Comments

THE CASE AGAINST A DELAWARE STATE COMMON LAW FRAUD ACTION FROM ALLEGED MISSTATEMENTS IN A FILING REQUIRED BY FEDERAL SECURITIES LAW

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In December 2009, Judge Laster, the Delaware Court of Chancery's newest Vice Chancellor, allowed a common law fraud action by a losing tender offeror against the winning tender offeror to proceed past the motion to dismiss stage, thus implying the availability of a damages award. This paper will first provide a brief summary of the case and will then address the legal and policy implications of allowing such an action.

Specifically, disgruntled tender offerors are not part of the protected class that Congress sought to protect under the Williams Act.\(^1\) Furthermore, the Supreme Court has already concluded that tender offerors do not have a private right of action under the Williams Act.\(^2\) Allowing a common law damages award stemming from disclosures required by the Williams Act has the potential to disrupt the market for corporate control. Because of the federalism policy concerns raised by fashioning a remedy contrary to federal securities law, this could also undermine Delaware's ultimate interest in remaining the preeminent state of incorporation by accelerating the possibility of the federalization of corporate law.

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2. Piper, 430 U.S. at 35.
I. INTRODUCTION OF THE NACCO CASE

On December 21, 2009, Judge Laster, the Delaware Court of Chancery’s newest Vice Chancellor, denied Harbinger’s (defendant hedge fund) motion to dismiss NACCO’s (plaintiff) common law fraud claim regarding Harbinger’s 13D filings during a takeover attempt of Applica Incorporated (“Applica”). Because this case will serve as the basis of discussion for the rest of the paper, it is important to introduce a brief synopsis of the facts.

NACCO is a holding company that owns Hamilton Beach, a manufacturer of small appliances. In 2005, NACCO approached Applica, manufacturer of the George Foreman Grill, about the possibility of a strategic transaction with Hamilton Beach. In early 2006, Applica’s board authorized merger discussions with NACCO and updated its non-disclosure agreement. At the same time NACCO agreed to a standstill provision. Over the next months, Applica’s board of directors decided to pursue NACCO’s merger proposal, conducted due diligence on Hamilton Beach’s operations, and, on July 24, 2006, the parties announced the Hamilton Beach Merger Agreement.

In the meantime, Harbinger had been purchasing Applica shares, and on March 13, 2006, Harbinger filed a Schedule 13G disclosing its 8.9% ownership of Applica common stock. Over the next couple of months, under the direction of principal Phillip Falcone, Harbinger had acquired 24.7% of Applica’s outstanding common shares. On May 14, 2006, Harbinger filed a Schedule 13D disclosing its position that the shares were being held for “investment purposes only” and that the acquisitions of the Shares were made “in the ordinary course of [Harbinger’s] business or investment activities . . . .”

During the time Harbinger had been acquiring shares, Falcone had other ideas about strategic alternatives for Applica. Falcone had engaged in discussions with his advisor, David Maura, regarding the possibility of acquiring Applica along with Salton, Inc.—a competing small electronic appliance manufacturer. On February 11, 2011, it was reported that Harbinger paid NACCO $60 million to settle the lawsuit. Mark Maremont, Harbinger Settle Suits in Nacco Suit, WALL ST. J., Feb. 17, 2011, at C3.

3. NACCO Indus., Inc. v. Applica Inc., 997 A.2d 1, 7 (Del. Ch. 2009). 4. Id. 5. Id. 6. Id. 7. Id. 8. Id. at 7–8. 9. Id. at 8. 10. Id. at 9. 11. Id. 12. Id. at 8.
appliance distributor—and combining the two. According to the complaint, Harbinger began to effectuate this plan in May 2006 when it began its acquisition of Salton.

