DELAWARE LAW REVIEW

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TABLE OF CONTENTS

Key Decisions Of 2012 In Delaware Corporate And Alternative Entity Law 1
Bruce L. Silverstein, Kathaleen St. J. McCormick and Tammy L. Mercer

Developments In Delaware Health Law: Addressing Prescription Drug Abuse 29
Nathan Trexler

Law Firm Dissolutions: When The Music Stops, Does Anyone Need To Account For Any Unfinished Business? 41
Michael D. DeBaecke and Victoria A. Guilfoyle

Recent Developments In Labor And Employment Law 69
Allyson Britton DiRocco, Timothy M. Holly, Mary I. Akhimien and Jerry M. Cutler

Forty Years Of Title IX: History And New Applications 83
Margaret E. Juliano

The "2010" Amendments To Delaware UCC Article 9 91
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The *Delaware Law Review* (ISSN 1097-1874) is devoted to the publication of scholarly articles on legal subjects and issues, with a particular focus on Delaware law. With this issue, the Delaware State Bar Association is changing the focus of the law review format to provide an overview of recent developments in case law and legislature that impacts Delaware practitioners. This shift in the focus of the publication is in keeping with the ever-evolving role of the Delaware State Bar Association to remain relevant to the bar as a practical resource.

The Delaware State Bar Association expresses it gratitude and appreciation to Danielle Gibbs for 4 years of exemplary service as Editor-in-Chief of the *Delaware Law Review*. Alisa E. Moen is the incoming Editor-in Chief. She is a partner at Blank Rome LLP and currently serves as the firm's Corporate Litigation Vice Practice Group Leader.*

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KEY DECISIONS OF 2012 IN DELAWARE CORPORATE AND ALTERNATIVE ENTITY LAW

Bruce L. Silverstein, Kathaleen St. J. McCormick and Tammy L. Mercer*

I. CORPORATE LAW

A. Transactions Involving Controlling Stockholders

In *Americas Mining Corp. v. Theriault* ("*Southern Peru*"),[1] the Delaware Supreme Court affirmed the Court of Chancery's post-trial judgment of more than $1.3 billion in damages (plus in excess of $600 million in pre- and post-judgment interest) against a controlling stockholder and its affiliates on the controlled corporation's board of directors. In affirming the judgment, the Delaware Supreme Court established a new rule that the burden of proving the "entire fairness" of "a transaction involving self-dealing by a controlling shareholder" will remain with defendants at trial where the record does not permit a pretrial determination that the burden should be shifted to the plaintiff(s).[2] The *Southern Peru* ruling does not address, much less answer, the related question of whether the standard of judicial review at trial will be "entire fairness" or "business judgment" in non-control situations where (i) one or more directors is self-interested or lacks independence, and (ii) a pretrial determination cannot be reached on the question of the proper standard of judicial review.

Southern Peru arose out of a merger transaction by which Southern Copper Corporation ("Southern Peru") acquired a 99.15% interest in Minera México, S.A. de C.V. ("Minera") from Southern Peru's controlling stockholder, Grupo México, S.A.B. de C.V. ("Grupo Mexico"), which indirectly owned an absolute majority of Southern Peru's voting shares.[3] In consideration of the merger, Grupo Mexico (through a wholly owned subsidiary) acquired 67.2 million shares of Southern Peru stock.[4] The challenged transaction was not subject to a vote of a majority of Southern Peru's minority stockholders.[5] The merger was, however, negotiated on behalf of Southern Peru by a four-member special committee of outside directors over a period of eight months.[6] While accepting that the members of the special committee

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* Mr. Silverstein is a partner in and Mses. McCormick and Mercer are associated with the Corporate Counseling and Litigation Section of Young Conaway Stargatt & Taylor, LLP. While the authors and their firm represented parties in some of the decisions discussed in this Article, the views expressed herein are those of the authors alone and do not necessarily represent the views of their firm or its clients. The authors express their gratitude to members of the Corporate Counseling and Litigation Section of Young Conaway Stargatt & Taylor, LLP, including Emily V. Burton, Benjamin Z. Grossberg, Thomas E. Williams, and Lakshmi A. Muthu for their contributions to this article

1. 51 A.3d 1213 (Del. 2012) (hereinafter *Southern Peru).*

2. *Id.* at 1241-42.

3. *Id.* at 1218-19.

4. *Id.* at 1219.

5. *See id.* at 1228.

6. *See id.* at 1219.

were disinterested and independent (even though one member of the committee was not optimally suited to serve on the committee due to a different form of conflict),[7] the Court of Chancery found that the special committee members had a "controlled mindset" that prevented them from functioning in an independent manner.[8] Accordingly, the court required the defendants to carry the burden of proof on the issue of entire fairness.[9]

In affirming the Court of Chancery's ruling, the Delaware Supreme Court rejected the defendants' contention that the trial court erred by failing to make a pre-trial determination of which party bore the burden of proof respecting the question of entire fairness.[10] The Supreme Court acknowledged the nature of this inquiry is necessarily fact intensive, and a post-trial determination concerning burden shifting creates "practical problems" because it requires defendants to litigate as if they bore the burden of proof during trial.[11] Nonetheless, the Supreme Court rejected the defendants' argument that this approach would deter corporations from using protective devices. In this regard, the Supreme Court observed that the procedural benefit of burden shifting is a "modest" one,[12] and that the real benefit of a well-functioning special committee is that it is persuasive evidence of a fair process.[13] The Supreme Court explained that "[a] fair process usually results in a fair price," and that "the proponents of an interested transaction will continue to be incentivized to put a fair dealing process in place that promotes judicial confidence in the entire fairness of the transaction price."[14]

The Supreme Court separately affirmed the trial court's determination that the special committee did not function with sufficient independence to earn a shift in the burden in this particular case, in any event.[15] Relatedly, the Supreme Court approvingly quoted the following observation of the Court of Chancery:

> A close look at *Tremont* suggests that the [burden shifting] inquiry must focus on how the special committee actually negotiated the deal — was it "well functioning" — rather than just how the committee was set up. The test, therefore, seems to contemplate a look back at the substance, and efficacy, of the special committee's negotiations, rather than just a look at the composition and mandate of the special committee.[16]

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7. *See id.* at 1232.

8. *Id.* at 1245.

9. *Id.* at 1242. On the merits, the Court of Chancery determined that Grupo Mexico's interest in Minera was worth $2.4 billion, and that the 67.2 million shares of Southern Peru stock "paid" to Grupo Mexico were worth $3.7 billion. *Id*. at 1218. Both "values" were contested at trial. *See id*. at 1250-51. The Court of Chancery determined the value of Grupo Mexico's interest in Minera using a form of "fair value" analysis akin to that employed in a statutory appraisal action. *See id*. at 1250. Because the shares of Southern Peru were publicly traded, the Court of Chancery used their trading price to determine the amount paid to Grupo Mexico. *See id.* at 1250 n.62.

10. *Id.* at 1239-44.

11. *Southern Peru, 51 A.3d* at 1241.

12. *Id.* at 1242.

13. *Id.* at 1243.

14. *Id.*

15. *Id.* at 1241-43.

16. *Id.* at 1240-41 (quoting the Court of Chancery opinion) (citations omitted).

In *Frank v. Elgamal*,[17] Vice Chancellor Noble denied a motion to dismiss a claim challenging a merger in which four stockholders of the target corporation — consisting of the CEO, COO, and two non-director officers — collectively held 71.19% of the company's common stock and received different consideration from that paid to the public stockholders, including equity in the acquiror.[18] The plaintiffs alleged that these four stockholders constituted a "control group" and argued that their receipt of disparate consideration implicated the "entire fairness" standard under *Kahn v. Lynch Communication Systems, Inc*.[19] The Court of Chancery agreed that the entire fairness standard applied, but did so under *In re John Q. Hammons Hotels, Inc. Shareholder Litigation*,[20] and not *Kahn*.[21] The distinction between the two cases — and the doctrines they establish — is that (i) under *Kahn* the use of a special committee and a majority of the minority vote will not eliminate fairness scrutiny (although either will shift to the burden of proving fairness to the plaintiffs), whereas (ii) under *Hammons*, the use of both prophylactics will eliminate "entire fairness" scrutiny and the business judgment rule will be applicable.[22]

The transaction challenged in *Frank* was a merger through which American Surgical Holdings, Inc. ("American Surgical") was acquired by Great Point Partners I, L.P. ("Great Point") for $2.87 in cash per share of common stock.[23] When the board of American Surgical approved the merger, all members of the alleged control group (a) agreed to vote for the merger, (b) exchanged some, but not all, of their common stock in American Surgical (17.4% of the outstanding common stock) for preferred stock representing 14.9% of the equity of Great Point, and (c) signed employment agreements with the corporation surviving the merger.[24] The merger was ***not*** subject to a "majority-of-the-minority" vote requirement.[25] Accordingly, absent a termination of the merger agreement in advance of a stockholder vote, the voting agreements assured stockholder approval of the merger.[26]

In denying the defendants' motion to dismiss the complaint, the Court of Chancery determined that the plaintiffs' allegations were sufficient to support an inference that the stockholders who received disparate treatment in the merger were a "control group."[27] Accordingly, because the merger was not conditioned on a vote of a majority of the minority stockholders, the court held that the merger would be judged by the "entire fairness" standard if the plaintiffs later established that the alleged control group was, in fact, a control group.[28] Although the outcome in *Frank* favored the stockholder

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17. C.A. No. 6120-VCN, 2012 Del. Ch. LEXIS 62 (Del. Ch. Mar. 30, 2012).

