Securities Regulation Daily Wrap Up, TOP STORY—Del. Sup. Ct.: Fishing expedition over AbbVie inversion fails to hook justices (Nov. 5, 2015)

By Anne Sherry, J.D.

Delaware's highest judiciary seems skeptical that an AbbVie shareholder has the right to inspect the company's books and records after the board backed out of an inversion deal, incurring a significant break-up fee. At oral argument on the shareholder's appeal, Chief Justice Strine questioned whether an inspection right arises any time something goes wrong with a business. "On that basis, you could sue for New Coke," he quipped (*Southeastern Pennsylvania Transportation Authority v. AbbVie, Inc.*, November 4, 2015).

Background. SEPTA is appealing the chancery court's decision not to allow it to inspect AbbVie's books and records to determine if it had an actionable derivative claim. According to the pension fund, misconduct may have underlay the board's recommending the shareholders approve a proposed inversion deal, then backing out after Treasury cracked down on the tax loophole that would have made the deal advantageous. AbbVie paid a 3-percent break-up fee, amounting to $1.635 billion.

Investigation of potential corporate wrongdoing is a proper purpose for an inspection under DGCL Section 220, but the chancery court noted that the directors were exculpated from liability for breach of the duty of care. Therefore, the inspection would only have a proper purpose if SEPTA could show a credible basis from which the court could infer that the directors breached their fiduciary duty of loyalty. SEPTA argued that the exculpatory provision should be disregarded for purposes of Section 220, but the court dismissed this argument based on analogous Delaware decisions. On appeal, SEPTA claims that this holding imposed a heightened threshold burden on a party seeking inspection to establish evidence of a non-exculpated breach.

Colorable basis. Chief Justice Strine asked SEPTA's attorney why there is a colorable basis to infer gross negligence simply because something went wrong with the deal. The undisputed record evidence showed that the board relied on tax advisors and other professionals, and it was unclear to the Chief Justice that the sinking of the deal demonstrated any departure of care, much less a gross departure. The attorney replied that the chancery court recognized an inference that the board failed to consider the determinative impact of the tax benefit. But Chief Justice Strine saw another possibility: that the trial court gave SEPTA the benefit of an assumption on that point and concluded that even with that assumption, it had no colorable basis for an inspection.

The chief justice also grilled the SEPTA attorney on whether the tax implications of the deal were highlighted in the proxy. "Did they tell the stockholders that one of the benefits of the merger was considerable tax savings?" The attorney answered "not in those words, but yes"—which Strine seemed to consider facetious. Chief Justice Strine identified a finding in the chancery court opinion that the proxy explicitly said the company had weighed the tax benefit against the risk of the loophole closing. "You have no colorable basis on conscious disregard," he told the lawyer.

The break-up. Strine asked AbbVie's counsel how to reconcile the board's change of heart with an earlier investor call at which the CEO suggested the tax benefits were not the primary rationale for the deal. In fact, the attorney responded, the CEO said that there were many good reasons to do to the deal, but that AbbVie was paying a premium price. When the tax benefits went away, the board's conclusion was not that the deal was undesirable at all, but that it wasn't in the stockholders' best interest at the negotiated price. Strine seemed satisfied with the explanation, even finishing the lawyer's sentence.

The attorney for AbbVie went further into the decision to back out of the deal. At the time the board approved the inversion, Congress was gridlocked, and IRS and Treasury had publicly stated that they lacked the power to deal with inversions through administrative actions. Following the deal's approval, Treasury changed its mind and said it would deal with inversions, but left the market guessing as to how it would act. This culminated in a complex set of new rules announced on September 22. There was no way the board could have predicted that Treasury would act at all, much less the specific actions it took, the lawyer concluded.

Justice Valihura asked whether the merger agreement included a condition to deal with such an eventuality. AbbVie's counsel said that they tried to negotiate that condition, but the ultimate price was the 3-percent break-up fee. SEPTA's challenge to the failure to get a free fiduciary out is "Monday morning quarterbacking," he said. On rebuttal, the attorney for SEPTA pointed out that other inversions negotiated at the time included fiduciary outs. SEPTA's point in raising the issue was not that AbbVie was required to get a free out, but that the break-up fee put the onus on stockholders to absorb the costs of the board's risk-taking.

Exculpatory provision. The justices also seemed interested in the effect of Section 102(b)(7), which permits companies to exculpate directors for liability for breaching the duty of care. AbbVie denies that the chancery court created a new rule requiring a shareholder to plead a non-exculpated breach; to the contrary, counsel argued, it followed a long line of 102(b)(7) cases. Justice Valihura pointed out that 102(b)(7) does not foreclose claims seeking equitable relief. By relying on 102(b)(7), aren't you asking the court upfront to decide that no equitable relief could be fashioned?

AbbVie's counsel conceded that 102(b)(7) doesn't bar equitable relief, but said that the plaintiff did not articulate any such basis. The chancery court said that this is a damages action, so the shareholder must bring a claim that could potentially lead to damages. Ultimately, the point is immaterial in AbbVie's view because there was no showing of a credible basis. On rebuttal, SEPTA's attorney took issue with this argument. Some of the relief would not be barred by the exculpatory provision, he said, and the rule imposed by the chancery court would apply more broadly to require an evaluation of potential remedies prior to any investigation of derivative claims.

The case is No. 239, 2015; Appellant's Opening Brief; Appellee's answer; Appellant's reply.

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Companies: Southeastern Pennsylvania Transportation Authority; AbbVie Inc.

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