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Delaware Quarterly, Recent Developments in Delaware Business and Securities Law

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Two merger cases involving breach of fiduciary duty claims decided in a post-closing environment — *In re John Q. Hammons Hotels Inc. Shareholder Litigation*,¹ and *In re NYMEX Shareholder Litigation*,² — top the list of significant Delaware decisions during the past quarter. In *Hammons*, the Chancery Court examined the contours of the *Lynch* doctrine and the appropriate standard of review for a merger involving both a controlling shareholder and a third-party purchaser, ultimately concluding that the *Lynch* doctrine (mandating the application of the entire fairness standard in certain types of controlling stockholder deals) did not apply where the controlling stockholder did not stand on both sides of a merger transaction. Notably, however, the Court nevertheless applied entire fairness review, denying the directors' and controlling stockholder's motions for summary judgment due to the absence of the "robust procedural protections" the Court found necessary to protect minority stockholders in a transaction of this type. In *NYMEX*, on the other hand, the Chancery Court dismissed all of plaintiffs' post-closing breach of fiduciary duty claims, holding, among other things, that certain of those claims were precluded by the exculpatory provision in the company's charter, while others were either too conclusory to state a claim or mere allegations of entrenchment and thus purely derivative in nature.

Delaware courts also issued decisions across a broad range of other issues: (1) the duty of good faith; (2) procedural matters, including standing, personal and subject matter jurisdiction, and waiver of the right to a jury trial; (3) indemnification and advancement of attorneys' fees; (4) hurdles to establishing demand futility; (5) the value of securities valuations and therapeutic disclosures in deter-

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mining class certification; (6) extension of corporate legal existence following dissolution; (7) approval of “proxy put” provisions; (8) factors to consider in determining lead counsel in a class action; (9) dual representation; (10) pleading a proper purpose and submitting the proper documentation for a books and records demand; (11) the scope of an arbitrator’s authority; (12) the duty to disclose; (13) the scope of Section 225 summary proceedings; (14) various aspects of contract claims; (15) the admissibility of expert evidence; (16) “red flags”; (17) substantive and procedural arbitrability; (18) discovery disputes involving waiver, confidentiality designations, redaction, clawback, the proper methods of claiming privilege, and a rare default judgment and (19) the application of laches. These and other developments are discussed below.

In re John Q. Hammons Hotels Inc. Shareholder Litigation.

John Q. Hammons Hotels, Inc. (JQH), a company engaged in the business of owning and operating hotels whose controlling stockholder was John Q. Hammons (Hammons), merged with a company indirectly owned by Jonathan Eilian (Eilian), a third party with no ties to Hammons or JQH. Holders of JQH Class A common stock received cash consideration in the transaction, while Hammons, in exchange for his Class B stock and other interests, received a small equity stake in the surviving entity, a preferred interest with a large liquidation preference, and various other contractual rights. Plaintiffs, Class A stockholders, brought suit, alleging that (i) Hammons, as a controlling stockholder, breached his fiduciary duties to the minority by using his control position to negotiate private benefits for himself that were not shared with them, (ii) JQH’s directors breached their fiduciary duties to the minority by allowing a deficient merger process and by voting in favor of the merger, (iii) the merger acquisition vehicles aided and abetted such breaches and (iv) the proxy statement was inaccurate and misleading in at least four respects (discussed below). On cross-motions for summary judgment, the Court considered the critical threshold issue of whether to apply the entire fairness or business judgment standard of review.

Standard of Review

In favor of entire fairness, plaintiffs had argued that the merger was a minority squeeze-out transaction that, under *Kahn v. Lynch Communication Systems, Inc.*,³ mandated entire fairness review regardless of any procedural protections, because Hammons stood on both sides of the transaction and had merely restructured his interests for tax and liquidity purposes rather than actually selling them to Eilian. While noting that plaintiffs’ argument had “some appeal,” Chancellor Chandler ultimately disagreed, finding that Hammons was not on both sides of the transaction because, unlike in *Lynch*, where the controlling stockholder itself had made an offer to the minority stockholders, this transaction involved an unrelated third party. Moreover, Eilian had negotiated separately with Hammons and with the minority shareholders who, the Court noted, were represented by a disinterested and independent special committee. Thus, the Court found that *Lynch* did not mandate entire fairness review. The Court also rejected plaintiffs’ argument that, even if Hammons did not stand on both sides of the transaction a la *Lynch*, the policy rationale underlying *Lynch* nevertheless warranted extending its holding. Instead, the Court determined that the cases that had extended the rationale involved, for example, a board with an interested majority.

But the Court did not then simply default to business judgment review. Rather, it went on to conclude that the absence of certain procedural protections for the minority stockholders precluded it on the facts of this case.⁴ Specifically, by the terms of the merger agreement, the minority stockholders' vote (i) could have been waived by the special committee and (ii) only required a majority of the minority actually voting, as opposed to a majority of all minority stockholders. In the Court's view, such provisions did not amount to "robust procedural protections" sufficient to ensure that minority stockholders had bargaining power and the ability to make an informed choice as to whether to accept Eilian's offer. Additionally, the Court explained, to give "maximum effect" to these procedural protections, they must be conditions to the transaction; "the lack of such requirements cannot be 'cured' by the fact that they would have been satisfied if they were in place."

Accordingly, the Court held that, although not mandated by *Lynch*, entire fairness review was appropriate in this case, but emphasized that it could have been otherwise:

In this case — which, again, I have determined is not governed by *Lynch* — business judgment would be the applicable standard of review if the transaction were (1) recommended by a disinterested and independent special committee, and (2) approved by stockholders in a non-waivable vote of the majority of all the minority stockholders.

Application of Entire Fairness

Turning to the two components of entire fairness (fair price and fair dealing), the Court declined to grant summary judgment on either prong. Hammons and the directors had moved for summary judgment on the issue of fair price, placing heavy reliance on a fairness opinion provided to the special committee by Lehman Brothers and arguing that, even if entire fairness review applied, there was no triable issue with respect to the fairness of the price. The Court disagreed, finding that a series of factual and legal disputes remained concerning the persuasive value of Lehman's fairness opinion, precluding summary judgment.

The Court likewise rejected plaintiffs' motion for summary judgment on fair dealing, finding that the issue must be tried because (i) the mere possibility that the minority stockholders would have remained in the minority if Hammons had chosen not to sell his shares was not, by itself, sufficient coercion to render the special committee ineffective, and (ii) there were insufficient facts on the current record to determine whether, as plaintiffs contended, Hammons had depressed the pre-merger price of minority shares by improper self-dealing, on the one hand, or whether, as Hammons contended, any undervaluing resulted from the lack of a control premium.⁵ The Court therefore denied both parties' motions for summary judgment on entire fairness. It also left open the question of whether, under *Lynch*, the special committee's process and approval were sufficient to shift the burden to plaintiffs.

Disclosure Claims

With respect to plaintiffs' disclosure claims, the Court rejected at the outset the notion that defendants were entitled to summary judgment because the transaction had already closed and there was therefore no longer a remedy available for any alleged disclosure violations. The Court noted that because entire fairness governed, and issues of loyalty are intertwined with transactions subject to

entire fairness review, this was “not a case in which the Court will refrain from granting relief for disclosure violations because the transaction has been completed.” The Court likewise denied the director defendants’ motion for summary judgment based on a 102(b)(7) exculpatory provision.

Plaintiffs asserted that the proxy statement contained four misstatements and omissions. First, by allegedly failing to convey the special committee’s “subservient, deferential approach,” it mischaracterized the committee’s work as an effective and independent arm’s-length process. The Court concluded, however, that plaintiffs had identified no specific factual misrepresentations or misleading disclosures, but sought merely to have defendants disclose plaintiffs’ own characterization of the special committee process. Because such “self-flagellation” is “clearly” not required under Delaware law, the Court granted summary judgment in favor of defendants on this claim.

Second, plaintiffs alleged that the proxy statement should have disclosed Lehman’s alleged conflict of interest based on its contacts with Eilian regarding the possibility of underwriting a post-merger security offering planned by Eilian. The Court rejected defendants’ arguments that any potential conflict was immaterial because the group at Lehman that had had contact with Eilian was different from the group advising the special committee, and, in any event, Lehman did not ultimately get the underwriting business. The Court concluded that it is “imperative” that even potential conflicts of interest be disclosed — particularly where there has been no public auction of the company and shareholders may place heavy weight upon an expert opinion — so that stockholders can decide for themselves what weight to give such potential conflicts.⁶ The Court was also unpersuaded by the argument that because the contacts regarding the refinancing occurred after Lehman had already opined that a lower offer than the ultimate purchase price was fair, the potential conflict was immaterial to its opinion: “There is no rule ... that conflicts of interest must be disclosed only where there is evidence that the financial advisor’s opinion was actually affected by the conflict.” The Court held that important factual issues about the alleged conflict remained, including the timing and content of such contacts and what the board knew, or should have known, about the alleged conflict, thus precluding summary judgment for defendants.

Similarly, plaintiffs alleged that the proxy statement should have disclosed that Katten Muchen, the special committee’s legal advisor, had a potential conflict due to concurrent representation of a company providing financing for the merger. The Court held that the special committee’s waiver of the conflict and the law firm’s erection of an ethical screen may have resolved any potential ethical violation, but did not obviate the need to disclose the dual representation, and the special committee’s conflict waiver, to stockholders. The Court reiterated the view that such disclosure was particularly important in a case such as this one, in which stockholders were relying on the special committee to negotiate on their behalf.