18. *Id.* at *3, 8-9.

19. 638 A.2d 1110 (Del. 1994) (cited at 2012 Del. Ch. LEXIS 62, at *24).

20. C.A. No. 758-CC, 2009 Del. Ch. LEXIS 174 (Del. Ch. Oct. 2, 2009) (hereinafter *Hammons).*

21. *Frank,* 2012 Del. Ch. LEXIS 62, at *25-26.

22. *Id.*

23. *Id.* at *6.

24. *Id.* at *8-9.

25. *Id.* at *33.

26. *Id.* at *33-38.

27. *See id.* at *26-29.

28. *See id.* at *26.

plaintiffs in that particular case, the court's application of *Hammons* is a divergence from *Kahn* that permits a merger in which a controlling stockholder (or control group) receives disparate treatment to receive business judgment protection if appropriate procedural safeguards are employed. The Delaware Supreme Court has yet to address this specific legal issue.

In *In re Delphi Financial Group Shareholder Litigation*,[29] Vice Chancellor Glasscock found that the plaintiffs had established a probability of proving that a controlling stockholder committed a breach of fiduciary duty by insisting that super-voting stock receive greater per-share merger consideration than ordinary voting stock where (i) the company's certificate of incorporation required equal treatment of the two classes of stock in a merger,[30] (ii) the merger was conditioned on an amendment to the certificate of incorporation that would eliminate the equal treatment provision,[31] and (iii) the proposed charter amendment and merger were negotiated by a special committee of disinterested and independent directors and conditioned on a vote of a majority of the minority public stockholders.[32] Nonetheless, the court declined to grant a preliminary injunction against the proposed transaction on the grounds that the stockholders could be made whole in a post-merger damages proceeding.[33] Thereafter, Delphi agreed to pay an additional $49 million to the public stockholders.[34]

In *Delphi*, Tokio Marine Holdings, Inc. ("Tokio") made an offer to acquire Delphi Financial Group, Inc. ("Delphi") in an all-cash, third party merger.[35] Delphi had two classes of common stock: (i) Class A shares, which had one vote per share, and (ii) Class B shares, which had ten votes per share.[36] The certificate of incorporation provided that the Class B shares were convertible into Class A shares on the sale of the company and would receive the same consideration in the sale as the Class A shares.[37] Robert Rosenkranz ("Rosenkranz") was Delphi's founder, Chairman, and CEO.[38] Additionally, although Rosenkranz owned less than 13% of Delphi's equity, he controlled 49.9% of the vote — largely through the Class B shares, which were owned exclusively by Rosenkranz and his affiliates.[39]

In 2011, Tokio contacted Rosenkranz about the possible acquisition of Delphi.[40] Rosenkranz negotiated with Tokio, and Tokio offered $45 per share, which was a 106% premium over the market price of the Class A shares.[41] After

29. C.A. No. 7144-VCG, 2012 Del. Ch. LEXIS 45 (Del. Ch. Mar. 6, 2012).

30. *Id.* at *42.

31. *Id.* at *52.

32. *See id.* at *4-5, 52

33. *Id.* at *7, 73, 74.

34. *See* Transcript at 7-8, *In re* Delphi Fin. Grp. S'holder Litig., C.A. No. 7144-VCG (Del. Ch. July 31, 2012) (hereinafter *Delphi* Trans.); Order at 3, 6, *In re* Delphi Fin. Grp. S'holder Litig., C.A. No. 7144-VCG (Del. Ch. July 31, 2012) (hereinafter *Delphi* Order).

35. *See Delphi,* 2012 Del. Ch. LEXIS 45, at *3-4.

36. *Id.* at *3.

37. *Id.* at *12.

38. *Id.* at *8.

39. *Id.* at *10-11.

40. *Id.* at *15.

41. *Id.* at *20.

those negotiations, Rosenkranz informed Delphi's board of directors (the "Delphi Board") that he would not vote for a sale at $45 per share, but that he was willing to vote for a merger that provided greater consideration for his Class B shares.[42] The Delphi Board established a special committee to negotiate with Rosenkranz over the price he would accept for the Class B shares.[43] After originally demanding $59 per share, Rosenkranz and the special committee ultimately agreed upon $53.875 for the Class B shares.[44] At the same time, Rosenkranz further negotiated with Tokio for a per share price to be paid to all stockholders without a differential.[45] Tokio agreed to pay $46 per share.[46] Delphi then informed Tokio that the aggregate amount of the consideration should be allocated $53.875 for the Class B and $44.875 for the Class A.[47] The merger was conditioned upon a majority of Class A shares held by the public (and not Rosenkranz or his affiliates) being voted in favor of both (i) an amendment to the certificate of incorporation allowing the Class A shares and Class B shares to receive different consideration in a merger, and (ii) a post-amendment merger.[48] During the negotiation of the merger, Rosenkranz also discussed with Tokio either continuing certain terminable contracts that Delphi had with a Rosenkranz affiliate or Tokio actually purchasing the affiliate from Rosenkranz.[49] The Court found (preliminarily) that no agreement was reached, but that Rosenkranz expected to complete an agreement with Tokio shortly after the merger closed.[50]

In considering a motion for a preliminary injunction against the proposed merger, the Court "assume[d]" (but did not determine) that the *Hammons* rubric applied.[51] Despite the use of both a special committee and a majority of minority vote, however, the Court determined that the plaintiffs established a probability of success that "in negotiating for disparate consideration and only agreeing to support the merger if he received it, Rosenkranz violated duties to the stockholders."[52] The court did not identify the specific "duties" it found Rosenkranz likely to have violated.

In *In re Synthes, Inc. Shareholder Litigation*,[53] Chancellor Strine dismissed a complaint arising out of the acquisition of Synthes, Inc. ("Synthes") by an unaffiliated third party in which the same consideration was paid to all stockholders of Synthes, including Synthes's founder, CEO, and alleged controlling shareholder, Hansjoerg Wyss ("Wyss"). In so doing, the court rejected the plaintiffs' effort to state a claim that Wyss was self-interested in the merger on account of an alleged

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42. *Id.* at *20, *29.

43. *Id.* at *20-23.

44. *Id.* at *30-31.

45. *Id.* at *28-30.

46. *Id.* at *30.

47. *Id.* at *32.

48. *Id.* at *33.

49. *Id.* at *34-36.

50. *Id.* at *35.

51. *Id.* at *43 n.57.

52. *Id.* at *61.

53. 50 A.3d 1022, 1031, 1046 (Del. Ch. 2012).

need for liquidity.[54] The court found, among other things, that the complaint was devoid of any well-pleaded allegations that would support an inference that Wyss had conflicting interests with the common stockholders sufficient to "justify invocation of the entire fairness standard."[55]

The litigation in *Synthes* arose out of a merger by which Johnson and Johnson Company ("J&J") acquired Synthes for blended consideration consisting of 65% stock and 35% cash.[56] Although Wyss received the same consideration as all other holders of common stock, the plaintiffs alleged that Wyss "received liquidity benefits [in the J&J transaction] that were not shared equally with the rest of the stockholders and colored his decision to support the Merger."[57] The plaintiffs also argued that this alleged need for liquidity caused Wyss "to supposedly improperly reject further consideration of [another bid]" in which Wyss would be required to rollover shares.[58] The court assumed, for the purpose of considering the defendants' dismissal motion, that Wyss was a controlling stockholder and that he was actively involved in negotiating the merger, and focused its analysis on the question of whether Wyss had a disabling conflict giving rise to heightened scrutiny.[59]

In rejecting the plaintiffs' invocation of the entire fairness standard of review, the court applied the general rule that a controller's need for liquidity does not create a conflict of interest sufficient to give rise to scrutiny under the entire fairness standard except under "very narrow circumstances" that were not pleaded by the plaintiffs.[60] The court also observed that Wyss had no obligation to consider an alternative that would have required him to roll over shares to his detriment but to the minority shareholders' benefit, and that Delaware law does not "impose on controlling stockholders a duty to engage in self-sacrifice for the benefit of minority shareholders."[61]

B. Transactions Involving *"Revlon"* Scrutiny

In *In re El Paso Corp. Shareholder Litigation*,[62] Chancellor Strine determined that the stockholder plaintiffs established a probability of proving the process that led to an agreement by which El Paso Corp. ("El Paso") would be acquired by Kinder Morgan, Inc. ("Kinder") was tainted by questionable negotiating decisions and conflicts of interest on the part of El Paso's CEO and investment banker. Nonetheless, the court declined to grant a preliminary injunction that would have delayed or prevented a vote by the stockholders of El Paso, because (i) there was no rival bidder for El Paso that the merger agreement was precluding, and (ii) the merger represented a substantial premium over market and the El Paso stockholders "may find [it] desirable in current market conditions, despite the disturbing behavior that led to its final

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54. *Id.* at 1034-38.

55. *Id.* at 1031.

56. *Id.* at 1024.

57. *Id.* at 1034.

58. *Id.* at 1029 n.27, 1034.

59. *Id.* at 1034.

60. *Id.* at 1035, 1036.

61. *Id.* at 1040.