By June 21, 2006, Harbinger had increased its position in Applica to 32% of the common outstanding shares. At this time, Harbinger filed another Schedule 13D which stated that it had “acquired [Applica] Shares . . . for investment.” Thus, this Schedule 13D differed from the previous Schedule 13D in that it had dropped the word “only” from the disclosure. Harbinger added a disclosure stating that the company “evaluate[s] their investment in the Shares on a continual basis including, without limitation, for possible synergies with their other current investments.” Harbinger also disclosed that it “reserve[d] the right to be in contact with members of [Applica’s] management, the members of [Applica’s] Board of Directors, other significant shareholders and others regarding alternatives that [Applica] could employ to maximize shareholder value.” In the complaint, “NACCO allege[d] that these disclosures were false not only because Harbinger already planned to influence or control Applica, but also because . . . Harbinger had zeroed in on and was pursuing the specific alternative of an Applica-Salton combination.”

By August 17, 2006, Harbinger had acquired 39.24% of Applica’s outstanding common stock. In all of its August 2006 Schedule 13D filings, Harbinger repeated its position that it was holding shares for investment purposes and did not include any statements regarding intentions to influence or control Applica. According to the complaint, NACCO claimed that “in reliance on Harbinger’s Schedule 13D filings, Applica’s reassurances that Harbinger would support the deal, and Harbinger’s lack of any prior deal jump attempts, NACCO believed that Harbinger would not make a competing bid or seek to influence the outcome of the merger vote.”

On September 14, 2006, Harbinger filed a Schedule 13D/A amending its disclosures in its prior Schedule 13D forms and at the same time made a

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13. Id. at 8–9.
14. See id. at 9 (alleging that by June 24, 2010 Harbinger had acquired $100 million of the company’s preferred stock and in excess of the $100 million in its debt).
15. Id.
16. Id.
17. Id.
18. Id.
19. Id.
20. Id. at 9.
21. Id. at 11.
22. Id.
23. Id.
On October 10, 2006, Applica terminated the Hamilton Beach Merger Agreement and entered into a merger agreement with Harbinger.\textsuperscript{25} On October 19, Applica paid NACCO the $4 million termination fee and $2 million in expense reimbursement under the Hamilton Beach Merger Agreement, which provided for such compensation in the event the Agreement was validly terminated to accept a topping bid.\textsuperscript{26}

On November 13, 2006, NACCO brought an action against Applica and Harbinger for specific performance of the Hamilton Beach Merger Agreement.\textsuperscript{27} After being informed that the Court could not facilitate a full trial prior to the projected closing of the Harbinger Merger, NACCO moved for a preliminary injunction but withdrew its injunction application after a preliminary exchange of documents.\textsuperscript{28} Over December 2006 and January 2007, NACCO and Harbinger engaged in a bidding contest for Applica with Harbinger ultimately succeeding with a tender offer of $8.25 per share ($2.25 more than the price per share in the original Harbinger Merger Agreement).\textsuperscript{29} On January 24, 2007, Applica shareholders approved the Harbinger Merger Agreement and NACCO terminated its efforts to acquire Applica.\textsuperscript{30}

II. NACCO’S COMMON LAW FRAUD CLAIM

Central to NACCO’s fraud claim is that Applica’s preliminary proxy statement regarding the Harbinger Merger Agreement contained significantly different information than the Schedule 13D disclosures made by Harbinger throughout the first half of 2006.\textsuperscript{31} As Vice Chancellor Laster acknowledged in his opinion, there exists a jurisdictional issue of

\textsuperscript{24} See id. at 11 (amending disclosure stating that the Applica shares had been acquired “in order to acquire control of [Applica]” rather than the previously stated purpose of investment).

\textsuperscript{25} Id. at 12.

\textsuperscript{26} Id.

\textsuperscript{27} Id.

\textsuperscript{28} Id.

\textsuperscript{29} Id. at 13. It should be noted that Harbinger had the advantage of owning approximately forty percent of the common stock; thus Harbinger was effectively bidding for only sixty percent of Applica, whereas NACCO, which had been limited by the standstill agreement, was bidding for all of Applica. Id.

\textsuperscript{30} See id. at 13 (noting that, due to the additional bidding process, Applica increased NACCO’s termination fee from $4 million to $7 million and their expense reimbursement fee from $2 million to $3.3 million).

