Westlaw Journal

CORPORATE OFFICERS & DIRECTORS LIABILITY

Litigation News and Analysis • Legislation • Regulation • Expert Commentary

VOLUME 29, ISSUE 11 / DECEMBER 2, 2013

WHAT'S INSIDE

41391338

CONFERENCE

Delaware must fix state takeover law now, professor warns

A corporate law professor has advised Delaware lawyers to fix what he says are flaws in the state's anti-takeover law because companies incorporated there will soon have to rely on it as their main defense against unwanted merger offers.

CONTINUED ON PAGE 19

Courtesy of Widener University Law School

Harvard Law School professor Guhan Subramanian speaks at the Pileggi Distinguished Lecture in Law on Nov. 22 at the Hotel DuPont in Wilmington, Del.

COMMENTARY

3rd Circuit rules Delaware Chancery Court arbitrations must be open to the public

Gardner Davis and Danielle Whitley of Foley & Lardner discuss the reasons they believe the 3rd U.S. Circuit Court of Appeals made the right call in affirming a ruling that barred Delaware's Chancery Court from holding nonpublic arbitration proceedings.

SEE PAGE 3

Westlaw Journal Corporate Officers & Directors Liability

Published since November 1985

Publisher: Mary Ellen Fox

Executive Editor: Donna M. Higgins

Managing Editor: Phyllis Lipka Skupien, Esq.

Senior Editor: Frank Reynolds
Frank.Reynolds@thomsonreuters.com

Managing Desk Editor: Robert W. McSherry

Senior Desk Editor: Jennifer McCreary

Desk Editor: Sydney Pendleton

Westlaw Journal Corporate Officers & Directors Liability (ISSN 2155-5885) is published biweekly by Thomson Reuters.

Thomson Reuters
175 Strafford Avenue, Suite 140
Wayne, PA 19087
877-595-0449
Fax: 800-220-1640
www.westlaw.com
Customer service: 800-328-4880

For more information, or to subscribe, please call 800-328-9352 or visit west.thomson.com.

How to Find Documents on Westlaw
The Westlaw number of any opinion or trial filing is listed at the bottom of each article available. The numbers are configured like this: 2013 WL 000000. Sign in to Westlaw and on the "Welcome to Westlaw" page, type the Westlaw number into the box at the top left that says "Find this document by citation" and click on "Go."

TABLE OF CONTENTS

3rd Circuit rules Delaware Chancery Court arbitrations must be open to the public

By Gardner Davis, Esq., and Danielle Whitley, Esq.
Foley & Lardner

The resolution of business disputes through arbitration proceedings conducted by the Delaware Chancery Court must be public, according to a recent federal appeals court ruling.

The 3rd U.S. Circuit Court of Appeals ruled in *Delaware Coalition for Open Government v. Strine*[1] that the state's business dispute arbitration program, conducted by Chancery Court judges, consists of essentially civil trials and, therefore, must be open to the public, under the First Amendment. The Delaware Bar and various business groups argued that the confidentiality of Chancery Court arbitration proceedings is essential to the success of the program. Most corporate lawyers recognize, however, that Delaware's little-known Section 349[2] arbitration program, even without blanket confidentiality, remains a very attractive option for the resolution of many business disputes.

Corporate lawyers routinely provide in contracts that Delaware courts will be the exclusive jurisdiction and venue for dispute resolution. Delaware courts enjoy an excellent reputation for responsiveness to corporate concerns, judicial expertise in business and corporate law matters, and a docket which produces relatively expeditious decisions. The principal drawback of choosing Delaware courts, however, is the lawsuit is too expensive and formal. The lack of privacy in a civil trial is also a legitimate concern, but the public and the press have no interest in most business disputes. Moreover, the Chancery Court rules provide ample measures for protecting legitimate trade secrets from public disclosure.

Chancery Court judges are the gold standard when it comes to knowledge of the law, institutional respect, judicial demeanor and a reputation for ruling expeditiously.

LITIGATE OR ARBITRATE?

Arbitration is also a popular method for resolving business disputes. The primary disadvantage of arbitration in the minds of many lawyers is the uncertainty regarding the arbitrator who will handle the dispute. Groups such as JAMS Inc. and the American Arbitration Association screen the arbitrators. Legitimate concerns can arise about private arbitrators' substantive knowledge, judicial temperament and experience, though. In contrast, Chancery Court judges are the gold standard when it comes to knowledge of the law, institutional respect, judicial demeanor and a reputation for ruling expeditiously. The non-jury Delaware Chancery Court, founded in 1792, is recognized as providing fast-track trials on complex business disputes by very knowledgeable and practical judges.

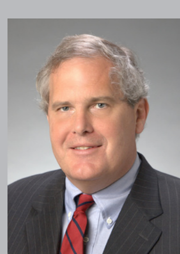
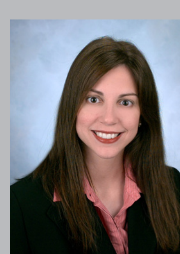
The new Section 349 Chancery Court arbitration, adopted by the Delaware Legislature in 2009, provides an ideal, hybrid business dispute resolution process. To be eligible for the Chancery Court arbitration, the parties must consent, at least one party must be a Delaware business entity, neither party can be a "consumer" and the amount in controversy must be at least $1 million.

The parties start the arbitration by filing a petition with the Chancery Court and paying a $12,000 filing fee. The fee increases $6,000 per day after the first day in the courtroom. After receiving a petition, the chancellor selects a Chancery Court judge to hear the arbitration. The arbitration begins about 90 days after the petition is filed and is conducted in the Delaware courthouse during normal business hours. Regular Court of Chancery Rules 26-37, governing depositions and discovery, apply to the proceedings, but the rules can be modified by consensual agreement of the parties.

The Chancery Court judge presiding over the arbitration "may grant any remedy or relief that he deems just and equitable within the scope of any applicable agreement of the parties."[3]

ARBITRATION APPEAL OPTION UNAPPEALING

Once a decision is reached, the final judgment or decree is automatically entered.

Gardner Davis (L) is a partner in the transactional and securities practice of **Foley & Lardner** in Jacksonville, Fla. He frequently represents buyers and sellers in M&A transactions and advises boards of directors and special committees in regard to fiduciary duty issues in various contexts. He can be reached at (904) 359-8726 or gdavis@foley.com. **Danielle Whitley** (R) is senior counsel in the firm's finance and financial institutions and transactional and securities practices. She focuses her practice in the areas of mergers and acquisitions, finance, and general corporate law. She can be reached at (904) 359-8789 or dwhitley@foley.com.

Both parties have a right of appeal to the Delaware Supreme Court, but review of the arbitration award is very deferential and will generally only be set aside upon fraud, judicial misconduct or material mathematical error.

The aspect of Delaware's Section 349 arbitration process causing the controversy was the provision barring public access to the proceedings. Arbitration petitions are confidential and not included as part of the public docketing system. The public cannot determine the parties or the nature of the matter. Attendance at the arbitration is limited to the parties, and all pleadings and material communications are protected from disclosure.

The Delaware Coalition for Open Government challenged the provisions related to confidentiality under the First Amendment in federal court. U.S. District Judge Mary McLaughlin granted judgment on the pleadings. She ruled that the arbitration proceedings, conducted under Delaware law and Chancery Court rules, where a sitting judge hears evidence, finds facts and issues an order dictating the obligations of the parties, are essentially non-jury trials. Therefore, the First Amendment protects a qualified right of access, and the business arbitration proceeding must be open to the public.[4]

Business groups, including the U.S. Chamber of Commerce and the New York Stock Exchange, urged the 3rd Circuit to maintain the closed arbitration process, saying companies should be allowed to resolve disputes in private if all sides agree.

A GREATER GOOD

The argument of the business interests makes sense, but for the long-standing tradition of public access to court proceedings under the U.S. Constitution. Presumably, the parties in most litigation would prefer to close the proceeding to the public. There is a greater, countervailing public good, however, from public access to trials. Ironically, the predictability of Delaware corporate law and the prestige of the Chancery Court derives, in substantial part, from public access to Delaware court opinions.

The First Amendment prohibits governments from "abridging the freedom of speech, or of the press," which the U.S. Supreme Court in *Richmond Newspapers v. Virginia* interpreted to include a right to public access to trials.[5] The First Amendment is made applicable to the states by the 14th Amendment.

In *Richmond Newspapers* the Supreme Court held that closing a criminal trial to the public violated the First Amendment. The court emphasized the important role public access plays in the administration of justice. The court concluded that the "explicit, guaranteed rights to speak and publish concerning what takes place at a trial would lose much meaning if access to observe the trial could … be foreclosed arbitrarily."[6]

> The Chancery Court judge presiding over the arbitration "may grant any remedy or relief that he deems just and equitable within the scope of any applicable agreement of the parties."

