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RECENT DEVELOPMENTS IN DELAWARE CORPORATE GOVERNANCE

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Board Oversight Duties

A. Delaware Supreme Court Adopts *Caremark*

Ten years after the Delaware Chancery Court issued the seminal *In re Caremark Int'l, Inc. Deriv. Litig.*,¹ decision, the Delaware Supreme Court adopted *Caremark* in *Stone v. Ritter*.²

Stone arose from the appeal of a dismissal of a derivative complaint alleging a *Caremark* claim. Plaintiffs alleged that the directors of AmSouth Bancorporation were liable for failing to ensure the company had adequate internal controls. Plaintiffs claimed demand should be excused because a majority of the board “faced a substantial likelihood of liability for their failure to implement adequate internal controls”³ the board was not disinterested and independent. Although plaintiffs’ complaint conclusorily alleged that AmSouth’s board had “consciously and intentionally disregarded their [fiduciary duties]” after deficiencies with the company’s Bank Secrecy Act (“BSA”) anti-money-laundering (“AML”) compliance program were noted,⁵ on appeal, plaintiffs conceded that there were no “red flags” the directors consciously disregarded.⁶

Plaintiffs’ derivative claim arose from \$50 million in fines AmSouth paid to resolve criminal and civil governmental investigations related to the company’s failure to comply with anti-money-laundering regulations (“AML”) and the Bank Secrecy Act (“BSA”).⁷ Federal authorities investigated AmSouth’s compliance after a “Ponzi Scheme” operation was discovered using the bank’s services. At the conclusion of the investigation, an order and report was issued finding that AmSouth violated BSA/AML reporting and monitoring requirements, noting particularly the lack of “board and management oversight” and “that reporting to management for the purposes of monitoring and oversight of compliance activities was materially deficient.”⁸ The order also required AmSouth to improve its BSA/AML compliance programs.⁹

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In dismissing the complaint, the Chancery Court held that plaintiffs failed to plead particular facts necessary to establish the *Caremark* conditions for directors' oversight liability.¹⁰ Plaintiffs failed to point to any facts showing that the board received any warning signs or to any facts suggesting the board consciously took no action in the face of warning signs.¹¹ Accordingly, plaintiffs failed to connect the directors to any wrongdoing and demand was not excused.¹²

On appeal, the plaintiffs conceded that there were no warning signs and that the board "neither knew or should have known that violations of the law were occurring."¹³ Plaintiffs contended, instead, that AmSouth's directors failed to implement *any* internal controls or "statutorily required" monitoring systems that would have allowed them to discover any violations or warning signs of misconduct.¹⁴

The Delaware Supreme Court affirmed dismissal, and approved and adopted *Caremark* as the standard to determine a "director's potential personal liability for failing to act in good faith in discharging his or her oversight responsibilities."¹⁵ The Delaware Supreme Court ruled:

Caremark articulates the necessary conditions predicate for oversight liability: (a) "a sustained or systematic failure of the board to exercise oversight such as -the directors utterly failed to implement any reporting or information system or controls; or (b) having implemented such a system or controls, consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention. ***In either case, imposition of liability requires a showing that the directors knew that they were not discharging their fiduciary obligations.***"¹⁶

The Court further explained that "where a claim of directorial liability loss is predicated upon ignorance of liability creating activities within the corporation," the first *Caremark* prong must be established.¹⁷

In adopting *Caremark* as the standard for "oversight" claims, the Court also resolved a material conflict among the Chancellors regarding the duty of "good faith." The Court explained that a board's duty to oversee corporate compliance with the law is rooted in a director's duty to act in good faith.¹⁸ But, the Court ruled that the duty to act in good faith is not a stand-alone fiduciary duty independent of the duties of loyalty and care.¹⁹ Instead, "the failure to act in good faith may result in liability because the requirement to act in good faith is a subsidiary element of the fundamental duty of loyalty."²⁰ As a result, when a director fails to act in good faith "the fiduciary duty violated by that conduct is the duty of loyalty."²¹

The Court further held the Chancellor applied the *Caremark* standard properly. Dismissal was proper because demand was not excused – plaintiffs failed to plead any facts necessary to establish the *Caremark* conditions for assessing director oversight liability.²² Because plaintiffs conceded that AmSouth's board was ignorant of the illegal conduct, plaintiffs could not establish a *Caremark* claim unless it demonstrated that the board failed to implement any system of controls to monitor the corporation's compliance with the BSA and AML. There were reporting deficiencies in AmSouth's monitoring program but those deficiencies were the failure of employees to report misconduct, thereby denying the board the opportunity to be warned of the corporation's potential violations.²³ Therefore, the fines and corporation's noncompliance with BSA/AML were not a product of inadequate board oversight, but failures by employees to follow the compliance program and report potential violations to the board. Because the board implemented controls and did not receive any warning flags, the board had no known duty to act. "In the absence of red flags, good faith in the context of oversight must be measured by the director's actions to assure a reasonable information and reporting system exists."²⁴ The Court refused to hold the "directors personally liable for such failures by the employees."²⁵

B. Direct, Derivative or Both?

In *Gentile v. Rossette*,²⁶ the Delaware Supreme Court addressed the circumstances under which a the character of a shareholder claim should be considered to be both derivative and direct. In reversing the Chancellor's grant of partial summary judgment to defendants, the Court ruled that shareholders have standing to assert a direct claim for breach of fiduciary duty "where a *Tri-Star* type transaction reduces the voting power of the corporation's public shareholders" even if the transaction does not reduce the public shareholders' voting power from majority to minority status.²⁷

SinglePoint Financial, Inc. ("SinglePoint") was a high-technology financial services company that supported financial advisors and their clients with the ability to manage assets online. SinglePoint was founded in 1995 by plaintiff John A. Gentile and defendant Douglas W. Bachelor. The initial investment in SinglePoint came from defendant Pasquale David Rossette, a childhood friend of Gentile.

SinglePoint's short existence was marred by its inability to develop a commercially viable product or produce significant revenues.

Over the course of SinglePoint's five-year existence, Rossette advanced over \$3 million to SinglePoint in exchange for promissory notes, which were convertible into shares of SinglePoint common stock. The original conversion rate in the governing Stock Purchase Agreement was \$1.33 of debt per share. However, by October 23, 1999, Single Point had agreed to reduce the conversion rate for a second time to \$0.50 of debt per share.²⁸

Out of concern that the \$3 million of debt owed Rossette was deterring third-party investment in SinglePoint, Rossette decided to convert \$2.2 million of his SinglePoint debt into equity. In March of 2000, the sole directors of SinglePoint, Rossette and Bachelor, met to negotiate the terms of the conversion. Bachelor purportedly represented SinglePoint and Rossette purportedly represented himself individually. Though the contractual conversion rate at the time of the negotiation was \$0.50 of debt per share, Rossette and Bachelor agreed to a conversion rate of \$0.05 of debt per share. Rossette received over 44 million shares of SinglePoint common stock, which "was 40 million shares more than he would have received under the contractual conversion rate of \$0.50 per share."

