MERGERS & ACQUISITIONS CASE LAW UPDATE

June 2019

*By the Mergers and Acquisitions Committee, State Bar of Texas Business Law Section**

TEXAS MERGERS & ACQUISITIONS LITIGATION

Houston's Fourteenth Court of Appeals Considers Merger Documentation as Evidence of Promissory Note Ownership

On August 22, 2008, the president of Progressive Trade Enterprises signed a promissory note for $132,371.83 in favor of Sterling Bank. Progressive made no payments on the note and Sterling Bank merged with Comerica Bank in 2011. Because no payments were made, Comerica filed suit against Progressive in 2014. At trial, Comerica did not present the original note, but instead used a copy of it. Progressive moved for a directed verdict arguing the plaintiffs had no reason not to show the original note, and without it, Comerica could not establish that they were the present owners. The trial court granted Progressive's motion and Comerica appealed.

On appeal, the appellate court held that Comerica was entitled to recover on the promissory note. The court found that Comerica established that it was the present owner of the note because of the combination of the identical copy of the note from Progressive, the testimony of Comerica's vice president, and the evidence of the merger with Sterling. Because of the merger, all of Sterling's rights, titles and interests to property (including the note) vested in the surviving entity.

[Comerica Bank v. Progressive Trade Enters., 544 S.W.3d 459 (Tex. App. 2018)]

Austin's Third Court of Appeals Holds that Foreign LLC's Signing of Acquisition Letter of Intent with Texas LLC is Insufficient to Establish Personal Jurisdiction in Texas

WaterWorks Corral Creek, LLC and Saltwater Disposal Systems LLC (collectively, "WaterWorks") signed a letter of intent with Aqua Tech Water Disposal ("AquaTech") so that AquaTech could potentially acquire Waterworks' saltwater disposal wells. WaterWorks eventually sold the wells to another entity, and AquaTech sued Waterworks based on a non-circumvention provision in the letter of intent, claiming breach of contract, tortious interference with existing contract, tortious interference with prospective business relationship and civil conspiracy.

WaterWorks and Saltwater Disposal are both North Dakota LLCs, with all of their substantive assets located in North Dakota and some books and records located in Ohio and Florida. AquaTech is a Texas limited liability company and sued Waterworks in Texas. Waterworks made a special appearance to deny jurisdiction. The trial court denied the special appearance, but the appellate court found that Waterworks

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had no contacts with Texas other than entering into a letter of intent with a Texas entity, which was not enough by itself to impose jurisdiction over an out of state defendant.

[WaterWorks Corral Creek, LLC v. AquaTech Saltwater Disposal LLC, No. 03–16–00309–CV, 2018 Tex. App. LEXIS 1363 (Tex. App. 2018)]

DELAWARE MERGERS & ACQUISITIONS LITIGATION

Delaware Court of Chancery Rules Section 220 Complaint Survives *Corwin* Defense asserted by Acquiror

In light of Tesla Corporation's acquisition of the unsustainably leveraged SolarCity Corporation, shareholders filed suit against Tesla Corporation's board of directors and CEO Elon Musk on the grounds of breach of fiduciary duty and breach of duty of loyalty, among others. The Plaintiff-shareholders had previously invoked Section 220 of the Delaware General Corporation Law, which is a statute used by shareholders to request Tesla's company books and records. These books and records were then used by Plaintiff-shareholders to successfully file a suit and plead that Elon Musk, the single largest shareholder of and director of Tesla, exercised control over the company such that a *Corwin* defense could not be a defense asserted by Defendants Tesla and Musk.

Under the *Corwin* defense doctrine, once a merger or acquisition has been approved by a majority of fully informed and uncoerced shareholders, the merger or acquisition must be reviewed under the business judgment rule, which makes it significantly easier for corporations, executives, and board directors to obtain dismissals of lawsuits. In this case, a majority of Tesla shareholders approved the acquisition of SolarCity before this suit was filed, which would normally invoke the *Corwin* defense and the business judgment rule therein. However, Delaware Vice Chancellor Slights ruled that a *Corwin* defense was premature in a books-and-records action brought by Plaintiff-shareholders under Section 220 of the Delaware General Corporation Law. As such, Plaintiff-shareholders' claims circumvented the *Corwin* defense which corporations, executives, and board directors have consistently and successfully used in recent years to obtain dismissals in shareholder suits. [In re Tesla Motors, Inc. Stockholder Litigation, C.A. No. 12711-VCS]

[In re Tesla Motors, Inc. Stockholder Litigation, C.A. No. 12711-VCS]

Delaware Court of Chancery Again Rules Section 220 Complaint Survives *Corwin* Defense asserted by Seller

West Corporation agreed to be acquired by Apollo Global Management. Plaintiff Lavin was a shareholder of West and after unsuccessfully making a Section 220 claim to West for company books and records, filed suit against the same asserting breach of fiduciary duty. It was Plaintiff-shareholder's opinion that West and its directors, for self-interested reasons, favored a less valuable sale of West in its entirety over more valuable separate sales of each of its products and business segments. West's main argument was to invoke the *Corwin* defense because the acquisition had already been approved by a disinterested, fully informed stockholder vote, thereby limiting any post-closing challenges for mismanagement, waste, or wrongdoing by West and its directors.

Similar to his ruling in *In re Tesla*, Delaware Vice Chancellor Slights ruled that the *Corwin* defense did not apply because Plaintiff had previously asserted a Section 220 claim for West's books and records, regardless of whether Plaintiff was successful in doing so. Chancellor Slights also ruled that Plaintiff-shareholder was not required to prove any mismanagement, waste, or wrongdoing as a prerequisite to obtaining West's company books and records.

