting a limited preliminary injunction solely based on disclosure, the court concluded the proxy statement omitted material information concerning the Lear CEO's personal financial interests in the merger. Shortly before Icahn had broached his going-private proposal, the CEO, who had spent 35 years with Lear, asked the board to allow him to accelerate certain retirement benefits while remaining employed as CEO. A compensation consultant presented alternatives to accelerate the CEO's retirement benefits, but noted that any of them could spark stockholder objections. Although the CEO chose not to pursue any of the alternatives, the court concluded the facts concerning the CEO's negotiations with the board were material in the context of the Icahn merger proposal, which effectively allowed the CEO to accomplish his dual objectives of securing his retirement benefits and remaining as CEO. The following facts influenced the court's decision: (1) the CEO waited for more than a week before disclosing to the board his going-private discussions with Icahn; (2) the board permitted the CEO to conduct the negotiations with Icahn outside the presence of any independent director or the special committee's investment banker and without specific pricing guidance from the special committee; (3) the merger allowed the CEO to cash out his equity stake in Lear for one lump sum and (4) Icahn agreed to employment terms with the CEO that allowed him to secure a short-term schedule for the payout of his retirement benefits, obtain improved salary and bonus and a large grant of options in the post-merger Lear. The court concluded a "reasonable stockholder would want to know an important economic motivation of the negotiator singularly employed by a board to obtain the best price for the stockholders, when that motivation could rationally lead that negotiator to favor a deal at a less than optimal price, because the procession of a deal was more important to him, given his overall economic interest, than only doing a deal at the right price." The court rejected plaintiffs' other disclosure claims. The court determined that one of eight earlier iterations of Lear's discounted cash flow models developed by its investment banker was not material. The court noted that plaintiffs failed to show that either the banker or Lear

management considered the omitted DCF model reliable. The court also rejected disclosure claims relating to certain aspects of Lear's pre-signing and post-signing market checks.

Louisiana Mun. Police Employees' Ret. Sys. v. Crawford, 2007 WL 625006 (Del. Ch.); 918 A.2d 1172 (Del. Ch. 2007). Stockholder class action seeking to enjoin the proposed stock-for-stock merger of Caremark Rx and CVS Corporation. Among plaintiffs challenging the transaction was Express Scripts, Inc., which had launched a hostile bid for Caremark. Plaintiffs alleged, inter alia, the Caremark directors breached their fiduciary duty of disclosure and that a supplemental proxy statement failed to cure those disclosure violations.

In the first of two opinions enjoining the proposed merger (2007 WL 625006 (Del. Ch.)), the court entered a temporary restraining order to permit stockholders sufficient time to consider supplemental disclosures that defendants made in an SEC Form 8-K approximately eight days before the scheduled merger vote. Those disclosures included the revelation that Caremark had considered potential transactions with Express Scripts on at least three prior occasions and that, in the event of a merger, other plaintiffs engaged in derivative litigation against the defendant directors relating to option backdating claims might lose standing to assert those claims. Having determined these supplemental disclosures were material, the court concluded there was insufficient time for stockholders—even institutional stockholders—to digest and analyze the disclosures and return a proxy in time for the scheduled vote. The court further noted that the defendants' predicament was self-inflicted, as the information contained in the 8-K was not new or unavailable at the time of the initial proxy statement.

In a subsequent opinion granting a limited preliminary injunction (918 A.2d 1172 (Del. Ch. 2007)), the court required additional disclosure to Caremark stockholders concerning their right to demand appraisal and the contingent nature of the financial advisors' fees. The court held that the payment of a special dividend to Caremark stockholders constituted part of the merger consideration, thus triggering appraisal rights under DGCL §262. Because Caremark failed to advise stockholders of their right to demand appraisal, the stockholders' meeting could not go forward absent compliance with the 20 day notice period under Section 262. The court also concluded the disclosures concerning the investment bankers' entitlement to a total of $35 million in contingent fees contained material omissions. The proxy statement failed to disclose that the initial trigger of the contingent right to the $35 million in fees was the approval and public announcement of the transaction, which had already occurred. The court rejected plaintiffs' seven other disclosure claims, which were directed to the purpose of the proxy supplement, relationships among Caremark directors and their advisors, the expected tenure of the chairman of the combined entity, the negotiation of the special dividend, the impact of the merger on option backdating claims and antitrust risks.

In re CheckFree Corp. S'holders Litig., 2007 WL 3262188 (Del. Ch.). Stockholder action alleging directors of CheckFree violated their fiduciary duty of disclosure in soliciting proxies for a proposed merger with Fiserv, Inc. Plaintiffs sought a preliminary injunction arguing the definitive proxy statement failed to disclose: (1) management's projections for CheckFree, even though the financial advisor relied on the projections, (2) the nature or effect of the merger on a stockholder derivative action pending in Georgia and (3) sufficient background detail of the merger. Fiserv's offer was higher than any other offer and presented the stockholders of CheckFree with a premium over CheckFree's then-current stock price.

In an opinion denying plaintiffs' motion for preliminary injunction, the court held there is no per se rule in Delaware requiring that management projections be disclosed in a merger proxy statement. The court distinguished its recent opinion in In re Netsmart Techs, Inc. S'holders Litig., 924 A.2d 171 (Del. Ch. 2007), from this case. In Netsmart, the proxy statement "affirmatively disclosed an early version of *some* of management's projections," and the court required additional disclosure of certain management projections that the corporation's investment banker used in generating its discounted cash flow analysis. In CheckFree, however, the proxy statement never purported to disclose management's projections and plainly stated that CheckFree's financial advisor had to interview members of management to determine the risks related to the accuracy of the projections. The court further concluded management's projections were admittedly incomplete and may have been misleading if disclosed. The court also held that defendants were not required to give stockholders legal advice by disclosing that the merger would extinguish pending derivative claims in another jurisdiction. Disclosing that the merger would relieve one director of potential insider trading liability in the Georgia action, where all of the directors approved the merger, would not likely alter the total mix of information available to stockholders. Notably, the court held the balance of harms and the consideration of the public interest favored defendants because CheckFree stockholders would suffer substantial harm in the form of lost time value of money and lost opportunities, whereas plaintiffs did not face the likelihood of substantial harm. Plaintiffs did not meet the "especially strong" showing required to enjoin a premium transaction in the absence of a competing bid. The court rejected plaintiffs' argument that the proxy statement's description of the background of the merger was not long enough, noting a plaintiff may not merely state that the disclosure is lacking, but must explain what is lacking.

Portnoy v. Cryo-Cell Int'l, Inc., 2008 WL 131348 (Del. Ch.). Action under DGCL §225 challenging an election of directors. Plaintiff alleged defendants engaged in improper vote buying and breached their fiduciary duties in obtaining votes to support the management slate and in conducting the stockholders' meeting.

In a post-trial opinion, the court determined defendants breached their fiduciary duties, which warranted a new election. First, the court held that the board's agreement to put an insurgent stockholder on the management slate in exchange for the insurgent's voting support did not constitute an improper vote-buying arrangement subject to entire fairness review. Although that arrangement had not been disclosed to the stockholders, the court concluded the arrangement was an unmistakable inference to be drawn by a reasonable stockholder and, therefore, did not constitute a disclosure violation. Second, the court held the board's promise to expand the board and appoint the insurgent's designee to the board after the election in exchange for the insurgent's buying additional shares and voting them for management should have been disclosed. The court declined to decide whether this arrangement constituted improper vote buying or ran afoul of the Schnell doctrine ("inequitable action does not become permissible simply because it is legally possible"). Third, the court found the corporation's CEO breached her fiduciary duty by coercing and inducing a stockholder to vote for the management slate. Finally, the court found the CEO breached her fiduciary duty by refusing to close the polls and count the vote at the annual meeting and for calling an extended break during the meeting to secure enough votes for a management victory. The court found the CEO gave false reasons for delaying the vote count and acted in bad faith. As a remedy, the court ordered a new election and required the management slate to bear the costs of its proxy solicitation as well as the costs of conducting the new meeting.

C. Entire Fairness Standard of Review

Valeant Pharms. Int'l v. Jerney, 921 A.2d 732 (Del. Ch. 2007), appeal dismissed, 929 A.2d 784 (Del. 2007). Action to recover, inter alia, $3 million bonus paid to Valeant's former president and director, Adam Jerney. The bonus to Jerney was part of more than $47 million in cash awards paid to Valeant's management, directors and employees from proceeds of a partial IPO of a wholly owned subsidiary. Each of the board's outside directors, including all three members of the compensation committee, received $330,050 in bonuses, and former Chairman and CEO Milan Panic received more than $33 million. After a special litigation committee determined to take over an existing derivative action and pursue claims for the bonuses, the corporation sought return of the bonuses and other damages. The corporation settled its claims with all of the director defendants except Jerney.

In a post-trial opinion, the court held Jerney liable for breach of the duty of loyalty. The court concluded Jerney was unable to satisfy the safe harbor of DGCL §144 because the bonuses, which had not been approved by a disinterested majority of directors or a fully informed vote of the stockholders, were not entirely fair to the corporation. The court determined the process was deeply flawed and dominated by management and, in particular, by Panic. The court found that the three compensation committee members were self-interested because they would receive bonuses, and two members were not independent because of their relationships with Panic and ongoing negotiations with Panic for consulting contracts with the corporation. The court found the committee process was designed simply to justify a predetermined outcome dictated by Panic and management. The court also held that the amount of the bonuses was unfair and unsupported by any reference to comparable transactions. The court held Jerney could not avoid liability by asserting reliance on the advice of experts pursuant to DGCL §141(e). First, the court held Section 141(e) is not a defense to a claim subject to the entire fairness standard. Instead, reliance upon experts is merely a factor for consideration. Second, the record lacked credible evidence of any expert advice from counsel or the compensation consultant that the bonuses were entirely fair.

Jerney was held liable not only for what he personally received, but for additional damages flowing from his breach of loyalty. In fashioning relief, the court ordered Jerney to disgorge the entire amount of his bonus, rejecting Jerney's argument that he should be permitted to keep what might have been considered a "fair" bonus. Similarly, the court held the settlements reached with the other defendants did not trigger apportionment of Jerney's liability or reduction of his obligation to disgorge his bonus under the Delaware Uniform Contribution Among Tortfeasors Law 10 Del. C. §6301 et seq. Jerney, who was one of twelve directors, was also held liable for 1/12 of the amount of the bonuses to non-director employees, 1/12 of the costs incurred in conducting the special litigation committee investigation and all amounts advanced to him by the corporation for his defense of the action.

In re TD Banknorth S'holders Litig., 2007 WL 4788445 (Del. Ch.). Opinion rejecting a proposed class action settlement of litigation concerning the freeze-out merger of TD Banknorth (Banknorth) by which its controlling stockholder, Toronto-Dominion Bank (TD), acquired Banknorth's remaining public shares for $32.33 in cash. TD and Banknorth were parties to a stockholders agreement that prevented TD from proposing or initiating any going-private transaction prior to March 1, 2007, unless invited to do so by a special committee of outside Banknorth directors. Objectors argued TD violated the stockholders agreement, which gave rise

to claims of breach of contract and breach of the duty of loyalty that plaintiffs did not assert and did not extract settlement consideration. The court agreed, noting that discovery revealed these claims had "some substantial strength" and would be subject to the entire fairness standard of review. The court rejected defendants' contention that the contract claim was derivative, and therefore standing was extinguished in the merger. The court observed that it was the minority stockholders whose shares were cashed out by an allegedly unfair process in contravention of the stockholders agreement, and any resulting monetary recovery should flow to the stockholders, not the corporation.

D. Enhanced Scrutiny of Defensive Measures and Control Transactions: Recent Applications of Unocal/Unitrin,[3] Revlon[4] and Blasius[5]

Mercier v. Inter-Tel (Delaware), Inc., 929 A.2d 786 (Del. Ch. 2007). Stockholder class action alleging directors of Inter-Tel breached their fiduciary duties by manipulating the corporate machinery and making inadequate disclosure in connection with a proposed cash-out

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[3] Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985), enunciated an "enhanced scrutiny test" applicable to defensive measures in contests for corporate control. Under Unocal, before board action can be given the protection of the business judgment rule, the board must bear its burden of demonstrating (1) that the board had reasonable grounds for believing that a danger to corporate policy and effectiveness existed and (2) the board's defensive action was reasonable in relation to the threat posed. Id. at 955. Unitrin, Inc. v. American General Corp., 651 A.2d 1361 (Del. 1995), further clarified the reasonable response, or "proportionality," test as requiring an analysis of whether a defensive measure is preclusive or coercive and, if neither, whether the measure falls within a range of reasonableness.

[4] Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986). The Delaware Supreme Court explained when Revlon's enhanced scrutiny standard is triggered in Arnold v. Society for Savings Bancorp, Inc., 650 A.2d 1270, 1289-90 (Del. 1994):

> The directors of a corporation "have the obligation of acting reasonably to seek the transaction offering the best value reasonably available to the stockholders," Paramount Communications, Inc. v. QVC Network, Inc., Del. Supr., 637 A.2d 34, 43 (1994), in at least the following three scenarios: (1) "when a corporation initiates an active bidding process seeking to sell itself or to effect a business reorganization involving a clear break-up of the company," Paramount Communications, Inc. v. Time Inc., Del. Supr., 571 A.2d 1140, 1150 (1990) [Time-Warner]; (2) "where, in response to a bidder's offer, a target abandons its long-term strategy and seeks an alternative transaction involving the break-up of the company," id.; or (3) when approval of a transaction results in a "sale or change of control," QVC, 637 A.2d at 42-43, 47. In the latter situation, there is no "sale or change in control" when "'[c]ontrol of both [companies] remain[s] in a large, fluid, changeable and changing market.'" Id. at 47 (citation and emphasis omitted).

[5] Blasius Industries, Inc. v. Atlas Corp., 564 A.2d 651, 661 (Del. Ch. 1988), held that the board bears the "heavy burden of demonstrating a compelling justification" for board action taken for "the primary purpose of impeding the exercise of stockholder voting power."

merger of Inter-Tel. The proxy ballot contained two provisions: one to approve the merger and one authorizing the board to postpone or adjourn the special meeting of stockholders to permit the corporation to seek additional votes in favor of the merger. On the morning of the special meeting, proxy ballots were running overwhelmingly against the merger and against the proposal to authorize adjournment or postponement. Defendants rescheduled the meeting, stating stockholders needed additional time to consider recent information. After setting a new record date and disseminating a proxy supplement with additional information, the merger was approved. Plaintiffs argued the last-minute postponement violated the defendants' fiduciary duties under Blasius and the proxy supplement violated defendants' duty of disclosure.

In an opinion denying plaintiffs' motion for a preliminary injunction, the court criticized the Blasius standard as "so pejorative that it is more a label for a result than a useful guide to determining what standard of review should be used by a judge to reach an appropriate result." The court reasoned that the Blasius "compelling justification" standard was inapplicable to corporate election disputes that did not directly involve the election of directors or contests having consequences for corporate control. Instead, the court concluded a "reasonableness" test under Unocal was the appropriate standard of review to judge directors' fiduciary duties in connection with the merger vote, but suggested the court should do so with a keen eye to prevent inequitable conduct. The court explained the directors bore the burden of identifying "a legitimate corporate objective" served by rescheduling the merger vote and setting a new record date. The directors were required to "show that their motivations were proper and not selfish" and that "their actions were reasonable in relation to their legitimate objective, and did not preclude the stockholders from exercising their right to vote or coerce them into voting a particular way." In applying its test, the court was convinced the directors were properly motivated to obtain stockholder approval for the merger, which the defendants believed was in the stockholders' best interests and would be "irretrievably lost" if the original meeting had gone forward. The court found that rescheduling the meeting and changing the record date allowed stockholders to consider fuller information about Inter-Tel's operating performance and prospects, the state of the debt markets and the value of a competing recapitalization proposal. The court found the change in record date did not determine the outcome; instead, stockholders (and their advisors such as ISS) came to view the merger as the "value-maximizing option." The court further concluded the defendants satisfied their burden under Blasius. The court found defendants' primary purpose was not to disenfranchise stockholders but to give them more time to deliberate before voting. Furthermore, defendants demonstrated a compelling justification for their action: to preserve what they believed to be a value-maximizing offer. The court also rejected plaintiffs' disclosure claims.

In re Topps Co. S'holders Litig., 926 A.2d 58 (Del. Ch. 2007). Action by disgruntled stockholders and competing bidder to enjoin the proposed going-private merger between Topps and a private equity firm led by Michael Eisner at $9.75 per share in cash. Plaintiffs alleged, inter alia, that Topps's directors breached their fiduciary duty of disclosure and their duties under Revlon to obtain the highest price reasonably available to them. The competing bidder—Upper Deck—was a marketplace competitor of Topps and had made past acquisition proposals. In exchange for obtaining confidential information from Topps during the 40-day go-shop period contained in the Eisner/Topps merger agreement, Upper Deck entered into a standstill agreement. Among other things, the standstill prevented Upper Deck from making any public disclosure about any proposed transaction between Topps and Upper Deck, and for a period of two years prevented Upper Deck from acquiring or offering to acquire any of Topps's common

stock, including by way of a tender offer, without Topps's consent. Two days prior to expiration of the 40-day go-shop provision contained in the merger agreement with Eisner, Upper Deck made a non-binding indication of interest to acquire Topps at $10.75 per share. Two days after the expiration of the go-shop period, the Topps board met and determined it would not pursue discussions with Upper Deck beyond the expiration of the go-shop period. In its proxy statement, Topps explained: (1) the Upper Deck proposal contained financing conditions, (2) Upper Deck did not assume the risk of delay or disapproval by antitrust regulators and (3) the proposed reverse-breakup fee of $12 million was inadequate. Upper Deck later submitted another $10.75 offer that purported to address antitrust concerns and included a letter from its financial advisor that it was "highly confident" it could deliver financing.

