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Ninth Circuit creates circuit split for Section 14(e) claims regarding tender offers

By William K. Pao, Esq., Jonathan Rosenberg, Esq., Edward Moss, Esq., Anton Metlitsky, Esq., and John Hill, Esq.
O'Melveny & Myers

On April 20, 2018, the Ninth Circuit in *Varjabedian v. Emulex*, No. 16-55088, 2018 WL 1882905 (9th Cir. Apr. 20, 2018), split from five of its sister circuits, holding that plaintiffs seeking to recover under § 14(e) of the Securities Exchange Act ("Exchange Act") for alleged material misstatements or omissions in tender-offer filings need only plead (and prove) negligence, not scienter.

The circuit split threatens to invite forum shopping and make the Ninth Circuit a magnet for § 14(e) actions, and sets up a potential Supreme Court resolution.

BACKGROUND

On February 25, 2015, Avago Technologies Wireless Manufacturing, Inc. ("Avago") and Emulex Corp. ("Emulex") issued a joint press release announcing a merger agreement under which Avago would offer to pay $8.00 per share of Emulex stock, reflecting a 26.4% premium over Emulex's closing stock price at the time.

After Avago initiated the tender offer, Emulex filed with the SEC a 48-page Recommendation Statement in support of the offer, which included a nine-factor analysis and a summary of Goldman Sachs's fairness opinion.

Emulex omitted, however, Goldman Sachs's one-page "Premium Analysis," showing that while Emulex's 26.4% premium fell within the normal range of merger premiums in comparable transactions, it was also below the average.

Shortly after Emulex and Avago completed the merger, a class of former Emulex shareholders filed a putative class action complaint alleging that the $8.00 share price was too low in light of Emulex's growth before the tender offer.

> The circuit split created by *Varjabedian v. Emulex* substantially increases the likelihood of Supreme Court review.

Plaintiffs later amended their complaint to allege that defendants had violated § 14(e) by failing in the Recommendation Statement to summarize the Premium Analysis and to disclose that the 26.4% premium was below the average of premiums in similar mergers.

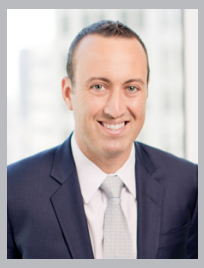
On January 13, 2016, the district court dismissed the § 14(e) claim for failure to plead that the misstatement or omission was made "intentionally or with deliberate recklessness." *Varjabedian v. Emulex Corp.*, 152 F. Supp. 3d 1226, 1233 (C.D. Cal. 2016), *aff'd in part, rev'd in part and remanded*, No. 16-55088, 2018 WL 1882905 (9th Cir. Apr. 20, 2018).

Citing the "obvious" parallels between Rule 10b-5 and § 14(e), the district court reasoned that Rule 10b-5's scienter requirement should also apply to § 14(e) claims. *Id.* at 1232. The court also emphasized that numerous other courts have "unanimously [held] that § 14(e) claims require proof of scienter." *Id.*

NINTH CIRCUIT RULING

In reversing the district court's ruling, the Ninth Circuit began by noting that § 14(e) contains two separate clauses, "each proscribing different conduct" — i.e., (1) making or omitting an untrue statement of material fact, and (2) engaging in fraudulent, deceptive, or manipulative acts or practices.[1] *Varjabedian v. Emulex Corp.*, No. 16-55088 (9th Cir. Apr. 20, 2018) (Slip op. at 10). The Ninth Circuit reasoned that the first clause, on its face, does not include a scienter requirement. *Id.*





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The Ninth Circuit acknowledged that five other circuits (the Second, Third, Fifth, Sixth, and Eleventh) had held that § 14(e) requires that plaintiffs plead scienter, but was "persuaded that the rationale underpinning those decisions" should not actually apply to the first clause of §14(e). *Id.* at 11.

According to the Ninth Circuit, those other circuits ignored or misread Supreme Court precedent in relying on the "similarities between Rule 10b-5 and § 14(e)" to import Rule 10b-5's scienter requirement to § 14(e) claims.[2] *Id.*

That is because the Supreme Court in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976), made clear that adding "scienter [a]s an element of Rule 10b-5(b) had nothing to do with the text of Rule 10b-5." *Id.* at 12.

To the contrary, the Court in *Hochfelder* "acknowledged that the wording of Rule 10b-5(b) could reasonably be read as imposing a scienter *or a negligence* standard." *Id.* (emphasis in original).

It nonetheless found that "Rule 10b-5 requires a showing of scienter because it is a regulation promulgated under Section 10(b) of the Exchange Act, which allows the SEC to regulate *only* 'manipulative or deceptive device[s],'" which necessarily entails scienter. *Id.* at 13 (emphasis in original).

In other words, Rule 10b-5 requires a showing of scienter because of the authorizing statute, not based on the Rule's language. According to the Ninth Circuit, "[t]his rationale regarding Rule 10b-5 does not apply to Section 14(e), which is a statute, not an SEC rule." *Id.* at 14.

The Ninth Circuit also found "compelling" the Supreme Court's ruling in *Aaron v. SEC*, 446 U.S. 680, 696–97 (1980), that Section 17(a)(2) of the Securities Act of 1933 — a provision that applies to initial public offerings and is worded similarly to the first clause of § 14(e)[3] — "does *not* require a showing of scienter." *Varjabedian v. Emulex Corp.*, No. 16-55088 (9th Cir. Apr. 20, 2018) (Slip op. at 14) (emphasis in original).

Noting that "statutes dealing with similar subjects should be interpreted harmoniously," *id.*, the Ninth Circuit found that the first clause of Section 14(e), like Section 17(a)(2), "requires a showing of negligence, not scienter." *Id.* at 16.

The Ninth Circuit distinguished the contrary rulings in the five other circuits by noting that they were either decided before *Ernst & Ernst* and *Aaron* or failed to follow the reasoning of those decisions and acknowledge the distinction between Rule 10b-5 and § 14(e). *Id.* at 15–16.

TAKEAWAYS

We see four things to note about *Varjabedian*.

First, the decision (assuming Emulex and Avago do not petition for and obtain en banc review) will likely incentivize plaintiffs pursuing § 14(e) claims to file in Ninth Circuit courts.

Under § 27 of the Exchange Act, § 14(e) claims may be brought in "the district wherein any act or transaction constituting the violation occurred" or in the district "wherein the defendant is found or is an inhabitant or transacts business." *See* 15 U.S.C. § 78aa; *accord Bourassa v. Desrochers*, 938 F.2d 1056, 1057 (9th Cir. 1991) (stating same).

Thus, plaintiffs pursuing § 14(e) claims on behalf of a nationwide class of shareholders have some choice of jurisdictions in which to file suit — to the extent that potential defendants transact business in the Ninth Circuit or alleged violations occur there — and may attempt to use that flexibility to file in the Ninth Circuit.

Second, the circuit split created by *Varjabedian* substantially increases the likelihood of Supreme Court review.

Even if the other circuits that already have addressed § 14(e) want to revisit the issue in light of *Varjabedian*, they could do so only through en banc proceedings or after a contrary Supreme Court decision. *See, e.g., United States v. Sanchez*, No. 17-11043, 2018 WL 1882961, at *1 (5th Cir. Apr. 19, 2018) ("One panel of this court may not overrule the decision of another absent a superseding en banc or Supreme Court decision.").[4]

Moreover, it is not clear that those circuits would agree with the Ninth Circuit on the merits in any event. As the Fifth Circuit noted, "Congress adopted in [the first clause of] Section 14(e) the substantive language of the second paragraph of Rule 10b-5 and in so doing accepted the precedential baggage those words have carried over the years." *Smallwood v. Pearl Brewing Co.*, 489 F.2d 579, 605 (5th Cir. 1974).

Thus, when Congress drafted the first clause of § 14(e), it arguably did so with the understanding that it was borrowing language (from Rule 10b-5) that included an implied scienter requirement. Because of those divergent interpretations, the Supreme Court could be persuaded to resolve the circuit split, perhaps even in response to a cert petition in *Varjabedian*.

Third, *Varjabedian* brings Ninth Circuit § 14(e) tender-offer claims in line with § 14(a) proxy-statement claims, which the Ninth Circuit held in *Knollenberg v. Harmonic, Inc.*, 152 F. App'x 674, 682–83 (9th Cir. 2005), do not require scienter.

The Ninth Circuit's reasoning in *Knollenberg* was similar to *Varjabedian*; the court distinguished § 14(a) from § 10(b) because the former lacked any reference to a "manipulative device or contrivance," and on that basis held that § 14(a) did not include a scienter requirement. *Id.* at 682.

There is also a circuit split as to the interpretation of Section 14(a), *compare Adams v. Standard Knitting Mills, Inc.*, 623 F.2d 422, 431 (6th Cir. 1980) ("[A]n action under 14(a) requires proof of scienter."), and the Supreme Court has reserved judgment on the issue, *see Va. Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1090 n.5 (1991). This increases the chances of Supreme Court review.

Fourth, even under *Varjabedian*, defendants still have several avenues to challenge § 14(e) claims. Nothing in *Varjabedian*, for example, limits defendants' ability to argue, as they often do in M&A cases, that the alleged misstatements or omissions are not material.

The district court in *Varjabedian* did not reach the defendants' argument that the Premium Analysis was not material, *Varjabedian v. Emulex Corp.*, 152 F. Supp. 3d at 1232, and the Ninth Circuit noted that it will be "difficult to show that [the] omitted information was indeed material." *Varjabedian v. Emulex Corp.*, No. 16-55088 (9th Cir. Apr. 20, 2018) (Slip op. at 18). WJ

NOTES

[1] § 14(e) provides in relevant part: "It shall be unlawful for any person [1] to make any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or [2] to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer...."

[2] *Compare* § 14(e) ("It shall be unlawful for any person [1] to make any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made,

not misleading or [2] to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer....") *with* Rule 10b-5 ("It shall be unlawful for any person ... [t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or [t] o engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.'").

[3] Under § 17(a)(2), "[i]t shall be unlawful for any person in the offer or sale of any securities (including security-based swaps) ... to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading."

[4] *See also In re Zarnel,* 619 F.3d 156, 168 (2d Cir. 2010) (Panels are "bound by the decisions of prior panels until such time as they are overruled either by an en banc panel of our Court or by the Supreme Court."); *Blair v. Scott Specialty Gases,* 283 F.3d 595, 610–11 (3d Cir. 2002) (stating same); *United States v. Lee,* 793 F.3d 680, 684 (6th Cir. 2015) (stating same); *United States v. Brown,* 342 F.3d 1245, 1246 (11th Cir. 2003) (stating same).

Rite Aid

CONTINUED FROM PAGE 1

Brown v. Rite Aid Corp., No. 2017-0480, opening memorandum filed, 2018 WL 2091140 (Del. Ch. May 3, 2018).

The pharmacy chain filed a May 3 memorandum in the Delaware Chancery Court supporting its motion for a judgment on the pleadings, arguing that Brown's suit for indemnification of legal fees stemming from two other lawsuits violates the company's charter.

Rite Aid is based in Pennsylvania but incorporated in Delaware, where companies routinely reimburse the legal bills of their officers and directors. However, Rite Aid's memo says Brown failed to submit the required written claim for indemnification before bringing this suit.

In addition, Brown is not entitled to defense costs regarding his 2003 criminal conviction in a fraudulent conspiracy to conceal tens of millions of dollars funneled to himself, CEO Martin Grass and other senior executives, the company says.

HISTORY

Brown, of Harrisburg, Pennsylvania, served as general counsel and was a member of the Rite Aid board since it went public in 1968. He retired in May 2000 but remained a board member, according to his June 2017 complaint.

Martin Grass, the son of Rite Aid founder Alex Grass, took control of the company in the mid-1990s and began an aggressive expansion campaign, the suit says. It was Brown's service at that time that resulted in the charges against him, the complaint says.

Rite Aid's shares soared during that period, but took a drastic hit when the company revealed in March 1999 that it had vastly overestimated expected profits and was forced to restate its earnings by $1.6 billion, according to the suit.

The restatements prompted a Securities and Exchange Commission investigation and civil lawsuits from shareholders. According to the complaint, the shareholder suits were resolved with a $193 million settlement in 2000.

U.S. District Judge Stewart Dalzell of the Eastern District of Pennsylvania issued a "complete bar order" as part of the settlement, precluding Rite Aid from raising any other claim related to the settlement against "released parties." *In re Rite Aid Sec. Litig.,* MDL No. 1360, 99-cv-2493, 2001 WL 35964566 (E.D. Pa. Aug. 16, 2001).

Brown asserts that as a former Rite Aid officer, he is one of those "released parties."

FOUR OFFICERS

Brown was also one of four Rite Aid defendants named in a 2002 criminal indictment, and he was convicted of witness tampering, conspiracy and lying to the SEC in 2003 following a jury trial. *U.S. v. Grass*, No. 02-cr-146, *verdict returned* (M.D. Pa. Oct. 17, 2003).

Brown alleges Rite Aid abruptly stopped advancing his attorney fees which he says is required by the company's bylaws nine months before the start of trial, severely hampering his defense and contributing to his conviction.

Delaware law requires indemnification to continue until the defendant officer receives an unappealable ruling that he acted dishonestly or disloyally.

Rite Aid also filed an eight-count civil complaint against Brown in Pennsylvania's Cumberland County Court of Common Pleas in December 2003, alleging breach of fiduciary duty, fraud, conspiracy and breach of contract. *Rite Aid Corp. v. Brown*, No. 2002-04922, *complaint filed* (Pa. Ct. Com. Pl., Cumberland Cty. Dec. 26, 2003).

The Cumberland County litigation continued until Dec. 16, 2015, when Rite Aid moved for summary judgment on $297.4 million it claimed Brown owed for the company's defense of the criminal and civil actions, as well as accounting fees and settlement payments, according to Brown's suit.

SURPRISE PACT

It was only while investigating Rite Aid's claims that Brown's attorneys discovered the 2001 order barring claims against parties released as part of the previous settlement, his complaint says.

Brown moved to enforce the order in the Eastern District of Pennsylvania, and Judge Dalzell entered an order June 7, 2016, barring Rite Aid from continuing to pursue the Cumberland County matter. *In re Rite Aid Corp. Sec. Litig.*, No. 99-cv-1349, 2016 WL 3181717 (E.D. Pa. June 7, 2016).

Judge Dalzell clarified his order after Rite Aid explained that it relied on the eighth count of the Cumberland County suit for its defense against a counterclaim from Brown seeking indemnification. The judge granted the company's motion to exclude only that count from his June 7 order, according to Brown's complaint.

Brown's indemnification suit seeks an order to compel Rite Aid to indemnify his successful defense of the seven dismissed counts in the Cumberland County suit, and mandatory advancement to cover the costs of litigating the pending eighth count.

In its memo, Rite Aid says Brown's suit is invalid because he filed it without first making a written claim and waiting the required 30 days for an answer.

It also says that the Cumberland action has since been resolved and those claims are moot. WJ

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Related Filings:
Opening memorandum: 2018 WL 2091140

New DOJ policy grants companies expanded credit for voluntary disclosure of criminal misconduct

By Joseph A. Fazioli, Esq., Hector Gonzalez, Esq., and Jacob Grubman, Esq.
Dechert LLP

In a development with potentially far-reaching consequences for white collar enforcement, the U.S. Department of Justice (DOJ) Criminal Division has expanded the opportunity for companies to earn credit for voluntary disclosure of criminal misconduct. The policy change may encourage voluntary disclosure consistent with prior DOJ initiatives, which have sought to increase corporate disclosure of apparent Foreign Corrupt Practices Act (FCPA) violations.

In a March 1, 2018 speech at the American Bar Association National Institute on White Collar Crime in San Diego, Acting DOJ Criminal Division Head John Cronan announced that the Criminal Division will begin to apply the FCPA Corporate Enforcement Policy (CEP) as "nonbinding guidance" outside the FCPA context.

Though Mr. Cronan, whose announcement was affirmed the following day by Deputy Attorney General Rod Rosenstein, emphasized a presumption of declination of charges in response to adequate disclosures, the CEP and the new policy appear to offer the possibility of resolutions more akin to non-prosecution agreements with conditions. Which form these future DOJ resolutions primarily take will determine the true significance of the recent announcement.

VOLUNTARY DISCLOSURE POLICY CHANGE

The new policy builds upon a recent development in FCPA enforcement, which made certain credit available to companies disclosing misconduct in violation of the FCPA. In November 2017, Deputy Attorney General Rosenstein announced that the DOJ would codify the CEP, which the DOJ has characterized as including a presumption of declination for companies that disclose apparent FCPA violations.

While a declination traditionally involves no charges at all, the CEP's provisions indicate a disclosure benefit that appears more like an NPA, which can include conditions such as the disgorgement of profits. Under the new policy, the Criminal Division will apply the CEP as nonbinding guidance when companies disclose non-FCPA-related misconduct.

In FCPA matters, the DOJ currently resolves matters with non-prosecution when companies meet three requirements.

First, companies must disclose apparent violations soon after discovering them and before a government investigation is imminent.

Second, they must cooperate fully with government investigators, providing complete, detailed, and timely disclosures and updates.

> The new Criminal Division policy marks a significant development in white collar enforcement, as companies will now have the opportunity to earn disclosure credit in most white collar matters.

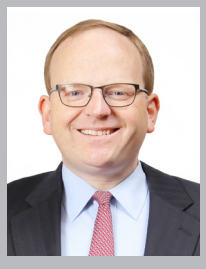
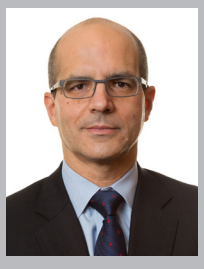
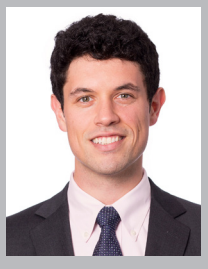
Third, companies must take steps to address the causes of the misconduct and prevent future violations.

Beyond the three pillars of corporate disclosure — disclosure, cooperation, and remediation — the DOJ also requires consideration of potential aggravating circumstances.

Under the CEP, the presumption of non-prosecution does not apply where (1) executive management is involved in misconduct, (2) the misconduct results in significant profit, (3) the misconduct is pervasive, or (4) the company is a repeat offender. In such instances, DOJ is required to recommend a 50% reduction off the minimum sanction under the U.S. Sentencing Guidelines.

