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Recent Judicial Developments in Delaware Corporate Law

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A number of recent decisions from the Delaware courts are discussed below. The decisions involve developments relating to mergers and acquisitions, venture capital and corporate governance. Specifically, the Delaware Court of Chancery recently held that (1) a survival clause in stock purchase agreement may shorten the otherwise applicable statute of limitations, (2) a board's grant of stock options in excess of plan limits could constitute a breach of fiduciary duty, and (3) Apollo did not breach a "reasonable best efforts" clause in a merger agreement by trying to renegotiate the deal price after signing. The Delaware Supreme Court also recently held that Delaware's statutory scheme for corporate dissolutions does not create an effective statute of limitations for claims that can be asserted against the dissolved corporation.

Survival Clause in Stock Purchase Agreement Shortens Statute of Limitations

In *ENI Holdings, LLC v. KBR Group Holdings, LLC*, C.A. No. 8075-VCG (Del. Ch. Nov. 27, 2013), the Delaware Court of Chancery upheld a contractual statute of limitations contained in a survival clause of a stock purchase agreement which effectively shortened the otherwise applicable three-year statute of limitations to fifteen months.

In December 2010, Plaintiff and Counterclaim Defendant, ENI Holdings, LLC ("ENI"), a holding company for a joint venture between two private equity firms, sold its stock in Roberts & Shaefer Co. ("R&S"), to Defendant and Counterclaimant, KBR Group Holdings, LLC ("KBR"), pursuant to a Stock Purchase Agreement ("SPA"). The parties agreed to a purchase price of $280 million, subject to working capital and indemnification adjustments. The parties also placed $25 million into an escrow fund (the "Indemnity Escrow Fund") to satisfy any indemnification claims brought pursuant to the SPA. Under the SPA, the Indemnity Escrow Fund constituted the parties' "sole and exclusive remedy" for all claims relating to KBR's acquisition of R&S, other than claims for fraud and claims

that could only be addressed by equitable relief. Article VI of the SPA further provided that specified representations and warranties (the "Non-Fundamental Representations") terminated on March 23, 2012 (the "Termination Date").

On December 3, 2012, ENI filed a verified complaint alleging that KBR breached several provisions of the SPA, as well as the implied covenant of good faith and fair dealing. KBR responded with counterclaims, alleging that ENI had engaged in fraudulent misconduct and breached the SPA by, *inter alia*, manipulating R&S's financial condition to inflate the purchase price. KBR sought to rescind the transaction and recover the purchase price, or alternatively, to recoup the $25 million in the Indemnity Escrow Fund, as well as damages for ENI's fraud and attorney fees. ENI moved to dismiss KBR's counterclaims on June 17, 2013. In this decision on ENI's motion to dismiss, the Court dismissed certain of KBR's counterclaims as untimely under the parties' contractual statute of limitations.

Under Court of Chancery Rule 12(b)(6), a counterclaim will only be dismissed if it clearly lacks merit as a matter of law or fact. KBR's counterclaims related to alleged breaches by ENI of its representations and warranties and fraud. ENI advanced a number of arguments for the dismissal of these claims. Notably, ENI argued that KBR did not file its claims relating to alleged false Non-Fundamental Representations prior to the Termination Date and were therefore untimely under the survival clause in the SPA, which provided, in pertinent part: "Except as set forth below, all of the representations and warranties of Seller contained in this Agreement shall survive the Closing until, and shall terminate on, the Termination Date…." Slip op. at 19. KBR countered that the survival clause could not effectively shorten the applicable statute of limitations, under Delaware law, from three years to fifteen months, unless it provided that not only the representations, but also their corresponding remedies, expired on the termination date. KBR also argued that the contractual time limitation did not, and could not, apply to fraud claims.