In an opinion granting plaintiffs' motion for preliminary injunction, the court found fault with the defendants' post-merger agreement conduct, but concluded their negotiation process and deal protection measures contained in the merger agreement were not unreasonable. For example:

- The court found the 40-day go-shop provision was reasonable in lieu of conducting a pre-signing market check or an auction, as certain insurgent/dissident directors had advocated. The provision permitted the board to entertain offers after the go-shop period and accept a superior proposal, subject to Eisner's matching right.
- The court found that taking Eisner's "bird in hand" offer of $9.75 per share despite having received an unsolicited indication of interest from Upper Deck a few days before signing the merger agreement was not unreasonable.
- The termination fee of 4.0% of equity value for a competing bid accepted during the go-shop period and 4.3% of equity value for a bid accepted after the go-shop period, although "a bit high in percentage terms," included the acquirer's expenses and "can be explained by the relative small size of the deal" (i.e., $385 million purchase price) and was not unreasonable. Indeed, the court noted that the termination fee did not seem to deter Upper Deck, which did not stress the point in the litigation.

On the other hand, the court found the board's conduct after the execution of the merger agreement constituted a breach of fiduciary duty. The court concluded the Topps board had not conducted "diligent good faith efforts at bargaining with Upper Deck." The court suggested a motivating factor may have been that Eisner had agreed to retain current management and continue involvement of members of the founding family, whereas Upper Deck, which was in the same line of business, presumably did not need to make such a promise. The court found that the Topps board had made public statements disparaging and misrepresenting Upper Deck's offer, which Upper Deck could not publicly defend without violating the terms of the standstill agreement. The court noted that standstill agreements serve the legitimate purposes of preventing bidders from misusing confidential information and providing a board with leverage to extract concessions from potential bidders. Nevertheless, a board may not misuse standstill agreements to favor one bidder over another when doing so is not in the best interests of the stockholders. The court concluded that the Topps board had, in breach of its duties under Revlon, misused the standstill agreement to prevent Upper Deck from communicating with Topps stockholders and presenting a materially more favorable bid than the Eisner merger. In fashioning relief, the court enjoined the transaction until Topps granted a waiver of the standstill agreement to permit Upper Deck to make an all-shares, all-cash tender offer of at least $10.75

per share and to permit Upper Deck to communicate with Topps stockholders about its version of the relevant events. The court also entered a preliminary injunction requiring Topps to make corrective disclosures.

In re Netsmart Techs., Inc. S'holders Litig., 924 A.2d 171 (Del. Ch. 2007). Stockholder action to enjoin a stockholder vote on a proposed merger of Netsmart Technologies, Inc. and two private equity firms. Plaintiffs alleged, inter alia, that the merger was a result of a "poorly-motivated and tactically-flawed" sales process during which the defendants breached their fiduciary duties under Revlon by making no attempt to canvass the market for strategic buyers. Plaintiffs argued defendants' motive for limiting their market canvass to a few financial buyers was management's desire to effect a transaction only if they continued as corporate officers and retained their equity stake in the corporation. The defendants responded that their actions were well within the bounds of reason and that Delaware law does not require any single blueprint on the means by which the highest value for the stockholders must be pursued. Defendants argued that by negotiating relatively lax deal protections, including only a 3% break-up fee, a window-shop provision and a fiduciary-out allowing the board to recommend against the deal if a materially better offer surfaced, the post-signing market check implicitly satisfied their fiduciary duties under Revlon.

In an opinion granting plaintiffs' motion for a preliminary injunction, the court held plaintiffs were likely to prevail on their Revlon claim. Rather than enjoin the only deal on the table, however, the court's relief was limited to enjoining the stockholder vote until Netsmart disclosed a "fuller, more balanced description" of its search for a strategic buyer. In rejecting the defendants' arguments, the court explained that although there is "no single blueprint" to satisfy Revlon, "[t]he mere fact that a technique was used in different market circumstances by another board and approved by the court does not mean that it is reasonable in other circumstances that involve very different market dynamics."

Critically, the court found that under the circumstances Netsmart's post-signing market check was ineffective. The court reasoned that because of the micro-cap size of Netsmart, its niche market and that the private equity buyers intended to leave management in place, simply announcing the deal was not a reliable way to survey the market. This was particularly the case because Netsmart did not have the contractual right to shop, requiring any interested suitor to make the substantial investment of a hostile topping bid.

The court further found Netsmart's pre-signing market canvass ineffective. The defendants' decision to exclude strategic buyers was not a result of a serious sifting of the strategic market. Rather, the decision was based on a series of "erratic, unfocused, and temporally-disparate discussions" by the CEO with potential strategic suitors that haphazardly occurred over the past decade. Moreover, the decision had apparently been made at an informal board meeting where no minutes were kept and prior to the formation of the special committee.

The court was just as critical of Netsmart's special committee. As an initial matter, instead of seeking out independent financial advice, the special committee hired management's financial advisor. The special committee also failed to oversee due diligence, leaving the possibility for management overtures towards favored suitors. Finally, the special committee failed to formalize meeting minutes until after litigation ensued. Overall, the court described the record evidence of the sale process to look more like an "after-the-fact justification for a decision already made, than a genuine and reasonably informed evaluation of whether a targeted search

might bear fruit." Regardless, rather than "playing games with other people's money," the court recognized no other offer had emerged and left it for the stockholders to decide for themselves whether to accept or reject the deal, once they were fully informed.

In re Lear Corp. S'holder Litig., 926 A.2d 94 (Del. Ch. 2007). Stockholder action alleging directors of Lear failed to satisfy their duty to obtain the highest value reasonably available under Revlon and breached their duty of disclosure in connection with the proposed going-private merger of Lear with an entity controlled by Carl Icahn. Shortly before Icahn had broached his going-private proposal, the CEO, who had spent 35 years with Lear, asked the board to allow him to accelerate certain retirement benefits while remaining employed as CEO. A compensation consultant presented alternatives to accelerate the CEO's retirement benefits, but noted that any of them could spark stockholder objections. Although the CEO chose not to pursue any of the alternatives, the court concluded the facts concerning the CEO's negotiations with the board were material in the context of the Icahn merger proposal, which effectively allowed the CEO to accomplish his dual objectives of securing his retirement benefits and remaining as CEO.

In an opinion granting a limited preliminary injunction for failure to disclose the facts that gave rise to potentially conflicting interests of the CEO, the court concluded the board's conduct, though far from ideal, satisfied Revlon. The court criticized the special committee's decision to allow the potentially conflicted CEO to lead the merger negotiations without the involvement of an independent director or the special committee's investment banker and without substantial guidance from the special committee on strategy or price. Nevertheless, the court concluded the defendants' overall approach to obtaining the best price appeared to be reasonable. The court concluded that the board's decision not to conduct a pre-signing auction out of fear of losing Icahn's $36 per share bid or, if the auction response was underwhelming, allowing him to acquire the corporation at a lower price was reasonable. The court noted that even plaintiffs acknowledged Lear could have been considered to be "in play" since Icahn had first acquired his interest several months before the merger was announced, and no serious expressions of interest had been made, even when the stock was trading at $23 per share. The court did not credit the merger agreement's two-tiered termination fee, providing for a lower fee if a superior proposal were accepted and signed during the 45-day go-shop period, as particularly meaningful. Instead, the court evaluated the reasonableness of the termination fee based on the higher, post go-shop amount, which was 3.5% of equity value and 2.4% of enterprise value. The court noted that it was "arguably more important to look at the enterprise value metric" because the buyer was required to acquire Lear's equity and refinance all of its debt. The court concluded that the termination fee was reasonable under either metric, and that the combination of the termination fee and limited matching right afforded to Icahn in the event of a topping bid was reasonable. The court also rejected plaintiffs' argument that any chance of a topping bid was illusory because other bidders feared retribution from Icahn. The court noted that Icahn had signed a voting agreement to support a superior proposal that he did not match. In refusing to enjoin the transaction based on plaintiffs' challenge under Revlon, the court was particularly concerned about taking the decision to accept a premium offer out of the hands of fully informed stockholders where no other bidder had emerged and dissenting stockholders could seek appraisal.

Louisiana Mun. Police Employees' Ret. Sys. v. Crawford, 918 A.2d 1172 (Del. Ch. 2007). Stockholder class action seeking to enjoin the proposed stock-for-stock merger of Caremark Rx and CVS Corporation. Among plaintiffs challenging the transaction was Express Scripts, Inc., which had launched a hostile bid for Caremark. Plaintiffs alleged the Caremark directors breached their fiduciary duties by agreeing to unfair deal protection measures, failing to investigate other opportunities and failing to disclose material information to the Caremark stockholders. Plaintiffs also alleged CVS aided and abetted those breaches of duty.

In an opinion granting a limited injunction to require additional disclosures, the court appeared critical of the many deal protection devices employed by the merger parties. First, the court reiterated that there is no bright-line test for determining the reasonableness of a termination fee, which in this case was $675 million. Instead, the Chancellor provided a number of factors influencing the court's fact-sensitive review:

> That analysis will, by necessity, require the Court to consider a number of factors, including without limitation: the overall size of the termination fee, as well as its percentage value; the benefit to shareholders, including a premium (if any) that directors seek to protect; the absolute size of the transaction, as well as the relative size of the partners to the merger; the degree to which a counterparty found such protections to be crucial to the deal, bearing in mind differences in bargaining power; and the preclusive or coercive power of all deal protections included in a transaction, taken as a whole. . . . Though a "3% rule" for termination fees might be convenient for transaction planners, it is simply too blunt an instrument, too subject to abuse, for this Court to bless as a blanket rule.

The court declined to address the specific deal protection measures at the preliminary injunction stage, concluding the stockholders were not subject to irreparable harm so long as they were afforded the opportunity to exercise a fully informed vote on the transaction.

Gradient OC Master, Ltd. v. NBC Universal, Inc., 930 A.2d 104 (Del. Ch.), appeal refused, 930 A.2d 928 (Del. 2007). Actions by preferred stockholders of Ion Media Networks, Inc. alleging, inter alia, a proposed exchange offer for the preferred was wrongfully coercive and Ion directors and two large (and allegedly controlling) stockholders breached their fiduciary duties to the preferred. The exchange offer was part of a complex restructuring of Ion, which ultimately would allow one of the two stockholder defendants to gain control of Ion. Plaintiffs sought to enjoin the exchange offer in which Ion offered to acquire certain preferred stock in exchange for debt and newly issued convertible preferred stock. According to plaintiffs, the transaction was coercive because: (1) tendering stockholders were required to consent to the elimination of certain rights contained in the certificate of designation; (2) depending on the number of shares tendered, certain preferred shares held by the alleged controlling stockholders would be converted to subordinated debt that would rank above plaintiffs' shares in Ion's capital structure, thereby reducing the value of plaintiffs' stock and (3) Ion's solicitation documents failed to disclose certain material information. Defendants argued the transaction was not wrongfully coercive and that, as preferred stockholders, plaintiffs' rights were limited to the election of two directors under the certificates of designation, and that those certificates effectively precluded plaintiffs from obtaining a preliminary injunction.

In an opinion denying plaintiffs' motion for a preliminary injunction, the court held plaintiffs failed to show the exchange offer was wrongfully coercive. The court found that the

elimination of the voting and other rights of the preferred shares was not actionably coercive because it required the approval of a majority of the preferred stockholders. Under the terms of the preferred stock's certificate of designation, those rights were always subject to elimination by a majority vote of the preferred holders. The court also held that the provisions of the transaction that elevated the preference of the stock held by NBC Universal and CIG were not actionably coercive. Although the elevation provisions offered an incentive for the preferred stockholders to tender their shares in the exchange offer, the transaction was in the best financial interests of the corporation and its stockholders. Even in light of the provision, the stockholders still had the choice to tender their shares based on the economic merits of each alternative. The court rejected plaintiffs' contention that they should have the right to maintain the status quo, noting that the prevailing case law did not support such a "sweeping proposition." The court also found that none of the disclosure deficiencies alleged by plaintiffs amounted to actionable coercion. The court further concluded the defendant stockholders (either individually or collectively) were not controlling stockholders, even though they held a significant equity position and possessed other contractual rights requiring their consent to certain transactions.

Fogel v. U.S. Energy Sys., Inc., 2007 WL 4438978 (Del. Ch.). Action to determine proper officers of U.S. Energy under DGCL §225 and to compel a special stockholders' meeting. Plaintiff was purportedly terminated as CEO and chairman at a special meeting of the board. Two days later, pursuant to the authority granted to the CEO and chairman under the bylaws, plaintiff called a special meeting of stockholders for the purpose of removing the other directors and electing their replacements. Later that day, during a scheduled board meeting, the board formally passed a resolution terminating plaintiff. Defendants subsequently ignored plaintiff's call for a special meeting of stockholders. Plaintiff contended his purported termination was ineffective because it had not occurred at a board meeting and his attendance was procured by deception. Plaintiff also alleged defendants breached their duty of loyalty under Blasius by refusing to hold the special stockholders' meeting.

In a post-trial opinion, the court ordered the corporation to hold the special meeting of stockholders that had been called by the chairman and CEO. The court found plaintiff had not been validly removed as CEO and chairman prior to the time he called for a special meeting of stockholders. Therefore, the stockholders' meeting had been validly called. Notably, however, the court rejected plaintiff's fiduciary duty claim under Blasius. The court concluded defendants' decision to ignore plaintiff's call for a special meeting was not made for the primary purpose of preventing stockholders from electing a new board majority. Instead, the court found defendants ignored plaintiff's call for a special meeting because they held a good faith belief that he had been terminated and therefore lacked authority to call such a meeting.

Perlegos v. Atmel Corp., 2007 WL 475453 (Del. Ch.). Actions to determine proper officers of Atmel Corporation under DGCL §225 and to compel a special stockholders' meeting pursuant to DGCL §211. Plaintiff George Perlegos had been Atmel's president, CEO and chairman, and his brother Gust had been a director and officer. Both were purportedly terminated as officers by a special committee of the board following an investigation into corporate travel expenses. After his purported termination as an officer, George Perlegos, pursuant to his authority as board chairman, called a special meeting of stockholders to be held two months later for the purpose of removing the directors who had comprised the special committee. The next day, the board removed George Perlegos as chairman and elected a new chairman who was then authorized and ordered to rescind the notice of special meeting of

stockholders. Plaintiffs alleged the cancellation of the special meeting constituted an improper use of the corporate machinery, entrenchment and intentionally impeded stockholders from exercising their right to vote. The corporation had held an annual meeting just three months earlier; thus, there was no issue that the corporation had failed to hold an annual meeting within the time required under DGCL §211.

In a post-trial opinion, the court ordered the corporation to hold the special meeting of stockholders that had been canceled by the newly elected chairman. As a threshold matter, the court upheld the special committee's termination of plaintiffs as officers. The court also agreed with defendants that the bylaw provision authorizing the chairman to call a special meeting of stockholders, but silent on the authority to cancel the meeting, impliedly authorized the new chairman to cancel the meeting. Nevertheless, the court concluded defendants' cancellation of the meeting was not justified as a matter of equity. The court avoided the parties' disagreement over whether the plaintiffs' equitable challenge to cancellation of the meeting was governed by the stringent "compelling justification" standard under Blasius. Instead, the court concluded defendants were unable to justify their decision even if it were subject to the more lenient reasonableness standard under Unocal. Defendants claimed that cancellation of the special meeting was justified because of its cost and the possibility it would distract management and confuse employees and stockholders. Defendants further argued there was a threat that the corporation could lose its listing on NASDAQ if its independent directors were removed. The court found none of these reasons persuasive and concluded cancellation of the special meeting was improper.

E. Waste of Corporate Assets

Sample v. Morgan, 914 A.2d 647 (Del. Ch. 2007). Stockholder derivative action alleging, inter alia, directors of Randall Bearings, Inc. breached their fiduciary duties and wasted corporate assets when they approved and implemented an incentive stock plan. All 200,000 shares of Randall stock authorized under the plan were issued to three inside directors. Plaintiff argued that the stock received by defendants represented nearly one-third of Randall's voting power and had fair market value of at least $2.3 million. The recipients paid only par value of $0.001 per share, for an aggregate of $200, and the corporation undertook additional debt to pay the taxes incurred by the recipients of the incentive awards. Although the shares vested over a period of years, they possessed immediate voting power and dividend rights and would become fully vested upon a change of control. Defendants responded that the grants under the incentive stock plan were necessary to attract and retain key employees, there was a business purpose for the grants and, therefore, they could not constitute waste.

In an opinion denying defendants' motion to dismiss, the court held the allegations supported an inference of waste. The court explained the doctrine of waste was the residual protection for stockholders that polices the outer boundaries of the business judgment rule. Thus, when economic terms of a transaction are so disparate that no reasonable person acting in good faith could conclude the transaction was in the corporation's best interest, the presumption of the business judgment rule is lost. The incentive grants here were extraordinary, represented nearly one-third of the corporation's voting power, were acquired for only $200 and there was no indication that the three recipients had offers to go elsewhere.

In re infoUSA, Inc. S'holders Litig., 2007 WL 2419611 (Del. Ch.). Stockholder derivative action on behalf of infoUSA, Inc., alleging certain directors breached their fiduciary duties, wasted corporate assets and violated the DGCL largely to the benefit of the corporation's founder, CEO, director and 41% stockholder Vinod Gupta. Plaintiffs challenged various self-dealing transactions between infoUSA and Gupta, such as the sale of a stadium skybox to the corporation by a Gupta-owned corporation and payments for private use of planes, luxury cars and a yacht. Plaintiffs also alleged a consulting agreement between the corporation and former President Clinton constituted waste. Defendants moved to dismiss for failure to make a demand under Rule 23.1 and for failure to state a claim.

In an opinion granting in part and denying in part defendants' motion to dismiss, the court concluded the complaint stated a claim for waste of corporate assets. The court found the allegations challenging a series of self-dealing transactions involving Gupta stated a claim for waste. The court concluded the complaint presented a series of related-party transactions and improper benefits allowed to flow to Gupta from a board he dominated and controlled, and the board allowed Gupta to extract value from the corporation by selling assets to infoUSA at inequitable prices. On the other hand, the court held allegations challenging a consulting contract with former President Clinton did not state a claim for waste. The court observed the complaint failed to allege facts suggesting the agreement was illegitimate, and the court could not conclude a public corporation could never legitimately purchase the services of a former President.