\textsuperscript{31} Id. Specifically, the Applica proxy stated that Harbinger representatives had contacted Applica in mid-July concerning the possibility of a strategic transaction, whereas the 13D filings made by Harbinger at that time said that the shares were only being accumulated for investment purposes. Id.
whether a Delaware court can provide common law fraud relief. Vice Chancellor Laster concluded that Delaware courts ultimately had the ability to enforce a common law fraud claim by relying on the text of Section 28(a) of the Exchange Act which states that the Exchange Act “shall be in addition to any and all other rights and remedies that may exist at law or in equity . . . .” By allowing a common law fraud claim, this ruling has the potential to alter dramatically the landscape for hedge funds making disclosures under the Exchange Act. Given the enhanced scrutiny of Schedule 13D disclosures by the legal community the following analysis will focus on: (1) whether state courts (specifically Delaware) should legally allow a private right of action by a disgruntled bidder on the grounds of common law fraud from allegedly misleading and/or false Schedule 13D disclosures; and (2) the policy ramifications of allowing such a claim—specifically who bears the burden of such a civil action.

III. WHETHER DELAWARE SHOULD HAVE ALLOWED THE COMMON LAW FRAUD ACTION TO CONTINUE

A. The Williams Act and Schedule 13D Disclosures

In response to the growing use of cash tender offers as a means for achieving corporate takeovers, Congress passed the Williams Act as a set of amendments to the Securities Exchange Act of 1934 (“Exchange Act”). Prior to the Williams Act, there was a void in disclosure requirements for tender offer transactions. Under the Williams Act, a potential takeover bidder must file a statement with the Securities and Exchange Commission (“SEC”) “indicating . . . ‘the background and identity’ of the offeror, the source and amount of funds or other consideration to be used in making the purchases, the extent of the offeror’s holdings in the target corporation, and

32. Id. at 20.
33. Id. (quoting 15 U.S.C. § 78bb (2006)).
34. Id. at 24. Harbinger argued that it was “widely believed in the community of hedge funds who frequently file Schedule 13Ds that one need not disclose any intent other than an investment intent until one actually makes a bid.” Id. at 28.
36. See Piper v. Chris-Craft Indus., Inc., 430 U.S. 1, 22 (1977) (discussing the history of the Williams Act); 15 U.S.C. §§ 78m(d), 78n(d)–(f).
37. Piper, 430 U.S. at 22 (citing 113 CONG. REC. 854 (1967) (remarks of Sen. Williams)).
the offeror’s plans with respect to the target corporation’s business or corporate structure.”

B. Tender Offerors Do Not Have a Private Right of Action Under §14(e)

The Exchange Act contains an anti-fraud provision in §14(e) which states that “[i]t shall be unlawful for any person to make any untrue statement of a material fact or omit to state any material fact . . . in connection with any tender offer or request or invitation for tenders . . . .” In Piper v. Chris-Craft Industries, the Supreme Court faced a very similar issue to the one in the NACCO case. Specifically, the Piper Court addressed the issue of whether “an unsuccessful tender offeror in a contest for control of a corporation has an implied cause of action for damages under §14(e) of the Securities Exchange Act of 1934 . . . .” The Supreme Court noted that Section 14(e) does not explicitly authorize a private right of action like other sections of the Exchange Act. However, the Court did acknowledge that “in some circumstances a private cause of action can be implied with respect to the 1934 Act’s antifraud provisions, even though the relevant provisions are silent as to remedies.” The Court explained that “where congressional purposes are likely to be undermined absent private enforcement, private remedies may be implied in favor of the particular class intended to be protected by the statute.” The Court then conducted an in-depth examination of the legislative history to determine the congressional purpose underlying the specific statutory prohibition in §14(e).