ANALYSIS

The new Criminal Division policy marks a significant development in white collar enforcement, as companies will now have the

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opportunity to earn disclosure credit in most white collar matters.

It is uncertain whether the new policy is indicative of (1) an extension of the so-called "Yates Memo" and its progeny's emphasis on cultures of compliance or (2) the vanguard of a new era of significantly reduced white collar enforcement.

The recent announcement could represent the next step in the DOJ's approach to criminal enforcement that began with the Yates Memo in September 2015. That document instructed DOJ personnel and components to emphasize individual prosecutions in cases of corporate misconduct.

In April 2016, the DOJ announced its FCPA Pilot Program, which enabled companies to earn credit and avoid full criminal penalties for voluntarily disclosing misconduct, an approach that the DOJ believed would lead to increased individual prosecutions.

In 2017, the DOJ brought several significant individual prosecutions in the FCPA context, with individual cases representing approximately 70% of the DOJ's FCPA cases last year. Many of these cases were likely initiated under the prior administration, though, so 2018 may be more indicative of the Trump Administration's approach.

On the other hand, the new policy may indicate a fundamental retrenchment of white collar enforcement, with the U.S. Government shifting greater responsibility for uncovering and remediating misconduct to private companies.

Past commentary by Trump Administration officials has suggested a preference for allowing self-regulation by the market, which may lead to a reduced number of white collar enforcement actions under the new policy.

As companies consider the impact of this latest DOJ policy development, they should continue to emphasize strong compliance policies and practices. Companies must also develop procedures for assessing and disclosing misconduct where appropriate in order to avoid or reduce criminal penalties.

Given the contents of the CEP, companies must also be cognizant of limitations to the credit they may receive for disclosing misconduct.

Although the DOJ's recent announcement raises the possibility of earning declinations (which generally involve situations where cases are not prosecuted or criminally resolved), the benefit of self-reporting may in practice be primarily limited to non-prosecution agreements with potentially onerous terms. WJ

Delaware high court rejects Tesla CEO's bid to halt merger challenge

Delaware's highest court has affirmed the denial of Tesla Inc. CEO Elon Musk's request for an immediate appeal of a ruling that greenlights a challenge to the 2016 merger of the electric car company and SolarCity Corp.

Musk et al. v. Arkansas Teacher Retirement System et al., No. 221, 2018, 2018 WL 2072822 (Del. May 3, 2018).

A three-judge panel of the Delaware Supreme Court said Vice Chancellor Joseph R. Slights III of the Delaware Chancery Court correctly found that Musk did not meet the "strict standards" for an interlocutory appeal of the judge's earlier decision to let a consolidated shareholder suit proceed. *In re Tesla Motors Inc. Stockholder Litig.*, No. 12711, 2018 WL 2006678 (Del. Ch. Apr. 27, 2018).

The vice chancellor rejected Tesla's argument that he disregarded Delaware case law when he ruled March 28 that despite owning only 22 percent of the company, Musk exerted a controlling influence over the board, which meant the deal was subject to higher scrutiny. *In re Tesla Motors Inc. Stockholder Litig.*, No. 12711, 2018 WL 1560293 (Del. Ch. Mar. 28, 2018).

MORE THAN THE 'BALLOT BOX'

In his April 27 order, Vice Chancellor Slights noted that his opinion cites Delaware decisions holding that "control of the ballot box is not always dispositive of the controlling stockholder inquiry," and facts and testimony might show that Musk did not control Tesla. Therefore, the March 28 decision was not case-dispositive or worthy of an immediate appeal, he said.

That opinion denied a motion by Tesla's officers and directors to dismiss a consolidated breach-of-duty and waste-of-assets suit accusing them of disloyally agreeing to the $2.6 billion acquisition to rescue Musk's SolarCity investment at Tesla shareholders' expense.

Palo Alto, California-based Tesla is incorporated in Delaware, where corporate law generally gives decisions by independent, unconflicted directors the benefit of the doubt under the business-judgment rule.

The Delaware Supreme Court has said evidence of director self-dealing or conflict of interest in a transaction such as a contested merger may be excused by shareholder ratification — unless a controlling shareholder could have influenced the board. *Corwin v. KKR Fin. Holdings*, 125 A.3d 304 (Del. 2015).

MUSK THE EXCEPTION?

Vice Chancellor Slights said Musk was that exception because, despite his small ownership stake, the plaintiffs pleaded facts suggesting he controlled Tesla's board through his authority as CEO and chairman, his status as the company's visionary and product architect, and his fundraising role.

Tesla and SolarCity, an alternative-energy equipment maker based in San Mateo, California, announced their $2.6 billion merger Aug. 1, 2016.

After the March ruling, Musk and Tesla's directors sought the vice chancellor's permission to take an immediate appeal, arguing that no previous Delaware decision had ever deemed a 22 percent stockholder to be a controlling shareholder in an acquisition.

In gauging Musk's influence, the judge mistakenly used a test meant to determine whether a merger's proponents should get the deference of the business-judgment rule or must prove it was fair under the entire-fairness standard, Tesla said.

CLARIFICATION REQUESTED

That wide-ranging definition of control by a minority blockholder will make it difficult for transaction planners in the future unless the high court steps in and clarifies the standard, Tesla said in its application for certification of interlocutory appeal.

In their opposition, the plaintiffs argued that even if the appeal established that Musk was not a controlling shareholder, the case still would have to resolve issues of inadequate disclosure and corporate waste, leaving no potential for saving court resources.

Moreover, there is no conflict with established Delaware law regarding the definition of a controlling shareholder, the plaintiffs say, because numerous decisions list factors other than the amount of stock held when it comes to determining control, and the opinion adequately addressed them.

REUTERS/Joe Skipper

Tesla Inc. CEO Elon Musk, shown here, lost a bid to stop shareholder suit claiming that despite owning only 22 percent of the company, he exerts a controlling influence over the board.

The vice chancellor noted that his March 28 opinion only found that at the pleading stage, Musk was in a controlling position for purposes of the acquisition, and even that determination is not case-dispositive.

Therefore, he said, "Delaware's strong policy against piecemeal litigation makes interlocutory appeal inappropriate where, as here, the court has not made a final determination as to any dispositive issue."

Tesla then sought permission directly from the state Supreme Court for an immediate appeal despite the vice chancellor's order.

But the high court's brief ruling endorsed Vice Chancellor Slights' "detailed order" explaining why the appeal is not warranted "under the principles and criteria of Supreme Court Rule 42(b)." WJ

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Related Filings:
Chancery Court order: 2018 WL 2006678
March 28 opinion: 2018 WL 1560293
Application for certification: 2018 WL 1785817
Opposition to application: 2018 WL 1948834
Supreme Court order: 2018 WL 2072822

See Document Section A (P. 23) for the order and Document Section B (P. 28) for the opinon.

Judge halts Fuji merger; Xerox cedes control but lets investor suit pact expire

Xerox Corp. has tentatively agreed to settle a challenge to its $6.1 billion sale to Fujifilm Holdings Corp. after dissident shareholders persuaded a New York judge to halt the deal and find Xerox's directors let its "massively conflicted" CEO hijack the negotiations.

In re Xerox Corp. Consolidated Shareholder Litigation, No. 650766/18, 2018 WL 1988860 (N.Y. Sup. Ct., N.Y. Cty. Apr. 27, 2018).

According to statements by activist shareholders, however, Xerox effectively canceled the peace agreement by letting it expire May 3 without making the corporate governance changes it had agreed to in return for an end to the shareholder litigation.

New York County Supreme Court Justice Barry R. Ostrager's April 27 ruling granted the plaintiff investors' motion for a preliminary injunction of a scheduled Xerox shareholder vote on the "cashless" Fuji merger and a director election that excluded activist investors Carl Icahn and Darwin Deason's candidates.

Justice Ostrager said the plaintiffs would likely be able to prove Xerox's directors not only breached their duty by letting the CEO they were about to replace take over the negotiations, but "acted in bad faith" in structuring the deal.

Norwalk, Connecticut-based Xerox, which is incorporated in New York, announced the acquisition deal with imaging giant Fuji on Jan. 31.

RULING BRINGS PACT

Two business days after Justice Ostrager issued his sharply worded critique of the merger, Xerox announced it was postponing a vote on the deal and had reached a tentative settlement of all shareholder litigation contesting the merger and Xerox's upcoming director election.

In a May 1 statement, Xerox said the pact calls for six newly appointed board members to immediately replace CEO Jeff Jacobson and six of the company's 10 incumbent directors. Icahn representatives Keith Cozza and John Visentin will serve as the company's new chairman and CEO, respectively, Xerox said.

REUTERS/Vasily Fedosenko

The May 1 statement said the newly constituted board would meet promptly to discuss strategic alternatives for Xerox. Deason and Icahn praised the outcome of the intensely fought contest for control, with Icahn saying it "marks a watershed moment for corporate governance generally and for Xerox specifically."

However, Icahn and Deason released a joint statement May 4 claiming Xerox had failed to implement the agreed-upon corporate governance changes before the tentative settlement expired May 3, which would cause the litigation to resume. No one at Xerox was immediately available to comment.

AN 'ARRESTING IRONY'

Justice Ostrager's decision greenlighted the combined lawsuits of Deason and other shareholders after finding they were excused from a derivative suit requirement to let the directors first review the charges because there is proof they were too conflicted.

Normally, the business judgment rule gives director decisions the benefit of the doubt, but "this transaction was largely negotiated by a massively conflicted CEO in breach of his fiduciary duties to further his self-interest" and approved by equally conflicted directors, the judge said.

Justice Ostrager noted the "arresting irony" that the directors rushed through a deal with numerous shop-around restrictions and a $183 million penalty if it fell through, despite "scant evidence" of comparison shopping or economic necessity at Xerox.

HIDDEN 'CROWN JEWEL'?

In an April 19 amended complaint in his suit seeking to block the deal, Deason said he learned only after the acquisition was announced that the two companies had a 17-year-old joint venture agreement that contains a secret "crown jewel" lockup provision, making it effectively impossible for Xerox to negotiate with another suitor.

The lockup "allows Fuji to control Xerox's intellectual property and manufacturing rights in the $36 billion Asia-Pacific market if Xerox was to sell just 30 percent of the company to another suitor," Deason alleged in his original complaint.

The amended complaint claimed the directors breached their fiduciary duties of care, good faith, loyalty, candor and independence by not acting in the best interests of the shareholders. It also accused the directors, former CEO Ursula M. Burns and Xerox of common law fraud in their disclosures about the deal.

The defendants filed a memorandum in support of their motion to dismiss and in opposition to Deason's injunction motion April 19, saying Deason allied himself with Icahn "to disenfranchise the rest of Xerox's shareholders."

THE RULING'S 'LYNCHPIN'

Justice Ostrager said the "lynchpin" of his decision was Jacobson's conduct in taking over the negotiations with Fuji after the

board told him to stand down, and his knowledge that without the deal he would likely be replaced.

The judge's opinion also noted "the board's approval of a transaction that granted control of an iconic American company to Fuji without any cash payment by Fuji to Xerox shareholders and the board's acquiescence to Jacobson's conduct."

It said without the injunction, shareholders "will lose the potential opportunity to receive a superior control premium while being forced to vote on the proposed transaction despite Xerox's failure to make timely, material disclosures regarding the transaction and the Fuji joint venture." WJ

Related Filings:
Opinion: 2018 WL 1988860

See Document Section C (P. 36) for the opinion.

EXCLUSIVE-FORUM-SELECTION CLAUSE

Clause on exclusive-forum selection bars ex-exec's stock suit, company says

Delaware's Chancery Court should bar a former executive from filing suit in California against Vivint Wireless Inc. over his stock appreciation rights and share value, the company alleges, saying the suit would violate an exclusive-forum clause in his stock option agreement.

Vivint Wireless Inc. v. Bathija, No. 2018-0322, complaint filed, 2018 WL 2078621 (Del. Ch. Apr. 30, 2018).

Home security company Vivint says in its April 30 complaint that the agreement with former software development director Pravin Bathija requires that litigation be decided in Delaware.

Vivint seeks an injunction preventing Bathija from filing suit in California for breach of his agreement regarding stock options.

The company also says that because it fell on hard times, the value of a share of its stock was $0 when Bathija sought to cash in his options.

STOCK OPTIONS

Vivint says that when it hired Bathija in May 2013, he was granted 7,500 shares under a stock-appreciation-rights agreement, which said 20 percent of the total would vest on each of five subsequent anniversaries of that date.

But by September 2015, Vivint had stopped generating new customers and wrote off more than $53 million in assets.

One year later, the company was worth minus $76.4 million and by September 2017 its value was minus $30.6 million, the suit says.

According to the complaint, Vivint fired Bathija for poor performance in August 2017 and a month later he sought to exercise 6,000 recently vested shares.

While each share had a strike price of $5, the board determined the share value was $0, the suit says.

Vivint alleges that when it told Bathija he was not entitled to anything for his shares, his attorney threatened to sue in California, where Bathija lived.

BREACH OF AGREEMENT?

Bathija's stock option agreement contained a clause that requires him to file any legal action in Delaware, the suit says. A suit outside Delaware would violate that exclusive-forum-selection clause, Vivint says.

Bathija contends he can sue in California because the clause is unenforceable, but this would breach their agreement and thus requires an injunction, Vivint says.

The company also seeks a declaratory judgment that it owes Bathija nothing for his stock-appreciation-rights shares because they are worth nothing. It also seeks damages for all legal fees and costs in defending Bathija's potential California suit. WJ

Attorneys:
Plaintiff: Anne C. Foster, Brian F. Morris and John M. O'Toole, Richards, Layton & Finger, Wilmington, DE; Chet A. Kronenberg and Brandon J. Cory, Simpson Thacher & Bartlett, Los Angeles, CA

Related Filings:
Complaint: 2018 WL 2078621

Health insurer hid limited growth capacity, investor suit says

By Nicole Banas

Molina Healthcare Inc. concealed infrastructure problems that hurt the managed care company's 2016 and 2017 earnings and caused it to withdraw from certain health insurance exchanges, according to a shareholder lawsuit filed in Los Angeles federal court.

Steamfitters Local 449 Pension Plan v. Molina Healthcare Inc. et al., No. 18-cv-3579, complaint filed, 2018 WL 2001616 (C.D. Cal. Apr. 27, 2018).

The class-action complaint, filed in the U.S. District Court for the Central District of California, says Molina falsely claimed it had the administrative capacity to handle rapid growth stemming from health care reforms.

The Long Beach, California-based company manages Medicaid programs and other government-funded health insurance plans in 12 states and Puerto Rico, according to its website. It also provides administrative support to state Medicaid agencies and operates medical clinics.

Plaintiff Steamfitters Local 449 Pension Plan seeks compensation for Molina investors who allegedly overpaid for shares during a 33-month period ending Aug. 2, 2017.

The complaint also names as defendants ex-CEO J. Mario Molina, former Chief Financial Officer John Molina, Chief Operating Officer Terry Bayer and Chief Information Officer Rick Hopfer.

'SCALABLE' INFRASTRUCTURE

The suit says Molina predicted in 2012 that it would double its annual revenue over three years to $12 billion, partly due to reforms in the 2010 Patient Protection and Affordable Care Act.

Over the next two years, the company updated its administrative infrastructure to support existing and new markets, the suit says, such as the health insurance exchanges created by the ACA.

The defendants allegedly told investors in a third-quarter earnings call Oct. 31, 2014, that the company was achieving "greater administrative cost leverage" and margins because of the infrastructure improvements.

Molina also repeatedly assured investors that its infrastructure was "scalable," maintaining growth capacity despite a series of acquisitions in 2015 and 2016, the suit says.

Steamfitters claims the company "shocked" investors April 28, 2016, by revealing substantially lower first-quarter earnings and reducing its full-year forecast by 30 percent.

Then-CEO Molina acknowledged in a conference call that recent growth "stretched our operational resources," but he said the company expanded its infrastructure to prevent any "big glitches or stopgaps," the complaint says.

'BREAKDOWNS' EMERGE

The suit says Molina changed its tune about continued growth in early 2017 and told investors there were "too many unknowns" for the company to commit to participating in ACA exchanges beyond 2017.

The company announced the departure of its CEO and CFO on May 2, 2017, two months before revealing a second-quarter net loss of $230 million, the suit says.

In an earnings statement Aug. 2, 2017, it announced restructuring plans to withdraw from exchanges in Utah and Wisconsin at the end of the year.

Molina's interim CEO Joseph White allegedly said in a conference call that the company failed to absorb ACA-related growth or develop appropriate capabilities to appreciate that growth.

White also revealed that the company's infrastructure was "designed for a much smaller, simpler business," and experienced "breakdowns" in areas such as provider payment and information management, according to the suit.

Molina's share price fell nearly 6 percent on the news, closing Aug. 3, 2017, at $62.32, the suit says.

The defendants allegedly violated the anti-fraud provisions of the Securities Exchange Act of 1934, 15 U.S.C.A. §§ 78j(b) and 78t(a), by concealing that Molina's administrative infrastructure could not support fast growth and failed to fix "systemic issues" related to provider payment and other key functions. WJ

Attorney Profiles:
Plaintiff: Christopher J. Keller, Eric J. Belfi and Francis P. McConville, Labaton Sucharow LLP, New York, NY; Robert V. Prongay and Lesley F. Portnoy, Glancy Prongay & Murray, Los Angeles, CA

Related Filings:
Complaint: 2018 WL 2001616

CommerceHub's $1.1 billion private equity deal draws shareholder suit

By Nicole Banas

CommerceHub Inc. executives are violating federal securities laws by using an incomplete proxy statement to lock up a proposed $1.1 billion sale to affiliates of private equity firms GTCR and Sycamore Partners, according to an investor lawsuit seeking to block the deal.

Gordon v. CommerceHub Inc. et al., No. 18-cv-512, complaint filed, 2018 WL 2042234 (N.D.N.Y Apr. 27, 2018).

The proposed class action, filed April 27 in the U.S. District Court for the Northern District of New York, says the proxy statement left out key information about CommerceHub's finances, such as the raw data used to calculate adjusted earnings before interest, taxes, depreciation and amortization.

Albany, New York-based CommerceHub makes cloud-based software used by major retailers for e-commerce and marketing. The company's clients include Walmart, Costco and Samsung.

The proxy statement also did not say enough about CommerceHub's nondisclosure agreements with other potential acquirers, which contain "standstill" provisions limiting competitive bids, according to the complaint.

Without that information, shareholders cannot evaluate the adequacy of the sale price or the fairness of the sale process, the suit says.