F. Stockholder Ratification Issues

Sample v. Morgan, 914 A.2d 647 (Del. Ch. 2007). Stockholder derivative action alleging, inter alia, directors of Randall Bearings, Inc. breached their fiduciary duties and wasted corporate assets when they approved and implemented an incentive stock plan. All 200,000 shares of Randall stock authorized under the plan were issued to three inside directors. Plaintiff argued that the stock received by defendants represented nearly one-third of Randall's voting power and had fair market value of at least $2.3 million. The recipients paid only par value of $0.001 per share, for an aggregate of $200, and the corporation undertook additional debt to pay the taxes incurred by the recipients of the incentive awards. Although the shares vested over a period of years, they possessed immediate voting power and dividend rights and would become fully vested upon a change of control. Defendants responded that the grants under the incentive stock plan were necessary to attract and retain key employees, there was a business purpose for the grants and, therefore, they could not constitute waste. Defendants moved to dismiss, arguing, inter alia, the stockholders' fully informed approval of the incentive stock plan constituted ratification and extinguished any breach of fiduciary duty claims.

In an opinion denying defendants' motion to dismiss, the court rejected defendants' ratification argument for two reasons. First, the court explained that even if the terms of the incentive stock plan were fully disclosed to the stockholders, their entrusting the compensation committee to issue shares under discretionary terms and conditions was not a license for directors and the committee "to do whatever they wished, unconstrained by equity." Second, the court held the proxy statement disclosure seeking stockholder approval of the incentive stock plan was materially misleading and contained material omissions, thus defeating defendants' ratification argument. The court was particularly troubled by the size of the incentive stock plan—one-third of the corporation's voting power and more than twice the size of a typical

incentive stock plan—and allegations that, from its inception, all the shares authorized under the incentive stock plan were to be allocated to three inside directors. Most striking was the failure to disclose that, at the time the board approved the incentive stock plan, it also entered into an agreement with a significant stockholder preventing the corporation from issuing shares other than the incentive stock shares for the next five years.

G. Allocation of Power Between the Board and Stockholders

Sample v. Morgan, 914 A.2d 647 (Del. Ch. 2007). Stockholder derivative action alleging, inter alia, that the directors of Randall Bearings, Inc. breached their fiduciary duties and violated the DGCL in connection with the approval and implementation of an incentive stock plan and an agreement with the corporation's largest stockholder. As part of the agreement with its largest stockholder, the board could not issue any additional equity for the next five years except for the incentive stock plan shares, all of which were issued to three inside directors.

In an opinion denying defendants' motion to dismiss the complaint, the court held the defendants' agreement not to issue additional stock for five years other than the incentive stock plan shares did not contravene DGCL §141(a). The court observed that corporations often enter into contracts binding the corporation and limiting the board's authority into the future, and the agreement restricting the board's ability to issue stock for five years did not violate the board's statutory authority. The court acknowledged Delaware Supreme Court precedent holding that certain conduct to restrict the authority of future boards was invalid. The court distinguished those cases, however, as matters involving mergers and acquisitions and contests for corporate control. Although the court held the agreement was not statutorily invalid, it was subject to equitable review under fiduciary duty principles.

H. Jurisdiction over Disputes

1. Personal Jurisdiction

Sample v. Morgan, 935 A.2d 1046 (Del. Ch. 2007). Stockholder derivative action alleging, inter alia, the corporation's non-Delaware counsel aided and abetted the board's breaches of fiduciary duty in connection with transactions that transferred almost one-third of the voting power to three inside directors. The corporation's non-Delaware counsel and his non-Delaware law firm moved to dismiss solely on grounds of lack of personal jurisdiction.

In an opinion denying the motion to dismiss, the court held the lawyer and his law firm were subject to personal jurisdiction under Delaware's long-arm statute. The court concluded the complaint alleged the lawyer and his firm:

> i) prepared and delivered to Delaware for filing a certificate amendment under challenge in the lawsuit; ii) advertise themselves as being able to provide coast-to-coast legal services and as experts in matters of corporate governance; iii) provided legal advice on a range of Delaware law matters at issue in the lawsuit; iv) undertook to direct the defense of the lawsuit; and v) face well-pled allegations of having aided and abetted the top managers of the corporation in breaching their fiduciary duties by entrenching and enriching themselves at the expense of the corporation and its public stockholders[.]

The court acknowledged that it is exceedingly difficult for a plaintiff to allege a claim for aiding and abetting a breach of fiduciary duty against corporate counsel, but this was a "highly unusual case."

Ryan v. Gifford, 918 A.2d 341 (Del. Ch. 2007). Stockholder derivative action asserting a variety of claims against members of the board and compensation committee of Maxim Integrated Products, Inc. arising out of alleged backdating of stock options. Plaintiff alleged that defendants breached their duties of due care and loyalty by approving or accepting backdated stock options in clear violation of stockholder-approved stock option plans. Following denial of defendants' motion to dismiss or stay, plaintiff filed an amended complaint adding as defendants seven officers who allegedly received backdated options. The newly added officer defendants moved to dismiss for lack of personal jurisdiction.

The Court of Chancery granted the motion to dismiss as to six of the officer defendants and denied the motion to dismiss as to one other. Defendants argued that 10 Del. C. §3114(b), the nonresident officer consent to service of process statute, was inapplicable for three reasons: (1) none of the moving defendants engaged in any improper conduct in his capacity as an "officer," and since none were directors or otherwise accused of engaging in the approval or granting the options, they were outside the jurisdictional reach of Section 3114(b); (2) because the alleged backdating occurred between October 1997 and June 2003 and Section 3114(b) limits implied consent to jurisdiction of conduct in an official capacity commenced only after January 1, 2004, the challenged option grants cannot trigger jurisdiction under the statute and (3) certain of the moving defendants do not satisfy Section 3114(b)'s definition of "officer." With respect to four of the defendants, the court concluded that receiving and holding allegedly backdated options and allowing them to vest did not constitute a "continuing wrong." That is, the court rejected the argument as to these defendants that receiving and holding allegedly backdated vested options constituted one continuing wrong such that, where those options were received before January 1, 2004, and were alleged to have vested after January 1, 2004, the continuing wrong doctrine would permit the application of Section 3114(b). With respect to two other of the officer defendants, the court held that plaintiff failed to allege conduct or acts performed in their official capacity demonstrating a violation of the officer's duty to the corporation. Apparently holding and allowing options to vest are unrelated to the duties an officer owes to the corporation. The court declined to grant the motion to dismiss as to the chief financial officer of the corporation, who was alleged to have been an active participant in the backdating activities. Furthermore, his status as chief financial officer of the corporation satisfied Section 3114(b)'s "officer" requirement. Finally, the court rejected plaintiff's argument that the court should exercise jurisdiction because defendants had been unjustly enriched. Although an earlier opinion in this case indicated that unjust enrichment might be a viable claim, unjust enrichment alone is a claim for relief and not a basis for personal jurisdiction.

Multi-Fineline Electronix, Inc. v. WBL Corp. Ltd., 2007 WL 431050 (Del. Ch.). Action by independent directors of a Delaware corporation against the corporation's controlling stockholder for breach of fiduciary duty. The independent directors alleged the controlling stockholder owed a duty to the corporation to vote against a transaction that the independent directors had once authorized but no longer supported. Although the controlling stockholder was a Singapore entity, the independent directors argued Delaware courts had personal jurisdiction over the controlling stockholder because it had entered into a voting agreement that contained a Delaware choice of forum clause. The controlling stockholder argued that the court lacked

personal jurisdiction because the allegations did not arise from the voting agreement. The controlling stockholder argued that, in any event, it owed duties only to the stockholders and not the corporation generally, and absent allegations of unfair dealing, it was free to vote its shares according to its own economic interest.

In an opinion granting defendant's motion to dismiss, the court held that there was no claim or controversy arising from the voting agreement and, therefore, the court had no personal jurisdiction over the controlling stockholder. The court explained that claims for breach of fiduciary duty arose from common law. Because the court had no jurisdiction, it did not address the nature of the controlling stockholder's fiduciary duties.

2. Subject Matter Jurisdiction

AHS New Mexico Holdings, Inc. v. Healthsource, Inc., 2007 WL 431051 (Del. Ch.). Action for specific performance relating to post-closing price adjustment provisions in a stock purchase agreement between AHS and Healthsource. The parties disputed the scope of issues that could be submitted to an independent accounting firm for resolution under the agreement as well as the evidence that could be submitted to the accounting firm.

In an opinion adjudicating cross-motions for summary judgment, the court held the meaning of the stock purchase agreement was unambiguous. The court entered partial summary judgment determining the issues that could be submitted to the accounting firm and the evidence that could be submitted. The court denied Healthsource's motion for summary judgment that the parties reached a binding agreement to resolve certain subsidiary issues which would prevent their submission to the accounting firm. The court denied AHS's application for attorneys' fees under the fee shifting provision in the asset purchase agreement. The court concluded neither party "prevailed" at this stage to be entitled to attorneys' fees under the contract.

Matria Healthcare, Inc. v. Coral SR LLC, 2007 WL 763303 (Del. Ch.). Action to compel arbitration and for fraud relating to a merger agreement's post-closing dispute resolution provisions. The agreement provided for certain disputes to be submitted to the AAA and others to an accountant. When a dispute arose, plaintiff contended the matter was to be submitted to the accountant. Defendant filed an arbitration action with the AAA. Plaintiff's complaint in the Court of Chancery sought to compel arbitration before the accountant, to enjoin defendant from proceeding before the AAA and alleged claims of fraud.

In an opinion granting plaintiff's motion to compel arbitration and granting, in part, defendant's motion to dismiss, the court construed the merger agreement as permitting the court to determine arbitrability. The nature of the dispute related to the settlement of a claim with a large customer of the target entity that had not been fully disclosed to plaintiff prior to or at closing. The court held the merger agreement required that dispute to be submitted to the accounting firm and not the AAA. The court recognized that the dispute involved questions typically submitted to the AAA, not accountants, and doubted whether the result was what the parties had intended. Nevertheless, the court could not read the plain language of the complex and comprehensive agreements, drafted by sophisticated parties, differently. Accordingly, the court permanently enjoined defendant from proceeding with its arbitration claim before the AAA. The court also dismissed plaintiff's claim for fraud, finding the parties agreed in the merger agreement that all misrepresentation claims arising out of the merger agreement must be arbitrated and not litigated. In a subsequent letter opinion, the court clarified that dismissal of the fraud claim was based upon lack of subject matter jurisdiction and not failure to state a claim.

I. Director Liability and Indemnification

1. Statutory Immunity from Personal Liability

Globis Partners, L.P. v. Plumtree Software, Inc., 2007 WL 4292024 (Del. Ch.). Stockholder class action alleging directors of defendant Plumtree Software, Inc. breached their fiduciary duties in connection with their approval of a merger of Plumtree into BEA Systems, Inc. Plaintiff alleged, inter alia, defendants breached their fiduciary duties by failing to disclose adequate information in the merger proxy statement. Defendants moved to dismiss the complaint, arguing that plaintiff had failed to plead sufficient facts to overcome the business judgment rule and that the disclosure allegations failed to state a claim and were exculpated pursuant to a DGCL §102(b)(7) charter provision.

In an opinion granting defendants' motion to dismiss, the Court of Chancery held the complaint failed to state a claim for breach of the duty of disclosure. The court held the alleged omissions concerning analyses conducted by Plumtree's financial advisor, the financial advisor's actual fee, the omission of Plumtree's projections of future performance and the background of the merger were not material. Alternatively, the court determined Plumtree's exculpatory charter provision under DGCL §102(b)(7) required dismissal of plaintiff's disclosure claims. Because plaintiff sought only money damages for its disclosure claims, and plaintiff failed to demonstrate that defendants withheld information from stockholders in bad faith, the omissions would only amount to violations of the defendant directors' duty of care. As the §102(b)(7) provision exonerated the directors from breaches of their duty of care, defendants could not be held liable.

2. Director and Officer Indemnification and Advancement

Valeant Pharms. Int'l v. Jerney, 921 A.2d 732 (Del. Ch. 2007), appeal dismissed, 929 A.2d 784 (Del. 2007). Action to recover, inter alia, $3 million bonus paid to Valeant's former president and director. The bonus to Jerney was part of more than $47 million in cash awards paid to Valeant's management, directors and employees from proceeds of a partial IPO of a wholly owned subsidiary. The corporation settled its claims against most of the defendants and proceeded to trial against Jerney and former Chairman and CEO Milan Panic, who received more than $33 million in bonuses. Pursuant to the corporation's by-laws, the corporation advanced attorneys' fees and expenses incurred by Panic and Jerney, who had been jointly represented by the same counsel. Panic entered into a settlement after trial but before issuance of the court's opinion, leaving Jerney as the sole remaining defendant.

In a post-trial opinion, the court held Jerney liable for breach of fiduciary duty. Because Jerney was not successful in any part of his defense of the action, the court determined he was required to return all amounts advanced for his defense in the case. Rather than order a subsequent proceeding to allocate fees and expenses between Panic and Jerney in their joint representation, the court held Jerney responsible for one-half of the total amount advanced to Panic and Jerney. Although Panic had faced a potentially larger exposure, the court noted Jerney had been a willing participant in the bonus scheme, and his defense rested importantly on the defense of Panic. Thus, the court determined the equal division was consistent with whatever equitable contribution Jerney and Panic would have against each other with respect to their undertakings to repay the advanced amounts.

FGC Holdings Ltd. v. Teltronics, Inc., 2007 WL 241384 (Del. Ch.). Opinion adjudicating application for fees and expenses and indemnification following preferred stockholders' successful action to require registration of the transfer of shares and for the election of the preferred designee to the Teltronics board. The preferred stockholder and its designee sought, inter alia, mandatory indemnification under DGCL §145(c) and the corporation's bylaws for vindicating the right of the preferred designee to serve on the board.

In an opinion granting in part and denying in part plaintiffs' application, the court held plaintiffs were not entitled to mandatory indemnification. The court agreed that the director designee was successful on the merits in vindicating his right to office and that his status as a plaintiff did not prevent indemnification. Nevertheless, the director designee was not entitled to indemnification because he was not a present or former director at the time of the litigation. Therefore, he was not a party to the action "by reason of the fact that [he] is or was a director" of the corporation. The court awarded plaintiffs a portion of their attorneys' fees and expenses, however, under the bad faith exception to the American Rule.

Sassano v. CIBC World Markets Corp., 2008 WL 152582 (Del. Ch.). Action by former employee of CIBC World Markets seeking mandatory advancement of attorneys' fees and expenses relating to several proceedings, including an SEC investigation into mutual fund market timing practices. CIBC's bylaws provided for mandatory advancement to "officers with management supervisory functions." The corporation contended, inter alia, the bylaws extended mandatory advancement only to executive officers appointed by the board, not nominal officers. Furthermore, the corporation argued plaintiff was not a nominal officer, he did not exercise "management supervisory functions" and the proceedings for which plaintiff sought advancement were not brought by reason of the fact that he was an officer of the corporation.

In a post-trial opinion, the court concluded plaintiff was entitled to mandatory advancement. The court discredited the corporation's argument that the bylaw mandated advancement only to executive officers. Although the bylaws provided for two types of officers—executive officers and nominal officers—the court found the plain language of the mandatory advancement bylaw did not restrict advancement rights to nominal officers. In a detailed factual analysis, the court found plaintiff was a nominal officer at all relevant times with management supervisory functions. The court rejected the corporation's argument that the term "supervisory" should be construed in an industry-specific context, noting the corporation could have provided for an industry-specific definition of the term in its bylaws. The court also found that plaintiff had been sued by reason of the fact that he had been an officer and, alternatively, that he had served another enterprise at the corporation's request, which also qualified for mandatory advancement under the bylaws.

Thompson v. The Williams Cos., 2007 WL 2215953 (Del. Ch.). Action by a former employee to obtain advancement in the face of a bylaw that restricted advancement of defense costs to employees who were neither officers nor directors and gave the board broad power to impose conditions on advancement. The former employee, a defendant in a criminal proceeding, had not been an officer or a director. The bylaw authorized advances to employees "upon such terms and conditions, if any, as the Board of Directors deems appropriate." The board required the following conditions to advancement to Thompson: (1) Thompson was required to represent to the board his personal belief that his conduct fell within the standard for indemnification (i.e., that he acted in good faith and reasonably believed his actions were in the best interests of the corporation and not unlawful); (2) Thompson was required to provide a secured undertaking to

guarantee his obligation to repay all amounts advanced; (3) the amount of the security was required to exceed, at all times, both expenses advanced plus expenses requested to be advanced and (4) advancement was to be limited to legal expenses incurred after his indictment.

In an opinion following trial, the court held the bylaw was not invalid as against public policy and found that the board had acted rationally and in good faith in setting the conditions of advancement. Since the board acted both rationally and in the reasonable belief that the conditions were necessary to protect the corporation, the board's action fell within the protection of the business judgment rule and satisfied the contractual standard of good faith and fair dealing.

Thompson reinforces the legal concept that boards of Delaware corporations enjoy substantial flexibility in fashioning advancement and indemnification bylaw provisions. Mandatory advancement provisions, which deprive the board of discretion to respond to advancement requests on a case-by-case basis or to impose reasonable caps or restrictions, continue to crop up in a surprising number of situations. Thompson should serve as a useful reminder that counsel should review advancement and indemnification bylaws periodically to be certain that the policy reflected by such provisions reflects the current thinking of the board and the best interests of the corporation.

Levy v. HLI Operating Co., 924 A.2d 210 (Del. Ch. 2007). Action by former directors seeking indemnification for amounts paid in a class action settlement. Four of the director plaintiffs were designated to the HLI board by a limited partnership (JLL Fund) that held approximately 34% of HLI's stock. These four designees enjoyed indemnification rights under the JLL Fund's limited partnership agreement. The JLL Fund had contributed to the settlement amount for its designees, who did not personally contribute to the settlement. The directors sought mandatory indemnification against HLI under the HLI bylaws, and JLL Fund asserted claims against HLI for contribution and indemnification based on JLL Fund's payment of settlement funds on behalf of its HLI director designees. The directors also sought advancement and indemnification for fees and expenses incurred in the indemnification action. The directors based that claim upon an indemnification agreement, which required HLI to indemnify and advance fees and expenses incurred by the directors in an advancement or indemnification action, regardless of whether the directors were ultimately successful.