62. 41 A.3d 432 (Del. Ch. 2012).

terms."[63] The parties ultimately agreed to terms of a settlement, which was approved by the court, whereby the defendants paid $110 million in consideration of a global release of the plaintiffs' claims pertaining to the challenged transaction.[64]

In concluding that the plaintiffs had established a probability of success on their claims under *Revlon*, the court reaffirmed that:

> [*Revlon*] does not exist as a license for courts to second-guess reasonable, but arguable, questions of business judgment in the change of control context, but to ensure that the directors take reasonable steps to obtain the highest value reasonably attainable and that their actions are not compromised by impermissible considerations, such as self-interest.[65]

The court observed that the plaintiffs had succeeded in implicating "the core animating principle of *Revlon*"[66] by demonstrating that the "debatable tactical decisions were motivated not by a principled evaluation of the risks and benefits to the company's stockholders, but by a fiduciary's consideration of his own financial or other personal self-interests."[67]

Specifically, the court found that the following facts, among others, demonstrated that the plaintiffs were likely to succeed in proving that the transaction was motivated by a fiduciary's self-interest: *First*, Goldman Sachs was conflicted with respect to the transaction because it owned approximately 19% of Kinder (valued at approximately $4 billion), controlled two seats on Kinder's board of directors, and had placed two senior Goldman Sachs principals in those seats.[68] These conflicts were only partially disclosed to El Paso's board of directors (the "El Paso Board").[69] *Second*, Morgan Stanley, which was retained by El Paso as an adjunct to Goldman Sachs to advise exclusively on a sale of the company to Kinder, was constrained in several ways that compromised its ability to give independent advice on that deal.[70] *Third*, El Paso's CEO was conflicted because he was interested in acquiring El Paso's E&P business from Kinder in connection with the sale of El Paso,[71] this conflict was not disclosed to the El Paso Board, which had relied on the CEO to conduct the negotiations with Kinder,[72] and the CEO made proposals at levels below those authorized by the El Paso Board when negotiating with Kinder.[73] *Fourth*, Goldman Sachs reduced its valuation of the spin-off alternative after Kinder made its

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63. *Id.* at 434-35.

64. *See* Stipulation and Agreement of Settlement, *In re* El Paso Corp. S'holder Litig., C.A. No. 6949-CS (Del. Ch. Sept. 7, 2012); Final Order and Judgment, *In re* El Paso Corp. S'holder Litig., *C.A. No. 6949-CS (Del. Ch. Dec. 3, 2012).*

65. *El Paso*, 41 A.3d at 439.

66. *Id.*

67. *Id.*

68. *Id.* at 440.

69. *Id.* at 434.

70. *Id.* at 442.

71. *Id.* at 443-44.

72. *Id.*

73. *Id.* at 445.

acquisition proposal.[74] *Finally*, the merger agreement could not be terminated if a favorable bid emerged for only one of El Paso's two main businesses, which the Court concluded was a valuable alternative to the merger, and the termination fee was high when measured against only the portion of El Paso's business that Kinder intended to retain, making a competing offer by another party with a similar interest "very expensive."[75]

In the *Synthes* decision (discussed *supra* Section I.A), Chancellor Strine dismissed the complaint, in part on the grounds that *Revlon* scrutiny did not apply to a 65% stock, 35% cash deal.[76] The plaintiffs alleged that *Revlon* applied because the stockholders received mixed consideration of 65% J&J stock and 35% cash for their stock, and that this blended consideration represented their last chance to receive a premium for their shares.[77] The court observed this transaction did not result in a change of control because, post-merger, the stockholders would hold shares in a company whose shares are held in a large, fluid market.[78] The Court further observed that outcome was compelled by the Delaware Supreme Court in *In re Santa Fe Pacific Corp. Shareholder Litigation*,[79] in which "the Supreme Court held that a merger transaction involving nearly equivalent consideration of 67% stock and 33% cash did not trigger *Revlon* review when there was no basis to infer that the stock portion of that consideration was stock in a controlled company."[80]

C. *"Caremark"* Claims

In two cases in 2012, the Court of Chancery considered various "oversight" claims – commonly known as "*Caremark*" claims – that directors knowingly caused or consciously permitted the corporation to violate positive law, or failed utterly to attempt to establish a reporting system or other oversight mechanism to monitor the corporation's legal compliance.[81] Such claims were first recognized by the Court of Chancery in *In re Caremark International Inc. Derivative Litigation*,[82] and were subsequently recognized and further developed by the Delaware Supreme Court in *Stone v. Ritter*.[83]

In *South*, Vice Chancellor Laster determined that the plaintiffs were unsuccessful in pleading a *Caremark* claim. The plaintiffs' complaint in *South* was filed in response to Hecla Mining Company's ("Hecla") issuance of a press release announcing that it was lowering its projections for silver production and in response to the United States Mine Safety and

74. *See id*. at 441.

75. *Id.* at 445.

76. *Synthes,* 50 A.3d at 1047-48.

77. *Id.* at 1047.

78. *Id.* at 1047-48.

79. 669 A.2d 59, 71 (Del. 1995).

80. 50 A.3d at 1048.

81. *See* South v. Baker, C.A. No. 7294-VCL, 2012 Del. Ch. LEXIS 229 (Del. Ch. Sept. 25, 2012) (hereinafter *South*); and La. Mun. Police Emps.' Ret. Sys. v. Lennar Corp., C.A. No. 7314-VCG, 2012 Del. Ch. LEXIS 230 (Del. Ch. Oct. 5, 2012) (hereinafter *Lennar*).

82. 698 A.2d 959 (Del. Ch. 1996).

83. 911 A.2d 362 (Del. 2006).

Health Administration's issuance of "a press release noting that Hecla had been cited for numerous safety violations."[84] The complaint alleged that a series of safety incidents at Hecla's Lucky Friday mine in northern Idaho constituted "red flags" for the board.[85] In dismissing the complaint, the court observed that the plaintiffs failed to cite any positive law that the board consciously violated or facts from which such a decision could be inferred,[86] failed to indicated that the Lucky Friday incidents were connected, that the board was informed of such incidents, or whether the board responded to such information,[87] and failed to allege facts from which the court could infer a sustained or systematic failure.[88] To the contrary, the plaintiffs alleged that the Hecla board formed a Safety Committee of outside board members, which affirmatively refuted allegations of a systemic failure.[89]

The Court of Chancery dismissed the complaint in *South* pursuant to Rule 23.1 with prejudice and without leave to amend.[90] However, the court made the dismissal of the complaint with prejudice only as to the named plaintiffs, and expressly noted that the dismissal would not have preclusive effect on "the efforts of more diligent stockholders to investigate potential claims and, if warranted, file suit."[91] Additionally, the court observed that Delaware courts have "admonished stockholders repeatedly to use Section 220 of the General Coropration Law,[92] to obtain books and records and investigate their claims before filing suit,"[93] and the court criticized the plaintiffs' hasty filing and failure to make a "deliberate and thorough pre-suit investigation."[94]

Vice Chancellor Glasscock's decision in *Lennar*, however, demonstrates that not all efforts to use Section 220 to investigate *Caremark* claims will succeed. In *Lennar*, the court declined to order an inspection of books and records for the asserted purpose of investigating putative *Caremark* claims on the grounds that the plaintiff did not provide a "credible basis" for investigating such a claim.[95] The two bases for investigation proffered by the plaintiff, and which the court found to be insufficient, were (a) past lawsuits concerning the missclassification of employees to avoid paying overtime, and (b) two news articles reporting that Lennar is one of many companies being investigated by the Department of Labor.[96]

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84. *South,* 2012 Del. Ch. LEXIS 229, at *1.

85. *Id.* at *35-40.

86. *Id.* at *33.

87. *Id.* at *35.

88. *Id.* at *40.

89. *Id.* at *40.

90. *Id.* at *5.

91. *Id.* at *5, 42-45.

92. Del. Code Ann. tit. 8, § 220.

93. *South*, 2012 Del. Ch. LEXIS 229, at *2.

94. *Id.* at *2-5, 61.

95. *Id.* at *2.

96. *See id.* at *4-14.

D. Confidentiality Agreements And Standstill Agreements

1. Confidentiality Agreements

In *Martin Marietta Materials, Inc. v. Vulcan Materials Co.*,[97] the Delaware Supreme Court affirmed a decision by the Court of Chancery, enjoining Martin Marietta Materials, Inc. ("Martin") from pursuing an unsolicited effort to acquire Vulcan Materials Company ("Vulcan") for a period of four months, based on a post-trial determination that Martin had violated two confidentiality agreements with Vulcan, prohibiting Martin from disclosing certain non-public information obtained from Vulcan during prior, failed discussions pertaining to a potential consensual business combination. After Vulcan ended the consensual negotiations, Martin launched an unsolicited exchange offer and concurrently filed suit in the Court of Chancery to obtain a declaration that Martin did not breach the non-disclosure agreements in connection with its exchange offer.[98] Vulcan counterclaimed for breach of the agreements.[99] The Court of Chancery held that Martin violated the non-disclosure agreements by impermissibly disclosing non-public information obtained from the prior consensual negotiations, and enjoined the hostile takeover bid for a four month period.[100]

On appeal, the Delaware Supreme Court reviewed the lower court's interpretation of the relevant contracts *de novo*.[101] In addition, the Supreme Court rejected Martin's argument that the Court of Chancery erroneously converted the relevant confidentiality agreements into standstill agreements, holding that while it is undisputed that the agreements at issue were "true confidentiality agreements, not standstill agreements," which did not "categorically preclude Martin from making a hostile takeover bid for Vulcan[,] [w]hat they did was preclude Martin from using and disclosing Vulcan's confidential, nonpublic information except insofar as the agreements themselves permitted."[102]

In so holding, the Delaware Supreme Court defined the contents and purposes of these respective forms of agreements, observing that

> Standstill agreements and confidentiality agreements are qualitatively different. A standstill agreement expressly prohibits specific conduct by a contracting party to acquire control of the other contracting party. Typically, a standstill agreement will prohibit a hostile bid in any form, including a hostile tender offer to acquire stock control of the other contracting party and/or a proxy contest to replace all or some of its directors. Standstill prohibitions do not require, or in any way depend upon, a contracting party's use or disclosure of the other party's confidential, nonpublic information. Rather, a standstill agreement is intended to protect a contracting party against hostile takeover behavior, as distinguished from the unauthorized use or disclosure of the other party's confidential nonpublic information.
>
> A confidentiality agreement, in contrast, is intended and structured to prevent a contracting party from using and disclosing the other party's confidential, nonpublic information except as permitted by the

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97. No. 254, 2012, 2012 Del. LEXIS 342 (Del. July 10, 2012).