In addition to the company, the suit names as defendants Board Chairman Richard Baer, CEO Francis Poore and several directors.

GO-PRIVATE DEAL

CommerceHub announced March 6 that it had entered into a definitive agreement to be acquired by affiliates of GTCR and Sycamore for $22.75 per share.

GTCR is a Chicago-based private equity firm focused on investments in technology, media and health care, according to the statement announcing the deal.

Sycamore, headquartered in New York, specializes in investments in the consumer and retail sectors.

The proposed acquisition, which is subject to shareholder approval, is expected to close in the third quarter, the statement said.

MISSING FINANCIAL DATA?

Plaintiff Brian Gordon seeks to block a shareholder vote on the transaction until the defendants furnish more facts about the company's finances and a possible conflict of interest involving its financial adviser, Evercore Group LLC.

The complaint says the sale price "appears inadequate" given CommerceHub's strong financial performance, which includes three consecutive years of double-digit sales growth.

Shareholders currently are unable to assess the deal's fairness because the company's April 18 proxy statement to the Securities and Exchange Commission omitted crucial details of the internal financial projections prepared by company management, the suit says.

The statement also failed to conform to generally accepted accounting principles as required by SEC Regulation G, 17 C.F.R. § 244.100, Gordon claims.

'STANDSTILL' PROVISIONS

According to the complaint, most of the nondisclosure agreements and standstill provisions became moot when CommerceHub agreed to the private equity deal, but one provision relating to a company identified only as "Sponsor B" is still active.

The document did not provide any further details about Sponsor B's NDA or explain why it was different from the others, the suit says.

The proxy statement also failed to disclose the compensation Evercore received for providing investment services to GTCR in connection with an unrelated prior acquisition, the suit claims.

The complaint alleges violations of the proxy statement and control person provisions of the Securities Exchange Act of 1934, 15 U.S.C.A. §§ 78n(a) and 78t(a).

It seeks an injunction barring CommerceHub from proceeding with the sale until its directors disclose additional information. WJ

Attorneys:
Plaintiff: Innessa Melamed Huot, Faruqi & Faruqi, New York, NY

Related Filings:
Complaint: 2018 WL 2042234

Finish Line cheated shareholders in race to sell, suit says

By Dave Strausfeld

Finish Line Inc. executives violated their fiduciary duties in hurrying to sell the athletic-shoe retailer to avoid an activist investor's bid to obtain control of the company, a shareholder says in an Indianapolis federal court lawsuit.

Martinez v. Lyon et al., No. 18-cv-1342, complaint filed, 2018 WL 2069430 (S.D. Ind. May 2, 2018).

Finish Line shareholder Edward Martinez's class-action complaint filed May 2 in the U.S. District Court for the Southern District of Indiana says the $558 million sale price to U.K.-based JD Sports Fashion PLC is too low, reflecting a process that was "hastily conducted without a proper market check."

The all-cash deal announced March 26 calls for Finish Line shareholders to get $13.50 for each of their shares.

The complaint says current Finish Line Chairman and former CEO Glenn Lyon, CEO Samuel Sato, Chief Financial Officer Scott McNeill and six directors were motivated to sell by personal financial considerations.

The suit seeks to enjoin the proposed transaction or, if it is consummated without proper disclosures, recover damages.

Indianapolis-based Finish Line sells major-brand sneakers and athletic gear in its stores throughout the U.S. as well as in Macy's department stores. JD Sports is a sports fashionwear and outdoor clothing and equipment retailer.

'HASTILY CONDUCTED' MERGER

Martinez alleges that the "real reason" for the proposed merger was Finish Line's board was "desperate" to avoid dealing with the aggressive tactics of U.K.-based activist investor Sports Direct International PLC.

The board quickly forced through the merger with JD Sports, and due to the "overly accelerated" sales process, failed to consider other potential strategic partners that might have offered a higher price, the suit says.

Martinez says the defendants failed to disclose the rushed, flawed sales process in the company's April 24 preliminary proxy statement recommending that shareholders vote in favor of the deal.

The proxy statement also allegedly omitted crucial data and inputs underlying financial adviser PJ Solomon LP's opinion that the transaction is fair to Finish Line shareholders.

Some of the individual defendants will receive "massive financial benefits" from the merger, while the company's stockholders will be "cashed out at an unfair price," the suit says.

The defendants allegedly breached their fiduciary duties and violated the proxy provisions of the Securities and Exchange Act of 1934, 15 U.S.C.A. §§ 78n(a) and 78t(a). WJ

Attorneys:
Plaintiff: William N. Riley, Riley Williams & Piatt, Indianapolis, IN; Evan J. Smith and Marc L. Ackerman, Brodsky & Smith, Bala Cynwyd, PA

Related Filings:
Complaint: 2018 WL 2069430

Drugmaker execs urge judge to toss 'duplicative' investor suit

By Nicole Banas

Ocular Therapeutix Inc. directors are asking a Boston federal judge to dismiss or pause a shareholder lawsuit alleging they are personally liable for manufacturing problems that hindered the drugmaker's application for regulatory approval of an eye pain treatment.

Robinson v. Sawhney et al., No. 18-cv-10199, memo supporting motion to dismiss or stay filed, 2018 WL 2013750 (D. Mass. Apr. 30, 2018).

The derivative suit filed in January by Ocular shareholder Brian Robinson is "duplicative" of an earlier-filed consolidated action pending in Massachusetts state court, the defendants say in a memo filed in the U.S. District Court for the District of Massachusetts. *In re Ocular Therapeutix Inc. Deriv. Litig.*, No. 17-3425, consolidated *complaint filed* (Mass. Dist. Ct., Suffolk Cty. Feb. 28, 2018).

Robinson's suit names as defendants Ocular Executive Chairman Amarpreet Sawhney and seven other directors. It also names former director James Garvey and several former executives, including W. Bradford Smith, Ocular's chief financial officer from 2014 to 2017.

The defendants' memo says U.S. District Judge George A. O'Toole Jr. should toss Robinson's suit in deference to the state action or stay the litigation until the state court rules on a pending motion to dismiss.

The suits assert "nearly identical" claims for breach of fiduciary duties related to Ocular's disclosures about lead product candidate Dextenza, a steroid treatment for post-surgical eye pain, the memo says.

UNDISCLOSED DRUG CONTAMINATION?

Robinson's suit seeks to recover damages on behalf of Ocular for alleged misstatements about Dextenza that led to a subpoena from the Securities and Exchange Commission late last year.

The company resubmitted a new-drug application to the Food and Drug Administration for Dextenza in January 2017 after a 2016 inspection of its manufacturing facilities revealed various deficiencies, the suit says.

Another FDA inspection in April 2017 revealed more serious issues that Ocular did not fully disclose to investors, the complaint says.

The company experienced a "massive" share price drop in early July, wiping out more than $100 million in market value over three days, after two investing websites reported that the FDA inspections showed some batches of Dextenza were contaminated with particulate matter and aluminum, the suit says.

The FDA denied the Dextenza application July 11, according to the suit.

Ocular said in a Dec. 22 statement that it was facing multiple shareholder lawsuits and received a subpoena from the SEC for documents and communication related to the Dextenza application.

Robinson claims the defendants' misconduct has "devastated" Ocular's credibility, causing a total loss in market value of nearly $245 million.

The suit alleges breach of fiduciary duty, unjust enrichment and corporate waste.

'DEFICIENT' CLAIMS

The defendants' April 30 memo says Robinson's suit should be dismissed or stayed pursuant to the "prior-pending-action doctrine," which provides that an earlier-filed suit generally has priority over a later action.

Robinson's suit "varies little in substance" from the consolidated action, and he takes the same "deficient" position that a pre-suit litigation demand to Ocular's board of directors would have been futile, the memo says.

Judge O'Toole should at least stay the federal litigation until the state court determines whether the demand requirement is excused, the memo says.

The defendants say Robinson's suit also can be dismissed or stayed pursuant to the abstention principles the Supreme Court laid out in *Colorado River Water Conservation District v. United States*, 424 U.S. 800 (1976).

The *Colorado River* doctrine gives federal courts the option to dismiss or stay a federal lawsuit in deference to a parallel state court action if they determine that "considerations of wise judicial administration" favor abstention, the memo says.

Allowing Robinson to proceed with his lawsuit will result in "piecemeal" litigation and "wasteful and duplicative" discovery, the memo says. WJ

Attorneys:
Plaintiff: Peter C. Horstmann, Newton, MA; Brian J. Robbins, Craig W. Smith, Steven R. Wedeking and Shane P. Sanders, Robbins Arroyo LLP, San Diego, CA

Defendants: Michael G. Bongiorno and Peter J. Kolovos, Wilmer Cutler Pickering Hale & Dorr, Boston, MA; Joseph J. Yu and Jenny R.A. Pelaez, Wilmer Cutler Pickering Hale & Dorr, New York, NY

Related Filings:
Memo supporting motion to dismiss or stay: 2018 WL 2013750
Complaint: 2018 WL 703607

Under Armour suit says CEO unjustly enriched through related-party deals

By Daniel Rice

A shareholder is claiming in federal court that Under Armour Inc.'s directors breached their fiduciary duties by letting the athletic apparel company engage in self-dealing business transactions with entities controlled by CEO Kevin Plank.

King v. Plank et al., No. 18-cv-1264, complaint filed, 2018 WL 2013751 (D. Md. Apr. 30, 2018).

Scott King filed a derivate lawsuit April 30 in the U.S. District Court for the District of Maryland. The complaint claims Plank moved Under Armour's corporate headquarters to a site owned by his development company and later sold the property to the sportswear company for $70 million, more than double what he paid two years earlier.

Under Armour also leases industrial space, a hotel site, and a corporate jet and helicopter from businesses owned by Plank, the company's founder and chairman, and in some cases co-owned by his brother, according to the complaint.

Plank personally reaped the financial benefits of those "related-party transactions," especially Under Armour's relocation from the Locust Point area of south Baltimore to the city's Port Covington neighborhood, the suit says.

In addition to Plank, the complaint names as defendants Under Armour directors Eric T. Olson, George W. Bodenheimer, Douglas E. Coltharp, Karen W. Katz, A.B. Krongard, William R. McDermott and Harvey L. Sanders, and former director Bryon K. Adams Jr. It also names Plank's real estate development company, Sagamore Development Co.

HEADQUARTERS RELOCATES

According to the complaint, when Under Armour outgrew its Locust Point headquarters, the company publicly gave the impression that it would address the issue by expanding the existing facilities.

That was "essentially a ruse," King says. Plank instead planned to acquire real estate in Port Covington, sell some of it to the company at a profit and develop the rest, the suit claims.

Sagamore at first leased the property to Under Armour before selling it to the company outright in 2016, according to the complaint.

In addition to pocketing millions, Plank's businesses used the relocation to facilitate further development of the site for the benefit of Plank, who owns 65 percent of Under Armour, the suit says.

PRE-SUIT DEMAND

King sent a pre-suit demand in May 2017, asking Under Armour's board to investigate the transactions and take action, according to the complaint. The board responded by creating a separate "review group" of two directors to consider the demand.

The group produced a report finding the demand unsubstantiated, but the review was "unreasonable and lacked good faith," King's complaint says.

REUTERS/Steve Marcus

A shareholder has accused several Under Armour Inc. officers, including founder and CEO Kevin Plank, shown here in 2016, of exploiting company assets for personal gain.

The review group members, Olson and Bodenheimer, have insurmountable conflicts of interest, the suit says.

SEEKING CORPORATE REFORM

The suit seeks a declaration that the directors breached their fiduciary duties and that Plank and Sagamore have been unjustly enriched.

It also seeks damages on behalf of Under Armour and a court order requiring the company "to reform and improve its corporate governance and internal procedures ... with respect to related-party transactions." WJ

Related Filings:
Complaint: 2018 WL 2013751

Ex-American Apparel CEO's appeal of $20 million ruling should be tossed, ex-ally says

A lower court correctly found former American Apparel CEO Dov Charney breached agreements with Standard General LP to aid his unsuccessful bid to retake control of the clothing company, the hedge fund has told the Delaware Supreme Court.

Charney v. Standard General LP et al., No. 65-2018, answering brief filed, 2018 WL 1961168 (Del. Apr. 23, 2018).

In an answering brief, Standard General says the high court should affirm a Delaware Chancery Court decision granting it judgment on the pleadings and ruling its written agreements with Charney were valid and enforceable despite his claims of fraudulent inducement.

Chancellor Andre G. Bouchard correctly found Charney owes Standard General more than $20 million — the amount it lent him to amass a major block of stock in preparation for a proxy contest for control of American Apparel's board, the hedge fund argues. *Standard Gen. LP v. Charney*, No. 11287, 2017 WL 6498063 (Del. Ch. Dec. 19, 2017).

OUSTER AND AID FROM STANDARD

Charney founded Delaware-chartered American Apparel Inc. in the 1980s. He held a controlling stock share until a need for operating capital prompted a stock issuance that diluted his holdings, according to Chancellor Bouchard's opinion.

In June 2014 American Apparel's board of directors suspended Charney for alleged breaches of fiduciary duty and violations of company policies, the ruling said.

Charney enlisted the aid of Standard General in a campaign to amass enough stock to replace the directors who ousted him. Standard General loaned Charney $20 million and they entered several other agreements, according to the opinion.

In the following months, Charney, American Apparel and Standard General negotiated a standstill agreement calling for Charney to halt his campaign against the clothing company and for a newly reconstituted board to decide whether his suspension should become a termination, the ruling said.

In December 2014 the board terminated Charney for cause, the opinion said.

STANDARD WINS SUIT VS. CHARNEY

Standard General sued Charney in July 2015 in the Chancery Court, claiming he breached the standstill pact and other agreements and defaulted on the loan. It sought a declaratory judgment that the agreements were valid and enforceable and that he defaulted on the loan, making it due and payable.

Standard General also asserted claims for injunctive relief and damages relating to Charney's alleged impairment of the value of the collateral for the loan.

REUTERS/Mario Anzuoni

The hedge fund argues the judge correctly found that ex-American Apparel CEO Dov Charney, shown here in 2009, owes Standard General more than $20 million.

In the meantime, American Apparel filed for bankruptcy in October 2015 and the U.S. Bankruptcy Court for the District of Delaware confirmed a reorganization plan three months later.

In February 2017 Standard General moved for judgment on the pleadings.

Chancellor Bouchard granted the motion for the claims relating to the agreements, but said the claims relating to the collateral were moot because the company's reorganization had eliminated the collateral's value.

He entered a judgment in Standard General's favor for more than $29 million, including interest. *Standard Gen. LP v. Charney*, No. 11287, 2018 WL 322208 (Del. Ch. Jan. 8, 2018).

CHARNEY'S OPENING APPEAL BRIEF

Charney appealed, arguing in his opening brief that the suit should have been brought in a court of law like the Delaware Superior Court. The suit should not have been filed the Chancery Court, which has limited jurisdiction over matters in equity, because the action essentially sought a money judgment, he says.

The brief claims the judge improperly rejected Charney's affirmative defenses, including that he was fraudulently induced into the agreements with Standard General based on its assurance that it would help him retake control of American Apparel. The hedge fund "leveraged Charney's weakened position outside of the company to seize control for itself," according to the brief.

The Chancellor erred as a matter of law in asserting jurisdiction over a purely legal action for money damages and by not giving proper weight to Charney's arguments, the brief says.

STANDARD'S ANSWERING BRIEF

Standard General's answering brief says the Chancellor's 65-page opinion "painstakingly" examined and rejected each of Charney's arguments, and found Charney could not have reasonably relied on Standard General's alleged oral promises that conflicted with the written agreements, an element of fraudulent inducement.

The brief notes Charney did not dispute that the loan balance was unpaid.

Moreover, the suit's claims for specific performance, injunctive relief and the validity of a voting agreement "placed this case squarely within the Court of Chancery's jurisdiction, and the Court of Chancery retained jurisdiction of the entire case, even if certain equitable claims later became moot," the brief says. WJ

Attorney Profiles:
Defendant-appellant: David Graff, Robins Kaplan LLP, New York, NY

Plaintiffs-appellees: Shannon R. Selden, W. David Sarratt, Carl Micarelli, Holly S. Wintermute and Justin C. Ferrone, Debevoise & Plimpton, New York, NY; Raymond J. DiCamillo and Matthew D. Perri, Richards, Layton & Finger PA, Wilmington, DE

Related Filings:
Opening brief: 2018 WL 1625805
Answering brief: 2018 WL 1961168

ALISON FRANKEL'S ON THE CASE

New York judge halts Xerox deal. Would Delaware have done the same?

By Alison Frankel

(Reuters) – We will never know if consolidated shareholder litigation to block Fujifilm's $6.1 billion acquisition of Xerox Corp. would have turned out differently had it taken place in Delaware Chancery Court instead of New York State Supreme Court.

But a dramatic decision in the Xerox case has spurred lawyers and academics to ask whether Delaware has become too deferential to corporate boards.

On April 27, Manhattan State Supreme Court Justice Barry Ostrager issued a preliminary injunction barring Xerox from holding a shareholder vote on the proposed Fuji merger at its annual meeting in June. *In re Xerox Corp. Consolidated Shareholder Litigation*, No. 650766/18, 2018 WL 1988860 (N.Y. Sup. Ct., N.Y. Cty. Apr. 27, 2018).

After a two-day evidentiary hearing in which Justice Ostrager heard live testimony from eight witnesses, including Xerox's CEO and the chairman of its board, the judge concluded the Fuji deal was so tainted with conflict that it was likely the CEO and the board, abetted by Fuji, had breached their duty to Xerox shareholders.

The judge also ruled that Xerox must allow activist shareholder Darwin Deason to nominate an alternative slate of directors at the meeting in June.

Justice Ostrager blocked the deal even though a highly credentialed board unanimously approved the Fuji offer and no bidder has emerged with better terms than the complex, no-cash transaction Fuji proposed.

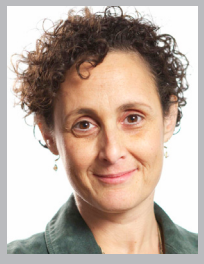
Xerox's lawyers at Paul Weiss Rifkind Wharton & Garrison had argued that the board's fully informed approval, which came after 10 months of board-supervised negotiations and some heated internal debate, showed independent directors acting carefully to decide what's best for shareholders.

Justice Ostrager found that depiction to be not credible, adopting instead the account of events proffered by Deason's lawyers at King & Spalding and lead shareholder class-action counsel from Grant & Eisenhofer and Bernstein Litowitz Berger & Grossmann.