A proceeding qualifies for First Amendment right of public access when "there has been a tradition of accessibility" for that kind of proceeding, and when "access plays a significant positive role in the functioning of the particular process in question."[7] The court applies an analysis known as the "experience and logic" test; in order to qualify for public access, both experience and logic must counsel in favor of opening the proceeding to the public. Once a presumption of public access is established, it may only be overridden by a compelling government interest.[8]

> Attendance at the arbitration is limited to the parties, and all pleadings and material communications are protected from disclosure.

THE EXPERIENCE PRONG

The 3rd Circuit held that, under the experience prong of the test, the court must "consider whether the place and process have historically been open to the press and general public because such a tradition of accessibility implies the favorable judgment of experience."[9]

"[U]ncritical acceptance of state definitions of proceedings would allow governments to prevent the public from accessing a proceeding simply by renaming it. A First Amendment right that mandated access to civil trials, but allowed closure of identical 'sivel trials' would be meaningless," Circuit Judge Dolores Sloviter wrote.[10]

The appeals court's opinion placed the Delaware Chancery Court arbitration process within a historical perspective. The 3rd Circuit recognized a long history of access to civil trials.

The English history of access dates back to the Statute of Marlborough passed in 1267, which required "all causes … to be heard, ordered and determined before the judges of the King's Courts [were to be heard] openly in the King's Courts."[11] According to the 3rd Circuit, "[t]his tradition of openness continued in English courts for centuries, insuring that evidence was delivered 'in the open court in the presence of the parties, their attorneys, counsel and all by-standards, and before the judge and jury.'"[12] According to Judge Sloviter, "one of the most conspicuous features of English justice, that all judicial trials are held in open court, to which the public have free access … appears to have been the rule in England from time immemorial."[13]

"This tradition of access to trials and the courthouse was adopted by the American colonies and preserved after the American revolution."[14] The 3rd Circuit said, "The courthouse, courtroom and trial remain essential to the way the public conceives of and interacts with the judicial system."[15]

"Although Delaware's government-sponsored arbitrations share characteristics such as informality, flexibility and limited review with private arbitrations, they differ fundamentally from other arbitrations because they are conducted before active judges in a courthouse, because they result in a binding order of the Chancery Court, and because they allow only a limited right of appeal."[16]

In applying the logic prong of the test, the 3rd Circuit addressed whether "access plays a significant positive role in the functioning of the particular process in question."[17] The appeals court said:

> We have recognized that public access to judicial proceedings provides many benefits, including [1] promotion of informed discussion of governmental affairs by providing the public with the more complete understanding of the [proceeding]; [2] promotion of the public perception of fairness which can be achieved only by permitting full public view of the proceedings; [3] providing a significant community therapeutic value as an outlet for community concern, hostility and emotion; [4] serving as a check on corrupt practices by exposing the [proceeding] to public scrutiny; [5] enhancement of the performance of all involved; and [6] discouragement of [fraud].[18]

The 3rd Circuit said all these benefits would be seen from opening Delaware's proceedings. Stockholders and the public would have a better understanding of how Delaware deals with business disputes during arbitration. Public access would also open the litigants, lawyers and judge to some criticism from the press and public, and it would prevent companies from making misrepresentations.[19]

THE SURPRISING DISSENT

Perhaps the most surprising aspect of the case is Circuit Judge Jane Roth's dissent. It is easy to understand Judge Roth's sympathy for a private arbitration process conducted by the Chancery Court for well-heeled, consenting businesses. Delaware's legislature panders to its business entities, which provide 24 percent of the state's general fund revenue. This is a civil dispute resolution process, however, established by state statute and state court rules, and where the decision is entitled to the dignity of a state court judgment and appeal to the state Supreme Court. Therefore, it must fall under the category of civil litigation and be subject to the First Amendment.[20]

Judge Roth stressed the need for confidentiality in resolution of conflicts involving sensitive data to prevent access by competitors. The Delaware court rules provide the tools for the court to protect legitimate confidential information from disclosure, though. The Delaware business arbitration statute, which extends confidentiality to the names of the parties and the general nature of the dispute, goes far beyond protecting "confidential" data.

Judge Roth, in her dissent, also said, "businesses in this country and abroad need to get commercial conflicts resolved as quickly as possible so that commercial relations are not disrupted."[21] Arbitration, with the rules set by the parties, allows businesses to do that, she said.[22] "The point of affording parties discretion in designing arbitration processes is to allow for efficient, streamlined procedures tailored to the type of dispute."[23] The 3rd Circuit's decision to provide public access consistent with the First Amendment does not interfere with any of these lofty objectives, though.

In the final analysis, Section 349 arbitration proceedings before the Chancery Court continue to provide an excellent dispute resolution option for lawyers drafting contracts. The loss of confidentiality is regrettable from the perspective of the contract parties. Still, the attractiveness of having the dispute handled by a judge of the Chancery Court, arguably the most respected and capable trial court in the world for business disputes, probably outweighs a confidential proceeding by an unknown and unproven arbitrator. In those cases where confidentiality is a paramount concern, private arbitration in another forum remains an option. WJ

NOTES

1 *Del. Coal. for Open Gov't v. Strine*, 2013 WL 5737309 (3d Cir. Oct. 23, 2013).

2 *See* 10 Del. Code. Ann. tit. 10, § 349 (2009); Del. Ch. R. 96-98.

3 Del. Ch. R. 98(f)(1).

4 *Del. Coal. for Open Gov't v. Strine*, 894 F. Supp. 2d 493 (D. Del. 2012).

5 *Richmond Newspapers Inc. v. Virginia,* 448 U.S. 555 (1980).

6 *Id.* at 576-77.

7 *Press-Enter. Co. v. Super. Ct.,* 478 U.S. 1, 10 (1986).

8 *Id.*

9 *Del. Coal.,* 2013 WL 5737309 at *4, quoting *N.J. Media Group v. Ashcroft*, 308 F.3d 198, 213 (3d Cir. 2002).

10 *Del. Coal.*, 2013 WL 5737309 at *4.

11 *Id.* at *5, citing *Publicker Indus. v. Cohen*, 733 F.2d 1059, 1068 (citing 2 Edward Coke, Institutes of the Law of England 103 (6th ed. 1681)).

12 *Del. Coal.*, 2013 WL 5737309 at *5.

13 *Id.*

14 *Id.*

15 *Id.*

16 *Id.* at *7.

17 *Id.* at *8, *quoting Press-Enter,* 478 U.S. at 8.

18 *Del. Coal.,* 2013 WL 5737309 at *8.

19 *Id.*

20 Del. Div. of Revenue 2011 Annual Report, available at http://www.corp.Delaware.gov/2011Corpar.pdf.

21 *Del. Coal.,* 2013 WL 5737309 at *13.

22 *Id.*

23 *Id.*

Representations and warranties insurance: An innovative solution

By D. Stephen Antion, Esq., and Philip Lang, Esq.
Katten Muchin Rosenman LLP

One of the most contentious and negotiated aspects of an acquisition transaction is the allocation of risk for post-closing breaches of the seller's representations and warranties, and the remedies available to the buyer for such breaches. The buyer will want to be protected and indemnified for any liabilities arising from a breach, while the seller will prefer a clean break at closing with minimal holdback of the purchase consideration and without responsibility for unknown contingent liabilities. The actual representations and warranties of the seller will also be heavily negotiated to ensure they work with the indemnification provisions to properly reflect the agreed upon allocation of post-closing risk.

To help bridge the distance between the buyer and seller and mitigate risk exposure, more and more buyers and sellers are turning to representations and warranties insurance, as well as other types of transaction liability insurance. Though representations and warranties insurance was first introduced in 1998, in the past few years, the market has seen a surge in the number of transactions using transactional insurance products. Although representations and warranties insurance is still in relatively limited use in the U.S., it has seen widespread use in Europe, Asia and Australia, with about 90 percent of Australian private equity deals utilizing such insurance. Other transactional insurance products can be utilized with representations and warranties insurance to address specific risks for a particular transaction.

HOW IS REPRESENTATIONS AND WARRANTIES INSURANCE USED?

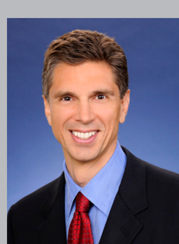
Representations and warranties insurance, whether buyer-side or seller-side, can be used as a backstop or supplement for the seller's indemnification obligations under the purchase agreement. It may also be used as a substitute remedy for indemnification that serves as the buyer's sole recourse in the event of breaches of the seller's representations and warranties. For the payment of a one-time premium, the insurer takes on the risk for breaches of the seller's representations and warranties and pays the buyer or the seller, as appropriate.