Finally, plaintiffs alleged that the proxy statement should have disclosed a presentation Eilian made to the special committee projecting JQH valuations higher than the eventual merger price. The Court concluded that it could not determine on the record before it whether and to what extent the presentation valuations were based on unlikely hypothetical scenarios and therefore denied summary judgment to defendants on this claim as well.

Aiding and Abetting Breach of Fiduciary Duty Claims

Plaintiffs also asserted that Eilian's acquisition subsidiaries aided and abetted Hammons' purported breach of fiduciary duties. Focusing on evidence showing that Eilian was aware that JQH's stock price was depressed because of Hammon's alleged self-dealing, the Court denied summary judgment.

While *Hammons* has been cited by many commentators as an example of "bad facts making bad law," a closer look suggests that the better view is that the case merely applies existing law to a bad set of facts. Nevertheless, there are, without doubt, valuable lessons to be learned from *Hammons*. Among other things, the decision suggests that in a transaction involving a controlling stockholder who does not stand on both sides of the transaction in the classic sense, a well-functioning, disinterested independent special committee, combined with a non-waivable vote of a majority of all minority stockholders, will be sufficient to afford business judgment, as opposed to entire fairness review. Questions remain, however, as to precisely where the line is drawn in determining what hat a controlling stockholder is wearing in a given transaction.

In re NYMEX Shareholder Litigation

NYMEX involved two Chancery Court putative class actions challenging the acquisition of NYMEX Holdings, Inc. (NYMEX), whose subsidiaries operated the world's largest commodity futures exchanges, by CME NY, an entity controlled by CME Group, Inc. (CME). The actions were brought on behalf of former stockholders of NYMEX, on the one hand, and Class A Members (*i.e.*, "seat holders" having contractual trading rights) of the NYMEX Exchange (a subsidiary of NYMEX), on the other.

Background

By way of background, the NYMEX Exchange operated as a non-profit membership organization from 1872 until 2000, when it demutualized and converted to a Delaware for-profit entity organized as a stock holding company with a subsidiary membership company. Upon demutualization, each member was given a Class A membership in the subsidiary exchange (representing trading privileges on NYMEX Exchange) and one share of common stock in NYMEX Holdings.

In July 2007, the board established the Strategic Initiatives Committee (the SIC) to consider, negotiate and recommend any significant transactions involving NYMEX. In June or July 2007, John Thain, then chairman of the New York Stock Exchange (NYSE) met with Richard Schaeffer, the chairman of NYMEX and NYMEX Exchange, and expressed interest in acquiring NYMEX. Though not a formal offer, Thain discussed a potential purchase price of \$142 per share, a significant premium to the then-trading price. According to the complaint, Schaeffer did not inform the SIC or the board of these communications with Thain and NYSE ultimately did not make a formal proposal because Schaeffer demanded a senior executive position for himself as a pre-condition to the deal.

In late spring 2007, Schaeffer and James Newsome, President, then-CEO and a member of the board of NYMEX, began negotiations for the sale of NYMEX to CME. In January 2008, NYMEX and CME signed a confidentiality agreement and entered into the first of a series of exclusive negotiating periods. Shortly thereafter, NYMEX announced that it was in the process of negotiating a potential

combination with CME and that CME had offered to buy NYMEX for \$119 per share (a 2.1 percent premium over the closing price on NYMEX shares on that day and an 11 percent premium over the closing price of the prior trading day), a substantial portion of which would be paid in CME stock. Within a week of the announcement, however, CME's stock fell dramatically. Because the CME offer did not contain a collar, the loss in value of CME stock had the effect of materially reducing the proposed merger consideration. Nevertheless, NYMEX extended the exclusivity period and the parties continued to negotiate. At some point during these negotiations, the complaint alleged that Schaeffer and Newsome committed to CME that NYMEX would not attempt to negotiate any of the economic terms of the proposed transaction.

On March 17, 2008, NYMEX announced that it had entered into a merger agreement with CME on the same terms as CME's original offer. Under the terms of the merger agreement, CME would acquire all of NYMEX's stock for \$36 per share in cash and 0.1323 shares of CME common stock per NYMEX share. Based on the value of CME's stock on the day the merger agreement was signed, the implied value of the merger consideration had fallen to \$100.30 per share. All of the NYMEX directors, more than 95 percent of the shares voted, and more than 80 percent of the Class A members approved the merger, which was consummated on August 22, 2008.

The Shareholder Class Action

The shareholder plaintiffs alleged that they did not receive fair value because of various breaches of the fiduciary duties of loyalty, due care and candor by the defendants, including the sale of NYMEX through an unfair process at an inadequate price so that Schaeffer and Newsome could obtain nearly \$60 million in severance payments. Plaintiffs brought a series of breach of fiduciary duty claims against the members of the board, as well as breach of fiduciary duty claims against Schaeffer and Newsome based on their joint role as the "principal negotiators" with CME.

Breach of Fiduciary Claims Against the Board

As a threshold matter, the parties disputed whether the so-called "*Revlon* standard" applied, requiring directors to "take reasonable measures to ensure that the stockholders receive the highest value reasonably attainable" – or whether the business judgment rule applied. The Court noted that *Revlon* scrutiny applies only to transactions in which a "fundamental change of corporate control occurs or is contemplated," and that such a change of control does not occur where control of the corporation remains, post-merger, in a large, fluid market. Thus, the Court noted that Delaware law is not clear on whether a transaction involving merger consideration that is a mix of cash and stock would trigger *Revlon* scrutiny.⁷ The Court, however, punted on the issue, finding that it did not need to decide whether *Revlon* applied to the transaction because the individual directors were protected against breach of due care claims in any event by an exculpatory clause in NYMEX's Certificate of Incorporation authorized by 8 Del. C. §102(b)(7). Thus, even if *Revlon* were to apply, the exculpatory clause would lead to dismissal unless plaintiffs had successfully pled a breach of the duty of loyalty or a failure to act in good faith.

Vice Chancellor Noble then went on to consider — and reject — each of plaintiffs' arguments in support of a purported breach of the duty of loyalty claim. The Court noted at the outset that to state a claim for breach of the duty of loyalty, a plaintiff must plead facts sufficient to show that a majority

of the board breached the duty of loyalty; it would not be sufficient to merely allege — even if they could do so successfully — that Schaeffer and Newsome breached their fiduciary duties. Rather, the plaintiffs had to plead that a majority of the board stood on both sides of the transaction or were “dominated and controlled by someone who did.” In this case, plaintiffs had not alleged that any member of the board other than Schaeffer and Newsome stood on both sides of the transaction. Instead, they alleged that a majority of the NYMEX board was under the domination and control of Schaeffer and had acted in bad faith. As evidence of such domination, plaintiffs pointed to the fact that, among other things, the board had approved the change of control severance plan, accepted CME’s first offer, permitted Schaeffer and Newsome to bypass the SIC, and failed to obtain a collar on the stock portion of the merger consideration. The Court rejected such arguments, finding that plaintiffs’ amounted to nothing more than the fact that the board relied on and, at times, deferred to its chairman:

That directors acquiesce in, or endorse actions by, a chairman of the board — actions that from an outsider’s perspective might seem questionable — does not, without more, support an inference of domination by the chairman or the absence of directorial will. The NYMEX directors were otherwise unquestionably independent — this is not an instance where certain relationships raised some concern but not sufficient doubt to sustain a challenge to director independence. In short, the Complaint alleges nothing more than a board which relied upon, and sometimes deferred to, its chairman. It does not allege dominance such that the independence or good faith of the Board may fairly be questioned. The Court concludes that it would be unreasonable to infer from these allegations that the Board was dominated by Schaeffer or that the Board acted in bad faith.

As such, the Court recognized that plaintiffs’ allegations were merely an attempt to convert their dissatisfaction with the board’s process — a due care claim — into a loyalty claim. But, the Court noted, Delaware law has long recognized that a board’s process need not be perfect and that “there is no single blueprint that a board must follow to fulfill its duties.” The Court also rejected plaintiffs’ allegations of bad faith, finding that the complaint had not alleged that the board had “utterly failed to obtain the best sale price.”⁸ The Court thus granted defendants’ motion to dismiss the fiduciary duty claims.

Breach of Fiduciary Duty Claims Against Schaeffer and Newsome

The Court also dismissed claims for breach of fiduciary duty that were brought against Schaeffer and Newsome in their capacity as the “principal negotiators” with CME (separate and apart from the claims brought against them as members of the board). Specifically, plaintiffs alleged that they had violated their fiduciary duties by (i) rejecting and keeping secret CME’s secret collar offer, (ii) ignoring the SIC and “withholding information regarding strategic opportunities and bids” from fellow directors, (iii) committing to CME that NYMEX would not attempt to renegotiate any of the economic terms of the proposed sale and failing to so advise the board and (iv) entering into an agreement with CME to vote their shares in favor of the proposed acquisition. Plaintiffs also alleged that Schaeffer breached his duties by rejecting NYSE’s interest due to its failure to abide by his personal demands.

The Court first observed that there was no requirement to involve an independent committee in negotiations and that it is “well within the business judgment of the Board to determine how merger negotiations will be conducted, and to delegate the task of negotiating to the Chairman and Chief Executive Officer.” In addition, because the board in this case was independent, there was no requirement to have a committee, and that “existence of such a committee [does not] mandate its use.” Similarly, the Court found that the allegation that Schaeffer and Newsome committed not to renegotiate any of the economic terms of the transaction is not actionable because plaintiffs had not offered any evidence as to how the two alone were capable of binding NYMEX to such an agreement without the board’s consent. Likewise, plaintiffs had not shown why entering into a voting support agreement was improper, particularly where the economic incentives of directors and shareholders are aligned. Accordingly, claims based on each of those allegations were summarily dismissed with little discussion.

