Client Alert

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Delaware Court Addresses *Revlon* and Disclosure Claims in Third-Party Merger

In *In re BioClinica, Inc. Shareholder Litigation*, C.A. No. 8272-VCG (Del. Ch. Oct. 16, 2013), the Delaware Court of Chancery dismissed a post-closing challenge to the sale of a company to a third party. The court's decision conforms to prior Delaware case law giving deference to independent board majorities in structuring sales processes. The court also rejected various disclosure claims. The key aspects of the court's decision are below.

- Stock Options Do Not Create a Disqualifying Interest. The court rejected as "frivolous" the plaintiffs' argument that the directors were interested in the merger because they held stock options that would vest in the transaction. To the contrary, the court observed that equity awards are intended to align directors' and managers' interests with those of stockholders generally.

- Deference to Independent Board Majorities. The court held that even if two members of the nine-person board of directors were "interested" in the merger, that was insufficient to overcome the business judgment rule. Under long-standing Delaware precedent, the plaintiffs had to plead that a majority of the directors were (i) interested, meaning they received material benefits not shared by other stockholders, or (ii) dominated and controlled by one or more persons who were interested in the transaction. This rule continues to be a significant impediment to plaintiffs who challenge third-party mergers in today's corporate governance environment, where there often is only one insider on the board of directors.

- Post-Closing Claims Require Bad Faith. The *BioClinica* merger had closed and the company's directors were exculpated from liability for breaches of the duty of care.[1] As a result, and because the court found that a majority of the board was not "interested," the only way for plaintiffs to pursue monetary damages was to plead that the directors breached their duty of loyalty by acting in bad faith. Citing to the Delaware Supreme Court's decision in *Lyondell Chemical Co. v. Ryan*, 970 A.2d 235 (Del. 2009), the court held that the directors must have "knowingly and completely failed to undertake their responsibilities" to meet this requirement. The court found the complaint devoid of any non-conclusory allegations as to why the directors would act other than in the best interests of the corporation.

- Latitude in Structuring Sale Processes. The court refused to find bad faith where the board of directors initially instructed the company's financial advisor to contact only financial sponsors. The court noted that "approaching private equity bidders seems like an entirely reasonable way to protect BioClinica's confidential information [from competitors] during a first market test." It also observed that the company later contacted strategic competitors, one of whom expressed "serious" interest in a transaction but never submitted a final bid. The court's holding can be contrasted with *In re Netsmart Techn. S'holders Litig.*, 924 A.2d 171 (Del. 2007), where then-Vice Chancellor (now-Chancellor) Leo E. Strine, Jr., held that a board of directors' decision at a so-

[1] The company's certificate of incorporation eliminated liability for breaches of the duty of care pursuant to Section 102(b)(7) of the Delaware General Corporation Law.

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called microcap company to limit a pre-signing market check to financial sponsors was probably a breach of fiduciary duty.

- Failure to Plead Disclosure Violations.
  - *Reasons for Revised Capital Expenditures*. The court held that the company did not have to disclose why the board of directors increased the estimated capital expenditures budget when considering the transaction, which allegedly made it easier for the company's financial advisor to render a fairness opinion. The court observed that stockholders were provided with the revised budget and that the failure to disclose "why" the revisions were made would not alter the "total mix" of information available.
  - *Free Cash Flow Projections*. The court rejected the plaintiffs' argument that the company should have disclosed its free cash flow projections. The court found no allegations that the company, as opposed to its financial advisor, had prepared any free cash flow estimates. Several other Delaware courts have similarly suggested that a key issue in determining whether free cash flow projections must be disclosed is whether they were prepared by management or the company's outside financial advisor.[2] Other Delaware courts, however, have stated that free cash flow estimates must still be alleged to be material in light of other information that has been disclosed to stockholders.[3]
  - *Don't Ask/Don't Waive*. The court held that defendants were not required to disclose the absence of so-called "don't ask/don't waive" provisions in standstill agreements entered into with potential acquirors. Following several recent Delaware cases,[4] "don't ask/don't waive" provisions have become the issue *de jour* for some plaintiffs' counsel. The court made clear, however, that "no disclosure could, or should attempt to, describe all clauses *not* included in [nondisclosure agreements]."

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[2] *See, e.g., Scully v. Nighthawk Radiology Holdings, Inc.*, C.A. No. 5890-VCL, trans. ruling (Del. Ch. Oct. 21, 2012) ("What would have been a disclosure issue for me was had management prepared a set of free cash flow projections and provided them to [its banker]."); *In re SeraCare Life Sciences, Inc. S'holder Litig.*, C.A. No. 7250-VCG, trans. ruling (Del. Ch. Mar. 20, 2012).

[3] *See In re Midas, Inc. S'holders Litig.*, C.A. No. 7346-VCP, trans. ruling at 18 (Del. Ch. Apr. 12, 2012) ("The mere fact that some issues may have proven material in a past case cannot endow that issue with talismanic properties or reduce it to a magic word forever after."); *Cox v. Guzy*, C.A. No. 7529-CS, trans. ruling at 7 (Del. Ch. June 8, 2012) ("I happen to know that EBITDA is essentially a very close proxy to free cash flow and that the metrics are almost indistinguishably different, usually. I know that when I read this, I've got management, I know I've got EBIT because there is an EBIT line. And, you know, I actually have [] pretty much an EBITDA line if you go down to the non-GAAP net income.")

[4] *See, e.g., In re Ancestry.com Inc. S'holder Litig.*, C.A. No. 7988-CS, trans. ruling (Del. Ch. Dec. 17, 2012); *In re Complete Genomics, Inc. S'holder Litig.*, C.A. No. 7888-VCL, trans. ruling (Del. Ch. Nov. 27, 2012); *In re Celera Corp. S'holder Litig.*, C.A. No. 6304-VCP, mem. op. at 53-54 (Del. Ch. Mar. 23, 2012).

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