Because this conversion required SinglePoint to issue more shares to Rossette than were authorized, a special shareholders meeting was called to amend SinglePoint's certificate of incorporation. However, SinglePoint never informed its shareholders that the reason it was seeking this authorization was to complete the conversion of Rossette's debt to equity. On March 27, 2000, the shareholders approved an increase of authorized shares of SinglePoint common stock from 10 million to 60 million shares, thereby enabling the conversion to occur. The conversion caused Rossette's equity ownership in SinglePoint to rise to 93.49% from 61.19%.

In May of 2000, Rossette negotiated a merger agreement with SinglePoint's only direct competitor, Cofiniti, Inc. ("Cofiniti"). Rossette, however, conditioned his approval of the merger as SinglePoint's majority shareholder on the receipt of certain benefits no other SinglePoint shareholder would receive. These side benefits included "a put agreement requiring Cofiniti, after one year, to repurchase 360,000 shares of Cofiniti stock that Rossette had received in the merger, at \$5 a share, for a total of \$1.8 million."²⁹ SinglePoint issued an Information Statement on October 13, 2000 that informed shareholders of the upcoming merger with Cofiniti. The Information Statement told shareholders the "approval of the merger is assured because several of our large stockholders, representing in the aggregate approximately 96.8% of our outstanding common stock, have agreed to vote their shares in favor of the merger."³⁰ The Information Statement, however, failed to disclose Rossette's put agreement with Cofiniti or that his approval of the merger was based on this put agreement. The merger was approved by a majority of SinglePoint's minority shareholders. On March 11, 2002, eighteen months after the merger, Cofiniti filed for bankruptcy.

Minority shareholders then filed a direct breach of fiduciary action against Rossette and Bachelor alleging that the defendants approved the debt conversion at “an unfairly and unreasonably low conversion rate,”³¹ which resulted in a dilution of the minority shareholders’ voting power and the economic value of their shares. Plaintiffs also alleged that Rossette conditioned his approval of the merger on receiving special benefits not available to other shareholders, which was also a breach of his fiduciary duty as CEO and majority shareholder.³² Defendants moved for summary judgment, arguing that because the claims were derivative in nature, plaintiffs did not have standing to pursue those claims as a result of the merger with Confiniti. The Chancery Court granted summary judgment on the plaintiffs’ dilution claim, but denied it on the claims against Rossette.³³

In granting summary judgment on the dilution claim, the Chancery Court ruled that the plaintiffs did not have standing to bring a direct claim because the debt conversion was derivative in nature. Relying on the Delaware Supreme Court’s decision in *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*,³⁴ the Chancery Court ruled that when a “board of directors authorizes the issuance of stock for no or grossly inadequate consideration, the corporation is directly injured and shareholders are injured derivatively ... [and] mere claims of dilution, without more, cannot convert a claim traditionally understood as derivative, into a direct one.” The Chancery Court further held that “where a transaction reduces the voting power of the corporation’s public shareholders,” ***the reduction must result in a change of status from majority to minority stockholder or be material*** “for the public shareholders to have standing to assert a direct claim against the fiduciaries responsible.”³⁶ On appeal, the Delaware Supreme Court explicitly rejected this “materiality” requirement.

The Delaware Supreme Court acknowledge that “[n]ormally, claims of corporate overpayment are treated as causing harm solely to the corporation and, thus, are regarded as derivative.”³⁷ The Court, however, explained that the Delaware courts have recognized “at least one transactional paradigm—a species of corporate overpayment claim—that Delaware case law recognizes as being both derivative and direct in character.”³⁸ The Court added that a breach of fiduciary duty claim that possesses this dual character exists where:

- (1) a stockholder having majority or effective control causes the corporation to issue ‘excessive’ shares of its stock in exchange for assets of the controlling stockholder that have a lesser value; and (2) the exchange causes an increase in the percentage of the outstanding shares owned by the controlling stockholder, and a corresponding decrease in the share percentage owned by the public (minority) shareholders.³⁹

The Court further ruled that the Chancellor’s requirement that the reduction be from a “majority to minority status” was not supported by Delaware case law.⁴⁰ The Court also rejected the Chancellor’s conclusion that there must be “material” reduction in voting power to establish a direct claim. The Court held that materiality “should play no part in any analysis of whether a claim is direct, derivative, or both. Such a requirement distracts from-and obscures-the nature of the harm inflicted upon the minority in a *Tri-Star* transaction, and denigrates the seriousness of the breach of fiduciary duty causing that harm.”⁴¹

In rejecting the Chancery Court’s interpretation of *Tooley*, the Delaware Supreme Court explained “the result reached here fits comfortably within the analytical framework mandated by *Tooley*.”⁴² The Court concluded that the harm from this type of transaction “is not confined to an equal dilution of the economic value and voting power of each of the corporation’s outstanding shares. A separate harm also results: an extraction from the public shareholders, and a redistribution to the controlling shareholder, of a portion of the economic value and voting power embodied in the minority interest.”⁴³ Indeed, the Court ruled that “the public shareholders are harmed, uniquely and individually, to the same extent that the controlling shareholder is (correspondingly) benefited.”⁴⁴

C. Directors Owe No Direct Duties To Creditors in Vicinity of Insolvency

In *North American Catholic Educational Programming Foundation, Inc.*,⁴⁵ a creditor of Clearwire Holdings, Inc. (“Clearwire”) appealed the dismissal of its direct fiduciary claim against Clearwire directors and the company’s financier, Goldman Sachs, alleging Goldman controlled the company through “financial and other influence.”⁴⁶ In a case of first impression, the Chancery Court and Delaware Supreme Court ruled that directors of a corporation operating in the vicinity of insolvency do not owe creditors direct fiduciary duties. The Supreme Court further ruled that while creditors of an *insolvent* corporation have standing to bring a *derivative* claim against an insolvent corporation’s directors, no *direct* cause of action exists.