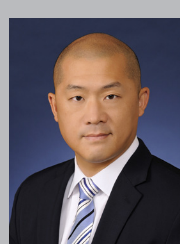
Buyer-side representations and warranties insurance is more common and provides for the direct payment by the insurer to the buyer to cover losses due to breaches of the seller's representations and warranties. This insurance can be used as a supplement to a negotiated indemnification provision, in which case the insurance can provide additional coverage and protection beyond the negotiated indemnification caps and survival periods. In the alternative, the parties may agree to delete the concept of indemnification in the purchase agreement and list recourse to the representations and warranties insurance as the sole remedy for a breach of the seller's representations and warranties. As one can imagine, this is very attractive to sellers and may be used competitively by buyers seeking an edge in an auction process.

> More buyers and sellers are turning to representations and warranties insurance, as well as other types of transaction liability insurance.

Seller-side representations and warranties insurance is typically used as a backstop to the seller's indemnification obligations under the purchase agreement in situations where the buyer demands indemnification and an escrow from the seller. With such a policy, the insurer will indemnify and pay sellers for any losses they are contractually required to indemnify the buyer for under the purchase agreement. One significant difference between seller-side and buyer-side representations and warranties insurance is that a seller-side policy will not provide coverage for breaches due to the seller's fraud, whereas such breaches are covered in a buyer-side policy. In addition to providing less comprehensive coverage, this policy leaves sellers in the middle and requires them to respond to and deal with post-closing claims from the buyer. Also, the terms of this policy may not completely mirror the terms of the representations and indemnities in the purchase agreement, so there could be a gap in coverage.

As a result, the policy can be beneficial but is likely to be used only where the buyer refuses to accept a buyer-side policy as its sole recourse.





D. Stephen Antion (L) is a partner and **Philip Lang** (R) is an associate at **Katten Muchin Rosenman LLP**. Antion heads the Los Angeles corporate group and represents private equity firms, entrepreneurial businesses and families in a wide range of transactions with an emphasis on mergers and acquisitions, corporate finance, and securities law. Lang represents private equity firms, private and public companies and private investors in a variety of corporate transactions, including mergers and acquisitions, joint ventures, corporate finance, and international transactions.

Structuring an acquisition with a representations and warranties insurance policy can greatly expedite the process by removing the lengthy negotiations of the indemnification and liability provisions. A policy can also be issued very quickly, usually in two to three weeks. As representations and warranties insurance has grown in usage, insurers have become more sensitive to the timing concerns in acquisition transactions and are, in turn, streamlining the insurance underwriting and issuance process.

COVERAGE AND PRICING

Representations and warranties insurance policies typically provide coverage up to a cap of 10 percent to 20 percent of the enterprise value of the target company, with higher coverages structured through multiple insurers. The premiums for representations and warranties insurance policies have decreased through the years and are now generally priced in an amount equal to 2.5 percent to 3.5 percent of the coverage amount. Similar to a "basket" in an indemnification provision, a representations and warranties insurance policy will also include a modest retention amount or deductible, with the insurer only required to pay when losses exceed the deductible.

The coverage period for representations and warranties insurance will generally mirror the survival periods for the representations and warranties in a typical purchase agreement. General representations and warranties have a shorter coverage period of up to two years, while certain fundamental representations and tax representations have a longer coverage period of up to six years. Although the liability of the seller for the representations and warranties in the purchase agreement may not survive the closing, the insurer will continue to cover losses for breaches of the seller's representations and warranties during the coverage period. As the use of representations and warranties insurance has continued to grow and develop, some insurers are now offering, for an increased premium, a coverage period of up to six years for all representations and warranties.

Every representations and warranties insurance policy has certain exclusions from coverage. Typical exclusions include the following:

- Losses arising from facts and circumstances of which the buyer had previous knowledge.
- Items included in the buyer's due diligence reports or listed on the disclosure schedules to the purchase agreement.
- Losses due to the breach of any of the seller's covenants and any post-closing purchase price adjustment.

It is important to note these exclusions may be disadvantageous to the buyer as compared to a traditional negotiated indemnification provision.

CONSIDERATIONS FOR THE BUYER

In determining whether a representations and warranties insurance policy is the right approach, the buyer will need to consider the benefits and disadvantages of the policy in the context of the particular facts and circumstances of the contemplated transaction.

> One significant difference between seller-side and buyer-side representations and warranties insurance is that a seller-side policy will not provide coverage for breaches due to the seller's fraud.

Are there concerns over the ability to collect from the seller?

A representations and warranties insurance policy can provide the buyer comfort and security in situations where the seller could present a credit risk or where there are concerns over the ability to collect for losses directly from the seller.

Is the target company a public company?

A representations and warranties insurance policy can be used in the acquisition of a public company for protection not otherwise available in typical public acquisitions, where individual shareholders do not stand behind the company's representations and warranties post-closing.

Are continuing members of management selling shareholders?

Representations and warranties insurance can ease some of the tension that may arise in a situation where the buyer seeks indemnification claims from former shareholder management members of the target company who are employed by the buyer after the closing.

Does the buyer insist that the seller provide an indemnity?

If the buyer insists that the seller or sellers stand by the representations and warranties and provide indemnification for the buyer, representations and warranties insurance may still provide benefits to the buyer. If the seller will only provide indemnification up to lower-than-desired limits, a representations and warranties policy can bridge any gaps in coverage.

Does the buyer want a longer period of coverage?

With the broad six-year representations and warranties insurance policy now being offered by certain insurers, a buyer could have a longer coverage period than what could be negotiated in an indemnification provision, which is usually one to two years.

Are there any potential significant liabilities known to the buyer?

As discussed above, a representations and warranties insurance policy excludes from coverage losses arising out of facts or circumstances that were known to the insured prior to the closing. In addition, losses arising out of matters that are described in any due diligence reports or disclosed in the disclosure schedules to the purchase agreement are also excluded. For example, in a situation where it is known and disclosed to all parties that there is pending litigation that may result in significant damages, a representations and warranties insurance may not provide any protection. The buyer would need specific line item indemnification of the litigation to ensure it is protected regardless of prior knowledge and disclosure of such matter.

A separate transactional insurance policy could be used together with a representations and warranties insurance policy to provide coverage that would otherwise be excluded, but such transactional insurance policies come at a higher price.

Are there concerns over sharing any diligence reports with the insurer?

As part of the underwriting process, the buyer will need to provide the insurer with copies of all diligence reports, including legal, financial and environmental reports.

Are there concerns about breaches of "fundamental representations" that could result in significant liabilities?

In a typical representations and warranties insurance policy, all claims will be subject to the same maximum cap on coverage and basket or deductible, regardless of the specific representation or warranty breached. In many purchase agreements with indemnification provisions, however, certain fundamental representations of the seller- such as organization, authority and capitalization, and representations relating to taxes- are excluded from the maximum cap and basket. The reasoning behind this is that consequences of breaching such representations may result in significant and irreparable damage to the buyer. Thus, the scope of the coverage may be less than what would be negotiated with a seller.

Does the seller have material post-closing covenants?

While a traditional indemnification provision will usually cover breaches of post-closing covenants, such covenant breaches are excluded from coverage under representations and warranties insurance. In the event a seller breaches a post-closing covenant, such as a non-compete or non-solicit provision, the only remedy for the buyer may be to sue such a seller for breach of contract.

Is the buyer involved in a competitive bidding process?

Given the benefits a representations and warranties insurance policy presents a seller, a buyer can make its bid more appealing to the seller by proposing a "clean break" deal structure that incorporates a representations and warranties insurance policy.

CONSIDERATIONS FOR THE SELLER

For a seller, the use of a representations and warranties insurance policy can be a very attractive way to structure a transaction.

The seller can have a clean exit.

From the seller's perspective, one of the key advantages of representations and warranties insurance is that it provides the confidence of a clean exit without contingent post-closing liabilities or any holdback or escrow of the purchase price. This is particularly true for private equity fund sellers where the absence of an escrow will enhance the fund's IRR by avoiding the delayed receipt of the escrowed proceeds. It may be critical if the fund is at the end of its term and needs to exit and distribute the proceeds to its limited partners.

Avoid issues that arise relating to joint and several liability with multiple sellers.

In an acquisition involving multiple sellers, a key point of contention is whether the sellers are subject to joint and/or several liability. A representations and warranties insurance policy can address the sellers' concerns and protect minority or passive sellers who may have minimal knowledge and/or control of the target company.

Propose a representations and warranties insurance policy from the onset.

Given the significant advantages, a seller may want to incorporate representations and warranties insurance into the proposed deal structure in its marketing materials and bid package when marketing the company to potential buyers. A number of private equity funds are now doing this as a matter of policy.

OTHER TRANSACTIONAL INSURANCE PRODUCTS

As the insurance industry has expanded its transactional insurance products, insurers are now able to offer specific products to address a variety of concerns, including tax, contingent liability, litigation buyout, fraudulent conveyance, successor liability and environmental insurance.

These products can be utilized to cover legacy liability concerns known to the buyer and excluded under a representations and warranties insurance policy. These types of transactional insurance policies may be more expensive than the premium for a representations and warranties insurance policy, though. For example, a tax insurance policy may have a premium of 4 percent to 6 percent of the coverage amount, while a litigation buyout insurance policy may have a premium equal to 10 percent of the coverage amount.

