INSIGHTS

THE CORPORATE & SECURITIES LAW ADVISOR

Volume 26 Number 11, November 2012

Stockholder Inspection Rights Under Delaware Law Page 2

KEVIN R. SHANNON, TYLER J. LEAVENGOOD, and **CHRISTOPHER N. KELLY** of Potter Anderson & Corroon LLP examine two recent Delaware cases that address the tension between encouraging stockholders to pursue their inspection rights while imposing on them the burden to demonstrate a proper purpose.

JOBS Act Provides Flexibility in Equity Offerings Page 9

FRANK G. ZARB, Jr. of Proskauer Rose LLP discusses two provisions of the Dodd-Frank Act that provide increased flexibility for equity financing—confidential submissions of registration statements and "testing waters" communications.

The "Liquidity Conflict" in Sale Transactions Page 16

PETER L. WELSH, C. THOMAS BROWN, and **JACOB M. HELLER** of Ropes & Gray LLP explore the trend among plaintiffs of pursuing post-closing damage cases in lieu of pre-closing settlements in merger and acquisition litigation alleging breach of the duty of loyalty.

DEPARTMENTS

Wolters Kluwer
Law & Business

DERIVATIVE LITIGATION

Striking the Appropriate Balance: Stockholder Inspection Rights Under Delaware Law

Section 220 of the Delaware General Corporation Law affords stockholders the right to inspect a corporation's books and records under certain circumstances. Two recent Delaware cases address the tension between encouraging stockholders to pursue their inspection rights while imposing on them the burden to demonstrate a proper purpose.

By Kevin R. Shannon, Tyler J. Leavengood, and Christopher N. Kelly

Section 220 of the Delaware General Corporation Law affords corporate stockholders the right to inspect the corporation's books and records under certain circumstances. Before a corporation is required to incur the expense and burden attendant to such an inspection, however, a stockholder must establish both a proper purpose for the inspection and that each category of documents requested is essential to that purpose.

Although imposing these threshold burdens on the stockholder, the Delaware courts have long encouraged stockholders to avail themselves of their Section 220 rights before filing claims. And, in recent cases, the Delaware Court of Chancery has been highly critical of stockholders who rushed to file claims before conducting an adequate investigation with the benefit of corporate records obtained pursuant to Section 220.[1]

As a result, there exists a potential tension between encouraging stockholders to pursue their Section 220 rights, while at the same time imposing upon them the burden of articulating a proper purpose for each category of documents requested. This tension reflects the concern that "[f]or all the good that can come from a shareholder's inspection of corporate books and records, [Section] 220, if not properly monitored by the Court, can become an effective and troubling tool for harassment and other mischief."[2]

Faced with these competing interests (*i.e.*, protecting corporations from the burdens associated with fishing expeditions, while at the same time ensuring that stockholders are able to secure corporate records in the appropriate circumstance), the Court of Chancery serves a critical "gate keeping role in Section 220 actions."[3] In that role, the "Court must carefully weigh the evidence presented in each case to avoid an abuse of the Section 220 process."[4] As discussed below, two recent cases, *Louisiana Municipal Police Employees' Retirement System v. Lennar Corporation*[5] and *Rock Solid Gelt Limited v. SmartPill Corporation*,[6] illustrate the important role played by the Court of Chancery in striking the appropriate balance between enforcing the rights of stockholders under Section 220 and protecting corporations from the abuse of such rights.

The Stockholder's Rights and Burdens Under Section 220

Pursuant to Delaware statutory law, stockholders enjoy a right to inspect the books and records of Delaware corporations in which they own stock. This inspection right, found in Section 220, allows stockholders to inspect the

Kevin R. Shannon is a partner, and Tyler J. Leavengood and Christopher N. Kelly are associates, at the Wilmington, Delaware law firm of Potter Anderson & Corroon LLP. Potter Anderson represented parties in some of the cases discussed in this article. The views expressed herein are the authors' views alone and may not be the views of Potter Anderson, or any of Potter Anderson's clients.

corporation's "stock ledger, a list of its stockholders, and its other books and records."[7] This right also extends to the books and records of the corporation's subsidiaries, if the corporation has, or could obtain, actual possession and control of the documents.[8]

To be entitled to inspect corporate documents, a stockholder first must comply with the requirements as to the form and manner of making a demand as set forth in Section 220(b).[9] This process begins with the stockholder delivering to the corporation a written demand under oath.[10] If the corporation refuses to permit the requested inspection or fails to respond to the demand within five business days, the stockholder may file a complaint in the Court of Chancery to compel the inspection.[11]

In addition to satisfying the procedural requirements, the stockholder has the burden of demonstrating that the inspection is for a proper purpose.[12] To be proper, the stockholder's purpose must be reasonably related to its interest as a stockholder,[13] and must not be adverse to the corporation's best interests.[14] The following are examples of purposes that have been found to be "proper" by Delaware courts: (1) seeking to investigate alleged improper transactions or mismanagement; (2) seeking to ascertain the value of stock; and (3) seeking to communicate with other stockholders in order to effectuate changes in management policies.[15]

Despite the numerous potential proper purposes, "[i]nspection under § 220 is not automatic upon a statement of a proper purpose."[16] Notably, where a stockholder asserts that the purpose of its inspection is to investigate potential mismanagement, the stockholder is required to provide some "credible basis" from which the court can infer that waste or mismanagement may have occurred.[17] The stockholder "must make more than mere conclusory statements that waste and mismanagement have occurred or are occurring."[18] Instead, the stockholder must satisfy its burden "through documents, logic, testimony or otherwise."[19]

It is important to emphasize that a stockholder does not have to prove the actual wrongdoing itself.[20] A stockholder may satisfy the "credible basis" standard, but "ultimately fall well short of demonstrating that anything wrong occurred."[21] Thus, while the credible basis standard is "not insubstantial," the standard sets "the lowest possible burden of proof."[22] The "only way to reduce the burden of proof further would be to eliminate any requirement that a stockholder show *some evidence* of possible wrongdoing."[23]

INSIGHTS
THE CORPORATE & SECURITIES LAW ADVISOR

INSIGHTS (ISSN No. 0894-3524) is published monthly for a subscription rate of $746/1 year; $1,268/2 years; $1,790/3 years: $75/Single Issue by Aspen Publishers, 76 Ninth Avenue, New York, NY 10011. POSTMASTER: Send address changes to **INSIGHTS,** 7201 McKinney Circle, Frederick, MD 21704.
To subscribe, call 1-800-638-8437.
For customer service, call 1-800-234-1660.

For article reprints and reprint quotes contact *Wrights Media* at 1-877-652-5295 or go to *www.wrightsmedia.com.*

Despite its low hurdle, Delaware courts have opined that the credible basis standard "strikes an appropriate balance between encouraging productive Section 220 actions where there is a reasonable likelihood of wrongdoing while preventing inspections without a factual basis from draining corporate resources."[24]

In addition to stating a proper purpose, the stockholder must establish that each of the requested documents is "necessary and essential" to a proper purpose.[25] Section 220 is "not a way to circumvent discovery proceedings, and is certainly not meant to be a forum for the kinds of wide-ranging document requests permissible under Rule 34."[26] Rather, a Section 220 document request should be "circumscribed with rifled precision."[27]

Encouraging Stockholders to Use Section 220 Before Filing Derivative Complaints

In 1984, the Delaware Supreme Court held that, to survive a motion to dismiss derivative claims under Court of Chancery Rule 23.1, the plaintiff must adequately plead demand futility by alleging "particularized facts" that create a "reasonable doubt" that "(1) the directors are disinterested and independent [or] (2) the challenged transaction was otherwise the product of a valid exercise of business judgment."[28] Following that decision, derivative plaintiffs often complained that it was difficult to meet the heightened pleading standard without the benefit of discovery.[29]

In apparent response to these concerns, in 1993, in *Rales v. Blasband*, the Delaware Supreme Court described some of the "tools at hand" for plaintiffs to develop the necessary information before filing a derivative action.[30] The Court explained that "a stockholder who has met the procedural requirements and has shown a specific proper purpose may use the summary procedure embodied in 8 *Del. C.* § 220 to investigate the possibility of corporate wrongdoing."[31] The Court expressed its "surpris[e]" that "little use has been made of section 220 as an information-gathering tool in the derivative context," querying whether the disinclination on the part of derivative plaintiffs to use Section 220 was the "unseemly race to the court house, chiefly generated by the 'first to file' custom seemingly permitting the winner of the race to be named lead counsel."[32]

In an attempt to reduce the "plethora of superficial complaints" that result from the common practice of filing hastily, the Supreme Court encouraged the Court of Chancery to reward plaintiffs' lawyers who use Section 220 before filing a derivative action by appointing them lead counsel instead of the first-filers.[33] "Nothing requires the Court of Chancery[ ]...to countenance this [fast-filing] process by penalizing diligent counsel who has employed [the tools at hand], including section 220, in a deliberate and thorough manner in preparing a complaint that meets the demand excused test of *Aronson*."[34]

Since *Rales*, "Delaware courts have strongly encouraged stockholder-plaintiffs to utilize Section 220 before filing a derivative action, in order to satisfy the heightened demand futility pleading requirements of Court of Chancery Rule 23.1."[35] The importance of conducting an adequate investigation before filing a derivative suit was highlighted by the Court of Chancery's recent decision in *South v. Baker*.[36] (*Editor's note: for further discussion of this case, see accompanying article in this issue "Delaware Chancery Court Dismisses Hastily Filed Caremark Action"*). In that case, the Court dismissed the "cursory complaint" with prejudice and without leave to amend as to the named plaintiffs.[37] The Court stated that the plaintiffs would have been better able to satisfy their pleading burden had they first pursued a Section 220 demand, "as the Delaware Supreme Court has recommended repeatedly."[38] In addition, based on the plaintiffs' failure to prosecute a Section 220 action before filing the derivative suit, Vice Chancellor Laster presumptively inferred disloyalty and inadequacy of representation on the part of the stockholder-plaintiffs.[39]

Balancing of the Rights of the Stockholder and the Corporation

In light of the strong encouragement that stockholders pursue books and records under Section 220 prior to filing a derivative complaint, there was concern among practitioners that a corporation would have little chance of success in litigation if it rejected a Section 220 demand. As explained below, however, the recent decisions in *Lennar* and *Rock Solid* demonstrate that, notwithstanding its admonition that stockholders inspect corporate records prior to filing a complaint, the Court of Chancery carefully will review each Section 220 demand to determine whether the stockholder met its burdens and, where appropriate, deny the requested inspection.

Lennar

The *Lennar*[40] case addressed plaintiff Louisiana Municipal Police Employees' Retirement System's (LAMPERS) Section 220 demand for the inspection of books and records of defendant Lennar Corp., one of the nation's largest homebuilders.[41] LAMPERS' stated purpose for its inspection demand was to investigate potential breaches of fiduciary duty involving an alleged failure of oversight, resulting in Lennar's purported failure to comply with certain labor laws.[42] In support of its demand, LAMPERS cited two newspaper articles that described a nationwide investigation by the Department of Labor (DOL) into possible employee misclassification violations under the Fair Labor Standards Act.[43] The articles noted that the investigation targeted the homebuilding industry (as well as other industries) and reported that the five largest homebuilders, including Lennar, had received requests for information from the DOL.[44]

After Lennar rejected LAMPERS' demand on the grounds that it did not provide a credible basis to suggest wrongdoing at Lennar, LAMPERS filed a complaint to compel the inspection.[45] The complaint cited the newspaper articles and, for the first time, eight employee lawsuits alleging labor violations at Lennar, the most recent of which was filed three years before LAMPERS' complaint.[46] Although LAMPERS conceded that it lacked standing to pursue derivative claims relating to alleged wrongdoing during the period of the employee lawsuits, it argued that the lawsuits, together with the articles, suggested a continuing pattern of improper conduct.[47]

The Court rejected the contention that the mere existence of past lawsuits constitutes credible evidence of current wrongdoing.