[Mark Lavin v. West Corporation., C.A. No. 2017-0547-JRS]

Injunction Suits Have Become More Popular in M&A

Fujifilm Holdings Corporation was in negotiations with Xerox Corporation to acquire a 50.1% controlling interest in Xerox. Plaintiffs Carl Icahn and Darwin Deason, among others, filed an injunction in New York Supreme Court to enjoin the proposed acquisition and to waive Xerox's advance notice bylaw, which requires that Plaintiff-shareholders propose a new slate of directors for election prior to Xerox's annual shareholders' meeting in which the shareholder vote on the acquisition was scheduled to take place. Then-CEO Jeff Jacobson, under significant pressure by shareholders and under significant risk of being relieved of his duties, conspired secretly with Fujifilms to undermine Xerox's board of directors, execute the acquisition, and remain as CEO after closing. Since the deal significantly undervalued Xerox and deprived shareholders of market-value premiums, Plaintiff-shareholders filed an injunction suit despite its lack of popularity and success in corporate litigation in recent years. New York Supreme Court Justice Ostrager ruled that the business judgment rule in this context did not serve to protect Xerox, its CEO, and its directors because there was overwhelming evidence of bad faith and self-dealing. The injunction was granted on both grounds such that Plaintiff-shareholders were allowed additional time ahead of the shareholder vote on the acquisition to propose a new slate of directors.

[In re Xerox Corporation Consolidated Shareholder Litigation, Index No. 650766/18]

Board Approval Does Not Absolve Breach of Fiduciary Claims Against Executives and Standard for Aiding & Abetting Claims

Xura, Inc., was in ongoing negotiations with Siris Capital Group, LLC, a private equity buyer, for the purchase of Xura. Plaintiff Obsidian Management, LLC, was a former minority Xura shareholder which sued Defendants Philippe Tartavull, then-CEO of Xura, and Siris on the grounds of breach of fiduciary duty and aiding and abetting. In the midst of clear indications from the board that his employment would be terminated if the sale did not close, the CEO engaged in clandestine negotiations with Siris for an undervalued sale without approval from the board. The CEO and Siris engaged in a concerted effort to exclude the board and the board's outside legal and financial advisors from the negotiations altogether.

The Delaware Chancery Court rejected Defendants' *Corwin* defense on the grounds that the shareholder vote was uninformed. Specifically, Vice Chancellor Slights ruled that the shareholders could not have been fully informed in light of the clandestine negotiations conducted without knowledge of the board and the board's little-known decision to remove the CEO. Tartavull then argued that his alleged breach of fiduciary duty was absolved because the board ultimately voted in favor of the sale. However, the court disagreed and ruled that a non-exculpated breach by the board in failing to supervise the CEO is not a precondition to claims against the CEO. The court went a step further to make a distinction between boards that place the entire process of M&A in the hands of the CEO and chairman without instilling any safeguards and boards that had safeguards in place but remained uninformed and unable to approve a deal that they did not know existed. In the former, boards can be held liable for a breach of fiduciary duty along with the executives.

Vice Chancellor Slights also expounded on the standard Plaintiffs must meet in order to well-plead an aiding and abetting claim. In order to plead a defendant, who is not a fiduciary, knowingly participated in the breach with a fiduciary, the Plaintiff must plead that the non-fiduciary was cognizant of "what the alleged conflict is and what it is not." The court ultimately ruled that Siris was only aware that the CEO sought to unilaterally facilitate a sale, without board approval; it was not aware that the CEO facilitated the sale *because* the CEO was going to lose his employment and any post-closing compensation. As such, aiding and abetting claims against Siris were dismissed.

[In re Xura, Inc., C.A. No. 12698-VCS]

Delaware Court of Chancery Denies *Corwin* Defense During Restatement Process

In the midst of an involuntary delistment from the NASDAQ and a restatement of financial reporting mandated by the SEC, the Defendant-directors of Tangoe, Inc., approved a sale of the company for a negative premium far less than the value prior to the delistment and restatement process. Because SEC rules did not permit lucrative director awards and compensation so long as the restatement process persisted, the directors promptly facilitated an ill-advised sale of Tangoe to a buyer indifferent to the restatement process. Plaintiff-shareholder filed a lawsuit claiming a breach of fiduciary duty, for which the directors filed a motion to dismiss on the grounds of an (i) exculpatory provision in Tangoe's bylaws and (ii) *Corwin* defense. A *Corwin* defense allows for the business judgment deference, a significantly less stringent burden, for Defendant corporations, directors and officers as long as the merger or acquisition was approved by a fully informed, uncoerced shareholder vote. Such a defense, if sufficiently pled, normally leads to courts granting motions for dismissal.

Delaware Vice Chancellor Slights dismissed the *Corwin* defense, stating that a shareholders' approval is insufficient if it is not fully informed and as such Tangoe was not entitled to the business judgment deference. Specifically, Tangoe failed to provide shareholders with audited financials and a timeline for the completion of the SEC-mandated restatement process. Furthermore, in the event of an exculpatory provision, the Plaintiff must well-plead a breach of loyalty against *each* individual director. Soon after the delistment, every director proceeded to ignore non-compliance letters from the NASDAQ and SEC and approved director awards vesting on an accelerated basis upon the sale of Tangoe. The court found the timing of these actions sufficient in determining the directors' shift from relistment and restatement to an ill-advised sale of Tangoe at a value far less than the initial offer for purely self-interested reasons.

[In re Tangoe, Inc. Stockholders Litigation, C.A. No. 2017-0650-JRS]