Client Alert

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Delaware Court Dismisses Post-Closing Challenge to Merger in *Dent v. Ramtron*

In *Dent v. Ramtron*, C.A. No. 7950-VCP (Del. Ch. June 30, 2014), the Delaware Court of Chancery dismissed a plaintiff's post-closing challenge to the sale of a public company to an unaffiliated buyer. Among other things, the court found the plaintiff failed to state a claim with respect to (i) the target board of directors' initial decision to resist an unsolicited takeover, (ii) a 4.5% termination fee and other customary deal protections in the merger agreement, and (iii) the omission of management's financial projections from the proxy statement. The decision has several notable take-aways for Delaware corporations.

Take-Aways

- As long as a majority of the board of directors is disinterested and independent, plaintiffs will have difficulty pursuing post-closing breach of fiduciary duty claims in third-party mergers.
  - Directors are typically exculpated from monetary liability for breaches of the duty of care. As a result, directors can be held liable after closing only if plaintiff can prove they acted in bad faith or otherwise breached their duty of loyalty.
  - While the recent decisions in *Rural/Metro*[1] and *Chen v. Howard-Anderson*[2] did find that target boards of directors acted "unreasonably" in breach of their *Revlon* duties, alleging bad faith against outside, "independent" directors in a third-party merger is very difficult.
  - In addition, the dynamics of M&A litigation give plaintiffs a much stronger incentive to litigate their claims pre-closing because of the leverage associated with the threat of a preliminary injunction, which could be based on disclosure violations, a breach of the duty of care, or a breach of the duty of loyalty (although typically irreparable harm, which is necessary to support an injunction, is available only for disclosure violations in the absence of a topping bid).
- Nevertheless, *Dent v. Ramtron* – which was decided almost two years after the merger was completed – shows the nuisance value associated with post-closing litigation.
  - Empirical research shows that most M&A lawsuits result in disclosure-only settlements before the mergers close.
    - According to Cornerstone Research, 65% of M&A transactions in 2013 were resolved before closing.[3] 88% of those cases were resolved by settlement.[4] Of

[1] *In re Rural/Metro Corp. S'holders Litig.*, 88 A.3d 54 (Del. Ch. 2014).

[2] *Chen v. Howard-Anderson*, C.A. No. 5878-VCL, mem. op. (Del. Ch. Apr. 8, 2014).

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the settlements, 75% were "disclosure only" and another 16% were in exchange for disclosures plus other terms.[5]

- In the absence of a settlement or a court's dismissal of the action, plaintiffs can often continue their lawsuits post-closing. In *Dent*, for example, the plaintiff's pre-closing motion for a preliminary injunction against the merger had been denied, but plaintiff continued to press its claims post-closing.
- In some cases, plaintiffs may believe they have meritorious claims to pursue after the merger is completed.
- There are also more cynical possibilities for explaining the pursuit of post-closing lawsuits.
  - Plaintiffs' counsel may be trying to encourage pre-closing settlements in other lawsuits in the future. In other words, post-closing cases remind companies, D&O insurance carriers, and defense lawyers of the nuisance value of M&A lawsuits and signal that plaintiffs' counsel "doesn't go away."
  - In addition, because plaintiffs' firms generally operate on a contingency fee basis, they have an incentive in maintaining a large portfolio of litigation, even if that includes post-closing claims, in the hope that some of the cases will materialize into attorneys' fees.
  - This conduct is constrained, however, by the fact that plaintiffs' counsel has to invest time and out-of-pocket expenses to pursue the litigation, which would seem to deter cases that have little prospect for success.

- Prior decisions have indicated that management's internal projections are material to stockholders.
  - *Dent* does not create any bright-line rule about disclosure of projections. Rather, it reflects the contextual nature of a "materiality" analysis that requires plaintiffs to show that additional disclosure would "alter the total mix" of information already available.
- Delaware courts continue to express some skepticism over stockholder litigation challenging public company M&A transactions.[6]

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[3] *See* Olga Koumrian/Cornerstone Research, Shareholder Litigation Involving Mergers and Acquisitions – Review of 2013 M&A Litigation, *available at* http://www.cornerstone.com/Shareholder-Litigation-Involving-M-and-A-2013-Filings.