In deciding Lennar's motion for summary judgment, the Court found that LAMPERS had stated a proper purpose for its inspection (*i.e.*, investigating ongoing mismanagement concerning compliance with labor laws), but that LAMPERS had not provided the requisite credible evidence of the alleged mismanagement.[48] Although recognizing that the "credible basis" standard sets the "lowest possible burden of proof," the Court held that LAMPERS failed even to "clear [that] low hurdle."[49] Vice Chancellor Glasscock opined that, "[t]o permit stockholders to demand corporate books and records based on the 'mere suspicion' of wrongdoing would 'invite mischief' and expose companies to 'indiscriminate fishing expeditions.'"[50]

The Court rejected the contention that the mere existence of past lawsuits constitutes credible evidence of current wrongdoing, and noted that (1) the lawsuits were all settled without any admission of wrongdoing, (2) there was no evidence that similar lawsuits had been filed during the three years preceding LAMPERS' complaint, and (3) there had been no suggestion that the number of lawsuits was disproportionate to Lennar's size.[51] The Court held that the

newspaper articles also did not constitute credible evidence of mismanagement because the articles did not directly implicate Lennar in wrongdoing, but merely reported that Lennar was "one of many companies in many industries caught up in the dragnet of a federal investigation."[52] Finally, the Court concluded that the lawsuits and articles, even considered together, amounted to no more than speculation that Lennar was engaging in worker misclassification.[53] Accordingly, the Court granted Lennar's motion for summary judgment.[54]

Rock Solid

In *Rock Solid*,[55] the Court of Chancery granted in part and denied in part a stockholder's application under Section 220. It permited the stockholder to inspect only a narrow subset of the documents that had been requested. In 2006, plaintiff Rock Solid purchased shares of preferred stock in defendant SmartPill.[56] Four years later, SmartPill's controlling stockholders proposed a term sheet for a new round of preferred stock financing pursuant to which the controlling stockholders would receive preferred stock at a valuation that was significantly lower than a prior financing, and all other shares of preferred stock would be converted into common stock.[57] SmartPill's board of directors established a special committee to negotiate the term sheet and to seek alternative financing.[58] The special committee ultimately approved the financing contemplated by the term sheet.[59] In connection with the financing, SmartPill entered into a stock purchase agreement (Fox SPA) with a minority stockholder who, like Rock Solid, originally had refused to participate in the financing.[60] Under the Fox SPA, the minority stockholder received, *inter alia*, preferred stock and warrants at a significant discount to previous financings.[61]

After the financing closed, Rock Solid made two written demands for books and records (both of which were rejected by SmartPill) and then filed a complaint to compel the inspection.[62] Rock Solid offered four purposes in support of its demand: (1) to investigate whether the Board breached its fiduciary duties regarding the financing; (2) to investigate the independence of the Special Committee; (3) to value its SmartPill shares; and (4) to investigate whether the Board breached its fiduciary duties with respect to the Fox SPA.[63]

It is the plaintiff in a books and records case who bears the burden of justifying the documents that it wants.

In its post-trial opinion, the Court of Chancery first examined each of the four purposes identified by Rock Solid to determine if it was a proper purpose and, where the purpose was to investigate alleged mismanagement, whether Rock Solid had met its burden of presenting a credible basis to warrant further investigation.[64] The Court held that the first three purposes referenced above were proper, and that Rock Solid had provided sufficient evidence of mismanagement to support an investigation of the financing.[65] With regard to Rock Solid's desire to investigate the Fox SPA, the Court acknowledged Rock Solid's frustration with the favorable deal offered to the other stockholder, but held that a stockholder's perception that a fellow stockholder acquired additional stock on favorable terms did not, without more, provide a credible basis to support "a conclusion that mismanagement or other improper conduct was [the] foundation for the Fox SPA."[66] As a result, the Court denied inspection of any documents relating to the Fox SPA.[67]

Having found that Rock Solid met its burden of establishing three proper purposes, the Court then determined the "scope of relief to be granted"—noting the "overriding principle… that only those records that are 'essential and sufficient' to the shareholder's purpose will be included in [a] court-ordered inspection."[68] Faced with requests that "read as [Rock Solid] were pursuing voluminous document discovery under

Court of Chancery Rule 34," the Court suggested that a broad rejection of [the] requests, simply because the requests are so broad, remains tempting. The Court should not be burdened with clearing away the clutter that an unjustifiably broad request produces. It is the plaintiff in a books and records case who bears the burden of justifying the documents that it wants.[69]

The Court explained that Rock Solid "minimally satisfied its burden in demonstrating a proper purpose, but it has done very little to justify why certain documents are 'essential and sufficient' for its purposes."[70] Accordingly, Vice Chancellor Noble ordered production of only the limited documents that "seem, by their very nature, appropriate for and responsive to its proper purposes."[71] The Court refused, however, "to search out, on its own, what might be a proper justification for some of the other documents which might conveniently fall within the broad scope defined by Rock Solid."[72]

Conclusion

The decision in *Lennar* makes clear that the stockholder's burden to provide a credible basis of mismanagement to support the Section 220 inspection may be a "low hurdle," but it is nonetheless a burden that must be satisfied.[73] As recognized by the Court, "[t]his requirement strikes an appropriate balance between encouraging productive Section 220 actions where there is a reasonable likelihood of wrongdoing while preventing inspections without a factual basis from draining corporate resources."[74] Similarly, the Court's careful analysis in *Rock Solid*, and its ultimate determination to order production of only a small subset of the documents requested, highlights not only the limited scope of the relief available under Section 220, but that the stockholder must establish that each category of documents requested is essential to its stated purpose before the Court will impose upon the corporation the burdens associated with the requested inspection.

Notes

1. *See, e.g.*, *South v. Baker*, 2012 WL 4372538, at *17 (Del. Ch.) ("When a stockholder rushes to file a [derivative complaint] without first conducting an adequate investigation ... the stockholder acts contrary to the interests of the corporation but consistent with the interests of the plaintiffs' firm that files the suit.").
2. *Shamrock Activist Value Fund, L.P. v. iPass, Inc*., 2006 WL 3824882, at *2 n.18 (Del. Ch.).
3. *La. Mun. Police Emps' Ret. Sys. v. Countrywide Fin. Corp*., 2007 WL 2896540, at *1 (Del. Ch.).
4. *Id.*
5. 2012 WL 4760881 (Del. Ch.).
6. 2012 WL 4841602 (Del. Ch.).
7. 8 *Del. C.* § 220(b)(1).
8. 8 *Del. C.* § 220(b)(2).
9. 8 *Del. C.* § 220(c)(2). *See also Central Laborers Pension Fund v. News Corp.*, 45 A.3d 139, 144 (Del. 2012); *Kaufman v. CA, Inc.*, 905 A.2d 749, 753 (Del. Ch. 2006).
10. 8 *Del. C.* § 220(b).
11. 8 *Del. C.* § 220(c).
12. 8 *Del. C.* § 220(c)(3). *See also Seinfeld v. Verizon Commc'ns, Inc.*, 909 A.2d 117, 121 (Del. 2006) ("In a section 220 action, a stockholder has the burden of proof to demonstrate a proper purpose by a preponderance of the evidence."). If a stockholder merely seeks to inspect stock ledgers or lists of stockholders (as opposed to other corporate books and records), the burden is on the corporation to establish that the inspection is for an improper purpose. 8 *Del. C.* § 220(c).
13. *Rock Solid Gelt Ltd. v. SmartPill Corp*., 2012 WL 4841602, at *3 (Del. Ch.).
14. *Grimes v. DSC Commc'ns Corp.*, 724 A.2d 561, 565 (Del. Ch. 1998).
15. *La. Mun. Police Emps' Ret. Sys. v. Morgan Stanley & Co., Inc.*, 2011 WL 773316, at *6 (Del. Ch.). Other "proper purposes" recognized by Delaware courts include seeking to clarify an unexplained discrepancy in the corporation's financial statements; to investigate the possibility of an improper transfer of assets out of the corporation; to discuss corporate finances and inadequacies of management; to determine stockholder sentiment for either a change in management or a sale; and to determine an individual's suitability to serve as a director. *Id.*
16. *City of Westland Police & Fire Ret. Sys. v. Axcelis Techs. Inc*., 1 A.3d 281, 290 (Del. 2010) (citing *Pershing Square, L.P. v. Ceridian Corp*., 923 A.2d 810, 818 (Del. Ch. 2007)).
17. *Thomas & Betts Corp. v. Leviton Mfg. Co., Inc.*, 681 A.2d 1026, 1031 (Del. 1996). *See also Seinfeld v. Verizon Commc'ns, Inc.*, 909 A.2d 117, 118 (Del. 2006) ("[S]tockholders seeking inspection under section 220 must present 'some evidence' to suggest a 'credible basis' from which a court can infer that mismanagement, waste or wrongdoing may have occurred.").

18. *Paul v. China MediaExpress Holdings, Inc.*, 2012 WL 28818, at *4 (Del. Ch.). *See also Seinfeld*, 909 A.2d at 122-23 (allowing an investigation of possible wrongdoing where the stockholder cannot provide the requisite credible basis to infer that wrongdoing occurred would grant a license for a "fishing expedition" that would be adverse to the interests of the corporation).

19. *Deephaven Risk Arb Trading Ltd. v. UnitedGlobalCom, Inc.*, 2004 WL 1945546, at *8 (Del. Ch.).

20. *See. First Corp. v. U.S. Die Casting & Dev. Co*., 687 A.2d 563, 567 (Del. 1997).

21. *Khanna v. Covad Commc'ns Grp., Inc.*, 2004 WL 187274, at *6 n.25 (Del. Ch.).

22. *Seinfeld*, 909 A.2d at 123.

23. *Id*.

24. *La. Mun. Police Emps.' Ret. Sys. v. Lennar Corp*., 2012 WL 4760881, at *3 (Del. Ch.).

25. *Pershing Square, L.P. v. Ceridian Corp.*, 923 A.2d 810, 818 (Del. Ch. 2007); *Sec. First Corp. v. U.S. Die Casting & Dev. Co.*, 687 A.2d 563, 565 (Del. 1997) (because Section 220 "is not an invitation to an indiscriminate fishing expedition," the stockholder "must justify each category of the requested production").

26. *Highland Select Equity Fund, L.P. v. Motient Corp*., 906 A.2d 156, 165 (Del. Ch. 2006).

27. *Sec. First Corp.*, 687 A.2d at 570.

28. *Aronson v. Lewis*, 473 A.2d 805, 814 (Del. 1984).

29. *See Levine v. Smith*, 591 A.2d 194, 208-10 (Del. 1991).

30. *Rales v. Blasband*, 634 A.2d 927, 934 n.10 (Del. 1993).

31. *Id*.

32. *Id*.

33. *Id*.

34. *Id*.

35. *King v. VeriFone Holdings, Inc*., 12 A.3d 1140, 1145 (Del. 2011). *Accord Beam ex rel. Martha Stewart Living Omnimedia, Inc. v. Stewart*, 845 A.2d 1040, 1056 (Del. 2004); *White v. Panic*, 783 A.2d 543, 556-57 (Del. 2001); *Brehm v. Eisner*, 746 A.2d 244, 266-67 (Del. 2000); *Scattered Corp. v. Chi. Stock Exch., Inc*., 701 A.2d 70, 79 (Del. 1997); *Security First Corp. v. U.S. Die Casting & Dev*. Co., 687 A.2d 563, 567 n.3 (Del. 1997); *Grimes v. Donald*, 673 A.2d 1207, 1216 (Del. 1996).

36. 2012 WL 4372538 (Del. Ch.).

37. *Id.* at *1.

38. *Id.* at *14. The Court also stated that "our Supreme Court has admonished stockholders repeatedly to use Section 220 ... to obtain books and records and investigate their claims before filing suit." *Id.* at *1.

39. *Id.* at *20 ("Rather than acting in the bests interests of the corporation, the [plaintiffs] filed hastily because doing so served the interests of their attorneys. In my view, these circumstances support an inference of disloyalty and a finding of inadequacy.").

40. *Louisiana Municipal Police Employees' Retirement System v. Lennar Corp*., 2012 WL 4760881 (Del. Ch.).

41. *Id.* at *1.

42. *Id.* at *2.

43. *Id.* at *1-*2.

44. *Id.* at *1.

45. *Id.* at *2.

46. *Id.*

47. *Id.* at *2, *5.

48. *Id.* at *5.

49. *Id.* at *3.

50. *Id.* (quoting *Seinfeld*, 909 A.2d at 122).

51. *Id.* at *4.

52. *Id*.

53. *Id.* at *5.

54. *Id.*

55. *Rock Solid Gelt Ltd. v. SmartPill Corp*., 2012 WL 4841602 (Del. Ch.).

56. *Id.* at *1.

57. *Id.*

58. *Id.*

59. *Id.* at *2.

60. *Id.*

61. *Id.*

62. *Id.*

63. *Id.* at *3.

64. *Id.*

65. *Id.* at *3-4.

66. *Id.* at *5.

67. *Id.* at *7.

68. *Id*. at *5 (quoting *Helmsman Mgmt. Servs., Inc. v. A & S Consultants, Inc*., 525 A.2d 160, 167 (Del. Ch. 1987)).

69. *Id.* (citing *Highland Select Equity Fund L.P. v. Motient Corp.*, 906 A.2d 156, 158 (Del. Ch. 2006) ("[I]t is not the court's responsibility to pick through the debris of a Section 220 demand in this state of disarray and to find the few documents that might be justified as necessary and essential to the plaintiff's demand.")).

70. *Id.* at *6.

71. *Id.*

72. *Id.*

73. *Lennar*, 2012 WL 4760881, at *3.

74. *Id.* (citing *Seinfeld*, 909 A.2d at 122-23).