In an opinion adjudicating cross-motions for summary judgment, the court held the JLL Fund's director designees were not entitled to indemnification for the amounts paid in settlement because they had not personally paid any of those settlement payments. The court also held JLL Fund was not entitled to indemnification from HLI, but instead was entitled to assert a claim for equitable contribution against HLI. The court reasoned that JLL Fund and HLI were each contractually committed to indemnify the JLL Fund director designees to the fullest extent of the law. Therefore, JLL Fund could assert a claim to force HLI to pay its fair share of the settlement amount, subject to HLI's defenses. The court also denied the application of the JLL Fund's director designees for their fees and expenses incurred in the indemnification action, or "fees on fees." The court rejected the argument of the JLL Fund director designees that their contract with HLI expressly obligated the corporation to indemnify them for fees and expenses incurred in the indemnification action regardless of whether they were ultimately entitled to indemnification. The court held that such a contract provision contravened DGCL §145 and was void as contrary to public policy.

Bernstein v. TractManager, Inc., 2007 WL 4179088 (Del. Ch.). Action for advancement by director and former officer of TractManager, Inc. for defending counterclaims that arose from actions taken before the conversion of its predecessor limited liability company into a corporation. Plaintiff sought advancement pursuant to the corporation's bylaws providing for mandatory advancement to directors and officers of the corporation. Plaintiff claimed the corporation's bylaws should be read to provide mandatory advancement for managers of the predecessor limited liability company, as well as directors and officers of the corporation. The corporation argued that plaintiff was not entitled to advancement because the allegations arose from the plaintiff's activities as manager of the limited liability company, and the limited liability company's operating agreement did not provide for mandatory advancement of its managers. The corporation also argued the counterclaims against the plaintiff did not arise "by reason of the fact" that he was a director of the corporation but because he had been the corporation's attorney.

In an opinion adjudicating competing motions for summary judgment, the court held plaintiff was not entitled to advancement. The court recognized the corporation's bylaws provided mandatory advancement only for the directors and officers of the corporation. Therefore, the court looked to the terms of the limited liability company's operating agreement to determine plaintiff's advancement rights for claims relating to plaintiff's pre-conversion conduct. The LLC operating agreement did not provide for mandatory advancement. Thus, the court concluded plaintiff was not entitled to mandatory advancement for acts occurring prior to the time he became a director and officer of the corporation. The court also denied advancement for acts that occurred after the plaintiff became a director of the corporation because the claims against plaintiff did not relate to his status as a director or officer of the corporation. The court rejected plaintiff's argument that he was entitled to mandatory advancement under the bylaw provision providing advancement to directors and officers acting in any other capacity while serving as a director or officer. The court reasoned that allowing advancement under these circumstances would allow a corporation's outside attorneys to seek advancement whenever they were accused of malpractice, as long as the corporation had adopted the most expansive advancement permitted under DGCL §145.

III. LIABILITY OF THE CORPORATION AND THIRD PARTIES

A. Aiding and Abetting

Sample v. Morgan, 935 A.2d 1046 (Del. Ch. 2007). Stockholder derivative action alleging, inter alia, the corporation's non-Delaware counsel aided and abetted the board's breaches of fiduciary duty in connection with transactions that transferred almost one-third of the voting power to three inside directors. The corporation's non-Delaware counsel and his non-Delaware law firm moved to dismiss solely on grounds of lack of personal jurisdiction.

In an opinion denying the motion to dismiss, the court held the lawyer and his law firm were subject to personal jurisdiction under Delaware's long-arm statute. The court concluded the complaint alleged the lawyer and his firm:

> i) prepared and delivered to Delaware for filing a certificate amendment under challenge in the lawsuit; ii) advertise themselves as being able to provide coast-to-coast legal services and as experts in matters of corporate governance; iii) provided legal advice on a range of Delaware law matters at issue in the lawsuit;

> iv) undertook to direct the defense of the lawsuit; and v) face well-pled allegations of having aided and abetted the top managers of the corporation in breaching their fiduciary duties by entrenching and enriching themselves at the expense of the corporation and its public stockholders[.]

The court acknowledged that it is exceedingly difficult for a plaintiff to allege a claim for aiding and abetting a breach of fiduciary duty against corporate counsel, but this was a "highly unusual case."

B. Liability of Stockholders

Territory of U.S. Virgin Islands v. Goldman, Sachs & Co., 937 A.2d 760 (Del. Ch. 2007). Action by the U.S. Virgin Islands to recoup distributions made to a stockholder of a dissolved Delaware corporation as part of the corporation's 1985 dissolution. The Virgin Islands waited until 1992 to bring its underlying claims against Panex for environmental damage. After obtaining a $51.6 million default judgment against a successor to the corporation's liquidating trust in 2005, the Virgin Islands filed suit against Goldman Sachs to recoup the funds it had received from Panex and the liquidating trust in 1984, 1985 and 1987. Defendant moved to dismiss the complaint arguing, inter alia, that plaintiff's claims were barred by the combined effect of DGCL §§278 and 325(b), concerning the winding up of the affairs of dissolved corporations and stockholder liability for corporate debts, respectively.

In a decision granting defendant's motion to dismiss, the Court of Chancery concluded the combined effect of DGCL §§278 and 325(b) precluded recovery. First, the court determined the clear language of §278 requires that claims against a dissolved corporation be brought within three years of dissolution. Because plaintiff failed to bring an action against Panex within that three-year period, plaintiff was now incapable of obtaining a judgment against Panex. The court then concluded that the plain language of §325(b) ("No suit shall be brought against any . . . stockholder for any debt of a corporation of which he is a[] . . . stockholder, until judgment be obtained against the corporation and execution thereon be returned unsatisfied.") barred plaintiff from holding defendant, as a former Panex stockholder, responsible for a corporate debt, such as liability for environmental contamination, without first obtaining a judgment against Panex. Considering the two statutes together, plaintiff's inability to obtain a judgment against Panex barred it from any recovery against the corporation's former stockholder.

The court also declined to apply the common law trust fund doctrine to make stockholders receiving distributions from a dissolving corporation potentially liable to the corporation's creditor-plaintiffs. The court reasoned that allowing such liability would put equity holders who received distributions from a dissolving corporation at perpetual risk that the funds would be clawed back. The court also ruled that plaintiff's claims were barred by laches because plaintiff failed to bring suit against defendant until long after the expiration of the analogous three-year statute of limitations.

IV. STOCK AND DIVIDENDS

A. Validity of Stock Issuance

MBKS Co. Ltd. v. Reddy, 924 A.2d 965 (Del. Ch. 2007). Action by parent corporation and two subsidiaries alleging, inter alia, the then-sole director of the subsidiaries breached his fiduciary duties by canceling the parent's stock in the subsidiaries and issuing stock in the subsidiaries to himself. The defendant director, in connection with a series of poorly documented agreements with the subsidiaries' only other director (since deceased), executed resolutions that purported to (a) cancel the parent's ten shares in each of its subsidiaries and reissue those shares in the name of himself and another stockholder in the parent and (b) issue ten shares of stock in each subsidiary to himself in exchange for his commitment to make future payments to individuals who were unrelated to the subsidiaries. The plaintiff corporations moved for summary judgment invalidating the resolutions.

In an opinion granting plaintiffs' motion for summary judgment, the court held that both sets of resolutions were invalid. Cancellation of the parent's stock in the subsidiaries and reissuance to the defendant director were ineffective for failure to comply with DGCL §242(a), which required amendments to the subsidiaries' certificates of incorporation. The court also held that the defendant director's subsequent share issuance to himself was void or voidable because the subsidiaries received no consideration for the shares. The court recognized that, in certain circumstances, it may be appropriate to take equitable considerations into account to find that stock issued for no consideration is voidable rather than void, if doing so will protect the rights of unwitting third party purchasers or creditors. In this instance, no factors were present to invoke these equitable considerations. The court concluded the shares that defendant purported to issue to himself had no voting rights and, therefore, he could not prevent the parent corporation from removing him as a director of the subsidiaries.

Fonds de Régulation et de Contrôle Café Cacao v. Lion Capital Mgmt., LLC, 2007 WL 315863 (Del. Ch.). Suit contesting the ownership of the New York Chocolate and Confectionary Company (NYCCC). Plaintiff sought to void the corporation's issuance of no-par value stock under DGCL §§152-153 because the board resolution authorizing the corporation's initial stock issuance did not specify the consideration received in exchange for the stock. Defendant's employee, who was NYCCC's sole board member at the time of the stock issuance, testified at trial that consideration was given, and described at great length services rendered both before and after NYCCC's incorporation. Defendant's counterclaim sought a declaration that 800 shares transferred by defendant to plaintiff were invalid because the transfer was subject to an agreement that plaintiff invest additional capital which it did not honor.

In a post-trial opinion, the court held the initial stock issuance was valid notwithstanding the board's failure formally to record the value of the consideration received. The court explained that generally a stock issuance without an exchange of valid consideration to the corporation is void. Moreover, longstanding precedent requires a board to place a value on the consideration received by the corporation. The court noted however that "equally longstanding precedent holds that this value need not be formally recorded." The court found plaintiff had not met its burden in showing that defendant never provided valid consideration or that the sole director did not value the consideration. The court also found that the transfer of shares from

defendant to plaintiff was not subject to an investment agreement and, therefore, concluded plaintiff rightfully held its shares.

B. Preferred Stock and Stock Preferences

Matulich v. Aegis Commc'ns Group, Inc., 2008 WL 187511 (Del.), aff'g 2007 WL 1662667 (Del. Ch.). Stockholder action to invalidate the short-form merger of Aegis Communications. The issue turned on the construction of the certificate of designation governing the corporation's Series B Preferred stock. The parent owned more than the statutorily required 90% of the outstanding common stock necessary to effect the short-form merger under DGCL §253. The parent did not, however, own more than 90% of the Series B Preferred. The Series B Preferred certificate of designation granted the class the right of "approval and consent" prior to any merger or consolidation. When the Series B Preferred stockholders could not be located, the Court of Chancery entered an order deeming the Series B Preferred to have consented to and approved the merger. Plaintiff, a common stockholder, challenged the merger on the grounds that the parent did not possess the authority to effect the short-form merger because it did not own the statutorily required 90% of outstanding Series B Preferred stock. Defendants argued the Series B Preferred did not possess the right to "vote" on the merger and pointed to a certificate provision expressly denying voting rights to the Series B Preferred stock. The Court of Chancery dismissed the complaint, holding the "approval and consent" language in the certificate of designation was contractual and was not legally synonymous with a statutory right to vote.

In an opinion affirming the Court of Chancery, the Delaware Supreme Court rejected plaintiff's argument that the right of approval and consent held by Series B Preferred stockholders constituted a right to vote on the merger. Based on the plain language of the certificate of designation, the Court held the Series B Preferred stockholders had a contractual right of approval and consent, but not a statutory right to vote on the merger itself. The Court reasoned DGCL §253 implicated only the right to vote on the merger, not the general right to consent or approve. Therefore, the parent was required to own at least 90% of each class of stock entitled to "vote on such merger." Plaintiff could not prevail because the certificate of designation did not grant holders of the Series B Preferred a statutory right to vote on the merger.

Gradient OC Master, Ltd. v. NBC Universal, Inc., 930 A.2d 104 (Del. Ch.), appeal refused, 930 A.2d 928 (Del. 2007). Actions by preferred stockholders of Ion Media Networks, Inc., alleging, inter alia, a proposed exchange offer for the preferred was wrongfully coercive and Ion directors and two large (and allegedly controlling) stockholders breached their fiduciary duties to the preferred. The exchange offer was part of a complex restructuring of Ion, which ultimately would allow one of the two stockholder defendants to gain control of Ion. Plaintiffs sought to enjoin the exchange offer in which Ion offered to acquire certain preferred stock in exchange for debt and newly issued convertible preferred stock. According to plaintiffs, the transaction was coercive because: (1) tendering stockholders were required to consent to the elimination of certain rights contained in the certificate of designation; (2) depending on the number of shares tendered, certain preferred shares held by the alleged controlling stockholders would be converted to subordinated debt that would rank above plaintiffs' shares in Ion's capital structure, thereby reducing the value of plaintiffs' stock and (3) Ion's solicitation documents failed to disclose certain material information. Defendants argued the transaction was not wrongfully coercive and that, as preferred stockholders, plaintiffs' rights were limited to the

election of two directors under the certificates of designation, and that those certificates effectively precluded plaintiffs from obtaining a preliminary injunction.

In an opinion denying plaintiffs' motion for a preliminary injunction, the court held plaintiffs failed to show the exchange offer was wrongfully coercive. As a threshold matter, the court rejected defendants' argument that plaintiffs were limited to contractual claims under the certificates of designation. The court observed that, although the rights of preferred stockholders are primarily contractual in nature, preferred stockholders have the same right as common stockholders to be free from wrongful or actionable coercion. The court found that, while there were elements of coercion in the exchange offer, plaintiffs failed to demonstrate a reasonable likelihood of success that the coercion was wrongful—i.e., preferred stockholders were inequitably induced to tender for reasons other than the economic merits of the offer—or that the exchange offer disclosure document was materially misleading or contained material omissions.

C. Stock Options

In re Tyson Foods, Inc. Consol. S'holder Litig., 919 A.2d 563 (Del. Ch. 2007); 2007 WL 2351071 (Del. Ch.). Derivative action charging board members of Tyson Foods breached their fiduciary duties in connection with the issuance of "spring-loaded" stock options. Spring-loading is the practice of granting options to executives immediately before the release of material inside information that might reasonably be expected to drive the share price higher. Plaintiffs challenged option grants made between 1999 and 2003. Defendants moved to dismiss the breach of fiduciary duty claims arising out of spring-loading for failure to make a demand under Court of Chancery Rule 23.1 and failure to state a claim.

The court denied the motion to dismiss for failure to state a claim in principal part. 919 A.2d 563 (Del. Ch. 2007) (Tyson I). Defendants first contended that the statute of limitations barred breach of duty claims related to pre-2003 option grants, claiming that Tyson had accurately disclosed the grants in public filings such that the stockholders had been placed on notice of the spring-loaded grants. The court rejected that contention, finding that the statute was tolled under the doctrine of equitable tolling and fraudulent concealment. The court reasoned that stockholders were not required "to sift through a proxy statement and . . . a year's worth of press clippings" to uncover wrongdoing by those the stockholders assume are protecting their interests. Second, defendants contended that the complaint failed to assert allegations sufficient to suggest lack of independence or disabling interest on the part of the board or to create a reasonable doubt as to the exercise of business judgment. Since the directors were not recipients of the spring-loaded options and were not alleged to have lacked independence, defendants' motion turned on whether the complaint created a reasonable inference that the directors' decisions fell outside the protection of the business judgment rule because those decisions were made in bad faith and therefore constituted a breach of the duty of loyalty. Allegations that the directors used inside knowledge to enrich employees while avoiding shareholder-imposed restrictions on the options were sufficient to raise a doubt as to the application of the business judgment rule, the court found. The court offered guidance for properly pleading a "spring-loading" claim. To plead a claim for breach of loyalty arising out of spring-loading of options, the complaint must allege three elements: (1) the options were issued pursuant to a stockholder-approved plan; (2) the directors approving the options possessed material, non-public information soon to be released that would drive the stock price higher and (3) the directors acted with the intent to circumvent terms of the plan that restricted the exercise price of the options.

The outside director defendants thereafter filed a motion for judgment on the pleadings with respect to "nonqualified stock options," which unlike the incentive stock options could be issued by the compensation committee and made exercisable at any price. The outside directors' motion rested on the holding in the prior opinion that denied a motion to dismiss in part because the challenged stock options may have been issued "with the intent to circumvent otherwise valid shareholder-approved restrictions upon the exercise price of the options." Defendants accordingly maintained that the nonqualified stock options were not subject to such a restriction so that a judgment on the pleadings was appropriate. The court denied the motion for judgment on the pleadings. 2007 WL 2351071 (Del. Ch.). After further reviewing the allegations of the complaint, the court slightly altered the test announced in Tyson I, concluding that allegations of an implicit violation of a shareholder-approved stock option plan are not necessary for the court to infer the decision to spring-load options lies beyond the bounds of business judgment. Instead, the court substituted a revised element that "where I may reasonably infer that a board of directors later concealed the true nature of a grant of stock options, I may further conclude that those options were not granted consistent with a fiduciary's duty of utmost loyalty."

Ryan v. Gifford, 918 A.2d 341 (Del. Ch. 2007). Stockholder derivative action asserting a variety of claims against members of the board and the compensation committee of Maxim Integrated Products, Inc. arising out of alleged backdating of stock options. Plaintiff alleged that defendants breached their duties of due care and loyalty by approving or accepting backdated stock options in clear violation of stockholder-approved stock option plans. Defendants moved to dismiss on multiple grounds, including failure to state a claim and failure to plead demand futility. Alternatively, defendants moved to stay in favor of prior pending litigation in California.

The court denied the motions, issuing a number of important rulings. First, with respect to the motion to stay, the court affirmed Delaware's compelling interest in resolving issues of first impression respecting the conduct of fiduciaries of Delaware corporations. Delaware courts had not addressed fundamental issues regarding stock option backdating, which are "of great importance to the law of corporations." Accordingly, the court declined to stay in favor of the California action. Denying the motion to dismiss in large part, the court held that a stockholder has no standing to maintain a derivative action challenging options issued prior to the date that he acquired shares in the corporation. The court also rejected defendants' statute of limitations defense, finding that the statute was tolled under the doctrine of fraudulent concealment because there had been no disclosure of the alleged backdating. The court also imputed to the whole board the compensation committee's approval of the grants because the compensation committee comprised more than half of the whole board. Finally, the court suggested that the failure of option recipients to have exercised their options was not a complete defense to claims of unjust enrichment.