CONCLUSION

Incorporating a representations and warranties insurance policy in an acquisition transaction can be an excellent way to both expedite the process and address the concerns of both parties over the allocation of risk in the event of post-closing breaches. Whether used as a supplement to or a substitute for traditional indemnification provisions, such a policy can be issued quickly and without the protracted negotiations of an indemnity. Plus, it substitutes the uncertainty of future contingent liabilities with a set, one-time premium payment. The buyer has a credit worthy source of recovery for breaches and will deal with an entity that is experienced in processing claims, unlike most sellers. Accordingly, deal participants should carefully consider whether to utilize this insurance product at the outset of their transactions. WJ

Investors win $882 million default award against Chinese-owned firm

A federal judge in Manhattan has awarded a stunning $882 million default judgment against officers of a Chinese software company accused of feeding American investors fabricated fiscal figures to inflate its stock price — if the shareholders can collect it.

***In re Longtop Financial Technologies Securities Litigation*, No. 3658, default judgment entered (S.D.N.Y. Nov. 14, 2013).**

In a Nov. 14 ruling U.S. District Judge Shira A. Scheindlin of the Southern District of New York said the same factors that led to the default judgment in the securities fraud action — the inability to track down Longtop Financial Technologies ex-CEO Wa Chau Lin and other officers — will make it tough to collect.

> Unfortunately, this is likely to be a Pyrrhic victory for the investors, said Kevin LaCroix, an insurance expert and editor of the D&O Diary blog.

Longtop once had a market capitalization of over $1 billion on paper and enjoyed a rapidly rising stock price after its initial public offering in 2007, but the price tanked in 2011 after stock analysts raised issues about the company's management and financial reporting.

Numerous shareholder lawsuits followed, including securities fraud suits in the District Court, and the cases were consolidated into this action.

U.S. District Judge Shira A. Scheindlin

But neither the company nor its officers responded to numerous attempts to serve them in China, resulting in a judgment calculated by a financial expert based on the number of shareholder and reported losses, the judge said.

Unfortunately, this is likely to be a Pyrrhic victory for the investors, Kevin LaCroix, an insurance expert and editor of the D&O Diary blog, said in a Nov. 20 post on the case.

"While the amount of the damages award is impressive, the question remains of how valuable the order will prove to be," he said.

"The likelihood that a Chinese court would recognize and enforce the judgment and that the plaintiffs could find assets of the company or Lin to satisfy the award is remote."

A previous ruling in April by Judge Scheindlin found no liability on the part of Longtop's auditor, Deloitte Touche Tohmatsu CPA Ltd., and dismissed it from the suit. *In re Longtop Fin. Techs. Sec. Litig.,* No. 3658, 939 F. Supp. 2d 360 (S.D.N.Y. Apr. 8, 2013).

Until they were unmasked by financial watchdog Citron Research in April, top executives of Beijing-based Longtop Financial Technologies Ltd. intentionally and systematically "misrepresented and overstated its financial condition," the suit said.

The action was part of a wave of shareholder litigation and regulatory investigations of China-based companies that have allegedly damaged American investors by playing fast and loose with corporate governance and fiscal reporting practices after entering the U.S. stock market.

Trading on its stock was halted May 17, 2011, and two days later the company canceled its fiscal reports for the year.

Longtop then announced May 23 that CFO Derek Palaschuk had quit and that Deloitte had resigned as the company's independent auditor. WJ

Supreme Court to revisit 'fraud on the market' presumption for class certification

The U.S. Supreme Court has agreed to rehear a dispute in the securities fraud class action against Halliburton Co. and will decide whether the "fraud on the market" presumption should still be used to establish investors' reliance for class certification.

***Halliburton Co. et al. v. Erica P. John Fund Inc.*, No. 13-317, cert. granted (U.S. Nov. 15, 2013).**

"Because of the possibility that the court could set aside the 'fraud-on-the-market' theory in the case, the long-running Halliburton securities suit could prove to be the most important securities case before the court in a generation," D&O Diary blog editor Kevin M. LaCroix said in a Nov. 18 post. He is not involved in the case.

In its petition for writ of *certiorari*, Halliburton said the high court should overrule or modify the holding in *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), which created the fraud-on-the-market presumption that allows investors to assert that common issues predominate for class certification.

The presumption allows plaintiffs suing for fraud under Section 10(b) of the Securities Exchange Act to secure class certification without having to show that each shareholder relied on the alleged misrepresentation. The judicially created procedural device has been criticized for giving investors a free pass to class certification.

APPELLATE COURT RULING

The suit began in 2002, and this is the second time it has come before the Supreme Court.

In the original complaint, the Erica P. John Fund asserted that Halliburton misled investors about its potential liability in asbestos litigation and overstated the benefits of a merger with competitor Dresser Industries.

Halliburton said in its *certiorari* petition that the fund claimed negative news about the litigation and merger caused the company's stock price to drop.

The proposed class-action period is June 3, 1999, to Dec. 7, 2001. The plaintiffs moved for class certification in 2007. But since the suit was filed, Halliburton has argued that any alleged misrepresentation did not impact the price of its stock.

On the case's first trip to the high court, the justices rejected Halliburton's argument and the holding of the 5th U.S. Circuit Court of Appeals that investors had to establish loss causation (or how company statements led to the stock drop) prior to obtaining class certification.

Earlier this year, in its second ruling on the case, the appellate court ruled that Halliburton was not allowed, prior to certification, to proffer rebuttal evidence about the impact of alleged misleading statements on its stock price. *Erica P. John Fund v. Halliburton Co. et al.*, No. 12-10544, 2013 WL 1809760 (5th Cir. Apr. 30, 2013).

Citing *Basic*, the appeals court said reliance on misleading statements in securities fraud actions is shown by the fraud-on-the-market presumption that says the market price of a security will incorporate any material public information. A showing of reliance on false or misleading statements is a key element in securities fraud cases.

According to LaCroix, in granting review again, the high court signaled its willingness to address *Basic*'s presumption, as well as whether it could be rebutted by evidence that the stock price did not change.

Halliburton maintains in its briefing that the *Basic* presumption is based on an outdated economic theory and that the stock market does not absorb information as efficiently as was previously thought.

Although commentators, including Doug Greene on the D&O Discourse blog, are questioning what would replace the presumption, they all appear to agree that attorneys will adapt their litigation to continue to pursue securities fraud claims.

REUTERS/Richard Carson

Halliburton Co. told the Supreme Court that the "fraud on the market" presumption is based on an outdated economic theory and that the stock market does not absorb information as efficiently as was previously thought.

But if the presumption is narrowed or thrown out, Section 10(b) misrepresentation suits will not be the gold mine for plaintiffs' attorneys.

"Without the benefit of being able to hold out the threat of ruinously large class-wide damages, plaintiffs' lawyers would be less able to extract the kind of massive settlements that have become a feature of private securities litigation," according to LaCroix.

He also noted that the elimination of the fraud-on-the-market presumption could materially reduce related insurance claims against public companies, their officers and directors. WJ

Investors sue China-based NQ Mobile alleging 'massive' securities fraud

An investor class action filed against NQ Mobile Inc. alleges the mobile privacy and security provider misrepresented its income from its initial public offering in 2011 in a "massive" securities fraud.

Martin et al. v. NQ Mobile Inc. et al., No. 13-8125, complaint filed (S.D.N.Y. Nov. 14, 2013).

In response to the suit, NQ Mobile said in a statement that it "takes any false allegations regarding our business extremely seriously. NQ Mobile will respond quickly, transparently and forcefully to these false allegations regarding our company."

According to the suit filed in the U.S. District Court for the Southern District of New York, NQ Mobile is incorporated in the Cayman Islands but has headquarters in Beijing and an office in Dallas.

Founded in 2005, the company provides Internet privacy services, mobile security, personalized cloud data storage and other electronic protections.

The suit seeks to represent investors in the company's American depository shares, or U.S. shares of foreign-based companies, traded on the New York Stock Exchange between May 5, 2011, and Oct. 24, 2013.

According to the complaint filed by investor James Martin, the company raised $82.8 million from its IPO in May 2011. During the proposed class period, the stock price rose significantly, and by early October 2013, the shares were trading at nearly $25 per share, the plaintiff adds.

He adds that NQ Mobile issued numerous positive reports regarding its growth in the last two years.

In early 2012 the company reported that net revenues for 2011 increased 129.8 percent and had achieved "excellent growth," according to the complaint. In early 2013 NQ Mobile reported that net revenues for fiscal year 2012 increased 126 percent to more than $92 million.

But equity research firm Muddy Waters LLC published an 80-page report on the company Oct. 24, and issued a "strong sell" rating with a projected target price of less than $1, the suit says.

According to the complaint, the report found that NQ Mobile "engaged in a 'massive fraud' in connection with its financial and operational reporting."

