

Significant Case Law Developments For M&A Practitioners in 2023

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In 2023, there were a number of court cases that are significant for M&A practitioners. We have set forth below summaries of the following developments that took place during the year.

1. Shareholder Lost Premium Provisions in Merger Agreements Unenforceable – *Crispo v. Musk*
2. No Use of Poison Pills by Registered Investment Funds – *Saba Capital CEF Opportunities 1, Ltd. et al. v. Nuveen Floating Rate Income Fund et al.*
3. Identity-Based Voting Rights Permitted – *Colon v. Bumble*
4. Liability Possible for Breaches of the Duty of Loyalty Despite “Conclusive and Binding” Clause – *CCSB Financial Corp. v. Totta*
5. Entire Fairness Review of Breach of Fiduciary Duty Claims against a SPAC Sponsor and Directors – *Delman v. GigAcquisitions3, LLC*
6. Mootness Legal Fee Awards Require “Plainly Material” Disclosure Change – *Anderson v. Magellan Health, Inc.*

1. Shareholder Lost Premium Provisions in Merger Agreements Unenforceable – *Crispo v. Musk*

On October 31, 2023, in *Crispo v. Musk*, the Delaware Court of Chancery called into doubt the enforceability of “Con Ed” provisions in the merger agreement governing the acquisition of Twitter, Inc. (now known as “X”) by Elon Musk and his affiliates.

“Con Ed provisions” became common in merger agreements following the 2005 Second Circuit’s holding, in *Consolidated Edison, Inc. v. Northeast Utilities*, that a “no-third-party beneficiaries” provision in a merger agreement precluded the target’s stockholders from enforcing the provisions that required the buyer to pay lost-premium damages. As a result, different forms of “Con Ed” provisions have evolved in merger agreements to expressly provide for the target’s recovery from a buyer of stockholder premium damages in the event of a buyer-side breach of the merger agreement resulting in termination.

The Twitter merger agreement contained Con Ed provisions requiring the buyer to pay damages in the amount of the lost benefit of the target’s stockholders, while also excluding stockholders as third-party beneficiaries of the merger agreement (subject to certain limited exceptions). In a merger, a target company (as opposed to its stockholders) has no entitlement to a premium if the deal is consummated. Accordingly, the court found to be unenforceable a provision purporting to define a target company’s damages to include lost-premium damages owed to its stockholders. The *Crispo* court ultimately found that only stockholders who are permitted third-party beneficiaries of the merger agreement would have standing to enforce a provision for lost-premium damages, and that the target company did not.

Should this ruling be affirmed, target companies may consider replacing Con Ed provisions with liquidated damages clauses in order to recover the damages now made unavailable to the target. Alternatively, Con Ed provisions may be tailored as a stated exception to “no third-party beneficiary” clauses to preserve recovery rights for the target’s shareholders.

2. No Use of Poison Pills by Registered Investment Funds – Saba Capital CEF Opportunities 1, Ltd. et al. v. Nuveen Floating Rate Income Fund et al.

In *Saba Capital CEF Opportunities 1, Ltd. et al. v. Nuveen Floating Rate Income Fund et al.*, the Second Circuit affirmed a ruling in the U.S. District Court for the Southern District of New York (SDNY) in favor of Saba Capital CEF Opportunities 1, Ltd. that certain Massachusetts-domiciled closed-end funds violated Section 18(i) of the Investment Company Act (the “ICA”) by adopting provisions in their bylaws mimicking state control share statutes.

The bylaw provision at issue would have precluded a shareholder that owned more than 10% of the fund’s outstanding voting shares (defined to be a “controlling shareholder”) from voting the shares it acquired after the provision was adopted, unless authorized by the affirmative vote of the holders of a majority of the shares held by non-controlling shareholders.

Section 18(i) of the ICA requires, among other things, that “every share of stock hereafter issued by a registered management company ... shall be a voting stock and have equal voting rights with every other outstanding voting stock.” The Second Circuit concluded that the bylaw provision violated both the requirement that every share of stock be voting stock, and that every share of stock have equal voting rights with every other share of voting stock.