98. *Id.* at *21.

99. *Id.*

100. *Id.* at *22-24, 50-51.

101. *Id.* at *25.

102. *Id.* at *31.

> agreement. In that respect it is qualitatively distinguishable from a prohibition that precludes a party categorically from engaging in specified hostile takeover activity. Thus, a confidentiality agreement will not typically preclude a contracting party from making a hostile bid to acquire control of the other party, so long as the bid does not involve the use or disclosure of the other party's confidential, non-public information. A confidentiality agreement is intended to protect a contracting party's non-public information, not its corporate ownership and control.[103]

2. "Don't Ask, Don't Waive" Standstill Agreements

In two bench decisions, and separately in the context of approving a class action settlement, the Court of Chancery considered the enforceability of agreements that prohibit counterparties from requesting a waiver to make a topping bid – which agreements colloquially have come to be known as "Don't Ask, Don't Waive" standstill agreements.[104]

In *Ancestry.com*, a challenge to the target company's enforcement of the "Don't Ask" aspect of its standstill agreements was mooted when the target's board waived the restriction in advance of a preliminary injunction hearing. While declining to delay the stockholders' consideration of the proposed transaction, Chancellor Strine ordered that the transaction could proceed only so long as the defendants promptly disclosed to the stockholders that potential bidders had been contractually restricted from making a topping bid prior to the waiver.[105] Notwithstanding the fact that the substantive issue of the validity of the challenged standstill agreement had been mooted by its waiver, the Chancellor volunteered his view that the plaintiffs would have had a probability of success on the merits of their substantive challenge to the use of the standstill agreement prior to its waiver.[106] The Chancellor was careful to note, however, that he was not endorsing any *per se* rule of invalidity or breach of fiduciary duty, and that his views were specific to the facts of the case before him. As the Chancellor explained in his bench ruling:

> I'm not prepared to rule out that they can't be used for value-maximizing purposes. But the value-maximizing purpose has to be to allow the seller as a well-motivated seller to use it as a gavel, to impress upon the people that it has brought into the process the fact that the process is meaningful; that if you're creating an auction, there is really an end to the auction for those who participate. And therefore, you should bid your fullest because if you win, you have the confidence of knowing you actually won that auction at least against the other people in the process.[107]

A few weeks earlier, in a bench ruling in *Complete Genomics*, Vice Chancellor Laster preliminarily enjoined a target company from enforcing a standstill agreement that prevented the counter-party from requesting (even in a non-public manner) a waiver of restrictions preventing it from making a superior offer to a merger transaction the target company's

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103. *Id.* at *28-30 (footnotes omitted).

104. *See* Transcript, *In re* Ancestry.com Inc. S'holder Litig., C.A. No. 7988-CS (Del. Ch. Dec. 17, 2012) (hereinafter *Ancestry.com* Trans.*);* Transcript*, In re* Complete Genomics, Inc., C.A. No. 7888-VCL (Del. Ch. Nov. 27, 2012) (hereinafter *Complete Genomics* Trans.*); In re* Celera Corp. S'holder Litig., C.A. No. 6304-VCP, 2012 Del. Ch. LEXIS 66 (Del. Ch. Mar. 23, 2012), *rev'd sub nom. on other grounds,* 59 A.3d 418 (Del. 2012).

105. *Ancestry.com* Trans. at 20-34.

106. *Id.* at 25-26.

107. *Id.* at 23.

board had approved (subject to stockholder approval).[108] The court did so on the grounds that the contractual agreement compromised the ongoing fiduciary duty of the target board's directors to evaluate competing offers, disclose material information, and make meaningful merger recommendations to the stockholders.[109] Although Chancellor Strine later explained in *Ancestry.com* that he did not view Vice Chancellor Laster's bench ruling in *Complete Genomics* to establish a per se rule of invalidity,[110] the bench ruling in *Complete Genomics* is not qualified by reference to specific facts, and appears to apply to all standstill agreements that purport to restrict the counter-party from requesting a waiver from the target company, even in a non-public manner.[111]

Similarly, in *Celera*, Vice Chancellor Parsons approved a contested class action settlement in part on the grounds that (i) obtaining a waiver of the standstill agreements constituted a therapeutic benefit to the class, and (ii) the plaintiffs' claims challenging the standstill agreements were colorable because such an agreement "arguably emasculates whatever protections the … fiduciary out otherwise could have provided."[112]

It is notable that the merger agreements in the cases considered by the Court of Chancery have authorized the target companies to release counter-parties to the standstill agreements from the contractual constraints imposed by the agreements if it were necessary to do so for the members of the target's board of directors to comply with their fiduciary duties. It does not appear that the Delaware courts have yet been called upon to determine (i) whether the standstill agreements are enforceable in the absence of such a "fiduciary out," or (ii) whether it would be a breach of fiduciary duty for a target board to agreed to a merger covenant that does not include a "fiduciary out" for a standstill agreement.

E. "Opt-Out" Rights In Class Action Litigation

In *BVF Partners, L.P. v. New Orleans Employees Retirement System*,[113] the Delaware Supreme Court held that the Court of Chancery committed reversible error in refusing to permit a discretionary opt-out right in connection with certification of a class and approval of a settlement in stockholder litigation that challenged a two-step transaction by which Quest Diagnostics Corporation ("Quest") acquired Celera Corporation ("Celera") for $8 per share in cash.[114] The settlement was opposed by BVF Partners L.P. ("BVF"), which (i) held approximately 25% of Celera's shares at the time of the challenged merger, (ii) believed the transaction substantially undervalued Celera by failing to properly value Celera's passive royalties in certain pharmaceuticals being developed by other companies, and (iii) sought to "opt-out" of the

108. *Complete Genomics* Trans. at 13.

109. *Id.* at 18. A few weeks earlier in that same matter, the Court declined to issue a preliminary injunction against the target company's enforcement of standstill agreements with other counter-parties, which precluded the counter-parties only from making public bids for the company, but did not preclude the counter-parties from making non-public bids. *See* Transcript, *In re* Complete Genomics, Inc., C.A. No. 7888-VCL (Del. Ch. Nov. 9, 2012). The court did so on the ground that the challenge was "unripe in that no real litigable concrete dispute has been presented" because it did not appear that there was any restricted party that wished to bid, but was being prevented from doing so by the challenged standstill agreement. *See id*. at 5. Despite denying the requested injunction, the court did require that the defendant board provide the plaintiffs with prompt notice if any party to a standstill agreement were to make a non-public request to be released from the agreement. *See id.*

110. *See Ancestry.com* Trans. at 22.

111. *See Complete Genomics* Trans. at 18.

112. *Celera*, 2012 Del. Ch. LEXIS 66, at *81-82.

113. 59 A.3d 418 (Del. 2012).

114. *See id.* at 423, 426.

proposed class to pursue what BVF claimed to be substantial damages claims against the defendants (and others).[115] The Court of Chancery overruled BVF's objections, certified a non-opt-out class pursuant to Rule 23(b)(2) with New Orleans Employees' Retirement System ("NOERS") as the class representative, and approved the settlement.[116] The Delaware Supreme Court affirmed the Court of Chancery's certification of the class and of NOERS as the class representative, but reversed the lower court's refusal to grant a discretionary opt-out right.[117] In view of the opt-out decision, the Delaware Supreme Court declined to rule on the fairness of the settlement, which BVF had also challenged.[118]

The stockholder suits challenging the merger in *Celera* were filed by NOERS and various other stockholders that held ownership interests in Celera that were relatively insubstantial in relation to BVF's stock ownership.[119] The suits were brought on behalf a proposed class consisting of all persons (other than the defendants) who owned stock in Celera from the date of the announcement of the proposed merger through the merger's consummation.[120] As such, the class definition included BVF.

A few weeks after the stockholder suits were commenced, the parties entered into a Memorandum of Understanding, by which the plaintiffs agreed to withdraw their motion for a preliminary injunction and work towards entering into a formal Settlement Agreement that would release the claims of the proposed class in consideration of the defendants' agreement to provide various "therapeutic benefits."[121] The proposed settlement did not provide for any increase in the merger consideration.

