

Distressed Governance Tracker in Q4 2022

Distressed Governance Tracker:
Proper Governance = Deal Certainty + Max Value

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What Can We Learn From the Delaware Court of Chancery in 2022?

While catching up on several interesting Delaware Court of Chancery decisions, I came up with a “Distressed Governance Express” regarding 10 cases from the last few months of 2022.

In re BCG Partners, Inc. Derivative Litig., C.A. No. 2018-0722-LWW *2022 WL 3581641 (Del. Ch. Aug. 19, 2022)*

Summary

The Chancery Court entered judgment in favor of defendants regarding consideration of breach of fiduciary duty claims under the entire fairness standard. The Chancery Court found that

1. the special committee and advisors were independent
2. the special committee was “fully empowered”
3. the special received the information it needed to make a decision on a “fully informed basis”
4. the special committee was “engaged and diligent” and “obtained meaningful concessions”
5. value agreed-upon by the special committee was in the range ascribed by the financial advisor and what the Court “concludes to be the range of fairness”

Restructuring Lesson

Full empowerment to and engagement by any independent fiduciary is critical to ensure deal certainty.

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In re Match Grp., Inc. Derivative Litig., C.A. No. 2020-0505-MTZ *2022 WL 3970159 (Del. Ch. Sept. 1, 2022)*

Summary

In a “stockholder challenge to a multi-step reverse spin-off initiated by a controller,” the Chancery Court dismissed the claims under MFW Worldwide on the basis that while a special committee member may have lacked independence, such member did not “infect” or “dominate” the special committee such that he disqualified the special committee as independent and disinterested.

Restructuring Lesson

If a board appoints a special committee to cleanse a transaction, it is critical that the controller not take action that could be perceived as dominating or infecting the special committee.

Ramcell, Inc. v. Alltel Corp., C.A. No. 2019-0601-PAF *2022 WL 16549259 (Del. Ch. Oct. 31, 2022)*

Summary

In an appraisal action to determine the value of shares in connection with a short-form merger, the Chancery Court noted that it “has the discretion to select one of the parties’ valuation models as its general framework or to fashion its own.” Finding that “[n]either party persuasively established that its projections used in their DCF mode were reliable,” the Court fashioned its own weighted average approach and awarded costs plus statutory interest to plaintiff from the date of the merger.

Restructuring Lesson

Absent a compelling and reliable expert record, the Chancery Court (and, as we know, the Bankruptcy Court) will fashion its own assessment of value.

Bighorn Ventures Nev., LLC v. Solis, C.A. No. 2022-1116-LWW *2022 WL 17948659 (Del. Ch. Dec. 23, 2022)*

Summary

The Chancery Court denied a motion to appoint a custodian or receiver, ruling that

1. a custodian was not appropriate where the governance structure provided for the appointment of an additional director that would necessarily break the alleged deadlock and, importantly, the Court suspected that the movant had manufactured the deadlock to create the need for judicial intervention
2. the Court would not exercise its discretion to appoint a receiver where there was insufficient evidence of insolvency and no special circumstances warranted approval of the relief requested

Restructuring Lesson

Evidence regarding deadlock and insolvency are critical regarding appointment of a custodian or receiver, respectively, and the Court will not condone contrived or manufactured deadlock.

Lebanon Cnty. Emps. Fund v. Collis, C.A. No. 2021-1118-JTL

2022 WL 17841215 (Del. Ch. Dec. 22, 2022)

Summary

Plaintiffs asserted breach of fiduciary duty claims against the company's officers and directors based upon the company's financial/reputational losses arising from alleged involvement in the nationwide opioid epidemic. Plaintiffs' claims were based upon 2 theories, "red flag" Caremark claims and Massey claims.

While the Chancery Court considered inferences favoring both plaintiffs and defendants in the context of defendants' motion to dismiss for failure to support an inference of demand futility, the Court granted the motion to dismiss on the basis of a compelling and thorough judgment entered by the West Virginia District Court after a 2 month trial in favor of defendants and an express finding that defendants had not violated their obligations.

Restructuring Lesson

While Caremark/duty of care cases seem to be in a constant flow, the Chancery Court once again dismisses such claims, this time for failure to adequately plead demand futility based upon a strong inference drawn from a comprehensive trial and judgment of another court.

Sciabacucchi v. Liberty Broadband Corp., C.A. No. 11418-VCG

2022 WL 1301859 (Del. Ch. May 2, 2022)

Summary

The Chancery Court denied defendants' motion for summary judgment, ruling that there was sufficient evidence that a majority of a defendant/company's board of directors lacked independence from interested parties. In deciding that competing inferences based on undisputed facts must be decided at trial, the Court emphasized that summary judgment proceedings do not allow the Court to evaluate the strength of the parties' inferences; rather, the Court is tasked with determining whether the parties' competing inferences, respectively, are plausible.