After reviewing Chancellor Strine's 2011 decision in *GRT, Inc. v. Marathon GFT Technology, Ltd.*, the Court held that the survival clause effectively shortened the applicable three-year statute of limitations for claims based on alleged breaches of Non-Fundamental Representations except to the extent the claims were based in fraud. Specifically, the Court rejected KBR's contention that the survival clause was ineffective because it failed to address remedies, because, although the simultaneous expiration of representations and their remedies bolstered the Court's finding in *GRT*, it did not provide the basis for the holding, which was that a period of survival of representations and warranties, followed by a date of termination, limited actions to the survival period. However, the Court found the SPA unclear on the issue whether the survival clause also

operated to time-bar intentional or fraudulent breaches of Non-Fundamental Representations. Although the survival clause did not contain an express exclusion for fraud claims, other provisions in the SPA indicated that the parties may not have intended to limit actions sounding in fraud to the survival period. For example, under the SPA, fraud claims were expressly excluded from a $2.5 million escrow deductible and a cap on damages. In addition, the SPA provided that indemnification is not the "sole and exclusive remedy" for "claims relating to the extent [sic] arising from fraud of a party." Thus, the Court granted EIN's motion to dismiss KBR's counterclaims relating to Non-Fundamental Representations as untimely except to the extent that they alleged fraud.

Chancery Court Declines to Dismiss Fiduciary Claims Arising from Board's Grant of Stock Options in Excess of Plan Limits.

In *Pfeiffer v. Leedle*, C.A. No. 7831-VCP (Del. Ch. Nov. 8, 2013), the Delaware Court of Chancery declined to dismiss a complaint which alleged that the members of a board of directors of a publicly traded Delaware corporation breached their fiduciary duties by approving stock option grants that exceeded the number of allowable grants under the company's equity incentive plans where the plaintiff was able to demonstrate a knowing and deliberate failure on the part of the board to comply with the plan because the plan's limitations were clear and unambiguous.

This action involved Healthways, Inc. ("Healthways"), a Delaware corporation and provider of healthy living programs for insurers and employers. In 2007, Healthways adopted a stock incentive plan (the "Plan") for directors, officers and employees which created various types of equity awards, including stock options, stock appreciation rights and performance awards. Section 4 of the Plan prohibited any participant from receiving stock options or stock appreciation rights to purchase more than 150,000 shares of Healthways' stock. In 2011, the board's compensation committee awarded Healthways' President a total of 449,436 stock options under the Plan. In 2012, the compensation committee awarded the President a total of 285,000 stock options. In its 2012 proxy statement, Healthways certified that all stock option grants to its President complied with the Plan's provisions.

In this action, plaintiff asserted that the Healthways' board breached its fiduciary duties by granting options that exceeded the board's authority under the Plan. Defendants moved to dismiss for failure to make a demand and to state a claim. Reviewing the parties' contentions, the Court held that the failure to make a demand on a disinterested and independent board could only be excused if the complaint set forth particularized facts indicating that the board knowingly or deliberately failed to adhere to the terms of a stock incentive plan. Under *Sanders v. Wang*, 1999 WL 1044880 (Del. Ch. Nov. 8, 1999), the

Court found that plaintiff met his burden by demonstrating that the stock option grants constituted a *clear* and *unambiguous* violation of the company's stock incentive plan. Although defendants argued that the excessive grants were really performance awards under the Plan and not subject to a 150,000 cap, the Court disagreed, finding that the challenged grants were indeed stock options regardless of whether they also complied with the requirements for a performance award. These same findings also allowed the Court to deny defendants' motion to dismiss for failure to state a claim because the Court found that a claim that directors knowingly violated a stock incentive plan stated a claim for breach of the fiduciary duty of loyalty.

The Court also dismissed a number of related fiduciary claims and a claim for unjust enrichment. Specifically, plaintiff also alleged that the Healthways' board breached its fiduciary duties by causing the company to issue a materially misleading proxy statement. Having already found that the alleged facts supported an inference that the Healthways' board knowingly or intentionally violated the Plan, the Court concluded that it was reasonably conceivable that the board knowingly or intentionally caused the company to issue a proxy statement containing misleading statements that the President's stock option grants complied with Plan requirements.