In Piper, the Court concluded by noting that, because the main purpose of the Exchange Act was to protect individual investors, it might be appropriate to imply a private action for them, but since Congress did not intend §14(e) to benefit the actual tender offerors, it would be inappropriate to infer a cause of action for them. The question arises:

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40. Piper, 430 U.S. at 4.
41. Id. at 24.
42. Id. (citing J.I. Case Co. v. Borak, 377 U.S. 426 (1964)).
43. Id. at 24.
44. Id. at 26 (quoting Senator Harrison Williams: “[The federal securities laws] provide protection for millions of American investors by requiring full disclosure of information in connection with the public offering and trading of securities. These laws have worked well in providing the public with adequate information on which to base intelligent investment decisions.” (citation omitted)).
45. Id. at 32–33. See also Mark J. Loewenstein, Section 14(e) of the Williams Act and the Rule 10b-5 Comparisons, 71 GEO. L.J. 1311, 1325 (1983) (explaining how courts assessing private rights of action will determine whether the plaintiff is a member of the class for whose special benefit the statute was enacted and how tender offerors did not
Why should Delaware allow a disgruntled tender offeror a private right of action where the Supreme Court and Congress have refused to allow one?\(^46\)

If the Supreme Court in *Piper* held that a tender offeror had no standing to sue for damages, should a state court be preempted from hearing a common law fraud claim that in effect creates the very remedy that the Supreme Court denied existence under §14(e)? Vice Chancellor Laster answered this question in the negative, but the statutory structure of the Exchange Act combined with subsequent precedential history interpreting the Act is not clear.

The jurisdictional provision in the Exchange Act states:

> The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this chapter [15 U.S.C. §§ 78a et seq.] or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter [15 U.S.C. §§ 78a et seq.] or the rules and regulations thereunder.\(^47\)

However, the Savings Clause in Section 28 of the Exchange Act states that “[t]he rights and remedies provided by [the Exchange Act] shall be in addition to any and all other rights and remedies that may exist at law or in equity . . . .”\(^48\)

Vice Chancellor Laster acknowledged in his opinion that “if NACCO were seeking to enforce Section 13 of the Exchange Act or asserting a claim for a violation of Section 13, that claim could be heard only by a federal court.”\(^49\) Furthermore, he stated that some of the language in NACCO’s complaint suggested that “NACCO [wa]s trying to replead a Section 13 violation as a state law fraud claim.”\(^50\) Relying on the Delaware Supreme Court’s analysis in *Rossdeutscher v. Viacom, Inc.*, the NACCO comprise such a class under the Williams Act).\(^46\)

\(46\). See *Piper v. Chris-Craft Indus., Inc.*, 430 U.S. 1, 35 (1977) (“[w]e find no hint in the legislative history, on which respondent so heavily relies, that Congress contemplated a private cause of action for damages by one of several contending offerors against a successful bidder or by a losing contender against the target corporation.”).


\(48\). 15 U.S.C. § 78bb. It should be noted that, had the NACCO case been in the form of a “covered class action” as defined by 15 U.S.C. § 78bb(t), the common law fraud and misrepresentation claims would have been completely preempted. See, e.g., *Behlen v. Merrill Lynch*, 311 F.3d 1087, 1096 (11th Cir. 2002) (holding that because plaintiff’s action was a “covered class action” asserting state law claims for misrepresentation and/or omission “in connection with” the purchase or sale of covered securities it was preempted and subject to dismissal).

\(49\). NACCO Indus., Inc. v. Applica Inc., 997 A.2d 1, 25 (Del. Ch. 2009).

\(50\). *Id.* (citing *Rossdeutscher v. Viacom*, 768 A.2d 8 (Del. 2001)).
court held that it was not preempted from entertaining the common law fraud claim against Harbinger.\footnote{Id.}