Four days before the merger closed, NOERS sold all of its Celera stock on the secondary market.[122] The parties entered into a formal settlement agreement four months after the merger closed, and the Court of Chancery scheduled a hearing on the questions of class certification and approval of the proposed settlement for a few months later.[123] The Court of Chancery's decision on class certification and approval of the proposed settlement was filed on March 23, 2012 – nearly a year after the challenged merger had closed.

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115. *See id.* at 426-28. In connection with its opposition to the settlement, BVF also identified an error in the valuation analysis of Celera's financial advisor — pertaining to the drug royalties — which BVF claimed to have had a material impact on the financial advisor's fairness opinion. *See id.* at 424-25.

116. *See id.* at 428.

117. *See id.*

118. *See id.*

119. *See id.* at 426-27.

120. *See id.* at 427.

121. Specifically, the defendants agreed (i) to reduce the termination fee from 3.5% to 2.3% of the transaction value, (ii) to waive standstill agreements that precluded potential competing bidders from making a Superior Offer for Celera, (iii) to extend the tender offer by seven days, and (iv) to issue supplemental disclosures regarding the investment banker's financial analysis and the transaction history. *See id. at 426.*

122. *See id.* at 426-27, 430.

123. *See id.* at 427.

On appeal, the Delaware Supreme Court concluded that the Court of Chancery erred by certifying the class without providing a discretionary opt-out right.[124] The Supreme Court held that the Court of Chancery did not err in certifying the class pursuant to Rule 23(b)(2), observing that "Delaware courts 'repeatedly have held that actions challenging the propriety of director conduct in carrying out corporate transactions are properly certifiable under both subdivisions (b)(1) and (b)(2).'"[125] The Delaware Supreme Court further observed that a "Rule 23(b)(2) class may seek monetary damages in addition to declaratory or injunctive relief, so long as the claim for equitable relief predominants [sic]."[126] The Supreme Court held, however, that the Court of Chancery committed reversible erred by denying BVF's request for a discretionary opt-out right under the circumstances of this case.[127] As the Supreme Court explained:

> [The Court of Chancery] could not deny a discretionary opt-out right where the policy favoring a global settlement was outweighed by due process concerns. Here, the class representative was "barely" adequate, the objector was a significant shareholder prepared independently to prosecute a clearly identified and supportable claim for substantial money damages, and the only claims realistically being settled at the time of the certification hearing nearly a year after the merger were for money damages. Under these particular facts and circumstances, the Court of Chancery had to provide an opt-out right.[128]

F. Attorneys' Fees In Derivative Litigation

Another notable aspect of the Delaware Supreme Court's decision in *Southern Peru* (discussed *supra* Section I.A) is the affirmance of the Court of Chancery's award of more than $300 million in attorneys' fees to plaintiffs' counsel. In so doing, the Delaware Supreme Court declined the defendants' argument for a cap or mandatory range on attorneys' fees in megafund cases,[129] and endorsed the Court of Chancery's reasoning that the award "creates healthy incentive for plaintiff's lawyers to actually seek real achievement for the companies that they represent in derivative actions and the classes that they represent in class actions."[130]

In affirming the Court of Chancery's fee award, the Delaware Supreme Court rejected the defendants' argument that the Court of Chancery erred in its application of the factors for awarding attorneys' fees set forth in *Sugarland Industries, Inc. v. Thomas*.[131] Specifically, the defendants argued that the trial court erred by ascribing "dispositive weight" to the benefit achieved by the litigation, and by failing to apply a "declining percentage" concept by which the percentage fee awarded decreases as the size of the common fund created by the litigation increases.[132] The Supreme Court concluded

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124. *Id.* at 433.

125. *Id.* at 432-33 (quoting *In re* Cox Radio, Inc. S'holders Litig., C.A. No. 4461-VCP, 2010 Del. Ch. LEXIS 102, at *28 (Del. Ch. May 6, 2010)).

126. *Id.* at 432-33.

127. *Id.* at 433.

128. *Id.* at 436.

129. *See Southern Peru,* 51 A.3d at 1252-63.

130. *Id.* at 1252 (quoting the Court of Chancery opinion).

131. 420 A.2d 142 (Del. 1980).

132. *Southern Peru,* 51 A.3d at 1252, 1258.

that the Court of Chancery had, in fact, applied the declining percentage concept by awarding 15% of the common fund as opposed to the 22.5% requested.[133] The Delaware Supreme Court also "decline[d] to impose either a cap or the mandatory use of any particular range of percentages for determining attorneys' fees in megafund cases."[134]

In a rare dissenting opinion, Justice Berger disagreed with the majority's affirmance of the attorneys' fee award (but concurred with the majority's decision on the "merits" aspect of the appeal).[135] According to the dissent, the trial court's analysis "focused on the perceived need to incentivize plaintiffs' lawyers to take cases to trial," and gave the impression that "the fundamental test for reasonableness is whether the fee is setting a good incentive, and that the only basis for reducing the fee would be envy."[136] Justice Berger wrote that such analysis "is not a decision based on *Sugarland*."[137]

In an equally rare move, Grupo Mexico moved for reargument of the Delaware Supreme Court's already en banc decision.[138] In its reargument motion, Grupo Mexico argued that

> the relevant "benefit achieved" for calculating attorneys' fees in a derivative case, against a majority stockholder and other defendants, is properly defined as the entire judgment paid to the corporation, or, in this case, 19% of the entire judgment paid to the corporation, because the majority stockholder defendant owns 81% of the corporation that will receive the judgment.[139]

The Delaware Supreme Court summarily denied the reargument motion, holding both (i) that Grupo Mexico waived the argument by failing to raise it before the Court of Chancery, and (ii) that Grupo Mexico's "look through" argument for attorneys' fees was without substantive merit, in any event.[140] Specifically, the court observed that "[i]n this case, the corporation was harmed and the total recovery is awarded to the corporation, … not 'nominally' but actually,"[141] and that "Delaware law does not analyze the 'benefit achieved' for the corporation in a derivative action, against a majority stockholder and others, as if it were a class action recovery for minority stockholders only."[142]

The Court of Chancery's decision approving attorneys' fees in *Delphi* (discussed *supra* Section I.A) also is notable. There, Vice Chancellor Glasscock awarded the plaintiffs' counsel $12 million of a $49 million settlement fund created after the Court of Chancery determined (on a preliminary injunction record) that the plaintiffs had a reasonable probability of success, but denied the injunction on other grounds.[143] In approving the fee award, the court observed:

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133. *Id.* at 1258-59.

134. *Id.* at 1261.

135. *Id.* at 1263.

136. *Id.*

137. *Id.*

138. *See* Ams. Mining Corp. v. Theriault, No. 29, 2012, 2012 Del. LEXIS 520, at *2 (Del. Sept. 21, 2012).

139. *Id.*

140. *Id.* at *3-4.

141. *Id.* at *5.

142. *Id.* at *7.

143. *Delphi* Trans. at 11-12.

> When addressing corporate benefit doctrine fee requests where the benefit is intangible, such as where there has been an additional disclosure made as a result of litigation, the Court … may apply the *Sugarland* factors with apparent precision[,] but is always acting on really nothing more than intuition or basing its decision on some prior decision which was rendered by that judge based on intuition. It is substantially different in this case because of the result, the hard monetary result that was achieved for the stockholders.[144]

More recently, in the *El Paso* litigation (discussed *supra* Section I.B) — which also involved the denial of a preliminary injunction despite a finding that the plaintiffs had a reasonable probability of success — the plaintiffs' counsel were awarded $26 million of a $110 million settlement fund.[145]

II. ALTERNATIVE ENTITY LAW

A. "Default" Fiduciary Duties In Limited Liability Companies

In *Gatz Properties, LLC v. Auriga Capital Corporation*,[146] the Delaware Supreme Court made crystal clear that "the question remains open" whether the Delaware Limited Liability Company Act (the "Act") imposes "default" fiduciary duties upon managers and controllers of a Limited Liability Company (a "LLC") organized under the Act, where the members of the LLC have not specifically contracted that such duties will not apply.[147] The Supreme Court made this pronouncement in the course of affirming Chancellor Strine's decision in *Auriga Capital Corporation v. Gatz Properties, LLC*,[148] in which the Chancellor determined that Gatz Properties, LLC ("Gatz") — the manager of Peconic Bay, LLC ("Peconic") (an LLC organized under the Act) — had violated certain fiduciary duties that were expressly imposed by the terms of Peconic's Limited Liability Company Agreement.[149] The Chancellor's decision separately held that Gatz was subject to certain "default" fiduciary duties.[150] While stopping short of formally vacating this aspect of the lower court's decision, the Delaware Supreme Court wrote that "the [lower] court's statutory pronouncements must be regarded as dictum without any precedential value."[151]

A few weeks after the Delaware Supreme Court decided *Gatz*, Vice Chancellor Laster decided *Feeley v. NHAOCG, LLC*,[152] which partially denied a motion to dismiss certain counterclaims that were based, among other things, on alleged

144. *Id.* at 10.

145. *Id.* at 10.

146. 59 A.3d 1206 (Del. 2012).

147. *Id.* at 1218-20 & n.62.

148. 40 A.3d 839 (Del. Ch. 2012).

149. *See Gatz*, 40 A.3d at 859.

150. *See id*. at 849-56.

151. *Gatz,* 59 A.3d 1218.