[4] *See* Olga Koumrian/Cornerstone Research, Settlements of Shareholder Litigation Involving Mergers and Acquisitions: Review of 2013 M&A Litigation, *available at* http://www.cornerstone.com/Publications/Reports/Settlements-of-Shareholder-Litigation-Involving-Me.

[5] *Id.*

[6] *See, e.g., In re Medicis Pharm. Corp. S'holders Litig.*, Consol. C.A. No. 7857-CS, trans. ruling (Del. Ch. Feb. 26, 2014) (rejecting a proposed settlement where the supplemental disclosures did not "alter the total mix of information"); *In re Transatlantic Holdings Inc. S'holders Litig.*, Consol. C.A. No. 6574-CS, trans. ruling (Del. Ch. Feb. 28, 2013) (same); *In re Talbots, Inc. S'holders Litig.*, C.A. No. 7513-CS, trans. ruling (Del. Ch. Dec. 16, 2013) (expressing skepticism over the merit of plaintiffs' claims that had been settled); s*ee also In re Gen-Probe S'holders Litig.*, Consol. C.A. No. 7495-VCL, trans. ruling (Del. Ch. Apr. 10, 2013) (reducing requested fee award and

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- In *Dent*, Vice Chancellor Parsons observed that the plaintiff "makes the same allegations that have become routine in the ubiquitous shareholder litigation that immediately follows the announcement of any public company merger or acquisition transaction."

Background

Ramtron International Corporation ("Ramtron") was approached several times by a larger strategic competitor about a possible merger. After being rebuffed, the competitor initiated a hostile tender offer to acquire Ramtron. In response, Ramtron's board of directors contacted 24 potential bidders and ultimately negotiated a friendly transaction with the competitor. During the negotiations, the competitor increased its offer by 25%. Prior to Ramtron's stockholder meeting, the Court of Chancery denied the plaintiff's motion for a preliminary injunction, and the transaction closed in 2012.[7]

Court of Chancery's Decision

The Court of Chancery dismissed the plaintiff's breach of fiduciary duty claims. Among other things, the court found that the plaintiff failed to show that a majority of the independent directors were interested or lacked independence. Similarly, the plaintiff failed to show that the directors acted in bad faith. Plaintiff's argument that Ramtron's board of directors should have engaged with the competitor before its hostile offer, the court said, "amounts to little more than *ex post* quibble with the independent and disinterested Board's negotiation strategy." The court continued that, "[e]ven assuming that the Board undertook the wrong strategy, … that fact, without more, does not make it reasonably conceivable that the Board's decision to sell the Company… was made in bad faith."

The court also found that the "deal protections" in the merger agreement were not "preclusive" or "draconian." The deal protections included a no-solicitation clause with a fiduciary out, matching rights, and a termination fee equal to 4.5% of the transaction's equity value. The court stated that "[s]imilar, if not more potent, combinations of deal protection devices often have been upheld," and there was no evidence that the directors agreed to such provisions in bad faith.

The court also rejected the plaintiff's argument that the directors violated their disclosure duties by omitting management's financial projections from the company's proxy statement. The court held that "[t]here is no per se duty under Delaware law to disclose to stockholders financial projections given to and relied on by a financial advisor." The court also explained that the proxy statement disclosed four different financial analyses undertaken by Ramtron's financial advisor. Of those, only the financial advisor's discounted cash flow analysis resulted in a range above the merger consideration. Thus, the court reasoned that stockholders were already informed that management's projections led to a valuation range above the merger price:

> Because the stockholders were informed that the transaction consideration was lower than the DCF range, by how much it was lower, and that the DCF range was based on management projections, a reasonable stockholder could infer that the transaction consideration was lower than the Company's estimate of its own future earning potential.

The court also noted that the plaintiff obtained the projections in discovery and had failed to explain how they altered the total mix of information already available.

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expressing concern over the size of fee awards in disclosure-only settlements); *see also In re Complete Genomics S'holders Litig.*, Consol. C.A. No. 7888-VCL, trans. ruling (Del. Ch. Oct. 2, 2013) (same).

[7] *See Dent v. Ramtron*, C.A. No. 7950-VCP, trans. ruling (Del. Ch. Nov. 19, 2012).

