

Delaware Litigation 2017: Assessing Trends at Year-End

Article

12.20.2017

Law360

Litigation in Delaware in 2017 has somewhat turned on its head the long-held expectation that “every public deal draws a lawsuit” but “private company stockholders rarely sue.” Early indications that public company deal litigation would decrease in Delaware courts have proven to be accurate through 2017. Yet the Delaware Court of Chancery has been busier than ever - so much that Chief Justice Leo Strine has requested that the Delaware General Assembly approve two new seats on that court. It appears that public company strike suits have been replaced by other types of litigation in Delaware - including private company cases, governance and post-closing contract disputes, and appraisal claims. We expect these litigation trends to continue into 2018.

REDUCTION IN NUISANCE LITIGATION

In what was characterized as the “first wave of litigation following significant developments in merger law,” commentators found evidence that the volume of merger litigation had been substantially diminished starting in 2015.¹ The Cornerstone Review found that this decrease in merger litigation followed the Trulia decision in the Court of Chancery,² which has significantly reduced disclosure-only settlements. Important recent decisions such as KKR³ and MFW⁴ also provided pathways for deal makers to obtain business judgment deference with respect to mergers under certain conditions. The upshot: far less merger litigation in Delaware. The trend of merger litigation moving away from Delaware has accelerated in 2017, with only 9 percent of such litigation being filed in Delaware and 87 percent being filed in federal courts.⁵

THE COURT OF CHANCERY REMAINS BUSY

Despite the downturn in merger litigation, judges on the Court of Chancery remain busy with calendars already filling up months into 2018. Chief Justice Strine has made a budget request to fund the addition of two new judicial seats on the Court of Chancery.⁶ Such an increase has not occurred since the boom of merger litigation in the 1980s. Perhaps related to the workload of the court, we have also noticed what appears to be an increase in substantive decisions being issued in the form of orders (rather than full opinions) from the Court of Chancery.

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INCREASE IN PRIVATE COMPANY CASES

Various types of private company litigation have increased in recent years. Some of these cases have involved claims of breach of fiduciary duty seeking personal damages against directors. In one such case, the Court of Chancery reiterated principles from its much-noted Trados decision of a few years ago, including that the fiduciary duties of directors of a venture-backed company run primarily to the holders of common stock, not the holders of preferred stock (who may control the board).⁷ Thus, the court refused to dismiss claims that the board had breached its fiduciary duties by liquidating assets and hoarding cash to facilitate the preferred stockholders' right to redemption, when an alternative strategy could have been to preserve cash and ensure the health of the business as a going concern even if that did not pay the preferred in full.

Fiduciary claims have also been at the center of the much-watched litigation in Delaware concerning Uber in 2017. The litigation began with claims by a leading venture fund against the company's ousted CEO.⁸ More recently, a different stockholder plaintiff brought claims against the entire board related to the purchase of a self-driving car company that allegedly stole its intellectual property from Google.⁹ In yet another case of note for private companies in 2017, the Chancery Court had to deal with the intersection of fiduciary and contractual claims, where a stockholder plaintiff argued that a "drag-along" contractual provision that required parties to support a merger did not apply if the board breached its fiduciary duties in approving the merger. The court credited this argument and allowed the case to proceed to factual discovery.¹⁰

The Court of Chancery has also handled a spate of cases involving stockholder rights to information, including extensive financial information to investigate alleged "mismanagement" or value shares, and at least one case concerning transfer restrictions, which may become a more disputed area as private companies attempt to restrict secondary markets for their shares.

Another burgeoning area of complex litigation in Delaware courts involves post-closing contract disputes. This type of litigation generally pits parties from the buy side and sell side against one another in pursuit of post-closing indemnities, damage awards and other remedies. Provisions at issue have related to fraud, indemnification and standards for efforts that the parties must make toward obtaining approvals and closing the transaction.

Two notable decisions from the Court of Chancery regarding these provisions of a merger agreement were EMSI¹¹ and Sparton.¹² Key issues in these cases were the types of fraud included in a carveout and the individuals who may make representations and incur liability on behalf of the corporate party to the contract. Although the drafting at issue in these cases was quite different, each demonstrates the complexity of the issues and fact-intensive nature of the contractual construction.