NACEPF is a license holder of a significant portion of radio wave spectrum licenses which are used for educational programs. In 2001, NACEPF and Clearwire entered into a master agreement where Clearwire acquired plaintiff’s licenses “as then-existing leases expired and the then-current lessees failed to exercise rights of first refusal.”⁴⁷ However, in June 2002, with the commencement of the WorldCom litigation, the wireless spectrum market collapsed. As a result, Clearwire attempted to end its obligations with NACEPF and other members of its parent alliance. Clearwire settled with other license holders to end its obligations, but it did not settle with NACEPF. In 2003, Clearwire effectively went out of business as it was unable to acquire any financing after it settled its other obligations. Plaintiff filed suit alleging breach of fiduciary duties owed to plaintiff “as a putative creditor” while Clearwire “was either solvent or operating in the zone of solvency.”⁴⁸

Specifically, plaintiff argued that “when a corporation is in the zone of insolvency, this Court should recognize a new direct right for creditors to challenge director’s exercise of business judgments as breaches of the fiduciary duties owed to them.”⁴⁹ The Chancery Court rejected the plaintiff’s argument to expand the director’s existing fiduciary duties. Because creditors have existing protections provided by “their negotiated agreements, their security instruments, the implied covenant of good faith and fair dealing, fraudulent conveyance law, and bankruptcy law,” the Chancery Court reasoned that recognizing direct claims for breach of fiduciary duties would provide creditors minimal, if any, benefit.⁵⁰ More importantly, the Chancery Court asserted that recognizing such a direct claim would have the opposite effect of protecting creditors or encouraging sound business judgment. The Chancery Court reasoned that “an otherwise solvent corporation operating in the zone of insolvency is one in most need of effective and proactive leadership-as well as the ability to negotiate in good faith with its creditors-goals which would likely be significantly undermined by the prospect of individual liability arising from the pursuit of direct claims by creditors.”⁵¹

On appeal, the Delaware Supreme Court affirmed and specifically held that “no direct claims for breach of fiduciary duties may be asserted by the creditors of a solvent corporation that is operating in the zone of insolvency.”⁵² The Delaware Supreme Court also emphasized that directors have a legal responsibility to manage the corporation for the benefit of its shareholder owners and “fiduciary duties are imposed upon the directors to regulate [directors’] conduct when they perform *that* function.”⁵³ The Delaware Supreme Court went a step beyond the Chancery Court and acknowledged its reluctance to extend directors’ fiduciary duties was based, in part, on the need provide directors with clear guidance regarding their duties. The Court articulated its goal “to provide directors with clear signal beacons and brightly lined channel markers” to execute their fiduciary duties on behalf of a corporation and its shareholders.⁵⁴ It is also this goal that aided in the Court denying creditors the right to bring a direct action against directors. The Court additionally pointed out that even when a corporation is operating in the zone of insolvency, the directors “must continue to discharge their fiduciary duties to the corporation and its shareholders by exercising business judgment in the best interests of the corporation for the benefit of its shareholder owners.”⁵⁵

After determining whether creditors are able to bring direct claims when solvent companies are operating in the zone of insolvency, the Court determined whether the creditors of *insolvent* corporations may assert direct claims of breach of fiduciary duty against directors. The Court reiterated the settled rule that when a corporation is insolvent “the creditors take the place of shareholders as the residual beneficiaries of any increase in value.”⁵⁶ Consequently, the Court recognized that the rule grants creditors “standing to pursue derivative claims against the directors of an insolvent corporation.”⁵⁷ However, the Court emphasized that such derivative claims belong to the corporation and not the creditors. Therefore, even though the corporation is insolvent, derivative claims do not turn into direct creditor claims.⁵⁸

In holding that “individual creditors of an insolvent corporation have no right to assert direct claims for breach of fiduciary duty against corporate directors,”⁵⁹ the Delaware Supreme Court explained that acknowledging such a claim would create uncertainty and conflict when directors are “exercising business judgment in the best interest of the corporation” as directors need their freedom to act in the best interests of the corporation.⁶⁰ Because creditors are not permitted to bring direct claims for breach of fiduciary duty against directors of a corporation operating in the zone of insolvency or of an insolvent company, the Delaware Supreme Court affirmed dismissal of plaintiff’s complaint.

New Case Law Trends – Going Private Transactions With Private Equity

In the last two years, the market has seen private equity funds voraciously gobbling up public companies. To date, there seems to be no slowing of this trend. Several recent Delaware Chancery Court decisions may give Boards and their advisors pause and increase their vigilance over management’s involvement in merger negotiations. While the private equity fund’s appetite may not decline, closings on these transactions are slowing as the Chancery Court requires greater disclosure and expresses concern that management is conflicted in their consideration of such deals.

Unlike the leveraged buy-out boom of the 1980s, wherein purchasers paid significant premiums to shareholders with the promise of ousting management and directors, today’s private equity purchasers intend to retain management and often dangle continued employment and significant perks. Shareholders who are about to be cashed out are, not surprisingly, crying foul. And the Delaware Chancery Court is responding swiftly. In the *Netsmart*, *Lear*, and now *Topps* decision the Court has not hesitated to criticize management and the boards that allow executives who are self-interested in their continued employment and benefits attendant thereto while negotiating mergers. Each one of the following three mergers has been preliminarily enjoined – sometimes for the board’s violation of its *Revlon* duties, but more often to require pre-vote additional disclosures regarding the conflicting interests of officers who conducted negotiations.

D. The Topps Drama

Clearly, the rise of private equity firms buying up public companies has triggered active response from state courts. It has also presented a significant problem for the defense of these cases in more than one forum. On May 9, 2007, in the *In re The Topps Co. Shareholders Litig.*,⁶¹ Vice Chancellor Strine issued a ruling denying the Topps Company’s motion to stay Delaware litigation in favor of parallel actions filed first in New York State Court. Instead, Vice Chancellor Strine invited the New York court to revisit the stay of its own proceeding.⁶² Needless to say, the New York state court, Judge Cahn, declined that invitation, concluding in its June 8th opinion that Vice Chancellor Strine’s decision was based on “outdated and incorrect legal principles” which interfered with the rules of comity. Judge Cahn scheduled plaintiff’s preliminary injunction motion for hearing on June 18th, but on June 12th, Topps sought relief from Judge Cahn’s ruling and New York’s appellate division granted a stay. Two days later, on June 14th, Vice Chancellor Strine ruled on the merits of plaintiffs’ motion to enjoin the transaction and issued a limited injunction. On June 14th, the New York Times made this skirmish between these states’ courts public, and on July 12, the Wall Street Journal also reported on the dispute.

Traditionally, it is the court holding the first filed case that retains jurisdiction when plaintiffs have filed the same suit against the same defendants in multiple jurisdictions. And, if the first filed *Topps* case had been filed in Delaware, there would likely be no dispute to report. However, the first filed *Topps* case was filed by an Ohio resident in New York – one day before the second case was filed in Delaware. Nevertheless, the Delaware Chancery Court refused to stay its proceeding and expressed disdain for the first filed rule which ignores today’s reality – there is an Olympiad-like race to the courthouse whenever a merger is announced.⁶³

On the merits, the *Topps* litigation is a shareholder class action seeking to enjoin Topps’ merger with a private equity fund. The company initially moved to stay the New York action, but the New York court refused to even allow defendants to present that motion on the ground that the New York action was first filed. By that time, however, the Delaware actions had been consolidated, expedited discovery had begun, and a motion for preliminary injunction was scheduled soon thereafter.⁶⁴ Because defendants faced the prospect of litigating in two courts and the attendant expense and risks of inconsistent ruling, they moved the Delaware court to stay ruling on the injunction motion.⁶⁵