The Court gave greater consideration to plaintiffs’ allegations that Schaeffer and Newsome failed to obtain a collar on the transaction and the claim against Schaeffer with respect to the failed negotiations with NYSE, which involve “more complex legal issues.” As to the first, the Court found it was pled in speculative and conclusory fashion, failing to satisfy even the “plaintiff friendly” standards of Rule 12(b)(6). Vice Chancellor Noble explained that (i) “failure to secure deal protections that, in hindsight, would have been beneficial to shareholders does not amount to a breach of the duty of care,” and (ii) plaintiffs’ attempt to convert a duty of care claim into a duty of loyalty claim by arguing that a collar would have diminished the value of Schaeffer’s and Newsome’s stock options failed because it did not establish a conflict (indeed, if it did, every director who had options would have suffered from the same conflict). The Court also discounted the allegation that Schaeffer and Newsome had failed to inform the board of CME’s “offer” to collar the stock portion of the merger consideration. As the Court noted, the board had never requested a collar nor found one worth negotiating for, and it was well within the board’s judgment — regardless of any views that might be ascribed to Schaeffer and Newsome — to omit a collar while negotiating other merger terms. “Whether, in retrospect, such a trade-off was worthwhile is ‘of no legal moment.’”

The Court also dismissed plaintiffs’ claim that Schaeffer prevented a potentially lucrative bid by the NYSE by demanding a position for himself, finding that such a claim (which was a violation of the duty of loyalty and thus not precluded by NYMEX’s exculpatory provision) was derivative, not direct, in nature, and thus plaintiffs lost standing to pursue them following NYMEX’s merger with CME. Noting that the question of whether a claim raised by a plaintiff in a merger context is direct or derivative has historically “proven elusive,” the Court looked to the “nature of the wrong alleged” and who would receive the benefit of any recovery, as set forth in *Tooley v. Donaldson, Lufkin & Jenrette, Inc.*,⁹ and concluded that it may be best seen as an entrenchment claim. Entrenchment claims, the Court noted, are generally derivative in nature.

The Court rejected the argument that plaintiffs’ claim fell under the *Parnes*¹⁰ exception for entrenchment claims in the merger context, which permits claims where a “stockholder who directly attacks the fairness or validity of a merger alleges an injury to the stockholders, not the corporation.” As Vice Chancellor Noble observed, Delaware courts have interpreted the *Parnes* exception “very narrowly,” and “mentioning a merger [in the complaint] does not talismanically create a direct action.” Rather, there must be a causal link between the breach complained of and the ultimate unfairness of the merger. In this case, the Court found that the alleged breached of fiduciary duties were “far too atten-

uated” from the ultimate CME transaction and the price CME paid to establish a causal link. Among other things, the complaint itself alleged that the CME negotiations began only after the NYSE negotiations had been aborted. Moreover, unlike in *Parnes* and its progeny, there was no allegation that the alleged breach occurred in order to benefit CME or provided Schaeffer a personal pecuniary benefit that the NYSE offer did not. Indeed, the Court noted that Schaeffer was not alleged to have received anything of value from the CME transaction apart from the consideration received by all shareholders. As such, allegations relating to the failed NYSE negotiations were purely derivative in nature.

Disclosure Claims

Plaintiffs also alleged that the directors breached their fiduciary duties by not providing class members with all material information about the fairness of the deal. Among other things, plaintiffs alleged that the proxy statement failed to disclose certain details surrounding the NYSE’s \$142 per share offer, Schaeffer’s alleged self-interest in connection with the NYSE transaction and additional information regarding the fairness opinions. The complaint also alleged that the fairness opinions should have been updated to reflect the \$2 billion reduction in merger consideration as a result of the fall in CME’s stock price. The Court dismissed the claims, finding that, to the extent they were grounded in the duty of care, they were barred by NYMEX’s exculpatory clause, and to the extent they were grounded in the duty of loyalty, they were too conclusory: “A mere conclusory allegation that the alleged disclosure violations also constitute a violation of the duty of loyalty is not sufficient to survive a motion to dismiss, particularly in light of the holding that the Complaint fails to otherwise state a non-exculpated claim against the Director Defendants for breach of fiduciary duty.”

Aiding and Abetting Claim

The Court also dismissed a claim against the CME defendants for aiding and abetting the NYMEX defendants’ alleged breach of fiduciary duties, which the Court found was far too conclusory. The Court rejected the argument that CME’s representative knowledge that Schaeffer and Newsome committed not to renegotiate the terms of the transaction sufficiently alleged “knowing encourage[ment]” or participation in an alleged breach, showing only that they were “deft negotiators,” seeking to “lock up” a transaction that they viewed as favorable to CME. The Court noted that the complaint did not allege that CME induced the commitment, and that the “Court’s role on a motion to dismiss is not to redraft the Complaint for the Plaintiffs.”

The Greene Action, on behalf of Class A Member Plaintiffs

The Class A Member plaintiff alleged that defendants breached their fiduciary duties owed to Class A Members in a number of ways, including by failing to maximize the consideration offered for Class A Memberships, failing to provide a fairness opinion with respect to the purchase price of Class A Memberships and certain additional breaches relating to the Class A Members’ Section 311(G) rights. Plaintiff also asserted a claim for breach of fiduciary duty and aiding and abetting breach of fiduciary duty against CME.

Breach of Fiduciary Duty and Aiding and Abetting Claims

Breach of fiduciary duty claims brought by the Class A member plaintiff against the NYMEX directors were rejected because the Court found that, after the demutualization, no vested property right existed in the member seats to give rise to a fiduciary duty. The demutualization severed the Members' equity stake in the Exchange and transferred it to an equity stake in NYMEX and, with that, the fiduciary duties owed to them as members were terminated and the resultant fiduciary relationship existed only by way of their status as shareholders.

The Court rejected plaintiff's argument that a fiduciary duty existed because "members in a no-stock corporation are owed the same fiduciary duties by the corporation's governing body as a shareholder in a stock corporation is owed by the corporation's board of directors," noting that the relevant inquiry is whether there is a "separation of legal control from beneficial ownership" with respect to a valid property interest "necessary for the imposition of a trust relationship with concomitant fiduciary duties." In this case, plaintiff members did not retain an equity stake by way of their membership post-demutualization. The Court rejected the notion that the existence of leasing market for seats on the Exchange evidences a vested property interest that carries with it fiduciary duties, since the members did not cede legal control of their property interest, such that they "repose[d] special trust in and reliance on the judgment of those in control;" instead, they determined whether or not to lease their seat, as well as the terms of any such lease. The Court also rejected plaintiff's argument that various provisions of the Exchange Charter and Bylaws implied any fiduciary duties.

As such, the Court found that the NYMEX defendants owed no fiduciary duty to Class A Members solely by virtue of their membership, stating that, to find otherwise, would "expand the fiduciary relationship far beyond the boundaries previously established by Delaware courts." In addition, because any liability against CME would have necessarily been derivative of duties owed by the NYMEX defendants, the aiding and abetting and breach of fiduciary duty claims against the CME defendants, the Court dismissed those claims as well.

Section 311(G) Claims

The Court also rejected claims that Class A members are entitled to certain payments resulting from Exchange bylaws because a supermajority of Class A members had voted to amend the bylaws and eliminate those payment rights. Because the Court dismissed all claims by Class A members as members or stockholders, it did not reach the issue of whether a waiver and release relinquishing certain of their payment rights was coercive.

Additional Recent Developments in Delaware Business and Securities Law

In addition to the topics discussed above, the Delaware courts also issued noteworthy decisions in the following areas:

"Bad Faith" vs. the "Absence of Good Faith"

- In *Amirsaleh v. Board of Trade of the City of New York Inc.*,¹¹ Chancellor Chandler reconfirmed the Chancery Court view that "a lack of good faith" equates to "bad faith," departing from "suggestions" in a couple of earlier Delaware Supreme Court cases¹² that the two concepts are not one and the same.

In January 2007, the non-profit Board of Trade of the City of New York, Inc. merged into a subsidiary of Intercontinental Exchange, Inc. and became a wholly owned for-profit subsidiary of ICE. In order to maintain his voting rights, plaintiff elected to exchange his membership interests in the pre-merger NYBOT for shares in the new entity instead of cash, as provided in the merger agreement, but he did so late. Although the NYBOT administrators had accepted all other late elections, they refused to accept plaintiff's untimely election and he, in turn, sued for breach of the merger agreement's implied covenant of good faith and fair dealing. While plaintiff argued that a showing of the absence of good faith — rather than a showing of bad faith — was all that was necessary to establish his claim, Chancellor Chandler disagreed, finding that “‘good faith’ conduct can only be understood by reference to ‘bad faith’ conduct.” If no “stand-alone definition of ‘good faith’ exists,” the Court questioned “how the phrase ‘a lack of good faith’ has any ascertainable meaning”; in other words, “how can the plaintiff prove the absence of something that is undefined?” In so holding, Chancellor Chandler agreed with Vice Chancellor Strine’s reasoning in an earlier case¹³ that “sensible policy, logical, and linguistic grounds” call for a rejection of the notion that “not in good faith” means something different than “bad faith.” Having established that “bad faith” must be shown to establish an implied covenant breach, Chancellor Chandler turned to how one proves bad faith, stating that, a plaintiff must demonstrate that the defendant’s conduct was “motivated by a culpable mental state,” or, put another way, “an improper purpose.” Finding that a factual dispute remained over whether defendants’ decisions had been “driven by an improper purpose,” the Court denied plaintiff’s motion for summary judgment.