Similarly, the Court declined to dismiss breach of fiduciary claims asserted against Healthways' President. The Court found that the complaint supported a reasonable inference that the company's President knew or should have known that his receipt of more than 150,000 stock options in a year violated the Plan because he received a copy of the Plan, and was therefore charged with knowledge of the Plan's contents. Specifically, the President signed an acknowledgement that he received the Plan and "agree[d] to be bound by all the terms and provisions thereof." Slip op at 24 n. 59. Finally, because it was reasonably conceivable that the President was not, in fact, entitled to the stock options that he was granted, the Court declined to dismiss an unjust enrichment claim asserted against him.

Chancery Court Declines to Order Specific Performance of Apollo's Buyout of Cooper Tire & Rubber Co. or Find Breach of "Reasonable Best Efforts" to Close Covenant

In *Cooper Tire & Rubber Company v. Apollo (Mauritius) Holdings Pvt. Ltd.*, C.A. No. 8980-VCG (Del. Ch. Nov. 8, 2013) (TRANSCRIPT), the Delaware Court of Chancery rejected claims by plaintiff Cooper Tire & Rubber Company ("Cooper") that defendant Apollo (Mauritius) Holdings Pvt. Ltd ("Apollo") breached a "reasonable best efforts" clause in the parties' merger agreement by, *inter alia*, trying to renegotiate the deal price after labor unrest at various Cooper manufacturing facilities increased the likely cost of the

acquisition to Apollo. The Court declined to order specific performance of the merger agreement in a subsequent letter decision in the matter, *Cooper Tire & Rubber Company v. Apollo (Mauritius) Holdings Pvt. Ltd*, C.A.No.8980-VCG (Del. Ch. Nov. 9, 2013), but certified the decision for interlocutory appeal from the bench.

This case arose after labor issues in both the U.S. and China threatened to unravel Apollo's proposed $2.5 billion buyout of Cooper. Workers at Cooper's China venture, Cooper Chengshan (Shandong) Tire Co., seized the company's largest manufacturing facility in July 2013, to protest the deal and rendered it unlikely that Cooper would be able to deliver timely, third-quarter financial statements to Apollo as required by the parties' agreements. In addition, as a result of the merger announcement, Cooper's domestic union, United Steelworkers ("USW"), filed an arbitration matter, alleging that the merger agreement violated the union's collective bargaining agreements for Cooper's Tennessee plants. An arbitrator thereafter issued an order preventing Cooper from consummating the merger absent renegotiation of existing labor contracts between Cooper and the USW. As a result, Apollo and Cooper entered into an agreement with the USW, which prohibited closing on the merger until the union contracts were renegotiated in accordance with the arbitrator's decision.

Cooper filed this action on October 4, 2013, seeking a ruling that Apollo breached the parties' merger agreement by failing to use reasonable best efforts to reach the required agreement with the USW. Cooper also sought immediate specific performance of the merger agreement—far ahead of the December 31, 2013, "drop dead" date in the merger agreement—so that Cooper would not breach its own obligations to deliver third quarter financing statements to Apollo on November 14, 2013. Cooper has been unable to retrieve necessary financial data from its Chinese subsidiary which has been physically blocked by its majority joint venture party.