Specifically, it is well established that the reference to a federal statute in a state court proceeding is not enough to invoke federal court jurisdiction and thus preempt the state law action.\footnote{NACCO, 997 A.2d at 22 (citing Grable & Sons Metal Prods., Inc. v. Darue Eng’g & Mfg., 545 U.S. 308 (2005)).} As Vice Chancellor Laster correctly stated, in the context of the Exchange Act, “removal jurisdiction has been held to exist where the state law claim necessarily turned on the meaning of federal securities regulations.”\footnote{See id. (citing Sparta Surgical Corp. v. National Ass’n of Sec. Dealers, Inc., 159 F.3d 1209 (9th Cir. 1998) for the proposition that removal was proper because the complaint stated the issuer had no state law claim unless the defendant violated its own rules which were issued pursuant to the Exchange Act directive, thus the case hinged on the interpretation of federal regulations).} Additionally, state common law fraud and misrepresentation claims have both been remanded back to state courts by district courts\footnote{See Sung ex rel. Lazard Ltd. v. Wasserstein, 415 F. Supp. 2d 393, 395 (S.D.N.Y. 2006) (allowing remand to state court of claims involving “the issuance of false and/or misleading statements, including the preparation of the false and/or misleading press releases and SEC filings,” even though the complaint contained references to federal laws).} and retained by district courts on the principle of pendent jurisdiction.\footnote{See Diceon Elecs., Inc. v. Calvary Partners, L.P., 772 F. Supp. 859, 862 (D. Del. 1991) (“The Court will therefore not dismiss the plaintiff’s common law fraud claim unless all of the plaintiff’s federal causes of action are dismissed and it appears that the Court can no longer retain pendent jurisdiction over the state law claim.”).} Furthermore, it is clear that the Supreme Court has contemplated a state law remedy to the “extent that the offeror seeks damages for having been wrongfully denied a ‘fair opportunity’ to compete for control of another corporation.”\footnote{Piper v. Chris-Craft Indus., Inc., 430 U.S. 1, 41 (1977), (citing Cort v. Ash, 422 U.S. 78, 84 (1975)).}

In this case, where NACCO complained of the fraud in the disclosure, it is immaterial to the state law claim that the disclosure happened to be required by federal securities regulation. No interpretation of federal securities law is necessary to adjudicate the merits of the common law fraud claim. Accordingly, Vice Chancellor Laster found that the “issue can be adjudicated by [Delaware Chancery Courts] as a question of fact, separate and independent from what the line items of Schedule 13G and Schedule 13D require.”\footnote{NACCO, 997 A.2d at 25.} Vice Chancellor Laster explained that while he would only be ruling on Delaware common law, he would not be precluded from considering federal standards and precedent as “guideposts” and persuasive authority in determining whether the statements were false or misleading.\footnote{Id. (citing Grable & Sons Metal Prods. v. Darue Eng’g & Mfg., 545 U.S. 308 (2005)).} For the aforementioned reasons, as explained by Vice
Chancellor Laster, Delaware courts are probably not preempted in a legal sense from hearing the common law fraud action. As will be discussed in later sections, it might be appropriate for Delaware to reexamine its precedent in *Rossdeutscher* given the significant policy implications on the tender offer market flowing from the *NACCO* case.

C. Policy Argument Against Allowing a Common Law Fraud Action

While Vice Chancellor Laster’s decision is probably not violative of the text of the Exchange Act, his decision to allow the common law fraud claim contradicts the Supreme Court’s decision in *Piper* prohibiting a tender offeror to receive damages. It is arguable on a policy level that Delaware should be hesitant to allow an action where the federal government has refused one.

Congress, in drafting 15 U.S.C. § 78bb(a), “[d]id not indicate congressional intent to occupy the entire field of securities regulation, but rather, to occupy that field only inasmuch as state laws ‘conflict with the provisions of [the Act] or the rules and regulations thereunder.’”59 Likewise, the Williams Act does not expressly prohibit states from regulating corporate takeovers, but it does carry with it the full strength of the Supremacy Clause60 in invalidating state laws that have conflicting objectives of the Williams Act.61 The ultimate interpretation of such acts is vested in the Supreme Court of the United States. Therefore, it seems inappropriate for a state court effectively to usurp both Congress’s and the Supreme Court’s judgment in fashioning remedies regarding securities transactions.