Discretionary Decline of Jurisdiction

- Invoking “an appropriate regard for comity” in *Third Avenue Trust v. MBIA Insurance Corp.*,¹⁴ Vice Chancellor Strine abstained from exercising jurisdiction over a dispute governed by New York choice of law and forum selection provisions, involving entities with substantial ties to New York and implicating complex questions of New York law. Delaware-based noteholders whose principal places of business are in New York brought contract and fraudulent conveyance claims against MBIA, a New York-based insurance company, alleging that MBIA had sold substantially all of its assets to an affiliate for no consideration in order to create a single health company (the transferee) that would have all of MBIA’s productive assets without the dubious assets and liabilities it left behind. The noteholders alleged that, as a result of the transaction, which was approved by New York’s Superintendent of Insurance and effectuated in a transaction on February 18, 2009, they were left with the securities of an insolvent company. MBIA sought a stay or dismissal of the action, arguing, among other things, that, because the transaction was approved by the Superintendent of Insurance, who found that MBIA would remain solvent following the transfer and had not transferred “all or substantially all of its assets,” plaintiffs’ claims were essentially an impermissible “collateral attack” on that finding that can only be brought by way of an action under Article 78 of New York’s Civil Practice Law and Rules, which grants parties a statutorily-defined opportunity to challenge the findings of administrative officers. MBIA also noted that the parties had contracted for New York courts to hear all disputes relating to the exercise of the Superintendent’s authority. The noteholders argued that, under New York law, the mere fact that the transaction was approved by the Superintendent does not foreclose them from suing based on contractual rights or New York fraudulent conveyance law. Though acknowledging that plaintiffs may ultimately be entitled to sue on such theories, Vice Chancellor Strine nevertheless dismissed the claims without prejudice. Noting the significant New York precedent precluding collateral attacks on the Superintendent’s findings, and finding that “the issue regarding the collateral effect of the Superintendent’s ruling on [plaintiffs’] ability to press its breach of contract and fraudulent

conveyance claims” is an important one of New York public policy, the Court concluded that courts in New York, which “has a far greater interest than Delaware in resolving this question,” should be given the opportunity to determine in the first instance whether the claims constituted an improper collateral attack on the judgment of the Superintendent.¹⁵

- Applying the first-filed rule and principles of comity and efficiency in *Choice Hotels International, Inc. v. Columbus-Hunt Park DR. BNK Investors, L.L.C.*,¹⁶ Vice Chancellor Parsons stayed a Delaware action in favor of consolidated, earlier-filed Maryland actions involving borrowers who had defaulted on loans from hotel-franchiser Choice Hotels International, Inc. Five weeks after Choice and the borrowers had filed dueling complaints against each other in Maryland state court, Choice filed a second suit against many of the same parties in the Chancery Court. Defendants argued for a stay under the *McWane*¹⁷ doctrine, which favors such a result “when there is a prior action pending elsewhere, in a court capable of doing prompt and complete justice, involving the same parties and the same issues.”¹⁸ While Choice argued that 6 Del. C. §18-110, which provides for summary proceedings to resolve uncertainty concerning the governance of limited liability companies, precluded a stay under *McWane*, the Vice Chancellor disagreed, holding that the policies underlying §18-110 do not always trump *McWane* and that it was necessary for courts instead to balance the respective policies of each. The Court held that (i) the Maryland actions were earlier filed, (ii) the parties and issues were the same because the complexity of the claims created a significant risk that separate actions would result in inconsistent or conflicting rulings, (iii) Maryland courts were capable of providing prompt and complete justice given that the actions there were on an expedited “Business and Technology Track” and (iv) the balance of hardships weighed in favor of staying the Delaware action.

Jurisdictional Issues

- In *Sokol Holdings, Inc. v. Dorsey & Whitney, LLP*,¹⁹ the Chancery Court denied a motion to maintain jurisdiction filed by defendant law firm Dorsey & Whitney, LLP and transferred the case to the Delaware Superior Court. A former client sued Dorsey for professional negligence and breach of fiduciary duty in connection with allegations of overbilling. After the parties failed to achieve settlement in voluntary mediation, plaintiff suggested that the Chancery Court did not have jurisdiction and sought to retain the right to a jury trial if the case were transferred. Dorsey filed a motion to maintain jurisdiction or, alternatively, to seek a bench trial in the Superior Court. Vice Chancellor Strine held that the Chancery Court — which has no power to determine any matter for which sufficient remedy may be had before any other Delaware court — did not have jurisdiction. Dorsey argued that plaintiff’s breach of fiduciary duty allegations invoked the Court’s equitable jurisdiction, but Vice Chancellor Strine explained that the attorney-client relationship did not create a true fiduciary relationship because attorneys generally do not exercise control over their clients’ property. Although the conduct of attorneys can in some circumstances raise fiduciary concerns, here the Court held the dispute was “simply about fees.” The Court transferred the case to the Superior Court for a bench trial, holding that plaintiff had waived its right to a jury trial by bringing the action in the Chancery Court in the first instance.

- In *Total Holdings USA, Inc. v. Curran Composites, Inc.*,²⁰ Vice Chancellor Strine held that a consent provision in §15-114 of the Delaware Revised Uniform Partnership Act provided the Chancery Court with personal jurisdiction over, and that there was no due-process problem with applying the DRUPA to, a party in a dispute over the meaning of a Delaware partnership’s general partnership agreement. Defendant, a Missouri holding company with no facilities or business in Delaware, exercised a put

option provided for in a general partnership joint venture agreement it entered with plaintiffs and, when sued for allegedly being overpaid on the put, argued that a Delaware general partnership is governed by the DRUPA only if it registers with the state. The Vice Chancellor disagreed, finding that the text of the DRUPA itself indicated a legislative intention to cover both registered and unregistered partnerships. While defendant also argued that the case was merely a routine contract dispute that did not implicate § 15-114, Vice Chancellor Strine found that the allegation that defendant owed a debt to a partner under the joint venture agreement clearly related to the “business of the partnership,” thus triggering the DRUPA. The Court also reasoned that the application of § 15-114 did not violate due process because defendant should not be surprised that such a dispute would be adjudicated in Delaware and his self-interest in avoiding its contractual bargain is outweighed by Delaware’s “strong public interest” in adjudicating internal disputes between partners.

Advancement and Indemnification Provisions

- In *Martinez v. Regions Financial Corp.*,²¹ the Chancery Court refused to impose a reasonableness requirement in enforcing the terms of an advancement provision in an employment contract between plaintiff, a former bank executive, and her previous employer. Plaintiff brought breach of contract claims to collect golden parachute, bonus and other payments allegedly due her under a change of control agreement with defendant’s pre-merger predecessor and then moved for partial summary judgment on her advancement claim. The defendant bank moved for summary judgment on the merits of all claims and argued that the clause in the employment agreement providing for advancement of “all legal fees and expenses which the Executive may *reasonably* incur” was a limitation that was not satisfied because the Seventh Circuit had rejected similar requests in interpreting similar provisions in an executive contract. Vice Chancellor Parsons granted only in part plaintiff’s motions seeking employment benefits but ordered advancement of her legal fees and expenses, refusing to condition the award of fees on a determination of reasonableness. The Court explained that the only limitation to plaintiff’s broad advancement rights under the plain language of the employment agreement is the implied right of good faith and fair dealing, and defendant had not shown that plaintiff acted in bad faith in bringing any of her claims, despite the fact that she did not prevail on all of them and despite the unfavorable that Seventh Circuit precedent.²²
- In *O’Brien v. IAC/Interactive Corp.*,²³ the Chancery Court held that laches did not bar plaintiff’s claim for indemnification from his former employer’s former parent corporation and ordered advancement. Plaintiff and his former employer entered arbitration concerning the acquisition of a failing company he had approved before his termination. In 2005, the arbitration panel found that neither party was entitled to recovery against the other and that each was responsible for its own legal fees, even though the company had contractually agreed to indemnify plaintiff. Later that year, plaintiff sued the company for indemnification in a Florida trial court, which granted summary judgment to his former employer. Plaintiff appealed to a state circuit court, which vacated the decision and remanded for determination of the amount of advancement due, but the proceedings were stayed after the company filed for bankruptcy under Chapter 11. After the company’s reorganization plan was approved in June 2008, plaintiff sued the company’s former parent in Delaware in July 2008 to enforce its prior agreement to assume the company’s indemnification and advancement obligations. Defendant argued that the claims were stale under Florida’s five-year statute of limitations or Delaware’s three-year statute, but Vice Chancellor Parsons rejected the argument, holding that the doctrine of “laches guides considerations of timeliness in a court of equity, especially where there are unusual or mitigating

circumstances, as here.” Citing the “procedural purgatory” plaintiff faced during the period between the trial court’s denial of his indemnification claim and the appellate court’s reversal, and crediting plaintiff’s argument that his claim against defendant had not ripened until his former employer’s bankruptcy precluded recovery from it, the Chancery Court held that plaintiff had not unreasonably delayed bringing his claims against defendant. Because these “unusual and mitigating circumstances” rebutted the presumption that the three-year statute of limitations period should control, the Court denied defendant’s motion for summary judgment on the issue of indemnification in the arbitration, Florida actions, and bankruptcy proceeding and granted plaintiff’s motion for summary judgment on advancement in the instant case.

