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Locke Lord QuickStudy: Two Recent Delaware Decisions Provide Practical Transaction Guidance

WRITTEN BY

Stanley Keller

Two year-end decisions by the Delaware Court of Chancery provide practical guidance for mergers and other transactions, one on the meaning of "commercially reasonable efforts" and other commonly used standards of efforts and the other on the effectiveness of corporate authorizing action.

Standards of Efforts

In *Himawan v. Cephalon, Inc.*,[1] the court, in addressing at the pleading stage a dispute over an earnout in a merger transaction, catalogued the Delaware cases dealing with the "commercially reasonable efforts" and similar standards for conduct in "efforts clauses." The court's holding was to deny a motion to dismiss plaintiff-seller's claim that defendant-buyer failed to use "commercially reasonable efforts," as required by, and "inartfully" defined in, the merger agreement.

Among the decisions identified by the court were *Williams Companies, Inc. v. Energy Transfer Equity L.P.*[2] involving whether the defendant used "reasonable best efforts" and "commercially reasonable efforts" to satisfy a failed closing condition for a tax opinion, and *Akorn, Inc. v. Fresenius Kabi AG*[3] involving upholding termination of a merger agreement for, among other things, failure to exercise "commercially reasonable effort" or "reasonable best efforts."[4] The court noted that the decisions catalogued were at various stages in the proceeding and that the meaning of the standard used will depend on the context of the obligation, such as efforts to satisfy conditions to complete a transaction, to meet performance covenants pre-closing and to operate on a discretionary business basis post-closing.

Parties to transaction agreements often contend with the standard to provide for efforts required to perform obligations. This decision is a resource for understanding how the Delaware courts will apply alternative efforts clauses. Although deal practitioners have often approached the alternatives of "best efforts," "reasonable best efforts," "reasonable efforts," "commercially reasonable efforts," and "good faith efforts" as a hierarchy to be finely parsed, the Delaware courts have sensibly recognized that words do not have the precision of numbers and have declined to make these fine distinctions. Specifically, in *Williams*, as noted in *Akorn*, the Delaware Supreme Court chose not to distinguish between "commercially reasonable efforts" and "reasonable best efforts." Both standards required taking all reasonable steps to consummate the transaction, or in *Akorn*, to take all reasonable steps to maintain its operations in the ordinary course of business.

Effectiveness of Consents

In *Brown v. Kellar*,[5] the court addressed the effectiveness of stockholder consents under §228 of the Delaware General Corporation Law when notice of a non-unanimous consent has not been given to non-consenting stockholders as required by §228(e). This can be an issue in the approval of a merger or other fundamental transaction. It also arises in connection with a corporate control dispute, which was the context of this decision in a proceeding to determine the composition of the board of directors.[6] The court held that the consent is effective upon its delivery to the corporation and thus the action is taken immediately upon delivery of the requisite consents. The court determined that the notice to non-consenting stockholders is not a condition to the corporate action but rather an additional obligation.[7] The court did note that even though the consent action is legally effective there can be unique circumstances in which the delay in giving the required notice will be a basis for a court declining to give effect to the action, at least until the notice is given.[8] This case did not present those circumstances.

The court then addressed whether the failure to give the 20 day notice required by Rule 14c-2 of the Securities and Exchange Commission's proxy rules prevented the consent action from being effective.[9] The court held that the 14c-2 notice was an independent requirement that did not affect the effectiveness of the consents under Delaware law.

The effectiveness of a stockholder consent before the required notices under §228 and Rule 14c-2 were given to other stockholders was a critical issue in the battle for control of CBS. In that situation, the controlling stockholder sought with a bylaw amendment to defuse action taken by independent directors to dilute that stockholder's voting control.[10] Although that issue was not resolved as a result of the settlement that was reached, it has now been answered by the Court of Chancery in this decision. While providing the requisite notices is still the correct way to proceed, the holding of the court in this case offers a basis for proceeding with the action before notices are given when there is a need to do so.

1 C.A. No. 2018-0075-SG (Del. Ch. Dec. 28, 2018), available here.

2 159 A. 3d 264 (Del. 2017).

3 2018 WL 4719347 (Del. Ch. Oct. 1, 2018); aff'd 2018 WL 6427137 (Del. Dec. 7, 2018).

4 The *Akorn* decision is best known for upholding termination of the merger agreement on the basis of a "material adverse change" affecting the target company.

5 C.A. No. 2018-0687-MTZ (Del. Ch. Dec. 21, 2018), available here.

office. The decision addressed a number of issues regarding the scope of §225 proceedings.
7 The notice required by §228(e) was not given because the corporation declined to give it and the consenting stockholders, as outsiders, were not in a position to give it.
8 The court cited as an example *DiLoreto v. Tiber Holding Corp.*, 1999 WL 1261450 (Del. Ch. June 29, 1999), where the corporation delayed notice to non-consenting stockholders for months even though the action taken was relevant to litigation involving minority non-consenting stockholders.

9 Although the corporation filed a preliminary information statement with the SEC, it refused to send it to stockholders to comply with Rule 14c-2 because it claimed that

filings by the consenting stockholders made the information statement misleading.

10 *See CBS Corporation v. National Amusements, Inc.*, 2018 WL 2263385 (Del. Ch. May 17, 2018) (denying plaintiff's motion for temporary restraining order), and *In re CBS Corporation Litigation*, Consol. C.A. No. 2018-0342-AGB (July 13, 2018) (addressing document production issues).

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