Following that decision, in *Saba Capital Master Fund, LTD. et al. v. ClearBridge Energy Midstream Opportunity Fund Inc. et al.*, another SDNY court granted summary judgment in favor of a group of plaintiffs (led by an affiliated Saba fund) against various Maryland-domiciled closed-end funds. The funds had adopted resolutions opting into a provision of Maryland’s Control Share Acquisition Act that allows a fund to strip the voting rights of any shares that result in a shareholder holding 10% or more of the fund’s voting power. The SDNY court found the provisions to violate Section 18(i) of the ICA and ordered the boards of those funds to rescind the resolutions.

Saba has filed other cases against Delaware-based funds challenging similar “poison pill” provisions.

3. Identity-Based Voting Rights Permitted – Colon v. Bumble

In *Colon v. Bumble, Inc.*, the Delaware Court of Chancery found that a provision in Bumble Inc.’s certificate of incorporation that provided for “identity-based voting” does not violate the Delaware General Corporation Law (the “DGCL”).

Bumble Inc.’s certificate of incorporation provided that each class A common share entitled the holder to one vote per share, other than shares held by a “Principal Stockholder” (a term defined in a stockholder’s agreement to mean Bumble Inc.’s individual founder and Blackstone, Inc., its financial sponsor), which would entitle the holder to ten votes per share.

The Chancery Court’s opinion discussed previous rulings that upheld the allocation of voting rights using a formula, including tenured voting rights (based on how long shares are owned by the applicable holder), scaled voting rights (based on the total number of shares owned by the applicable holder), and per capita voting rights (which disregard the number of shares owned by the applicable holder). In *Bumble*, the Chancery Court found that neither the formula’s dependence on “facts ascertainable outside of the certificate of incorporation” (i.e., the identity of the owner), nor the formula resulting in different outcomes for shares in the same class, violated the DGCL. The Chancery Court concluded that because the voting formula applied to all shares in the class and the certificate of incorporation clearly specified how voting rights are calculated, they complied with Sections 102(a)(4) and 151(a) of the DGCL. This case is particularly interesting for companies considering a dual class structure, as it affirms the legal validity under the DGCL of a mechanism for a group of shareholders to maintain voting control using one class of stock that provides for equal economic rights for all holders. However, the Chancery Court’s opinion concluded by noting that its

decision did not address situations in which a governance structure using identity-based voting could be found to be invalid because it is inequitable. Corporate actions under Delaware law may be tested for legal compliance and again in equity, and the plaintiffs in *Bumble* had only challenged the former.

4. Liability Possible for Breaches of the Duty of Loyalty Despite “Conclusive and Binding” Clause – CCSB Financial Corp. v. Totta

In *CCSB Financial Corp. v. Totta*, the Delaware Supreme Court affirmed the Court of Chancery’s decision that a “conclusive and binding provision” in a CCSB Financial Corp.’s certificate of incorporation did not bar the Court from reviewing whether the board of directors met their duty of loyalty.

CCSB’s certificate of incorporation provided that a board’s decision not to count stockholder votes determined by the board to exceed a 10% stockholder voting cap, if made in good faith, would be final and binding on the corporation and its stockholders. The Court of Chancery had found that the board incorrectly applied the voting limitation and wrongfully refused to count votes that would have resulted in the election of a dissident slate of directors.

In its decision, Delaware Supreme Court noted that Section 102(b)(7) of the DGCL “specifically prohibits a charter provision that directly or indirectly limits director liability for breaches of the duty of loyalty.” While permissible in agreements for Delaware LLCs or partnerships, which may opt to alter or eliminate fiduciary duties, the Court concluded that they were not permissible in a certificate of incorporation for a Delaware corporation and conflicted with the public policy of the State of Delaware to hold fiduciaries accountable for breaches of the duty of loyalty.

5. Entire Fairness Review of Breach of Fiduciary Duty Claims against a SPAC Sponsor and Directors – Delman v. GigAcquisitions3, LLC

In *Delman v. GigAcquisitions3, LLC*, the Delaware Court of Chancery denied a motion to dismiss breach of fiduciary duty claims (among others) by a SPAC stockholder against the SPAC’s sponsor and members of its board of directors.

