

Corporate and Chancery YEAR IN REVIEW

Top 10 Delaware corporate opinions of 2007

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THE YEAR 2007 WAS ANOTHER BANNER YEAR for Delaware corporate opinions, including the decisions in *Ryan v. Gifford*, *In re Tyson Foods, Inc., S'holder Litig.*, and *Desimone v. Barrows*, concerning the recent stock option scandals. Although it is a difficult task given the many important corporate cases in the Delaware Supreme Court and Court of Chancery in 2007, below we have summarized those we have determined to be the top 10

most influential corporate opinions coming out of these Delaware courts in the past year. For more information or for copies of any of the opinions listed below, contact Cathy L. Reese, a Principal in the Delaware office of Fish & Richardson P.C. and head of its Corporate and Chancery Litigation practice, or Brian M. Rostocki, an Associate in the Delaware office of Fish & Richardson P.C.



- Atlanta
- Austin
- Boston
- Dallas
- Delaware
- Munich
- New York
- San Diego
- Silicon Valley
- Twin Cities
- Washington, DC

Opinion Date and Topics	Case and Summary
1/23/2007 Derivative Action Breach of Fiduciary Duty Waste Shareholder Ratification	<p>Sample v. Morgan, 914 A.2d 647 (Del. Ch. 2007) (Strine, V.C.)</p> <p>The Delaware Court of Chancery denied as “frivolous” a motion to dismiss a lawsuit accusing the board of directors of a Delaware corporation of failing to disclose to shareholders that a proposed stock incentive plan would result in three of the directors receiving nearly a third of the company’s stock at a vastly reduced per share price. Although the corporation’s shareholders approved the transactions, the Court found that shareholder approval was sought through seriously misleading disclosures and that the transactions were approved at the board level through a conflicted process. The Court questioned the directors’ compliance with their fiduciary duties and, interestingly, allowed the shareholders to proceed with claims that included waste of corporate assets, a claim that rarely survives a motion to dismiss because of the stringent standards it must meet under Delaware law. The Court also rejected the argument that shareholder ratification cured the transactions, reasoning that even informed shareholder approval of such an incentive plan does not give management a “blank check.” The Court held that such corporate actions “must be twice tested: first, by the technical rules having to do with the existence and proper exercise of the power; and second, by equitable rules somewhat analogous to those which apply in favor of a cestui que trust to the trustee’s exercise of wide powers granted to him in the instrument making him a fiduciary.”</p>
2/6/2007 Stock Options Backdating Spring-loading Bullet-dodging Derivative Business Judgment	<p>Ryan v. Gifford, 918 A.2d 341 (Del. Ch. 2007) (Chandler, C.) and In re Tyson Foods, Inc. Consol. S'holder Litig., 919 A.2d 563 (Del. Ch. 2007) (Chandler, C.)</p> <p>In <i>Ryan</i>, the Delaware Court of Chancery declined to grant a motion to dismiss breach of fiduciary duty claims in a derivative action arising from allegations that the defendant directors approved and/or accepted backdated stock option grants. The plaintiff alleged that the director defendants represented to stockholders that the exercise price of options granted pursuant to the company’s stock option plan would be no less than 100 percent of the fair market value of the underlying shares. The plaintiff alleged that the director defendants “deliberately attempted to circumvent their duty to price the shares at no less than market value on the option grant dates by surreptitiously changing the dates on which the options were granted.” The Court held that these allegations rebutted the business judgment rule, and therefore the Court denied the director defendants’ motion to dismiss. The Court reasoned that the plaintiff’s allegation that the board knowingly and intentionally violated the terms of the stock option plan raised sufficient doubts concerning the board’s exercise of valid business judgment to excuse the pre-suit demand. The Court also reasoned that pre-suit demand was excused due to the substantial likelihood of liability faced by the directors.</p> <p>In <i>Tyson</i>, the Delaware Court of Chancery denied a motion to dismiss in a derivative action challenging allegedly “spring-loaded” option grants by the director defendants. The plaintiffs alleged that the stock option plan required the exercise price of stock options to be no lower than the fair market value of the company’s stock on the day of the grant. The plaintiffs further alleged that while the director defendants did award the stock options at fair market value, the director defendants did so while possessing material non-public data soon to be released that was not available to shareholders. Chancellor Chandler found that such allegations were sufficient to survive a motion to dismiss, stating: “A director who intentionally uses inside knowledge not available to shareholders in order to enrich employees while avoiding shareholder-imposed requirements cannot, in my opinion, be said to be acting loyally and in good faith as a fiduciary.”</p>
4/16/2007 Dilution Claims Direct v. Derivative Equity	<p>Gatz v. Ponsoldt, 925 A.2d 1265 (Del. 2007) (Jacobs, J.)</p> <p>The Delaware Supreme Court reversed the Delaware Court of Chancery’s decision that the shareholder plaintiffs’ claim of dilution was exclusively derivative, and held that the claim could be brought directly by the shareholder plaintiffs. The significance of this decision is two-fold. First, claims for dilution may be directly filed by a class of shareholders where a significant or controlling shareholder causes a corporation to engage in a transaction wherein shares having more value than what the corporation received in exchange are issued to the controller, thereby increasing the controller’s percentage of stock ownership and diluting the public shareholders’ interest. Second, the Supreme Court will use equity to look beyond the form to the substance of the underlying transactions. As the Court stressed: “transactional creativity should not affect how the law views the substance of what truly occurred, or how the public shareholders’ claim for redress should be characterized.”</p>