According to Muddy Waters, at least 72 percent of NQ's reported $32.2 million in China mobile security applications revenue in 2012 was fraudulent, the complaint says. Moreover, the report said the company's largest customer was really a shell company that it controlled.

The research firm also said NQ's market share in China was not nearly as high as the 55 percent reported by the company, the suit says. Rather its real market share in China is about 1.4 percent, it said. The report also said that the majority of the $127.9 million in cash and investments that the company had reported was not in its accounts.

Based on this news, NQ shares declined 47 percent from $22.88 to $12.09 per share on unusually heavy sales volume.

The complaint alleges that NQ Mobile violated Sections 11 and 12(a)(2) of the Securities Act, 15 U.S.C. §77K, as well as Sections 10(b) and 20(a) of the Securities Exchange Act, 15 U.S.C. §§ 78j(b) and 78t(a).

The suit names as defendants Chairman and Co-CEO Henry Yu Lin, Co-CEO Omar Sharif Khan, COO Vincent Wenyong Shi, CFO Suhai Ji and the board of directors, as well as underwriters Piper Jaffrey & Co., Oppenheimer Holdings Inc. and Canaccord Genuity Inc.

The underwriters collectively earned $6.2 million from the IPO, the suit says.

The plaintiff is seeking unspecified compensatory damages, interest and fees on behalf of the proposed class. WJ

Attorneys:
Plaintiff: Joseph P. Guglielmo, Scott & Scott, New York; David R. Scott, Scott & Scott, Colchester, Conn.; Amber L. Eck, Zeldes Haeggquist & Eck, San Diego

Related Court Document:
Complaint: 2013 WL 6022479

See Document Section A (P. 23) for the complaint.

SECURITIES FRAUD

Syringe manufacturer allegedly misled shareholders about sales

A shareholder of Unilife Corp. has alleged in a securities fraud class action that the medical device maker misled investors about its financial condition and business prospects.

Brandt v. Unilife Corp. et al., No. 13- 2690, complaint filed (M.D. Pa. Nov. 1, 2013).

Unilife produces retractable syringes for pharmaceutical companies and medical equipment suppliers and sells them directly to patients.

According to plaintiff Bryon Brandt's complaint, filed in the U.S. District Court for the Middle District of Pennsylvania, former Unilife employee Talbot Smith sued the company in late August, alleging he was fired in retaliation for reporting regulatory violations. Smith alleges Unilife purposely ran fake production at a facility to mislead visiting investors into believing that demand for its products were high. *Smith v. Unilife Corp.*, No. 13-5101, 2013 WL 4784777, *complaint filed* (E.D. Pa. Aug. 30, 2013).

Smith says he reported these alleged violations to the company's board of directors and, as a whistle-blower, to the Securities and Exchange Commission.

In a letter issued to stockholders regarding the securities fraud complaint, Unilife CEO Alan Shortall said, "I can assure you that Unilife is in full compliance with all applicable regulatory requirements." The company also said it believed Smith's claims to be meritless.

According to Smith, Unilife suppressed internal reports that showed the cost of developing the syringes was higher than the price the company was able to charge customers. He also says Unilife failed to comply with the FDA's required validation process.

Smith says the company bought 1 million components of the syringes per month even though it did not have the orders to support the purchases. According to Smith, Unilife wanted to make suppliers believe that the company had orders in the hopes this information would be leaked to the financial markets.

Brandt's securities fraud complaint is primarily based on Smith's allegations, as well as a Forbes article published Sept. 3 titled, "How is a $329M syringe company still unprofitable after 11 years?" The article said the company's main manufacturing facility was operating at 3 percent of capacity.

Forbes called Unilife a "parable of broken promises."

On this news, Unilife securities declined 52 cents per share, or more than 14 percent, to close at $3.03 the following day, the suit says.

Brandt says the company and its top corporate officials misled investors about their business prospects in violation of the anti-fraud provisions of federal securities laws contained in Sections 10(b) and 20(a) of the Securities Exchange Act, 15 U.S.C. §§ 78j(b) and 78t(a).

Also named as defendants are CEO Alan D. Shortall, CFO R. Richard Wieland and COO Ramin Mojdeh.

The proposed class period is from July 13, 2011, when Unilife first began filling orders for its Unifill syringe, to Sept. 9, 2013.

Attorneys:
Plaintiff: Walter W. Cohen and Kevin J. Kehner, Obermayer Rebmann Maxwell & Hippel, Harrisburg, Pa.; Jeremy A. Lieberman and Lesley F. Portnoy, Pomerantz Grossman Hufford Dahlstrom & Gross, New York

Related Court Document:
Complaint: 2013 WL 5869604

Child labor stain can't cross Atlantic to taint Hershey board, court master says

Even if West African farms that supply cocoa to Hershey Co. abuse child laborers, there's no proof that wrongdoing infects the chocolatier's board of directors, according to a master's report advising the Delaware Chancery Court to dismiss a shareholder's records inspection action.

Louisiana Municipal Police Employees' Retirement System v. Hershey Co., No. 7996, master's final report filed (Del. Ch. Nov. 8, 2013).

Abigail LeGrow, one of the masters who act as fact finders to help Chancery Court judges resolve issues and speed up litigation, said in her final report Nov. 8 she found no "reasonably conceivable set of circumstances" in which the suit could link the board with the abuse.

Without that link, a Hershey shareholder cannot show it has more than mere suspicion on which to base its claim that the directors breached their duty to the company by allegedly exposing it to liability in an international child labor abuse scandal, the report said.

Therefore, the investor, a municipal retirement fund, has no credible basis for a demand to search corporate records for evidence of wrongdoing by the board, and the records access demand should be dismissed, LeGrow recommended.

The Louisiana Municipal Police Employees' Retirement System filed a books-and-records action asserting its right as a shareholder of a Delaware-chartered company to inspect board minutes and correspondence for evidence of wrongdoing. Hershey's directors said the lawsuit was without foundation and moved to dismiss it.

In a preliminary report released Aug. 16 on whether LMPERS' suit had enough substance to survive a motion to dismiss, LeGrow said the suit was not based on "credible evidence" of wrongdoing, as required by the law of Delaware, Hershey's state of incorporation.

Without evidence that the Hershey directors knew of specific cocoa purchases that tainted their products with child labor abuses, LMPERS' basis for a records request "melts away," she wrote in the preliminary report.

However, LMPERS filed a reply brief Oct. 25 in support of its motion for reconsideration on the draft report's conclusions before LeGrow submitted her final report.

REUTERS/Kwasi Kpodo

A family of cocoa growers helps with drying cocoa beans in Akim Akooko, Ghana. In a lawsuit a shareholder of Hershey Co. said the company directors are hiding behind middlemen in making cocoa purchases from West African farmers it knew were abusing child laborers.

The books-and-records suit is often an opening-round action to gather ammunition for a follow-up breach-of-duty lawsuit against a board of directors for alleged wrongdoing.

In its reply brief, the pension fund argued to no avail that the preliminary report allowed Hershey's directors to hide behind middlemen in making cocoa purchases from farmers it knew were abusing child laborers.

LMPERS said Hershey's board knows what it needs to do to make its chocolate abuse-free but does not want to take the steps necessary to do that.

LeGrow's final report says the plaintiff's reasoning is essentially guilt by association.

No one alleges that Hershey violated the law or is under investigation for its business dealings in the West African cocoa industry, the report says.

LeGrow notes that even if Hershey has not gone as far as it could to enforce a code of conduct for cocoa suppliers, an industry agreement it signed "does not require that a company take particular, or even any, action to address illegal labor within its supply chain."

"LMPERS' philosophical disagreements with the effectiveness of Hershey's supplier code of conduct do not amount to credible evidence," the final report says.

Since the Chancery Court usually endorses the recommendations of masters' final report, this shareholder action — which generated numerous headlines about corporate social responsibility and the ethics of dealing with abusive cocoa plantations — will likely die in its infancy. WJ

Attorneys:
Plaintiff: Michael J. Barry and Justin K. Victor, Grant & Eisenhofer, Wilmington, Del.

Defendants: Srinivas Raju and Robert L. Burns, Richards, Layton & Finger, Wilmington

Related Court Document:
Reply brief in support of exceptions: 2013 WL 5823686

See Document Section B (P. 38) for the reply brief.

Delaware high court appeal centers on validity of CEO removal

The outcome of a boardroom battle for control of Allegro Development Corp. will turn on the Delaware Supreme Court's decision as to whether the risk management software firm's directors' surprise removal of the CEO was "void" or only "voidable."

Klaassen v. Allegro Development Corp. et al., No. 583, 2013, opening brief filed (Del. Nov. 11, 2013).

In an opening brief to the high court, founder Eldon Klaassen says his enemies on the board of directors improperly ambushed him with a secret removal action that violated company bylaws and was therefore void — clearly invalid and of no effect.