As is typical for a SPAC, the sponsor had appointed the SPAC’s board of directors, many of whom were sponsor insiders, and the sponsor would lose the value of its investment if the SPAC were to fail to acquire a target company before a specified deadline, after which the SPAC would liquidate and return to its public shareholders all funds they had invested. Before the deadline expired, the SPAC identified a target, purportedly relying on projections showing substantial growth, and 98% of the SPAC’s public shareholders voted to approve the merger. Only 29% of those holders exercised their right to redeem their shares before the merger closed. Following poor performance and lowered projections after closing, the trading price of the combined company’s shares dropped substantially.

Due to the conflict of interests of the SPAC’s directors and the sponsor, as a controlling shareholder of the SPAC, relative to the interest of the SPAC’s public shareholders, the Court determined that the entire fairness standard, rather than the business judgment rule, should apply to the analysis of whether the sponsor and directors had breached their fiduciary duties. The Court dismissed the defendant’s arguments that shareholders had waived their breach of duty of loyalty claims by choosing to invest in the SPAC and approve the merger, even though the inherent conflicts of interest between the sponsor and the SPAC’s public shareholders had been disclosed in the IPO prospectus and the proxy statement for the proposed merger. Nor, the Court found, did such disclosure preclude an entire fairness review.

The SPAC’s structure incentivized shareholders to vote to approve the proposed merger, even if they planned to redeem their shares. Because their voting interest were decoupled from their economic interest, the Court found, their vote to approve the transaction did not “cleanse” it of the board’s conflicts and permit the application of the business judgement rule. Moreover, due to omissions and misleading disclosure in the proxy statement, the vote was not fully informed and of no real consequence.

The court considered several factors to determine that the plaintiff had sufficiently pleaded that the proxy statement contained material misstatements and omissions and that the transaction was not the product of fair dealing, including: (i) that the SPAC had not obtained a fairness opinion, (ii) that the IPO underwriters served as financial advisors to the SPAC and also had a conflict that incentivized them to support the proposed merger, and (iii) that, despite standard cautionary disclosure about forward looking statements, that the projections included in the proxy materials predicted substantial growth that the board conceivably should have known was unrealistic.

6. Mootness Legal Fee Awards Require “Plainly Material” Disclosure Change – Anderson v. Magellan Health, Inc.

The Delaware Court of Chancery July 6, 2023 decision in *Anderson v. Magellan Health, Inc.* *Magellan* builds upon the Court’s 2016 *In re Trulia, Inc. Stockholders Litigation* decision, and marks the latest initiative of the Delaware courts to disincentivize stockholder-plaintiffs from pursuing meritless deal litigation by raising the standard that supplemental disclosures must meet to justify an award of attorneys’ fees.

In *Anderson*, the plaintiff challenged Magellan Health’s acquisition by Centene Corporation, a publicly traded healthcare company. The plaintiff alleged that certain deal protections associated with an earlier (but separate) sale process remained in effect, impeded the sale to Centene, and were not adequately disclosed in Magellan Health’s proxy statement. The company responded by providing supplemental disclosures and agreed to loosen the deal protections that remained in effect. No other bidders emerged, and the plaintiff agreed that the company’s actions mooted his claims.

In subsequent proceedings, the plaintiff petitioned the Court of Chancery for an award of attorneys’ fees and expenses. Previously, the Court of Chancery had held that mootness fees could be awarded where supplemental disclosure in response to a shareholder claim “provides some benefit to stockholders, whether or not material to the [merger approval] vote.” However, in *Magellan*, the Court held that going forward, mootness fees will only be permissible for disclosures that are “plainly material.”

Because Delaware has adopted the federal standard for materiality in the stockholder disclosure context, *Magellan* means that courts should only award mootness fees going forward “if there is a substantial likelihood that a reasonable shareholder would consider [the disclosures] important in deciding how to vote” or tender shares. The Court’s decision should thus provide a useful tool to merger parties insofar as it is likely to reduce the overall amount of attorneys’ fees and expenses paid by corporations to settle stockholder litigation that provides no discernable benefit to stockholders.

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