Demand Futility

- In *King v. Baldino*,²⁴ Magistrate Mary Pat Thyng of the District of Delaware dismissed a complaint for failure to plead demand futility by plaintiff stockholder of Cephalon, Inc. in a derivative suit alleging that members of the Cephalon board breached their fiduciary duties by failing to rein in improper marketing of the company’s pharmaceutical products. The complaint alleged that Cephalon employees aggressively marketed three prescription drugs for “off-label” use in violation of FDA regulations and the Food and Drug Administration Modernization Act of 1997,²⁵ resulting in a \$425 million settlement with the Philadelphia United States Attorney’s Office of federal and state Medicaid claims. Plaintiff argued that demand would have been futile because the Cephalon directors were financially interested due to benefits received for board service and because bringing the derivative action on their own would have required them to sue themselves and/or their fellow directors. The Court, however, observed that in Delaware, allegations that directors are paid for their services, without more, do not establish financial interest, and the Court held that plaintiff failed to plead particularized facts supporting the conclusory allegation that the directors’ “entangling alliances, interests, and dependencies” would have prohibited them from vigorously prosecuting a derivative action. Plaintiff’s claim that defendants’ failure to act breached their *Caremark* duties of loyalty also was rejected by the Court because (i) the complaint did not allege that the board failed to implement any reporting or information systems or controls and (ii) plaintiff did not show, without the benefit of hindsight, that the directors had consciously ignored, or were even aware of, purported “red flags” of the company’s wrongdoing.
- In *Lola Cars International Ltd. v. Krohn Racing, LLC*, related actions²⁶ concerning partners in a race car design and manufacturing venture, the Chancery Court addressed several issues in denying a motion to dismiss one complaint and dismissing a second one without prejudice. In the first action, Vice Chancellor Noble held that plaintiff satisfied the demand excusal standard where one of two LLC directors was found to be interested because he faced a substantial risk of liability under the facts alleged in the litigation. The Court also held that the LLC operating agreement granting the corporate defendant exclusive power to replace the CEO did not defeat the claim for breach of implied covenant of good faith and fair dealing because the Court could draw a reasonable inference that defendant acted in bad faith by failing even to consider plaintiff’s request to remove the CEO, who was also a named defendant. The Court additionally declined to dismiss plaintiff’s request for judicial dissolution under Section 18-802 of Delaware’s Limited Liability Company Act²⁷ because it was uncertain whether the company could carry on its business with reasonable practicality where (i) the members’ vote was deadlocked at the board level, (ii) the buy-out mechanism in the operating agreement was entirely voluntary and (iii) it was doubtful whether the insolvent company could continue to operate

given its financial condition and the alleged carelessness and disloyalty of its CEO.²⁸ In the second action, the Court dismissed the complaint without prejudice for failure to state a claim because the complaint in the first action, by not advising defendants of the consequences of failure to rectify alleged breaches of the company's operating agreement, did not constitute proper notice under the terms of the agreement.

Class Certification

- In *In re Countrywide Corp. Shareholders Litigation*,²⁹ the Chancery Court certified a class action by stockholders of Countrywide Financial Corporation challenging the 2008 merger of Countrywide with the Bank of America and approved a settlement agreement between the class and BofA and its directors, overruling objections that federal securities law claims arising from statements made by BofA CEO Kenneth Lewis should have been carved out of the settlement. The objectors had argued that the settlement was unfair because it provided no monetary benefit, but the Court found the purported securities claims possessed no obvious value so it was not unreasonable or unfair to surrender them for “therapeutic disclosures” before the merger was approved. The Court also rejected the argument that the federal securities law claims predominated over the equitable claims in the class action complaint. The objectors further failed in their argument that the settlement was overbroad because the claims based on the Lewis statements arose out of different operative facts from those upon which the class action was based, as the Court found all of the claims based on the same broad, underlying theory, *i.e.*, that certain individuals at Countrywide and BOA behaved improperly in effecting the merger.

Determination of Lead Counsel in Class Action

- In *Dutiel v. Tween Brands Inc.*,³⁰ Chancellor Chandler consolidated putative class actions challenging a proposed merger between clothing retailers and appointed a group of Ohio-based litigants as lead plaintiffs over a competing Delaware-based plaintiff because various law firms involved in the Ohio actions had worked together to choose one lead counsel. After identifying the relevant factors the Court ought to consider in making such a determination — *i.e.*, the quality of the pleading that would best represent the plaintiff class, which shareholder plaintiff has the greatest economic stake and whether a particular litigant has prosecuted the lawsuit with greater energy, enthusiasm or vigor — the Court found it could not identify differences in the pleadings or in the level of enthusiasm. The Court likewise found it could not rely on the timing of the filings as evidence of their enthusiasm, since “the notion that the first to file a lawsuit in this Court wins some advantage in the race to represent the shareholder class ... has neither empirical nor logical support.” The Court noted, however, the different levels of economic interest, with the Ohio plaintiffs’ collective \$11,000 more than 1,200 percent greater than the Delaware plaintiff’s \$900. Accordingly, the Court appointed the Ohio plaintiffs as lead counsel.

In a follow-up decision,³¹ Chancellor Chandler denied plaintiff’s motion for reargument and, among other things, rejected plaintiff’s contentions that (i) precedent required relative economic stakes to be given greater weight than simple economic stakes³² and (ii) the Court’s earlier decision created an incentive for plaintiffs to game the system by filing in a different jurisdiction first and seeking a second bite of the apple by filing in Delaware after determining that their first action is going to be stayed or dismissed.

Discretionary Extension of Corporate Legal Existence Beyond Three-Year Period Following Dissolution

- In *In the Matter of Texas Eastern Overseas, Inc.*,³³ the Chancery Court held that a receiver may be appointed for a dissolved corporation under DGCL § 279 despite the expiration of the three-year extension of corporate legal existence under § 278, provided the corporation still has undistributed assets — finding that “§ 279 could be said to provide a discretionary extension of the time limitations of § 278.” Petitioner had sought indemnification from respondent in federal district court³⁴ for hazardous waste remediation expenses involving a California industrial cleaning facility owned by respondent’s predecessor. When respondent moved for dismissal under 8 Del. C. § 278, arguing that the corporation could no longer be sued because it had been dissolved for more than three years, the district court stayed the federal action to allow petitioner to seek the appointment of a receiver under § 279 in the Court of Chancery. Vice Chancellor Noble held that good cause for the receiver’s appointment existed because (i) petitioner had asserted reasonable grounds to conclude that respondent has undistributed assets in the form of general liability insurance rights, (ii) § 278’s policy of protecting former shareholders, officers, and directors would be only minimally implicated and (iii) it was undisputed that petitioner had a bona fide claim against respondent in the federal action. While respondent argued that the dissolved corporation’s shareholders, officers and directors faced potential exposure should any liability exceed its insurance coverage, the Vice Chancellor made clear that § 279 limited the receiver’s authority to “take charge of the corporation’s property, and ... collect the debts and property due and belonging to the corporation” for the purpose of prosecuting and defending lawsuits, not to pursue property belonging to former directors, officers or shareholders.

Standing: Direct v. Derivative

- In *Case Financial, Inc. v. Alden*,³⁵ the Chancery Court held that Case Financial, a litigation finance company, has standing to assert direct claims for fraud and breach of fiduciary duty against its former CEO and director for conduct he engaged in while concurrently serving in the same position for the company’s wholly owned subsidiary. Vice Chancellor Parsons first rejected Case Financial’s “unusual” attempt to pierce its own corporate veil by arguing that parent and subsidiary should be treated as one. Although the two companies filed consolidated statements with the SEC and have overlapping boards and Case Financial directed actions by the subsidiary to be taken by written consent rather than by meetings of the subsidiary’s board, the company failed to meet its “substantial burden” by failing to show undercapitalization or insolvency of, or siphoning of funds from, the subsidiary, that corporate formalities were not observed, or that the subsidiary functioned as a façade for the parent. On the second ground for standing, the CEO argued that Case Financial could not sue directly because the alleged misconduct occurred entirely within the subsidiary and therefore any injury by Case Financial was suffered derivatively through its equity in the subsidiary. However, after a bifurcated trial on this and other threshold issues, the Court found that Alden’s service as CEO and director to the parent imposed on him fiduciary duties to Case Financial directly and that those duties were breached even if the conduct occurred entirely within the subsidiary.

Proxy Put

- In *San Antonio Fire & Police Pension Fund v. Amylin Pharmaceuticals, Inc.*,³⁶ the Supreme Court affirmed the Chancery Court’s widely-noted decision³⁷ that Amylin Pharmaceutical’s directors had

not breached their duties of care in authorizing a “proxy put” provision in an indenture agreement. Sitting *en banc*, the Supreme Court articulated a reason “implicit” in the lower court’s opinion: plaintiffs had not shown “that approving the ‘proxy put’ at that point in time would involve any reasonably foreseeable material risk to the corporation or its stockholders,” a risk that materialized only later and was “aggravated by the unexpected, cataclysmic decline in the nation’s financial system and capital markets.”