In their depiction, Xerox's CEO, Jeff Jacobson, was on the verge of losing his job under pressure from activist Carl Icahn, who, along with Deason, controls about 15 percent of Xerox shares.

As Xerox's board was searched for Jacobson's replacement, Jacobson stepped up desultory talks with Fuji, a Xerox joint venture partner, proposing a deal structure that would minimize Fuji's cash outlay.

Fuji executives, sensing an opportunity to take advantage of Jacobson's precarious state, promised to keep him in charge. And the board, despite some early opposition, went along with the deal because Fuji pledged to retain five Xerox directors after the merger.



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

The judge agreed Jacobson's priority in the Fuji deal was his own job — and the board didn't give enough weight to Jacobson's conflict.

"Once Jacobson learned that he had been targeted for replacement by Xerox's largest shareholder and eventually the board itself, he abandoned the board's request to obtain a value-maximizing all-cash transaction and engineered the framework for a one-sided deal that includes Jacobson retaining his position as CEO post-transaction," wrote Justice Ostrager (who was formerly an ace corporate defense litigator at Simpson Thacher & Bartlett). "There is ample evidence that he collaborated with Fuji to make himself indispensable to the transaction."

That hearing probably wouldn't have happened, said shareholder lawyer Sabella, if this case had been litigated in Delaware.

As recently as 2012, Delaware judges would, in rare instances, enjoin transactions. In 2011 Vice Chancellor Travis Laster blocked a shareholder vote on a $3.5 billion leveraged buyout of Del Monte because of its financial adviser's alleged conflicts. *In re Del Monte Foods Co. S'holders Litig.*, 25 A.3d 813 (Del. Ch. 2011).

The following year, Chancellor Leo Strine (now chief justice of the Delaware Supreme Court) enjoined Martin Marietta's hostile tender offer for Vulcan Materials. *Martin Marietta Materials Inc. v. Vulcan Materials Co.*, 56 A.3d 1072 (Del. Ch. 2012).

Even if Delaware judges were deciding the Xerox case based on the record developed before Justice Ostrager, said Brooklyn Law professor Minor Myers, they might well have rejected shareholder attempts to block the deal

One of the most damning documents, which Justice Ostrager said would have been sufficient by itself to prove the board's likely breach of its fiduciary duty, was a text message, witnessed by board chairman Robert Keegan and another director, in which Jacobson told a high-ranking Fuji executive that he and Fuji were a "team" aligned against Icahn, their "mutual enemy."

From nearly the beginning of the litigation, said Deason lawyer Richard Marooney of K&S and shareholder class-action lawyer James Sabella of G&E, Justice Ostrager was determined to hear from Xerox witnesses, not just lawyers on both sides. In April he set a punishing pretrial schedule, including a pair of depositions in Japan of Fuji witnesses.

"He did it right," said Marooney, who credited his firm's New York litigators for running at the judge's fast pace. "He wanted to understand the facts, and not just on paper. He wanted to get to the truth."

But in 2014's *C&J Energy Services v. City of Miami General Employees' and Sanitation Employees' Retirement Trust*, 107 A.3d 1049 (Del. 2014), the Delaware Supreme Court reversed an injunction against C&J's merger with Nabors Industries.

The state justices essentially said that when independent boards exercise their business judgment to approve strategic mergers — and give shareholders a right to vote on the deals — the Chancery Court should not stand in the way, particularly if there's no competing bid for the company.

Since then, said Harvard law school professor Guhan Subramanian, the trajectory in Delaware Chancery Court has been away from scrutiny of deal processes.

Subramanian, who was an expert witness for shareholders in the Xerox case, said he was impressed that, in contrast to Delaware courts in recent years, Justice Ostrager was willing "to engage in a meaningful way" with details of the deal.

Even if Delaware judges were deciding the Xerox case based on the record developed before Justice Ostrager, said Brooklyn Law professor Minor Myers, they might well have rejected shareholder attempts to block the deal.

"You could easily image a Chancery judge, with all the factual findings, nevertheless saying, 'I'm going to let shareholders vote,'" said Myers, who was not involved in the Xerox case but read the April 27 ruling.

It's going to be interesting, said shareholder lawyer Sabella, to track whether shareholders who suspect deals were tainted by real conflicts try to find a way to bring their cases in New York after the Xerox decision.

Xerox is incorporated in New York, so filing in state court in Manhattan was an easy call for its shareholders. But for shareholders of Delaware-incorporated companies headquartered in New York, "this decision is going to make New York a more attractive jurisdiction," Sabella said.

I emailed Xerox counsel Jay Cohen of Paul Weiss and Fuji lawyers Erik Olson and James Hough of Morrison & Foerster but didn't hear back. Xerox told Reuters on April 27 that it will appeal Justice Ostrager's ruling.

"The company strongly believes that its shareholders should be allowed to exercise their right to vote on the transaction and decide for themselves," Xerox said. "The Xerox board undertook a rigorous process to reach its decision to approve the proposed transaction, including a comprehensive review of the company's strategic and financial alternatives, as well as potential transaction structures in its negotiations with Fujifilm." WJ

Corporate governance roundup for the week ending May 4, 2018

Here's a quick overview of key corporate governance activity reported on Westlaw's Practitioner Insights for Corporate Governance page.

CORPORATE AND SHAREHOLDER DEVELOPMENTS

- **Sturm Ruger & Co.** says a majority of the gunmaker's investors backed a resolution calling for a report on efforts to make guns safer as shareholders attempt to get corporate America to help prevent mass shootings. Read more: 5/9/18 REUTERS 18:36:24 and 2018 WL 2148143
- Toymaker **Mattel Inc.** highlights its corporate governance policies, recent leadership changes and new strategic initiatives to gain shareholder support for its proposed director slate and executive compensation plans at its 2018 annual meeting. Read more: 2018 WL 2137758
- Activist hedge fund **Elliott Management LP** proposes an all-cash offer to acquire **Athenahealth Inc.** for $160 per share in a deal that would value the health care software maker at about $6.9 billion including debt. Read more: 5/7/18 REUTERS 15:40:25
- **Voce Catalyst Partners LP** seeks the support of **Natus Medical Inc.** shareholders in its campaign to replace half the medical technology company's six incumbent directors, including the chairman, over concerns about Natus' financial performance and strategy. Read more: 2018 WL 2123589
- **Xerox Corp.**'s board says its intends to resume merger discussions with **Fujifilm Holdings Corp.**, seeking a superior deal to terms announced at the end of January that have spurred a proxy fight over the print technology giant. Read more: 5/9/18 REUTERS 13:37:28
- Activist investor **Land & Buildings Investment Management LLC** says if it wins a board seat at **Taubman Centers Inc.** it will attempt to implement major governance changes, including removing **CEO Robert Taubman** as chairman and eliminating the mall operator's dual-class stock. Read more: 2018 WL 2111890
- **Wynn Resorts Ltd.**'s largest shareholder, **Elaine Wynn**, gains the support of proxy advisers **Institutional Shareholder Services Inc.** and **Glass & Lewis & Co.** to oust a board member she describes as handpicked by her ex-husband **Steve Wynn**, who quit as CEO and chairman in February after sexual misconduct allegations. Read more: 2018 WL 2126701
- Social gaming company **Zynga Inc.** announces it will eliminate its multiclass share structure, a move that will reduce founder **Mark Pincus**' voting power from about 70 percent to 10 percent. Read more: 2018 WL 2107875
- Enterprise data management firm **Commvault Systems Inc.** says it will replace longtime **CEO N. Robert Hammer** and get two new independent directors to further its new "strategic transformation plan" under an agreement with activist hedge fund **Elliott Management Corp.** Read more: 2018 WL 2103915
- Leading proxy advisory firm **Institutional Shareholder Services Inc.** backs activist investor **KBS Strategic Opportunity REIT**'s bid to seat two new directors at **Whitestone REIT** and a proposal to declassify the commercial real estate investment trust's board. Read more: 2018 WL 2138470
- Broadcast company **E.W. Scripps Co.** wins the support of major shareholder advisory firm **Institutional Shareholder Services Inc.** in its proxy fight for board seats with activist investor **Gamco Asset Management Inc.** Read more: 2018 WL 2037145
- **DowDuPont Inc.** shareholders approve a proposal to nix supermajority voting standards despite the chemical company's position that it needs the higher standard to complete its planned split into three separate businesses. Read more: 2018 WL 2037144
- A **Sturm, Ruger & Co.** investor, expressing concerns about the weapons maker's ties to the **National Rifle Association**, says it may oppose the re-election of a board member who formerly led the gun rights group unless the company commits to certain gun safety measures. Read more: 2018 WL 2002230
- The **International Brotherhood of Teamsters** opposes the re-election of two longtime board members at **Stericycle Inc.**, saying the directors bear significant responsibility for a billing scandal that has harmed the medical waste disposal firm's finances and reputation. Read more: 2018 WL 2034451
- A **Citigroup Inc.'s** investor request that the bank lower its threshold of shareholder support needed to call a special stockholders' meeting fails by the slimmest of margins, winning the approval of 49.9 percent of votes cast. Read more: 2018 WL 2016416
- **Allergan PLC CEO Brent Saunders** says he opposes fundamental changes to the drug manufacturer's business strategy, even as the Botox maker's board considers drastic moves like splitting the company or selling off assets to turn around a steep drop in its share price. Read more: 4/30/18 REUTERS 17:01:54
- **Realogy Holdings Corp.** seeks shareholder support for its executive compensation metrics in light of a report by proxy adviser **Institutional Shareholder Services Inc.** recommending that investors vote against the real estate and relocation services company's 2017 pay packages. Read more: 2018 WL 1997159
- One of **Destination Maternity Corp.**'s activist investors questions whether the clothing retailer has complied with his requests for shareholder information in an ongoing proxy contest to replace the company's board. Read more: 2018 WL 2016413
- U.S. activist fund **Elliott Management** begins a legal dispute with South Korea over a controversial $8 billion merger of two **Samsung** affiliates in 2015 that Elliott had tried to block through a proxy contest. Read more: 5/1/18 REUTERS 14:53:45

- Technology maker **Aptiv PLC**, apparel conglomerate **VF Corp.**, and oil and gas refiner **Marathon Petroleum Corp.** receive shareholder support for their executive compensation despite reporting some of highest reported CEO-to-median worker pay under new disclosure rules. Read more: 2018 WL 2057600
- **Connecticut Water Service Inc.** receives antitrust clearance for its pending $750 million merger with fellow water utility **SJW Group Inc.**, but a rival bidder **Eversource Energy** creates a new potential hurdle to closing the transaction by launching a proxy contest for shareholder votes against the merger. Read more: 2018 WL 2036203
- **McKesson Corp.** adds a compliance specialist to its board as lawsuits, federal investigations and investor campaigns press the largest U.S. drug distributor to take accountability for its role in the opioid epidemic. Read more: 2018 WL 2016419
- Timeshare operator **ILG Inc.** satisfies an activist investor's demand by striking a $4.7 billion cash-and-stock deal to merge with key competitor **Marriott Vacations Worldwide Corp.** Read more: 2018 WL 2002224
- **Goldman Sachs Group Inc.**'s leaders report that more than 87 percent of shares were voted in favor of its executive pay at the investment firm's annual shareholder meeting and that shareholders approved a stock plan for employees by more than 65 percent of votes cast. Read more: 5/2/18 REUTERS 17:42:29

REGULATORY ACTIVITY

- A coalition of 133 labor, public interest and advocacy organizations calls on the **Securities and Exchange Commission** to oppose mandatory arbitration of securities fraud claims, saying forced arbitration would deprive investors of the right to file class actions. Read more: 2018 WL 2106802

COURT ACTIVITY

- **Xerox Corp.** files an appeal with a **New York appellate court** of an order temporarily blocking the print technology giant's merger with Japan's **Fujifilm Holdings Corp.** as top investors **Carl Icahn** and **Darwin Deason** continue to oppose the deal and challenge Xerox's board. Read more: 2018 WL 2125895
- A special board committee formed to consider bulk shipper **Baltic Trading Ltd.**'s merger with parent **Genco Shipping & Trading Ltd.** was sufficiently independent notwithstanding its members' past business relationships with the parent and its chairman, a **New York appeals court** concludes. Read more: 2018 WL 2108622
- Drugmaker **Esperion Therapeutics Inc.** and top executives failed to disclose serious safety risks for a cholesterol-lowering medication that led to patient deaths in a recent clinical trial, according to a shareholder lawsuit filed in **Michigan federal court**. Read more: 2018 WL 2142671
- **LendingClub Corp.** must compensate investors for losses stemming from the peer-to-peer lending platform's false promises to borrowers that there were "no hidden fees" on their loans, a shareholder fraud lawsuit filed in a **California federal court** says. Read more: 2018 WL 2111048
- A **New York appellate court** declines to reinstate a shareholder lawsuit accusing **McGraw Hill Financial Inc.** executives of harming the credit ratings agency by pursuing a business strategy that inflated the value of structured financial instruments in the lead-up to the 2008 financial crisis. Read more: 2018 WL 2142514
- **China Fund Inc.** postpones its annual shareholders meeting to appeal a **Manhattan federal judge**'s refusal to stop an investor group from soliciting "misleading" proxies to remove the closed-end investment fund's external manager. Read more: 2018 WL 2048654
- A **Visionsense Corp.** shareholder sues in **Delaware Chancery Court** to inspect the surgical technology company's books and records to investigate possible wrongdoing by its directors in its $65 million acquisition by **Medtronic Corp.** Read more: 2018 WL 2050014
- **Under Armour Inc.**'s directors breached their fiduciary duties by letting the athletic apparel company engage in self-dealing business transactions with entities controlled by **CEO Kevin Plank**, a shareholder alleges in a **Baltimore federal court** lawsuit. Read more: 2018 WL 2054662

CASE AND DOCUMENT INDEX

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TESLA-DEFENDANT APPLICATION

2018 WL 1785817 (Del.Ch.) (Trial Motion, Memorandum and Affidavit)
Chancery Court of Delaware.

In re TESLA MOTORS, INC. Stockholder Litigation.
No. 12711-VCS.
April 9, 2018.

Defendants' Application for Certification of Interlocutory Appeal

Ross Aronstam & Moritz LLP, David E. Ross (Bar No. 5228), Garrett B. Moritz (Bar No. 5646), Benjamin Z. Grossberg (Bar No. 5615), 100 S. West Street, Suite 400, Wilmington, Delaware 19801, (302) 576-1600, for defendants Tesla, Inc., Elon Musk, Brad W. Buss, Robyn M. Denholm, Ira Ehrenpreis, Antonio J. Gracias, Stephen T. Jurvetson and Kimbal Musk.

Of Counsel: William Savitt, Graham W. Meli, Anitha Reddy, Steven Winter, David E. Kirk, Wachtell, Lipton, Rosen & Katz, 51 West 52nd Street, New York, NY 10019.

1. On March 28, 2018, the Court issued an opinion (the "Opinion") denying defendants' motion to dismiss the complaint, which challenged Tesla, Inc.'s acquisition of SolarCity Corp. The Court held that the complaint adequately alleged that Elon Musk, Tesla's CEO and chairman, was Tesla's controlling stockholder for purposes of the acquisition, even though Musk held only a 22% stake, made no retributive threats, and his shares were excluded from the stockholder vote on the acquisition.

2. No previous Delaware decision had ever deemed a 22% stockholder who had sterilized his shares in favor of the public to be a controlling stockholder. The Opinion itself acknowledged that the holding was "a close call." Op. 2.

3. The reasoning of the Opinion conflicts with other decisions of this Court. Under those decisions, whether a minority stockholder can be deemed controlling turns on whether it had the ability to effectively control a contested stockholder vote, such that it was practically situated as though it had majority voting control. The Opinion did not apply that test. Instead, the Opinion based its finding of pleaded control on factors that prior decisions considered relevant in determining the standard of review in non-controller cases or the fairness of controlled transactions, but not in determining whether a minority stockholder was controlling. The Opinion thus creates substantial uncertainty regarding the test for control.

4. The Opinion's determination that Musk was pleaded to be a controlling stockholder provisionally establishes entire fairness as the standard of review. Prompt appellate review of that determination will allow the Supreme Court to not only address the potentially dispositive standard of review in this case, but also to provide guidance to litigants and transactional planners on one of the most practically and doctrinally important questions in Delaware law: When is a minority stockholder a controlling stockholder?

5. For these reasons, defendants and their counsel believe in good faith that the criteria set forth in Supreme Court Rule 42 are satisfied and respectfully ask this Court to certify an interlocutory appeal of the Opinion.

BACKGROUND

6. In July 2016, Tesla, a manufacturer of electric cars and clean energy storage products, agreed to acquire SolarCity, a producer of solar power systems. At the time, Tesla had seven directors and one class of stock. Its chairman and CEO was Elon Musk, who held a 22% stake in the company. Musk did not have, and was not alleged to have, any additional voting power or rights to influence the appointment of Tesla's directors. Musk, who also held a 22% stake in SolarCity and served as a director, recused himself from the vote in which Tesla's board approved the acquisition.

7. Tesla was not required by Delaware (or any other) law to submit the acquisition to a vote of its unaffiliated stockholders. But Tesla's board decided to condition the acquisition on the majority vote of the unaffiliated shares, defined as shares other than those held by Musk or any other director or officer of SolarCity. Over 85% of Tesla's unaffiliated voting shares, and over 58% of Tesla's unaffiliated shares outstanding, were voted in favor of the acquisition. *See* Defs.' Opening Br. (Dkt. No. 110) Ex. 4 (Tesla, Inc. Nov. 18, 2016 Form 8-K).

8. Several Tesla stockholders filed suit in this Court challenging the acquisition and alleging that Musk was Tesla's controlling stockholder. The Court denied defendants' motion to dismiss, holding that the complaint adequately pleaded that Musk was Tesla's controlling stockholder and that dismissal based on *Corwin* ratification was therefore unavailable.

ARGUMENT

9. Supreme Court Rule 42 permits immediate appeal of an interlocutory ruling if the ruling "decides a substantial issue of material importance that merits appellate review before a final judgment" and "there are substantial benefits that will outweigh the certain costs that accompany an interlocutory appeal." In determining whether that standard is met, the Court may consider several factors, including whether (1) "[t]he decisions of the trial courts are conflicting upon the question of law," (2) "[r]eview of the interlocutory order may terminate the litigation," and (3) "[r]eview of the interlocutory order may serve considerations of justice." Sup. Ct. R. 42(b)(iii). The standard of Rule 42 is satisfied here.

