SULLIVAN & CROMWELL LLP

S&C memo

September 17, 2024

Delaware Chancery Court Dismisses Claims Against Controlling Shareholder

Court Clarifies Two Issues of Delaware Law Regarding Lawsuits Challenging Mergers on "Unique Benefit" Grounds

SUMMARY

Vice Chancellor J. Travis Laster dismissed claims against a controller last week in *Clement* v. *Apollo Global Management, LLC*. Plaintiff alleged that a merger was unfair because the controller allegedly extracted "unique benefits" in the merger. The court held that the complaint failed to state a claim and took the opportunity to clarify two issues regarding "unique benefits" and standing.

BACKGROUND

The action was brought by former minority shareholders of Redbox Entertainment Inc.—a company that rented out DVDs through vending machines—against its controlling shareholder. The controller had purchased Redbox in 2016; in October 2021, Redbox became a public company through a de-SPAC transaction but defendant remained Redbox's controlling shareholder.

Four months after Redbox became a public company, it announced that it was exploring strategic alternatives, to which the market reacted negatively as Redbox's stock price dropped approximately 50%.[1] In May 2022, Redbox announced a merger with Chicken Soup for the Soul Entertainment ("CSSE"), which the court described as "a dramatic takeunder" because the closing price before the merger announcement was $5.60 per share, and the merger consideration was 69 cents per share.[2] The court stated, "[g]iven all those facts, I think it's understandable why the plaintiff sued and sought to challenge this transaction. That valuation differential alone is striking."[3]

Plaintiff alleged that the controlling shareholder breached its fiduciary duties to Redbox's minority shareholders by extracting two "unique benefits" in the merger and that the merger should therefore be reviewed under the "entire fairness" standard. The two alleged benefits were:

(1) Converting a deeply subordinated loan the controller had made to Redbox that was valued at $27.6 million into CSSE equity worth $2.8 million at the merger price, thereby diluting the equity held by minority shareholders; and

(2) A release the controller received from Redbox and CSSE for any claims that may have existed from the time that the controller solely owned Redbox.[4]

THE CHANCERY COURT'S DECISION

The court granted the controller's motion to dismiss in a bench ruling after oral argument.

With respect to the loan conversion, the court held that the controller's receiving 10 cents on the dollar for the loan was a "unique detriment," not a "unique benefit."[5] With respect to the release, the court held that plaintiff failed to plead that the release covered any "viable claim[s]" that could survive a motion to dismiss, and thus the controller was not shown to have received a material unique benefit.[6]

In reaching these conclusions, the court took the opportunity to elaborate upon two issues of Delaware "unique benefit" law in controlling stockholder transactions:

- The first is whether the unique benefit received by the controller "has to be at the expense of the minority" shareholders.[7] The court said that "the question really turns on whether we approach fiduciary liability using th[e] concept of compensatory damages" (which focuses on the plaintiff's loss) or "principles of disgorgement" (which focuses on the defendant's gain).[8] Because disgorgement is "the dominant paradigm" in "a fiduciary world" where "we're dealing with equity," the court stated that, in its view, "it doesn't make sense to limit the cause of action to one where there's diversion of consideration."[9] Therefore, a unique benefit can arise "where the fiduciary takes a benefit, even if it's not at the expense of the minority stockholders."[10]
- The court also addressed a seeming divergence in views with Vice Chancellor Glasscock with respect to the framework for analyzing challenges to a merger where the claimed benefit is the elimination of litigation exposure. In *In re Primedia, Inc. Shareholders Litigation*, Vice Chancellor Laster had analyzed the issue through the lens of standing, whereas Vice Chancellor Glasscock's decisions "jump over the concept of standing to address the merits of a challenge to an interested transaction."[11] The court stated that "when you have a controller that is a controller at the time of the merger . . . it really doesn't matter" which framework is used because "it's the same analysis for both" that all "coalesces into one thing": "[t]here has to be an inference of something material that results in a conflict."[12]

* * *

Sullivan & Cromwell represented Defendants in the *Clement* litigation.

ENDNOTES

1 *Clement* v. *Apollo Global Management, LLC*, C.A. No. 2023-0904-JTL, at 5 (Del. Ch. Sept. 11, 2024) (TRANSCRIPT).

2 *Id.* at 6.

3 *Id.* at 7.

4 *Id.* at 6, 7-8.

5 *Id.* at 10-11.

6 *Id.* at 15-16.

7 *Id.* at 8.

8 *Id.* 15-16.

9 *Id.* at 8-10.

10 *Id.* at 10.

11 *Id.* at 12 (discussing *In re Primedia, Inc. S'holders Litig.*, 67 A.3d 455 (Del. Ch. 2013), and *In re Riverstone Nat'l, Inc. S'holder Litig.*, 2016 WL 4045411 (Del. Ch. July 28, 2016)).

12 *Id.* at 12-15.

ABOUT SULLIVAN & CROMWELL LLP

Sullivan & Cromwell LLP is a global law firm that advises on major domestic and cross-border M&A, finance, corporate and real estate transactions, significant litigation and corporate investigations, and complex restructuring, regulatory, tax and estate planning matters. Founded in 1879, Sullivan & Cromwell LLP has more than 900 lawyers on four continents, with four offices in the United States, including its headquarters in New York, four offices in Europe, two in Australia and three in Asia.

CONTACTING SULLIVAN & CROMWELL LLP

This publication is provided by Sullivan & Cromwell LLP as a service to clients and colleagues. The information contained in this publication should not be construed as legal advice. Questions regarding the matters discussed in this publication may be directed to any of our lawyers or to any Sullivan & Cromwell LLP lawyer with whom you have consulted in the past on similar matters. If you have not received this publication directly from us, you may obtain a copy of any past or future publications by sending an e-mail to SCPublications@sullcrom.com.