Paul | Weiss

CLIENT MEMORANDUM

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Delaware Court of Chancery Holds That Activision Merger Approval Process Violated DGCL

In *Sjunde AP-fonden* v. *Activision Blizzard, Inc., et al.* (an opinion by Chancellor Kathaleen St. J. McCormick), the Delaware Court of Chancery declined to dismiss claims that common market practices used by the Activision Blizzard, Inc., board in approving its merger agreement with Microsoft Corporation resulted in a Delaware General Corporation Law (DGCL) violation. The opinion interprets the statutory requirements strictly, invalidating established market practice, which at least in the short term will result in disruption to deal parties and practitioners.

Unless and until this opinion is further clarified in subsequent decisions by the Chancellor or on appeal, parties to merger agreements would be well served to have final "clean up" board meetings (or actions by unanimous written consent) after they send the directors a complete merger agreement with all schedules and exhibits, including the surviving corporation charter, attached and all blanks (including real names rather than code names for the parties and the cash value or exchange ratio) filled in.

Background

In December 2021, Activision agreed to be acquired by Microsoft at a price of $95 per share. In January 2022, the Activision board met and approved a then-current draft of the merger agreement. The approved draft merger agreement did not yet include, as is often the case: (i) the company disclosure letter or disclosure schedules; (ii) the surviving company's charter; or (iii) the consideration amount and Activision's name as the target, instead including placeholders for both (which are typically added only just before signing and announcement in order to maximize confidentiality). The merger agreement also failed to address the "key open issue" of dividends that Activision could pay while the deal was awaiting regulatory approval. The board delegated this issue to a board committee, which ultimately negotiated a resolution.[1] The full board did not review or approve any subsequent version of the merger agreement. The proxy statement sent to Activision stockholders attached the merger agreement without the disclosure letter, disclosure schedules or the surviving company's charter. In April 2022, Activision stockholders approved the merger, with more than 98% voting in favor of it.

In November 2022, the plaintiff filed suit in the Court of Chancery, alleging that the merger agreement approval process violated Sections 251 and 141 of the DGCL, as well as various other related claims. In January 2023, the plaintiff added allegations concerning regulatory developments relating to the merger, as well as a count for breach of fiduciary duty based on speculation that the defendants had agreed to extend the merger's outside termination date. Activision did later agree to extend the outside

1 At the very end of negotiations, it is fairly common for boards to set a minimum acceptable level on a particular issue like dividends and then give a committee the mandate to try to do better.

termination date, but not until six months after the plaintiff filed the amended complaint. Ultimately, the merger cleared regulatory hurdles and closed in October 2023.

Holding

The court declined to grant the defendants' motion to dismiss with respect to certain of the claims as follows:

- <u>Section 251(b) Violation</u>. This section requires the board to approve the "agreement of merger" when the corporation desires to engage in a merger transaction. The plaintiff argued that the board must approve the final execution version of the merger agreement, while defendants argued that this interpretation of Section 251(b) is not required by the language, would be contrary to market practice and would create uncertainty about the validity of a very large number of Delaware corporation mergers. The court acknowledged that requiring board approval of the execution version "does not square with norms of market practice" (e.g., disclosure schedules are often negotiated up until signing or sometimes delivered after signing), but added that "[w]here market practice exceeds the generous bounds of private ordering afforded by the DGCL, then market practice needs to check itself." Ultimately, the court assumed "for the sake of analysis . . . that Section 251(b) does not require board approval of the execution version of a merger agreement" but, at a bare minimum, does require "a board to approve an essentially complete version of the merger agreement." Applying that standard, the court found that plaintiff's claim survived the motion to dismiss.

- <u>Section 251(c) Violation</u>. This section requires a notice of the stockholder meeting set for the purpose of acting on the merger agreement to contain either (i) the merger agreement or (ii) a brief summary thereof. Here, defendants chose to attach the merger agreement to the notice. However, the attached agreement omitted a copy of the surviving company's charter, which is required by statute, and therefore, the plaintiff's claim survived the motion to dismiss. The fact that the defendants summarized the merger agreement in the proxy statement was of no consequence according to the court because the summary was not in the notice itself, as required by the statute, even though both the notice and the merger agreement summary were part of the same document—the proxy statement.

- <u>Section 141(c) Violation</u>. This section prohibits delegating to a board committee any power or authority that is specifically reserved for the board, including the adoption of an agreement of merger under Section 251. In this case, the Activision board delegated to a committee the open issue of the dividends that Activision could pay while awaiting regulatory approval of the deal. The court stated that because this was a merger agreement provision that in its view must be approved by the board, such committee delegation was a statutory violation, and the plaintiff's claim survived the motion to dismiss.

- <u>Conversion Claims</u>. A claim for the tort of "conversion" requires that, at the relevant time, (i) the plaintiff held a property interest in company stock, (ii) the plaintiff had a right to possession of the stock and (iii) the defendant converted the plaintiff's stock. In the context of pleading the tort, a defendant "converts" the plaintiff's stock through "any act of control or dominion . . . without the [plaintiff's] authority or consent, and in disregard, violation, or denial of [the plaintiff's] rights as a stockholder of the company." Here, the plaintiff's shares were converted (in the sense relating to his receipt of merger consideration) into the right to receive cash in the merger. The court stated that "[t]hrough the merger, [d]efendants took [p]laintiff's shares and replaced them with something else, in disregard of his rights as a stockholder under Section 251." Because, according to the court, the plaintiff adequately alleged that the merger was invalid under Section 251, its conversion claim survived the motion to dismiss.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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