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5/2/2007 Appraisal Standing	<i>In re Appraisal of Transkaryotic, Inc.</i>, No. 1554-CC, 2007 WL 1378345 (Del. Ch. May 2, 2007) (Chandler, C.) The Delaware Court of Chancery addressed whether “a beneficial owner, who acquires shares after the record date for the merger votes, must prove that each of its specific shares for which it seeks appraisal was not voted in favor of the merger?” The Court answered that question as follows: “No . . . only a record holder . . . may claim and perfect appraisal rights. Thus, it necessarily follows that the record holder’s actions determine perfection of the right to seek appraisal . . . Only the record holder possesses and may perfect appraisal rights. The statute simply does not allow consideration of the beneficial owner in this context.” This decision is also noteworthy because of the Court’s comments with respect to a policy argument raised by the defendant that the Court’s “decision will ‘pervert the goals of the appraisal statute by allowing it to be used as an investment tool for arbitrageurs as opposed to a statutory safety net for objecting shareholders.’” The Court responded that to the extent that this concern has validity, it is for the General Assembly to address legislatively.
5/16/2007 Indemnification Contribution Fees-on-Fees	<i>Levy v. HLI Operating Co., Inc.</i>, 924 A.2d 210 (Del. Ch. 2007) (Lamb, V.C.) The Delaware Court of Chancery held that a corporation’s directors lacked standing to pursue their indemnification claims because those directors suffered no actual loss as a result of the settlement of a lawsuit where their directors’ portion of the settlement was paid by another entity that also provided the directors with indemnification rights. The Court reasoned that where directors enjoy the fullest-extent-of-the-law indemnification rights under two separate contracts – one with the corporation and one with the stockholder responsible for their election to the corporation’s board, the directors are only entitled to indemnification for monies paid out of their own pockets and are not entitled to indemnification for monies paid on their behalf by the stockholder. The Court explained that the appropriate cause of action is a claim for contribution against the corporation by the stockholder who had the joint indemnification obligation with the corporation. The Court also addressed the ability of a corporation to obligate itself to advance fees in a “fees-on-fees” case. In doing so, the Court invalidated a provision in the directors’ indemnification agreements that purported to require the corporation to indemnify the directors for fees and expenses incurred in bringing an indemnification action regardless of their success on the merits.
5/18/2007 Direct v. Derivative Creditor Insolvency Standing	<i>North Am. Catholic Educ. Programming Found, Inc. v. Gheewalla</i>, 930 A.2d 92 (Del. 2007) (Holland, J.) The Delaware Supreme Court limited the type of creditor claims that may be brought against directors of a corporation operating within the zone of insolvency or an insolvent corporation. In doing so, the Court clarified the fiduciary duties that directors owe when the corporation is insolvent or operating within the zone of insolvency. First, the Court held that direct claims for breach of fiduciary duty may not be asserted by creditors against a corporation’s director when the corporation is in the zone of insolvency. The Court reasoned that when a solvent corporation is navigating in the zone of insolvency, “directors must continue to discharge their fiduciary duties to the corporation and its shareholders by exercising their business judgment in the best interests of the corporation for the benefit of its shareholder owners.” The Court further reasoned that creditors of a corporation operating within the zone of insolvency are afforded other protections, including the creditor’s contractual agreements with the corporation, fraud and fraudulent conveyance law, implied covenants of good faith and fair dealing, bankruptcy law, and other sources of creditor rights. Second, the Court held that creditors may not assert direct claims for breach of fiduciary duty against a corporation’s directors when the corporation is insolvent. The Court reasoned that recognizing a new right of action for creditors to bring direct fiduciary claims against directors of an insolvent corporation would create a conflict between those directors’ duties to maximize the value of the insolvent corporation for the benefit of all having interests in the corporation and the newly recognized direct fiduciary duties to individual creditors’ claims on behalf of the corporation against directors insolvent corporation. Third, the Court held that creditors may nevertheless assert derivative fiduciary duty claims against directors of an insolvent corporation.
6/7/2007 Stock Options Backdating Spring-loading Bullet-dodging Derivative Business Judgment	<i>Desimone v. Barrows</i>, 924 A.2d 908 (Del. Ch. 2007) (Strine, V.C.) The Delaware Court of Chancery dismissed a stockholder derivative suit alleging stock option backdating, spring-loading, bullet-dodging and other option manipulations. The plaintiff alleged that the company’s directors had backdated some options and engaged in both “spring-loading” and “bullet-dodging” in connection with other options. The Court dismissed the action because the plaintiff lacked standing to challenge option grants made prior to the time at which he acquired his shares and because the plaintiff failed to satisfy his pleading burden with respect to demand futility. The Court explained that plaintiffs will be required to plead demand futility and stock option timing manipulation with a high degree of particularity. The Court also suggested that claims for breach of fiduciary duty based on spring-loading and bullet-dodging allegations were unlikely to succeed absent unusual facts.