He's appealing an Oct. 11 Chancery Court ruling in which Vice Chancellor J. Travis Laster found that the board's Nov. 1, 2012, removal action was only voidable, meaning it could be challenged and possibly proven to be invalid. *Klaassen v. Allegro Dev. Corp. et al.*, No. 8626, 2013 WL 5739680 (Del. Ch. Oct. 11, 2013).

Klaassen later used his majority stock holdings to replace one of the opposing directors and hold on to his director position, according to the vice chancellor's opinion. However, Klaassen was outmaneuvered in his bid to oust all his enemies on the board and win back his CEO job, the opinion said.

In a subsequent Nov. 7 decision, the vice chancellor acknowledged that the void-or-voidable issue was a proper issue for the state high court to consider on appeal, but he refused to impose a boardroom truce or litigation stay while the justices considered the case. *Klaassen v. Allegro Dev. Corp. et al.* No. 8626, 2013 WL 5951762 (Del. Ch. Nov. 7, 2013).

CORPORATE LAW SORE SPOT

The interpretation of the void-or-voidable issue has been a recurring problem for the Chancery Court in deciding challenges to the validity of corporate actions, said professor **Lawrence Hamermesh**, who heads the corporate law department at the **Widener University School of Law**.

"The *Klaassen* case highlights a recurring sore spot in Delaware's corporate law doctrine: namely, distinguishing between corporate actions that are void and actions that are merely voidable, and determining what difference that makes," he said in emailed comments.

"While voidable actions can be cured after the fact, void actions are thought to be irredeemable, beyond repair and indefensible on equitable grounds," Hamermesh said.

That made all the difference in this battle. If Klaassen had been given no notice at all of the board meeting at which he was removed (rather than just no notice of the removal vote itself), he would have had a much easier time establishing that the board's action was simply void.

In that case, the strength of Klaassen's attack on that vote would not have mattered, Hamermesh pointed out.

The battle for control of the Dallas-based developer of energy trading and risk management software stemmed from the dissatisfaction among board members over the company's failure to perform financially as Klaassen allegedly promised when they made significant capital investments.

Klaassen filed this declaratory judgment action in Delaware, where Allegro is incorporated, seeking a court ruling that he was the rightful CEO and that he had validly removed his rival board members.

JUST 'VOIDABLE'

In his Oct. 11 opinion, Vice Chancellor Laster found that Klaassen did not get proper notice of the board's plan for a vote to remove him as CEO. He said, however, that type of failure of notice is not the same as if he got no notice of the meeting at all, which could have rendered the board's action void rather than simply voidable.

The judge found that based on past cases, Klaassen did not prove his removal was void or show valid reasons for contesting a voidable action.

The vice chancellor had to "wrestle mightily" with the fine points of this void-vs.-voidable issue in both opinions, Hamermesh said.

In his appeal brief, Klaassen argued that he had been excluded from the board meetings in which the directors decided to remove him and drew up paperwork to that effect, so the action was clearly void and need not be challenged.

However, Hamermesh said Klaassen has a tough row to hoe on appeal.

> The interpretation of the void-or-voidable issue has been a recurring problem for Delaware courts in deciding challenges to the validity of corporate actions, Widener University law professor Lawrence Hamermesh said.

'NOT CRYSTALLINE'

"I think the vice chancellor got it right: the claim of lack of notice was premised on the idea that Klaassen was equitably entitled to notice because he was also a majority stockholder and capable of throwing out the board before they got a chance to fire him as CEO," he said.

"The vice chancellor, however, recognized that the case law on the subject of voidness and voidability is anything but crystalline, and it's an area that the Delaware Supreme Court could usefully try to clarify." WJ

Attorneys:

Plaintiff: R. Judson Scaggs Jr., Kevin M. Coen and Frank R. Martin, Morris, Nichols, Arsht & Tunnell, Wilmington, Del.; George P. Young and Kelli Larsen Walter, Haynes & Boone, Fort Worth, Texas

Defendants: Peter J. Walsh Jr. and Ryan T. Costa, Potter Anderson & Corroon, Wilmington; Van H. Beckwith, Jonathan R. Mureen and Jordan H. Flournoy, Baker Botts LLP, Dallas

Related Court Documents:
October opinion: 2013 WL 5739680
November opinion: 2013 WL 5951762

Shareholder suit against Healthways directors survives dismissal

A shareholder derivative suit accusing a health care cost-management firm's directors of giving the company president too many stock options in violation of its stock incentive plan can proceed in Delaware Chancery Court.

Pfeiffer et al. v. Leedle et al., No. 7831, 2013 WL 5988416 (Del. Ch. Nov. 8, 2013).

In a Nov. 8 opinion, Vice Chancellor Donald F. Parsons held that because plaintiff Milton Pfeiffer had raised reasonable doubts about the independence of Healthways' board of directors, he did not have to bring his complaints to the board's attention before filing suit, as Delaware law usually requires.

The judge also found that the business judgment rule, which normally shields directors from liability for the consequences of their ordinary business discretion, did not apply to Pfeiffer's claims because the board allegedly violated an express and unambiguous provision of the corporate stock plan.

"[W]hen a plaintiff presents particularized factual allegations that indicate that the board clearly violated an unambiguous provision of a stock plan, it is proper to infer that such violation was committed knowingly or intentionally and, therefore, that demand should be excused," Vice Chancellor Parsons wrote, citing *Sanders v. Wang*, 1999 WL 1044880 (Del. Ch. 1999).

Pfeiffer's suit claims breach of fiduciary duty against Healthways' directors and company President Ben Leedle Jr. in connection with 734,000 stock options the board allegedly gave Leedle between 2011 and 2012.

According to the complaint, the board in both years violated the company's stock incentive plan, which prohibits any participant from receiving more than 150,000 shares of stock options or stock appreciation rights in any calendar year.

The suit also alleges unjust enrichment against Leedle and seeks disgorgement of his profits.

The defendants moved to dismiss in November 2012, arguing that Pfeiffer had failed to make a pre-suit demand on the board asking it to take action itself, as Delaware law normally requires. Healthways is a Delaware corporation.

Pfeiffer countered that such a demand would have been futile because the Healthways' board is self-interested rather than disinterested.

Vice Chancellor Parsons applied the two-part test the state Supreme Court articulated in *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984), for determining whether a pre-suit demand would have been futile.

Under *Aronson*, the plaintiff does not have to make a pre-suit demand if his or her allegations create a reasonable doubt that the directors are disinterested and independent or that their actions were otherwise the product of valid business judgment.

Citing *Sanders*, the judge found that Pfeiffer had raised significant doubts about the applicability of the business judgment rule.

Under *Sanders*, a company's directors cannot claim the protection of the business judgment rule if they departed from clear corporate rules knowingly or intentionally.

If Healthways' directors indeed violated an express an unambiguous provision of the corporate stock plan, they met that standard, Vice Chancellor Parsons said.

Pfeiffer therefore did not have to make a pre-suit demand because he satisfied the second prong of the *Aronson* test, the judge held, declining to dismiss his claims. WJ

Attorneys:
Plaintiff: Brian E. Farnan and Michael J. Farnan, Wilmington, Del.; Eduard Korsinsky and Douglas E. Julie, Levi & Korsinsky, New York

Defendants: William M. Lafferty and D. McKinley Measley, Morris Nichols Arsht & Tunnell, Wilmington; Wallace W. Dietz, Bass Berry & Sims, Nashville, Tenn.

Related Court Document:
Opinion: 2013 WL 5988416

Delaware judge: Don't sue in Delaware to enforce forum clauses

By Alison Frankel

Davis Polk & Wardwell had an interesting post Nov. 7 at the Harvard Law School Forum on Corporate Governance. As the post noted, shareholder lawyers recently dropped their appeal of a ruling in June by Chancellor Leo Strine of Delaware Chancery Court that upheld the validity of corporate bylaws requiring shareholders to litigate in Delaware. *Boilermakers Local 154 Ret. Fund et al. v. Chevron Corp. et al.*, No. 433-2013; *IClub Inv. P'ship v. FedEx Corp. et al.*, No. 434, 2013, *notice of voluntary dismissal filed* (Del. Oct. 16, 2013).

With Chancellor Strine's ruling in *Boilermakers v. Chevron* entrenched, at least for now, as Delaware precedent, Davis Polk asked, is there any reason why businesses shouldn't rush to adopt forum-selection provisions? *Boilermakers Local 154 Ret. Fund et al. v. Chevron Corp. et al.*, No. 7220; *IClub Inv. P'ship v. FedEx Corp. et al.*, No. 7238, 73 A.3d 934 (Del. Ch. June 25, 2013). According to the firm, about 120 corporations, mostly in Delaware, have done just that.

But Davis Polk also said there are a couple of reasons to wait. For one thing, shareholders may look askance at forum selection provisions, and could even try to extract revenge against board members who push for them. And for another, it's not clear that judges in jurisdictions outside of Delaware will obey the law according to Leo Strine.