The court then assessed the application of the business judgment rule in light of the allegations of the complaint. At the pleading stage, the court held plaintiffs' allegations were sufficient to create a doubt as to the application of the business judgment rule because "a director who intentionally uses inside knowledge not available to shareholders in order to enrich employees while avoiding shareholder-imposed requirements cannot . . . be said to be acting loyally and in good faith as a fiduciary." The court suggested a three-part test for determining the sufficiency of a pleading attacking spring-loaded options issued by a disinterested board. To raise the specter of bad faith in such a circumstance, the complaint should allege: (1) the options

were issued pursuant to a plan approved by the stockholders; (2) the directors approving the options possessed material non-public information soon to be released that would impact the share price and (3) the issuing directors had the intent of circumventing the shareholder-approved restriction on the exercise price of the options.

Brandin v. Deason, 2007 WL 2088877 (Del. Ch.). Stockholder derivative action on behalf of Affiliated Computer Services alleging current and former officers and directors of Affiliated breached their fiduciary duties by backdating stock options in violation of the corporation's stock option plans. Several defendants moved to stay the action in favor of a later-filed action pending in federal court in Texas, which also involved claims that defendants violated federal securities laws. Defendants argued that the Delaware action should be stayed while the broader legal issues presented by the Texas litigation were resolved. Defendants also asserted that plaintiff lacked standing to challenge the validity of stock options granted on eleven of the twelve dates in question because he did not own Affiliated stock on those dates. Defendants, who were Texas residents, argued litigating the issues in Delaware presented a hardship for them.

In denying defendants' motion to stay, the court determined the case should be litigated in Delaware because Delaware law governed all of the state law claims in both the Texas and Delaware actions. The court opined it was important for Delaware to decide the issues in light of the large number of option backdating cases pending around the country. Those issues include the unsettled Delaware law question of whether a plaintiff who purchases shares before some of the alleged backdated option grants and before the backdating practices came to light has standing to challenge option grants that occurred before plaintiff acquired its stock, even where it is alleged defendants actively concealed their wrongdoing. Another issue was whether defendants' decision to answer the complaint and begin discovery constituted waiver of their right to argue demand was not excused. The court focused on federalism issues in declining to cede the field in favor of the later-filed derivative action in federal court where the federal securities law claims—over which the federal courts have exclusive jurisdiction—were predicated on the same conduct giving rise to the state law derivative claims. The court concluded that blind deference where Delaware corporate law and federal securities law overlap would render Delaware courts a forum of last resort and do a disservice to the stockholders of Delaware corporations.

Desimone v. Barrows, 924 A.2d 908 (Del. Ch. 2007). Derivative action alleging directors and officers of Sycamore Networks, Inc. breached their fiduciary duties in connection with stock option grants, including option spring-loading and backdating. As to spring-loading, plaintiff alleged the directors manipulated the release of non-public information so the recipients of the options would benefit from an artificially low strike price. Defendants moved to dismiss, arguing the options were granted in accordance with the stockholder approved incentive plan which provided for nondiscretionary, regularly-scheduled option grants to directors on the date of the corporation's annual stockholders' meeting.

In an opinion granting defendants' motion to dismiss, the court held the plaintiff failed to state a claim under Rule 12(b)(6) regarding spring-loading of options. The court recognized that directors have the ability to control the flow of information into the market, and that well-pled facts alleging they misused corporate information to circumvent the terms of an option plan may constitute a breach of their fiduciary duties. When the terms of the option plan provide for automatic, regularly-scheduled option grants, however, to state a claim the complaint must allege

that the corporation deviated from its regular disclosure pattern in a deceptive, non-candid effort to influence the strike price of the option grant. Because plaintiff had only alleged the directors received options annually on a specific date regardless of whether the regular disclosure preceding the grant was positive or negative, the court concluded no claim for breach of fiduciary duty had been stated. The court dismissed the backdating claims for failure to plead demand futility.

Conrad v. Blank, 2007 WL 2593540 (Del. Ch.). Derivative action challenging stock options issued to senior management members between 1994 and 2003 that were allegedly backdated when issued. Defendants moved to dismiss on two grounds. First, defendants asserted the complaint failed to plead demand futility, claiming the allegations were weak and failed to establish a pattern of backdating. Second, defendants argued plaintiff lacked standing to challenge 7 of the 12 option grants that predated plaintiff's stock purchase in 1998.

In an opinion granting in part and denying in part the motion to dismiss, the court found that the complaint adequately pleaded demand futility. The court applied the demand futility test of Rales since it was the compensation committee, consisting of less than half the members of the board, that authorized the option grants. Rales requires a derivative plaintiff to plead facts creating a reasonable doubt that a majority of the directors could appropriately consider the demand through the exercise of independent and disinterested business judgment. The court concluded that the complaint raised a reasonable inference that the compensation committee members acted knowingly in awarding options priced at dates other than the actual dates of the grant. In respect to defendants' second argument, the court concluded, with "grave misgivings," that the plaintiff lacked standing to prosecute option backdating misconduct predating her share purchase in 1998. Although plaintiff was a long-term stockholder who bought shares without knowing of the alleged wrongdoing, the court concluded that recent decisions refusing to extend the "continuing wrong" exception to the contemporaneous ownership rule were controlling here. The court held that plaintiff would not be allowed to seek relief with respect to option grants made prior to 1998, but left the door open to intervention by another stockholder who purchased shares prior to 1998.

Lillis v. AT & T Corp., 896 A.2d 871 (Del. Ch. 2005). Action by former holders of options to purchase shares of AT & T Wireless Services, Inc. (Wireless), alleging Wireless and AT & T breached the option agreement when plaintiffs' out-of-the-money options to acquire Wireless stock were rendered worthless in Wireless's merger with Cingular Wireless Corporation. Plaintiffs were former officers and directors of MediaOne Group and originally received MediaOne options pursuant to a 1994 MediaOne stock option plan. Upon AT & T's acquisition of MediaOne, the options were exchanged for AT & T options of equivalent value. When AT & T subsequently spun off Wireless, plaintiffs' AT & T options were adjusted, with plaintiffs receiving new options in both AT & T and Wireless. In Wireless's later merger with Cingular, stockholders received $15 per share for their stock, and options were adjusted into the right to receive $15 per share upon payment of the exercise price. Thus, plaintiffs received no consideration for the portion of their unexercised Wireless options that were out of the money.

In a post-trial opinion, the court entered judgment for plaintiffs against AT & T for breach of the option plan. The anti-destruction provision of the operative option plan required an adjustment at the time of the triggering event such that the option holder's "economic position with respect to the [option] Award shall not, as a result of such adjustment, be worse than it had been immediately prior to such event." The court concluded the term "economic position" was

ambiguous and apparently unique to this option plan. Using extrinsic evidence, the court interpreted the phrase to mean that plaintiffs were entitled to an option adjustment that required preservation of their economic position, not merely the intrinsic value of their in-the-money options. In calculating damages, the court accepted plaintiffs' expert's Black-Scholes valuation analysis and found the value of plaintiffs' options at the time of the merger to be $16.5 million, which was approximately $11.3 million more than they had received in payment for their options in the merger.

Knight v. Caremark Rx, Inc., 2007 WL 143099 (Del. Ch.). Action by former officer of Caremark to compel the corporation to permit his exercise of stock options. The corporation contended plaintiff's claims regarding his options had been released pursuant to a settlement of litigation between plaintiff and Caremark in Alabama. In an opinion granting summary judgment for Caremark, the court, applying Alabama law, held that the plain language of both the general release and the specific release in the Alabama settlements precluded plaintiff from exercising his options.

V. MEETINGS, ELECTIONS AND VOTING

A. Compelled Meeting of Stockholders

Fogel v. U.S. Energy Sys., Inc., 2007 WL 4438978 (Del. Ch.). Action to determine proper officers of U.S. Energy under DGCL §225 and to compel a special stockholders' meeting. Plaintiff was purportedly terminated as CEO and chairman at a special meeting of the board. Two days later, pursuant to the authority granted to the CEO and chairman under the bylaws, plaintiff called a special meeting of stockholders for the purpose of removing the other directors and electing their replacements. Later that day, during a scheduled board meeting, the board formally passed a resolution terminating plaintiff. Defendants subsequently ignored plaintiff's call for a special meeting of stockholders. In a post-trial opinion (2007 WL 4438978 (Del. Ch.)), the court ordered the corporation to hold the special meeting of stockholders that had been called by the chairman and CEO. The court found plaintiff had not been validly removed as CEO and chairman prior to the time he called for a special meeting of stockholders. After the court issued its decision to compel an annual meeting, but before setting the meeting date, the corporation filed for bankruptcy. The corporation argued the automatic stay under Section 362 of Chapter 11 of the Federal Bankruptcy Code barred the Court of Chancery from scheduling the annual meeting.

In its opinion ordering that a stockholders meeting be held (2008 WL 151857 (Del. Ch.)), the court rejected the corporation's argument that the issue was one for the bankruptcy court, not the Court of Chancery. The court also rejected plaintiff's argument that the court's scheduling of an annual meeting under DGCL §211 was a "ministerial act" of the court and, therefore, an exception to the automatic stay provision. Nevertheless, the court concluded that, to prevent the Court of Chancery from compelling an annual meeting, a debtor corporation must show the petitioner is guilty of "clear abuse" such that rehabilitation of the debtor corporation will be "seriously threatened rather than merely delayed." The corporation failed to make such a showing, and the court scheduled the annual meeting to be held fourteen days after the date of its opinion.

Perlegos v. Atmel Corp., 2007 WL 475453 (Del. Ch.). Actions to determine proper officers of Atmel Corporation under DGCL §225 and to compel a special stockholders' meeting pursuant to DGCL §211. Plaintiff George Perlegos had been Atmel's president, CEO and chairman, and his brother Gust had been a director and officer. Both were purportedly terminated as officers by a special committee of the board following an investigation into corporate travel expenses. After his purported termination as an officer, George Perlegos, pursuant to his authority as board chairman, called a special meeting of stockholders to be held two months later for the purpose of removing the directors who had comprised the special committee. The next day, the board removed George Perlegos as chairman and elected a new chairman who was then authorized and ordered to rescind the notice of special meeting of stockholders. Plaintiffs alleged the cancellation of the special meeting constituted an improper use of the corporate machinery, entrenchment and intentionally impeded stockholders from voting. The corporation had held an annual meeting just three months earlier; thus, there was no issue that the corporation had failed to hold an annual meeting within the time required under DGCL §211.

In a post-trial opinion, the court ordered the corporation to hold the special meeting of stockholders that had been canceled by the newly elected chairman. As a threshold matter, the court upheld the special committee's termination of plaintiffs as officers. The court also agreed with defendants that the bylaw provision authorizing the chairman to call a special meeting of stockholders, but silent on the authority to cancel the meeting, impliedly authorized the new chairman to cancel the meeting. Nevertheless, the court concluded defendants' cancellation of the meeting was not justified as a matter of equity. The court avoided the parties' disagreement over whether the plaintiffs' equitable challenge to cancellation of the meeting was governed by the stringent "compelling justification" standard under Blasius. Instead, the court concluded defendants were unable to justify their decision even if it were subject to the more lenient reasonableness standard under Unocal. Defendants claimed that cancellation of the special meeting was justified because of its cost and the possibility it would distract management and confuse employees and stockholders. Defendants further argued there was a threat that the corporation could lose its listing on NASDAQ if its independent directors were removed. The court found none of these reasons persuasive and concluded cancellation of the special meeting was improper.

B. Required Vote

Matulich v. Aegis Commc'ns Group, Inc., 2008 WL 187511 (Del.), aff'g 2007 WL 1662667 (Del. Ch.). Stockholder action to invalidate the short-form merger of Aegis Communications. The issue turned on the construction of the certificate of designation governing the corporation's Series B Preferred stock. The parent owned more than the statutorily required 90% of the outstanding common stock necessary to effect the short-form merger under DGCL §253. The parent did not, however, own more than 90% of the Series B Preferred. The Series B Preferred certificate of designation granted the class the right of "approval and consent" prior to any merger or consolidation. When the Series B Preferred stockholders could not be located, the Court of Chancery entered an order deeming the Series B Preferred to have consented to and approved the merger. Plaintiff, a common stockholder, challenged the merger on the grounds that the parent did not possess the authority to effect the short-form merger because it did not own the statutorily required 90% of outstanding Series B Preferred stock. Defendants argued the Series B Preferred did not possess the right to "vote" on

the merger and pointed to a certificate provision expressly denying voting rights to the Series B Preferred stock. The Court of Chancery dismissed the complaint, holding the "approval and consent" language in the certificate of designation was contractual and was not legally synonymous with a statutory right to vote.

In an opinion affirming the Court of Chancery, the Delaware Supreme Court rejected plaintiff's argument that the right of approval and consent held by Series B Preferred stockholders constituted a right to vote on the merger. Based on the plain language of the certificate of designation, the Court held the Series B Preferred stockholders had a contractual right of approval and consent, but not a statutory right to vote on the merger itself. The Court reasoned DGCL §253 implicated only the right to vote on the merger, not the general right to consent or approve. Therefore, the parent was required to own at least 90% of each class of stock entitled to "vote on such merger." Plaintiff could not prevail because the certificate of designation did not grant holders of the Series B Preferred a statutory right to vote on the merger.

C. Elections of Directors

Portnoy v. Cryo-Cell Int'l, Inc., 2008 WL 131348 (Del. Ch.). Action under DGCL §225 challenging an election of directors. Plaintiff alleged defendants engaged in improper vote buying and breached their fiduciary duties in obtaining votes to support the management slate and in conducting the stockholders' meeting.

In a post-trial opinion, the court determined defendants breached their fiduciary duties, which warranted a new election. First, the court held that the board's agreement to nominate an insurgent stockholder on the management slate in exchange for the insurgent's voting support did not constitute an improper vote-buying arrangement subject to entire fairness review. Although that arrangement had not been disclosed to the stockholders, the court concluded the arrangement was an unmistakable inference to be drawn by a reasonable stockholder and, therefore, did not constitute a disclosure violation. Second, the court held the board's promise to expand the board and appoint the insurgent's designee to the board after the election in exchange for the insurgent's buying additional shares and voting them for management should have been disclosed. The court declined to decide whether this arrangement constituted improper vote buying or ran afoul of the Schnell doctrine ("inequitable action does not become permissible simply because it is legally possible"). Third, the court found the corporation's CEO breached her fiduciary duty by coercing and inducing a stockholder to vote for the management slate. Finally, the court found the CEO breached her fiduciary duty by refusing to close the polls and count the vote at the annual meeting and for calling an extended break during the meeting to secure enough votes for a management victory. The court found the CEO gave false reasons for delaying the vote count and acted in bad faith. As a remedy, the court ordered a new election and required the management slate to bear the costs of its proxy solicitation as well as the costs of conducting the new meeting.

Openwave Sys. Inc. v. Harbinger Capital Partners Master Fund I, Ltd., 924 A.2d 228 (Del. Ch. 2007). Consolidated actions brought by Openwave Systems and certain stockholders (Harbinger) to determine the directors of Openwave pursuant to DGCL §225. Harbinger nominated two candidates for election to Openwave's board of directors in advance of Openwave's annual meeting. Openwave listed Harbinger's nominees on the ballot, but reserved the right to challenge the nominations for failure to comply with the corporation's advance notice bylaws. When one of Harbinger's nominees received the highest number votes at the annual

meeting, Openwave disqualified both of Harbinger's nominees. Harbinger attacked the validity of the advance notice bylaws as so confusing as to excuse compliance. Harbinger also challenged the Openwave board's decision to reduce the size of the board several months prior to the annual meeting.

In a post-trial opinion, the court held that Harbinger's director nominations did not comply with the advance notice bylaws and were invalid. The court admitted the bylaw provisions were confusing and could be interpreted to provide at least two different nomination deadlines. Nevertheless, Harbinger failed to make its nominations before either of the deadlines had passed and never considered compliance until after the deadlines had passed. The court also rejected Harbinger's equitable argument that compliance should be waived. The court acknowledged that in some circumstances it may be appropriate for a corporation's board to waive advance notice bylaws, such as where there has been a material change in circumstances related to the election after the deadline has passed, but the court found no such circumstances were present here. The court also upheld the Openwave directors' decision to reduce the size of the board. The court found that the reduction of the number of directors was not a defensive measure intended to interfere with stockholder voting rights and, at the time of the reduction, the board had no reason to believe that Harbinger was a threat to control. The court was particularly influenced by Harbinger's status as a schedule 13G filer, in which it represented that it did not intend to influence the management or control of Openwave. It was not until after Openwave eliminated the vacant board spot and the nomination deadlines had passed that Harbinger filed a schedule 13D, revealing for the first time its intent to influence the management or control of the corporation. Therefore, the court refused to apply heightened scrutiny under Unocal or Blasius.

Fogel v. U.S. Energy Sys., Inc., 2007 WL 4438978 (Del. Ch.). Action to determine proper officers of U.S. Energy under DGCL §225 and to compel a special stockholders' meeting. Plaintiff was purportedly terminated as CEO and chairman at a special meeting of the board. Two days later, pursuant to the authority granted to the CEO and chairman under the bylaws, plaintiff called a special meeting of stockholders for the purpose of removing the other directors and electing their replacements. Later that day, during a scheduled board meeting, the board formally passed a resolution terminating plaintiff. Defendants subsequently ignored plaintiff's call for a special meeting of stockholders. Plaintiff contended his purported termination was ineffective because it had not occurred at a board meeting and his attendance was procured by deception. Plaintiff also alleged defendants breached their duty of loyalty under Blasius by refusing to hold the special stockholders' meeting.

In a post-trial opinion, the court found that the initial purported termination of plaintiff was ineffective and void because it had not occurred at a valid board meeting. Even though a meeting had been noticed, plaintiff's removal was not on the agenda. The court found that the three defendant directors had caucused before the meeting and then met with plaintiff to tell him they wanted him to resign by the end of the day or he would be terminated. The court concluded the informal caucus did not constitute a meeting under DGCL §141. Instead, it was a "hasty, unhelpful gathering" that did not permit plaintiff to respond or defend himself, and there was no discussion of the issue and no vote of the board. The court noted: "A proper board meeting should be informative and should encourage the free exchange of ideas so that a corporation's directors—through their active, meaningful participation—may keep themselves fully informed and in compliance with their fiduciary duty of care." The court also held the meeting was void because plaintiff's participation was procured by deception. The court rejected defendants'

contention that plaintiff's removal was valid because it had been ratified two days later. The court held the defendants could not ratify a void act. Therefore, plaintiff's termination could only have been effective as of the time of the ratification vote. Because plaintiff had not been removed when he called a special meeting of stockholders, the court held plaintiff, as chairman and CEO, was authorized to call the meeting. Although the court ordered defendants to hold the special meeting of stockholders, the court rejected plaintiff's fiduciary duty claim under Blasius. The court concluded defendants' decision to ignore plaintiff's call for a special meeting was not made for the primary purpose of preventing stockholders from electing a new board majority. Instead, the court found defendants ignored plaintiff's call for a special meeting because they held a good faith belief that he had been terminated and therefore lacked authority to call such a meeting.