The JOBS Act Provides New Flexibility in Public and Private Equity Offerings

The provisions of the JOBS Act permitting confidential submissions of registration statements and "testing-the-waters" communications together enhance an issuer's ability to respond flexibly when raising capital in rapidly evolving market conditions. While taking advantage of these new provisions, issuers should be careful when navigating a number of regulatory issues and concerns.

By Frank G. Zarb, Jr.

The enactment of the Jumpstart Our Business Startups (JOBS Act) earlier this year has resulted in uncertainty about the extent to which it might achieve its purpose—to promote emerging growth companies (EGCs), which reportedly are a principal driver of job creation. There has been skepticism that some key provisions—such as curtailed disclosure requirements—would actually have a significant impact on corporate growth. Would a company base a significant decision to pursue a public offering on marginal savings in effort and expense? Nonetheless, the market has spoken, and answered these critics with its response to two of the least glamorous parts of the legislation. One of these provisions permits confidential submissions of registration statements to the SEC, allowing an issuer to receive SEC Staff comments on multiple drafts of a registration statement out of public view. The second provision—the so-called "testing-the-waters" option—allows communications with investors before, during, and after a public offering without running afoul of the SEC's rules against "gun jumping."

These two provisions can be used in tandem to enhance an issuer's ability to react flexibly to rapidly evolving market conditions. An issuer that is unsure whether to proceed with an offering, or is deciding between a public versus a private offering, can hedge its bets by submitting a draft registration statement to the SEC, and then reaching out to certain investors to gauge market interest, and to evaluate pricing and other terms. Meanwhile, without having flagged its intentions to the market (including risking an adverse market reaction to a later withdrawal of a publicly-filed document), the issuer can get a head start on the lengthy SEC review and comment process. If the issuer later decides to proceed with a public offering, it can be as few as 21 days from completing the public offering. If the issuer instead proceeds with a private offering, it can use the confidentially-filed document as a basis for preparing an offering memorandum.

An EGC is any issuer that, during its most recently completed fiscal year at the time of registration with the SEC, had less than $1 billion in annual gross revenues. Thus, most companies that undertake an initial public offering meet the definition of an EGC and can take advantage of the new flexibility provided by the JOBS Act. For example, among approximately 25 companies that completed initial public offerings in the third quarter of 2012, 20 indicated that they qualified as EGCs. An EGC can continue to take advantage of the JOBS Act provisions for up to five years following an IPO.

Mr. Zarb, Jr. is a partner in the corporate department of Proskauer Rose LLP in Washington, DC. He acknowledges the invaluable assistance of Elizabeth Crimer Walsh, an associate in the corporate department, in the preparation of this article

Confidential Filings

The JOBS Act amended Section 6(e) of the Securities Act of 1933 (Securities Act) to allow EGCs to submit draft registration statements confidentially with the SEC. Before the amendment, even early drafts of registration statements were filed and available for public inspection on the SEC's website.[1] An issuer now can submit a draft registration statement confidentially, leave it in draft form indefinitely, and go through multiple rounds of SEC Staff comments. This new flexibility is available for both initial registration statements, as well as secondary offerings by selling shareholders or registrations of employee benefit plans on Form S-8, so long as the issuer maintains its status as an EGC. A debt-only issuer with Securities Act-registered sales of debt securities may use the confidential submission process if it otherwise qualifies as an EGC.

A confidential submission creates new opportunities for an issuer to pursue side-by-side public and private offerings.

Confidential submissions provide flexibility in timing a public offering, as well as in choosing the offering method. An issuer, for instance, can keep a draft registration statement on file with the SEC indefinitely (as long as it continues to qualify as an EGC) without running the risk that the market will view it as a stalled or failed offering, or in the case of a secondary offering, that the "market overhang" caused by the anticipation of an increase in the number of outstanding securities will have a dampening effect on price. When the issuer is ready to proceed with the offering, it can do so without significant delay (as long as the earlier draft has been fully vetted by the Staff). The SEC Staff has stated that a confidential filing must be made public at least 21 days prior to being declared effective.

One issuer went through the SEC review and comment process confidentially and commenced its public offering only 22 business days after making its filings public.[2] Indeed, to date, confidential filers have commenced public offerings an average of 33 business days after converting from a confidential to a public filer.[3] By comparison, before the confidential submission process was available, an issuer's first draft registration statement would be publicly available immediately, and the ensuing review process would take between 90 and 180 days, if not longer.

Confidential submissions provide flexibility in timing a public offering, as well as in choosing the offering method.

Issuers that have used the confidential submission process also have cited other benefits. For example, many high-growth companies go to great lengths to avoid public disclosure of sensitive strategic information and intellectual property, and a confidential submission delays the need to make public disclosures that could compromise the security of this information. Moreover, a confidential submission avoids having to commit to a public offering at the time of submitting the registration statement, and creates new opportunities for an issuer to pursue side-by-side public and private offerings, while making use of the same offering document, or to pursue only one of the two approaches.

Confidential submissions of registration statements also can impact the dynamics of public offerings, and strengthen the hands of managing underwriters. Managing underwriters have access to the contents of a confidentially-submitted registration statement, whereas other members of the syndicate often do not, and indeed other syndicate members may not be invited to join until after a decision is reached to make a public filing.

There are, however, a few limitations on confidential filings. Once an issuer publicly files a later draft of a registration statement, it must simultaneously file all earlier drafts of the filed registration statement. The SEC Staff also will publicly release comment letters and issuer responses no earlier than 20 business days following the effective date of a registration statement (the same time frame for the public release of Staff comment letters and issuer responses with respect to filings that are not submitted confidentially).[4] In addition, an issuer must publicly file a registration statement at least 21 days before the earlier of either of the date of the first road show (or, as previously noted, where there is no road show, the issuer's request that the registration statement become effective). Furthermore, some issuers have indicated that, in practice, confidential filings may not be as confidential as expected.[5]

"Testing-the-Waters"

Another section of the JOBS Act, Section 105, amended Section 5 of the Securities Act to provide that issuers can communicate with both qualified institutional buyers (QIBs)[6] and institutional "accredited investors"[7] before, during, and after the filing of a registration statement "to determine whether such investors might have an interest in a contemplated securities offering ...." These amendments could significantly facilitate public financing by expanding permissible issuer-investor communications. In order to understand the new amendments, it is necessary to understand the legal framework that preceded them.

Communications Before the JOBS Act

Under Section 5 of the Securities Act prior to the JOBS Act amendments, an issuer could not engage in communications before a public offering if those communications could be viewed as an "offer." An offer is broadly defined to capture any statement that could directly or indirectly encourage investment.[8] An example of such a statement is the publication in Playboy magazine of an interview with the founders of Google right before the company's initial public offering. As a result of the published interview, Google disclosed the potential liability and other risks associated with having engaged in such illegal "gun-jumping" in its registration statement.

Prior to the JOBS Act, an issuer could make oral "statements" or "offers" of its securities after a registration statement is filed, but could not use written materials (other than a preliminary prospectus filed with the SEC). After a registration statement is declared effective, any such written materials would have to be accompanied or preceded by the delivery of a written prospectus. Generally, for materials that are electronically disseminated, a hyperlink to the final prospectus satisfies this requirement.[9]

There was one exception to the restrictions described above prior to the JOBS Act amendments to Section 5, which still remains available: the use of "free writing prospectuses" under rules adopted in 2005. This exception permits an issuer or underwriting participant to disseminate written materials after a registration statement is filed, without fear of running afoul of the requirements under Section 5.[10] Because oral statements are not restricted after the filing of a registration statement, the free writing prospectus rules focus only on written materials, which include emails and other graphic writings, as well as recorded presentations.[11] There are, however, some restrictions. First, issuers are usually required to file the materials on the date that they are first made publicly available. Second, the filed materials subject the issuer (or underwriter if it disseminates the materials) to liability under Section 12(a)(2) of the Securities Act, and Rule 10b-5 under the Securities Exchange Act of 1934 (Exchange Act) for material misstatements or omissions.

Post-JOBS Act

Section 105 of the JOBS Act amended Section 5 of the Securities Act to add a new

paragraph (d), providing that an EGC and "any person authorized to act on behalf of an [EGC]" may communicate with QIBs and institutional accredited investors at any time without such communications running afoul of the "gun-jumping" restrictions described above. This amendment builds on the flexibility provided by free writing prospectuses and provides issuers with a useful tool to gauge market interest for a proposed offering. It also makes it easier for issuers to pursue other financing schemes as an alternative to, or in addition to, a public offering. In short, it allows issuers to keep their "fingers on the pulse" of fluctuating market conditions, so that they can adjust the timing and structure of an offering with those conditions.

An issuer or underwriter may not only communicate with potential investors, but also may obtain "indications of interest."

Issuers and underwriters are already taking advantage of the flexibility provided by the JOBS Act. Underwriters, for example, are using the new flexibility to communicate with investors in order to gauge their reactions to a new business model or business sector. As noted above, oral communications are now permissible before a registration statement is filed by an EGC, so long as such communications are limited to QIBs and institutional accredited investors. In regard to such pre-filing communications, underwriters have confronted one market-based limitation: Unless a potential transaction is close at hand, investors are reluctant to allocate their time and attention to these types of discussions. Written communications with QIBs and institutional accredited investors also are now permitted, without the corresponding filing and other obligations that would have applied to such materials under the "free writing prospectus" rules.

Under the JOBS Act amendments, it appears that an issuer or underwriter may not only communicate with potential investors, but also may obtain "indications of interest," including the number of shares that a customer might purchase at a given price, as long as no request to buy or commitment to order is made. While the SEC has not provided an interpretation of the new language added to paragraph (d) of Section 5 under the JOBS Act, it has addressed the question from the point of view of Exchange Act Rule 15c2-8(e). This rule prohibits a registered broker-dealer's associated persons from "soliciting" customer orders without first providing those customers with a copy of the preliminary registration statement. The SEC has clarified that the rule does not apply until a registration statement has been filed.[12] If "solicitations of interest" did trigger the rule's requirement, then pre-filing "testing-the-waters" communications with potential investors could potentially run afoul of the rule.

In addition to gauging the market's interest and optimizing the timing of an offering, issuers and underwriters have used the new flexibility afforded by Section 105 to continue to evaluate alternative financing options even as the public offering process begins. As previously noted, an issuer might consider a side-by-side private placement or a follow-on private or public offering, depending on the circumstances, or evaluate whether to abandon the financing effort altogether.

"Testing-the-waters" communications could lose protection under new Section 5(d), and be viewed as "gun-jumping."

Of course, there are risks to engaging in "testing-the-waters" communications. While written materials disseminated to QIBs and institutional accredited investors need not be formally filed, the SEC Staff may review copies of such materials in the course of their review of the draft

registration statement. The Staff may well use these materials as a basis for further comments and may ask that certain information included in the materials also be included in future drafts of the registration statement.

Finally, issuers and offering participants should implement rigorous procedures to verify their "testing-the-waters" audience is limited to institutional accredited investors or QIBs. The consequence of a mistake could be severe, as "testing-the-waters" communications could lose protection under new Section 5(d), and be viewed as "gun-jumping" in violation of Section 5. The text of the JOBS Act clearly limits communications to QIBs and institutional accredited investors, and there is no express flexibility if, after investigation, an investor does not fit within one of those categories. By contrast, under Rule 144A an issuer need have only a "reasonable belief" in the status of a QIB. While the SEC may ultimately interpret the new language to provide for such flexibility, it has not yet done so.

Indeed, in a somewhat different context, the SEC Staff has already taken a hard line on the inclusion of unqualified investors in the audience for "testing-the-waters" communications. As noted above, an issuer that has submitted a draft registration statement confidentially must file it publicly at least 21 days prior to a road show (or effectiveness). The Staff has stated that if an issuer does not conduct a traditional road show, but has communications that do not meet the conditions for "testing-the-waters" under Section 5(d)—for example, by holding an investor meeting that is not limited to QIBs or institutional accredited investors—then the registration statement would need to be filed at least 21 days before the meeting.[13]

Other Regulatory Considerations

An issuer that decides to take advantage of the new "testing-the-waters" flexibility afforded by the JOBS Act should be vigilant of the sometimes complex regulatory considerations that may come into play.

Integration. Although not necessarily an obstacle under current rules and interpretations, issuers engaged in "testing-the-waters" communications should be careful that multiple public and/or private offerings are not "integrated" with each other. Integration of multiple offerings can, on occasion, result in non-compliance with applicable rules.