"The non-Delaware judge considering the motion may be influenced, but will not be bound, by the *Chevron* decision," the Davis Polk post said. "We may imagine, and some have confidently predicted, that over time a body of law will develop upholding these provisions under the internal affairs doctrine. But that day has not yet arrived, and in the meantime companies will have to fund some level of litigation to defend their position. These companies may, like Chevron and FedEx, have the satisfaction of having moved the law in a positive direction, but others may be happy to have the trailblazers reap the honor."

The judge declined to grant Edgen an anti-suit injunction to block a shareholder suit in Louisiana, even though Edgen's lawyers (from Morris James and Dechert) warned that the case could potentially interfere with Sumitomo Corp.'s $12-per-share offer for the drilling equipment company — and even though Vice Chancellor Laster called the underlying shareholder claim "exceedingly weak" and castigated plaintiffs' lawyers at Robbins Geller Rudman & Dowd for "unsatisfying and, dare I say, pathetic representational contortions" seemingly designed to preserve an argument that Delaware doesn't have personal jurisdiction over the shareholder who sued in Louisiana.

> Vice Chancellor Travis Laster of Delaware Chancery Court raised an obstacle for forum-selection trailblazers in a ruling from the bench Nov. 5 in *Edgen Group v. Genoud*.

Vice Chancellor Travis Laster of Delaware Chancery Court raised an obstacle for forum-selection trailblazers in a ruling from the bench Nov. 5 in *Edgen Group v. Genoud*, No. 9055, *bench ruling issued* (Del. Ch. Nov. 5, 2013), a case in which Edgen was trying to enforce a provision in its corporate charter that requires shareholders to litigate claims in Delaware. According to Vice Chancellor Laster, companies with forum-selection clauses shouldn't expect Delaware judges to block their colleagues in other states from hearing shareholder cases, at least until the corporations have asked judges outside of Delaware to enforce the provisions and dismiss shareholder suits.

"When I review the *Chevron* decision," Vice Chancellor Laster wrote, "it is seemingly apparent on the face of that decision that Chancellor Strine contemplated, at least for purposes of his ruling in that case, that the forum selection provision would be considered in the first instance by the other court."

The Delaware Supreme Court made clear in its decision last spring dismissing a derivative suit against Allergan's board that it expects Chancery Court to respect rulings by sister state and federal courts under the Full Faith and Credit Clause of the U.S. Constitution. *Pyott et al. v. La. Mun. Police Employees' Ret. Sys.et al.*, No. 380, 2012, 2013 WL 1364695 (Del. Apr. 4, 2013).

Vice Chancellor Laster's decision in the *Edgen* case shows that Chancery took to heart the state Supreme Court's admonitions about intrastate comity, even when corporations have specified Delaware as their forum of choice.

For Edgen, Vice Chancellor Laster's ruling means that it must attempt to win the dismissal of the Louisiana case before it can get help from Chancery Court. That suit was filed by a Canadian shareholder named Jason Genoud after Edgen announced in October that it had agreed to Sumitomo's $12-per-share offer. The offer represents a 55 percent premium over Edgen's trading price and treats Edgen's controlling shareholders no differently from minority owners, but Genoud nevertheless sued the board for breach of

Alison Frankel updates her blog, "On the Case," multiple times throughout each day on WestlawNext Practitioner Insights. A founding editor of Litigation Daily, she has covered big-ticket litigation for more than 20 years. Frankel's work has appeared in The New York Times, Newsday, The American Lawyer and several other national publications. She is also the author of "Double Eagle: The Epic Story of the World's Most Valuable Coin."

fiduciary duty in state court in Baton Rouge, where the company is headquartered.

In a Nov. 6 letter to Vice Chancellor Laster, Genoud counsel Randall Baron of Robbins Geller explained that the shareholder wanted to challenge Edgen's forum-selection provision, which was "unilaterally adopted" in an amendment to offering documents in Edgen's IPO in April 2012.

"We believed that the civil law system in Louisiana would allow the court to assess the validity of the provision under Louisiana contract law without undue reliance on the Delaware precedent in *Boilermakers* that we do not believe should be followed outside of Delaware," Baron wrote.

Edgen sued Genoud in Delaware, seeking an injunction to bar the Louisiana case from moving forward. Unless Vice Chancellor Laster enforced Edgen's forum-selection clause, the company argued, it risked irreparable harm if the Louisiana court enjoined the Sumitomo deal. That injunction, Edgen said, could even come before a decision on the company's motion to dismiss Genoud's case under its forum selection clause.

"Common sense suggests that there would be some sequence in Louisiana that would have our forum motion decided prior to the injunction motion, but there is no guarantee as to sequence," Edgen counsel Joseph Slights of Morris James told Vice Chancellor Laster. "And if this transaction is enjoined in Louisiana — we don't think it should be, but if it is, it's too late for us to really seek to invoke our exclusive forum provision at that point."

Vice Chancellor Laster was sympathetic, especially because he was so skeptical about Genoud's claims. "This case really exemplifies the interforum dynamics that have allowed plaintiff's counsel to extract settlements in M&A litigation and that have generated truly absurdly high rates of litigation challenging transactions," he said. "It also demonstrates why corporations have seen fit to respond with forum selection provisions in an effort to reduce the ability of plaintiff's counsel to extract rents from what is really a market externality."

For Edgen, the judge's ruling means that it must attempt to win the dismissal of the Louisiana case before it can get help from Chancery Court.

The vice chancellor was also notably irritated that Robbins Geller insisted it did not represent Genoud in the Delaware case, although it is handling the Louisiana case for him. Genoud had refused to accept service of Edgen's case, and Vice Chancellor Laster implied that Robbins Geller made a tactical decision to contest the Delaware court's jurisdiction over the shareholder. Vice Chancellor Laster called that strategy "quite disappointing behavior from a firm that otherwise has done a great deal to build up reputational capital and credibility with the Delaware courts."

The Louisiana suit, he said, clearly violated Edgen's forum-selection clause. But Vice Chancellor Laster concluded that precedent on forum-selection clauses, whether in bylaws or corporate charters, is simply too undeveloped to grant anti-suit injunctions as a first recourse for Edgen.

"It may be that in the right case an anti-suit injunction is appropriate, but I do think that *Chevron* suggests that primacy should be given in the first instance to the non-contractually selected forum," he said.

Wachtell, Lipton, Rosen & Katz, which has championed forum-selection clauses, chose to regard Vice Chancellor Laster's decision as a glass half-full, emphasizing the judge's finding that Edgen's charter provision is presumptively valid. But in a phone interview, Baron of Robbins Geller told me Vice Chancellor Laster appropriately concluded that it's up to non-Delaware courts to decide how much deference to give to forum selection clauses.

"We know the bylaws are valid in Delaware," he said. "The next question is to what extent each jurisdiction is obligated to give full faith and credit to those holdings."

In an email, Baron also responded to Vice Chancellor Laster's comments about his firm's strategy. "Vice Chancellor Laster is one of the best jurists in the country and clearly an expert in Delaware law," he said. "I understand his desire to have Delaware courts hear issues on Delaware law. That said, our client was legally entitled to file and have the forum selection clause issue decided in the principle place of business of Edgen. And our client is legally entitled to assure that Defendants properly served him and had personal jurisdiction over him before subjecting him to orders in the forum of their choice."

Edgen counsel at Morris James didn't respond to my phone messages. WJ

NEWS IN BRIEF

NEW YORKER PLEADS GUILTY TO $19 MILLION CHECK-CASHING SCHEME

Flushing, N.Y., check-cashing company Belair Payroll Services and its owner pleaded guilty Nov. 5 in Brooklyn federal court to violating the Bank Secrecy Act. Federal prosecutors said owner Craig Panzera, 47, allowed foreign nationals to cash more than $19 million in checks without filing the proper U.S. currency transaction reports, which are aimed at detecting money laundering and other criminal activity. Under the terms of a plea agreement Belair will forfeit $3.3 million and Panzera will pay $947,000 in restitution. Panzera also pleaded guilty to tax fraud conspiracy for failing to pay income and payroll taxes. Belair operated five storefront offices in Queens and unlawfully cashed checks from 2009 through 2011, according to a superseding indictment. A sentencing date has not been set. Brooklyn federal court records show that Bank Secrecy Act charges are pending against two Belair customers, Lasha Goletiani and Zhan Petrosyants.

United States v. Belair Payroll Services Inc. et al., No. 11-CR-00591, pleas entered (E.D.N.Y. Nov. 5, 2013).