While sympathetic to the defendants’ plight, Vice Chancellor Strine refused to stay the proceeding, explaining that when all actions are “essentially filed simultaneously,” the complaints raise new issues of unsettled Delaware law, and the state of incorporation is an efficient and convenient forum, a first-filing plaintiff’s choice of forum “has no rational force in determining where a motion to enjoin that transaction should be heard.”⁶⁶ The Court focused on the representative nature and impact of these merger cases on all shareholders of a corporation and ruled that the individual shareholder plaintiff “has no legitimacy to ‘call forum’ for all the other stockholders of a corporation.”⁶⁷ The Court emphasized that “[w]hat is most important is” that the stockholders “have their legitimate expectations upheld.”⁶⁸

The Court also stressed the respect that both the United States Supreme Court and New York Supreme Court grant the “compelling state interest in ensuring the consistent interpretation and enforcement of its corporation law.”⁶⁹ Indeed, Vice Chancellor Strine stated, “[t]he important coherence-generating benefits created by our judiciary’s handling of corporate disputes are endangered if our state’s compelling public policy interest in deciding these disputes is not recognized and decisions are instead routinely made by a variety of state and federal judges who only deal episodically with our law. This concern is heightened where, as in *Topps*, the case “involves important questions of [Delaware] law in an emerging area.”⁷⁰ Although Vice Chancellor Strine viewed this compelling state interest to be determinative, he also did not hesitate to speak to the practical realities of these suits:

Representative plaintiffs seeking to wield the cudgel for all stockholders of a Delaware corporation *have no legitimate interest* in obtaining a ruling from a non-Delaware court. For investors in Delaware corporations, it is important that the responsibilities of directors be articulated in a consistent and predictable way. *Random results may be good for plaintiffs’ lawyers* who can use the disparate forums to negotiate settlements of cases that might otherwise be dismissed as unmeritorious. But random litigation results are not good for investors.... [S]tockholders want to have unmeritorious cases dismissed without rewarding plaintiffs’ lawyers for the simple fact that they filed a lawsuit.⁷¹

Topps’ desire for a Delaware court to hear the case against it might be one it now regrets for Vice Chancellor Strine ruled that its proxy statement was materially misleading, granted plaintiffs a limited preliminary injunction, and released an interested strategic buyer from a standstill agreement which Topps was using to prevent it from making a tender offer for the company at a much higher dollar amount per share than the private equity deal Topps preferred.⁷²

Topps' business was in decline and in 2005 it had been threatened with a proxy contest. To avoid that contest and protect the positions of its CEO and Chairman, Arthur Shorin (the son of Topps' founder), a deal was struck in which the board was expanded, and Shorin and three insurgent directors were elected.⁷³ However, before that deal was struck former Disney CEO Michael Eisner called and intimated he was interested in a going private transaction with Topps.⁷⁴ After the insurgent directors joined the Topps board, an ad hoc committee was formed comprised with two insurgents (the "dissident directors") and two incumbent directors to evaluate Topps' strategic direction.⁷⁵ The dissident and insurgent directors disagreed on whether company should be sold with the dissident directors insisting on a public auction and the incumbent directors opposed to such a process.⁷⁶ Meanwhile, Eisner was lurking and expressing interest in making a bid for the company. Eventually, one of the incumbent directors informed Eisner that the incumbent directors (a majority of the board) might accept a \$10 per share bid for the company. Eisner subsequently presented a \$9.24 per share and retention of existing management. Eisner refused a pre-signing auction but was willing to accept a go-shop provision.⁷⁷ The ad hoc committee was evenly divided over Eisner's bid and the dissident directors refused to participate in negotiations with Eisner.⁷⁸ Eisner raised his offer to \$9.75, agreed to a forty-day go shop period, the company's right to accept a superior proposal, subject to a termination fee and match right in favor of Eisner.⁷⁹

After the merger was announced, Topp's chief competitor expressed an interest in buying the company and to gain access to Topp's confidential competitive information during due diligence, the competitor agreed to a standstill that Topps demanded. The standstill agreement limited the competitor's use of Topps' confidential information and prohibited the competitor from commenting publicly on the negotiations and from making a tender offer for the company's stock. Two days before the end of the go shop period, the competitor presented a conditional \$10.75 per share bid. A merger by Topp's competitor, however, would have ousted Topp's existing management,⁸⁰ and the board refused to deem the competitor's bid a superior proposal. Not dissuaded, the competitor improved its offer after the go-shop period ended by withdrawing its financing and other conditions.⁸¹ Still the board refused to deem the offer as a superior proposal.⁸² Topps thereafter disclosed its competitor's bid, but Topps misrepresented the proposal and disparaged the competitor's seriousness. Topps also refused the competitor's request for relief from the standstill agreement so it could tell its version of the events and make a tender offer.⁸³

The Court granted a preliminary injunction against the merger vote until such time as Topps (i) disclosed additional material facts in the proxy statement, in particular that Eisner assured management it would be retained, and (ii) released the competitor from the standstill so it could publicly comment on its negotiations with Topps and make a tender offer but only on conditions as, or more, favorable than those it offered to Topps' board.⁸⁴

The Court found that, in violation of the directors' duties to maximize shareholder value, the directors improperly favored Eisner.⁸⁵ The Court explained, that "when directors have made the decision to sell the company, any favoritism that they display toward bidders must be justified solely by reference to the objective of maximizing the price the stockholders receive for their shares."⁸⁶ When, as in this case, the directors favor a bidder "more likely to continue current management, they commit a breach of their fiduciary duty."⁸⁷

The Court also found that the proxy statement was false and misleading in its description of the reasons why the board refused to consider the competitor's bid to be a superior proposal. Indeed, the Court found the board's reasons to be pretextual.⁸⁸ Moreover, the Court also found that the proxy statement created "a misleading impression that Topps managers [were] given no assurances about their future with Eisner," despite the fact that Eisner had repeatedly assured them of his intent to retain them.⁸⁹ The proxy statement was also misleading in its disclosure of the financial analyses that the

company's investment banker (Lehman Brothers) used in connection with its advice to the board and its fairness opinion.⁹⁰ Aggressive and conservative presentations were used, with the Court's approval. The Court, however, was highly critical of certain assumptions Lehman Brothers changed, e.g., the discount rate and terminal multiples, that lowered Topp's projected value because no rational justification for these changes.⁹¹ Indeed, the Court concluded:

Given the major subjective changes that Lehman made that were not explained, given that those changes made the Eisner bid look more attractive, and given that those changes were made only after [the director's] attempts to negotiate a price higher than \$9.75 had finally failed, the Proxy Statement is materially misleading for failing to discuss the advice given to the Board about valuation.⁹²

Finally, the Court also found that the proxy statement's characterization and disparagement of its competitor's bid was also materially misleading.⁹³

E. *In Re Netsmart Technologies, Inc. Shareholder Litigation*

In *Netsmart*,⁹⁴ shareholders sought a preliminary injunction to prevent the shareholder vote on a merger agreement on the alleged grounds that during the course of the sales process the board of directors violated its *Revlon* duties. Specifically, the plaintiffs alleged that the proxy materials soliciting stockholder approval of the transaction contained misleading and incomplete disclosures because it failed to disclose the information relied on by Netsmart's financial advisors in formulating its fairness opinion. The plaintiffs also alleged that Netsmart's board failed to canvass the market for possible strategic buyers for the company, focusing instead on private equity opportunities only and that the board made this decision to enable Netsmart's management team to continue serving as corporate officers and retain an equity stake in the company. Vice Chancellor Strine preliminarily enjoined the merger and required Netsmart to disclose in its proxy statement: (i) the revenue and earnings projections upon which its financial advisor based its fairness opinion and (ii) a more comprehensive description of Netsmart's efforts to find a strategic buyer or a copy of the Court's decision.

