Delaware VC/PE Update

A periodic "heads-up" of legal developments in Delaware relevant to venture and private equity funds

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Recurring Issues for VC and PE Funds: Guidance from Recent Delaware Cases

Director Designee Conflicts of Interest

Recent Delaware court decisions show healthy skepticism toward claims that a fund's board designee is conflicted due to the position of the fund, such as its potential interest in future deals with a conflicted party, or being in wind-down mode.

- Allegations that three funds had made several lucrative investments in the past with the "superstar" founder of Imperva Inc., and wished to continue doing so in the future, did not make the funds' designees on Imperva's board conflicted for purposes of voting on a transaction between Imperva and an affiliate of the founder. *Greater Pennsylvania Carpenters' Pension Fund v. Giancarlo* (Del. Chanc. Sept. 2, 2015)
- Allegation that funds were winding down and needed liquidity, which allegedly motivated their board designees on a 25%-owned portfolio company to approve a sale of the company, did not establish conflict where plaintiff failed to show that the funds could not be extended or had a particular need for cash. *Chen v. Howard-Anderson* (Del. Chanc. April 8, 2014)

Upshot: Good news for funds and their directors … but "disclose and abstain," or use of committee of independent directors, may still be safest course if directors arguably have material conflict … check governing documents for director exculpation and indemnification provisions … beware the *Trados* fact pattern where board of portfolio company is controlled by designees of preferred stockholders and a sale of the company only benefits the preferred …

"Aiding and Abetting" Liability for Advisors and Major Stockholders

In the sale context, Delaware courts will look closely at financial advisor conflicts and work product, and whether a board's breach of fiduciary duty may have been aided and abetted by the financial advisor or, possibly, a large stockholder who agitated for the sale.

- In public company sale context, court found that pleaded facts supported claims that seller's board had breached its fiduciary duties, and that sell-side banker was potentially liable for aiding and abetting the breach, where the key flaw in the process was the advisor's failure to disclose (and the board's failure to discover) the advisor's extensive relationship with the buyer until just before the sale was approved. The court also permitted aiding and abetting claims to proceed against a hedge fund with an influential board representative which had agitated for the sale. *In re PLX Technology* (Del. Chanc. Sept. 3, 2015); *see also In re TIBCO Software* (Del. Chanc. Oct. 20, 2015) (potential aiding and abetting liability of Goldman Sachs as sell-side advisor for allegedly failing to advise board of share miscalculation); *but see In re Zale Corporation* (Del. Chanc. Oct. 29, 2015) (because transaction had been approved by dis-

interested stockholder vote, and board had not been grossly negligent, court dismissed aiding and abetting claim against Merrill Lynch as sell-side advisor for allegedly failing to disclose that it had pitched the acquisition to buyer)

- In private company sale context, where option holders were owed the "fair market value" of their options, court found valuation firm's analysis so flawed and result-oriented as to support an inference of bad faith against the valuation firm and contract damages against the company. *Fox v. CDX Holdings* (Del. Chanc. July 28, 2015)

Upshot: Counsel must be ruthless in uncovering advisor conflicts … consider use of engagement letter to mandate disclosure, including duty to update … Delaware courts are repeat players and experts in the valuation game, on the lookout for result-driven analysis, manipulation of projections … easy for plaintiff to plead "aiding and abetting" when an advisor or major stockholder plays active role in process…

Information Sharing Between Director Designees and Their Fund

The Delaware Court of Chancery recently adopted a practical, "contextual" approach to information sharing.

- In the recent *Dole* decision, best known for finding a controlling stockholder and his hand-picked general counsel personally liable for $150 million for orchestrating an unfair cash-out merger, the court also considered the right of a director to share confidential information with an affiliated stockholder and its advisors. The court provided lukewarm comfort, stating that such information sharing was "not inherently a breach of fiduciary duty … But our law does not appear to me to have adopted a bright-line position. The use and sharing of information is rather another context-dependent inquiry." *In re Dole Food Co. Stockholder Litigation* (Del. Chanc. Aug. 27, 2015)

Upshot: Risky territory for directors as a matter of fiduciary duty … greater protection if the stockholder negotiates for contractual rights to information, leaving the director out of the information chain…

For further information on any of these developments, feel free to contact Jeff Wolters or any member of the Morris Nichols Corporate Counseling Group.

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