A. The Opinion conflicts with other Court of Chancery decisions

10. In a line of cases interpreting the Supreme Court's seminal decision in *Kahn v. Lynch,* 638 A.2d 1110, 1113 (Del. 1994), the Court of Chancery refined the test for determining when a minority stockholder "exercises control over the business affairs of the corporation" and is therefore charged with fiduciary duties as a controlling stockholder. The Opinion adopts a test that conflicts with that case law.

11. In *Lynch,* the Supreme Court held that "actual control of corporation conduct" is essential to a finding that a less-than-50% holder is a controlling stockholder and that substantial stockholdings--even those above 40%-are not enough. *Id.* at 1114. Rather, the Court emphasized, a finding of "actual control" must rest on a showing that the minority holder had the power to compel compliance with its wishes by threatening or ousting directors who resist its demands. *Id.* at 1114-15.

12. In three important decisions, the Court of Chancery applied this lesson from *Lynch.* In *In re Cysive, Inc. Shareholders Litigation,* 836 A.2d 531, 552-53 (Del. Ch. 2003), the court explained that the "premise" of the *Lynch* doctrine is that the defining attribute of a controlling stockholder is "potent retributive capacity." The court found that a 40% blockholder had that capacity because "[i]f [he] becomes dissatisfied with the independent directors, his voting power positions him well to elect a new slate more to his liking without having to attract much, if any, support from public stockholders." *Id.* at 552.

13. In *In re PNB Holding Co. Shareholder Litigation,* 2006 WL 2403999, at *9 (Del. Ch. 2006), the court further refined the test: Less-than-50% stockholders are controlling only if they "have such formidable voting and managerial power that they, as a practical matter, are no differently situated than if they had majority voting control." And in *In re Morton's Restaurant Group Shareholders Litigation,* 74 A.3d 656, 665 (Del. Ch. 2013), the court emphasized that to meet this test, "the minority blockholder's power must be so potent that independent directors cannot freely exercise their judgment, fearing retribution from the controlling minority blockholder."

14. In *In re KKR Financial Holdings LLC Shareholder Litigation,* 101 A.3d 980, 995 (Del. Ch. 2014), the Court of Chancery applied the test for controlling stockholder status as synthesized in *Cysive, PNB, and Morton's.* The plaintiffs contended that KKR was the controlling stockholder of KFN, despite owning less than 1 percent of KFN's outstanding stock, because KKR "managed [KFN's] day-to-day business," making KFN "operationally dependent" on KKR. *Id.* at 983. The court determined that KKR could not be deemed KFN's controlling stockholder because, based on the pleaded facts, KKR lacked "sufficient voting power" to "remove [KFN's directors] from their positions if they rejected the merger or took any other action that KKR did not like." *Id.* at 994. "In sum," the court held, the complaint failed to plead that KKR was KFN's controlling stockholder because it did not allege that "KKR had the power to exact retribution by removing the [KFN] directors from their offices if they did not bend to KKR's will." *Id.* at 995.

15. On appeal, the Supreme Court endorsed the inquiry articulated in *Cysive, PNB, and Morton's* as the governing test for control and held that the Court of Chancery had "correctly applied the law." *Corwin v. KKR Fin. Holdings LLC,* 125 A.3d 304, 308 (Del. 2015).

16. The Opinion does not apply the test developed in *Cysive, PNB,* and *Morton's.* It instead conducts an analysis that conflicts with those decisions in at least three significant ways.

17. First, the Opinion does not apply the principle that minority stockholders may be deemed controlling "only" when they "have such formidable voting and managerial power that they, as a practical matter, are no differently situated than if they had majority voting control." *Corwin,* 125 A.3d at 307 & n.8. To the contrary, the Opinion cites that test only once--and not as part of the governing test,

but rather as a description of defendants' position (which the Opinion declined to credit). Nor does the Opinion acknowledge that, under *Corwin,* the governing test is not met where the minority stockholder lacks "the power to exact retribution by removing the [independent] directors from their offices if they did not bend to [its] will." *Id.* at 308.

18. Instead, the Opinion concludes that the complaint adequately pleads that Musk is Tesla's controlling stockholder even though it does not plead facts showing that Musk is, "as a practical matter, ... no differently situated than if [he] had majority voting control." *Corwin,* 125 A.3d at 307 & n.8. To the contrary, the Opinion recognizes that Musk could bridge the "quite wide" gap between his 22% stake and a majority voting position only by "rally[ing] other stockholders" to his side. Op. 44.

19. The Opinion counts the fact that Musk must convince fellow stockholders to vote in favor of his preferred corporate policy as support for the complaint's allegation of control. Op. 44. But under *Lynch* and its progeny, the fact that Musk must persuade the electorate (rather than rely on the "inherent threat" of his "potent retributive capacity") to advance his corporate agenda demonstrates a *lack* of control. Influence arising from the ability to persuade (rather than the ability to intimidate or compel) has never been, and cannot logically be, a sign of a controlling stockholder. What's more, the stockholder majority that approved the SolarCity acquisition did not even include Musk and his 22% stake because Musk's shares were excluded from that ratifying vote.

20. The Opinion suggests that Musk's 22% stake gives him "blocking power" in stockholder votes because Tesla's bylaws require a two-thirds stockholder majority to amend certain bylaws--even though plaintiffs did not argue in opposition to the motion to dismiss that the requirement supported their allegation of control. Op. 45; Defs.' Opening Br. (Dkt. No. 110) Ex. 10 (Tesla's bylaws), at art. X. But Musk's 22% stake is too small to be used as a veto when a 66.6% vote is required, and it is undisputed that the supermajority requirement does not apply to Tesla's director elections, to the SolarCity acquisition, or to alternative acquisitions. Moreover, the complaint does not (and cannot) allege that Musk ever attempted or threatened such a veto. In any event, the existence of the supermajority requirement makes it harder, not easier, for Musk to retaliate against independent directors and stockholders by proposing vindictive changes to the bylaws.

21. The Opinion holds that Musk is Tesla's controlling stockholder, notwithstanding his inability to remove Tesla's other directors, because of his "singularly important" role in Tesla's management. Op. 48-49; 54-55. That reasoning is in tension with *KKR Financial,* which found that KKR could not be KFN's controlling stockholder given its inability to remove KFN's independent directors--even though it was undisputed that KFN was "completely reliant" on KKR to manage its day-to-day operations. 101 A.3d at 985, 995. Moreover, there is and can be no allegation that Musk ever threatened to abandon his role at Tesla if the board or stockholders did not approve the SolarCity acquisition or that Musk made any retributive threats of any kind. (The Opinion observes that the complaint alleges that Musk orchestrated the removal of the CEO. But, as the complaint makes clear, Musk allegedly did so more than 10 years ago, at a time when he held a "controlling stake" and well before Tesla had gone public.)

22. Second, the Opinion diverges from prior case law in holding that "whether a board is comprised of independent or disinterested directors is relevant to the controlling stockholder inquiry because the answer, in turn, will inform the court's determination of whether the board was free of the controller's influence such that it could exercise independent judgment in its decision-making." Op. 50. According to the Opinion, this factor supports the conclusion that the complaint "adequately pleads Musk's controller status" because three of Tesla's directors were alleged to be either dependent on Musk or interested in the SolarCity acquisition. Op. 40, 50-53.

23. The Opinion's rationale for considering the independence or disinterestedness of the directors in the controlling stockholder inquiry risks making that inquiry circular. One cannot decide if a director is "free of the controller's influence" without first deciding if a minority blockholder is a controlling stockholder. Op. 50. The Opinion cites *KKR Financial* as support for considering that issue as part of the controlling stockholder inquiry, Op. 50, but *KKR Financial* recognized that the independence of directors presented "a separate question" from control. 101 A.3d at 994 n.54, 995-98. Moreover, *KKR Financial's* ratification holding is explicitly premised on the importance of keeping those questions separate because, as that decision recognized, *Corwin* ratification of a transaction is available even when a board is not independent or disinterested, but not when a controlling stockholder dominates the transaction. *Id.* at 999.

24. Third, the Opinion considers the absence of procedural protections at the board level, such as a special committee, as a factor supporting a finding of control. But the absence of such procedural protections is not relevant to the test for controlling stockholder status endorsed in *Corwin.* This Court did not consider such protections in *KKR Financial.* And in *Cysive,* a case *Corwin* cites with approval, this Court assigned such procedural devices importance only in determining whether the transaction was fair, not in deciding whether the alleged controlling stockholder was indeed controlling. 836 A.2d at 552-54.

25. The Opinion's invocation *of Dell Inc. v. Magnetar Global Event Driven Master Fund,* 177 A.3d 1 (Del. 2017), highlights the doctrinal tension. There, the Supreme Court found that Michael Dell, who, like Musk, was "the face" of his company, was not a controlling stockholder with respect to the challenged transaction-not because of the use of a special committee but instead because (as in this case) he had a relatively low voting stake of only 15% and pledged to vote his shares in accordance with unaffiliated stockholders. *Id.* at 30.

B. The Opinion initially determines the potentially dispositive standard of review

26. The Opinion's determination that Musk is Tesla's controlling stockholder provisionally establishes entire fairness as the standard of review. "Because ... the standard of entire fairness [is] so exacting, the determination of the appropriate standard of judicial review frequently is determinative of the outcome of [the] litigation." *Unitrin v. Am. Gen. Corp.,* 651 A.2d 1361, 1371 (Del. 1995). For this reason, this Court has recognized that the standard of review is a substantial issue for the purpose of deciding to certify interlocutory review. *See, e.g., In re Pure Res., Inc. S'holders Litig.,* 2002 WL 31357847, at *2 (Del. Ch. Oct. 9, 2002) ("[t]he first requirement of Supreme Court Rule 42(b) appears to have been met, because it is difficult to say that determining that the entire fairness standard does not apply to the exchange offer did not 'determin[e] a substantial issue' ").

27. Furthermore, appellate review could remove the controlling stockholder issue from the case at the pleadings stage, thus significantly reducing the scope of discovery and permitting dismissal of the complaint or summary judgment on the basis of *Corwin* ratification. As a result, "there are substantial benefits that will outweigh the certain costs that accompany an interlocutory appeal." Sup. Ct. R. 42(b)(ii).

C. Prompt clarification of the test for controlling stockholder status will benefit transactional planners and so serve considerations of justice

28. The Opinion introduces uncertainty into the controlling stockholder doctrine by holding, for the first time, that a stockholder with a stake nowhere near majority control and no right to designate directors, who made no retributive threats, and who even sterilized his vote on a transaction, can be deemed a controlling stockholder with respect to that transaction.

29. The need for guidance in this area is acute. The Opinion declines to apply the test for control developed in *Cysive, PNB,* and *Morton's;* applied in *KKR Financial;* and endorsed in *Corwin.* Instead, the Opinion merges the control inquiry with the previously distinct inquiries into board independence and special committee protections. Confirming the need for further clarity, the Opinion itself states that Court of Chancery decisions addressing whether a minority stockholder is a controlling stockholder are characterized by "[t]he absence of a discernable pattern." Op. 42.

30. The test for control is too important to leave without predictable guidance. The Delaware courts have long endeavored to create an "overall body of case law [that] coherently fills in a map that guides transactional and corporate governance advisors in charting a course for their clients that is relatively risk free." Leo E. Strine, Jr., *The Delaware Way,* 30 Del. J. Corp. L. 673, 683 (2005). Whether a transaction will be treated as one involving a controlling stockholder is perhaps the single most important question for transactional planners in deciding whether to pursue a transaction, and if so, how to structure the process to reduce litigation and deal risk. By increasing the uncertainty surrounding this question, the Opinion not only complicates the decision-making of economic actors sensitive to risk and cost, but also reduces the incentives for founders and other early-stage majority stockholders to relinquish controlling voting power to the public. The foreseeable result of greater legal uncertainty will be fewer productive economic transactions.

31. As a pleadings-stage decision involving limited and straightforward facts and presenting a pure question of law, the Opinion is an optimal vehicle for the Supreme Court to clarify a fundamental question of corporate law. Absent review, transactional planners will face uncertainty as to whether relatively small blockholders will be held to owe fiduciary duties as controlling stockholders.

CONCLUSION

For the foregoing reasons, the Opinion should be certified for interlocutory review.

ROSS ARONSTAM & MORITZ LLP

/s/ Garrett B. Moritz

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TESLA-PLAINTIFF OPPOSITION

2018 WL 1948834 (Del.Ch.) (Trial Motion, Memorandum and Affidavit)
Chancery Court of Delaware.

In re TESLA MOTORS, INC. Stockholder Litigation.
No. 12711-VCS.
April 19, 2018.

Plaintiffs' Opposition to Defendants' Application for Certification of Interlocutory Appeal

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1. This action challenges the $2.6-billion acquisition (the "Acquisition") of SolarCity Corporation ("SolarCity") by Tesla, Inc. ("Tesla"). Elon Musk ("Musk") was the co-founder, largest stockholder and chairman of both Tesla and SolarCity. Tesla's Board of Directors (the "Board" or "Defendants") included Musk's closest business partners and long-time allies. With SolarCity facing bankruptcy absent a bailout, Musk led and the Board approved the Acquisition to serve their own financial interests. Plaintiffs now seek to remedy the damages caused by the Acquisition, bringing claims for breach of fiduciary duty and corporate waste.

2. In moving to dismiss Plaintiffs' claims, Defendants did not contest whether the Board engaged in disloyal conduct or that the Acquisition is subject to an entire fairness review *ab initio.* Instead, Defendants sought dismissal based on stockholder ratification pursuant to *Corwin v. KKR Financial Holdings LLC,* 125 A.3d 304 (Del. 2015). Defendants acknowledged, however, that even their ratification arguments fail, at this stage, if Plaintiffs adequately pled that Musk controlled Tesla.

3. On March 28, 2018, the Court issued Memorandum Opinion denying the motion to dismiss (the "Order"). Relying on well-established legal standards, the Court determined that it was reasonably conceivable that Musk controlled the Board in connection with the Acquisition. Order at 2. Defendants are now seeking an interlocutory appeal to challenge the Court's Order.

4. Interlocutory appeal is appropriate "only in exceptional circumstances." *Emerson Radio Corp. v. Int 'l Jensen Inc.,* 1996 WL 526015, at *1 (Del. Aug. 23, 1996). The moving party must not only identify a "substantial issue of material importance" that will be addressed

on appeal, but the Court "should refuse to certify the interlocutory appeal" if there is any doubt as to whether potential benefits of an appeal may be outweighed by the resulting costs and delays. Supr. Ct. R. 42(b)(iii).

5. Defendants do not meet this standard. As discussed below, (1) Defendants have not identified a substantial issue of material importance to be addressed on appeal, (2) the Court applied well-established precedent in denying the motion to dismiss, and the interests of justice will not be served by appeal, and (3) any theoretical benefits of an interlocutory appeal are outweighed by the resulting costs and delays. Accordingly, Plaintiffs respectfully request that Defendants' application be denied.

ARGUMENT

6. "No interlocutory appeal will be certified by the trial court or accepted by [the Delaware Supreme] Court unless the order of the trial court decides a substantial issue of material importance that merits appellate review before a final judgment." Supr. Ct. R. 42(b)(i). "Interlocutory appeals should be exceptional, not routine, because they disrupt the normal procession of litigation, cause delay, and can threaten to exhaust scarce party and judicial resources." Supr. Ct. R. 42(b)(ii). When considering an application to certify an interlocutory appeal, "the trial court should identify whether and why the likely benefits of interlocutory review outweigh the probable costs, such that the interlocutory review is in the interests of justice. If the balance is uncertain, the trial court should refuse to certify the interlocutory appeal." Supr. Ct. R. 42(b)(iii).

7. Here, Defendants present three arguments in support of their application: (1) the Court's ruling on Musk's controller status is potentially dispositive and therefore presents a substantial issue of material importance; (2) the Court misapplied the applicable law regarding controlling stockholders; and (3) interlocutory review will provide clarity as to this legal issue and is thereby in the interests of justice. As discussed below, each of these arguments are without merit and do not outweigh the significant disruption, costs and delays that would be caused to this case - which has already been pending for over 18 months - by interlocutory review.

A. No Substantial Issue of Material Importance Exists Because The Court Did Not Make Any Final Determination as to a Dispositive Issue

8. To obtain interlocutory certification, an applicant must show that the trial court resolved a "substantial issue," which occurs only if the Court decided a substantive legal issue that relates to the ultimate merits of the action. *Ryan v. Gifford,* 2008 WL 43699, at *4 (Del. Ch. Jan. 2, 2008); *Castaldo v. Pittsburgh-Des Moines Steel Co.,* 301 A.2d 87, 87 (Del. 1973). A decision on a motion to dismiss, where defendants maintain their defenses at summary judgment and trial, is not a "final determination" for the purposes of certification of an interlocutory appeal. *See Fuqua Indus., Inc. v. Lewis,* 504 A.2d 571 (Table) (Del. 1986); *Sutherland v. Sutherland,* Del. Ch., No. 2399, Lamb, V.C. (May 29, 2008) (ORDER) (same) [attached hereto as Exhibit A]. In denying interlocutory review of a ruling on a motion to dismiss in *Fuqua,* the Supreme Court explained that "no final determination was being made on the merits of plaintiffs claims, but only that plaintiff would be afforded the right to pursue discovery related to the allegations of the complaint." 504 A.2d at 571.[1]

9. Here, the preliminary nature of the Court's Order does not present a substantial issue that can warrant interlocutory appeal. In denying Defendants' motion to dismiss, the Court found: "[T]he combination of well-pled facts relating to Musk's voting influence, his domination of the Board during the process leading up to the Acquisition against the backdrop of his extraordinary influence within the Company generally, the Board level conflicts that diminished the Board's resistance to Musk's influence, and the Company's and Musk's own acknowledgements of his outsized influence, all told, *satisfy Plaintiffs' burden to plead* that Musk's status as a Tesla controlling stockholder is reasonably conceivable." Order at 56-57 (emphasis added).

10. The Court expressly recognized that it was not making a final determination as to this issue, explaining: "*The facts developed in discovery may well demonstrate otherwise.* But Plaintiffs have secured a right to pursue that discovery by adequately pleading their breach of fiduciary duty claims and the *ab initio* inapplicability of *Corwin*." *Id.* at 57 (emphasis added and citations omitted).