Netsmart was a micro-cap sized company covered by only one research analyst.⁹⁵ Netsmart's relatively thin float also prevented institutional investors from taking large positions in the company. Due to Netsmart's small size and narrow market niche, its CEO, James Conway, began searching for larger companies to acquire Netsmart beginning in the late 1990s. But Conway's inquiries were isolated and sporadic and Conway claimed that although he made clear that Netsmart was available to be acquired, none of these potential strategic acquirers expressed interest.⁹⁶

In November 2003, Netsmart engaged William Blair & Co LLC. Although the purpose of this engagement was for Blair to assist Netsmart in acquiring its largest competitor, CMHC, Netsmart also agreed to pay Blair a fee of 1.7% of the value of any sale of Netsmart if it was sold.⁹⁷ Between 2003 and 2005, Blair dropped Netsmart's name when it trolled for business, but in these calls Blair did not state that it represented Netsmart or that it was authorized to discuss a transaction.⁹⁸ Not surprisingly, no strategic acquirer materialized and Netsmart turned its attention to acquisitions, culminating in the October 2005 announcement that Netsmart was acquiring CMHC, Netsmart's largest direct competitor.⁹⁹ This announcement piqued the interest of several private equity firms.

In May of 2006, the Netsmart board met to consider its various strategic options. At this meeting, Blair presented and focused on the benefits of a going-private sale to a private equity buyer and characterized a sale to a strategic buyer as an option that had been tried before and failed. The independent directors met later in the day and the minutes of their meeting demonstrated their focus was largely on a sale to a private equity firm. Thereafter, Blair prepared a final report which was presented

on May 19 to an “informal,” *i.e.* unminuted, meeting of the board. At this meeting, the board decided to sell the company, but it also made the tactical decision to skip an active canvass of strategic buyers.¹⁰⁰ Instead, the Board decided and instructed Blair to seek out a going-private transaction with a private equity acquirer.

After the May 19 meeting, management and Blair pursued a private equity deal. In response to a July 2006, preliminary, conditional proposal, the Board formed a Special Committee of independent directors.¹⁰¹ Rather than retain independent counsel or independent financial advisors the Special Committee retained Blair. At another unminuted meeting, the committee also decided on a targeted approach to selling the company which consisted of contacting six additional private equity firms Blair identified.¹⁰² Four of the seven private equity firms expressed interest and conducted limited due diligence. That due diligence was controlled by Netsmart’s management, not the Special Committee or Blair, despite the fact that management was “keenly interested” in a continuing role with the company and future incentives the buyers could offer them.¹⁰³

After receiving preliminary bids from these four private equity firms in August, the Special Committee again rejected any broader market canvass and, instead, offered the two highest bidders an opportunity for further due diligence in the hopes of procuring more attractive final bids by the end of August. At the end of August, the Special Committee authorized Blair to pursue negotiations with one of the bidders (which had expressed interest at \$16.75 per share) on terms that included a price of \$17 per share. Management, without the Special Committee’s involvement, administered this process which led to an offer no higher than its original expression of interest and which the Special Committee ultimately rejected.¹⁰⁴ The Special Committee then turned its attention back to Insight, another private equity firm that had expressed interest in the \$15.40-\$15.60 level much earlier in the process.¹⁰⁵

On October 4, Insight submitted a written expression of interest at \$16.40 per share. By this time, Netsmart’s management was retaining its own counsel to negotiate conditions on which a private equity buyer might retain them. Netsmart ultimately reached an agreement to sell to Insight at \$16.50 per share.¹⁰⁶ However, the Special Committee acceded to Insight’s rejection of a “go shop” clause after the merger announcement and accepted, instead, a “window shop” provision.¹⁰⁷ While these negotiations were ensuing, management was separately negotiating their future employment and benefits with Insight although those negotiations did not lead to management’s receipt of any financial windfalls.¹⁰⁸

From the outset, Blair produced a series of financial reports including earnings projections and discounted cash flow analyses to assist the Board and then the Special Committee in evaluating the company’s prospects. It produced updated reports again on November 16 to assist the Special Committee’s evaluation of the fairness of Insight’s offer and orally provided the Special Committee with its fairness opinion. On November 17, the Special Committee decided to recommend the merger and the Board approved it. On November 18, Blair presented its final fairness opinion and the merger was executed. On November 20, the merger was announced and later in that week the lawsuits were filed.

On December 21, 2006, the Special Committee met and approved formal minutes for ten meetings that took place between August 10, 2006 and November 28, 2006. The same day, Netsmart filed a preliminary proxy statement with the SEC and the definitive Proxy Statement was filed on February 28, 2007. The special stockholder meeting to consider and vote on the merger was scheduled for April 5, 2007.

Plaintiffs alleged that the Proxy Statement omitted material information regarding Netsmart’s financial prospects. They also alleged that directors breached their duty of care by conducting a flawed sales process that excluded potential strategic buyers.

The Court of Chancery found that the Proxy Statement was deficient and granted a limited injunction pending the disclosure of additional information. The Court held that Netsmart's failure to include the final projections of Netsmart's future cash flows as a stand-alone company that were utilized by Blair in issuing its fairness opinion amounted to a material omission. The Court explained that directors must "disclose fully and fairly all material information within the board's control when they seek shareholder action."¹⁰⁹ In instances where stockholders "must vote on a transaction in which they would receive cash for their shares," the Court found "information regarding the financial attractiveness of the deal is of particular importance."¹¹⁰