The Court determined that Section 6.12 of the merger agreement governed the parties' dispute: "[Apollo] and [Cooper] shall each use their reasonable best efforts from and after the date of this Agreement to satisfy and obtain prior to the Effective Time, such third-party consents, waivers and approvals as may be required in connection with the consummation of the merger." Cooper advanced a number of arguments to support its claim that Apollo failed to use "reasonable best efforts" to reach an agreement with USW and thereby breached Section 6.12 of the merger agreement. First, Cooper argued that Apollo breached Section 6.12 by making its negotiations with USW conditional on a reduction in the merger price. The parties had excluded any union issues relating to the USW contracts from the events that would constitute a material adverse effect and entitle Apollo to walk away from the deal. Thus, according to Cooper, any attempt by Apollo to condition talks with the USW on a price reduction in the merger agreement was a bad faith

attempt to get out of the parties' bargain in violation of the "reasonable best efforts" provision. Although the Court found that Apollo did try to use its obligation to negotiate with the USW, the events at Cooper's China facility, and the disappointing interim financials it received from Cooper, to reduce the merger consideration, the Court found that in doing so Apollo did not breach the "reasonable best efforts" provision. According to the Court, Apollo's negotiations over price were premised on a good faith but unavailing position that the developments with Cooper's unions might constitute a material adverse effect under the merger agreement.

The Court also rejected Cooper other primary argument—that Apollo had no intention of entering into a new contract with the USW and was using the lack of an agreement with USW to run out the clock. Although there was plenty of evidence that Apollo's bankers urged Apollo to adopt this approach, the Court did not find any evidence that Apollo was intentionally dragging its heels. Instead, the Court found credible the testimony of Apollo's vice chairman that Apollo still wanted the deal albeit for less money. The Court also found persuasive evidence that: (1) Apollo's representatives, including high-level executives, immediately travelled to Tennessee to meet with Cooper and the USW after learning of the arbitrator's order; (2) Apollo continued meetings over the next several weeks in an attempt to reach an agreement; and (3) Apollo hired experts to facilitate an agreement with USW. The Court also found testimony of one of Apollo's expert persuasive on the issue whether Apollo had, in fact, used its reasonable best efforts to reach an agreement with the USW. The Court also did not fault Apollo for choosing to exclude Cooper from its negotiations with USW given the apparent acrimony between the USW and Cooper.

For the reasons set forth above, the Court found that Apollo had not breached its obligation under the merger agreement to use "reasonable best efforts" to negotiate an agreement with USW. In a subsequent letter opinion, the Court addressed whether Cooper was entitled to specific performance of the merger agreement by the next business day. The Court found unclear whether Cooper had satisfied all conditions to closing, and declined to order specific performance where the parties still had plenty of time to perform before the "drop dead" date of December 31, 2013. Thus, the Court refused to effectively relieve Cooper of the obligation to disclose third quarter financials to Apollo and its lenders before November 14, 2013

Delaware Supreme Court Vacates Injunction against Activision Blizzard Stock Buyback

In *Activision Blizzard, Inc. v. Hayes*, C.A. No. 497, 2013 (J., Berger) (Del. Nov. 15, 2013), the Delaware Supreme Court explained an earlier bench ruling in which it

reversed an entry, by the Court of Chancery, of a preliminary injunction against consummation of a stock purchase agreement (the "SPA"), under which Vivendi, S.A. ("Vivendi") would divest its controlling interest in Activision Blizzard, Inc. ("Activision"), and Activision would reacquire Vivendi's stockholdings for $5.83 billion. The Delaware Court of Chancery enjoined the transaction after finding that plaintiff established a reasonably likelihood of success on the merits of his claims that Activision's certificate of incorporation required unaffiliated Activision stockholder approval of the SPA.

This decision arose from a proposed buyback by Activision of Vivendi's controlling interest in the company through Activision's acquisition of a newly-formed Vivendi subsidiary ("Amber"), which held 429 million shares of Activision stock and $675 million in net operating loss carry forwards (NOLs). Under the SPA, Vivendi also agreed to sell an additional 172 million Activision shares to ASAC II, LP, a limited partnership owned, in part, by Robert Kotick, Activision's President and CEO, and Brian Kelly, Co-Chairman of the Activision board. As a result of the SPA and related transactions, Vivendi's ownership interest in Activision would drop from 61% to approximately 11%, and Vivendi would lose control of Activision's board.