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6/14/2007 Revlon Duties Deal Protection Devices Injunction Supplemental Disclosures	<i>In re Topps Co. S'holders Litig.</i>, 926 A.2d 58 (Del. Ch. 2007) (Strine, V.C.) This case challenged the proposed sale of The Topps Company to a private equity firm run by former Disney CEO Michael Eisner. This case is important for several reasons. First, the Court endorsed the board's decision not to conduct a public auction but rather to negotiate with the equity firm run by Eisner. Second, the Court also approved several deal protection terms contained in the agreement with Eisner, including matching rights, a 4.3% break-up fee, and a 40-day go-shop period. The Court, however, was critical of the Topps board's failure to pursue negotiations with Upper Deck Co., a rival of Topps, once it became clear that Upper Deck could offer a transaction that was significantly superior to the Eisner offer. As a result, the Court entered a preliminary injunction requiring corrective proxy disclosures and ordered the Topps board to free Upper Deck from a standstill agreement it had with Topps during the go-shop period following execution of the agreement with Eisner.
6/15/2007 Revlon Duties Deal Protection Devices Injunction Supplemental Disclosures	<i>In re Lear Corp. S'holder Litig.</i>, 926 A.2d 94 (Del. Ch. 2007) (Strine, V.C.) This case challenged the fairness of a going private merger. When Carl Icahn, an investor in Lear Corp., suggested to Lear's CEO that a going private transaction was in the corporation's best interest, the corporation's board of directors formed a Special Committee. The Committee authorized the CEO to negotiate merger terms with a company affiliated with Icahn. After agreeing on the terms of the sales process, the board's advisors shopped the corporation to potential buyers; however, no one made a bid topping Icahn's bid. Lear stockholders moved for a preliminary injunction to stop the deal, arguing that the corporation's directors breached their duties and failed to disclose material facts necessary for the stockholders to cast an informed vote. The Delaware Court of Chancery found that the Lear board had not breached their Revlon duties, even though the agreement with Icahn was made without a full pre-signing auction. The Court reasoned that the company conducted a pre-signing market check that revealed no serious bidders, that the merger agreement's termination fee (3.5% of equity value and 2.4% of enterprise value) was reasonable, and that the board obtained Icahn's agreement to vote his 24% stake in the company in favor of any superior proposal. The Court, however, was critical of the fact that the Special Committee allowed Lear's CEO to handle the negotiations with Icahn without any direct supervision, stating that the situation was "far from ideal." The Court was also concerned with the CEO's conflicts caused by his large equity holdings in the company, interest in remaining with the company post-buyout, and expectation of post-buyout options at a price dependent on the deal price. Ultimately, however, the plaintiffs' motion for a preliminary injunction was largely denied and the deal was allowed to proceed, with the exception that a preliminary injunction was issued preventing the merger vote until a supplemental disclosure was issued regarding the CEO's economic motivations in the deal.
11/20/2007 Special Committee Attorney-Client Privilege	<i>Ryan v. Gifford</i>, No. 2213, 2007 WL 4259557 (Del. Ch. Nov. 20, 2007) (Chandler, C.) The Delaware Court of Chancery held that the presentation of a Special Committee's report to the entire board of directors of a corporation, including counsel for the directors that had been sued in a derivative suit, waived the attorney-client privilege with respect to both the Special Committee's report and all the communications between the board, the Special Committee, and the Special Committee's lawyers. This decision puts corporate boards and their attorneys on notice of the risk that the attorney-client privilege may not protect corporate investigations from discovery in shareholder suits, especially if the Special Committee provides a report to a full board when named defendants and their counsel are present.