Under Section 4(2) of the Securities Act (or the corresponding safe harbor provided by Rule 506), for example, an issuer generally can conduct side-by-side public and private offerings, so long as no private investors were solicited as a result of the filing of the registration statement and/or other public offering activities. Under Rule 155, an issuer may pursue a private offering after terminating a public offering process, so long as no securities were sold in the public offering, investors are provided with certain information regarding the offering, and the effective date of the withdrawal of the registration statement is at least 30 days prior to the commencement of the private offering. A terminated private offering also may be followed by a public offering under the rule, subject to similar conditions. We expect that the SEC will clarify, and likely liberalize, its rules and interpretations on the integration of offerings in light of the amendments that added new Section 5(d) to the Securities Act, but the timing of any such clarification is unknown.

Uneven disclosure. Exchange Act Rule 12b-20 provides that, "[i]n addition to the information expressly required to be included in a statement or report, there shall be added such further material information, if any, as may be necessary to make the required statements, in the light of the circumstances under which they are made not misleading." Accordingly, if an issuer files or plans to submit or file a registration statement, it should be careful when communicating with potential investors that it avoids providing

material information that is not disclosed in the publicly filed (or confidentially submitted) document. The SEC Staff may ask the company to defend the omission of such other information from disclosure in the registration statement.

Regulation FD. When engaging in "testing-the-waters" communications, issuers that are already publicly reporting should be mindful of Regulation FD. Regulation FD requires an issuer to disseminate material, non-public information in a broad manner so that all investors have an equal opportunity to learn about it in a timely manner. Selective communications with potential investors could violate the regulation if such communications contain material, non-public information. While there is an exception to the application of Regulation FD for communications following the filing of a registration statement, it is unclear whether the exception would apply if the public offering is not ultimately completed (as compared to, for instance, an alternative private offering), or if the communication did not clearly relate to the public offering. A registration statement that is confidentially submitted to the SEC is not "filed" for these purposes and would not form the basis for an exception to Regulation FD.

Insider trading. Issuers should ensure that they do not inadvertently run afoul of the laws against insider trading. If a "testing-the-waters" communication with a potential investor includes material, inside information, and the investor trades on that information, the issuer could be viewed as a tippee and potentially subject to liability. Ways to address this concern have been developed in other contexts, such as placing potential investors under confidentiality arrangements.

Anti-fraud liability. Both oral and written "testing-the-waters" materials would be subject to liability under Rule 10b-5, the anti-fraud rule under the Exchange Act, and potentially under Section 12(a)(2) of the Securities Act.[14]

Conclusion

Overall, in 2012, IPOs have increased over previous years, but have still not reached previous highs—in 2007, 240 IPOs were conducted, raising around $59.4 billion, while in 2012 to date, 123 IPOS have closed, raising approximately $38.8 billion (Facebook alone accounted for $16.1 billion of this).[15] It is doubtful that the slight increase in deal flow from 2011 to 2012 is attributable to the JOBS Act, as compared to other factors, such as the strong performance of the securities markets. The true extent of the JOBS Act's impact, then, likely remains to be seen, but the new flexibility for equity financing described above suggests that the impact should be positive over time.

Notes

1. In some circumstances, foreign private issuers have been allowed to submit confidential drafts of registration statements.

2. Trulia, Inc.'s draft registration statement on Form S-1 became publically available on the SEC's EDGAR website on August 17, 2012, and the initial public offering was priced on September 19, 2012.

3. Based upon a comparison of 9 issuers who filed confidential draft registration statements since May of 2012 and averaging the number of business days between when the registration statement was publically available on EDGAR and when the issuer received a notice of effectiveness from the SEC.

4. Issuers are asked to resubmit their responses to comment letters when they first file registration statements on EDGAR.

5. While many issuers appeared to succeed in keeping the confidential filing secret, others were not as successful, although the leaks are unlikely to have derived from the SEC. For example, there were rumors that Trulia, Inc. had filed a registration statement, as early as the end of May of 2012, over two months before Trulia's Form S-1 became publically available on the SEC's EDGAR website on August 17, 2012 (confirming the rumors). *See* Reuters, Exclusive: Silicon Valley startup, Workday, quietly files for IPO, by Poornima Gupta, July 17, 2012, *http://www.reuters.com/article/2012/07/18/us-workday-ipo-idUSBRE86H00A20120718*; Reuters, Real estate listings firm Trulia quietly files for IPO-sources, by Olivia Oran and Alistair Barr and Nadia Damouni, July 25, 2012, *http://in.reuters.com/article/2012/07/25/trulia-ipo-idINL2E8IJBTN20120725*; Wall Street Journal Deal Journal, Workday IPO Shows Jobs Act Rule in Action, August 31, 2012, *http://blogs.wsj.com/deals/2012/08/31/workday-ipo-shows-jobs-act-rule-in-action/*.

6. "QIB" or qualified institutional buyer is defined in Rule 144A and generally include an institution which owns and invests on a discretionary basis at least $100 million in securities. Example entities include: insurance companies; investment companies; business development companies; small business investment companies; employee benefit plans; corporations; and partnerships.

7. "Accredited investors" as defined in Rule 501(a), and institutional accredited investors are institutional investors that come within one of the enumerated categories.

8. "Since that term is defined in §2(a)(3) to include "every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value," it goes well beyond the common law concept of an offer." *See* Securities Regulation, Chapter 1.a., Loss, Seligman and Paredes.

9. SEC interpretive Release No. 34-36345 (October 6, 1995) entitled "Use of Electronic Media for Delivery Purposes" first introduced the SEC willingness to equate access to a final prospectus with delivery (*see* examples 15 and 35).

10. Issuers that qualify as Well-Known Seasoned Issuers, or WKSIs, may use free writing prospectuses prior to the filing of a registration statement. In addition, issuers that are eligible to file shelf registration statement on Form S-3 may generally use free writing prospectuses before the time of a take down off the shelf, based on the previous filing of a base registration statement.

11. *See* Securities Offering Reform Release No. 34-52056, July 19, 2005.

12. August 22, 2012, Frequently Asked Questions (FAQs) About Research Analysts and Underwriters, Question 1.

13. *See* Jumpstart Our Business Startups Act Frequently Asked Questions, Confidential Submission Process for Emerging Growth Companies, Question 9, *http://www.sec.gov/divisions/corpfin/guidance/cfjumpstartfaq.htm*

14. *See Gustafson v. Alloyd Co. Inc.*, 513 U.S. 561 (1995) the Supreme Court held that liability under Section 12(a)(2) of the Securities Act was limited to sales effected by means of a prospectus meeting the requirements of Section 10 of that Act. Since that decision, federal courts have disagreed about its scope, and about whether liability might attach to some quasi-public offerings. It is unclear, for instance, if such liability would attach to a written "testing-the-waters" communication sent to investors in advance of a public offering.

15. Ipreo; as of October 23, 2012. Ipreo is a leading global provider of market intelligence, deal execution platforms, and investor communication tools to investment banks and corporations around the world. *http://www.ipreo.com.home*.

The "Liquidity Conflict" and the Duty of Loyalty Under Delaware Law

Recently, post-closing damages cases have become more common in transactional litigation in Delaware. Not surprisingly, creative shareholder plaintiffs' attorneys have sought new theories for alleging breaches of the duty of loyalty, in hopes of evading motions to dismiss. In a series of recent cases, the Chancery Court has addressed the latest of these theories, which the authors call the "liquidity conflict."

By Peter L. Welsh, C. Thomas Brown, and Jacob M. Heller

A number of recent decisions in the Delaware Chancery Court have highlighted a trend among plaintiffs of pursuing post-closing damages cases in lieu of pre-closing settlement in merger-and-acquisition litigation.[1] Notable examples include Chancellor Strine's post-trial decision in the *In re Southern Peru* case, recently affirmed by the Delaware Supreme Court, which resulted in a blockbuster award of $2 billion in damages and $300 million in attorneys fees.[2] Vice Chancellor Laster's scathing opinion in the *Del Monte* case led to a settlement of $89 million in another post-closing damages case. And just last month, Kinder Morgan announced that it would pay $110 million to settle post-closing damages claims related to its acquisition of El Paso Corp., again after a highly critical opinion issued by Chancellor Strine.[3] All three of these cases—*Southern Peru*, *Del Monte*, and *El Paso*—shared a common theme: Shareholder plaintiffs credibly alleged that key players in the deal, including directors, executives, and bankers, had significant conflicts of interest which, in the Chancery Court's view, undermined their ability to protect shareholders' interests and implicated the fiduciary duty of loyalty.

The eye-popping numbers at stake—and, of course, the potential for commensurately large fee awards—have prompted agile plaintiffs' lawyers to search for new and inventive ways to allege conflicts in search of monetary settlements and rich fee awards. Alleged conflicts of interest can trigger review under the searching and fact-intensive entire fairness standard, and, as such, are not readily susceptible to defeat on a motion to dismiss. Successfully pleading a conflict of interest can give a plaintiff enormous leverage. As then-Vice Chancellor Strine's opinion in *In re Cox Communications* observed, "because of the costs of discovery and time to the defendants [under the entire fairness rule]," cases with colorable loyalty allegations not susceptible to a motion to dismiss "always have settlement value."[4]

This article discusses the most recent riff on the conflicted fiduciary theme—what we refer to herein as the "liquidity conflict." A liquidity conflict arises, according to shareholder plaintiffs, where a shareholder with more than *de minimis* holdings, and its representatives on the board of directors, are alleged to be inherently conflicted in a sale of the company because of an interest in monetizing the shareholder's investment. This allegation is made commonly, although not necessarily, in cases involving target companies with relatively thinly-traded stocks, where a sale of the entire company is the only practical

Peter L. Welsh is a partner, and C. Thomas Brown is a senior associate, in the Securities Litigation Practice Group of Ropes & Gray LLP in Boston. Jacob M. Heller is an associate in the Litigation Department at Ropes & Gray.

way to monetize a large holding. In approving a transaction that provides liquidity to a significant shareholder, directors affiliated with the relevant holder are alleged to have breached their fiduciary duty of loyalty. This playbook has been used increasingly by frequent-filer plaintiffs in Delaware and elsewhere.[5]

What Alleged "Liquidity Conflicts" Look Like

A simple desire for liquidity is easy to allege. Many publicly-traded companies have a greater than 5 percent shareholder with board representation.[6] Yet, if an interest in liquidity, without more, is sufficient to establish a conflict, and to potentially trigger entire fairness review, an alleged "liquidity conflict" can dramatically increase litigation risk for otherwise unremarkable transactions. This means, among other things, that understanding possible and perceived conflicts up front is important for guiding a board's negotiation process, and for managing deal risk.

The "liquidity conflict," as we have framed it, also poses a more fundamental question: Why is the desire for liquidity a conflict of interest at all? While there is always a risk of "the proverbial 800 pound gorilla who wants the rest of the bananas all for himself,"[7] in an arms-length transaction with a third party, a significant shareholder has more at stake in the transaction than a smaller shareholder and therefore has a stronger interest in getting a higher price. The pursuit of liquidity permits such a holder to realize profits while encouraging transactions with the potential to create future economic benefit for others. As former Vice Chancellor Lamb has observed, in an arm's-length sale to a third party, significant shareholders have an "interest in maximizing" the value of their shares, and that interest is "directly aligned with that of the minority."[8] These are goals that a well-ordered set of laws for corporate governance would presumably seek to nourish, not stifle.

In recent decisions, the Chancery Court has sought to balance, on the one hand, policing genuine loyalty conflicts, against, on the other hand, protecting the legitimate interest of significant shareholders in seeking liquidity. What emerges from the cases is that, to state a claim for breach of loyalty based on a liquidity conflict, a plaintiff must allege more than that a significant shareholder desired liquidity in a fundamental transaction. There also must be additional factors, including, at a minimum, well-pled facts which, if true, would indicate that liquidity was obtained pursuant to a significantly flawed process and to the detriment of other shareholders. This approach protects legitimate business interests and prevents the "liquidity conflict" from becoming a tool to extract settlements in otherwise flimsy cases.

Alleged "Liquidity Conflicts" in Recent Cases

We begin with a summary of three recent cases in which an alleged "liquidity conflict" loomed large: *New Jersey Carpenters Pension Fund v. Infogroup, Inc.*,[9] *In re Answers Corp. Shareholder Litigation*,[10] and *In re Synthes, Inc. Shareholder Litigation*.[11]

The alleged conflict of interest was similar in all three of these cases: A large shareholder allegedly desired to cash out, but was unable to do so because the stock was traded thinly relative to the size of the holder's stake, such that a sale of the holder's stake absent a sale of the company would potentially depress the share price. In each case, the plaintiffs alleged that the "interested" shareholder, and its board representatives, persuaded a majority of the board to sell the company in a transaction that was otherwise not in the best interest of the majority of shareholders, but which allegedly served the liquidity interests of the significant shareholder.[12] In *Infogroup* and *Answers*, the complaint survived a motion to dismiss; while in *Synthes*, the liquidity-related allegations were rejected.

New Jersey Carpenters Pension Fund v. Infogroup, Inc.