Plaintiff below, a stockholder of Activision, argued that the transactions contemplated by the SPA could not be consummated, under Section 9.1(b) of Activision's certificate of incorporation ("Section 9.1(b)"), without the approval of the unaffiliated Activision stockholders. Activision adopted Section 9.1(b) in 2007, in connection with its sale to Vivendi of over 350 million shares of Activision common stock in exchange for a video game subsidiary and $1.7 billion in cash. Section 9.1(b) protected Activision's unaffiliated stockholders from specified related-party transactions (between Activision and Vivendi) without a vote of the unaffiliated Activision stockholders:

> Unless Vivendi's Voting Interest (i) equals or exceeds 90% or (ii) is less than 35%, *with respect to any merger, business combination or similar transaction* involving the Corporation or any of its Subsidiaries, on the one hand, and Vivendi or its Controlled Affiliates, on the other hand, in addition to any approval required pursuant to the DGCL and/or the Corporation's by-laws, the approval of such transaction shall require the affirmative vote of a majority in interest of the stockholders of the Corporation, other than Vivendi and its Controlled Affiliates, that are present and entitled to vote at the meeting called for such purpose.

Slip op. at 9 (emphasis added). In *Hayes v. Activision Blizzard, Inc.*, C.A. No. 8885-VCL (Del. (Del. Ch. Sept. 18, 2013) (TRANSCRIPT), the Delaware Court of Chancery concluded that the transactions contemplated by the SPA constituted a "business combination" within the meaning of Section 9.1(b), based on the dictionary definition of a

"business combination" and the definition of a "business combination" contained in Section 203 of the General Corporation Law of the State of Delaware ("Section 203")—Delaware's business combination statute. The Court looked to Section 203, even though Section 203 had been rendered inapplicable to the SPA, because it believed that Section 9.1(b) was adopted to serve a similar purpose, which was to afford Activision's unaffiliated stockholders with a veto over significant transactions with a controller. Because more that 10% of Activision's assets (in the form of cash) were being transferred, the transactions contemplated by the SPA fit with the definition of a "business combination" contained in Section 203.

On October 10, 2013, the Delaware Supreme Court reversed the Court of Chancery's entry of an injunction without issuing a written opinion. *Activision Blizzard, Inc. v. Hayes*, C.A. No. 497, 2013 (Del. Oct. 10, 2013) (ORDER). Activision completed its stock buyback and acquisition of Vivendi's NOLs the following day. In this subsequent decision explaining the earlier bench ruling, the Delaware Supreme Court held that the proposed transactions were not a "business combination" because they did not involve any combination or intermingling of Vivendi's and Activision's businesses. Rather, in the Court's view, the two companies would be separating their business connection, leaving Vivendi as a minority stockholder without voting or board control over Activision. The Supreme Court acknowledged that, by virtue of Activision's acquisition of Amber, there would be a business combination of sorts, but the Court declined to exalt form over substance:

> Technically, Activision will combine with Amber…. Amber has never and will never conduct any business. It is a shell company created by Vivendi and its sole function is to serve as a vehicle for the transfer of valuable NOLs together with the Activision stock. Calling Amber a business for purposes of Section 9.1(b) disregards its inert status and glorifies form over substance.

Slip op. at 11. The Delaware Supreme Court also noted that Activision's bylaws required a majority of independent directors to approve any related-party transaction, regardless of its form or magnitude, which would presumably address the broader policy concern that the Chancery Court read into Section 9.1(b).

Based on the foregoing, the Delaware Supreme Court vacated the preliminary injunction entered by the Court of Chancery.