Disqualification

- In *Boston Scientific Corp. v. Johnson & Johnson Inc.*,³⁸ the District of Delaware found that Howrey LLP, which was representing pharmaceutical company Wyeth in a European patent case, violated Rule 1.7 of the ABA Model Rules of Professional Conduct by concurrently representing plaintiffs in the instant consolidated cases in which Wyeth was a defendant. However, given that the suits here were unrelated and Howrey instituted an ethical wall between its Washington, DC-based lawyers handling the instant suit and its Europe-based lawyers handling the patent suit, the Court ruled that disqualification was not the proper remedy and instead ordered Howrey to maintain its ethical wall. In so doing, the Court recognized that case law in other jurisdictions suggests that a violation of Model Rule 1.7 should result in disqualification, but stated that disqualification in the Third Circuit and in Delaware “depends on the facts of the case and is never automatic.”

Inspection of Books and Records

- In *City of Westland Police & Fire Retirement System v. Axcelis Technologies, Inc.*,³⁹ Vice Chancellor Noble limited the practical impact of a Pfizer-style corporate governance policy requiring directors failing to receive a majority of the stockholder vote to submit their resignations to a committee of the corporation’s board. The Court denied a request to compel inspection of books and records of defendant Axcelis Technologies, Inc. under 8 Del. C. § 200, which requires that a plaintiff demonstrate a “proper purpose” for inspection, “reasonably related to such person’s interest as a stockholder.” Plaintiff argued that the documents were needed to investigate whether members of Axcelis’ board breached their fiduciary duties by retaining three directors who had tendered their resignations after having failed to obtain a majority of votes cast at the annual shareholders’ meeting and by failing to accept an acquisition offer from a competitor to whom it soon thereafter sold the company’s principal asset for less than the initial offer. Although investigation of suspected wrongdoing on the part of management or directors is a proper purpose for inspection of the corporation’s books and records, the Court held that plaintiff failed its burden of presenting “some evidence to suggest a credible basis from which [this Court] can infer that mismanagement, waste, or wrongdoing may have occurred,” even though that “lowest possible burden of proof in Delaware jurisprudence” can be satisfied “through documents, logic, testimony or otherwise” without any proof that wrongdoing actually occurred. The Court found insufficient plaintiff’s “bare accusation” that retention of the three directors by the independent members of the board was for defensive purposes or motivated by entrenchment, and it likewise found no basis from which to infer that the board’s actions involving sale of the company and its asset were anything other than good faith business decisions, findings that obviated a heightened Unocal review.

- In *Smith v. Horizon Lines, Inc.*,⁴⁰ the Chancery Court dismissed without prejudice a complaint seeking to enforce inspection rights because plaintiff’s submission of a heavily-redacted account

statement did not show beneficial ownership and therefore failed the “documentary evidence” requirement under 8 Del. § 220 — the express statutory requirements of which, the Court observed, are strictly applied. Plaintiff, a purported stockholder of defendant, served a demand letter along with the redacted statement supposedly showing plaintiff’s beneficial stock ownership and a verification stated under oath attesting that the documentary evidence was what it purported to be. Explaining that the stockholder’s sworn statement and documentary evidence of beneficial ownership are independent requirements under § 220, Chancellor Chandler refused plaintiff’s argument that any documentary evidence is sufficient to show ownership merely because a plaintiff has sworn it is “true and correct.” Plaintiff was, however, granted additional time to file a new demand.

Scope of Arbitrator’s Authority

- Holding that an arbitrator had not exceeded his authority in refusing to award attorneys’ fees, the Chancery Court in *World-Win Marketing, Inc. v. Ganley Management Co.*⁴¹ denied plaintiff’s motion to partially vacate the arbitration award and granted summary judgment to defendant. The arbitrator had ruled that defendant, a Cleveland auto dealership, and plaintiff, a marketing company for auto dealers, were equally negligent in the performance and breach of a sales promotion contract between the parties, ordered that plaintiff receive only half of the damages it sought, and concluded that each party should bear its own costs. In bringing the action in Chancery Court, plaintiff argued that the arbitrator exceeded his powers by failing to implement a section of the contract providing that the prevailing party in an action to enforce the contract shall be entitled to recover attorneys’ fees. Specifically, Chancellor Chandler rejected plaintiff’s formulation of Delaware case law that an award of any damages in a contract action necessarily means that a plaintiff has prevailed.⁴² The Court also rejected the plaintiff’s argument that the arbitrator’s decision should be vacated because the parties had not raised the issue of attorneys’ fees.⁴³ More generally, the Court several times repeated that it was not an appeals court for the decisions of an arbitrator and therefore would not review the substantive merits of the arbitrator’s decision, “even where the issue is a contractual term that has an established meaning under Delaware case law.”

Duty to Disclose

- In *Xu v. Heckmann Corp.*,⁴⁴ the Chancery Court adopted New York case law holding that where a director negotiates a general release with the corporation amid suspicions or allegations that the director committed fraud, the director has no fiduciary duty to disclose all his wrongful acts before signing the release and the release will be enforced to settle all fraud claims, even those whose scope were unknown at signing. Chancellor Chandler explained that requiring a director to disclose all prior wrongdoing would remove any incentive to settle fiduciary duty claims based on fraud. In this case, however, the Court dismissed a counterclaim alleging breach of fiduciary duties because it could not conclude that defendant holding company knew that its director allegedly had engaged in fraud before signing a post-merger agreement containing a general release.
- In *Laborers Local 235 Benefit Funds v. Starent Networks, Corp.*,⁴⁵ Chancellor Chandler granted plaintiff’s motion to expedite where defendant corporation’s proxy statement contained inconsistent valuation methodologies for its treatment of stock-based compensation expenses. While noting that there may be a valid reason for the differing methodologies, the Chancellor stated that the fact that the discrepancy was not disclosed or otherwise highlighted gave him “pause.” Having concluded

that plaintiff established a colorable disclosure claim, the Court went to observe that, under Delaware law, “nearly all disclosure violations are *per se* irreparable harm because the harm arising from the un- or misinformed transaction is of a nature where the injury cannot be compensated adequately in damages.” Accordingly, the Chancellor found that plaintiff had adequately demonstrated a threat of irreparable harm and scheduled a preliminary injunction hearing.

Scope of Section 225 Suits

- In *Levinhar v. MDG Medical, Inc.*,⁴⁶ Vice Chancellor Strine outlined the scope of claims permitted in a summary proceeding pursuant to Section 225 of the Delaware General Corporation Law, which is designed to address the appropriate composition of a board. Plaintiffs sought to litigate claims that were related to a previously-settled 225 action, but had not been included in that suit. Ruling that such claims were barred by *res judicata*, the Vice Chancellor stated that claims that bear on the appropriate composition of the board of directors may be brought in connection with a Section 225 action, despite the fact such suits are summary in nature. Thus, a Section 225 action must include not only the specific issue of proper board composition, but also any related issues that bear on that issue.

Contract Claims

- *Airborne Health, Inc. v. Squid Soap, LP*,⁴⁷ a breach of contract case, is perhaps most noteworthy as the first significant decision handed down by Vice Chancellor Laster, the Chancery Court’s newest member. The parties entered into an asset purchase agreement (APA) pursuant to which the plaintiff, a cold-remedy maker, purchased patents and other intellectual property from the defendant, a soap-dispenser startup, for \$1 million cash at closing and the potential for earn-out payments of up to \$26.5 million, with provisions for the return transfer of the assets if certain sales and marketing targets were not met within a year. After closing, plaintiff paid approximately \$60 million to settle fraud claims in a class action in California and proceedings brought by the Federal Trade Commission and 32 state Attorneys General, resulting in a “maelstrom of media attacks” that, as alleged in defendant’s counterclaims, damaged plaintiff’s ability to achieve the earn-out targets. Despite a forum selection clause in the APA providing for a Delaware forum, defendant brought an action in federal district court in Texas alleging fraud and other claims relating to the APA. After the Texas action was dismissed, plaintiff and the law firm it hired to draft the APA sought a declaratory judgment in Delaware Chancery Court to establish that they were not liable under the APA. Defendant counterclaimed against both, who then moved for judgment on the pleadings. Defendant argued that plaintiff violated a clause in the APA requiring it to disclose any litigation that was reasonably likely to prohibit or restrain its ability to enter into the APA or to “consummate the transactions contemplated [t]hereby.” Defendant argued that the “transactions” referred to the earn-out payments, but Vice Chancellor Laster, drawing on his experience [a]s a corporate and business practitioner prior to joining the Court, started with the “general observation that ‘consummate the transactions contemplated hereby’ is language that refers to closing,” rather than achieving earn-out targets. Vice Chancellor Laster buttressed that conclusion with support from a leading deal treatise, legal and standard English dictionaries, and other APA clauses, and awarded judgment on the pleadings in favor of plaintiffs. The Vice Chancellor also found that the APA’s integration clause did not constitute a valid anti-reliance provision barring defendant’s extra-contractual counterclaims for fraud, but held that those claims failed in any event for lack of particularity under Delaware pleading standards. The Court also dismissed defendant’s counterclaim

for equitable fraud because there was no fiduciary duty or other special circumstance since both entities were sophisticated parties who negotiated the APA at arms' length, as well as its counterclaims for breach of contract and breach of the implied covenant of good faith and fair dealing because defendant failed to include in the APA performance commitments provisions "familiar to any transactional lawyer." While the Court granted plaintiffs' requests for a declaration that they had not breached the APA, it declined to issue a declaration on the validity of the forum selection clause or to grant specific performance compelling defendant to accept return of the purchased assets.