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Finally, the court rejected numerous other disclosure claims based on what it called the "proverbial laundry list of issues [plaintiff] raised in the Complaint." Most of these claims related to the analyses performed by Ramtron's financial advisor. Among other things, the court cited to prior Delaware cases in ruling that plaintiff was entitled only to a "fair summary" of the work performed by the financial advisor, that claims asking "why" a particular action was taken are not meritorious, and that companies do not have to provide stockholders with information that would enable them to conduct an independent valuation.

Conclusion

Difficulty in Pursuing Claims Against Outside Directors in Third-Party Mergers

Dent shows the difficulty for plaintiffs in challenging a third-party merger when a majority of the board of directors is disinterested and independent. Because directors are generally exculpated for care violations,[8] plaintiffs must articulate a loyalty violation. This requires a showing that the directors utterly failed to obtain the best price reasonably available or otherwise acted in bad faith because they had an improper purpose.[9] In most third-party mergers, this is difficult to establish. The board of directors must take its duties seriously, but the threat of personal liability is very low for conscientious directors.

Post-Closing M&A Litigation

Nevertheless, *Dent* shows the potential for stockholder litigation to continue post-closing. While most M&A lawsuits are settled before closing for additional disclosures, plaintiffs can continue to pursue cases that are not settled – even when the party is with a third-party merger and was overwhelmingly approved by stockholders. Post-closing litigation continues to impose costs on defendants through discovery and briefing a motion to dismiss.

Post-closing claims may be pursued in good faith. The contingent fee structure on which most plaintiffs' lawyers operate, however, gives them an incentive to maintain a large portfolio of cases in the hope that as many cases as possible lead to attorneys' fees. In addition, it is possible that some plaintiffs' lawyers pursue post-closing litigation to encourage pre-closing settlements in future cases. *Dent* thus illustrates the nuisance value associated with post-closing suits and shows why, from the defendants' perspective, it is often desirable to enter into disclosure-only settlements providing modest fee awards to plaintiffs' counsel, even when the plaintiffs' claims are without merit.

Disclosure of Projections

Finally, *Dent* does not create any bright-line rules regarding the disclosure of management's financial projections. Prior Delaware decisions have reached different results on whether management projections can be material to stockholders.[10] *Dent* employed a contextual analysis in concluding that, in this case, management's internal projections would not have "altered the total mix" of information already

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[8] Exculpation of directors pursuant to a company's certificate of incorporation is authorized by Section 102(b)(7) of the Delaware General Corporation Law.

[9] *See Lyondell Chem. Co. v. Ryan*, 970 A.2d 235 (Del. 2009) (stating that plaintiffs must show the directors "utterly failed to obtain the best sale price"); *see also Chen v. Howard-Anderson*, C.A. No. 5878-VCL, mem. op. (Del. Ch. Apr. 8, 2014) (stating that bad faith can also be demonstrated by an "improper motive").

[10] Compare *Skeen v. Jo-Ann Stores, Inc.*, 750 A.2d 1170 (Del. 2000) (holding that projections were not material), and *In re CheckFree Corp. S'holders Litig.*, No. 3193-CC, 2007 WL 3262188, *3 (Del. Ch. Nov. 1, 2007) (same), with *Maric Capital Masterfund, Ltd. v. Plato Learning, Inc.*, 11 A.3d 1175, 1178 (Del. Ch. 2010) (stating that "in my view, management's best estimate of the future cash flow of a corporation that is proposed to be sold in a cash merger is clearly material information").

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available.[11] The court explained that, because the buyer had completed its first-step tender offer, the only decision to be made by stockholders was whether to accept the back-end merger consideration or seek appraisal. It further explained that the stockholders were told that the financial advisor's discounted cash flow analysis – which was based on management's projections – had resulted in a valuation range in excess of the merger price. As a result, the court concluded that "disclosing the projections themselves would not provide stockholders with any meaningful additional information or insight." Thus, *Dent* is not a broad ruling and reflects the fact-dependent nature of Delaware's materiality standard for disclosure.

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[11] *See also Globis Partners, L.P. v. Plumtree Software, Inc.*, 1577-VCP 2007 WL 4292024 (Del. Ch. Nov. 30, 2007) (holding that projections must be reliable in order to be material).