Vinod Gupta was the founder of Infogroup, a director of the company, and its largest shareholder, controlling approximately 37 percent of its common stock.[13] But as a result of settlements arising out of other actions against Gupta, he owed millions of dollars to the SEC and to Infogroup, and was forced to step down as Infogroup's CEO in 2008.[14] Moreover, Gupta had debt exceeding $13 million and had plans to launch a new business.[15]

After determining that "the size of his position [in Infogroup] rendered it illiquid," a "desperate" Gupta decided that the sale of Infogroup "was the best option to fulfill his need for liquidity, regardless of whether the timing, price, or process employed here in the best interests of [Infogroup's] other shareholders."[16] The complaint alleged that Gupta engaged in a number of "rogue activities" designed to influence the board into agreeing to sell the company, despite the fact that the Infogroup's future prospects were improving and the market was ill-suited for a sale.[17] In particular, "Gupta's campaign for a sale employed some rather indelicate methods of persuasion."[18] He allegedly "harassed, threatened, baited, and bullied" the board into "providing him the opportunity to cash out his illiquid holdings."[19] For example, Gupta threatened to sue the other board members if they did not agree to a sale, and he was "generally disruptive" at board meetings.[20] Gupta's tactics allegedly wore the board down; at one point, a board member commented that he was concerned that "the majority of the board … just want to 'dump the company and run.'"[21]

On December 22, 2008, the board announced that Infogroup would retain a financial advisor to help them analyze Infogroup's strategic alternatives. The next month, the board formed an M&A committee comprised of independent directors to receive proposals to acquire the company.[22] It was then over a year before, in February 2010, Infogroup received an offer from Vector Capital to buy the company at $8 a share, and from CCMP Capital Advisors LLC for $8.40.[23] The M&A committee determined that Vector's offer was inferior, and began negotiating with CCMP.[24] On March 3, 2010, CCMP lowered its bid to $7.60 based on poor February 2010 revenue results, but a few days later agreed to increase its offer to $8.00 per share, which Infogroup accepted.[25] The merger was announced on March 8, 2010. The shareholders approved the merger on June 29, 2010, and the deal closed on July 1, 2010.[26]

The plaintiffs alleged multiple deficiencies in the sale process, including that not all bidders were treated equally, that CCMP's eventual ownership was treated as a foregone conclusion, and that the board failed to investigate alternative offers after CCMP lowered its bid to $7.60.[27] Moreover, Gupta allegedly influenced the sales process by adding and removing potential buyers from the sales contact list, by negotiating with bidders without the board's authorization, and by leaking confidential information to third parties.[28] Finally, the plaintiffs contended that Infogroup was sold for a much lower price than it otherwise might have—the share price was $8.16 per share just prior to the announcement of the merger at $8.00 per share.[29]

The Chancery Court denied Gupta's motion to dismiss the plaintiffs' duty of loyalty claim.[30] The court explained that Gupta, because he was in desperate need of cash, was interested in the sale of Infogroup: "Liquidity has been recognized as a benefit that may lead directors to breach their fiduciary duties."[31] Importantly, the court explained that, although "all of the shareholders received cash in the [m]erger, *liquidity* was a benefit unique to Gupta," since only Gupta, and no one else, faced problems with liquidity because of his large stake in the Infogroup.[32] The court thus concluded that "it is reasonable to infer that Gupta suffered a disabling interest when considering how to cast his vote in connection with

the [m]erger, which would provide him with over $100 million in cash."[33] The court also found that plaintiffs had adequately alleged that the rest of the board was under Gupta's control as a result of Gupta's pattern of threats, intimidation, and bizarre behavior, and as a result were imputed with the Gupta's debilitating conflict in the sale.[34]

In re Answers Corp. Shareholder Litigation

The *Answers* case involved much less extreme circumstances than *Infogroup*, but still saw the plaintiffs' claims of loyalty breaches survive a motion to dismiss—including against clearly independent directors.

Two members of Answers' seven-person board were appointees of Redpoint Ventures, a venture capital fund that owned approximately 30 percent of Answers.[35] The plaintiffs alleged that in early 2010, Redpoint determined that it wanted to monetize its investment in Answers.[36] Because Answers's stock was thinly-traded, the plaintiffs alleged that this exit could effectively only be accomplished by a sale of the company.[37] The Redpoint-affiliated directors put the CEO of Answers in contact with a financial advisory firm and pressed him to seek a buyer for the company. Redpoint also informed the CEO that if a buyer for Answers could not be found, the entire management team (including the CEO) would be replaced.[38]

With the approval of the Answers board, the CEO began negotiations with AFCV Holdings, a portfolio company of the private equity firm Summit Partners, in March 2010.[39] The parties entered into a confidentiality agreement in July 2010.[40] In September 2010, AFCV sent an indication of interest at a price range of $7.50 to $8.25 per share.[41] The market price for the stock at the time was approximately $4.50 per share.[42] Negotiations continued through the fall of 2010. On November 4, AFCV submitted a revised bid of $10 per share and requested exclusivity.[43] Despite the fact that the bid implied a 100 percent premium over the undisturbed market price at the time discussions commenced, Answers did not agree to exclusivity. Negotiations continued, however, and on November 8, AFCV offered the Answers board $10.25 per share for Answers, repeating its request for exclusivity.[44] Answers agreed to proceed to finalize a deal at $10.25 but once again declined to grant exclusivity, offering instead to reimburse AFCV's expenses should the deal fall through.

Having failed to obtain exclusivity, AFCV instead pressed for a quick market check of just two weeks.[45] UBS, which was advising the Answers board, told the board that it believed a market check of only two weeks would not be a "real" market check, particularly in view of the fact that the market check would occur in the middle of the Christmas holiday season.[46] The plaintiffs alleged that the board and AFCV knew that Answers would shortly be reporting favorable results for the fourth quarter, which might push the stock—then trading at over $8—above AFCV's offering price, likely spelling the end of the deal. As a result, the plaintiffs alleged, the board conducted a "quick" market check. None of the 10 companies contacted by UBS expressed interest.[47]

The stock continued to trade above $8 through January and early February, reaching a high of $8.78 per share before the merger (but not the previous quarter's earnings) was announced, and the Company's cash position was improving. Answers' CEO asked AFCV if it could increase its bid. On February 1, 2011, AFCV offered $10.50 per share. The next day the Answers board received an opinion from UBS that $10.50 was a fair price, and approved the deal.[48] A shareholder vote was scheduled for April 12, 2011. On April 8, 2011, Answers received an offer of $13.50 per share from an individual investor. The board determined that there was substantial doubt about the individual investor's ability to finance the proposed transaction and, so, rejected the offer. The board did, however, adjourn the

shareholder meeting for two days in order to allow shareholders time to be informed about the competing $13.50 offer.[49] The merger was ultimately approved by a 3 to 1 margin of shares voted, with just under 60 percent of holders actually voting in favor.

Vice Chancellor Noble denied a pre-closing motion for a preliminary injunction, finding that shareholders had been "adequately" informed. The decision to proceed with the deal, the Vice Chancellor stated, was "a matter for stockholder democracy and, thus, the Court should stand down and let the shareholders decide."[50]

Having lost their bid to enjoin the merger, the plaintiffs pursued post-closing damages claims against both the Answers board and the buyout group. The plaintiffs alleged that the Redpoint's interest in liquidity and the CEO's interest in protecting his job created conflicted loyalties for the CEO and the Redpoint directors, leading them to press for a sharply curtailed market check and the quick consummation of the AFCV deal. The plaintiffs alleged that, had the board run a robust, independent process, shareholders would have received more than the $10.50 per share price in the deal. Finally, in what is perhaps the most questionable part of a questionable decision, the plaintiffs alleged that the buyout group aided and abetted the board's supposed breach of fiduciary duty by pressing for a truncated—and therefore an allegedly inadequate—market check and a quick closing, all while in possession of confidential information about Answers' favorable fourth quarter results.

Defendants later moved to dismiss the claim outright, arguing that the plaintiffs had not stated a claim against any defendant for breach of fiduciary duty. On April 11, 2012, Vice Chancellor Noble denied defendants' motion.[51] The court held that Redpoint's desire for liquidity in an otherwise thinly-traded company was, by iteslf, a "unique interest" that created conflict of loyalty for the directors affiliated with Redpoint.[52] Here, the Vice Chancellor found that the complaint adequately alleged that the Redpoint-affiliated Answers directors "manipulated" the sales process to prefer Redpoint's need for liquidity over the interests of other shareholders of Answers.

The decision to proceed with the deal was "a matter for stockholder democracy."

Remarkably, the court also held that even the "independent" directors (those not affiliated with Redpoint or the CEO), who formed a majority of 4 on a 7-member board, were potentially liable for breach of the duty of good faith and loyalty, notwithstanding their unquestioned disinterestedness. In so holding, the court reasoned that the independent directors "allegedly knew that [the affiliated directors] wanted to end the sales process quickly so that the board would enter into the Merger Agreement before the market price for Answers' stock rose above AFCV's offer price. Nevertheless, they agreed to expedite the sales process."[53] The Vice Chancellor held that this alleged "manipulation" of the sales process came at the expense of Answers' shareholders: "That is a well-pled allegation that those Board members consciously disregarded their duty to seek the highest value reasonably available for Answers' shareholders."[54] The immediate effect of this holding was that the independent directors did not receive the benefit of Section 102(b)(7) of the Delaware General Corporation Law at the pleading stage of the case.

Defendants quickly filed motions to reconsider, arguing that the court had not properly applied the law of fiduciary duty to the plaintiffs' allegations. On July 19, 2012, Vice Chancellor Noble denied Defendants' motion for reconsideration.[55] In denying the motion, the Vice Chancellor focused on the allegations that the directors not affiliated with Redpoint acted in bad faith. The Vice Chancellor reiterated the presumption under Delaware

law that directors act on an informed basis in the good-faith belief that their actions are in the best interest of the company.[56] But he described the decision to hasten the "go shop" and sign a deal in advance of the upcoming (favorable) earnings announcement as "not typical," and therefore sufficient to support a claim for breach of the duty of loyalty.[57]

Going beyond independence and delving into the alleged substance of the directors' decision-making, the Vice Chancellor concluded that the directors' decision-making—in particular, their agreement to a truncated "go shop" that would end before favorable results were to be announced—could not be squared with the directors' duty under *Revlon* to obtain the highest value for shareholders reasonably obtainable, even absent any apparent advantage to, or other ulterior motive on the part of, the independent directors. The Vice Chancellor found that alleged deficiency sufficient to state a claim for breach of the duty of good faith and loyalty. As the Vice Chancellor put it, "[d]irectors can act in bad faith in breach of their duty of loyalty even if there is no whiff of self-dealing from their actions."[58] The Vice Chancellor also distinguished the hurried signing and go-shop from a mere failure to maximize value, concluding that "the well-pled facts of the Complaint suggest that the Board was purposefully trying to do something other than obtain the best price reasonably available for Answers's shareholders in a sale of the Company."[59]

In re Synthes, Inc. Shareholder Litigation

In *Synthes*, Hansjörg Wyss, the founder and recently-retired CEO of Synthes, owned almost 40 percent of the company's stock, but allegedly controlled approximately 52 percent of Synthes' shares through his control of shares owned by family members and trusts.[60] Wyss founded Synthes in the 1970s. But now that he was "well past retirement age," the plaintiffs alleged that he wanted to step down as Chairman of the company and divest his stock holdings in Synthes to "achieve certain estate planning and tax goals."[61] But, as with the major shareholders in *Infogroup* and *Answers*, Wyss "could not liquidate his entire Synthes stake on the public markets without affecting the share price," and so he "needed to sell his personal holdings to a single buyer."[62]

> ***"[D]irectors can act in bad faith in breach of their duty of loyalty even if there is no whiff of self-dealing from their actions."***

In April 2010, the Synthes' board began to discuss the possibility of finding a potential buyer for the company as part of an ongoing review of the company's strategic initiatives.[63] The board appointed an independent director to lead the search for a buyer and hired a financial advisor.[64] Synthes then entered into conversations with four potential buyers that expressed interest, but after some time, only two buyers were truly in contention, the global healthcare manufacturer Johnson & Johnson and a consortium of three private equity funds that were considering a club deal to purchase Synthes.[65] Johnson & Johnson offered a combination of cash and stock for all outstanding shares of Synthes. In contrast, the private equity firms' bid "required Wyss to convert a substantial portion of his equity investment in Synthes into an equity investment in the post-merger company."[66] That is, the bid from the private equity firms "was contingent on Wyss' financing part of the transaction with his own equity stake in order to lower the acquisition cost of an already expensive purchase, and Wyss remaining as a major investor in Synthes."[67] Both bids were priced in Swiss Francs (CHF).