Perlegos v. Atmel Corp., 2007 WL 475453 (Del. Ch.). Actions to determine proper officers of Atmel Corporation under DGCL §225 and to compel a special stockholders' meeting pursuant to DGCL §211. Plaintiff George Perlegos had been Atmel's president, CEO and chairman, and his brother Gust had been a director and officer. Both were purportedly terminated as officers by a special committee of the board following an investigation into corporate travel expenses. Plaintiffs argued, inter alia, the special committee had been improperly constituted because the board meeting at which the committee was created did not comply with the notice requirements in the Atmel bylaws, and therefore the committee lacked authority. Even if the special committee had been properly constituted, plaintiffs argued it did not have authority to terminate plaintiffs. Plaintiffs further argued the special committee's action constituted a breach of duty because the decision to terminate plaintiffs was not made in good faith. After his purported termination as an officer, George Perlegos, pursuant to his authority as board chairman, called a special meeting of stockholders to be held two months later for the purpose of removing the directors who had comprised the special committee. The next day, the board removed George Perlegos as chairman and elected a new chairman who was then authorized and ordered to rescind the notice of special meeting of stockholders.

In a post-trial opinion, the court determined that plaintiffs had been validly removed as officers of the corporation. First, the court rejected plaintiff's challenge to the creation of the special committee based on inadequate notice. The court determined that delivery of notice of the special board meeting by e-mail satisfied the bylaw's notice provision that authorized giving notice by "other electronic or wireless means." The court found that adequate telephonic notice had also been given. The court held the board's delegation to the special committee of "full power and authority of the Board of Directors to take any action it deem[ed] appropriate on behalf of the Company with respect to the travel related expenses and other issues" included the power to terminate plaintiffs. The court held this authority to terminate officers was permitted under DGCL §141(c) and there was no bylaw prohibiting that delegation of board authority to a board committee. The court rejected plaintiffs' challenge to the independence of the special committee and the process it undertook in terminating plaintiffs. The court concluded the decision, though far from ideal, was fair and reasonable and was not a pretext for removing plaintiffs from the corporation. Nevertheless, the court ordered the corporation to hold the special meeting of the stockholders that had been validly noticed before George Perlegos was removed as chairman of the board.

B.F. Rich & Co. v. Gray, 933 A.2d 1231 (Del. 2007). Action under DGCL §225 to determine the directors and officers of Rich Realty, Inc. Plaintiff, a stockholder of Rich Realty, challenged written stockholder consents purporting to replace directors and officers of Rich Realty. The key issue concerned the validity of a written consent for 49% of the corporation's voting power executed by defendant Gray on behalf of his two minor children. Gray, a convicted felon with a checkered past as a corporate fiduciary, claimed the right to vote his minor children's shares pursuant to a court-approved stipulation in a Connecticut divorce proceeding. In a post-trial opinion, the Court of Chancery held the consents were legally effective and defendants were properly removed as officers and directors and replaced by Gray and members of his family.

In an opinion reversing the Court of Chancery, the Delaware Supreme Court held the written consent executed by defendant Gray was legally defective because he lacked legal authority to vote the shares owned by his minor children. The Court interpreted a Connecticut statute providing that a parent or guardian of a minor "shall not receive or use any property belonging to the minor in an amount exceeding ten thousand dollars in value unless appointed the guardian of the estate of the minor." Although Gray had not been appointed guardian of the estate his minor children, the trial court held Gray's voting of the stock owned by his minor children did not constitute a "use" of the stock under the statute. The trial court reasoned that voting stock was analogous to commencing litigation on behalf of a minor, which did not require appointment of a guardian over the minor's estate. The Delaware Supreme Court disagreed, concluding that these circumstances were akin to taking control of a monetary recovery after successful prosecution of a lawsuit on the minor's behalf. The Court reasoned that Gray's electing himself as a director, president and treasurer placed him in operational control of the corporation and enabled him to reduce the economic worth of the corporation and the value of the minor children's stock interest. The Court stated: "In the case of [Mr. Gray] the gravity of that risk is well documented in this record." Because Gray's consent was invalid, no action by majority written consent occurred and the purported appointment of Gray and his family members as officers and directors was invalid.

D. Inspection of Books and Records[6]

Louisiana Mun. Police Employees' Ret. Sys. v. Countrywide Fin. Corp., 2007 WL 2896540 (Del. Ch.); 2007 WL 4373116 (Del. Ch.). Stockholder action to compel inspection of books and records for the purpose of investigating possible mismanagement and breaches of fiduciary duty relating to the awarding of stock options to officers and executives of Countrywide. The main issue was whether plaintiff had established through a statistical analysis and testimony by its expert "some evidence of possible mismanagement as would warrant further investigation of the matter." Plaintiff's expert concluded there was a statistically significant correlation between option grants to Countrywide executives and subsequent positive short-term performance of Countrywide stock.

In a post-trial opinion, the court concluded plaintiff had established the minimum necessary to warrant inspection of books and records. The court's analysis of plaintiff's burden

[6] DGCL §220 gives a stockholder the right to inspect books and records of the corporation upon delivering to the corporation a demand, under oath, setting forth a proper purpose (i.e., one reasonably related to the person's interest as a stockholder).

appeared analogous to a determination of the admissibility of expert testimony. In concluding plaintiff had met its burden through its expert's analysis, the court noted plaintiff's expert was a well-credentialed economics and statistical expert who offered reliable evidence. The corporation's own expert undercut plaintiff's expert, but did not totally discredit plaintiff's proffer. The court's opinion also reveals the importance of promptly raising confidentiality and privilege issues in Section 220 proceedings. In discussing the ultimate scope of plaintiff's inspection, the court noted that the corporation had not asserted privilege that might limit the scope of inspection. Similarly, although the corporation had, in its pretrial order, sought to impose a confidentiality restriction on documents ultimately to be produced, the corporation had not articulated any legitimate corporate interests requiring an order of confidentiality. In a clarifying letter opinion, however (2007 WL 4373116 (Del. Ch.)), the court stated that the corporation had not waived attorney-client privilege or the right to request confidential treatment of documents produced in response to the court's order.

Melzer v. CNET Networks, Inc., 934 A.2d 912 (Del. Ch. 2007). Stockholder action to inspect books and records related to stock option backdating after being ordered to do so by a federal judge in California. The corporation admitted it had engaged in backdating. The judge in the California action dismissed the complaint, with further leave to amend, based on plaintiffs' failure to plead demand futility and issued a stay pending adjudication of a books and records demand in Delaware. The parties in the Delaware action disputed the scope of the books and records to which plaintiffs were entitled. Specifically, the corporation contended that plaintiffs were not entitled to books and records dating from the time period before plaintiffs became a stockholder of the corporation, because plaintiffs lacked standing under DGCL §327 to maintain a derivative suit for any claims that accrued before they owned such stock.

The court rejected defendant's argument and ordered production of books and records predating plaintiffs' purchase of stock. The court reasoned that plaintiffs did not seek the earlier, "pre-stock purchase" books and records in order to investigate potential new causes of action, but rather to plead demand futility with respect to the causes of action that they did have standing to maintain. Furthermore, since one way for plaintiffs to show that the board was not exercising valid business judgment would be to show that there was a "sustained or systemic failure of the board to exercise oversight," plaintiffs might reasonably need to consult documents that predated their stock ownership.

Highland Select Equity Fund, L.P. v. Motient Corp., 2007 WL 907650 (Del. Ch.), aff'd, 922 A.2d 415 (Del. 2007) (Order). Stockholder action to inspect books and records pursuant to DGCL §220 for the stated purposes of investigating possible mismanagement and communicating with stockholders in connection with an announced proxy contest. Motient refused inspection, arguing, inter alia, plaintiff's actual purpose was to use the Section 220 demand to attack Motient's management in connection with the proxy contest. After the Court of Chancery issued a post-trial opinion denying plaintiff relief, 906 A.2d 156 (Del. Ch. 2006), the Delaware Supreme Court remanded with instructions to clarify whether the Court of Chancery found all of Highland's actual purposes improper and, if the court found some of Highland's actual purposes were proper, to state the basis on which the court determined that Highland was not entitled to relief.

On remand, the court clarified that Highland stated proper purposes and presented credible evidence of possible corporate misconduct. The court found, however, that Highland's stated purposes were pretextual, and its actual and improper purpose was to use the demand as a

platform in plaintiff's proxy contest. The court reached this decision based upon, inter alia, the overbreadth of plaintiff's Section 220 demand, the way Highland pressed its demand to expedite the litigation and Highland's repeated publication of its "detailed and excessive demand."

Pershing Square, L.P. v. Ceridian Corp., 923 A.2d 810 (Del. Ch. 2007). Stockholder action to inspect books and records for the stated purposes of: (1) communicating with stockholders regarding an ongoing proxy contest, (2) investigating the "suitability" of the current board and (3) investigating mismanagement by the current board. Ceridian refused to provide two letters drafted by certain officers to the board purportedly alleging mismanagement by the former CEO and lack of board oversight. Plaintiffs learned of the letters from the president of a Ceridian subsidiary who disagreed with the parent's strategy and had discussed being a candidate on a Pershing Square slate in an upcoming proxy contest. Ceridian claimed: (a) plaintiffs' stated purpose of investigating director "suitability" was not a proper purpose, (b) plaintiffs' stated purpose was not their primary purpose, (c) plaintiffs' access to Ceridian's records should be limited to stockholder lists because they wanted to communicate with stockholders, (d) plaintiffs could not rely on a purpose that was not articulated in their demand letter or complaint and (e) the letters were confidential communications between the board and management and disclosure would chill these communications.

In a post-trial opinion, the court denied inspection. As a threshold matter, the court held as a matter of first impression that investigating an individual's "suitability" to serve as a director was a proper purpose to inspect books and records. Nevertheless, the court found plaintiffs' unstated, but primary, purpose was improper: "to find a legal vehicle by which [plaintiffs could] publicly broadcast improperly obtained confidential information." The court noted neither plaintiffs nor the subsidiary's president were concerned that the president violated his fiduciary duties to his employer and disclosed confidential information to plaintiffs in furtherance of his improper and self-interested goals. After reviewing the documents in camera, the court determined the letters were confidential, and even if plaintiffs' purposes were proper, disclosing the letters under these facts would chill communications between executive officers and the board. Therefore, the potential harm from disclosing the letters outweighed the benefit.

Robotti & Co., LLC v. Gulfport Energy Corp., 2007 WL 2019796 (Del. Ch.). Action to inspect books and records for the purpose of valuing plaintiff's stock and investigating suspected mismanagement related to Gulfport Energy's 2004 rights offering. Gulfport Energy opposed inspection, arguing, inter alia, all necessary, essential and sufficient information to value plaintiff's stock was publicly available, and plaintiff failed to demonstrate a credible basis to infer possible mismanagement related to the rights offering.

In a post-trial opinion, the court concluded the information available in public filings was sufficient to value plaintiff's shares. On the other hand, the court held plaintiff "cobbled together sufficient evidence, taken as a whole" to warrant limited inspection of the corporation's books and records concerning the rights offering. The court noted that the price of the rights offering was just low enough to trigger anti-dilution provisions governing options to management and warrants to Gulfport Energy's controlling stockholder. In addition, the corporation made an upfront payment of $240,000 as part of a "backstop" agreement with the controlling stockholder to purchase any shares not sold in the rights offering; yet all of the rights were ultimately sold and the backstop agreement was never triggered. The court then determined the specific categories of books and records that were necessary and essential to satisfy plaintiff's purpose to investigate possible mismanagement related to the rights offering.

VI. STOCKHOLDER APPRAISAL RIGHTS

A. Right to Appraisal

In re Appraisal of Transkaryotic Therapies, Inc., 2007 WL 1378345 (Del. Ch.). Opinion clarifying beneficial owner's right to seek appraisal for shares acquired after the record date for the merger. Petitioners beneficially owned approximately 2.9 million shares on the record date. Between the record date and the consummation of the merger, petitioners acquired approximately 8 million additional shares and subsequently sought appraisal for all of the approximately 10.9 million shares beneficially owned. The record holder for all of petitioners' shares, Cede & Co., held more than 29.7 million shares on the record date and voted approximately 12.9 million of its shares in favor of the merger. Thus, more than 16.8 million shares held by Cede either voted against, abstained or did not vote in favor of the merger. The respondent (Transkaryotic) moved for partial summary judgment, arguing petitioners had the burden to show that the shares they acquired after the record date had not been voted in favor of the merger.

In an opinion denying respondent's motion for partial summary judgment, the court held petitioners' shares acquired after the record date were eligible for appraisal. The court observed that under the appraisal statute (DGCL §262) only a record holder is entitled to claim and required to perfect appraisal rights. Therefore, the actions of a beneficial owner are irrelevant. In this case, Cede perfected appraisal rights to all of the approximately 10.9 million shares beneficially owned by petitioners for which appraisal was sought. The court also addressed the respondent's policy concern that permitting appraisal for shares acquired after the record date would encourage arbitrageurs to "buy in" to appraisal actions and thus "pervert the goals of the appraisal statute by allowing it to be used as an investment tool by arbitrageurs as opposed to a statutory safety net for objecting stockholders." The court observed that concern was better left to the legislature, not the court.

Louisiana Mun. Police Employees' Ret. Sys. v. Crawford, 2007 WL 2896540 (Del. Ch.); 2007 WL 4373116 (Del. Ch.). Stockholder class action seeking to enjoin the proposed stock-for-stock merger of Caremark Rx and CVS Corporation. Plaintiffs alleged, inter alia, the payment of a special dividend in connection with the merger triggered the right to appraisal under DGCL §262. Defendants invoked the doctrine of independent legal significance, arguing the dividend payment was a separate transaction that could not be recognized as merger consideration. Therefore, because the merger was a stock-for-stock transaction in a publicly traded corporation, stockholders were not entitled to appraisal rights.

In an opinion granting a limited injunction, the court held that the payment of a special dividend to Caremark stockholders constituted part of the merger consideration, thus triggering appraisal rights under DGCL §262. First, the payment of the dividend was contingent upon approval of the CVS/Caremark merger agreement. Second, the payment was due upon or after the effective time of the merger. Third, CVS, not Caremark, controlled the value of the dividend. Fourth, the defendants warned in the proxy statement that the dividend might be treated as merger consideration for tax purposes. The court concluded the special dividend was merely "cash consideration dressed up in a none-too-convincing disguise." Because Caremark failed to advise stockholders of their right to demand appraisal, the stockholders' meeting could not go forward absent compliance with the 20 day notice period under Section 262.

B. Determination of Appraised Value

Hildreth v. Castle Dental Ctrs., Inc., 2007 WL 3407200 (Del.). Appeal of appraisal action challenging the allocation of fair value between common and preferred stock. The preferred was convertible into common stock, and under the merger agreement preferred holders received the same consideration for their shares on an as-converted basis. In violation of the certificates of designation of the preferred, however, the corporation did not maintain a sufficient number of authorized and unissued shares of common stock to permit conversion. Petitioners, who owned common stock, alleged the preferred stock was void because the corporation had failed to authorize sufficient shares of common stock for conversion. Alternatively, petitioners asserted that merger consideration should be allocated only among the actual number of authorized common shares. Following trial, the Court of Chancery rejected petitioners' claims and found that the merger agreement had properly allocated the merger consideration among the common and preferred stock.

The Delaware Supreme Court affirmed, rejecting petitioners' claim that the failure to authorize sufficient shares of common stock to permit conversion voided the preferred stock. The Court found that, although the failure to authorize sufficient common shares may have affected the enforceability of the preferred stockholders' conversion rights, the shortfall in unauthorized shares did not nullify the original issuance of the preferred stock. The Court also rejected petitioners' alternative contention that the merger consideration should be allocated solely among the authorized common shares. The Court observed that, regardless of the mechanism used to determine the value of the preferred stock, the primary issue was the fairness of the allocation of the corporation's equity. Because petitioners failed to present evidence that the allocation of equity to the preferred stockholders was unfair, the lower court did not abuse its discretion in upholding the merger agreement's allocation of the merger consideration.

Highfields Capital, Ltd. v. AXA Fin., Inc., 2007 WL 4788448 (Del. Ch.). Appraisal action arising out of the 2004 all-cash, all-shares merger of The MONY Group, Inc. into AXA Financial, Inc. at $31.00 per share. Petitioner's three experts, using several valuation techniques, placed a going-concern value range of between $37 and $47 per share. Respondent countered that MONY's going concern value on the merger date was no more than $21 per share, and that because of the arm's-length negotiation process that led to the merger, the court should give great weight to a market-based valuation approach that valued the business based on the merger price, minus any synergies that would result from the transaction.

In a post-trial opinion the court valued petitioner's stock at less than the merger price. The court first determined that several of the valuation methodologies suggested by the parties were unreliable. Although Delaware courts generally favor discounted cash flow models in appraisal proceedings, the court noted that DCF analyses are not as helpful where the transaction is an arm's-length merger and where the business being valued has unreliable positive and negative cash flows, as are common in the life insurance business. The court similarly rejected the parties' comparable transactions and comparable companies analyses. The court did, however, agree with respondent's expert that in arm's-length transactions the merger price, less any synergies that result from the merger, is probative of going-concern value. The court also found that the "sum-of-the-parts" analysis conducted by respondent's expert to value MONY's various business segments was entitled to consideration, although with some modifications. Placing 75% weight on its modified shared synergies analysis and 25% weight on an

independent sum-of-the-parts analysis, the court concluded that petitioner was entitled to $24.97 per share for its MONY stock.