152. C.A. No. 7304-VCL, 2012 Del. Ch. LEXIS 274 (Del. Ch. Nov. 28, 2012).

violations of "default" fiduciary duties by the manager of a Delaware LLC. In sustaining the plaintiffs' right to pursue its claims for violation of default fiduciary duties, the Court of Chancery relied, among other things, on the Chancellor's decision in *Auriga Capital Corporation*.[153] In so doing, the court expressly acknowledged the Delaware Supreme Court's opinion in *Gatz*, and wrote:

> Although the Delaware Supreme Court determined that the Chancellor should not have reached the question of default fiduciary duties, his explanation of the rationale for imposing default fiduciary duties remains persuasive, at least to me. In citing the Chancellor's discussion I do not treat it as precedential, but rather afford his views the same weight as a law review article, a form of authority the Delaware Supreme Court often cites.[154]

Definitive resolution of the issue will need to await the Delaware Supreme Court's next opportunity to address the question or action by the Delaware legislature to amend the LLC Act.

B. Contractual "Special Approval" Provisions In Limited Partnership Agreements

In at least four opinions, the Court of Chancery explored the effect of a "Special Approval" provision in a limited partnership agreement of a publicly held master limited partnership. In all but one of the cases, the Court of Chancery dismissed all claims against the defendants because the use of the Special Approval process, and the related "conclusive presumption" of good faith created by the receipt of a fairness opinion. All of the dismissals were appealed to the Delaware Supreme Court.

1. *Gerber v. Enterprise Products Holdings, LLC*

The first "Special Approval" case decided in 2012 was *Gerber v. Enterprise Products Holdings, LLC*,[155] which was decided by Vice Chancellor Noble. *Gerber* involved a challenge to two conflict transactions (a sale of assets and a merger) involving Enterprise GP Holdings, L.P. ("EPE"). The Court of Chancery held that the challenged transactions were protected from judicial scrutiny for fairness, good faith or fiduciary breach because they were approved in accordance with certain terms of EPE's limited partnership agreement (the "EPE LPA"), which specified that any alleged conflict transactions would be:

> deemed approved by all Partners, and shall not constitute a breach of this Agreement or of any agreement contemplated herein or therein, or of any duty stated or implied by law or equity if the resolution or course of action in respect of such conflict of interest is … approved by Special Approval.[156]

"Special Approval" was defined in the EPE LPA as approval by a committee of three or more directors meeting the independence requirements of the Securities and Exchange Act and the New York Stock Exchange.[157] In the case of

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153. *Id*. at *21-26.

154. *Id*. at *25.

155. C.A. No. 5989-VCN, 2012 Del. Ch. LEXIS 5 (Del. Ch. Jan. 6, 2012).

156. *Id*. at *30-31 (modifications in original).

157. *Id*. at *32-33.

the challenged transactions, the Special Approval process was utilized and the independent committee relied upon the opinion of an independent financial advisor.[158]

Prior to the two transactions challenged in *Gerber*, EPE and Enterprise Products Partners, L.P ("Enterprise Products") were in a two-tier limited partnership structure, the entirety of which was controlled, indirectly, by Dan Duncan ("Duncan"). Specifically, Duncan owned and controlled Dan Duncan LLC ("Duncan"), which owned or controlled Enterprise Products Holding, LLC (the "General Partner"), which was EPE's general partner. In turn, EPE owned and controlled Enterprise Products GP, LLC, which Enterprise Products' general partner.[159]

The first transaction challenged in *Gerber* was EPE's sale of its ownership interest in Texas Eastern Products Pipeline Company, LLC ("Teppco") to Enterprise Products (the "Teppco Sale"). The Teppco Sale was considered by the Audit, Conflict, and Governance Committee (the "ACG Committee") of the board of General Partner (the "Board"). The ACG Committee hired Morgan Stanley & Co. ("Morgan Stanley") to render an opinion regarding the fairness of the Teppco Sale, and Morgan Stanley opined that the Teppco Sale was fair from a financial point of view.[160] The ACG Committee and the Board thereafter approved the Teppco Sale.[161]

The second transaction challenged in *Gerber* involved a merger of EPE and Enterprise Products (the "Enterprise Merger").[162] In considering the Enterprise Merger, the ACG Committee met with Morgan Stanley and its legal advisors to discuss the actions involved in the Teppco Sale and a prior transaction involving Teppco – both of which had led to separate claims against Duncan and related entities (collectively the "Teppco Claims"). Following this discussion, EPE and Enterprise Products eventually agreed on terms for the Enterprise Merger. Morgan Stanley opined that the terms of the Enterprise Merger were fair to the holders of EPE's LP units, but EPE never obtained any separate valuation of the Teppco Claims.[163]

The plaintiff in *Gerber* challenged both the Teppco Sale and the Enterprise Merger. The plaintiff named Duncan and his various affiliated and controlled entities as defendants. The plaintiff alleged, among other things, that the defendants breached their express and implied duties under the EPE LPA by causing EPE (i) to undertake the Teppco Sale and (ii) to enter into the Enterprise Merger without valuing the Teppco Claims.[164] The defendants moved to dismiss the plaintiff's complaint, and the Court granted the motion.

In support of its dismissal of the complaint in *Gerber*, the court found that the EPE LPA displaced common law fiduciary duties in connection with the approval of any transaction involving a conflict of interest, and that the plaintiff could not sustain his breach of fiduciary duty claims against any defendant because the Teppco Sale and the Enterprise Merger both had been approved by the "Special Approval" process in the EPE LPA.[165] The court also addressed the

158. *Id.* at *36-37, 58.

159. *Id.* at *4.

160. *Id.* at *6-7.

161. *Id.* at *7.

162. *Id.* at *7-8.

163. *Id.* at *8-9.

164. *Id.* at *10-11.

165. *Id.* at *37, 58.

plaintiff's claim for an alleged breach of the implied covenant of good faith and fair dealing. The court observed that the implied covenant is a contractual duty that binds only the named parties to the EPE LPA.[166] Because General Partner was the only defendant that was a party to the EPE LPA, the court rejected the plaintiff's claim as to all defendants other than General Partner.[167] As to General Partner, the court held the implied covenant required that General Partner act in good faith when it exercised its contractually-conferred discretion to utilize the Special Approval process.[168] The court concluded that the complaint could fairly be read to allege a claim that General Partner acted in bad faith when it elected to use the Special Approval process.[169] Nonetheless, the EPE LPA directly addressed the issue of "good faith" — providing that General Partner was entitled to a conclusive presumption of good faith if General Partner took any act in reliance upon the opinion of an expert.[170] Because the ACG Committee relied upon an opinion from Morgan Stanley, the court held that General Partner was entitled to a conclusive presumption that it acted in good faith in utilizing the Special Approval process.[171] In so doing, the court acknowledged that it was the ACG Committee, and not General Partner, that had relied upon the Morgan Stanley opinion. The court reasoned, however, as follows:

> [It would be] unreasonable … for the Court to infer that although an independent subset of the Board relied upon a fairness opinion, the entity that the Board manages did not rely upon that opinion. Thus, the only reasonable interpretation of the well-pled facts is that [General Partner] relied upon [t]the 2009 Morgan Stanley Fairness Opinion in deciding whether to use the Special Approval process to take advantage of the contractual duty limitations provided by Section 7.9(a).[172]

In a footnote, the court addressed the question of how a section of the EPE LPA could preclude a claim for a breach of the implied covenant when the Delaware Limited Partnerships Act provides that a partnership agreement may not eliminate the implied covenant of good faith and fair dealing.[173] The court reasoned that (i) the implied covenant is a "gap-filler" that comes into play only where there is a gap in the contract, and (ii) there was no gap in the contract with respect to the AGC Committee's ability to rely on the opinion of an expert because the parties had expressly addressed the issue in the EPE LPA.[174]

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166. *Id*. at *40.

167. *Id*.

168. *Id*. at *44-45.

169. *Id*. at *45.

170. *Id*. at *46-47.

171. *Id*. at *48.

172. *Id*. at *47-48.

173. *Id*. at *41 n.46.

174. *Id*. at *50-51 & n.58.

2. *In Re K-Sea Transportation Partners L.P. Unitholders Litigation*

The next case to raise similar issues was *In re K-Sea Transportation Partners L.P. Unitholders Litigation*,[175] which was decided by Vice Chancellor Parsons. *K-Sea* involved an unaffiliated third-party acquisition of K-Sea Transportation Partners, L.P. ("K-Sea") in which K-Sea's general partner ("K-Sea GP") received disparate consideration from that received by K-Sea's common unitholders.[176] Specifically, the common unitholders received $8.15 in cash per unit,[177] while K-Sea GP received a separate cash payment of $18 million for certain IDRs held exclusively by K-Sea GP.[178] On account of the differential consideration in the merger, K-Sea GP formed a conflicts committee to review and make a recommendation regarding the merger.[179] The members of the conflicts committee met the requirements imposed on them by K-Sea's limited partnership agreement (the "K-Sea LPA") in that none of them held an ownership interest in the limited partnership or any affiliated entity other than common units.[180] Each member of the conflicts committee did, however, subsequently receive 15,000 "phantom" partnership units, which entitled the holder to one common unit (or its cash equivalent) upon vesting — which occurred immediately upon a change of control.[181] Thus, if the merger occurred, each member of the conflicts committee would receive 15,000 partnership units (or their cash equivalent). The conflicts committee hired a financial advisor ("Stifel") to opine on the fairness of the merger.[182] Stifel opined that the $8.15 per share being paid to the holders of the common unitholders was fair. Stifel did not opine on the fairness of the $18 million payment to the general partner.[183] After the conflicts committee passed on fairness of the merger, the full board of K-Sea GP approved the transaction.