Admissibility of Expert Evidence

- In *General Motors Corp. v. Grenier*,⁴⁸ the Delaware Supreme Court reconfirmed that Delaware follows federal *Daubert*⁴⁹ standards governing the admissibility of expert evidence in affirming a jury verdict holding GM liable for plaintiff's asbestos injuries. Applying Delaware's Evidence Rule 702 (which is identical to the federal rule), Justice Berger, writing for four of the five Justices sitting *en banc*, found no abuse of discretion in the trial court's decision to admit causation testimony of two asbestos researchers who had "employed reliable methodology, based on what is known and inferences derived by the scientific method." Chief Justice Steele dissented based on the facts presented, finding that the trial judge had improperly allowed the jury to hear the expert testimony before completing the *Daubert* analysis and without sufficient factual support for the methodologies.

Red Flags

- In *Collins & Aikman Corp. v. Stockman*,⁵⁰ the District Court for the District of Delaware denied motions to dismiss malpractice and breach of contract claims against third-party auditor defendants where numerous "red flags" should have alerted them to purported wrongdoing by the primary corporate and individual defendants. Judge Robinson, disagreeing in part with the magistrate's report and recommendation, found the amended complaint "replete with allegations that there were risk factors ('red flags')" sufficient to warn of accounting irregularities such as (i) overstatement of the company's deferred tax assets, (ii) improper reporting of related party transactions and (iii) inadequate disclosure about liquidity issues and ability of the company to continue as a going concern — allegations that raised a right to relief above the speculative level.

Substantive and Procedural Arbitrability

- In *Lefkowitz v. HWF Holdings, LLC*,⁵¹ Vice Chancellor Parsons held that under the parties' purchase agreement, the validity of contractual and statutory time-bar defenses were procedural questions that must be decided in the first instance by an arbitrator. Accordingly, the Court denied a motion for preliminary injunction and declaratory judgment and dismissed the action for lack of subject matter jurisdiction. Plaintiffs sold their shares of stock in a flooring retail business to defendants pursuant to a purchase agreement containing an arbitration clause. After managing the business for two years and then ceasing operations, defendants notified plaintiffs that they would seek arbitration in Chicago to pursue indemnification claims for alleged breach of the purchase agreement. Plaintiffs sued in the Court of Chancery seeking (i) a declaratory judgment that the claims by defendant purchasers were time barred, and (ii) an injunction prohibiting defendants from bringing arbitration proceedings in Chicago. Defendants argued that (i) the Federal Arbitration Act governed and mandated arbitration in the first instance, thus removing jurisdiction from the Court. Plaintiffs argued that two choice of law references in the purchase agreement evinced the parties' intention for governance by the Delaware

Uniform Arbitration Act,⁵² which provided for jurisdiction by the court where a party invokes a time bar defense. The Court held that the parties had unequivocally demonstrated their intent to displace the federal arbitration standard, but they had not clearly demonstrated whether they intended the DUAA or the Model Uniform Arbitration Act to govern. Because the FAA is displaced only where the parties “clearly evidence their intent to be bound” by a state act such as the DUAA, the FAA governed by default. The Court nonetheless continued with an examination of whether it would have jurisdiction even if the purchase agreement called for application of the DUAA. The Court reviewed the distinction between substantive arbitrability — a “gateway question” asking whether the parties decided in the contract to submit a particular dispute to arbitration — and procedural arbitrability — whether the parties have complied with the terms of the arbitration clause, and an even more basic question of “who should decide whether the parties decided in the contract to submit a particular dispute to arbitration or to a court.” Vice Chancellor Parsons cited the *Willie Gary*⁵³ two-prong test for determining whether an arbitration clause constitutes clear and unmistakable evidence of the parties’ intent to overcome the presumption that courts rather than arbitrators should decide whether the parties had contracted for arbitration: did the arbitration clause (i) generally refer all disputes to arbitration and (ii) “reference a set of arbitral rules that empowers arbitrators to decide arbitrability?” The Court held that the purchase agreement here satisfied both prongs because it designated arbitration without any broad carve-outs and it stated unequivocally that the arbitration is to be governed by the American Arbitration Association Rules. In contrast to substantive arbitrability, the Court explained, “the law presumes that procedural arbitrability questions will be handled by arbitrators and not by courts.” To overcome that presumption here, plaintiffs would have to show that the DUAA’s jurisdiction clauses clearly applied under the parties’ purchase agreement. Vice Chancellor Parsons found that the AAA Rules, which “plainly assign to the arbitrator in the first instance the responsibility to resolve procedural arbitrability questions, such as contractual time limit and statute of limitations defenses,” empowered the arbitrator to decide questions of procedural arbitrability. The DUAA, which under the purchase agreement serves as a gap filler, therefore did not apply. Finally, the Court refused to invoke its traditional general equity jurisdiction because (i) the claims here were not committed to arbitration by the parties, and (ii) plaintiffs had an adequate remedy at law and therefore could not show irreparable injury.

Discovery-Related Issues

In a trio of decisions, the Chancery Court provided some useful guidance on various aspects of discovery under Delaware law, including the proper use of privilege logs, waiver of privilege through selective disclosure, the scope of redaction and disclosure of underlying facts within privileged documents, the use of “highly confidential” designations, clawback of inadvertently produced privileged documents and, last but not least, the severe penalty potentially resulting from delay and bad faith in the production of documents and payment of attorneys’ fees.

- In *Cephalon, Inc. v. Johns Hopkins University*,⁵⁴ Vice Chancellor Parsons sustained plaintiff’s claim that defendants’ privilege log was inadequate where it merely provided the conclusory notation of “Attorney-Client Privilege,” and ordered defendants, under penalty of producing the documents, to revise the logs as to each such document to (i) state whether it has been withheld on the basis of attorney-client privilege or work product immunity, and (ii) state that it contains confidential information made “for the purpose of facilitating the rendition of professional legal services to the client” or provide a similar basis for privilege. The Court also rejected plaintiffs’ request that defendants re-review all of

their privileged documents to determine whether any contain purely factual information that should be produced, noting that not all facts contained anywhere in a privileged document need to be produced, but “may be required if the factual information easily can be segregated from other aspects of a document and produced without disclosing privileged communications.” Vice Chancellor Parsons thus ordered defendants to produce in redacted form “isolated factual information that does not qualify for attorney-client or work product protection.”

- In *eBay Domestic Holdings, Inc. v. Newmark*,⁵⁵ concerning discovery disputes between online auction website eBay and majority owner-directors of the classified advertising Web site Craigslist, Chancellor Chandler provided helpful guidance on “highly confidential” designations, redaction, and clawback. Defendants moved for an order compelling eBay to withdraw the “highly confidential” designation from documents previously produced to the New York Attorney General in previous litigation so that defendants could review them. The Court credited defendants’ good faith effort to reduce eBay’s burden by reducing by 90 percent the number of documents for which they sought the designation change, and accordingly the Court ordered eBay to review within one week the remaining 1,900 documents for a determination of whether they warrant the highly confidential designation. Defendants also sought production of complete versions of eBay board minutes, portions of which eBay had redacted because it contended they were unrelated to Craigslist or not otherwise relevant. Reasoning that evidence of eBay’s conduct could be relevant to rebut evidence that eBay did not pose a threat to Craigslist, the Court ordered eBay to produce unredacted version of the minutes. Finally, defendants requested the Court to order eBay to produce documents eBay sought to “claw back” on grounds of privilege after it had inadvertently produced them. Defendants argued that the documents are not privileged and that their production by eBay waived any privilege that may have otherwise applied. Stating its concern that severely constraining clawback would deter the disclosure of non-privileged documents while also noting the inconsistent positions each party had taken as to the privileged status of the documents, the Court ruled that the “appropriate and equitable solution” would be to base the decision on whether each document was actually privileged. eBay was given one week to provide a detailed privilege log identifying and describing each document and its basis for privilege, after which defendants would have the opportunity to object and the Court would make a final determination.⁵⁶

- In *Minna v. Energy Coal S.p.A.*,⁵⁷ “one of those rare cases where the extreme sanction of a default judgment is warranted,” the Supreme Court affirmed a Court of Chancery award of more than \$700,000 in attorneys’ fees for discovery violations and a \$10 million default judgment against two individual defendants who allegedly induced plaintiff energy companies to invest in coal industry ventures. Defendants failed to make payments pursuant to a settlement of the Court of Chancery litigation, missed several deadlines for the production of documents following the granting of motions to compel, and made several misrepresentations to the Court concerning the purported reasons for their discovery failures. Vice Chancellor Strine ordered defendants to pay, at risk of default, what they considered to be plaintiffs’ reasonable attorneys’ fees. Defendants failed to do so and provided no affidavit supporting their claimed inability to pay. Finding no good faith effort to comply with the Court’s fee award sanction, Vice Chancellor Strine entered final judgment against defendants jointly and severally. The Supreme Court concluded that the Court of Chancery had properly considered the factors supporting default: the defendants (i) were personally responsible for the improper conduct, (ii) prejudiced plaintiffs in the form of excessive legal fees, (iii) had a clear history of dilatoriness, (iv) exhibited bad faith through willful misrepresentations to plaintiffs and the Court, (v) undermined alternative

sanctions by flaunting previous motions to compel and (vi) likely would lose on the merits because the record supported plaintiffs' claim of fraud in the inducement.