Simply stated, a disgruntled tender offeror is indifferent to whether his access to damages arises from federal or state law. Even though Vice Chancellor Laster was indifferent as to the medium in which the alleged misstatements occurred (i.e. in a disclosure mandated by federal securities law), it is nonetheless relevant to the policy considerations in this case because it is fair to assume that the federal government is best situated to determine and fashion remedies for violations of federal securities law. If Congress or the SEC, through its discretionary rulemaking authority, had wanted to allow tender offerors to sue for damages as part of the federal securities regulatory scheme, they could have easily drafted such a rule.

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59. Whistler Invs., Inc. v. Depository Trust & Clearing Corp., 539 F.3d 1159, 1165 (9th Cir. 2008).
60. U.S. CONST. art. VI, cl. 2.
61. See, e.g., Fleet Aerospace Corp. v. Holderman, 637 F. Supp. 742, 744 (S.D. Ohio 1986) (holding the Ohio Control Share Acquisition Act, which attempted to restrict federally regulated tender offers, to be unconstitutional).
D. Tender Offerors Only Have the Ability to Sue for Injunctive Relief

Though it is well established that tender offerors do not belong to the protected class in order to sue for damages, courts have held that §14(e) “supports the implication of a private right of action on behalf of tender offerors suing for injunctive relief . . . given that in so doing offerors would contribute to achieving the provision’s purpose of protecting the shareholders from having to confront the offer on the basis of inadequate information.” For example, in a case with facts similar to those in NACCO, the tender offeror plaintiff in Humana, Inc. v. American Medicorp, Inc. alleged that the target corporation made material misrepresentations in violation of §14(e) of the Exchange Act. The offeror then wanted to amend its complaint to sue for violations of the Williams Act by a competing offeror. Citing Piper, the court acknowledged that a tender offeror does not have standing to sue for damages under the Act because allowing such a suit would not be “consistent with the underlying purposes of the legislative scheme.” The Humana Court then stated that Piper left open the question of whether a tender offeror could bring a suit for injunctive relief against a competing tender offeror. Ultimately, focusing on the narrowness of the opinion in Piper, the district court in Humana held that one tender offeror could sue a competing tender offeror for injunctive relief. Specifically, the Supreme Court in Piper approved of Judge Friendly’s reasoning in Electronic Specialty Co. v. International Controls Corp. that pre-contest injunctive relief, rather than post-contest lawsuits, “is the time when relief can best be given.”

62. See Piper, 430 U.S. at 42 n.28 (“We hold only that a tender offeror, suing in its capacity as a takeover bidder, does not have standing to sue for damages under § 14(e).”)
64. Humana, Inc. v. American Medicorp, Inc., 445 F. Supp. 613, 614 (S.D.N.Y. 1977). It should be noted that, unlike the NACCO case, the plaintiff in this case did not bring state common law claims. Id.
65. Id. at 614 (citation omitted).
66. Id. at 614 (citation omitted).
67. Piper, 430 U.S. at 48 n.33 (“We intimate no view upon whether as a general proposition a suit in equity for injunctive relief, as distinguished from an action for damages, would lie in favor of a tender offeror under either § 14(e) or Rule 10b-6.”)
69. Piper, 430 U.S. at 41 (citing Electronic Specialty, 409 F.2d 937, 947 (2d Cir. 1969); see also Edward Ross Aranow et al., Standing to Sue to Challenge Violations of the Williams Act, 32 BUS. LAW. 1755, 1761 (1976) (stating that the best time for courts to provide relief for misstatements by a target’s management is “at the initial stages of the tender offer, when such statements may be corrected or enjoined.”).
As one treatise points out, “it is clear that Congress did intend to preserve a balance between the positions of a tender offeror and the target’s management in contested tender offers,” and that, if a tender offeror were prohibited from seeking injunctive relief, “the balance between the legal positions . . . would be substantially tipped in favor of the target’s management.” Thus, “it may be argued that Congress intended to create a right for offerors to seek injunctive relief against misstatements . . . .” The same logic is applicable to a case where a tender offeror is competing with another tender offeror rather than the target management.

There is a strong policy argument against allowing a tender offeror to sue for damages because a monetary remedy for a losing tender offeror would create an award that “would not redound to the direct benefit of the [target shareholders].” In the case of injunctive relief, the only benefit to the tender offeror would be enforcement of the Williams Act, and it would therefore also further Congressional goals in protecting shareholders.