The Court ruled that because the Proxy Statement failed to include the information that Blair relied on in making its fairness opinion that "the Proxy now fails to give the stockholders the best estimate of the company's future cash flows as of the time the board approved the Merger."¹¹¹ The Court explained, "the cursory nature of such an 'opinion' is a reason why the disclosure of the bank's actual analyses is important to stockholders; otherwise, they can make no sense of what the bank's opinion conveys, other than as a stamp of approval that the transaction meets the minimal test of falling within some broad range of fairness."¹¹² The Court added, "[i]n a cash-out transaction, this information is highly material, as the stockholders are being asked to give up the possibility of future gains from the on-going operation of the company in exchange for an immediate cash payment."¹¹³ The Court concluded, "[t]he conclusion that this omission is material should not be surprising. Once a board broaches a topic in its disclosures, a duty attaches to provide information that is materially complete and unbiased by the omission of material facts."¹¹⁴ The Court held that the Proxy Statement was misleading because it suggested that a "more reasoned and thorough decision-making process had been used, and that the process was heavily influenced by earlier searches for a strategic buyer that provided a reliable basis for concluding that no strategic buyer interest existed in 2006."¹¹⁵ Indeed, the Court was highly critical of the Proxy Statement's characterization of the reasons why Netsmart failed to pursue strategic acquirers,¹¹⁶ concluding "[f]rankly, there is no credible evidence in the record" to support the Proxy Statement's version of events.¹¹⁷ Moreover, the absence of minutes for the critical May 19 board meeting and "omnibus" consideration of meeting minutes for ten Special Committee meetings troubled the Court, which characterized these omissions as "not confidence-inspiring."¹¹⁸ The Court did, however, stop short of issuing a "more aggressive injunction" requiring Netsmart to conduct a search for a strategic buyer prior to a vote on the Merger agreement out of concern that such an order would "give Insight the right to walk."¹¹⁹

The Court also considered whether the Netsmart board had breached its fiduciary duties, as defined by *Revlon v. MacAndrews & Forbes Holdings, Inc.*¹²⁰ As an initial matter, the Court held that Netsmart's board did not breach its Revlon duties in the process involving the private equity firms that were involved in the limited auction process. Although the Court was troubled by Conway's influence on the Special Committee, the due diligence process and the Special Committee's failure to demand a price increase from Insight following its partnering with another equity firm but it concluded that these facts did not amount to a breach of the Special Committee's *Revlon* duties. Though the Special Committee was "less than ideally engaged," the Court was not convinced that Special Committee actions "actually had any negative effect on the bidding process."¹²² It added, "[u]pon close examination, the process used seem to have had no adverse consequences."¹²³

The Court, however, did conclude that plaintiffs had demonstrated a likelihood of success on their *Revlon* claim because the board failed to engage "in any logical efforts to examine the universe of possible strategic buyers and to identify a select group for targeted sales overtures was unreasonable and a breach of their *Revlon* duties."¹²⁴ Indeed, the Court held "the informal and haphazard market canvass Netsmart's board relied on was insufficient."¹²⁵ While the Court ruled that the fiduciary duty to undertake reasonable efforts to secure the highest price realistically achievable given the market for the company "does not, of course, require every board to follow a judicially prescribed checklist of sales activities,"¹²⁶ it does require the board to "act reasonably, by undertaking a logically sound process to get

the best deal that is realistically attainable.”¹²⁷ “[T]o test the market for strategic buyers in a reliable fashion,” the Court noted, “one would expect a material effort at salesmanship to occur.”¹²⁸ In this case, however, “[t]he record evidence regarding the consideration of an active search for a strategic buyer is more indicative of an after-the-fact justification for a decision already made, than of a genuine and reasonably-informed evaluation of whether a targeted search might bear fruit.”¹²⁹

F. Chancery Court Limits The Apparent Scope of *Netsmart* in *Lear*

As in *Netsmart*, shareholders of Lear Corporation sought a preliminary injunction to prevent the shareholder vote on a going private merger between Lear and a private equity firm. *In re Lear Corp. S’holder Litig.*¹³⁰ was also heard by Vice Chancellor Strine and plaintiffs did their level best to plead facts to bring their claims within the *Netsmart* framework. While the Court in *Lear* did issue a preliminary injunction and required Lear to amend its proxy statement, it did so on narrow grounds and seized the opportunity to narrow its decision in *Netsmart* to its very narrow and unusual facts and circumstances.

The *Lear* plaintiffs alleged that Lear’s board breached its *Revlon*¹³¹ duties and failed to disclose all material information related to the merger in the proxy statement. Following on *Netsmart*’s heels, plaintiffs alleged the proxy statement failed to disclose: (i) certain preliminary projections prepared by Lear’s financial advisors, (ii) certain aspects of Lear’s market checks before and after signing the merger agreement. The Court rejected both these claims but accepted that the proxy statement’s failure to disclose facts relating to the interest in the transaction of the Lear’s CEO warranted a preliminary injunction.

Lear’s CEO, Robert Rossiter, had much of his personal wealth tied up in Lear stock.¹³² Although Lear was a Fortune 200 company traded on the NYSE, its business (a leading automotive interior supplier) was in a declining industry due to outside forces and had come near bankruptcy in 2005 and 2006. Rossiter had a lucrative retirement plan (valued at more than \$14 million) with Lear but the plan was not secured by any of Lear’s assets and Rossiter was not entitled to receive full benefits under that plan until he turned 65 in 2011. Moreover, while Rossiter could take approximately 70% of his retirement benefits by mid-2007, he could only do so if he retired. As a result, in November 2006, Rossiter approached Lear’s compensation committee and requested the company grant him some form of relief from the plan’s restrictions.¹³³ The committee retained a compensation advisor who presented the committee with alternatives, but also noted that each alternative was likely to be viewed negatively by investors.¹³⁴ Nevertheless, the committee was willing to provide Rossiter with the relief requested, but when it told Rossiter to expect an adverse reaction, Rossiter declined the committee’s offer.

Earlier in 2006, well-known investor Carl Icahn had made two significant purchases of Lear stock bringing his holdings in Lear to 24% of its outstanding shares. In January 2007, Rossiter and Lear met to discuss the changing industry environment and effects of these changes on Lear’s competitive position. During this meeting, Rossiter lamented the negative impact these changes were having on Lear and Icahn responded by raising the possibility he would acquire the company. Rossiter agreed this might be in Lear’s interest and the two began to explore the feasibility of such an acquisition.¹³⁵

On January 23, 2007, Rossiter informed several independent board members of the developing merger discussions and he brought Lear’s outside counsel into the discussions. On January 25, the board met and formed a special committee comprised of independent directors to oversee the merger process. Believing that Rossiter’s negotiation of the merger posed no conflict, the Special Committee allowed Rossiter to negotiate the merger while it stood back and observed the process. On January 30, 2007, the Special Committee was informed that Icahn and his affiliated entity, American Real Estate Partners, LP. (“AREP”), had signed confidentiality agreements and were conducting due diligence. The Special Committee then engaged the services of Lear’s long-standing legal and financial advisors, Winston & Strawn and JPMorgan, respectively.

On February 2, 2007, Icahn communicated an initial bid of \$35 per share. Rossiter told Icahn he could not support the offer, but agreed to communicate it to the Special Committee. The committee rejected this offer, and Icahn increased his bid to \$35.25. Rossiter immediately rejected this bid without consulting the Special Committee because, based on his discussions with the committee, he believed that the bid was too low. Icahn countered with an offer of \$36 per share. Before communicating this offer to the Special Committee, Rossiter attempted to persuade Icahn to raise his bid again. In response, Icahn was firm that the \$36 per share offer was final and told Rossiter that if the board chose to undertake a full-blown auction of the company, he would take his offer off the table.