The bid from the private equity firms was for slightly more, CHF 151, compared to Johnson & Johnson's offer of somewhere between CHF 145–150.[68] Moreover, the private equity bid promised all cash to holders except Wyss, compared to the Johnson & Johnson offer of 40 percent cash and

60 percent stock, payable to both Wyss and all other holders.[69] Despite the all-cash offer, the private equity deal faced a substantial financing risk.[70]

After receiving these bids, the Synthes board met to discuss these offers, and weighed the different prices and relative risks. They also allegedly discussed the fact that the bid from the private equity firms would require Wyss to continue to roll much of his equity into the new entity in order to finance the deal.[71] The plaintiffs alleged that Wyss was opposed to this part of the deal because he wanted to cash out with the rest of Synthes' shareholders rather than having a substantial portion of his wealth tied up in a company where he no longer had the same voting clout, "and thus would have an illiquid, private company-bloc with no control or exit power."[72] Wyss allegedly forced the board to cease consideration of the bid from the private equity firms, and from that point on the board exclusively negotiated with Johnson & Johnson.[73] After a series of negotiations, Synthes eventually got Johnson & Johnson to increase its bid to CHF 159, with 65 percent in Johnson & Johnson stock and 35 percent in cash.[74] The Synthes board approved and announced the merger in April 2011, and it was approved by the shareholders nearly eight months later.

The shareholders sued, challenging the good faith of Wyss and the board majority he supposedly controlled. As Chancellor Strine pithily put it, the plaintiffs' basic argument was that "Wyss was a really rich dude who wanted to turn the substantial wealth he had tied up in Synthes into liquid form—and fast," and so, allegedly, had a disabling conflict of interest in the choosing the best future course for the company.[75]

Chancellor Strine called the plaintiff's theory of liability "a chutzpah version" of the "differential consideration" fact-pattern, in which a controlling stockholder used his influence to divert proceeds from the transaction to itself that should have been shared equally with all stockholders.[76] He contrasted this theory with the general presumption that "a fiduciary's financial interest in a transaction as a stockholder (such as receiving liquidity value for her shares) does not establish a disabling conflict of interest when the transaction treats all stockholders equally," as this merger did.[77] Moreover, Chancellor Strine explained, so long as a major shareholder affords the minority *pro rata* treatment, the rule should be that "they know that they have docked within the safe harbor created by the business judgment rule."[78] If the rule were otherwise, and such transactions were subject to entire fairness review anyway, the major shareholder would have no reason not to negotiate a deal on unequal terms, or simply to sell off his share only, leaving the minority shareholders stuck with a depressed stock price.[79]

Chancellor Strine admitted that there may be "very narrow circumstances" wherein a controlling shareholder's liquidity needs might constitute a disabling conflict of interest when all stockholders are treated ratably.[80] But that situation would "have to involve a crisis, fire sale" where the controller who needed to satisfy some exigent need "agreed to a sale of the corporation without any effort to make logical buyers aware of the chance to sell, give them a chance to do due diligence, and to raise the financing necessary to make a bid that would reflect the genuine fair market value of the corporation."[81] Chancellor Strine offered a colorful example to illustrate this unlikely scenario:

> A mogul who needed to address an urgent debt situation at one of his coolest companies (say a sports team or entertainment or fashion business), would sell a smaller, less sexy, but fully solvent and healthy company in a finger snap (say two months) at 75 percent of what could be achieved if the company sought out a wider variety of possible buyers, gave them time to digest non-public information, and put together financing. In

> that circumstance, the controller's personal need for immediate cash to salvage control over the financial tool that allows him to hang with stud athletes, supermodels, hip hop gods, and other pop culture icons, would have been allowed to drive corporate policy at the healthy, boring company and to have it be sold at a price less than fair market value, subjecting the minority to unfairness.[82]

Critically, the complaint in *Synthes* was devoid of any such alleged facts. Wyss was wealthy and had no immediate need for capital. Indeed, the plaintiffs did not allege that he sold any of his stock at any point after stepping down as CEO in 2007 as one might do if they were eager to liquidate.[83] And it was the board, not Wyss, who initiated the idea of looking for strategic alternatives.[84] The acquisition and negotiation process also was deliberate, protracted, did not discriminate against any buyers, and was calculated to extract the highest possible value from Johnson & Johnson.[85] "The plaintiffs' argument that Wyss had somehow become an impatient capitalist is therefore strikingly devoid of well-pled facts to support it."[86]

The plaintiffs also argued that Wyss was conflicted because he had no incentive to accept a deal with the private equity consortium, in which his shares would remain largely tied up in the company rather than being liquid, even if such a deal would supposedly be better for the other shareholders because it was an all cash offer.[87] Chancellor Strine noted, however, that Delaware law requires only equal treatment; there is no requirement for Wyss to be an altruist and enter into a deal that treats minority shareholders better at his expense.[88] Equally unpersuasive to Chancellor Strine was the plaintiffs' argument that Synthes should have continued negotiations with the private equity firms. Those firms could have re-approached Synthes with another, more favorable offer, if they so desired. Synthes was under no obligation to specifically reach out to the firms and inform them that they could continue bidding.[89] There being no sufficient allegation that the Synthes board violated their duty of loyalty, beyond the mere allegation that Wyss was interested in liquidity, Chancellor Strine dismissed the plaintiffs' claims.[90]

Will an Alleged "Liquidity Conflict" Survive a Motion to Dismiss?

When read together, *Infogroup*, *Answers*, and *Synthes*, suggest a general rule for when alleged "liquidity conflicts" may or may not carry a case into discovery, at least in the Delaware Chancery Court. In Delaware, at least, the simple (alleged) fact of a liquidity interest should not, by itself, permit a plaintiff to survive a motion to dismiss. There must be something more—allegations that a large shareholder and its board representatives, consciously and in less than good faith, pursued liquidity to the detriment of the minority shareholders.

The continued protection of the business judgment rule in "liquidity conflict" cases, absent exceptional circumstances, also vindicates two other key interests of Delaware corporate law.

First, and most fundamentally, it maintains the alignment of incentives, encouraging significant shareholders to achieve the greatest value for their shares in a manner that is shared ratably with the minority. Small upticks in price can translate into significant sums for large holders. In the vast majority of such transactions, there is little reason to question the basic understanding that "as the owner of a majority share, the controlling shareholder's interest in maximizing value is directly aligned with that of the minority."[91]

Second, it protects most otherwise non-conflicted transactions from the risk of review under the entire fairness standard. Absent a requirement to plead something beyond a mere interest in liquidity—an interest surely common

to many holders—plaintiffs would be able to exert significant leverage against otherwise fair and desirable transaction. Many significant shareholders, especially in thinly-traded stocks, face the problem confronted by the holders in *Infogroup*, *Answers*, and *Synthes*: They cannot sell without substantially affecting the price of the stock, and so if they wish to monetize their holdings they must do so to a single buyer. Significant shareholders should be able to support transactions that permit them to cash out on equal terms with other shareholders without paying a toll to shareholder plaintiffs in the process. As Chancellor Strine noted in *Synthes*, invoking entire fairness review in every case where it appears that a significant shareholder desires liquidity—that is, in most cases—would be disadvantageous to minority holders because it would give major shareholders little reason not to "sell their control bloc, and leave the minority stuck-in."[92]

Conclusion

Plaintiffs recently have had success in stating loyalty claims based on alleged liquidity conflicts. But cases such as *Infogroup* and *Answers* do not, in our view, suggest that the Chancery Court is now open to allowing any case with a potential liquidity conflict to proceed to discovery, much less to trigger entire fairness review. Nevertheless, prudent boards should be cognizant of the potential for alleged liquidity conflicts when conducting a sale process. Particularly where a non-controlling holder has actual or perceived liquidity needs that may be (or perceived to be) driving a transaction, boards should consider whether a special committee may be appropriate. And even directors who are unaffiliated with a holder that may be alleged to desire liquidity should be aware of the potential for conflict, given that under the *Answers* case, they may potentially be liable for acting in bad faith if they are seen to be permitting a sales process to the advantage of the "conflicted" directors that are primarily interested in liquidity.

Notes

1. *In re El Paso Corp. Shareholder Litig.*, 41 A.3d 432 (Del. Ch. 2012); *In re S. Peru Copper Corp. Shareholder Derivative Litig.*, 30 A.3d 60 (Del. Ch. 2011); *In re Del Monte Foods Co. Shareholders Litig.*, No. 6027-VCL, 2011 WL 2535256 (Del. Ch. June 27, 2011).
2. *Americas Mining Corp. v. Theriault*, No. 29-2012, 2012 WL 4335192, at *42 (Del. Aug. 27, 2012).
3. A very significant catalyst for the recent trend of post-closing damages litigation was the $200 million settlement of litigation arising out of the leveraged buyout of Kinder Morgan in 2006.
4. *In re Cox Commc'ns, Inc.*, 879 A.2d 604, 622 (Del. Ch. 2005).
5. Three recent cases in which such allegations were central have led to full opinions by the Chancery Court. *See In re Synthes, Inc. Shareholder Litig.*, No. 6452, 2012 WL 3641014 (Del. Ch. Aug. 17, 2012); *In re Answers Corp. Shareholder Litig.*, No. 6170, 2012 WL 1253072, at *7 (Del. Ch. Apr. 11, 2012), *affirmed on reh'g*, 2012 WL 3045678 (Del. Ch. July 19, 2012); *N.J. Carpenters Pension Fund v. Infogroup, Inc.*, No. 5334, 2011 WL 4825888 (Del. Ch. Sept. 30, 2011). *See, e.g.*, Complaint at ¶¶ 5, 70, *In re Allos Therapeutics, Inc., Shareholders Litig.* (Del. Ch. Sept. 1, 2011) (No. 6714), 2011 WL 3897077 (alleging that merger was conducted to provide a major shareholder "with a liquid market for its large, otherwise illiquid block of over 26 million shares of Allos common stock"); Complaint at ¶¶ 3, 22, *Jervis v. Shackelton* (Del. Ch. May 16, 2011) (No. 6489), 2011 WL 1870742 ("The Proposed Buyout was designed to provide … liquidity for the Company's largest inside shareholders"); Complaint at ¶ 3, *Young v. ev3, Inc.* (Minn. D. Ct. June 7, 2010), available at *http://tinyurl.com/9udzsdq* ("[T]he Acquisition appears designed to simply provide ev3's largest shareholder, … [which holds] approximately 24 percent of ev3's outstanding common stock, the ability to cash out of its substantial ev3 stock holdings en mass, which it would otherwise not have been able to do on the open market without driving the Company's stock price down significantly.").
6. For example, one study found that 89 percent of a sample of Fortune 500 firms had a greater than 5 percent shareholder. Clifford G. Holderness, *The Myth of Diffuse Ownership in the United States*, 22 Rev. Fin. Stud. 1377, 1378 (2009).
7. *In re Cox Commc'ns, Inc. Shareholders Litig.*, 879 A.2d 604, 617 (Del. Ch. 2005).
8. *In re CompuCom Sys., Inc. Stockholders Litig.*, Civ. A. 499-N, 2005 WL 2481325, at *6 (Del. Ch. Sept. 29, 2005).
9. No. 5334, 2011 WL 4825888 (Del. Ch. Sept. 30, 2011).
10. No. 6170, 2012 WL 1253072 (Del. Ch. Apr. 11, 2012), *reh'd deined*, 2012 WL 3045678 (Del. Ch. Ct. Aug. 17, 2012).
11. No. 6452, 2012 WL 3651014 (Del. Ch. Aug. 17, 2012).
12. Other cases have also found that a shareholders interest in liquidity may create a conflict of interest. For example, in the recent and

well-known *Southern Peru* case, a liquidity conflict played into Chancellor Strine's findings that a special committee was ineffectual in negotiating a transaction involving a controlling shareholder. *See In re S. Peru Copper Corp. Shareholder Derivative Litig.*, 30 A.3d at 86 n.68, 99-101 (deeming special committee's work was ineffectual in part because the committee's chairman represented a minority holder that could not otherwise monetize its investment, but noting a "reluctan[ce] to call a stockholder's desire for liquidity an interest, because there is likely utility in having directors who represent stockholders with a deep financial stake that gives them an incentive to monitor management and controlling stockholders closely"). A liquidity conflicts has also been alleged in a case where a shareholder needed to take cash from one business to put it into another. *See McMullin v. Beran*, 765 A.2d 910, 921-22 (Del. 2000) (finding plaintiff stated breach of duty of care where plaintiff alleged that "ARCO initiated and timed the Transaction to benefit itself because ARCO needed cash to fund the $3.3 billion cash acquisition of Union Texas Petroleum Holdings").

