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Market Practice Needs to Check Itself" – A Reminder from the Court of Chancery that M&A Practitioners Must Strictly Abide by Statutory Requirements When Approving Mergers

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In *Sjunde AP-Fonden v. Activision Blizzard, Inc.*, the Delaware Court of Chancery refused to dismiss claims against Activision Blizzard, Inc. (the company) and its board of directors (the board) that the board had violated, among other things, Section 251(b) of the Delaware General Corporation Law (the DGCL) by approving an incomplete merger agreement in connection with the company's acquisition by Microsoft Corporation (Microsoft). The court's ruling upends public company M&A market practice and highlights the importance of strictly complying with the DGCL, especially as it relates to mergers. Specifically, unless and until further clarification is provided by the Delaware courts or legislature, practitioners should assume that a merger agreement must be presented to a target board of directors in "execution version" to be compliant with Section 251(b) and to avoid any uncertainty related to the validity of the merger process. Practitioners must also closely follow the linear sequence provided for in Section 251. First, the board must approve the execution version of the merger agreement. Second, the agreement, "so adopted," must be signed by an authorized person. Third, the signed agreement must be submitted to the stockholders for a vote.

Background

On January 17, 2022, the board approved a merger agreement pursuant to which Microsoft would acquire the company. The merger agreement that was presented to the board did not contain the company disclosure letter, the disclosure schedules, the surviving corporation's charter, the amount of consideration, the name of the target, or certain interim restrictions on dividend payments. The board also delegated authority to a committee of the board to negotiate the provision covering those interim restrictions on dividend payments. On March 21, 2022, the company filed a proxy statement to seek stockholder approval of the merger. The proxy statement contained a version of the merger agreement attached as an annex and a brief description of the merger agreement. This version of the merger agreement did not include the surviving corporation's charter, the disclosure letter, the disclosure schedules, and an additional notice containing a summary of the merger agreement was not provided. On November 3, 2022, a company stockholder filed suit against the company and the board, claiming that the board violated Section 251(b) of the DGCL because it had approved an incomplete draft version of the merger agreement. Under the stockholder's interpretation of the statute, a board must approve an execution version (*i.e.*, final version) of a merger agreement to be compliant. The stockholder also argued that, in providing notice of the stockholder meeting, the company did not satisfy the requirements of Section 251(c) of the DGCL, which requires that the notice to be sent to stockholders concerning the merger contain the merger agreement or a brief summary of the agreement. Finally, the stockholder argued that the board violated Section 141(c)(2) of the DGCL in delegating negotiations over the company's ability to make dividends during the interim period to a board committee because, under that section, a committee does not have power to approve any terms of a merger.

Analysis

The court held that it was reasonably conceivable that the board failed to approve the merger agreement in compliance with Section 251(b) of the DGCL. The court also rejected the company and board's policy-based arguments that highlighted the common market practice involving the approval of a merger agreement in draft or near-draft form, including disclosure schedules. In so doing, the court did not find it necessary to rule on whether Section 251(b) of the DGCL requires an "execution version" of the merger agreement to be approved, but even construing the statute as requiring an "essentially complete" version of the merger agreement, the merger agreement in the case before it "inferably crossed it" by omitting key terms such as the consideration, the disclosure letter, and the dividend restriction provision. In the words of the court, Section 251(b) of the DGCL "does not say that the board can get away with approving the gist of the merger" and that "[w]here market practice exceeds the generous bounds of private ordering afforded by the DGCL, then market practice needs to check itself."

The court also refused to dismiss the stockholder's Section 251(c) claim, holding that it was reasonably conceivable that the company failed to comply with Section 251(c) of the DGCL because the version of the merger agreement that was attached to the formal notice did not include the surviving corporation's charter as required by the statute. Additionally, according to the court, while the summary of the merger agreement was included in the proxy statement, the summary was not included in the formal notice itself.

Finally, the court refused to dismiss the stockholder's Section 141(c) claim, holding that it was reasonably conceivable that the board violated the statute when it impermissibly delegated the negotiation of the dividend restriction provision to the committee because that section does not permit a committee to approve the terms of a merger.

Takeaways

- Because of the "unique status [of mergers] within the DGCL," strict compliance with Section 251 of the DGCL is necessary.

- Unless and until the decision is appealed or the statute is amended, practitioners should assume that a merger agreement must be presented to a target board of directors in "execution version" to be compliant with Section 251(b) and to avoid any uncertainty related to the validity of the merger process.

- In addition, the board of directors must follow the linear sequence provided for in Section 251. The board must first approve the execution version of the merger agreement. Then, and only then, the agreement, "so adopted," must be signed by an authorized person. Finally, the adopted and signed agreement must be submitted to the stockholders for a vote.

- In the wake of the court's decision, targets, their boards of directors, and their counsel who may have already undertaken a faulty merger process and are in the midst of an interim period of a transaction, may seek to reapprove the final version of the merger agreement, together with all exhibits and disclosure schedules, to the extent an incomplete version of the merger agreement was previously approved. Finally, boards of directors may seek to have their counsel prepare ratifying resolutions under Section 204 of the DGCL to retroactively ratify the approval of an incomplete merger agreement as a defective corporate act.

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