Restructuring Lesson

Another important ruling that stresses the importance of uncontroverted independence and maintenance of deal certainty.

Goldstein v. Denner, C.A. No. 2020-1061-JTL

2022 WL 1671006 (Del. Ch. May 26, 2022)

Summary

Defendants moved to dismiss plaintiff's claims of breach of fiduciary duty. In ruling that plaintiff's claims were sufficient to survive a motion to dismiss, the Chancery Court found that plaintiff properly pled that the controlling party acted in bad faith, including concealment of discussions

with buyer regarding purchase price, violation of the company's insider trading policy, "slashing" projections to justify a reduced purchase price even though the initial projections placed a much higher value, and refusal to consider offers from other potential buyers.

Restructuring Lesson

In another restatement of the obvious, controller involvement in the process and bad acts will substantially impact deal certainty, cost and value.

In re Aerojet Rocketdyne Holdings, Inc., No. CV 2022-0127-LWW *2022 WL 1446782 (Del. Ch. May 5, 2022)*

Summary

Plaintiffs, half of the company's board of directors, were competing in a proxy contest with defendants, the other half of the board that was also aligned with management. Plaintiffs filed a motion to compel, seeking documents withheld by defendants on the basis of the company's attorney/client privilege. Defendants argued that plaintiffs were not entitled to the company's privileged information because the plaintiffs sought it in furtherance of their proxy contest, not their fiduciary duties.

The Chancery Court held that where plaintiff and defendant board members are adverse to one another in a proxy contest, they are entitled to equal access to the company's privileged information and, under the facts of this case, none of the exceptions to a director's access to board information were applicable. Exceptions to the general rule include

1. agreement of the parties
2. the privilege accorded a special committee with separate counsel
3. adversity between a director and the "company" (not other directors) such that there could not be a reasonable expectation that the director was a client of the board's counsel

Restructuring Lesson

Board directors are entitled to privileged information provided to the board, absent one or more exceptions. So don't assume in an intra-board dispute that the other directors will not see communications with counsel.

Manti Holdings, LLC v. Carlyle Grp. Inc., C.A. No. 2020-0657-SG *2022 WL 1815759 (Del. Ch. June 3, 2022)*

Summary

Stockholders brought post-sale breach of fiduciary duty claims against the company's CEO, directors, and controlling stockholder, and the defendants moved to dismiss. The Chancery Court denied the motion to dismiss on the basis that the controller who pushed for the sale was conflicted, the directors were conflicted, and the CEO lacked independence from the controller.

As a result, the Chancery Court concluded that the entire fairness applied and the complaint sufficiently alleged that the sale was not entirely fair due to unfair price and unfair process.

Restructuring Lesson

The establishment of an empowered independent committee will preserve business judgment and deal certainty.

35 Claver LLC v. Basis Real Estate Cap. II, LLC, C.A. No. 2022-0603-KSJM *(Del. Ch. Dec. 21, 2022)*

Summary

The owner of a membership interest in an LLC (that, in turn, owned real estate) sought to enjoin an auction of such interest (collateral for the loan). Defendants sent proper notice of the auction and excluded plaintiff from participation at the auction on the basis of an intercreditor agreement. Plaintiff alleged that such exclusion was not commercially reasonable.

Chancellor McCormick denied the request for injunction, relying on the uncontroverted testimony of defendants' expert, who confirmed that it is common practice to exclude a borrower as a qualified bidder at a collateral auction.

Restructuring Lesson

An owner of collateral may be excluded from bidding at an auction for such collateral where the record is clear that such exclusion is market.

Bonus Lesson From 2023

Richard Delman v. GigAcquisitions3, LLC, et al., C.A. No. 2021-0679-LWW *(January 4, 2023)*

Summary

In a case that is sure to be instructive and closely reviewed going forward, defendants alleged breach of fiduciary duties against sponsor and directors due to their impairment of the SPAC stockholders' ability to decide whether to redeem or invest in the post-merger entity. It was alleged that defendant-sponsor received significant returns at the expense of plaintiff-stockholders.

The Chancery Court denied defendants' motion to dismiss, applying "long-established principles of Delaware law [that] require fiduciaries to deal candidly with stockholders and avoid conflicted, unfair transactions" and ruled that the transaction is subject to the entire fairness standard of review.

Restructuring Lesson

When considering the magnitude of SPAC transactions that were consummated in 2020 and beyond, and the Chancery Court's application of entire fairness, the chapter 11 process and employment of independent fiduciary-review will provide meaningful resources to address such claims.