The plaintiffs, certain common unitholders of K-Sea, challenged the transaction. The plaintiffs alleged that K-Sea GP, certain of its affiliates, and the directors of K-Sea GP had breached the K-Sea LPA and their fiduciary duties in approving the merger.[184] The plaintiffs specifically argued that (1) the conflicts committee and the board had breached their fiduciary duties by not evaluating the fairness of the $18 million payment to K-Sea GP, and (2) K-Sea GP and the board had breached their duties by relying on the approval of a conflicts committee that was tainted by their ownership of the phantom units.[185] The defendants moved to dismiss, and the Court of Chancery granted the motion.

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175. C.A. No. 6301-VCP, 2012 Del. Ch. LEXIS 67 (Del. Ch. Apr. 4, 2012).

176. *Id.* at *6.

177. *Id.* at *8.

178. *Id.* at *6.

179. *Id.*

180. *Id.* at *7.

181. *Id.*

182. *Id.* at *7-8.

183. *Id.* at *8.

184. *Id.* at *3.

185. *Id.*

In dismissing the complaint, the court first examined the effect of an exculpatory provision in the K-Sea LPA, which stated: “Notwithstanding anything to the contrary set forth in this Agreement, no Indemnitee shall be liable for monetary damages to the Partnership [or] the Limited Partners … for losses sustained or liabilities incurred as a result of an act or omission if such Indemnitee acted in good faith.”[186] Based on this provision of the K-Sea LPA, the court determined that the plaintiffs’ claim could survive dismissal only if the plaintiffs had pled facts showing that the “[d]efendants both (1) breached the [K-Sea] LPA or a fiduciary duty and (2) in doing so, acted in bad faith.”[187]

In assessing whether the complaint stated a viable claim that the defendants had breached the K-Sea LPA, the court observed that the challenged transaction was a merger and that the K-Sea LPA set forth a procedure for approval of merger that required (1) the consent of K-Sea GP, and (2) an affirmative vote by a majority of the holders of K-Sea common units.[188] There was no dispute that the second requirement had been satisfied.[189] As to the first requirement, the court found that the K-Sea LPA placed no limits on K-Sea GP’s consent, except to exercise its “discretion.”[190] In that regard, the court observed that K-Sea LPA expressly provided that K-Sea GP was entitled to “consider only such interests and factors as it desires and shall have no duty or obligation to give any consideration to any interest of, or factors affecting, the Partnership [or] any Limited Partner” when exercising discretion under the K-Sea LPA.[191] Based on this contractual language, the court rejected the plaintiffs’ argument that the merger must be “fair and reasonable” to the limited partners.[192]

The court also considered whether K-Sea GP’s contractual duty to consent was “constrained by any other default or fiduciary duty.”[193] In that regard, the court found that the K-Sea LPA displaced any such duties with a provision that required only that K-Sea GP not “exercise its discretion in a manner inconsistent with the best interests of the Partnership as a whole.”[194] The court held that this “narrower” duty required only that K-Sea GP not act in bad faith.[195] With respect to the question of bad faith, the court observed that the K-Sea LPA provided that K-Sea GP was entitled to a conclusive presumption of good faith when it acted in reliance upon the professional opinion of an expert, and concluded that the conflicts committee’s reliance on Stifel’s report immunized K-Sea GP from a finding that it had breached the express contractual obligation to act in good faith or that it had breached the implied covenant of good faith and fair dealing.[196]

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186. *Id.* at *17 (modifications in original).

187. *Id.* at *18.

188. *Id.* at *19.

189. *Id.* at *20.

190. *Id.* at *21.

191. *Id.* at *20 (modification in original).

192. *Id.* at *21.

193. *Id.* at *22.

194. *Id.* at *22-23.

195. *Id.* at *23.

196. *Id.* at *31-32. Notably, the court reached this decision (in reliance upon the K-Sea LPA) despite its acknowledgment that the well pleaded allegations of the complaint supported a reasonable inference that K-Sea GP “failed to act in good faith” in approving the merger. *Id.* at *29-30. The allegations that supported this inference included that the “K-Sea Board caused K-Sea GP to refuse to consent to any transaction until [the acquirer] offered a separate payment of $18 million for K-Sea GP’s IDRs” and “that the K-Sea board incentivized the otherwise independent members of the Conflicts Committee to approve the Merger Agreement by granting on the eve of negotiations phantom units, which would vest upon a change of control.” *Id.* at *30.

3. *In Re Encore Energy Partners LP Unitholder Litigation*

In re Encore Energy Partners LP Unitholder Litigation,[197] also decided by Vice Chancellor Parsons, was the next case involving "Special Approval" provisions. *Encore* arose from the merger of Vanguard Natural Resources, LLC ("Vanguard") and Encore Energy Partners LP ("Encore") – the general partner of which ("Encore GP") was controlled by Vanguard.[198] After Vanguard proposed the merger, Encore GP formed a conflicts committee of independent directors with broad authority to consider the proposed merger and to negotiate on behalf of Encore.[199] The pertinent provision of Encore's Limited Partnership Agreement (the "Encore LPA") provided that approval of the merger "by a majority of the members of the Conflicts Committee acting in good faith" would constitute "Special Approval" such that "any resolution or course of action by [Encore GP] or its Affiliates … shall be permitted and deemed approved by all Partners, and shall not constitute a breach of [the Encore LPA] … or of any duty stated or implied by law or equity …."[200] A determination made in "good faith" was further defined in the Encore LPA as a determination that an actor believes to be "in the best interests of the Partnership."[201]

The conflicts committee retained experienced legal and financial advisors, and conducted due diligence for approximately six weeks following Vanguard's offer.[202] Then, the conflicts committee countered Vanguard's initial offer by proposing a higher exchange ratio.[203] Vanguard ultimately agreed to the conflicts committee's counter offer of a higher exchange ratio, and the conflicts committee thereafter approved the merger.

The plaintiffs, certain unitholders of Encore, challenged the transaction. The plaintiffs named Encore GP, Vanguard, and the directors of Encore GP as defendants.[204] The plaintiffs alleged that the defendants breached the Encore LPA and the implied covenant of good faith and fair dealing by proposing and approving the merger.[205] Among other things, the plaintiffs alleged that Vanguard planned to propose a merger with Encore months before Vanguard actually proposed the merger, and that Vanguard monitored the spread between Vanguard and Encore's respective trading prices to seize upon an exchange ratio favorable to Vanguard.[206] The plaintiffs also alleged that Vanguard made public announcements and released pessimistic forecasts designed to drive down Encore's trading price.[207] The plaintiffs claimed the conflicts

197. C.A. No. 6347-VCP, 2012 Del. Ch. LEXIS 214 (Del. Ch. Aug. 31, 2012).

198. *Id*. at *2.

199. *Id*. at *12-14.

200. *Id*. at *31.

201. *Id*. at *33.

202. *Id*. at *13-15.

203. *Id*. at *16.

204. *Id*. at *4-5.

205. *Id*. at *25.

206. *Id*. at *11, 24-25.

207. *Id*. at *7-11.

committee's counter-offer was indefensibly low, and that the ultimate deal was less valuable to Encore's unitholders than the initial offer because of the increase in the spread in the company's respective trading prices over the course of negotiations.[208] The plaintiffs' sole claim alleged that "Defendants breached their contractual duties to Plaintiffs … by proposing, approving and consummating a transaction that was not fair or reasonable and was undertaken in bad faith."[209]

The Court of Chancery concluded that the only applicable duties would be those expressly set forth in the Encore LPA, which effectively eliminated any fiduciary duties that are legally capable of being waived.[210] In relevant part, the Encore LPA replaced any default duties with an express contractual duty to act in good faith when conducting the "Special Approval" process. The court concluded that the relevant contractual provision required the plaintiffs to allege that the defendants acted "in a matter they subjectively believed was *not* in the best interest of [the company] and its unitholders."[211]

The court held that the plaintiffs had not stated a claim for subjective bad faith. The court observed that the plaintiffs' allegations boiled down to a claim that the conflicts committee "ran a shoddy negotiation process."[212] The court concluded, however, that the complaint lacked allegations of "sufficient facts from which one reasonably could infer that the members of the conflicts committee subjectively believed they were acting contrary to the Partnership's interests by giving Special Approval to the Merger."[213]

The court also addressed the plaintiffs' claim that the defendants had breached the implied covenant of good faith and fair dealing. Pursuant to the terms of the Encore LPA, Encore GP was entitled to a conclusive presumption that it acted in good faith for conduct taken in reliance on the opinion of a financial advisor, and the plaintiffs' allegations supported the inference that Encore GP had relied upon the opinion of its financial advisors in connection with the challenged merger.[214] The court observed that "good faith" as used in the Encore LPA for the purpose of the conclusive presumption is at least as broad as ("and likely broader" than) the "good faith" standard applied under the implied covenant.[215] Thus, the plaintiffs could not plead a breach of the implied covenant because the defendants were entitled to the conclusive presumption of good faith set forth in the limited partnership agreement.[216] The court also observed that the plaintiffs' claim failed for the further reason that the complaint did not contain allegations from which the court could infer that the defendants' actions frustrated the plaintiffs' reasonable expectations arising out of the contract.[217]

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208. *Id*. at *21.

209. *Id*. at *22.

210. *Id*. at *30.

211. *Id*. at *33 (emphasis in original).

