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Delaware Court of Chancery Provides Clarity on the "Quasi-Appraisal" Remedy and Post-Closing Claims

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Applying Corwin *and clarifying and rejecting "quasi-appraisal" remedies*

On May 11, 2017, Chancellor Andre G. Bouchard of the Delaware Court of Chancery dismissed with prejudice a putative class action brought by stockholders of networking solutions in *In re Cyan, Inc. Stockholders Litigation.*[1]The former shareholders alleged two counts: (1) breach of fiduciary duty against Cyan's seven-member board in connection with Cyan's merger with Ciena Corporation in a cash-and-stock transaction and (2) equitable relief in the form of "quasi-appraisal."

This dismissal of this lawsuit is important for three reasons. First, the decision is yet another example of the Court of Chancery's adherence to *Corwin v. KKR Financial Holdings LLC,*[2]which held that the business judgment rule is the standard of review when a fully informed, uncoerced vote of disinterested stockholders approves a transaction.

Second, the decision demonstrates that if plaintiffs wish to bring disclosure claims post-closing, they must identify actual, material omissions with specificity. Mere laundry lists of disclosure violations and speculative violations will not survive a motion to dismiss.

Finally, and perhaps most noteworthy, Chancellor Bouchard made clear that "quasi-appraisal" is a remedy for a breach of fiduciary duty and that "artful pleading" is not a viable path to circumvent exculpation from monetary liability provided to directors by 8 *Del. C.* § 102(b)(7).

The court dismissed the breach of fiduciary claims on two alternative grounds: the plaintiffs failed to plead a non-exculpated breach of fiduciary duty, and alternatively, the fully informed, uncoerced vote of 98 percent of voting Cyan stockholders in favor of the merger invoked the protection of the business judgment rule under *Corwin*.

At issue was whether the plaintiffs pled that a majority of the board were interested or acted in bad faith. They did not. The plaintiffs first alleged that the directors desired to find a cash-rich buyer to ensure they would not be personally liable in an unrelated pending securities class action. As the argument was tenuous at best, implausible at worst, the court rejected this argument because the directors were protected by existing, independent indemnification and insurance. The plaintiffs' argument that three directors with significant Cyan stock holdings were motivated by a desire to receive make-whole payments triggered by the merger also failed because they were not a majority of the seven-member board. Finally, the court found it was not bad faith for the board to reject a demand letter from the plaintiffs to supplement the proxy months before the scheduled stockholder vote, because that letter alleged immaterial disclosure deficiencies.

The Court of Chancery also dismissed the first count on the alternate ground that the fully informed, uncoerced vote of 98 percent of voting Cyan stockholders in favor of the merger invoked the protection of the business judgment rule under *Corwin*. The court examined the plaintiffs' "three strongest disclosure claims" and found none to be material. The court rejected the plaintiffs' claim that the proxy failed to disclose adequately Cyan's dependence on its largest customer. On the contrary, the proxy *did* disclose this fact in detail, including by incorporating by reference extensive prior disclosures concerning that customer in Cyan's SEC filings. Finding that documents incorporated by reference can be part of the "c," the court held that this was a case where such incorporation was appropriate, as "the language incorporating the Form 10-K and Form 10-Q appears in a section of the Proxy where stockholders reasonably could expect to find the relevant information, and … the information was conspicuously laid out in the incorporated documents so that a reasonable stockholder reading the Proxy could find it without difficulty."

The Court of Chancery dismissed the plaintiffs' "claim for equitable relief" seeking the "remedy of quasi-appraisal" based on the disclosure allegations in the complaint. Citing *In re Orchard Enterprises, Inc. Stockholder Litigation* 88 A.3d 1 (Del. Ch. 2014), the court first reiterated that "quasi-appraisal" is an appropriate remedy when a fiduciary duty breach is based on disclosure violations. Despite the plaintiffs' own characterization of the cause of action as "frustration of the statutory right of appraisal," the court observed that the underlying cause of action was, in essence, breach of the fiduciary duty of disclosure. Because the court had already rejected the plaintiffs' disclosure claims on two alternative grounds and concluded that the plaintiffs failed to allege a non-exculpated breach of fiduciary duty, Cyan's exculpatory charter provision adopted pursuant to Section 102(b)(7) barred this second claim. The court held "[w]hen the cause of action supporting plaintiffs' request for a quasi-appraisal remedy is for breach of a fiduciary duty, plaintiffs cannot circumvent the protection afforded in Cyan's certificate of incorporation through artful pleading."

This opinion reinforces that plaintiffs cannot easily sidestep the *Corwin* protections pleading garden-variety disclosure claims. It also confirms the Delaware Chancery Court's continued skepticism of "quasi-appraisal" claims.

[1] C.A. No. 11714-CB (Del. Ch. May 11, 2017).

[2] 125 A.3d 304, 308-09 (Del. 2015).