13. *Infogroup*, 2011 WL 4825888, *at* *1-*2.
14. *Id.* at *2; Complaint at ¶¶ 26-30.
15. *Infogroup*, 2011 WL 4825888, at *2-*3.
16. *Id.* at *3.
17. Complaint at ¶ 36.
18. *Infogroup*, 2011 WL 4825888, at *4.
19. Complaint at ¶ 40, 2010 WL 6566617.
20. *Infogroup*, 2011 WL 4825888, at *4.
21. *Id.*
22. *Id.*
23. *Id.* at *5.
24. *Id.*
25. *Id.*
26. *Id.*
27. *Id.* at *6.
28. *Id.*
29. *Id.* at *7.
30. *Id.* at *11.
31. *Id.* at *9 (citing *McMullin*, 765 A.2d at 922-23).
32. *Id.* at *10.
33. *Id.*
34. *Id.* at *11.
35. *Answers*, 2012 WL 1253072, at *1.
36. *Id.*; *see* Complaint at ¶¶ 33, 37.
37. *Answers*, 2012 WL 1253072, at *1.
38. *Id.* at *2.
39. Complaint at ¶ 41.
40. *Id.*
41. *Id.* at ¶ 46.
42. *Answers*, 2012 WL 1253072, at *2.
43. Complaint at ¶ 52.
44. *Id.*
45. Complaint at ¶¶ 56, 59; *see Answers*, 2012 WL 1253072, at *2.
46. *Answers*, 2012 WL 1253072, at *2.
47. *Id.* at *3.
48. *Id.*
49. *Id.*
50. *In re Answers Corp. Shareholders Litig.*, No. 6170, 2011 WL 1366780, at *9 (Del. Ch. Apr. 11, 2011).
51. *Answers*, 2012 WL 1253072, at *10.
52. *Id.* at *7.
53. *Id.* at *8.
54. *Id.*
55. *Id.* at *4.
56. *Id.* at *2.
57. *Id.*
58. *Id.* at *3.
59. *Id.* at *2.
60. *Synthes*, 2012 WL 3641014, at *2.
61. *Id.*
62. *Id.*
63. *Id.*
64. *Id.* at *3.
65. *Id.*
66. *Id.* at *4 (formatting and emphasis omitted).
67. *Id.*
68. *Id.* at *3-*4.
69. *Id.*
70. *Id.* at *4.
71. *Id.*
72. *Id.*
73. *Id.*
74. *Id.* at *4-*5.
75. *Id.* at *9.
76. *Id.* at *8; *see, e.g.*, *In re John Q. Hammons Hotels Inc. Shareholder Litig.*, No. 758-CC, 2009 WL 3165613, at *14 (Del. Ch. Jan. 14, 2011).
77. *Synthes*, 2012 WL 3641014, at *9.
78. *Id.*
79. *Id.*
80. *Id.* at *10.
81. *Id.*
82. *Id.*
83. *Id.*
84. *Id.*
85. *Id.* at *11.

86. *Id.*

87. As Chancellor Strine observed, if Synthes were to instead accept the equity deal offered by the private equity firms, the plaintiffs would have likely sued Wyss since he would be uniquely allowed to roll some of his equity into the new corporation, while the minority shareholders were not. *Id.* at *12 n.80.

88. *Id.* at *12-*13.

89. *Id.* at *13-*14.

90. *Id.* at *17.

91. *In re CompuCom Sys., Inc. Stockholders Litig.*, No. 499-N, 2005 WL 2481325, at *6 (Del. Ch. Sept. 29, 2005).

92. *Answers*, 2012 WL 3641014, at *9.

STATE CORNER

Delaware Chancery Court Dismisses Hastily Filed *Caremark* Case

By Eduardo Gallardo, James Hallowell, Brian M. Lutz, and Jefferson E. Bell

On September 25, 2012, Vice Chancellor Travis Laster of the Court of Chancery of the State of Delaware dismissed the derivative complaint in *South v. Baker*[1] with prejudice. This decision reaffirms the Chancery Court's low tolerance for hastily filed shareholder derivative lawsuits brought under the *In re Caremark International Inc. Derivative Litigation*[2] line of cases where the plaintiff makes little effort to plead any connection between a "corporate trauma" and the conduct of a board of directors. At the same time, the *South* decision also finds that shareholders are entitled to, and should seek, books and records from Delaware corporations before bringing derivative lawsuits in Delaware. Accordingly, Delaware corporations should anticipate an increase in shareholder demands for books and records under Section 220 of the Delaware General Corporation Law in the wake of any "corporate trauma." In addition, the *South* decision found that dismissal of the *South* complaint did not preclude other Hecla shareholders from filing future derivative suits because the *South* plaintiffs did not use Section 220 and, therefore, did not adequately represent Hecla's interests.

The Facts

In 2011, Hecla Mining Company had three unfortunate, but apparently unrelated, safety incidents occur at one of its mining operations in Idaho. The incidents left several miners injured and two dead, and resulted in several negative safety reports from the U.S. Mine Safety and Health Administration (MSHA). In January 2012, Hecla announced that, on orders from the MSHA, it was closing the primary access shaft to the mine to remove debris. The closure was apparently unrelated to the safety incidents of 2011, but in connection with the closure, Hecla lowered its estimated silver production for 2012.

The Hecla announcement and a press release from MSHA regarding safety citations issued to Hecla led to a race to the courthouse. Two federal securities fraud class actions were filed, and thereafter, several derivative actions were filed in Idaho state and federal court. The *South* plaintiffs filed in the Delaware Court of Chancery two months after the Hecla announcement, and, as they later admitted at oral argument before Vice Chancellor Laster, they rushed to court in an attempt to prevent plaintiffs in other jurisdictions from asserting control of the litigation.

The gravamen of the *South* complaint was that the directors of Hecla were liable for any damages that Hecla suffered as a result of the mining incidents because the directors had breached their fiduciary duties by permitting the underlying legal violations to occur. Critically, before filing

Eduardo Gallardo, James Hallowell, and Brian M. Lutz are partners, and Jefferson E. Bell is an associate, at Gibson, Dunn & Crutcher LLP in New York, NY.

suit, the *South* plaintiffs and their counsel did not use Section 220 of the Delaware General Corporation Law, which permits a stockholder to obtain access to books and records of a corporation for a "proper purpose," to investigate what personal involvement, if any, the Hecla directors had with the circumstances that led to the mine incidents. Instead, the *South* plaintiffs premised their claims of director liability only upon Hecla's public announcement and MSHA press releases, which stated that "management" had failed to ensure appropriate safety at the mine.

The Chancery Court Decision

Vice Chancellor Laster found that the *South* plaintiffs did not adequately allege that the directors of Hecla had been involved in conscious wrongdoing. Thus, the plaintiffs failed to satisfy the requirements for bringing a derivative action under *Caremark*, which provides that directors of a corporation may be held liable for knowingly causing or consciously permitting the corporation to violate the law, or for failing to attempt to establish an oversight system to monitor the corporation's legal compliance. The court specifically faulted the plaintiffs for failing to take advantage of the investigative opportunities presented by Section 220 which, unlike public sources alone, may have enabled the plaintiffs to plead a connection between the mining accidents and the Board. Accordingly, the court dismissed the *South* complaint with prejudice.

The court, however, left the door open for other Hecla stockholders to file future derivate complaints, should those complaints prove to be the product of adequate investigation. In doing so, Vice Chancellor Laster articulated an evidentiary presumption that "a plaintiff who files a *Caremark* claim hastily and without using Section 220 or otherwise conducting a meaningful investigation has acted disloyally to the corporation and served instead the interests of the law firm filing suit." Vice Chancellor Laster held further that, in the circumstances of this case, the *South* plaintiffs and their counsel had not presented evidence sufficient to rebut this presumption, particularly since they could establish no adequate reason for failing to use Section 220 before filing suit. As a result, the court held that *Hecla's* interests had not been adequately represented in the *South* suit, and future derivative suits on behalf of Hecla were not precluded.

Practical Implications

The *South* decision raises several important issues for Delaware corporations to consider when litigating shareholder derivative claims under *Caremark* in Delaware. The *South* decision suggests that use of Section 220 is essentially required before a derivative plaintiff may bring suit under Delaware law. Delaware corporations should accordingly expect an uptick in Section 220 demands, which require careful assessment of whether the requesting shareholder has a "proper purpose" for making such a demand, and the appropriate scope of any production under Section 220. These determinations require careful consideration with counsel experienced in Delaware law issues.

(Editor's note: for further discussion of books and records demands under Section 220, see accompanying article in this issue, "Striking the Appropriate Balance: Stockholder Inspection Rights Under Delaware Law.")

Notes

1. C.A. No. 7294-VCL.
2. 698 A.2d 959 (Del. Ch. 1996).

IN THE COURTS

Shocking? Dissident Director Breached the Duty of Loyalty

By Steven M. Haas

In an October 1, 2012, ruling in *Shocking Technologies, Inc. v. Michael*, Vice Chancellor John W. Noble of the Delaware Court of Chancery held that a dissident director breached his fiduciary duty of loyalty by sharing confidential information with a third party and trying to discourage that third party from investing in the company.[1] The court's post-trial ruling came in spite of the director's claim that he acted in good faith and believed his actions would, over the long-term, address certain governance disputes that he had with the other directors. The court agreed that "fair debate" is an important aspect of corporate governance, but it found that he breached his fiduciary duty in light of the serious harm that could have resulted from his actions. The decision thus shows that there are limits on how far a director can go when he or she disagrees with the rest of the board. It also serves as a reminder to stockholders who sit on boards or otherwise have board representation that directors' duties run to all stockholders.

Background

Shocking Technologies involved a dissident director who was the sole board representative of two series of preferred stock. Over time, significant disagreements between the director and the other board members arose over executive compensation and whether there should be increased board representation for the preferred stock. The director argued that the company's governance problems needed to be resolved before it could attract additional equity funding. The director even called a special meeting of the company's stockholders to voice his concerns. The company alleged, however, that these disagreements were pretexts for the director's desire to increase his influence and control over the board at a time when the company faced financial difficulties.

As the disagreements escalated, the dissident director contacted a third party to discourage it from exercising warrants to purchase shares of the company's stock. The director also told the third party that the company was in a dire financial situation, that the third party was the only present source of financing, and that the third party should use this leverage to negotiate for more favorable terms, such as a lower price or board representation. At trial, the director claimed that his efforts were intended to "better the corporate governance structure" of the company and "reduce [the CEO's] domination" of the board.[2]

Court's Opinion

Following the trial, the court held that the dissident director breached his duty of loyalty by (1) trying to dissuade a third-party investment that would have provided much-needed cash to the company and (2) disclosing to that third party confidential information relating to the company's financing alternatives. The director knew the company was in a "precarious cash position" with no alternative source of funding; he also knew that his actions would frustrate the company's objective of "finding enough cash to survive."[3] Thus, because the director knew his

Steven M. Haas is a partner at Hunton & Williams LLP in Richmond, VA.

actions were against the company's best interests, the court ruled that he breached the fiduciary duty of loyalty.

The court noted that stockholders and directors have a right to seek a change in "corporate governance ambiance" and board composition.[4] Presumably, a minority stockholder is subject to few, if any, restrictions in that regard. In contrast, the court stated that "[t]he steps that a *shareholder-director* may take to achieve objectives are not without limits."[5] Even if the director believed he was furthering the company's long-term interests by improving its governance, the court held, "his taking steps that would foreseeably cause significant harm to [the company] amounts to nothing less than a breach of the fiduciary duty of loyalty."[6]

Post-trial adjudications of director liability are not common in Delaware.[7] The court denied the company's request, however, for monetary damages. Among other reasons, the third party exercised its warrant and was not dissuaded by the dissident director from investing in the company. The court also denied the company's request to shift its attorneys' fees to the defendant.