Delaware Supreme Court: Statutory Scheme for Corporate Dissolutions Does Not Create Statute of Limitations

In *In re Krafft-Murphy Company, Inc.,* C.A. No. 85, 2013 (Del. Nov. 26, 2013), the Delaware Supreme Court reversed a Chancery Court decision effectively denying

petitioners' request to appoint a receiver for Krafft-Murphy Company, Inc. ("Krafft-Murphy"), pursuant to Section 279 of the DGCL, and addressed several issues of first impression, including whether Delaware's statutory corporate dissolution scheme contains a generally applicable statute of limitations that effectively time-bars claims against a dissolved corporation by third parties.

Krafft-Murphy is a dissolved Delaware corporation that, before its dissolution in 1999, engaged in the plastering business. Beginning in 1989, Krafft-Murphy was named as a defendant in hundreds of asbestos-related personal injury lawsuits stemming from the corporation's use and installation of an asbestos laden, plastering product. These lawsuits continued to be filed more than 10 years after Krafft-Murphy's 1999 dissolution. At all relevant times, Krafft-Murphy's liability insurers funded and directed the asbestos-related lawsuits. In 2010, Krafft-Murphy (through its insurers) began seeking the dismissal of the personal injury lawsuits on the basis that the corporation could not be sued because it had been dissolved for longer than three years and was no longer a legal person under applicable Delaware law. Coverage for these claims had not yet been exhausted under Krafft-Murphy's insurance policies despite the sheer number of lawsuits.

In this action, Petitioners-Below/Appellants, who are tort claimants in the asbestos-related lawsuits pending against Krafft-Murphy in other jurisdictions, seek the appointment of a receiver to distribute Krafft-Murphy's property in the form of insurance coverage. The Delaware Court of Chancery denied Petitioner's request on the basis that Section 279 of the DGCL did not authorize the appointment of a receiver for claims brought more than ten years after the date of dissolution and, in the case of claims brought less than 10 years after dissolution, that the appointment of a receiver was unnecessary because Krafft-Murphy's insurers could continue to litigate the claims. Specifically, the Court of Chancery accepted Krafft-Murphy's argument that claims brought more than ten years after its dissolution were effectively time-barred because the corporation held no "property" to distribute as required by Section 279. According to the Court of Chancery, Sections 280-281 of the DGCL establish an outer limit of 10 years for Krafft-Murphy's potential liability to third parties for any claims, and the unexhausted liability policies could not constitute "property" under Section 279 for purposes of claims brought after ten years because the policies could not ultimately be tapped.

On appeal, the Delaware Supreme Court rejected the Chancery Court's finding that Sections 280-281 of the DGCL, which require a dissolved corporation to set aside assets for the payment of claims against the corporation that may arise or become known five to ten years after dissolution through either a court-supervised process or a dissolution plan, operate as an effective statute of limitations for claims brought after 10 years of dissolution. The Delaware Supreme Court found that these provisions were designed to

give directors two paths to discharge their fiduciary duties to existing and future claimants, while also enabling the corporation to make distributions to stockholders during its corporate winding-up. However, according to the Court, Sections 280-281 do not create a general statute of limitation for claims brought against the corporation itself after ten years. Since Krafft-Murphy's rights under the insurance policies were capable of vesting with respect to claims brought after ten years, the Delaware Supreme Court found that the policies constituted "property" for purposes of Section 279.

In the case of claims brought less than 10 years after dissolution, the Delaware Supreme Court held that the Court of Chancery erred by accepting the insurers' argument that Krafft-Murphy could continue to litigate those claims (through the insurers) without the appointment of a receiver. The Delaware Supreme Court held that, as a pure matter of statutory law, Krafft-Murphy presently lacks any authority to continue managing the winding-up of its business, which includes defending lawsuits brought against it. Under Section 278 of the DGCL, dissolved corporation ceases to exist as a "body corporate," after the three-year statutory wind-up period, and Krafft-Murphy's wind-up period expired in 2002. Thus, according to the Delaware Supreme Court, the Delaware Court of Chancery must appoint a receiver for Krafft-Murphy to obtain the authority to defend its interests in litigation.