11. Consequently, like in *Fuqua,* the Order did not decide a substantial issue of material importance because the Court made only a preliminary determination regarding the sufficiency of Plaintiffs' allegations and has not made a definitive determination about either Musk's controller status or the appropriate standard of review. The preliminary nature of the Court's ruling is by itself sufficient reason to deny Defendants' application for certification of interlocutory appeal.

12. Moreover, Defendants disregard that the Court's determination regarding Musk's controller status is far from dispositive. Defendants' motion to dismiss involved four substantive issues, including whether: (1) Musk was a controlling stockholder; (2) a

majority of disinterested Tesla stockholders voted in favor of the Acquisition; (3) material information was withheld from Tesla stockholders; and (4) the Acquisition constituted corporate waste. For the motion to dismiss to be granted, Defendants needed to prevail on each of these issues.

13. In denying the motion to dismiss, the Court found that the complaint pled facts supporting the reasonable inference that Musk was a controlling stockholder, and the Court therefore did not need to address the remaining arguments. Order at 37. Thus, if the Order were overturned on appeal, the action would not be still not be "terminated" pursuant to Rule 42(b)(iii)(G).[2] Rather, the Court would then have to consider Plaintiffs' other arguments against dismissal.

14. Consequently, the Court's Order - even if reversed - will not terminate the litigation, and it therefore does not present a substantial issue.

B. No Substantial Issue of Material Importance Exists Because The Court Correctly Applied the Law

15. When a decision is "the result only of the application of well-settled precedent to a set of particular and specific facts," it does not decide a "substantial issue." *Ryan,* 2008 WL 43699, at *4, 5; *see also Capella Holdings, Inc. v. Anderson,* 2015 WL 4722710 (Del. Ch. Aug. 4. 2015) (denying application to certify interlocutory appeal of denial of motion to dismiss where defendant "does not challenge the law which the Court applied; instead, he contends that the Court was wrong in how the law was applied"). This is precisely what occurred here.

16. Defendants' application is premised on the position that the Court misapplied the law when determining whether Plaintiffs pled facts that could support Musk being a controlling stockholder. Application ¶¶10-25. Specifically, Defendants assert that a minority stockholder may only be found to be a controller when the stockholder has "the power to compel compliance with its wishes by threatening or ousting directors who resist its demands," and the Court erred by considering a broader range of factors. *Id.* ¶¶11-16. Well-established case law demonstrates, however, that the ability to oust dissenting directors is just one relevant factor the Court may consider as part of a highly-contextualized inquiry.

17. "Actual control over business affairs may stem from sources extraneous to stock ownership, and the Court does not take an unduly restrictive view of the avenues through which a controller obtains corporate influence." *In re Zhongpin, Inc. S'holders Litig.,* 2014 WL 6735457, at *8 (Del. Ch. Nov. 26, 2014), *rev'd on other grounds sub nom., In re Cornerstone Therapeutics Inc. S'holder Litig.,* 115 A.3d 1173 (Del. 2015); *In re Cysive, Inc. S'holders Litig.,* 836 A.2d 531, 550-51 (Del. Ch. 2003) (explaining that "whether a large blockholder is so powerful as to have obtained the status of a 'controlling stockholder' is intensely factual"). Rather than requiring a mathematical approach focused solely on the alleged controller's voting power, the Court has explained that "there is no magic formula to find control; rather, it is a highly fact specific inquiry." *Calesa Assocs., v. American Capital,* 2016 WL 770251, at *11 (Del. Ch. Feb. 29, 2016). While a stockholder's percentage ownership in the company is to be considered when determining whether a plaintiff has sufficiently alleged control, there is not "any sort of linear, sliding-scale approach whereby a larger share percentage makes it substantially more likely that the court will find the stockholder was a controlling stockholder." *In re Crimson Exploration, Inc. Stockholder Litig.,* 2014 WL 5449419, at *10 (Del. Ch. Oct. 24, 2014); *In re PNB Holding Co. S'holders Litig.,* 2006 WL 2403999, at *9 (Del. Ch. Aug. 18, 2006) (holding that "there is no absolute percentage of voting power that is required in order for there to be a finding that a controlling stockholder exists").

18. As Defendants' own legal authority makes clear, control may be established through a combination of "voting power and management control." *Corwin,* 125 A.3d at 307. For example, in *In re Morton's Restaurant Group, Inc. Shareholders Litigation,* 74 A.3d 656, 665 (Del. Ch. 2013), then-Chancellor Strine discussed his ruling in *Cysive,* explaining that defendant Nelson Carbonell ("Carbonell") "not only held 35% of the company's stock, but he was the company's visionary founder, CEO, and chairman." Despite holding less than 50% of the Company's stock, Carbonell "exercised more power than a typical CEO" due to his "influence over even the ordinary managerial operation of the company." *Id.* at 665-66; *Cysive,* 836 A.2d at 552 (explaining that Carbonell was "involved in all aspects of the company's business, was the company's creator, and has been its inspirational force"). Even though the company established a special committee to evaluate the transaction at issue, the Court found that Carbonell nonetheless had "practical control" over the company due to his wide-ranging influence. *Cysive,* 836 A.2d at 552.

19. Plaintiffs may also sufficiently allege control based on the stockholder's influence over the disputed transaction. *In re Primedia Inc. Deriv. Litig.,* 910 A.2d 248, 257 (Del. Ch. 2006) ("However, the plaintiffs need not demonstrate that KKR oversaw the day-to-day operations of Primedia. Allegations of control over the particular transaction at issue are enough."); *Superior Vision Servs. v. ReliaStar Life Ins.,* 2006 WL 2521426, at *4 (Del. Ch. Aug. 25, 2006) ("In order to append the label of 'controlling shareholder,' pervasive

control over the corporation's actions is not required; indeed, a plaintiff can survive the motion to dismiss by alleging actual control with regard to the particular transaction that is being challenged."). As the Court explained in *Carsanaro v. Bloodhound Techs., Inc.,* 65 A.3d 618 (Del. Ch. 2013), "[t]he requisite degree of control can be shown to exist generally or with regard to the particular transaction that is being challenged." *Id.* at 659.

20. Controller status may also arise when a majority of the company's board is beholden to or lacks independence from the alleged controlling stockholder. *In re W. Nat'l Corp. S'holders Litig.,* 2000 WL 710192, at *11 (Del. Ch. May 22, 2000). For example, in *Calesa,* 2016 WL 770251, the Court held that the plaintiff had adequately pled that American Capital, Ltd. ("ACAS") was the controlling stockholder of Halt Medical, Inc. ("Halt") for purposes of a transaction with Halt. Although ACAS owned just 26% of Halt's outstanding stock, the plaintiff made allegations sufficient "to infer that a majority of the Board ... was under the influence of, or shared a special interest with, ACAS in regard to the Transaction," and thus adequately alleged that ACAS "was a controlling stockholder at the time of the Transaction." *Id.* at * 11.

21. Here, the Court properly evaluated similar factors as part of a highly fact-intensive inquiry. Specifically, the Court considered and discussed in detail Plaintiffs' allegations regarding: "(1) Musk's ability to influence the stockholder vote to effect significant change at Tesla, including the removal of Board members; (2) Musk's influence over the Board as Tesla's visionary, CEO and Chairman of the Board; (3) Musk's strong connections with members of the Tesla Board and the fact that a majority of the Tesla Board was 'interested' ... in the Acquisition; and (4) Tesla's and Musk's acknowledgement of Musk's control in its public filings," Order at 40-41, and concluded that "Musk's status as a Tesla controlling stockholder is reasonably conceivable." *Id.* at 57. Contrary to Defendants' contentions, the Order does not change the law for determining whether a stockholder is a controller.[3] The varying outcomes of the numerous decisions on this issue are a reflection of the fact-intensive nature of the controller inquiry. The Court's multi-faceted analysis is entirely consistent with decades of Delaware jurisprudence that a controlling stockholder inquiry "is not a formulaic endeavor and depends on the particular circumstances of a given case." *Zhongpin,* 2014 WL 6735457, at *7. Accordingly, interlocutory review is not warranted.

C. Interlocutory Review Will Not Serve Considerations of Justice

22. In considering an application for certification of interlocutory appeal, Courts may consider whether immediate review will "serve considerations of justice." Rule 42(b)(iii)(H). Merely arguing that an interlocutory appeal "will create litigation efficiencies" is not enough, as "such an argument can be made in any action, and cannot justify the extraordinary practice of interlocutory appeal." *Nistazos Holdings, LLC v. Milford Plaza Enters., LLC,* 2016 WL 5408123, at *3 (Del. Ch. Sept. 26, 2016).

23. Here, Defendants' argument that interlocutory review will serve considerations of justice because it "will benefit transactional planners" by helping to define the law. However, Defendants provide no basis for such a position other than to repackage their same argument that the Court misapplied the law as to determining the controlling status of a minority stockholder. *See* Application ¶¶28-31. As discussed above, the Court's ruling applies a well-settled body of law developed over many decades to the unique facts and circumstances of this case. Defendants do not identify any novel issue or split in decisions that will be addressed on an interlocutory appeal.

D. The Purported Benefits Do Not Outweigh the Substantial Costs of Interlocutory Appeal

24. Rather than "serving the interests of justice," interlocutory review here would result in the needless expenditure of time and resources by the Court and the parties and would delay the resolution of the Action. *See E.I. du Pont de Nemours & Co. v. Allstate Ins.,* 686 A.2d 1015, 1016 (Del. 1997) ("[I]nterlocutory appeals interrupt the progress of litigation and are counter-productive if they delay the final resolution of the case. The decision to grant interlocutory review is discretionary and highly case-specific.").

25. As stated above, if the Order were reversed on appeal, the Court would then consider Plaintiffs' additional arguments in opposition to the motion to dismiss. This is precisely the type of fragmentation of litigation that a proper application of Rule 42 is intended to avoid. *See id.* ("The goal, in all events, is to facilitate the orderly disposition of claims without inadvertently promoting a piecemeal approach to litigation."); *In re Pure Resources, Inc.,* 2002 WL 31357847, at *1 (Del. Ch. Oct. 9, 2002) ("Applications for interlocutory review ... should be granted only in exceptional circumstances, balancing the public interest in advancing appellate review of potentially case dispositive issues while avoiding fragmentation and delay when interlocutory review is unlikely to terminate the litigation or otherwise serve the administration of justice.") (internal citation omitted); *Reading,* 1984 WL 21202, at *1 ("fragmentation through the appellate process is undesirable").

CONCLUSION

26. For the foregoing reasons, Defendants' Application should be denied.

DATED: April 19, 2018

Respectfully submitted,

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Footnotes

[1] *See also MS Pawn Corp. v. Treppel,* 133 A.3d 560 (Table) (Del. 2016) (refusing interlocutory appeal of order holding that entire fairness standard applied and denying motion to dismiss); *Reading Co. v. Trailer Train Co.,* 1984 WL 21202, at *1 (Del. Ch. June 7, 1984) (refusing to certify interlocutory appeal of order that determined that the business judgment rule applied and noting that the order appealed from "has not foreclosed Reading from attempting to establish elements of the intrinsic fairness standard at a later stage in this lawsuit.").

[2] Defendants argue that interlocutory appeal is appropriate under Rule 42(b)(iii)(G) because the Order "determines the potentially dispositive standard of review." Defendants' Application for Certification of Interlocutory Appeal ("Application") ¶¶9, 26-27. Defendants misconstrue Rule 42(b)(iii)(G), which provides that that interlocutory review may be appropriate if "[r]eview of the interlocutory order may *terminate the litigation*" (emphasis added).

[3] *See Ryan,* 2008 WL 43699, at *6 (rejecting application to certify interlocutory appeal where "Maxim's 'Chicken Little' argument that the Court's November 30 decision changes the law of privilege ... is vastly overstated. The sky is not falling.").

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XEROX

2018 WL 1988860 (N.Y.Sup.) (Trial Order)
Supreme Court of New York.
New York County

In Re XEROX CORPORATION CONSOLIDATED SHAREHOLDER LITIGATION.
No. 650766/18.
April 27, 2018.

Decision & Order

Ostrager, J.

MOTION SEQ. NO. 001

***1** This case involves a transaction approved by the Xerox Corp. ("Xerox") Board of Directors (the "Board") on January 31, 2018 pursuant to which Fujifilm Holdings Corp. ("Fuji") will acquire a 50.1% controlling interest in Xerox. Fuji and Xerox have long been involved in a complex, interlocking joint venture called Fuji Xerox Ltd ("Fuji Xerox") that distributes Xerox products in Asia and the Pacific Rim, including Australia and New Zealand. At present, Fuji has a 75% interest in the joint venture and Xerox has a 25% interest in the joint venture. The specific terms of the transaction, which requires shareholder approval, would be accomplished in the following manner:
1. Fuji Xerox will take a loan to finance the repurchase of Fuji's 75% share of Fuji Xerox for 671 billion yen. Once Fuji's 75% share is bought out, Fuji Xerox would become a wholly-owned subsidiary of Xerox.

2. Thereafter, pursuant to the transaction documents, Xerox will issue new shares of common stock to Fuji that will represent 50.1% of the fully diluted capital stock of Xerox after such issuance. The transaction documents set the aggregate purchase price of the shares at $6.1 billion, which is equivalent to the 671 billion yen Fuji will receive for its 75% of the joint venture. The $6.1 billion would be used to repay to Xerox the loan that finances the acquisition of the purchase of Fuji's 75% interest in the joint venture.

3. Finally, before the transaction closes, Xerox will borrow $2.5 billion to pay its shareholders a special dividend of $2.5 billion.

Other provisions of the transaction documents include a non-solicitation clause that prevents Xerox from soliciting other purchasers of Xerox as well as a fiduciary-out provision that would enable the Xerox Board to consider a potential unsolicited superior proposal. In addition, Fuji receives a six-day match right against any unsolicited superior proposal and, in the event the transaction does not close, Fuji would receive a $183 million break-up fee. Significantly, the transaction documents provide that after the closing the CEO of Xerox, Jeff Jacobson ("Jacobson"), will be the CEO of the combined company and that five of the existing Xerox directors (and Mr. Jacobson) will be members of the twelve-person Board of Directors of the combined entity. The five current Xerox directors who are chosen to be on the Board of the combined entity are assured of remaining directorships of the combined entity for five years.

There are pending motions for a preliminary injunction enjoining the transaction filed by Darwin Deason ("Deason"), the third largest shareholder of Xerox who claims to have a $600 million investment in Xerox, and by certain pension funds that hold Xerox shares that have filed a consolidated class action against the defendants.[1] Deason also seeks a mandatory injunction requiring the Xerox Board to waive the advance notice bylaw that would have required Deason to propose on or before December 11, 2017 a slate of directors for election at the Xerox annual shareholders' meeting to run against the incumbent director slate. The "class" plaintiffs also seek an injunction adjourning the shareholder vote on the transaction to a date after the Xerox annual shareholder meeting.

***2** Xerox's largest shareholder, Carl Icahn ("Icahn"), made a timely filing of a slate of four directors challenging the four longest serving members of the Xerox Board of Directors. Xerox's current Board is presently composed of nine highly credentialed and experienced directors and Mr. Jacobson. Prior to filing his slate of directors, Icahn requested that Xerox extend the advance notice bylaw, which request the Board denied. On December 12, 2017, Icahn released an open letter to Xerox shareholders championing his

slate of directors and criticizing the long-tenured directors of Xerox, one of whom is Xerox Chairman Robert Keegan ("Keegan"). In January 2018, after the existence of the Fuji Xerox combination was publicly reported, Mr. Deason wrote a January 22, 2018 letter to the Xerox Board demanding public disclosure of the joint venture arrangements. Mr. Deason is now supporting Mr. Icahn's slate of four directors, and Mr. Icahn is sharing with Mr. Deason the costs of prosecuting this litigation.

For the reasons that follow, all three motions for a preliminary injunction are granted on the basis of the testimony adduced at the two-day evidentiary hearing that took place on April 26 and 27, 2018; the applicable law; and the voluminous submissions made by the parties in connection with the motions. During the evidentiary hearing, testimony was adduced from eight live witnesses who testified in person and four witnesses who testified by videotaped deposition.

Findings of Fact

It is undisputed that the joint venture agreement between Fuji and Xerox, which has been renewed multiple times for five-year terms over decades and which next expires in April 2021, contains various provisions that make it difficult, but not impossible, for Xerox to engage in any value-maximizing transaction with any party other than Fuji. Among the terms of the joint venture agreement are provisions that prohibits Xerox from selling more than 30 percent of its outstanding shares to a Fuji *competitor* without triggering a variety of adverse economic consequences to Xerox, including the cancellation of the joint venture and loss of the technology that Xerox has contributed to the joint venture over many decades. The provision in the joint venture agreement relating to the sale by Xerox of more than 30 percent of its stock to a Fuji competitor was first disclosed to Xerox shareholders and the public when the transaction was announced on January 31, 2018.

The Fuji Xerox joint venture accounts for approximately 25 percent of Xerox's revenues. In April 2017, there was an accounting scandal involving Fuji Xerox that caused Xerox to have to revise its earnings for 2017 and several years prior to 2017. All issues relating to the accounting scandal were not resolved at the time the Xerox Board approved the transaction, and a final audit of Fuji Xerox for 2017 that was received by Xerox on April 24, 2018 will cause Xerox to revise its earnings for the first quarter of 2018. The transaction documents required Fuji to deliver the audited financial statement by April 15, 2018, so it appears that there may be further negotiations between Fuji and Xerox. There are conflicting Japanese law expert reports on the issue of whether, under Japanese law (which governs the joint venture agreements and the joint venture transactional documents), Xerox could have withdrawn from the joint venture agreements because of the accounting scandal. Finally, the weight of the evidence adduced at the hearing, including Xerox's financial performance in 2017, established that on and before January 31, 2018 there was no exigent necessity for Xerox to engage in any change of control transaction. The evidence also established that Mr. Icahn had a strong desire to have Xerox sold in an all-cash transaction at a premium over Xerox's market value.

The lynchpin of this Court's decision turns on the conduct of Xerox CEO Jeff Jacobson in the time frame preceding the Board's approval of a transaction that granted control of an iconic American company to Fuji without any cash payment by Fuji to Xerox shareholders, and the Board's acquiescence in Jacobson's conduct.

***3** The testimony adduced at the hearing established that Fuji and Xerox had explored various potential transactions over a period of decades, including an outright purchase by Fuji of all Xerox shares. And, in early 2017, discussions relating to a purchase of all Xerox shares by Fuji were in process.