The board met on February 3, 2007, and reviewed Icahn's offer, as well as the projections and analyses of its financial advisors. Although the board debated opening the process up to a full auction, it was concerned that: (i) Icahn would pull his offer, (ii) the auction would not secure a higher bid, and (iii) Lear's stock would decline sharply. The board and Icahn engaged in several days of negotiations. During the negotiations, the Special Committee engaged JPMorgan to solicit offers from strategic buyers and private investors that might have an interest in Lear. This limited canvass did not turn up any prospects. On February 7, 2007, JPMorgan presented the Special Committee with its fairness opinion, which included a number of analytical perspectives. The Special Committee could not reach a consensus on Icahn's offer. Despite his pledge to pull his offer from the table so that it was not hanging out there like a public stalking horse, Icahn granted the Special Committee a one-day extension.

On February 8, 2007, the special committee approved the agreement. In contrast to the "window shop" provision accepted by the special committee in *Netsmart*, Lear's Special Committee negotiated a "go-shop" provision that allowed Lear to solicit interest.¹³⁶ In exchange, Icahn received the right to match any bid received during the 45-day, go-shop period or any subsequent unsolicited bids. Icahn also agreed, should a superior offer materialize, to vote his stock in favor of such an offer. In addition, the agreement provided termination fees of 2.79-3.52% for Icahn and AREP, and \$250 million for Lear.

Icahn also reached agreements with Lear's four top executives, including Rossiter, to continue their employment with Lear. Whereas the executives in *Netsmart* received employment deals that did not improve their financial benefits, Lear's executives increased their salaries and obtained improved retirement benefits. Indeed, for Rossiter, the retirement benefits he obtained from Icahn were similar to those he sought from the compensation committee in November 2006.

Lear announced the merger, set the shareholder vote for June 27, 2007, and shareholders filed suit to enjoin the shareholder vote. The Court rejected plaintiffs' *Revlon* claim but granted a limited injunction pending the disclosure of additional information.

Although the Court held that the Special Committee's failure to be involved in the negotiation process was not "a disaster warranting the issuance of an injunction," it was "far from ideal and unnecessarily raise[d] concerns about the integrity and skill of those trying to represent Lear's public investors."¹³⁷ Given Rossiter's personal financial interests, the Court noted "it would have been preferable for the Special Committee to have had its chairman or, at the very least, its lead banker participate with Rossiter in the negotiations with Icahn."¹³⁸ Nevertheless, the Court explained that the standard is "[r]easonableness, not perfection, measured in business terms relevant to value creation, rather than by what creates the most sterile smell, is the metric."¹³⁹ And, it concluded that the board had "sufficient evidence to conclude that it was better to accept \$36 if a topping bid did not emerge than to risk having Lear's stock price return to the level that existed before the market drew the conclusion that Lear would be sold because Icahn had bought such a substantial stake."¹⁴⁰ The Court also observed that "the \$36 price has been and is still being subjected to a real world market check, which is unimpeded by bid-detering factors."¹⁴¹

While the Court rejected plaintiffs' *Revlon* claim and held that the omission from the proxy statement of a draft projection was not material and that the proxy statement adequately disclosed the Company's market checks,¹⁴² the Court did conclude that Rossiter's November 2006 discussions with the compensation committee regarding his retirement benefits were material facts that should have been disclosed in the proxy statement. The Court reasoned that the merger "presented [Rossiter] with a viable route for accomplishing materially important personal objectives"¹⁴³ and "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."¹⁴⁴

Finally, the Court rejected plaintiffs' reliance on its *Netsmart* decision.¹⁴⁵ The Court explained that there were significant differences between the two cases. *Netsmart* was a microcap company, thinly traded, and covered by only one research analyst. *Netsmart* excluded strategic acquirers and chose to refrain from conducting any pre-signing market check. It also acceded to Insight's rejection of a "go shop" provision that would have enabled *Netsmart* to conduct a post-signing check. All of these barriers made it highly unlikely that a strategic acquirer would suddenly appear and make an unsolicited offer for the company without access to due diligence or company management.¹⁴⁶ In contrast, *Lear* was one of the largest companies in the United States, its entire industry was suffering a decline caused by outside forces, it negotiated for a go-shop provision, and Icahn agreed to vote his shares in favor of any superior proposal and a reasonable break up fee.

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1. *In re Caremark Int'l, Inc. Deriv. Litig.*, 698 A.2d 959 (Del. Ch. 1996).
 2. *Stone v. Ritter*, 911 A.2d 362 (Del. 2006).
 3. *Stone v. Ritter*, No. Civ. A. 1570-N, 2006 WL 302558 at *2 (Del. Ch. Jan. 26, 2006) (V.C. Chandler).
 4. The BSA is a federal mandate that requires bank employees to file Suspicious Activity Reports when there is reason to believe the bank's services are being used to facilitate illegal services. *Id.* at 365 n.4.
 5. *Id.*
 6. *Stone*, 911 A.2d at 364.
 7. *Id.* at 365.
 8. *Id.* at 366.
 9. *Id.* at 364.
 10. *Id.*
 11. *Id.* at 370.
 12. *Id.* at 371.
 13. *Id.* at 364.
 14. *Id.*
 15. *Id.* at 367.
 16. *Id.* at 370 (emphasis added).
 17. *Id.* at 369.
 18. *Id.*
 19. *Id.* at 369.
 20. *Id.* (citation omitted)
 21. *Id.* at 370.
 22. *Id.* at 373.
 23. *Id.*
 24. *Id.* (citation omitted).
 25. *Id.*
 26. *Gentile v. Rossette*, 906 A.2d 91 (Del. 2006).