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Private-company litigation has also focused on the standards applicable to parties' efforts to consummate the transaction. Through Delaware's common law, terms such as "commercially reasonable efforts" and "best efforts" have taken on accepted meanings. Two such decisions from the Court of Chancery in 2017 addressed contract disputes over provisions requiring "diligent efforts" and "reasonable cooperation."¹³ As with the indemnification disputes, litigation over efforts standards is highly fact-intensive and, when litigated vigorously (as is the case with numerous recent cases), leads to complex judicial opinions.

INCREASE IN APPRAISAL LITIGATION

Appraisal cases, in which a stockholder can demand a judicial valuation and payment of cash following a merger, continued to feature prominently in the Court of Chancery in 2017. Such cases increased notably following statutory changes in 2016, which allowed stockholders to receive interest while such claims were pending, and certain high-profile rulings that awarded well over the merger price - including a ruling in the Dell going-private case that awarded 28 percent more than the merger price, which translated to an aggregate deal value nearly \$7 billion greater than the transaction price.¹⁴ That trend hit an interesting speed bump in 2017. First, Delaware courts poured cold water on certain valuation theories, ruling that the deal price was a better indication of actual value than a post-deal judicial valuation.¹⁵ It even found actual value to be notably less than the deal price in one case.¹⁶ And in the Dell matter, the Delaware Supreme Court reversed the Court of Chancery's large award and remanded the case for reconsideration with greater emphasis on the deal price rather than the valuation methodologies that had convinced the Court of Chancery that the price was too low.¹⁷

CONCLUSION

Moving into 2018, we anticipate that litigation in the Delaware Court of Chancery will continue in steady volume and with greater focus on private company disputes and other "hard" cases. Whether the five current judges will receive relief from the proposed new members of the Court of Chancery, and what impact that may have on the format and content of decisions, is yet to be seen.

¹ Matthew D. Cain, Jill E. Fisch, Steven Davidoff Solomon and Randall S. Thomas, *The Shifting Tides of Merger Litigation* (University of Pennsylvania Law School, Institute for Law and Economics, March 2017) ("Shifting Tides"); see also Ravi Sinha, *Shareholder Litigation Involving Acquisitions of Public Companies: Review of 2015 and 1H 2016 M&A Litigation* (Cornerstone Research 2016) ("Cornerstone Review").

² 129 A.3d 884 (Del. Ch. 2016).

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³ 125 A.3d 304 (Del. 2015).

⁴ 88 A.3d 635 (Del. 2014).

⁵ Shifting Tides (updated November 2017) (noting also that the increase in cases filed in federal courts likely comprises “largely nuisance suits”).

⁶ Matt Bittle, Chief justice wants additions to Chancery Court, Delaware State News (Nov. 1, 2017) (available at <http://delawarestatenews.net/news/chief-justice-wants-additions-chancery-court/>).

⁷ The Frederick Hsu Living Trust v. ODN Holding Corp., C.A. No. 12108-VCL (Del. Ch. Apr. 14, 2017, corrected April 25, 2017).

⁸ Benchmark Capital Partners VII LP v. Kalanick, C.A. No. 2017-575-SG (Del. Ch.).

⁹ McElrath v. Kalanick, C.A. No. 2017-0888 (Del. Ch.)

¹⁰ In re Good Tech. Corp. S’holder Litig., C.A. No. 11580-VCL (Del. Ch.).

¹¹ C.A. No. 12648-VCS (Del. Ch. May 3, 2017).

¹² C.A. No. 12403-VCMR (Del. Ch. Aug. 9, 2017).

¹³ See BTG Int’l Inc. v. Wellstat Therapeutics Corp., 2017 WL 4151172 (Del. Ch. Sept. 19, 2017); TA Operating LLC v. Comdata Inc., 2017 WL 3981138 (Del. Ch. Sept. 11, 2017).

¹⁴ In re: Appraisal of Dell Inc., Consol. C.A. No. 9322-VCL (Del. Ch. May 31, 2016).

¹⁵ DFC Global Corp. v. Muirfield Value Partners LP, -- A.3d --, 2017 WL 3261190 (Del. Aug. 1, 2017).

¹⁶ ACP Master Ltd. v. Clearwire Corp., C.A. Nos. 8508, 9042-VCL (Del. Ch. July 21, 2017, corrected Aug 8, 2017).

¹⁷ No. 565, 2016 (Del. Dec. 14, 2017).

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Jeffrey R. Wolters and Nathan P. Emeritz, “Delaware Litigation 2017: Assessing Trends at Year-End,” *Law360* (December 20, 2017)

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