Crescent/Mach I P'ship, L.P. v. Turner, 2007 WL 1342263 (Del. Ch.). Consolidated appraisal and breach of fiduciary action arising out of a 1999 cash-out merger in which stockholders of Dr Pepper Bottling Holdings, Inc. received $25 per share. In the fiduciary duty action, minority stockholders alleged that the corporation's Chairman, CEO and 61.5% stockholder agreed to an unreasonably low sale price for the corporation in exchange for side payments and other special consideration for himself. In the appraisal action, petitioners' expert valued the stock at $48.69 per share, relying primarily on a discounted cash flow analysis. Respondent's expert, also using a DCF analysis, valued the stock at $25.10 per share.

In a post-trial opinion, the court prepared its own DCF analysis to determine fair value. Based primarily on the testimony of corporate management, the court adopted management's internal projections of 3% annual volume growth and 0.4% pricing growth, which yielded an annual EBITDA growth rate of 3%. The court also found the 5-year period used by management for internal projections to be preferable to the 7-10 year projection period used by petitioners' expert. In determining the appropriate terminal value input for its analysis, however, the court rejected respondent's expert's EBITDA multiplier methodology in favor of the Gordon Growth model advocated by petitioners' expert, finding the latter method to be a more consistent fit for the DCF analysis. Based on its analysis, the court concluded that the fair value of petitioners' stock was $32.31 per share. The court awarded prejudgment interest at the stipulated rate of 4.8%, compounded monthly from the date of the merger.

VII. INSOLVENCY AND DISSOLUTION

A. Appointment of a Receiver or Custodian

Cox v. Crawford-Emery, 2007 WL 4327775 (Del. Ch.). Action by 50% stockholder and director of Horse Power Ltd. seeking declaratory and injunctive relief and the appointment of a custodian pursuant to DGCL §226. Specifically, plaintiff sought to prevent defendants, who collectively held the other 50% of the corporation's stock and served as the other directors, from causing Horse Power to enter into administration or liquidation, from removing plaintiff as a director of Horse Power or from taking any steps that would dilute or eliminate his equity interest in Horse Power. Plaintiff alleged that the defendants had threatened to use their status as creditors of the corporation to force Horse Power into administration in England.

In a letter opinion denying plaintiff's motion for a preliminary injunction, the court held that the plaintiff had failed to demonstrate a sufficient threat of irreparable harm to justify an injunction. The court noted that a creditor's status as a fiduciary alone does not impose special limitations on its creditor rights. The court observed that there was evidence one of the defendants might use his authority as a director to cause the corporation to enter into administration in England in order to press his claims as a creditor. While this was a "potentially self-interested action," the defendant had not yet taken that step.

B. Zone of Insolvency/Fiduciary Duties to Creditors

North Am. Catholic Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92 (Del. 2007). Action by creditor of Clearwire Holdings, Inc. alleging three directors breached their fiduciary duties to the creditor while the corporation was insolvent and in the zone of insolvency.

Plaintiff alleged the three directors, less than a majority of the board, served at the behest of the corporation's controlling stockholder and favored its interests arising from a wireless spectrum license agreement. The Court of Chancery dismissed the complaint, holding plaintiff creditors failed to state a direct claim for breach of fiduciary duty.

In a case of first impression, the Delaware Supreme Court affirmed dismissal, holding creditors of an insolvent corporation or a solvent corporation that is operating in the zone of insolvency have no right, as a matter of law, to assert a direct claim for breach of fiduciary duty against directors. The Court addressed the issue on two levels. First, the Court held creditors of a solvent corporation that is operating in the "zone of insolvency"—a term the Court expressly declined to define—may not assert a direct claim against directors for breach of fiduciary duty. The opinion strongly suggests, but did not directly decide, that a creditor of a solvent corporation that is operating in the zone of insolvency may not assert a derivative claim for breach of fiduciary duty. Second, the Court held a creditor of an insolvent corporation may not assert a direct claim against directors for breach of fiduciary duty, but the creditor could assert a derivative claim on behalf of the corporation. The Court reasoned that creditors, unlike stockholders, can protect their interests through various mechanisms such as contractual agreements, fraudulent conveyance law and other sources of creditor rights, and adding another layer of protection through fiduciary duty law was deemed unnecessary.

Trenwick Am. Litig. Trust v. Ernst & Young, L.L.P., 906 A.2d 168 (Del. Ch. 2006), aff'd, 931 A.2d 438 (Del. 2007) (Order). Action by a litigation trust, formed in a bankruptcy reorganization of a wholly owned subsidiary of Trenwick Group, Inc., a publicly traded insurance holding company, against former directors of Trenwick Group and the subsidiary for breach of fiduciary duties, "deepening insolvency" and fraud. Plaintiff claimed defendants pursued an imprudent business strategy to acquire other insurers with underestimated claim exposures. Plaintiff asserted that the parent's former directors breached fiduciary duties owed to the subsidiary by overleveraging the subsidiary in a reorganization that made imprudent acquisitions. Plaintiff also asserted the former directors of the subsidiary breached their duty of care for not second-guessing the business judgment of the parent's former directors.

In an opinion granting defendants' motion to dismiss, which was summarily affirmed on appeal, the Court of Chancery held the complaint failed to state a claim for breach of fiduciary duty, that Delaware does not recognize the tort of "deepening insolvency" and that plaintiff failed to plead fraud with particularity. Observing established Delaware law that a parent corporation owes no fiduciary duties to its wholly owned subsidiary, the court concluded a wholly owned subsidiary cannot breach its duty of care by acting with loyalty to implement the business strategy adopted by its parent's board. Thus, the court refused to permit a wholly owned subsidiary to assert claims for breach of fiduciary duty by its parent's directors under the guise that the parent's business decisions led to the ultimate bankruptcy of the subsidiary. The court also refused to recognize the "deepening insolvency" claim, which is contrary to underlying principles of Delaware law.

C. Plan of Dissolution

Territory of U.S. Virgin Islands v. Goldman, Sachs & Co., 937 A.2d 760 (Del. Ch. 2007). Action by the U.S. Virgin Islands to recoup distributions made to a stockholder of a dissolved Delaware corporation as part of the corporation's 1985 dissolution. The Virgin Islands waited until 1992 to bring its underlying claims against Panex for environmental damage. After

obtaining a $51.6 million default judgment against a successor to the corporation's liquidating trust in 2005, the Virgin Islands filed suit against Goldman Sachs to recoup the funds it had received from Panex and the liquidating trust in 1984, 1985 and 1987. Defendant moved to dismiss the complaint arguing, inter alia, that plaintiff's claims were barred by the combined effect of DGCL §§278 and 325(b), concerning the winding up of the affairs of dissolved corporations and stockholder liability for corporate debts, respectively.

In a decision granting defendant's motion to dismiss, the Court of Chancery concluded the combined effect of DGCL §§278 and 325(b) precluded recovery. First, the court determined the clear language of §278 requires that claims against a dissolved corporation be brought within three years of dissolution. Because plaintiff failed to bring an action against Panex within that three-year period, plaintiff was now incapable of obtaining a judgment against Panex. The court then concluded that the plain language of §325(b) ("No suit shall be brought against any . . . stockholder for any debt of a corporation of which he is a[] . . . stockholder, until judgment be obtained against the corporation and execution thereon be returned unsatisfied.") barred plaintiff from holding defendant, as a former Panex stockholder, responsible for a corporate debt, such as liability for environmental contamination, without first obtaining a judgment against Panex. Considering the two statutes together, plaintiff's inability to obtain a judgment against Panex barred it from any recovery against the corporation's former stockholder.

The court also declined to apply the common law trust fund doctrine to make stockholders receiving distributions from a dissolving corporation potentially liable to the corporation's creditor-plaintiffs. The court reasoned that allowing such liability would put equity holders who received distributions from a dissolving corporation at perpetual risk that the funds would be clawed back. The court also ruled that plaintiff's claims were barred by laches because plaintiff failed to bring suit against defendant until long after the expiration of the analogous three-year statute of limitations.

VIII. DERIVATIVE ACTIONS

A. Derivative and Direct Claims Distinguished

Gatz v. Ponsoldt, 925 A.2d 1265 (Del. 2007) (en banc). Stockholder action alleging the directors of Regency Affiliates, Inc. and others breached their fiduciary duties in connection with several discrete transactions, including a recapitalization. Plaintiffs alleged the recapitalization resulted in the transfer of control from Regency's de facto controlling stockholder to a third-party that, prior to the recapitalization, owned no Regency stock. Over the course of three opinions, the Court of Chancery dismissed the claims, ultimately concluding they were derivative and plaintiffs failed to plead demand futility.

In an opinion reversing the Court of Chancery, the Delaware Supreme Court held plaintiffs' claims challenging the restructuring could be asserted directly. The Court held plaintiffs' claim challenging the recapitalization was not exclusively derivative and could be brought directly under the Court's recent decision in Gentile v. Rossette, 906 A.2d 91 (Del. 2006), because the recapitalization constituted (i) an expropriation of voting power and economic value from the public stockholders and (ii) a transfer of that voting power and economic value to another, to the corresponding detriment of the public shareholders – all accomplished by the de facto controlling stockholder. Defendants argued Rossette was

inapplicable because control was transferred in an arm's-length exchange to a non-fiduciary third party that held no previous stock ownership in the corporation and the former controlling stockholder received no corresponding benefit from the transaction. The Court rejected that argument, noting it was simply elevating form over substance. When analyzed as two separate transactions, the recapitalization fit the classic paradigm of Rossette and the seminal case of In re Tri-Star Pictures, Inc. Litig., 634 A.2d 319 (Del. 1993). Therefore, the claim was not exclusively derivative and could be brought directly.

Rhodes v. Silkroad Equity, LLC, 2007 WL 2058736 (Del. Ch.). Action by the two original stockholders of Colossus, Incorporated, alleging, inter alia, breach of fiduciary duty by the corporation's controlling stockholder. Plaintiffs alleged Colossus's primary creditor pressured them into granting an 80% stake in the corporation in exchange for, among other things, restructuring certain loan obligations. Once the creditor and its principals obtained control, the creditor allegedly initiated a scheme to depress the value of the entity and ultimately buy out the plaintiffs at a depressed price, pursuant to the terms of a stockholder agreement allowing the controlling stockholder to acquire plaintiffs' stock for fair market value. Defendants argued plaintiffs' claim was derivative and thus they lacked standing because they were no longer stockholders of the corporation.

In an opinion denying defendants' motion to dismiss in part, the court concluded that the plaintiffs' fiduciary duty claims were both direct and derivative. Plaintiffs' claims alleging, inter alia, the controlling stockholder sold assets to the corporation at inflated prices and loaded its own employees onto the corporate payroll were derivative. Nevertheless, the court found the allegations could be readily viewed as facilitating the defendants' efforts to drive out the plaintiffs at bargain prices. Thus, the court concluded the true substantive effect of the defendants' actions, as alleged, harmed the minority stockholders in a substantially different fashion than the controlling stockholder. Therefore, plaintiffs could assert the claims directly.

B. Standing

Desimone v. Barrows, 924 A.2d 908 (Del. Ch. 2007). Derivative action alleging directors and officers of Sycamore Networks, Inc. breached their fiduciary duties in connection with stock option backdating and spring-loading. Defendants moved to dismiss, inter alia, for plaintiff's failure to satisfy the contemporaneous ownership requirement under DGCL §327, since plaintiff did not become a Sycamore stockholder until after most of the challenged options were granted. Plaintiff argued he had standing to pursue all his claims because his claims attacked a pattern of "continuing wrongs," constituting an exception to the continuous ownership requirement.

In an opinion granting defendants' motion to dismiss, the court rejected application of the continuing wrongs exception and held plaintiff lacked standing to challenge option grants that occurred before he became a Sycamore stockholder. The court explained that the narrow scope of the "continuing wrongs" doctrine applies only when the alleged wrongful acts are "so inexorably intertwined that there is one continuing wrong." Because stock option grants are completed the moment the option is granted, the court found that each of the challenged grants could be easily separated. Therefore, the grants that occurred before plaintiff acquired his stock did not "continue" into the time period of plaintiff's stock ownership. The plaintiff's hodgepodge of policy arguments to the contrary, including that §327 should not apply to him because he had not purchased his stock to maintain a derivative action, were rejected, as the

court concluded the meaning of §327 was clear. To the extent plaintiff may have been harmed from the corporation's false disclosures respecting its accounting for stock options—i.e., plaintiff paid too much for his stock—the court found those claims to ring of fraud-on-the-market, and properly pursued only in federal court under federal securities laws. The remaining claims were dismissed either for failure to plead demand futility or failure to state a claim.

Brandin v. Deason, 2007 WL 4788444 (Del. Ch.). Stockholder derivative action on behalf of Affiliated Computer Services alleging current and former officers and directors of Affiliated breached their fiduciary duties by backdating stock options in violation of the corporation's stock option plans. Several defendants moved to stay the action in favor of a later-filed action pending in federal court in Texas, which also involved claims that defendants violated federal securities laws. Defendants argued that the Delaware action should be stayed while the broader legal issues presented by the Texas litigation were resolved. Defendants also asserted that plaintiff lacked standing to challenge the validity of stock options granted on eleven of the twelve dates in question because he did not own Affiliated stock on those dates. Defendants, who were Texas residents, argued litigating the issues in Delaware presented a hardship for them.

In denying defendants' motion to stay, the court determined the case should be litigated in Delaware because Delaware law governed all of the state law claims in both the Texas and Delaware actions. The court opined it was important for Delaware to decide the issues in light of the large number of option backdating cases pending around the country. Those issues include the unsettled Delaware law question of whether a plaintiff who purchases shares before some of the alleged backdated option grants and before the backdating practices came to light has standing to challenge option grants that occurred before plaintiff acquired its stock, even where it is alleged defendants actively concealed their wrongdoing. Another issue was whether defendants' decision to answer the complaint and begin discovery constituted waiver of their right to argue demand was not excused. The court focused on federalism issues in declining to cede the field in favor of the later-filed derivative action in federal court where the federal securities law claims—over which the federal courts have exclusive jurisdiction—were predicated on the same conduct giving rise to the state law derivative claims. The court concluded that blind deference where Delaware corporate law and federal securities law overlap would render Delaware courts a forum of last resort and do a disservice to the stockholders of Delaware corporations.

Feldman v. Cutaia, 2007 WL 2215956 (Del. Ch.). Action by co-founder and former stockholder of The Telx Group, alleging Telx's management and directors breached their fiduciary duties through a series of transactions including a recapitalization, approving the issuance of stock options to Telx employees and approving a stock repurchase. Approximately one year after plaintiff filed the litigation, Telx was merged into, and became a wholly owned subsidiary of, defendant GI Partners. When plaintiff subsequently amended his complaint to challenge the merger transaction, defendants moved to dismiss, asserting that all of plaintiff's claims were derivative and, therefore, plaintiff lost standing when he ceased to be a stockholder as a result of the merger. Plaintiff argued the equity dilution and merger-related claims could proceed because they were direct claims, and his remaining claims, although admittedly derivative, should be allow to proceed because defendants had violated discovery obligations.

In an opinion granting defendants' motion to dismiss, the court concluded that all of plaintiff's claims were derivative and not direct. Regarding the equity dilution claims, the court

concluded that plaintiff failed to allege either the presence of a controlling stockholder or that defendants were the sole beneficiaries of the schemes, which would be required to state a direct claim. The court applied the same reasoning in dismissing plaintiff's challenge to the merger, which was premised on the corporation's alleged failure to consider the validity of the options granted under the stock option plan. Because no exception to the continuous stock ownership requirement for maintaining derivative actions was present, the court concluded plaintiff lost his standing to pursue the derivative claims when he lost his stockholder status as a result of the merger. The court declined to create a new exception to the continuous ownership requirement based on defendants' alleged discovery abuses, holding that such abuses are not a proper basis for continuing litigation once a party has lost standing.

Schoon v. Smith, 2008 WL 375826 (Del.) (en banc). Action by director of Troy Corp. seeking to assert derivative claims on behalf of the corporation. In an opinion affirming the Court of Chancery, the Delaware Supreme Court held a director, acting in that capacity, lacks standing to sue on behalf of the corporation or its stockholders. Observing the absence of statutory authority permitting a director to bring a derivative action, the Court reasoned there was no basis to extend the doctrine of equitable standing to a corporate director. The doctrine of equitable standing was adopted to "prevent a complete failure of justice on behalf of the corporation." In this circumstance, the director seeking to assert derivative claims was elected by and aligned with a large stockholder that was actively litigating other claims against Troy Corp. Therefore, denying derivative standing to the director would not result in a complete failure of justice because the stockholder was well positioned to seek redress of injuries to the corporation.

C. Demand Futility Cases[7]

1. Demand Excused

Ryan v. Gifford, 918 A.2d 341 (Del. Ch. 2007). Stockholder derivative action asserting a variety of claims against the members of the board and compensation committee of Maxim Integrated Products, Inc. arising out of alleged backdating of stock options. Plaintiff alleged that defendants breached their duties of due care and loyalty by approving or accepting backdated stock options in clear violation of stockholder-approved stock option plans. Defendants moved to dismiss on multiple grounds, including failure to plead demand futility.

In an opinion denying the defendants' motion to dismiss, the court held that demand was excused. The complaint satisfied both the second prong of Aronson and, alternatively, the Rales test. Allegations that the board knowingly and intentionally violated the terms of the option

[7] Two seminal Delaware Supreme Court cases describe the contours of demand futility requirements. Aronson v. Lewis, 473 A.2d 805 (Del. 1984), requires plaintiff to allege particularized facts creating a reasonable doubt that (1) the directors were disinterested and independent or (2) the challenged transaction was otherwise the product of a valid business judgment. Rales v. Blasband, 634 A.2d 927 (Del. 1993), established the test for demand futility where the substantive claims do not challenge the exercise of the board's business judgment. Rales requires the court to determine whether the particularized allegations create a reasonable doubt that, as of the time the complaint is filed, the board could have properly exercised its independent and disinterested business judgment in responding to the demand.

plans raised a reasonable doubt respecting the board's exercise of a valid business judgment. Moreover, the court concluded that demand was excused under Rales, given the genuine prospect of liability on the part of the directors here. The court concluded that "option backdating could be so egregious on its face" that the directors lose the protection of the business judgment rule and face a substantial likelihood of liability.