Practical Implications

Board Dialogue and Debate

Shocking Technologies should be considered carefully by directors who are pursuing good faith disagreements with their fellow directors. Board dialogue is a critical aspect of corporate governance. While boards often act with unanimity and collegiality, directors may have significant differences of opinion with respect to issues of corporate governance or strategy. As the court noted, "fair debate may be an important aspect of board performance" and a "board majority may not muzzle a minority board member simply because it does not like what she may be saying."[8] "[A] dissident board member," the court continued, "has significant freedom to challenge the majority's decisions and to share her concerns with other shareholders."[9]

The line between challenging a board majority and breaching one's duties, however, can be seen by the facts of the case. The court rejected the company's argument that the dissident director acted disloyally by airing his governance grievances at the special meeting of the company's stockholders. The court stated that "this is the type of debate that courts are ill-equipped to referee."[10] The dissident went too far, however, when he shared with the third-party investor confidential information about the company's financing needs and alternatives.[11] "[I]nternal disagreement," the court wrote, "will not generally allow a dissident to release confidential corporate information."[12]

Dissident directors, therefore, should tread carefully when they take their dispute outside of the boardroom. In particular, *Shocking Technologies* reflects the general notion that the duty of loyalty includes a duty of confidentiality.[13] The problem is that, in practice, it may not always be clear when the public airing of a director's grievance, as was done at the Shocking Technologies stockholders meeting, crosses the line into an improper disclosure of confidential corporate information. Such issues will be left for future court decisions. For now, practitioners would be wise to remind directors of their duty of confidentiality when dealing with boardroom disagreements. In addition, they should revisit the company's governance guidelines and other board policies with respect to confidentiality.[14]

Boards and practitioners also should take note of the Court of Chancery's recent decision in *Sherwood v. Chan Tze Ngon*.[15] There, a dissident director brought suit after the board decided not to renominate him for election at the company's annual meeting. The court found that the plaintiff had alleged colorable disclosure claims against the company where the proxy statement suggested that the director's "questionable and

disruptive personal behavior was the *only* reason that motivated the board to remove him from the Company's slate."[16] The court explained that, while civility is a laudable goal, "it is also important that directors be able to register effective dissent." It continued that "[a] reasonable shareholder likely would perceive a material difference between, on the one hand, an unscrupulous, stubborn and belligerent director as implied by the Proxy Supplement and, on the other hand, a zealous advocate of a policy position who may go to tactless extremes on occasion."[17]

"Short-Term Pain for Long-Term Gain"

The court recognized that some director actions could have adverse short-term consequences in the pursuit of long-term corporate benefits. As a result, it suggested a balancing act in which such actions are reviewed on a continuum that takes into account the potential harm and benefit to the company. *Shocking Technologies*, however, involved a clear-cut case of improper conduct in which the director's actions "could have caused the demise" of the company.[18] In addition, the director's disclosure of confidential information to a potential investor was to "the substantial detriment of the Company" and thus "conduct which, in and of itself, is a breach of the duty of loyalty."[19] "That there may be some theoretical improvement in 'corporate governance,'" the court reasoned, "does not alter this conclusion."[20]

Unintentional Breach of the Duty of Loyalty

As a doctrinal matter, the court concluded that the director breached his fiduciary duty of loyalty even if he had legitimate goals. Typically, the duty of loyalty is viewed as a prohibition against certain kinds of self-dealing and a requirement to act in good faith. In this case, there was no self-dealing in the classic sense, and the dissident (who also was a significant stockholder) claimed to be acting in subjective good faith. There are a small number of Delaware cases, however, in which the courts have held that directors can unintentionally violate the duty of loyalty.[21] These cases are important because directors cannot be exculpated from liability for a breach of the duty of loyalty.

Directors' Duties Run to All Stockholders

Finally, *Shocking Technologies* is a reminder to directors who are elected by or represent a particular stockholder or class or series of stock that their fiduciary duties run to all stockholders. This is particularly important for large stockholders who serve on boards and for private equity and venture capital firms that designate principals to serve on the boards of their portfolio companies.

Generally speaking, a stockholder is free to act in its own self-interest. When that stockholder serves or is represented on the board, however, experience shows that it can be difficult to separate the two roles. For example, in *Schoon v. Troy Corp.*, the court found that a director did not have a proper purpose for inspecting the company's books and records where the request was "made in consultation with and at the direction of" the stockholder that appointed him.[22] The director's request was found to be improper because it allegedly was made to help sell the stockholder's shares—a purpose which typically is proper when made by a stockholder.[23] Another conflict of interest was present in *In re Trados Inc. S'holder Litig.*, where the court refused to dismiss breach of loyalty claims against a board of directors in approving a merger.[24] There, a majority of the directors were affiliated with preferred stockholders that benefitted from the merger, while common stockholders received nothing.

In *Shocking Technologies*, the dissident director's belief that the holders of the preferred shares with which he was affiliated deserved greater board representation did not justify his actions. The court held that, "[i]n short, a loyal director does not put the company in dire financial

circumstances in order to obtain what he perceives as a benefit for himself and his associated investors."[25] Directors with dual relationships need to be sensitive to their duties. In some situations, a director may need to be "walled off" from his or her affiliated stockholder or recuse himself or herself from the board's deliberations.

Notes

1. *Shocking Techs., Inc. v. Kosowsky*, 2012 Del. Ch. LEXIS 224 (Sept. 28, 2012) (Noble, V.C.).
2. *Id.* at *28.
3. *Id.* at *30.
4. *Id.* at *31.
5. *Id.* at *31 (emphasis added).
6. *Id.* at *33.
7. *See generally* J. Travis Laster & Steven M. Haas, Delaware Courts Impose Liability on Disloyal Directors, *Insights*, July 2006 at 21.
8. *Id.* at *37.
9. *Id.* at *37-38.
10. *Id.* at *19; *see also id.* ("They may reflect an attitude or an agenda, but, by themselves, they will rarely demonstrate a breach of the fiduciary duty of loyalty.").
11. Stephen Bainbridge, "If a director disagrees with the board's decisions, how far can he go in opposing it?," available at *http://www.professorbainbridge.com/professorbainbridgecom/2012/10/if-a-director-disagrees-with-the-boards-decisions-how-far-can-he-go-in-opposing-it.html#tp* (Oct. 10, 2012). *See also id.* (stating that "[t]he harder case would be, for example, a director who goes to the press to bad mouth the organization and his fellow directors").
12. *Shocking Techs.*, 2012 Del. Ch. LEXIS at *38.
13. *See Hollinger Int'l, Inc. v. Black*, 844 A.2d 1022 (Del. Ch. 2004); *see also Disney v. The Walt Disney Co.*, 2005 Del. Ch. LEXIS 94 (June 20, 2005) (referring to the company's confidentiality policy).
14. In *Disney*, which involved a determination of which materials were "confidential" in the context of a books and records inspection, the court observed: "The confidential nature of these documents is evidenced by the Company's written confidentiality policy that bars present and former directors from disclosing information entrusted to them by reason of their positions, and includes a prohibition on the disclosure of "non-public information about discussions and deliberations" of the board. Messrs. Disney and Gold participated as board members in the approval of this confidentiality policy and appear to be bound by it.… By adopting this policy, the board has recognized the necessity of keeping the thoughts, opinions, and deliberations of its members confidential. This board policy deserves significant weight." *Disney*, 2005 Del. Ch. LEXIS at *11.
15. *See Sherwood v. Chan Tze Ngon*, 2011 Del. Ch. LEXIS 202 (Dec. 20, 2011).
16. *Id.* at *25.
17. *Id.* at *26.
18. *Shocking Techs.*, 2012 Del. Ch. LEXIS at *33.
19. *Id.* at *34.
20. *Id.* at *34.
21. *See, e.g., Blasius Indus., Inc. v. Atlas*, 564 A.2d 651 (Del. Ch. 1988); *Johnston v. Pedersen*, 28 A.3d 1079 (Del. Ch. 2011).
22. *Schoon v. Troy Corp.*, 2006 Del. Ch. LEXIS 123, *4 (June 27, 2006).
23. *See id.* at *8; *accord CM&M Group, Inc. v. Carroll*, 453 A.2d 788, 793 (Del. 1982).
24. *In re Trados Inc. S'holder Litig.*, 2009 Del. Ch. LEXIS 128 (July 24, 2009); *see also Agranoff v. Miller*, 1999 Del. Ch. LEXIS 78 (Apr. 12, 1999) (finding that director improperly shared corporate information with a third party); *Endervelt v. Nostalgia Network, Inc.*, 1991 Del. Ch. LEXIS 131, *11 (July 23, 1991) (stating that a director-shareholder could be liable for "secur[ing] a better deal for himself alone on the basis of confidential corporate information). *See generally* Steven M. Haas, *Preferring Preferred Stockholders in M&A Transactions*, INSIGHTS, Sept. 2009 at 26.
25. *Shocking Techs.*, 2012 Del. Ch. LEXIS at *34.

CLIENT MEMOS

A summary of recent memoranda that law firms have provided to their clients and other interested persons concerning legal developments. Firms are invited to submit their memoranda to the editor. Persons wishing to obtain copies of the listed memoranda should contact the firms directly.

Cleary, Gottlieb, Steen & Hamilton LLP
New York, NY (212-225-2000)

Guide to Public ADR Offerings in the United States (October 1, 2012)

A discussion of the requirements applicable to American Depository Shares and American Depository Receipts through which the shares of many foreign corporations are traded in the US.

Davis Polk & Wardwell LLP
New York, NY (212-450-4000)

OCIE Staff Report on Broker-Dealer Information Barrier Practices (October 9, 2012)

A discussion of a report issued by the SEC's Office of Compliance Inspections and Examinations on the results of examinations by the SEC, Financial Industry Regulatory Authority, Inc. (FINRA), and NYSE of 19 broker-dealers focusing on controls around the misuse of material nonpublic information and information barriers under Section 15(g) of the Securities Exchange Act of 1934 (Exchange Act). The report identifies specific gaps in oversight that it observed, as well as practices at some firms that it believed were effective.

Implementing the SEC's Final Conflict Mineral Rules: Guidelines and Commonly Asked Questions (October 26, 2012)

A discussion of interpretive issues arising from the SEC's conflict minerals rules.

Gibson, Dunn & Crutcher LLP
Los Angeles, CA (213-329-7870)

JOBS Act: FINRA Proposes Rule Changes Relating to Research Analysts and Underwriters (October 11, 2012)

A discussion of proposed changes to NASD Rule 2711 filed by the FINRA with the SEC. The changes are designed to conform the rule to the requirements of the JOBS Act and address the participation of research analysts in certain emerging growth companies initial public offering pitch meetings.

UK Serious Fraud Office Revises Guidance on Facilitation Payments and Corporate Hospitality under the Bribery Act, and on Self-Reporting of Misconduct (October 11, 2012)

A discussion of revised guidance issued by the U.K. Serious Fraud Office relating to facilitation payments, corporate hospitality and self-reporting under the Bribery Act.

New EU Short Selling Regulation (October 13, 2012)

A discussion of a new regulation on short selling and certain credit default swaps adopted by the European Union. In addition, it discusses the European Securities and Markets Authority Q&As related to the regulation. Together, they create an EU-wide framework for the coordinated regulation of short-selling.

Hogan Lovells US LLP
Washington, DC (202-637-5600)

SEC Staff Updates Guidance on Shareholder Proposals (October 31, 2012)

A discussion of SEC Staff Legal Bulletin No. 14G issued by the Division of Corporation Finance. It addresses interpretive issues under Rule 14a-8, the shareholder proposal rule. It provides clarification with respect to the required proof of ownership and the use of websites in proposals and supporting statements.

Linklaters LLP
New York, NY 10105 (212-903-9000)

BIS Waters Down Proposals on Splitting Annual Reports (November 2012)

A discussion of draft regulations published by the U.K. Department of Business, Innovation and Skills that will require the current business review to be separated out from the rest of the directors' report.

Mayer Brown LLP
Chicago, IL (312-782-0600)

Changes to European Prospectus Rules Offer to Asia-Based Issuers (October 31, 2012)

A discussion of recent amendments to the European prospectus rules that may make the operation of certain employee stock plans in Europe, by multinationals listed outside of Europe, cheaper and more straightforward.

Morgan, Lewis & Bockius LLP
Philadelphia, PA (215-963-5000)

NYSE and NASDAQ Proposed Compensation Committee and Advisers Independence Rules (October 31, 2012)

A discussion of proposed amendments to the corporate governance listing standards filed by the New York Stock Exchange and NASDAQ Stock Market with the SEC. The amendments relate to compensation committee and adviser independence, as directed by SEC rules adopted to implement Section 952 of the Dodd-Frank Act.

Morrison & Foerster LLP
New York, NY (212-468-8000)

More SEC Guidance on Title I of the JOBS Act (October 9, 2012)

A discussion of guidance issued by the staff of the SEC Division of Corporation Finance in the form of updated FAQs to address a number of issues regarding the applicability of the provisions of the JOBS Act to merger and spin-off transactions.

Perkins Coie LLP
Seattle, WA (206-359-8000)

Perils of the Global Supply Chain, Part 2: Supply Chain Responsibility, or Else (October 25, 2012)

A discussion of the growing importance of reporting on corporate social responsibility (CSR) and the CSR risks that companies' supply chains expose them to.

Weil Gotshal & Manges, LLP
New York, NY (213-310-8000)

The 10b-5 Guide—A Survey of 2010-2011 Securities Fraud Litigation (September 2012)

A survey of 2010-2011 securities fraud litigation.

INSIGHTS
THE CORPORATE & SECURITIES LAW ADVISOR

Editor-in-Chief
Amy L. Goodman
Gibson, Dunn & Crutcher, LLP
1050 Connecticut Ave., NW
Washington, DC 20036—5306
(phone) 202-955-8653
(fax) 202-467-0539
agoodman@gibsondunn.com

EDITORIAL OFFICE
76 Ninth Avenue
New York, NY 10011
212-771-0600

Aspen Publishers
Doreen Meinck, Managing Editor, Securities
Betsey Cohen, Managing Editor

Wolters Kluwer
Law & Business

Aspen Publishers
Insights
Distribution Center
7201 McKinney Circle
Frederick, MD 21704

TIMELY REPORT
Please Expedite

November/ 9900600270