ROCK SINGER GETS PRISON TERM FOR $11 MILLION BANK FRAUD

The front man for the rock band Lights Over Paris was sentenced in Santa Ana, Calif., federal court Oct. 21 to seven years in prison for fraudulently obtaining more than $11 million in bank loans. Robert Brandon Mawhinney, 30, who went by the stage name Robb "TaLLLLL" University, used the money to maintain a lavish lifestyle and to fund his band and music business, including financing for a purported recording studio and a $750,000 custom touring bus, federal prosecutors said. He allegedly defrauded four banks from 2009 to 2011 by presenting them with altered financial statements showing he had assets of about $8 million when the accounts actually held less than $10,000. Mawhinney was arrested in January and pleaded guilty April 22 in California to four counts of making false statements to banks and one count of money laundering.

United States v. Mawhinney, No. 13-CR-00118, defendant sentenced (C.D. Cal. Oct. 21, 2013).

FEDS CHARGE MEDICAL EQUIPMENT SUPPLIER WITH $3 MILLION SCAM

The owner of a Louisiana durable medical equipment company was charged Nov. 1 in a federal court indictment with operating a $3 million Medicare billing fraud scheme. Federal prosecutors said Tracy Brown, 43, used her New Orleans company, Psalms 23-DME, to fraudulently bill Medicare for power wheelchairs and orthotic equipment from 2005 to 2009. Brown allegedly billed the government insurer for equipment the patients did not need or billed for more expensive equipment than she delivered to the Medicare patients. Prosecutors said Brown also paid kickbacks to "marketers" who referred Medicare beneficiaries to her business. She is charged with two counts of conspiracy, nine counts of health care fraud and seven counts of paying kickbacks. The indictment filed in New Orleans federal court seeks $3.2 million in asset forfeiture. Prosecutors said Brown faces a maximum of 20 years in prison on the conspiracy counts and 80 years on the other counts.

United States v. Brown, No. 13-CR-00243, indictment filed (E.D. La. Nov. 1, 2013).

Takeover law

CONTINUED FROM PAGE 1

Harvard Law School professor Guhan Subramanian, this year's speaker at the Pileggi Distinguished Lecture in Law, warned attorneys and judges at a Nov. 22 breakfast lecture at Wilmington's Hotel DuPont that Delaware's anti-takeover law isn't a reliable defense and won't withstand a constitutional challenge.

His thesis drew substantial criticism from the assembled corporate lawyers, some of whom had helped to craft the statute.

The anti-takeover law, Del. Gen. Corp. Law § 203, was enacted in 1988 to deter corporate raiders from using borrowed funds to quickly get control of companies and sell off their assets in the merger wars of the late 1980s.

It passed its first court challenges in takeover battles but then directors began to rely more on other defenses such as poison pills and staggered boards that could be incorporated into company bylaws.

The anti-takeover law was on the sidelines in later litigation over hostile offers.

BACK IN THE LINEUP?

Subramanian predicted that the anti-takeover law will soon be back in play as a defense again now that corporate boards are quickly dropping the staggered board and poison pill because of pressure from shareholder activist groups.

The staggered board puts only a fraction of the directors up for re-election in any given year, preventing hostile suitors from quickly replacing a majority of the board with friendly directors in one election proxy fight.

The poison pill makes the target company too expensive by exploding into thousands of discount-priced new shares for all stockholders of a target company except for the suitor who triggered it when he bought a certain percentage of the company's shares.

The anti-takeover law slows down a hostile bidder if he triggers it by acquiring more than a set percentage of the target company without getting the board's permission. It prevents the unwanted suitor from consummating the deal for three years, by which time his financing for the offer would have run out.

THE NEXT SHOE TO DROP

"Will Delaware get out in front of this problem" and fix the statute before it's challenged, or "will it wait and react" and try to fix it afterward, the professor asked. "This is the shoe that hasn't dropped," he said.

He said in the 1990s, 57 percent of the nation's major companies had staggered boards, but that's dropped to 8 percent to 10 percent today because studies have shown they deliver lower stock value for shareholders than those that put all directors up for election each year.

Similarly the use of poison pills — also very unpopular with shareholders — has dropped from a high of 62 percent of major U.S. companies in the 1980s to 12 percent today, he said.

> "Will Delaware get out in front of this problem" and fix the anti-takeover law before it's challenged, Harvard law professor Guhan Subramanian asked, "or will it wait and react" and try to fix it afterward?

"Shareholder activists like Institutional Shareholder Services have campaigned against (the re-election of) officers and directors who have kept poison pills and staggered boards," Submarian noted.

Since few companies with have those defenses to rely on, that means the next big takeover battle will probably test the constitutionality of the anti-takeover law, and it isn't likely to pass this time because it rests on faulty data and suppositions, he said.

The federal Williams Act of 1968, which amended the Securities Exchange Act of 1934, 15 U.S.C.A. § 78a, involving tender offers, bars states from passing laws that make it virtually impossible for an investor to acquire control of a company.

COULD THE ANTI-TAKEOVER LAW PASS AGAIN?

Originally, the anti-takeover law passed its court challenges because the judges accepted faulty data that showed investors could acquire at least 85 percent of the target corporation and satisfy the Williams Act, Subramanian said.

But none of the cases used to support the anti-takeover law actually allowed hostile suitors to acquire a controlling 85 percent of a target company, he said, and plaintiffs using research from new studies would be able to convince a judge that the statute is unconstitutionally restrictive.

However, Subramanian's contentions that the anti-takeover law is flawed and vulnerable drew critical responses from both lawyers and jurists in the audience.

A. Gilchrist Sparks III, a partner in the Wilmington defense firm Morris Nichols Arsht & Tunnell and a designer of the law, took the podium for a rebuttal.

He predicted that an attorney representing a hostile suitor challenging the anti-takeover law would have a hard time proving the law was unconstitutional when it had functioned well for more than a quarter century in restricting, but not preventing, hostile takeovers.

"(The law) hasn't stopped all takeovers even with the (aid of) poison pills," Sparks said.

Subramanian noted that most takeovers happened because the target company threw in the towel when it realized the hostile suitor would eventually win by means other than obtaining a controlling interest.

But the Delaware Chancery Court's chief judge, Chancellor Leo E. Strine, said even though many takeovers happened without the hostile suitor acquiring more than the 85 percent controlling interest that let them complete the deal, "the courts have viewed Section 203 as an anti-takeover law" and it has survived.

Other corporate lawyers in the audience warned that taking the anti-takeover law back into the state Legislature to revise it in this age of shareholder activism and powerful special interest lobbyists could open up a problematic, time-consuming and expensive can of worms. WJ

RECENTLY FILED COMPLAINTS FROM WESTLAW COURT WIRE*

sWestlaw Number	2013 WL 6079439
Case Title	Somerset Communications Group v. Wall to Wall Advertising, No. 13-2084 (W.D. Wash. Nov. 18, 2013)
Case Type	Securities fraud, misrepresentation
Allegations	Defendants offered and sold securities to plaintiff with the use of materially false information.
Damages Synopsis	Liquidated damages, rescission, interest, fees and costs

Westlaw Number	2013 WL 6061300
Case Title	Sobon v. Cole Real Estate Investments Inc., No. 13-2361 (D. Ariz. Nov. 18, 2013)
Case Type	Securities fraud, misrepresentation
Allegations	Class action. Defendant officers and members of the board of directors of Cole Real Estate breached their fiduciary duty owed to plaintiff stockholders when they entered into a merger agreement with co-defendant American Realty Capital Properties Inc. at a grossly inadequate price, which is unfair to plaintiffs and other public stockholders.
Damages Synopsis	Class certification, injunctive relief, rescission, accounting, disbursements, expenses, fees and costs

Westlaw Number	2013 WL 6042397
Case Title	West Palm Beach Police Pension Fund v. Bioscrip Inc., No. 13-8175 (S.D.N.Y. Nov. 15, 2013)
Case Type	Securities fraud, misrepresentation
Allegations	Class action. Defendant made false and misleading statements about the company's common stocks in order to artificially inflate the prices sold to plaintiff investors.
Damages Synopsis	Class certification, damages, interest, fees and costs

Westlaw Number	2013 WL 6061293
Case Title	Morgan v. Cole Real Estate Investment Inc., No. 13-6851 (Md. Cir. Ct. Nov. 14, 2013)
Case Type	Breach of duty
Factual Synopsis	Shareholder class action. Defendant Cole Real Estate Investment's directors breached their fiduciary duties to shareholders by selling the company too cheaply to defendant American Realty Capital Properties.
Damages Synopsis	Injunctive relief, damages to be determined at trial

Westlaw Number	2013 WL 6042398
Case Title	Mayer v. Pretium Resources Inc., No. 13-8170 (S.D. N.Y. Nov. 14, 2013)
Case Type	Securities fraud, misrepresentation
Allegations	Class action. Defendants defrauded plaintiff to purchase shares at artificially high market prices by employing illegal scheme.
Damages Synopsis	Class certification, compensatory damages, fees and costs

Westlaw Court Wire is a Thomson Reuters news service that provides notice of new complaints filed in state and federal courts nationwide, sometimes within minutes of filing.

CASE AND DOCUMENT INDEX