In re Tyson Foods, Inc. Consol. S'holder Litig., 919 A.2d 563 (Del. Ch. 2007). Derivative action charging board members of Tyson Foods with issuing "spring-loaded" stock options. Spring-loading is the practice of granting options to executives immediately before the release of material inside information that might reasonably be expected to drive the share price higher. Plaintiffs challenged option grants made between 1999 and 2003. Defendants moved to dismiss the breach of fiduciary duty claims arising out of spring-loading for failure to make a demand under Court of Chancery Rule 23.1 and failure to state a claim.

The court denied the motion to dismiss for failure to make a demand pursuant to Rule 23.1, holding that demand was excused. The court concluded that the complaint satisfied the first element of the Aronson test, alleging sufficient facts tying a majority of the board to members of the Tyson family and other insiders, thereby impugning the disinterest and independence of the board. The court's opinion provided interesting guidance in connection with the distinction between the standard for assessing allegations of interestedness and lack of independence in (1) the Rule 12(b)(6) motion to dismiss context and (2) the Rule 23.1 demand excused context. The court explained the differences as follows:

> In the context of a motion to dismiss under Rule 23.1, the Court considers the directors in office at the time a plaintiff brings a complaint, and plaintiffs may not rely upon the notice pleading standards of Rule 8(a). In the context of a motion to dismiss for failure to state a claim, on the other hand, the directors relevant to the Court's decision will usually be those in office at the time the challenged decision was made, and the standard, while perhaps more rigorous in derivative cases than in some others, does not reach so high a bar as Rule 23.1. In both cases this Court must make all inferences in favor of plaintiffs, but in the Rule 23.1 context such inferences may only be drawn from particularized facts, while in the former case I may draw from general, if not conclusory, allegations.

In re infoUSA, Inc. S'holders Litig., 2007 WL 2419611 (Del. Ch.). Stockholder derivative action on behalf of infoUSA, Inc., alleging certain directors breached their fiduciary duties, wasted corporate assets and violated the DGCL largely to benefit the corporation's founder, CEO, director and 41% stockholder Vinod Gupta. Plaintiffs sought to void various self-dealing transactions between infoUSA and Gupta that were not approved by disinterested directors or a vote of disinterested stockholders pursuant to DGCL §144 and option grants awarded in violation of DGCL §157. Plaintiffs also sought to invalidate a standstill letter agreement between infoUSA and Gupta whereby Gupta agreed not to acquire any additional infoUSA securities in exchange for infoUSA's agreement not to modify the stockholder rights plan to include Gupta. Plaintiffs alleged the agreement violated the terms of the stockholder rights plan and impermissibly restricted the directors' statutory and fiduciary obligation to manage the affairs of the corporation under DGCL §141. Defendants moved to dismiss for failure to make a demand under Rule 23.1 and for failure to state a claim.

In an opinion granting in part and denying in part defendants' motion to dismiss, the court concluded demand was excused. The opinion serves as a primer on the requirements of Rule 23.1 and Delaware law, such as the applicability of Rales or Aronson, and the court's view on the qualities of a good complaint. For example:

- In a complaint challenging the excesses given to a fiduciary (e.g., perquisites or executive compensation) it is insufficient merely to argue that no board exercising business judgment could have approved or stood idly by while the recipient allocated to himself the offending benefits. "Mere recitations of elephantine compensation packages . . . will rarely be enough to excuse a derivative plaintiff from the obligation to make a demand upon the board of directors."

- "[A] skilled litigant, and particularly a derivative plaintiff . . . places before the Court allegations that question not the merits of a director's decision . . . but allegations that call into doubt the motivations or the good faith of those charged with making the decision."

- In satisfying Rule 23.1, the plaintiff should provide a "detailed, fact-intensive, director-by-director analysis" to show that a majority of the board is either interested in the transaction or lacking independence.

Applying Rales, the court concluded that a majority of the board was not disinterested. First, the court determined that six of the nine directors were not disinterested because they faced a "substantial likelihood" of personal liability in the action. The court acknowledged that alleging a substantial likelihood of liability is a difficult standard for a derivative plaintiff to meet. The court found plaintiffs met this standard based on allegations that these six directors signed SEC Form 10-Ks which materially misrepresented the nature of benefits provided to Gupta. The court also held demand was excused because plaintiffs' additional allegations against four of the director defendants raised an inference that these directors were dominated by Gupta and, therefore, incapable of impartially considering a demand. The allegations included claims that (1) infoUSA's payments to one director's law firm were material; (2) another director received a financial grant from infoUSA deriving from his relationship with Gupta, and other infoUSA directors served on boards that could affect this director's professional advancement and (3) two directors received rent-free office space to operate their independent businesses, which had been identified as a potential conflict in a report prepared for the board.

The court rejected plaintiffs' invitation to adopt a per se rule that allegations of corporate waste, illegal or ultra vires acts, or breach of fiduciary duty automatically excused plaintiffs from making a demand. The court noted, however, that demand will be excused if a majority of the board that allegedly pursued the ultra vires action remains on the board at the time demand was made.

Conrad v. Blank, 2007 WL 2593540 (Del. Ch.). Derivative action challenging stock options issued to senior management members between 1994 and 2003 that were allegedly backdated when issued. Defendants moved to dismiss on two grounds. First, defendants asserted the complaint failed to plead demand futility, claiming the allegations were weak and failed to establish a pattern of backdating. Second, defendants argued plaintiff lacked standing to challenge 7 of the 12 option grants that predated plaintiff's stock purchase in 1998.

In an opinion granting in part and denying in part the motion to dismiss, the court found that the complaint adequately pleaded demand futility. The court applied the demand futility test of Rales since it was the compensation committee, consisting of less than half the members of the board, that authorized the option grants. Rales requires a derivative plaintiff to plead facts creating a reasonable doubt that a majority of the directors could appropriately consider the demand through the exercise of independent and disinterested business judgment. The court concluded that the complaint raised a reasonable inference that the compensation committee members acted knowingly in awarding options priced at dates other than the actual dates of the grant. In respect to defendants' second argument, the court concluded, with "grave misgivings," that the plaintiff lacked standing to prosecute option backdating misconduct predating her share purchase in 1998. Although plaintiff was a long-term stockholder who bought shares without knowing of the alleged wrongdoing, the court concluded that recent decisions refusing to extend the "continuing wrong" exception to the contemporaneous ownership rule were controlling here. The court held that plaintiff would not be allowed to seek relief with respect to option grants made prior to 1998, but left the door open to intervention by another stockholder who purchased shares prior to 1998.

2. Demand Not Excused

Desimone v. Barrows, 924 A.2d 908 (Del. Ch. 2007). Derivative action alleging directors and officers of Sycamore Networks, Inc. breached their fiduciary duties in connection with stock option grants, including option backdating and spring-loading. Plaintiff alleged, among other things, that the backdating of stock option grants to rank-and-file employees and officers was so pervasive and widely known throughout the corporation that the directors must have abdicated their oversight responsibilities by failing to take remedial action. Defendants argued plaintiff had failed to make a demand and that a majority of the corporation's directors were independent from and had no knowledge of the actual backdating activity.

In an opinion granting defendants' motion to dismiss, the court held in part that the plaintiff had failed to plead demand futility. The court found no reason to divest the Sycamore board of its authority to address the alleged misconduct. No facts were alleged that a majority of the directors were interested in the grants, and no facts were alleged to create an inference that the directors had any knowledge of the backdating. Moreover, the court found that no facts had been alleged to suggest the corporation's internal controls were inadequate. Rather, an internal memo that plaintiff had relied on stated that backdating was contrary to corporate policy and that individuals had intentionally hid the backdating from Sycamore's auditors and audit committee. The court was particularly critical of the plaintiff's generalized claims of wrongdoing because the plaintiff had not utilized DGCL §220 to inspect the corporation's books and records, which may have provided a factual basis to support the director involvement in the backdating activity that the plaintiff claimed. The court dismissed the spring-loading claims for failure to state a claim.

IX. SETTLEMENTS AND ENTITLEMENT TO FEES

Alaska Elec. Pension Fund v. Brown, 2007 WL 4465059 (Del.). Opinion addressing the rights of an out-of-state class action litigant to a portion of attorneys' fees awarded in connection with the settlement of parallel litigation in Delaware challenging the proposed going-private tender offer and merger of William Lyon Homes. The out-of-state litigant filed a competing action in California. Defendants and Delaware plaintiffs entered into a memorandum of

understanding providing for a settlement of the litigation, which included a $7.00 per share price increase and supplemental disclosure. The California plaintiff refused to join the settlement. Before the settlement was finalized, the tender offer price was increased by another $9.00 per share. In their application for attorneys' fees and expenses in connection with the settlement, the Delaware plaintiffs sought $1.2 million, based solely upon the initial $7.00 per share price increase and the supplemental disclosure. The California plaintiff intervened in the Delaware settlement, seeking 66% of any fee awarded. The Court of Chancery approved the settlement, awarded $1.2 to Delaware plaintiffs' counsel and denied California plaintiff's counsel's fee request.

Reversing in part, the Delaware Supreme Court held that the California plaintiff's counsel was entitled to a presumption that its litigation efforts contributed to the second increase in the tender offer. The Court noted that, generally, out-of-state litigants are not entitled to a presumption that their efforts were causally related to any benefit conferred in the settlement of litigation in Delaware. Instead, in order to share in any fee award, out-of-state litigants are required to substantiate their contribution to the benefit achieved in the settlement. Thus, the Court affirmed the trial court's determination that the California plaintiff's counsel was not entitled to attorneys' fees relating to the initial $7.00 price increase. Nevertheless, because Delaware plaintiffs' counsel claimed no role in achieving the second price increase, and the California plaintiff was the only remaining adversary, the Court determined the California plaintiff's counsel was entitled to the presumption that its efforts were causally related to the second price increase. The Court expressed no opinion on whether any fee ultimately awarded to the California plaintiff's counsel should be in addition to the amount already awarded to Delaware plaintiffs' counsel or whether it should be paid in whole or in part by defendants or the Delaware plaintiffs' counsel through a deduction in their fee award.

In re TD Banknorth S'holders Litig., 2007 WL 4788445 (Del. Ch.). Objection to proposed class action settlement of litigation concerning the freeze-out merger of TD Banknorth (Banknorth) by which its controlling stockholder, Toronto-Dominion Bank (TD), acquired Banknorth's remaining public shares for $32.33 in cash. The settlement consideration consisted of $0.03 per share in cash, supplemental proxy disclosures and a slight adjustment to the number of shares to be included in the majority-of-the-minority vote calculation. Objectors, who had originally filed suit in Maine to challenge the merger, primarily argued the settlement ignored valuable claims that were being released for no consideration.

In an opinion denying approval of the settlement, the court concluded the proposed settlement would release valuable claims that were not asserted by plaintiffs. TD and Banknorth were parties to a stockholders agreement that prevented TD from proposing or initiating any going-private transaction prior to March 1, 2007 unless invited to do so by a special committee of outside Banknorth directors. Objectors argued TD violated the stockholders agreement, which gave rise to claims of breach of contract and breach of the duty of loyalty that plaintiffs did not assert and did not extract settlement consideration. The court agreed, noting that discovery revealed these claims had "some substantial strength." The court also concluded the supplemental disclosure was inadequate consideration for the release, noting that the most substantive disclosures, for which plaintiffs claimed credit, appeared to have been made in response to SEC comment letters. The court further held the settlement notice was inadequate in several respects.

APPENDIX I

CASES ON APPEAL TO THE DELAWARE SUPREME COURT AS OF JANUARY 28, 2008

1. Bernstein v. TractManager, Inc., 2007 WL 4179088 (Del. Ch.); Del. Supr. No. 034, 2008.

2. In re Coca-Cola Enters., Inc. S'holders Litig., 2007 WL 3122370 (Del. Ch.); Del. Supr. No. 601, 2007.

3. Feldman v. Cutaia, 2007 WL 2215956 (Del. Ch.); Del. Supr. No. 466, 2007.

4. Lillis v. AT & T Corp., 896 A.2d 871 (Del. Ch. 2005); Del. Supr. Nos. 459 & 490, 2007.

5. MBKS Co. v. Reddy, 924 A.2d 965 (Del. Ch. 2007); Del. Supr. No. 300, 2007.

6. Territory of U.S. Virgin Islands v. Goldman, Sachs & Co., 937 A.2d 760 (Del. Ch. 2007); Del. Supr. No. 036, 2008.

APPENDIX II

2007 AMENDMENTS TO THE DELAWARE GENERAL CORPORATION LAW (DGCL)

HOUSE BILL NO. 160

Delaware enacted several amendments to the Delaware General Corporation Law (DGCL) in 2007, consistent with its practice of annually updating its corporation law. The 2007 amendments are technical, for the most part, though the amendments to the appraisal statute are more substantive in nature. Except for the amendments to the appraisal statute, Section 262, the amendments became effective as of August 1, 2007. The amendments to Section 262 became effective with respect to transactions consummated pursuant to agreements entered into after August 1, 2007 (or, in the case of mergers pursuant to Section 253, resolutions of the board of directors adopted after August 1, 2007), and appraisal proceedings arising out of such transactions.

DIRECTORS AND OFFICERS

Board of directors [8 Del. C. §141] – Section 141 is the seminal provision of the DGCL defining the powers of the board of directors. In 2006, the General Assembly amended Section 141(d) to authorize certificate provisions granting super voting powers to specific directors, irrespective of whether the director was elected by the holders of any class or series of stock. The 2007 amendment to Section 141(d) clarified that directors with super voting powers enjoy the same voting rights at the committee level as they do at the board level, unless the certificate or bylaws otherwise provide. The amendment closes a loophole in the statute that might have permitted the anomalous result of usurping at the committee level the voting power a "super voting" director would otherwise have at the full board level.

Business combinations with interested stockholders [Section 203] – Section 203 is Delaware's "business combination" statute, barring a corporation from engaging in a business combination with an "interested stockholder" for three years following the date that the stockholder became an interested stockholder unless certain conditions are satisfied. Section 203(b)(4)(ii) provides that Section 203's restrictions are inapplicable if the corporation does not have a class of voting stock authorized for quotation on the NASDAQ stock exchange. The amendment simply reflects the reality of changes in NASDAQ's structure and organization, having become a national securities exchange under the securities laws.

Quorum and required vote for stock corporations [Section 216(4)] – Section 216 prescribes quorum and voting requirements for Delaware stock corporations. The General Assembly's amendment to Section 216(4) clarifies that a plurality vote (and not a majority of the quorum) is the vote required in a director election where one or more classes or a series of stock vote separately for the election. The new provision may be viewed as a clarifying default rule which may be modified or nullified by a contrary provision in the certificate of incorporation or bylaws.

Merger, consolidation or conversion [Sections 251, 255, and 258] – Sections 251 and 255 are the seminal DGCL provisions governing requirements for mergers of domestic stock and nonstock corporations. The amendments to Sections 251 and 255 eliminate a possible trap for the unwary involving a ministerial requirement of the statutes. Specifically, the amendments eliminate the requirement that the merger agreement include a certification by the secretary or assistant secretary of the corporation that the agreement has been adopted by the required stockholder vote or otherwise as required by Section 251 (if a certificate of merger consolidation is filed with the Secretary of State in lieu of filing the agreement). The certification requirement continues with respect to merger agreements that are actually filed. Section 258(b) sets forth the procedures to be followed in mergers of domestic corporations with foreign corporations. The amendment clarifies that the agreement of merger or consolidation must also be certified by each of the constituent foreign corporations in accordance with the laws under which each was formed.

Appraisal rights [Section 262] – Section 262 sets forth the procedures and requirements for a stockholder to obtain appraisal of her shares in connection with certain mergers. The statute was amended in a number of important respects.

Section 262(b) provides a "market out" exception with respect to shares of the constituent that are "designated as a national market system security on an interdealer quotation system by the National Association of Securities Dealers, Inc." Because of the restructuring of NASDAQ, and its conversion to a "national security exchange" the separate reference to the interdealer quotation system in the statute was eliminated.

The amendment of Section 262(e) authorizes <u>beneficial</u> holders of shares held in street names to file petitions for appraisal with the Court of Chancery and to request a statement of shares as to which demands for appraisal have been received. Importantly, record owners, and not beneficial owners, continue to be required to make the actual demands for appraisal and dissent from the merger.

Section 262 now provides a presumptive interest rate on appraisal awards unless good cause is shown, thereby eliminating much needless litigation over the proper interest rate in particular appraisal cases. The presumptive interest rate provision should simplify appraisal proceedings and make them more efficient. The amendment to the statute adopts the Delaware legal rate of interest, in effect, by providing a presumption that interest is to be awarded for the period from the effective date of the merger until the payment of judgment, compounded quarterly and accruing at the rate of 5 percent over the Federal Reserve discount rate (including any surcharge).

Sections 262(k) and (e) were amended to clarify that a stockholder who has demanded appraisal may withdraw that demand within 60 days after the effective date of the merger. The right to withdraw applies even if a petition for appraisal has been filed with the Court of Chancery, as long as the withdrawing stockholder did not file the petition or join as a named party.

APPENDIX III

DELAWARE CONSTITUTIONAL AMENDMENT; SEC CERTIFICATION OF LEGAL QUESTIONS TO THE DELAWARE SUPREME COURT

SENATE BILL NO. 62

The Delaware Constitution, Article IV, paragraph (8) authorizes the Delaware Supreme Court to hear and determine questions of law certified to it by other Delaware courts or U.S. courts where the Supreme Court finds that there are "important and urgent reasons for an immediate determination" of such questions. In 2006, the 143rd General Assembly passed the first leg of an amendment to this provision adding the United States Securities and Exchange Commission to the list of bodies that may certify questions of law to the Delaware Supreme Court. With the second passage of the amendment by the 144th General Assembly, the amendment became effective.

Both the Delaware Supreme Court and the SEC welcomed the change. The amendment facilitates the SEC's ability to obtain rulings on Delaware corporate law issues, providing the SEC with an important tool in administering publicly traded corporations.