Endnotes

1. C.A. No. 758-CC, 2009 WL 3165613 (Oct. 2, 2009).
2. C.A. No. 3621-VCN, 2009 WL 3206051 (Sept. 30, 2009).
3. 638 A.2d 1110 (Del. 1994).
4. The Court stressed that application of the business judgment rule required *both* a disinterested and independent special committee *and* approval by a majority of all minority stockholders. "The majority of the minority vote serves as a complement to, and a check on, the special committee. An effective special committee, unlike disaggregate stockholders who face a collective action problem, has bargaining power to extract the highest price available for the minority stockholders. The majority of the minority vote, however, provides the stockholders an important opportunity to approve or disapprove of the work of the special committee and to stop a transaction they believe is not in their best interests." *Hammons*, at 30-31. The presence of the special committee in this case, even though deemed by the court to be disinterested and independent, therefore did not by itself trigger the business judgment rule.
5. The Court noted that plaintiffs could prevail at trial on the issue of fair dealing if they could establish that the price of the minority shares was depressed as a result of Hammons's improper self-dealing conduct.
6. "There is no rule ... that conflicts of interest must be disclosed only where there is evidence that the financial advisor's opinion was actually affected by the conflict." *Id.* at 40.
7. As the Court pointed out, in *In re Santa Fe Pacific Corp. Shareholder Litigation*, 669 A.2d 59, 64, 70-71 (Del. 1995), the Supreme Court held that a merger involving consideration of 33 percent cash and 67 percent stock did not trigger *Revlon*. In *In re Lukens Inc. Shareholders Litigation*, 757 A.2d 720, 732 n.25 (Del. Ch. 1999), the Chancery Court found that a merger involving 60 percent cash and 40 percent stock likely triggered *Revlon*. Thus, this transaction would fall between the standards of *Santa Fe* and *Lukens*.
8. *Id.* at 19 (quoting *Lyondell Chem. Co. v. Ryan*, 970 A.2d 235, 244 (Del. 2009)).
9. 845 A.2d 1031 (Del. 2004).
10. *Parnes v. Bally Entertainment Corp.*, 722 A.2d 1243 (Del. 1999).
11. C.A. No. 2822-CC, 2009 WL 3756700 (Del. Ch. Nov. 9, 2009).
12. *Dunlap v. State Farm Fire and Cas. Ins. Co.*, 878 A.2d 434 (Del. July 5, 2005) (commenting that "the case law frequently (and unfortunately) equates a lack of good faith with the presence of bad faith," but "[d]espite its evolution, the term 'good faith' has no set meaning, serving only to exclude a wide range of heterogeneous forms of bad faith"); *25 Mass. Ave. Prop. L.L.C. v. Liberty Prop. Ltd. P'ship.*, No. 188, 2008, 2008 Del. LEXIS 611 (Del. Nov. 25, 2008) ("The two concepts — bad faith and conduct not in good faith are not necessarily identical.").
13. *Liberty Prop. Ltd. P'ship. v. 25 Mass. Ave. Prop. L.L.C.*, C.A. No. 2822-CC, 2009 WL 224904 (Del. Ch. Jan. 22, 2009).
14. C.A. No. 4486-VCS, 2009 WL 3465985 (Del. Ch. Oct. 28, 2009).
15. The Court left open the possibility that plaintiffs could bring their claims in Delaware again should the New York courts first conclude that the claims are sufficiently un-related to matters addressed by the Superintendent as to fall outside the mandate of the forum selection clause.
16. C.A. No. 4353-VCP, 2009 WL 3335332 (Del. Ch. Oct. 15, 2009).
17. *McWane Cast Iron Pipe Corp. v. McDowell-Wellman Eng'g Co.*, 263 A.2d 281 (Del. 1970).
18. *Id.* at 283.
19. C.A. No. 3874-VCS, 2009 WL 2501542 (Del. Ch. Aug. 5, 2009).
20. C.A. No. 4494-VCS, 2009 WL 3238186 (Del. Ch. Oct. 9, 2009).

21. C.A. No. 4128-VCP, 2009 WL 2413858 (Del. Ch. Aug. 6, 2009).
22. *Gerow v. Rohm & Haas Co.*, 308 F.3d 721 (7th Cir. 2002).
23. C.A. No. 3892-VCP, 2009 WL 2490845 (Del. Ch. Aug. 14, 2009).
24. C.A. No. 08-54-GMS-MPT, 2009 WL 2750470 (D. Del. Aug. 26, 2009).
25. 21 U.S.C. § 360aaa, *et seq.*
26. C.A. Nos. 4479-VCN and 4886-VCN, 2009 WL 4052681 (Del. Ch. Nov. 12, 2009).
27. 6 Del. C. ch. 18.
28. The Court cited *Fisk Ventures, LLC v. Segal*, C.A. No. 3017-CC, 2009 WL 1478490 (Del. Ch. Jan. 13, 2009) for these three factors.
29. C.A. No. 3464-VCN, 2009 WL 2595739 (Del. Ch., Aug. 24, 2009).
30. C.A. Nos. 4743-CC, 4845-CC, 2009 WL 3208287 (consolidated) (Oct. 2, 2009).
31. C.A. Nos. 4743-CC, 4845-CC, 2009 WL 3494626 (consolidated) (Oct. 28, 2009).
32. Observing that plaintiff and a prior Chancery Court decision, *Wiehl v. Eon Labs*, C.A. Nos. 1116-N, 1117-N, 1119-N, 1125-N, 1134-N, 1136-N, 1139-N, 2005 WL 696764 (consolidated), at *3 (Del. Ch. Mar. 22, 2005), appeared to confuse absolute differences with relative ones, Chancellor Chandler identified the significance of an individual's stake in the litigation and the resulting incentive the individual has to participate in the litigation and monitor his or her counsel as an issue of fundamental import. *Dutiel* at 5-6.
33. C.A. No. 4326-VCN (Del. Ch. Nov. 20, 2009).
34. *AmeriPride Servs. Inc. v. Valley Indus. Servs., Inc.*, No. CIV. S-00-113 LKK/JFM (E.D. Cal.) (filed Jan. 19, 2000).
35. C.A. No. 1184-VCP, 2009 WL 2581873 (Del. Ch. Aug. 21, 2009).
36. No. 268, 2009, 2009 WL 3182602 (Del. Oct. 5, 2009).
37. C.A. No. 4446-VCL, 2009 WL 1337150 (Del. Ch. May 12, 2009).
38. Nos. 07-333-SLR, 07-348-SLR, 07-409-SLR, 07-765-SLR, 2009 WL 2600902 (consolidated) (D. Del. Aug. 25, 2009).
39. C.A. No. 4473-VCN, 2009 WL 3086537 (Del. Ch. Sept. 28, 2009).
40. C.A. No. 4573-CC, 2009 WL 2913887 (Del. Ch. Aug. 31, 2009).
41. C.A. No. 3905-CC, 2009 WL 2534874 (Aug. 18, 2009).
42. "[D]amages are not necessarily determinative on the issue of which party prevailed." *Id.* at 5.
43. "Whether plaintiff's failure to make certain arguments to the arbitrator was intentional or not, such failure does not provide this Court a reason to vacate the award of the arbitrator." *Id.* at 6-7.
44. C.A. No. 4637-CC, 2009 WL 3440004 (Del. Ch. Oct. 26, 2009).
45. C.A. No. 5002-CC (Del. Ch. Nov. 18, 2009).
46. C.A. No. 4301-VCS, 2009 WL 4263211 (Nov. 24, 2009).
47. C.A. No. 4410-VCL, 2009 WL 4043297 (Del. Ch. Nov. 23, 2009).
48. 981 A.2d 531 (Del. Aug. 24, 2009).
49. *Daubert v. Merrell Dow Pharm., Inc.*, 509 U.S. 579 (1993).

This article is intended only as a general discussion of these issues. It is not considered to be legal advice. We would be pleased to provide additional details or advice about specific situations. For additional information on this important topic, please feel free to call upon your Dewey & LeBoeuf relationship partner.

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50. Civ. No. 07-265-SLR/LPS, 2009 WL 3153633 (D. Del. Sept. 30, 2009).
51. C.A. No. 4381-VCP, 2009 WL 3806299 (Del. Ch. Nov. 13, 2009).
52. 10 Del. C. § 5701, *et seq.*
53. *James & Jackson, LLC v. Willie Gary, LLC*, 906 A.2d 76 (Del. 2006).
54. C.A. No. 3505-VCP, 2009 WL 2714064 (Del. Ch. Aug. 18, 2009).
55. C.A. No. 3705-CC, (Del. Ch. Sept. 16, 2009).
56. In a follow-up decision, Chancellor Chandler held that (i) defendants could begin or extend depositions relating to portions of documents produced as a result of the court's earlier decision, (ii) plaintiffs were compelled to produce documents from a custodian whose relevance was revealed by documents whose redactions were removed by the earlier decision, (iii) defendants were not entitled to an award of fees and expenses incurred in bringing its motions to compel because it was not clear that the erroneous redactions were intentional, nor were they entitled to fees for continued or additional depositions because Chancery Court Rule 37 only deals with costs "in obtaining the order" and (iv) an attorney for defendants could not attend an *in camera* review of board presentations to advise the court on their significance. C.A. No. 3705-CC, 2009 WL 3494348 (Del. Ch. Oct. 29, 2009). Then, in another letter opinion, Chancellor Chandler allowed an unclean hands defense and held that defendants could present evidence to show that they enacted corporate governance changes in response to conduct of plaintiff eBay and its representatives on the Craigslist board even if defendants were not aware of that conduct at the time. The court limited its holding by allowing only evidence that directly related to eBay's involvement with Craigslist's board or inequitable conduct, not mere evidence of pure competition in the marketplace. C.A. No. 3705-CC, 2009 WL 3806162 (Del. Ch. Nov. 9, 2009).
57. No. 267, 2009, 2009 WL 3823205 (Del. Nov. 16, 2009).