On March 7, 2017, Jacobson went to Japan to meet with Shigetaka Komori ("Komori"), Fuji's Chairman and CEO, and Kenji Sukeno ("Sukeno"), Fuji's President and COO. (PX 18).[2] According to Jacobson, during the meeting, Komori asked Jacobson whether Xerox would be interested in being acquired by Fuji. Komori and Sukeno explained that they believed a combination of Fuji, Xerox, and Fuji Xerox would provide the best value for both Fuji and Xerox shareholders and that Fuji understood that Xerox would likely require a 30 percent premium on its stock price. *Id*. The next day, Takashi Kawamura ("Kawamura"), Fuji's Head of Strategy, handed Jacobson a letter summarizing the parties' discussions and confirming Fuji's interest in acquiring Xerox. (PX 20).

On March 16, 2017, the Xerox Board met to discuss Fuji's proposal and agreed to engage Centerview Partners ("Centerview") as a financial advisor. Centerview gave a presentation to the Xerox Board analyzing the economics of a possible all-cash acquisition by Fuji. (PX 24).

Following the Xerox Board meeting, Jacobson sent a formal written response to Fuji's March 8 letter. (PX 347). Jacobson advised Fuji that "[w]e would be prepared to enter into discussions only" if Fuji's offer reflects an "appropriate premium to our current trading price" and provides "our shareholders 100% cash consideration." *Id*. Thus, as reflected in Jacobson's March 16, 2017 communication

to Fuji, as of at least March 16, 2017, the Board made clear to Fuji that Xerox was not in immediate or urgent need of a strategic combination and that it was only interested in pursuing an all-cash acquisition by Fuji. In short, the parameters of the change of control transaction under discussion in early 2017 were nothing like the terms to which the Xerox Board ultimately agreed to in January 2018.

Jacobson's role in negotiating the ultimate transaction must be viewed against the background of events that commenced on and after May 15, 2017 when Jacobson participated in a dinner with Carl Icahn at which Icahn told Jacobson, in the presence of two of Jacobson's direct reports, that Icahn did not believe Jacobson was the right person to be Xerox CEO and that Icahn wanted Xerox sold. Icahn further stated that Jacobson would be fired if Jacobson was unable to produce a sale transaction. Jacobson memorialized his recollection of his meeting with Icahn and shared it with the Xerox Board. (PX 50). In November 2016, Icahn had threatened a proxy contest which did not occur after Xerox and Icahn entered into a standstill agreement that had an outside expiration date of December 11, 2017. The agreement also made provision for the addition of Jonathan Christodoro ("Christodoro") to the Xerox Board as Icahn's representative with the ability to report to Icahn on issues before the Xerox Board. Christodoro ultimately resigned from the Xerox Board to be a member of Icahn's slate immediately prior to December 11, 2017.

***4** Shortly after the dinner meeting with Icahn, on or about May 22, 2017, Jacobson and the Xerox Board were advised that Fuji could not advance strategic discussions with Xerox until the Fuji Xerox accounting scandal was resolved. Fuji, embroiled in the Fuji Xerox accounting scandal, which involved allegations of fraud, proposed to suspend discussions and indicated that a purchase of all Xerox shares was too expensive for Fuji. Thereafter, the testimony established that Jacobson, working with Xerox's investment banker, Centerview, developed a transaction concept that would allow Fuji to make a cashless acquisition of Xerox.

Jacobson testified that he was authorized by Xerox Chairman Keegan to explore with Fuji alternatives to an all-cash deal, but the full Xerox Board was unaware of Jacobson's overture to Fuji which was presented to Fuji in June 2017. For all intents and purposes, Jacobson's cash-free acquisition concept took off the table any type of all-cash sale transaction with Fuji even though one of Xerox's financial advisors, David Hess of Centerview, testified that Fuji has cash reserves of $8 billion. And, while Fuji sought to delay a substantive meeting with respect to Jacobson's proposal, Jacobson insisted on pressing for a July 2017 meeting. It was only in July 2017 that Jacobson advised the full Xerox Board of his strategic acquisition proposal that could potentially transfer to Fuji control of Xerox.

During the late spring and early summer of 2017, Icahn and his Board nominee, Christodoro, were pressuring Jacobson and the Xerox Board to secure a transaction, and Jacobson believed Icahn would initiate a proxy contest to remove the Board. In July 2017, Icahn was informed of Jacobson's strategic acquisition concept, and Icahn advised Keegan that Icahn opposed a transaction that would leave Xerox shareholders with a 49.9% minority interest in a combined company controlled by Fuji. Icahn further requested that a search committee be formed to find a replacement for Jacobson. Keegan conceded at the hearing that he suggested to Jacobson that Jacobson propose to Fuji that Fuji purchase Icahn's shares in Xerox.

During the summer of 2017, while Jacobson was dialoguing with Fuji's most senior executives, the Xerox Board became disenchanted with Jacobson's performance as CEO and the Board decided that Jacobson was not the right person to lead Xerox into the future. Director Cheryl Krongard ("Krongard") testified that this was the unanimous view of the Board. Notes prepared by Keegan from April 2017 reflect that there was concern with Jacobson's performance as CEO as early as April 2017. In July 2017, the Board decided to form a committee called the "Scan Committee" to explore finding a potential replacement for Jacobson. Keegan testified that by September 2017 the Board had hired a professional search firm, Heidrick & Struggles ("Heidrick"), to identify potential candidates to replace Jacobson as CEO. (Keegan EBT, PX 236 at 188:18-23). The members of the Scan Committee were Directors Keegan, Reese, Brown and Christodoro. (*Id*. at 186:8-12).

The Xerox Board interviewed various candidates in October and November 2017. The Board specifically identified as Jacobson's potential replacement, Giovanni (John) Visentin ("Visentin"), a former IBM and HP executive that Xerox's Chairman Keegan described as "head and shoulders" better than Jacobson. The Board discussed compensation terms with Visentin and identified a start date for Visentin of December 11, 2017. Jacobson testified that he was unaware of any efforts to replace him prior to November 10, although this testimony is suspect given the large number of people aware of the work of the Scan Committee.

***5** On November 10, 2017 Keegan advised Jacobson that he might be replaced. Keegan further told Jacobson at the express and unanimous direction of the Xerox Board to desist from further discussions with Fuji about a possible combination of Xerox with Fuji and to cancel meetings in New York and Japan that were scheduled for November 14 and November 21, 2017. On November 12, 2017,

Jacobson emailed to his personal email account copies of his employment agreement and pension plan. (PX 247). Jacobson and Keegan both testified that Keegan advised Jacobson that Xerox had reached no decision as of November 10 to replace Jacobson as CEO, but correspondence with the head of Fuji's corporate planning department, Takashi Kawamura, makes clear that Jacobson communicated his "situation" to Fuji. And Hess testified that both Keegan and Jacobson informed Hess about Jacobson's precarious circumstances. On November 13, Jacobson sent Hess a text message stating that wherever Jacobson landed, he would work with Hess again. (PX 299).

For its part, Fuji, intrigued by the possibility of acquiring control of Xerox without any cash payment to Xerox shareholders, became increasingly susceptible to Jacobson's concept of a cashless strategic acquisition of Xerox by Fuji. Kawamura prevailed upon Jacobson to proceed with the November 14 meeting and Jacobson, in turn, successfully prevailed upon Keegan to allow the meeting to proceed. Keegan permitted Jacobson to continue his discussions without notifying or seeking authorization from any member of the Xerox Board other than Ann Reese. After the November 14 meeting, Keegan authorized Jacobson to go to Japan on November 20 to meet with Fuji executives. At a meeting on November 21, after Jacobson had apparently discussed his "situation" with Kawamura, Jacobson explained to Komori that Xerox needed a term sheet by November 28, 2017. On November 21, 2017, Jacobson also sent Hess an email questioning whether Hess thought Jacobson would receive his "package" from Xerox before Thanksgiving. Prior to the November 21 meeting, Kawamura texted Jacobson as follows:

> Welcome to Japan! Hope you had a good flight. I met Komori twice today. He made a lot of questions. He's looking forward to seeing you tomorrow. I have your discussion material today. He said he understands the contents and no need to spend much time on the presentation. ***He would focus on hearing current situation surrounding you and*** *XC* ***and what*** *we* ***can do....***But basically he's ready to send the term sheet unless anything unexpected happens tomorrow....Because Komori is in the good mood now. Better not do anything which may make Komori feel uncomfortable (PX 301) (emphasis added).

Significantly, Jacobson texted Centerview's David Hess that Kawamura "told me that there is no deal without me." (PX 302).

Fuji provided a term sheet (the "Fuji Term Sheet") on November 30 reflecting its formal merger proposal. Consistent with Jacobson's July 2017 proposal, instead of an all-cash deal, Fuji offered a structured transaction in which it would end up owning a 50.1 percent controlling interest in Xerox. At no time prior to a January 24, 2018 teleconference between Keegan and Komori did *any* Xerox director participate in *any* meeting with Fuji executives; all such meetings involved Jacobson. The Fuji Term Sheet set January 31, 2018 as the target date for a definitive agreement. Fuji wanted to close the deal quickly so that it could announce it at the same time Xerox announced its fourth-quarter 2017 earnings.

In December 2017, the Xerox Board established a four-person Transaction Committee to discuss and monitor the ongoing negotiations. The Transaction Committee was composed of Keegan and other long-serving Xerox directors.

After the constitution of the Transaction Committee, the Transaction Committee requested that Fuji increase the dividend to Xerox shareholders from $2 billion to $2.5 billion, and made some additional non-monetary governance demands, including a demand that there not be co-CEO's as Fuji proposed, but only one CEO--Jacobson, the person the Xerox Board had unanimously agreed to potentially replace with an identified successor literally weeks earlier. Fuji, of course, was receptive to having Jacobson be the sole CEO as he was the person who had delivered cash-free control of Xerox to Fuji. And, as Komori testified, Jacobson was the only Xerox director known to Fuji. Director Krongard testified that the Board was told both by Centerview and Xerox's outside counsel that Jacobson had to be the CEO of the combined companies. The most benign explanation of Keegan's insistence that Jacobson be the CEO of the much larger combined company is, as Director Krongard testified, that the Xerox Board trusted Komori to replace Jacobson if Jacobson did not perform. The Court finds this rationale perplexing.

***6** Notwithstanding testimony to the contrary from Jacobson and Keegan, it is simply counter-intuitive and not credible to the Court that Jacobson was not conflicted with respect to his dealings with Fuji on behalf of Xerox at least as of November 10, 2017. It is equally counterintuitive and not credible to the Court that Jacobson did not both explain his personal circumstances to Fuji and attempt to enlist Fuji's assistance in preserving his position as the contemporaneous documents established. Indeed, in one text message to Jacobson, Kawamura states that he and Jacobson should "be the one team to fight against [their] mutual enemy" in reference to Icahn. (PX 297). Keegan and Reese, who, like Jacobson, owed a duty of loyalty to all Xerox shareholders, both saw this email. Jacobson responded to Kawamura stating: "We are aligned my friend." *Id*. By the same token, notwithstanding the quality and experience of Xerox's Board, it was a breach of fiduciary duty for Keegan to authorize Jacobson to continue to be the primary interface

with Fuji after Keegan both told Jacobson he could be imminently terminated and, for that reason, he should cease communications with Fuji about any transaction.

On December 4, 2017, Centerview made a presentation to the Xerox Board. Among other issues, Centerview urged the Board to consider whether Fuji's proposal provided enough economic upside to compensate shareholders for ceding control. (PX 343). It also urged the Board to consider whether there were attractive and feasible strategic opportunities other than the Fuji structured transaction. *Id*. Thereafter, director Krongard expressed her extreme concern to Keegan about Jacobson's continuing role and blatant disregard of the Board's unanimous directive that he cease all further negotiations with Fuji. (PX 127). In a five-page hand-written letter to Keegan, Krongard stated, among other things, the following:
As one Director, I believe we are at, perhaps, the most defining moment of the company's future. To succeed, Xerox will need leadership and clarity of purpose. We know the right leadership is not there now.. . .

This Board exhausted every ounce of patience and coaching to make our current CEO a success. We then decided, unanimously, for a variety of reasons, he was not the leader we need. You and the "Scan" Committee conducted a very thorough talent review and have identified an individual you described to me as "head and shoulders better than Jeff." Jeff was told by you, as directed and supported by the Board, that the Board was disappointed by his performance and would likely look at outside talent. Additionally, you told him in no uncertain terms that he was to discontinue any and all conversations with FX and F regarding Juice [the transaction]. He blatantly violated a clear directive. Which brings us to where we find ourselves today.

We have a rogue executive, together with an advisor(s) who only gets a big payday if there is a deal. . . .

Jeff has put us, and mostly you, in a horrible situation. He is asking us to lie! In my most heartfelt and emotional outreach to you, I implore you not to let this happen! *Id*.

Krongard never received a response to this letter from Keegan, although she did learn that Keegan had authorized Jacobson to participate in the November 14 and November 21 meetings that advanced the Fuji discussions. On December 11, Fuji sent its "best and final offer" for the proposed transaction. Other than increasing the amount of Xerox's dividend to its shareholders - which was to be funded by a loan taken out by Xerox - Fuji did nothing to sweeten the deal. That same day, Jacobson texted Kawamura: "Tak, you will see on the internet, that Icahn has publicly called for Xerox to hire a new CEO. This is what we expected. We will finish our mission and win!". (PX 312). Kawamura responded "We are supporting you Jeff!" *Id*. The following day, Kawamura wrote to Jacobson: "Jeff, I met Komori again today and explained Icahn situation. I said we must win with Jeff and he was energized. He's keen to know any developments surrounding Icahn. Please keep me updated."

(PX 313). Jacobson responded to Kawamura: "Please thank Mr. Komori for me. I appreciate his support and loyalty!" *Id*.

***7** On January 16 and 17, 2018, senior Xerox executives and Centerview met in Tokyo with Fuji and Fuji's investment advisor, Morgan Stanley. Significantly, on January 17, 2018, Kawamura texted Jacobson that Komori was concentrating on the "new management and the board." (PX 325). Jacobson replied:
That is good. Are things on track as we discussed for you [sic] role and my role? Regards, Jeff. *Id*.

Kawamura:

I think so. But he did not mention the name....I heard you gave him your idea about the continuing directors. Can you give me top five candidates? *Id*.

Jacobson:

It is important that Mr. Komori tell Bob Keegan what he wants. I told Mr. Komori this. I believe the directors who will want to continue (to be confirmed) are Keegan, Reese,

Ruskowski, Prince, Tucker and Echevarria. Of the 6, there are 5 spots and all should be fine....Do you think Sukeno will be able to persuade M[r]. Komori? *Id*.

Kawamura:

Thank you. I mean Sukeno is not as excited as Komori about this deal.... *I* ***clearly told Komori to tell Keegan that he wants Jeff to be the CEO.*** *Id*. (emphasis added).

According to Fuji, it was necessary to keep Jacobson as CEO of Xerox, not because Fuji necessarily valued Jacobson's talent as a CEO, but rather, because Fuji, through Jacobson, could maintain complete control over the Xerox board. A Fuji internal memo states:

> As the 12/11 deadline for submission of the shareholder's proposal approaches, there has been a recent drop in stock price. The director under Mr. [Icahn's] control was putting very strong pressure on CEO Jacobson ... and was trying to dismiss Mr. [Jacobson] from his position as CEO. ***Hypothetically, if Mr. [Jacobson] was dismissed, then the next CEO would be someone associated with Mr. [Icahn], resulting in [Fuji] losing control of the [Xerox] board of directors through association with Mr. [Jacobson].*** **(PX 107)** (emphasis added).

Kawamura explained that the use of the word "control" was a short-hand way of explaining that Jacobson was the only director known to Fuji. But, it is clear from all the testimony that Fuji knew from Jacobson that without Jacobson the momentum for what Fuji considered to be a very attractive deal for Fuji would be lost.

On January 24, just a week before the deal was scheduled to be announced, David Hess of Centerview emailed Kawamura raising concerns that the "financial due diligence on [Fuji Xerox] is incomplete and requires more work and disclosure" and that "the current financial projections we have created together do not create enough value for [Xerox] shareholders." (PX 170). Given these concerns, Hess insisted that the "January 31 announcement is not possible." *Id*. Kawamura's response was that "Fujifilm will walk [a]way from this deal if you won't keep the announcement schedule." (PX 327).

On January 30, Centerview issued a fairness opinion on the transaction for which it was paid $10 million. Centerview will receive an additional $40 million only if the transaction is consummated.

The circumstance that the transaction that was ultimately approved by the Board transferred control of Xerox to Fuji without any payment to Xerox shareholders, with Jacobson as the CEO of the combined entity and privileged to opine to Komori on the five members of the Xerox Board who might be directors of the combined entity for five years, takes this transaction out of the realm of cases in which courts defer to the business judgment of independent directors. This transaction was largely negotiated by a massively conflicted CEO in breach of his fiduciary duties to further his self-interest and approved by a Board, more than half of whom were perpetuating themselves in office for five years without properly supervising Xerox's conflicted CEO. Indeed, Xerox director Krongard expressed herself in an email to Keegan:

***8** "If you try to argue both sides of the transaction, I can argue strongly that we are not acting in our shareholders' best interest in this transaction. No premium, minority position, no governance and a base from the LRP [Long Range Plan] which comprises fictional numbers." [PX 120]

Ms. Krongard's reference to fictional numbers included the value of the supposed and unquestionably speculative synergies that the transaction would produce separate and apart from the cost savings built into Xerox's Long-Range Plan. The supposed value proposition of the transaction largely turned on the value of the synergies and the valuation of Fuji Xerox, both of which are highly subjective.

The arresting irony of the transaction is the fact that while the transaction was rushed through to completion between November 2017 and January 31, 2018, there is scant evidence that Xerox had any exigent necessity to do any transaction on a timetable that would schedule the shareholder approval vote on the date of the Annual Meeting. And there is sparser evidence that Xerox came close to exhausting various alternative transactions with other parties that could have been more advantageous to Xerox. Indeed, Jacobson had learned in July 2017 that Fuji might be receptive to partnering with a private equity firm to acquire 100% of Xerox, but no effort was ever made to explore this option. Certainly, Fuji cannot be faulted to for taking advantage of the opportunity Jacobson presented Fuji which, in Komori's words, enabled Fuji to "take control of Xerox without spending a penny." [Amend. Compl. ¶ 274]. But, that does not mean Fuji did not aid and abet a breach of fiduciary duty.