27. *Id.* at 101. *In re Tri-Star Pictures, Inc.*, 634 A.2d 319 (Del. 1993), the Court held that plaintiffs, minority shareholders of Tri-Star, had standing to assert a direct claim challenging an assets-for-stock transaction with Coca-Cola, Tri-Star's largest shareholder. Coca-Cola and an aligned voting group held 56.6% of Tri-Star's stock. Plaintiffs alleged Coca-Cola had wrongfully caused Tri-Star to issue it an excessive number of Tri-Star shares in exchange for Coca-Cola assets of lesser value. *See Gentile*, 906 A.2d at 100-01. This exchange reduced public shareholders' interest from 43.4% to 20% and because Coca-Cola did not suffer a dilution in its stock value or voting power in the same proportion as the minority public shareholders, plaintiffs suffered an unique injury. Because the public shareholders' injury was unique, they were entitled to bring a direct action. *Id.*
28. *Id.* at 94-95.
29. *Id.* at 95.
30. *Id.*
31. *Gentile v. Rossette*, No. Civ. A. 20213-NC, 2005 WL 2810683 at *1 (Del. Ch. Oct. 20, 2005).
32. *Id.*
33. *Id.*
34. 845 A.2d 1031 (Del. 2004).
35. *Gentile*, 2005 WL 2810683 at *4 (citation omitted).
36. *Gentile*, 906 A.2d at 101.
37. *Id.* at 99.
38. *Id.*
39. *Id.* at 100.
40. *Id.*
41. *Id.* at 102.
42. *Id.* at 102.
43. *Id.* at 100.
44. *Id.*
45. *North American Catholic Educational Programming Foundation, Inc. v. Gheewalla*, 2007 WL 1453705 (Del. May 18, 2007).
46. *Id.* at 42.
47. *Id.* at *1.
48. *Id.* at *1. Plaintiff also alleged a claim for fraudulent inducement and tortious interference with prospective business opportunities belonging to the plaintiff the dismissal of which plaintiff did not appeal. *Id.*
48. *Id.* at *6.
50. *Id.*
51. *Id.* (citation omitted).
52. *Id.* at *7.
53. *Id.*
54. *Id.*
55. *Id.*
56. *Id.*
57. *Id.*
58. *Id.* at *8.
59. *Id.*
60. *Id.*
61. No. 2786-VCS, 2007 WL 1491451 (Del. Ch. May 9, 2007)
62. *Id.* at *1, *9.
63. *Id.* at *5. "The reality is that every merger involving Delaware public companies draws shareholder litigation within days of its announcement. An unseemly filing Olympiad typically ensues, with the view that speedy filing establishes a better seat at the table for the plaintiffs' firms involved." *Id.*
64. *Id.* at *1.

65. *Id.*
66. *Id.* at *5. Applying the first filed rule to these cases is “‘troublesome’ because the potential divergence in the best interests of the plaintiffs’ attorneys and the plaintiffs they are purporting to represent are not addressed, and indeed may be exacerbated by a legal rule that places determinative weight on which complaint was filed first.” *Id.* (internal quotations and citation omitted).
67. *Id.* at *4.
68. *Id.*
69. *Id.* at *5.
70. *Id.* at *7.
71. *Id.* (emphasis added)
72. *In re The Topps C. Shareholders Litig.*, Nos. 2998-CVS, 2786 VCS, 2007 WL 1732586, *3 (Del. Ch. June 14, 2007).
73. *Id.* at *1.
74. *Id.*
75. *Id.*
76. *Id.*
77. *Id.*
78. *Id.* at *2.
79. *Id.*
80. *Id.*
81. *Id.* at *11.
82. *Id.* at *2. The dissident directors dissented and were essentially shut out of performing any board functions with respect to the go shop period. *Id.* at *10.
83. *Id.* at *3.
84. *Id.*
85. *Id.* at *4.
86. *Id.*
87. *Id.*
88. *Id.* at *12. Moreover, the dissident directors were prevented from reviewing the proxy statement’s description of the events before the statement was filed with the SEC. *Id.* at *13.
89. *Id.* at *13-14.
90. *Id.* at *14.
91. *Id.* at *15-*16. “Candidly, the defendants have not made any confidence-inspiring explanations for Lehman’s analytical changes.” Indeed, the Court found that the record reflected “Lehman would manipulate its analyses to try to make the Eisner offer look more attractive once it was clear Eisner would not budge on price. *Id.* at *16.
92. *Id.* at *16.
93. *Id.* at *16-*20.
94. *In re Netsmart Technologies, Inc., S’holder Litig.*, No. Civ. A. 2563-VCS, 2007 WL 926213 (Del. Ch. Mar. 14, 2007).
95. *Id.* at *4.
96. *Id.* at *5.
97. *Id.*
98. *Id.*
99. *Id.* at *6.

100. *Id.* at *8.
101. *Id.* at *10-11.
102. *Id.* at *11.
103. *Id.*
104. *Id.* at *13.
105. *Id.*
106. *Id.*
107. *Id.* This provision allowed Netsmart only to consider an unsolicited, superior proposal.
108. *Id.* at *14.
109. *Id.*
110. *Id.*
111. *Id.* at *24.
112. *Id.* at *25.
113. *Id.* at *28.
114. *Id.* at *24.
115. *Id.* at *29.
116. *Id.* at *9.
117. *Id.* at *8.
118. *Id.* at *14.
119. *Id.* at *28.
120. 506 A.2d 173 (Del. 1986).
121. *Netsmart*, 2007 WL 926213 at *17.
122. *Id.*
123. *Id.* at *16. The Court did, however, express concern with the special committee’s “less than vigorous” role in due diligence and that it permitted management to run the process, noting that in other circumstances this “could be highly problematic.”
124. *Id.* at *21.
125. *Id.* at *9.
126. *Id.* at *15.
127. *Id.*
128. *Id.* at *19.
129. *Id.* at *21.
130. No. Civ. A. 2728-VCS, 2007 WL 1732588 (Del. Ch. June 15, 2007).
131. *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986).
132. 2007 WL 1732588, at *4.
133. *Id.* at *5.
134. *Id.*
135. *Id.* at *5-*6.
136. Lear actively sought potential buyers during the 45-day, go-shop period. Lear’s financial advisors contacted 41 potential buyers, including 17 strategic acquirers. At the end of the period, Lear was not able to find any interested buyers. Indeed, none of the solicited buyers even made preliminary bids, nor has an unsolicited bid emerged. *Id.* at *9-*10
137. *Id.* at *22.

138. *Id.*

139. *Id.*

140. *Id.*

141. *Id.* at *27.

142. The Court rejected plaintiffs' claim that Lear breached its duties by failing to disclose a model "prepared in Sinatra time by a no-doubt extremely-bright, extremely-overworked young analyst, who was charged with providing input to the senior bankers." *Id.* at *15. Because the model was not embraced as reliable by either the senior bankers in charge of the deal or by Lear management, plaintiffs' claim was without merit. The Court also rejected plaintiffs' claim that the Lear board failed to disclose certain aspects of the pre-signing and post-signing market checks – plaintiffs' "quibbles about the description of the negotiating and shopping processes...do not point to a material deficiency in the information provided by the proxy statement." *Id.* at *17. The Court added that Lear did provide a full and fair description of the checks.

143. *Id.* at *19.

144. *Id.* The Court considered several facts in concluding the omission was material: "(1) Rossiter discussed a going private transaction with Icahn for more than a week before he disclosed Icahn's expression of interest to the board; (2) The board thereafter permitted Rossiter to negotiate the key terms of the merger with Icahn outside the presence of any independent director or the Special Committee's investment banker without any specific pricing guidance from the Special Committee; (3) The merger allows Rossiter to cash out all of his equity stake in Lear in one lump sum; and (4) Icahn agreed to employment terms with Rossiter that allowed Rossiter to secure a short-term schedule for the payout of his retirement benefits, obtain an improved salary and bonus package, and secure a large grant of options giving him a lucrative upside if Lear performed well after the merger." *Id.*

145. *Id.* at *27, n.22.

146. *Id.*



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