212. *Id*. at *41.

213. *Id*. at *41.

214. *Id*. at *55-57.

215. *Id*. at *57 n.107.

216. *Id*. at *57-58.

217. *Id*. at *49-51.

4. *Brinckerhoff V. El Paso Pipeline GP Company*

The final case is *Brinckerhoff v. El Paso Pipeline GP Company*,[218] which Chancellor Strine decided from the bench following oral argument.[219] The challenged transaction in *Brinckerhoff* was a conflict transaction involving (i) El Paso Pipeline Partners, LP ("El Paso"), which was a publicly traded master limited partnership, and (ii) El Paso Corporation ("EPC"), which was the controller of El Paso's general partner.[220] In the challenged transaction, El Paso had agreed to acquire EPC's 51% interest in two other entities. El Paso's limited partnership agreement (the "El Paso LPA") eliminated any common law fiduciary duties and displaced those duties with contractual duties.[221] Specifically, the El Paso LPA provided four methods for obtaining approval of a transaction involving a conflict of interest.[222] If one of those four methods was employed, the El Paso LPA provided that the transaction "shall be permitted and deemed approved by all partners, and … shall not constitute a breach of [the El Paso LPA]."[223] For the challenged transaction, the defendants had elected to utilize the Special Approval method that required "approval by a majority of [the members of] the conflicts committee acting in good faith."[224] The El Paso LPA also created a rebuttable presumption that the conflicts committee acted in good faith.[225] Another provision of the El Paso LPA separately provided a conclusive presumption of good faith for acts taken by the general partner in reliance on the opinion of an independent expert.[226]

Among other things, the plaintiff alleged that (i) El Paso paid a grossly unfair price for the assets at issue, and (ii) critical information was omitted or not considered by the conflicts committee and its advisors in granting Special Approval – including information about contemporaneous and comparable transactions, and EPC's refusal to exercise a right of first refusal it held as to certain of the same assets. Based on these allegations, the plaintiff argued that he had rebutted the presumption of good faith created by the Special Approval process employed to approve the challenged transaction. The defendants argued that the plaintiff's allegations were insufficient to create an inference of bad faith sufficient to overcome the contractual rebuttable presumption of good faith resulting from the use of a conflicts committee. The defendants also argued that they were entitled to a conclusive presumption of good faith because the conflicts committee had obtained the opinion of an independent financial advisor.

The Court of Chancery held that the plaintiff had pleaded facts that, if true, would support a claim that the "[conflicts] committee consciously approved a transaction that it believed was unduly favorable to the parent at the expense

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218. Transcript, C.A. No. 7141-CS (Del. Ch. Oct. 26, 2012).

219. Before announcing his ruling, the Chancellor offered the following words of caution: "People now are putting too much stock in bench rulings. People who are not from Delaware used to never even see them, and now they trade as some sort of samizdat literature, as if they are published opinions or something. They're not, but they're important to the exercise of justice …." *Id.* at 52.

220. *Id.* at 5.

221. *Id.* at 6.

222. *Id.* at 7.

223. *Id.*

224. *Id.*

225. *Id.* at 7.

226. *Id.* at 34-35.

of the interest the committee was charged to protect."[227] These facts included the conflicts committee's failure to consider "a contemporaneous transaction in the same asset space involving the parent, a transaction that the pricing terms of which create[d] an inference of fairly gross price mismatching," and the fact that the parent "eschew[ed] the option" to buy into the same space as that was being sold to El Paso.[228] The court further observed:

> [T]he conflicts committee and its financial advisor, if they were doing their job, would have known of these inconvenient facts. The absence of any candid dealing with them and explanation of why they're distinct, and the pricing of the transaction at a multiple that the plaintiffs plead was exceedingly disparate, does to my mind create a pleading stage inference.[229]

The court also rejected the defendants' argument that the conclusive presumption of good faith applied because the conflicts committee had relied upon an independent financial advisor. The court questioned whether the El Paso LPA could be read to give a general partner the benefit of a contractual conclusive presumption of good faith in circumstances where a flawed conflicts committee process had failed to sustain the defendants' reliance upon a contractual rebuttable presumption of good faith.[230] In this regard, the court found the El Paso LPA to be ambiguous as to whether both contractual presumptions could apply at the same time, and observed that such ambiguities are "not read in favor of a party seeking exculpation or the narrowing of default duties that would otherwise exist …."[231] According to the court, "when [the limited partnership agreement] says that the conflict committee acts under a particular standard, that's the standard; and that the general partner is benefited for this reason."[232] The unstated implication of this statement appears to be that the court was not prepared to permit the general partner to obtain the benefit of a Special Approval process that was not formally employed in the challenged transaction — even if the facts might arguably have supported the employment of that process.

C. Implied Covenant Of Good Faith And Fair Dealing

In 2012, the Court of Chancery also clarified the scope of the implied covenant of good faith and fair dealing in the governing agreements of alternative entities. As set forth above, a number of the alternative entity cases involved claims for breach of the implied covenant of good faith and fair dealing. In a few of those cases, the court confirmed that a claim for breach of the implied covenant and fair dealing is not a substitute for a claim for breach of fiduciary duty.[233]

227. *Id*. at 56.

228. *Id*. at 56-57.

229. *Id*. at 8.

230. *Id*. at 15-17.

231. *Id*. at 55.

232. *Id*.

233. *See*, *e.g.*, *Encore*, 2012 Del. Ch. LEXIS 214, at *46 (holding that the implied covenant "is not a 'free floating duty' or 'a substitute for fiduciary duty analysis'"); *Gatz*, 40 A.3d at 854 (observing that "[a] generalized 'fairness' inquiry under the guise of an 'implied covenant' review is an invitation to, at best, reinvent what already exists in another less candid guise, or worse, to inject

continued on page 26

In *ASB Allegiance Real Estate Fund v. Scion Breckenridge Managing Member, LLC*,[234] the court further explained the difference between an implied covenant analysis and a fiduciary duty analysis.

In *ASB*, Vice Chancellor Laster held that the plaintiff, which was a party to an LLC agreement, was entitled to an award of fees pursuant to a contractual provision that awarded attorney's fees to a prevailing party in any action to "enforce the provisions of [the LLC Agreement]."[235] The defendant asserted that the LLC Agreement did not entitle the plaintiff to collect attorney's fees for defending counterclaims asserting breach of fiduciary duty and breach of the implied covenant of good faith and fair dealing. The court rejected the defendant's arguments, holding that the defendant's breach of fiduciary duty claim arose from a provision in the applicable LLC agreement and that the claim was one to enforce the terms of the LLC agreement.

As to the defendants' counterclaim for breach of the implied covenant of good faith and fair dealing, the court held that "[n]otwithstanding the covenant's potentially misleading moniker and decisional references to a culpable mental state, a claim for breach of the implied covenant is a contract claim …."[236] The court explained, in great detail, how a claim for a breach of the implied covenant of good faith and fair dealing differs from a "tort claim" for breach of fiduciary duty. The court reasoned that there is a temporal component that is "critical" to each claim.[237] In a breach of fiduciary duty claim, the "court examines the parties as situated at the time of the wrong."[238] The court considers "whether the defendant owed the plaintiff a duty" and "whether the duty was breached."[239] The court may consider historical events to inform its analysis, "but liability depends on the parties' relationship when the alleged breach occurred, not on the relationship as it existed in the past."[240] By contrast, an implied covenant claim "looks to the past."[241] In an implied covenant analysis, the court asks "what the parties would have agreed to themselves had they considered the issue in their original bargaining positions at the time of contracting."[242] The parties' relationship at the time of the wrong is less important in an implied covenant analysis. As such, the "fair dealing" component of an implied covenant analysis is not akin to a "fair dealing" analysis in an entire fairness review. Fair dealing in an implied covenant analysis is a "commitment to deal 'fairly' in the

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continued from page 25

unpredictability into both entity and contract law, by untethering judicial review from the well-understood frameworks that traditionally apply in those domains").

234. 50 A.3d 434 (Del. Ch. 2012).

235. *Id*. at 439.

236. *Id*. at 444-45.

237. *Id*. at 440.

238. *Id*.

239. *Id*.

240. *Id*.

241. *Id*.

242. *Id*.

sense of consistently with the terms of the parties' agreement …."[243] And, good faith in an implied covenant analysis is loyalty to the "scope, purpose, and terms" of the agreement, not loyalty to the counterparty to the agreement.[244]

The court noted that the temporal focus applies "equally to a party's discretionary rights" under a contract.[245] Thus, in situations where the implied covenant requires that a party exercise discretion reasonably, "what is 'arbitrary' or 'unreasonable'—or conversely 'reasonable'—depends on the parties' original contractual expectations, not a 'free-floating' duty applied at the time of the wrong."[246]

Finally, the court also dispelled any notion that a culpable mental state is required to prove a claim for the implied covenant of good faith and fair dealing. The court traced this notion through historical cases,[247] and showed that proving fraud was only "one way of establishing a breach of the implied covenant, but not the only way."[248] The court held, "[i] ncorporating a mental state or other tort-like concepts assists in measuring when a defendant's conduct passes beyond what the contracting parties would have agreed to in their original bargaining positions. It does not convert a breach of the implied covenant into a tort."[249]

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243. *Id*.

244. *Id*.

245. *Id*. at 441.

246. *Id*. at 441-42.

247. *Id*. at 442-45.

248. *Id*. at 444.

249. *Id*.