Legal Standard

To obtain a preliminary injunction under CPLR § 6311, a plaintiff must demonstrate: (i) a likelihood of ultimate success on the merits; (ii) the prospect of irreparable injury in the absence of injunctive relief; and (iii) a balance of equities tipping in the moving party's favor. *See Doe v. Axelrod*, 73 N.Y.2d 748, 750 (1988).

Injunction of the Proposed Transaction

Class plaintiffs and plaintiff Deason (together, "plaintiffs") seek a preliminary injunction enjoining defendants from taking any further action to consummate the change of control transaction between Xerox and Fuji that is currently scheduled for a shareholder vote in June 2018.

The plaintiffs have demonstrated a likelihood of success on the merits of their claim that defendants breached their fiduciary duties as directors in approving the proposed transaction and that Fuji aided and abetted such breach.[3] For the same reasons as those stated in the following analysis of the merits of plaintiffs' breach of fiduciary duty claim--and in the analysis of plaintiff Deason's motion for an injunction waiving Xerox's advance notice bylaw deadline--plaintiffs have clearly established irreparable harm and a balance of equities in their favor. Therefore, both motions for a preliminary injunction are granted.

"[I]n an action seeking to hold a director liable, a court must first determine whether the business judgment rule applies." *Patrick v. Allen*, 355 F. Supp. 2d 704, 711 (S.D.N.Y. 2005). "It is black-letter, settled law that when a corporate director or officer has an interest in a decision, the business judgment rule does not apply." *In re Croton River Club, Inc.*, 52 F.3d 41, 44 (2d Cir. 1995). No more evidence of a breach of fiduciary duty need be established than Keegan and Reese ignoring a memo characterizing Xerox's largest shareholder as the "common enemy" of Fuji and Xerox.

***9** "The elements of a cause of action to recover damages for breach of fiduciary duty are (1) the existence of a fiduciary relationship, (2) misconduct by the defendant, and (3) damages directly caused by the defendant's misconduct." *Varveris v. Zacharakos*, 110 A.D.3d 1059, 1059 (2d Dep't 2013) (internal quotations omitted). "Members of a board of directors of a corporation 'owe a fiduciary responsibility to the shareholders in general and to individual shareholders in particular to treat all shareholders fairly and evenly.' " *Deblinger v. Sani-Pine Prods. Co., Inc.*, 107 A.D.3d 659, 660 (2d Dep't 2013) (*quoting Schwartz v. Marien*, 37 N.Y.2d 487, 491 (1975)). The business judgment rule will not shield a decision from judicial inquiry if it was the product of bad faith or self-dealing. *Patrick*, 355 F. Supp. 2d at 710.

The facts adduced at the evidentiary hearing clearly show that Jacobson, having been told on November 10 that the Board was actively seeking a new CEO to replace him, was hopelessly conflicted during his negotiation of a strategic acquisition transaction that would result in a combined entity of which he would be CEO. There is ample evidence that he collaborated with Fuji to make himself indispensable to the transaction. Therefore, "[w]hen a shareholder attacks a transaction in which the directors have an interest other than as directors of the corporation, the directors may not escape review of the merits of the transaction." *Lewis v. S.L. & E., Inc.*, 629 F.2d 764, 769 (2d Cir. 1980). Once, the business judgment presumption is lost, defendants are required to demonstrate the "entire fairness" of the proposed transaction. *See Alpert v. 28 Williams St. Corp.*, 63 N.Y.2d 557, 570-71 (1984). As the testimony adduced at the hearing clearly established, once Jacobson learned that he had been targeted for replacement by Xerox's largest shareholder and eventually the Board itself, he abandoned the Board's request to obtain a value-maximizing all-cash transaction and engineered the framework for a one-sided deal that includes Jacobson retaining his position as CEO post-transaction. And, at all relevant times after his May 2017 dinner with Icahn, Jacobson was consistently acting without the knowledge of the entire Xerox Board even after the Board decided in November 2017 that he immediately cease any further communications and negotiations with Fuji about a possible transaction. Despite the Board's decision, Jacobson doubled down on his efforts and worked directly with Fuji to ensure a deal that is disproportionately favorable to Fuji, not Xerox.

"The concept of entire fairness has two prongs: fair dealing and fair price. The fair dealing prong of the entire fairness inquiry relates to how a transaction is structured and negotiated. The fair price prong relates to the economic and financial considerations of a proposed merger. When making a determination of a transaction's entire fairness courts examine the transaction as a whole looking at both fair price and fair dealing, without focusing on one component over another." *In re Viacom Inc. Shareholder Deriv. Litig.*, No. 602527/05, 2006 WL 6663987, at *7 (N.Y. Sup. Ct. N.Y. Co. June 23, 2006) (citation omitted); *see T. Rowe Price Recovery Fund, L.P. v. Rubin*, 770 A.2d 536, 553 (Del. Ch. 2000) ("The test of entire fairness is an exacting one and, where it applies, the 'challenged transaction must withstand rigorous judicial scrutiny.") (internal quotations omitted).

Plaintiffs have demonstrated a probability of success in establishing that the director defendants, a majority of whom would have future directorship positions on the board of the combined entity, acted in bad faith in structuring and negotiating the proposed transaction. According to Xerox's own financial advisor, Hess, the transaction undervalues Xerox, provides an inadequate control premium to shareholders, and provides Fuji with majority control over the combined entity.

***10** Plaintiffs have demonstrated that they will incur damage as a result of defendants' misconduct in the absence of injunctive relief, because shareholders will lose the potential opportunity to receive a superior control premium while being forced to vote on the proposed transaction despite Xerox's failure to make timely, material disclosures regarding the transaction and the Fuji Xerox joint venture. The facts adduced show that as of at least March 16, 2017, the Board made clear to Fuji that Xerox was not in immediate need of a strategic combination and that it was only interested in pursuing an all-cash acquisition with Fuji.

Plaintiffs' additional claim that Fuji aided and abetted the director defendants' breach of fiduciary duty is also likely to succeed on the merits. "A claim for aiding and abetting fiduciary duty requires (1) a breach by a fiduciary of obligations to another, (2) that the defendant knowingly induced or participated in the breach, and (3) that plaintiff suffered damage as a result of the breach." *Higgins v. New York Stock Exch., Inc.*, N.Y.S.2d 339, 364 (N.Y. Sup. Ct. 2005) (internal quotations and citations omitted). "One who aids and abets a breach of fiduciary duty is liable for that breach as well, even if he or she had no independent fiduciary obligation to the allegedly injured party, if the alleged aider/abettor rendered 'substantial assistance' to the fiduciary in the course of effecting the alleged breaches of duty." *Caprer v. Nussbaum*, 36 A.D.3d 176, 193-94 (2d Dep't 2006) (citations omitted). Courts have found "knowing participation" where "the terms of the transaction are so egregious ... as to be inherently wrongful." *Obeid v. Mack*, No. 14-CV-6498, 2016 WL 5719779, at *5 (S.D.N.Y. Sept. 30, 2016).

As discussed in great detail in the Court's factual findings, plaintiffs have demonstrated that throughout negotiations, Fuji's representatives Kawamura and Komori believed that the proposed transaction disproportionately favored Fuji at the expense of Xerox shareholders. (Komari: The transaction "enabled Fuji to take control of Xerox without spending a penny.") Fuji, knowing full well that Jacobson was under enormous pressure from Icahn and the Board and that Jacobson could soon be replaced as CEO, presented Jacobson with the opportunity to stay on as CEO of the combined entity that would emerge from a change of control transaction that deprived Xerox shareholders of an adequate control premium. The communications between Kawamura and Jacobson in particular, as discussed in the Court's findings of fact, demonstrate the significant degree to which the two were aligned in combating Icahn and the Board so that Fuji could consummate a deal entirely in its favor and so that Jacobson could maintain his position as CEO.

Injunction of Xerox's Advance Notice Bylaw Deadline

With respect to plaintiff Deason's motion for a mandatory injunction compelling Xerox to waive the advance notice bylaw to block Deason from fielding a slate of directors who would presumably object to a change of control transaction that was only disclosed to the shareholders after the advance notice had expired, the Court finds that the reasoning of *Hubbard v. Hollywood Park Realty Enterprises, Inc.*, 1991 WL 3151, 17 Del. J. Corp. L. 238 (1992) is directly applicable to this case and Deason should be allowed to propose to the shareholders a slate of directors, provided he does so in the next 30 days. While shareholders can, admittedly, vote against the proposed change in control transaction, the proposed full proxy contest sought by Deason is a fair and logical way to provide Xerox shareholders with choices relating to the proposed transaction. A board other than the Board that approved this transaction might decide to pursue an all-cash acquisition or a deal with a company other than Fuji. It also might negotiate a better deal with Fuji, particularly since Xerox has to revise its first quarter earnings for 2018 as a result of Xerox's belated receipt of audited 2017 financials for Fuji Xerox. For these reasons, Deason's motion for mandatory injunction waiving the advance notice bylaw deadline to enable him to field a competing slate of director nominees is granted.

***11** It is well-settled law that a shareholder is entitled to a waiver of a corporation's advance notice deadline for nominating directors when there is a material change in circumstances of the corporation after the nomination deadline. Certain material, post-deadline changes in business policy and direction may "foreseeably generate controversy and shareholder opposition. Under those circumstances, considerations of fairness and the fundamental importance of the shareholder franchise dictate[] that the shareholders be afforded a fair opportunity to nominate an opposing slate, thus imposing upon the board the duty to waive the advance notice requirement of the by-law." *Hubbard v. Hollywood Park Realty Enterprises, Inc.*, Civ. No. 11779, 1991 WL 3151, at *12 (Del. Ch. Jan. 14, 1991); *see Icahn Partners LP v. amylin Pharm., Inc.*, No. 7404-VCN, 2012 WL 1526814, at *3 (Del. Ch. Apr. 20, 2012) (granting mandatory injunction where plaintiffs alleged that after the advance notice bylaw deadline the board radically changed its outlook for the company).

Here, and as discussed in more detail *supra*, the Xerox Board made several significant decisions regarding a change of control transaction with Fuji, as well as significant disclosures regarding the terms of the Fuji Xerox joint venture, six weeks after the director nomination deadline in Xerox's bylaws. Those decisions and disclosures were clearly material as to Deason's desire to nominate a competing slate of directors to the Board. Thus, defendants' refusal to grant Deason's waiver request is without justification. And, as such, defendants likely breached their fiduciary duty of loyalty by refusing to waive the advance notice bylaw deadline to allow a competing slate of candidates so as to protect and secure their existing Board positions. *See Int'l Banknote Co. v. Muller*, 713 F. Supp. 612, 626 (S.D.N.Y. 1989) ("The Court also finds that there is a substantial likelihood that the [movant] will succeed at trial in showing that the Board's primary motivation for adopting the By-law was entrenchment.").

It is undisputed that the transaction at issue was announced after the December 11, 2017 advance notice date. On January 10, 2018, approximately one month after the deadline in the advance notice bylaw, the Wall Street Journal reported rumors of deal talks between Xerox and Fuji. It was not until January 31, 2018, more than six weeks after the director nomination deadline, that Xerox finally disclosed the existence and terms of the potential transaction. On the same day, and for the first time, Xerox decided to disclose copies of the joint venture agreements and their material terms. It is undisputed that the transaction was structured as a strategic transaction that, unlike a merger, deprives the Xerox shareholders of any appraisal rights. It is equally undisputed that extremely material terms of the joint venture arrangements between Fuji and Xerox were first revealed six weeks after the December 11, 2017 advance notice date. Among the provisions of the joint venture agreements that were not disclosed prior to December 11, 2017 is the provision that restricted Xerox from selling more than 30 percent of its equity to a competitor of Fuji without suffering significant economic dislocations. This is tantamount to a "lock up" agreement and is information that, if known by Deason and the shareholders prior to the December 11, 2017 advance notice date, might well have compelled Deason to take steps to challenge the incumbent Board.

After Deason learned of these material changes in circumstances at Xerox, he sent an open letter to the Board in February 2018 requesting that it waive the December 11, 2017 advance notice deadline for director nominations and reopen the nomination period for him and other shareholders to nominate a full slate of directors for election at the 2018 annual meeting. The Board rejected Deason's request for a waiver of the nomination deadline. Deason thus sought this injunction to achieve what his letter to the Board could not.

***12** "A corporate shareholder who has been wrongfully denied the fundamental right to vote their shares and gain representation on the board of directors is presumed to be threatened with irreparable harm if the corporate electoral process is tainted." *Broadway Ass'n v. Park Royal Owners, Inc.*, No. 123531/01, 2002 WL 34452788 (N.Y. Sup. Ct. Apr. 29, 2002). The nomination process is an integral part of shareholders' right to vote. "As the nominating process circumscribes the range of the choice to be made, it is a fundamental and outcome-determinate step in the election of officeholders. To allow for voting while maintaining a closed candidate selection process thus renders the former an empty exercise." *Hubbard*, 1991 WL 3151, at *6 (internal quotations omitted). Plaintiff has thus established irreparable harm in the absence of an injunction.

The balance of equities clearly tips in favor of waiving the advance notice bylaw deadline for director nominations. An injunction will enable Deason and any other shareholder to nominate a competing slate of directors who can represent their legitimate interests in determining the future direction of Xerox following a series of decisions and disclosures regarding a potential change of control transaction with Fuji. Defendants, by contrast, will suffer no cognizable harm if the Court allows for a brief period in which shareholders may nominate competing director candidates for the upcoming 2018 annual meeting.

The law and equitable considerations require that shareholders have the reasonable opportunity to consider nominations in light of the post-deadline, material changes to Xerox's future. The Court therefore grants plaintiff's request for a preliminary injunction waiving the advance notice by-law requirement so as to afford plaintiff Deason, and any other shareholder, the opportunity to nominate a competing slate of candidates to the Board in advance of any vote on the proposed transaction.

CPLR 6312(b) requires the posting of an undertaking in connection with injunctive relief. That section provides in relevant part that "prior to the granting of a preliminary injunction, the plaintiff shall give an undertaking in an amount to be fixed by the court, that the plaintiff, if it is finally determined that he or she was not entitled to an injunction, will pay to the defendant all damages and costs which may be sustained by reason of the injunction ..." The fixing of the amount of an undertaking is a matter "within the sound discretion of the court, and its determination will not be disturbed absent an improvident exercise of that discretion." Blueberries Gourmet, Inc. v Aris Realty Corp, 255 AD2d 348 (2d Dep't 1998). The sole requirement is that the undertaking must be "rationally related to defendants' potential damages should the preliminary injunction later prove to have been unwarranted." *Suttongate Holdings Limited v Laconm Management N. V., et al.*, 159 AD3d 514 (1st Dep't 2018), quoting *Peyton v PWV Acquisition LLC*, 101 AD3d 446 (1st Dep't 2012).

Defendants' potential damages here are the loss of the Fuji transaction. The evidence established that transaction potentially has a multi-billion dollar value to Xerox. Therefore, an undertaking in the amount of $150 million is rationally related to the potential damages. Accordingly, plaintiffs' must post an undertaking that totals that amount collectively within five business days of the entry of this decision and order. The Court holds only that plaintiffs have established the requisite for injunctive relief.

Accordingly, it is hereby

ORDERED that the motions by Plaintiffs in the above-referenced action and in *Deason v. Fujifilm, et al.*, Index No. 650675/18 (mot. seq. no. 001) for injunctive relief are granted to the extent of enjoining Defendants from taking any further action to consummate the change of control transaction between Xerox and Fuji that was announced on January 31, 2018 pending a final determination of the claims asserted in the underlying action; and it is further

***13** ORDERED that the motion by Plaintiffs in Deason v. Xerox Corp., et al., Index. No. 650988/18 (mot. seq. no. 001) for a injunctive relief is granted to the extent of enjoining Defendants from enforcing Xerox's advance notice bylaw provision requiring shareholders to nominate directors for election at the 2018 Xerox annual shareholder meeting by December 11, 2017, and requiring Defendants to waive such advance notice bylaw requirement so that Plaintiff can now notice a slate of directors for election at the 2018 annual meeting.

The injunctions are conditioned on the posting of an undertaking as set forth herein.

Dated: April 27, 2018

<<signature>>

J.S.C.

Footnotes

[1] The above caption reflects the consolidation of four separate actions commenced against Xerox Corporation, Fujifilm Holdings Corp., and various individuals (see NYSCEF Doc. No. 28). The plaintiffs in those actions were the Asbestos Workers Philadelphia Pension Fund (Index No. 650766/2018), the Iron Workers District Council of Philadelphia & Vicinity Benefit and Pension Plan (Index No. 650795/18), Robert Lowinger (Index No. 650824/18), and the Carpenters Pension Fund of Illinois (Index No. 650841/18). Each plaintiff filed on behalf of itself and "all others similarly situated." Darwin Deason, a major Xerox shareholder, commenced a similar action *Deason v Fujifilm, et al*. (Index No. 650675/18, known as *Deason I)* and has moved for injunctive relief similar to that sought by the *In Re Xerox* plaintiffs in their motion (both designated mot. seq. 001 in the respective actions) to enjoin Defendants "from taking any further action to consummate the change of control transaction between Xerox and Fuji that was announced on January 31, 2018" pending a final determination of the claims asserted in the underlying actions. Additionally, Mr. Deason commenced a second action naming Xerox and the same individuals as defendants but not naming Fuji (Index No. 650988/18, known as *Deason II)*. Plaintiff in *Deason II* has moved for a preliminary injunction "enjoining Defendants from enforcing Xerox's advance notice bylaw provision requiring shareholders to nominate directors for election at the 2018 Xerox annual shareholder meeting by December 11, 2017, and requiring Defendants to waive such advance notice bylaw requirement so that Plaintiff can now notice a slate of directors for election at the 2018 annual meeting" (mot. seq. 001). The three motions have been consolidated herein for disposition. The Court previously determined certain sealing motions and motions in limine addressed to three of plaintiffs' expert submissions. This decision also serves as the basis to deny the motions to dismiss, at least in part, as the Court has found that plaintiffs have claims against all defendants upon which relief can be granted. To the extent defendants assert that portions of the complaints should be dismissed, the denial of the motions is without prejudice to defendants' filing additional motions to dismiss, particularly in light of the very recent amendment to some of the pleadings. This decision also moots so much of the "class" plaintiffs' motion relating to the timing of the shareholder vote on the transaction.

[2] Plaintiffs' trial exhibits will be referred to as "PX" and defendants' trial exhibits will be referred to as "DX"

[3] It is unnecessary to address plaintiffs' claim for common law fraud as all the causes of action seek the injunctive relief that this Court now grants.

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