As evidenced above, federal courts have been reluctant to read the Williams Act reporting requirements broadly in favor of allowing damages stemming from private actions. It should be noted, however, that in one recent decision, *CSX Corp. v. Children’s Investment Fund Management (UK) LLP*, a federal district court slightly broadened the scope of 13D private actions. In *CSX*, a defendant hedge fund used total return swaps (“TRS”) to circumvent the Section 13(d) beneficial owner reporting requirements. The court explained that “[t]he purpose of Section 13(d) is to alert shareholders of ‘every large, rapid aggregation or accumulation of securities, regardless of technique employed, which might represent a potential shift in corporate control.’” Therefore, the court concluded that “[t]he SEC intended Rule 13d-3(a) to provide a ‘broad definition’ of

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70. Aranow, supra note 69, at 1761.
71. Id.
72. Piper, 430 U.S. at 39. This is not the type of state remedy that Congress envisioned to supplement federal securities regulation. Id. at 40. Rather, state law can coexist with federal securities regulation only “where congressional purposes are likely to be undermined absent private enforcement, private remedies may be implied in favor of the particular class intended to be protected by the statute.” Id.
73. Aranow, supra note 69, at 1761; see also Humana, 445 F. Supp. at 616 (“The granting of injunctive relief to an offeror, unlike the award of damages, is consistent with the underlying purposes of the Williams Act . . . .”) (quoting 32 BUS.LAW 1755, 1761 (July, 1977)).
74. CSX Corp. v. Children’s Inv. Fund Mgmt. (UK) LLP, 562 F. Supp. 2d 511 (S.D.N.Y. 2008), aff’d, 292 F. App’x. 133 (2d Cir. 2008) and aff’d in part, vacated in part, remanded, 654 F.3d 276 (2d Cir. 2011).
75. CSX, 562 F. Supp. 2d at 512.
76. Id. at 551 (citation omitted).
beneficial ownership so as to ensure disclosure ‘from all those persons who have the ability to change or influence control.’***77

However, despite finding that the defendant hedge fund “created and used the TRSs with the purpose and effect of preventing the vesting of beneficial ownership,” the court fashioned a limited remedy keeping in mind the limited availability of private remedies evidenced by the Congressional intent behind the Williams Act.78 Thus, even though the CSX Court read the Section 13(d) provision broadly, it was still reluctant to fashion a remedy that would not “redound to the direct benefit of the [target shareholders whom the Williams Act was meant to protect]”79: In this case, shareholders’ ability to vote their shares.80 The Court explained that:

The Williams Act was intended not only to prevent secret accumulation and undisclosed group activities with respect to the stock of public companies, but to do so without ‘tipping the balance of regulation either in favor of management or in favor of the person making the takeover bid.’ It must be applied, especially in private litigation, with due regard for the principle that the purpose of private equitable relief is ‘to deter, not to punish.’81

Accordingly, the Court only enjoined future violations of Section 13(d) but chose not to “preclude defendants from voting their CSX shares” or enjoin the current proxy solicitation as plaintiffs had requested.82 The court concluded that any “penalties for defendants’ violations must come by way of appropriate action by the SEC or the Department of Justice.”83

This reasoning and the principles that the court applied in CSX are applicable to the NACCO case. Even though there might be a possible Section 13(d) violation, courts should be hesitant broadly to grant remedies, especially where the remedy has the possibility of negatively affecting the very people whom the Williams Act was meant to protect. Thus, while the broad Section 13(d) interpretation in CSX was a departure from the “norm”, it can still be read as upholding the limiting remedy principles inherent in the Williams Act and reinforced by Piper.

Simply stated, the court in CSX reaffirmed the principle that any monetary penalties for Exchange Act violations should flow from the SEC or Department of Justice. Therefore, for continuity and federalism reasons, when state courts decide to hear disputes stemming from alleged fraud in

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77. Id. at 540 (citation omitted).
78. Id. at 552.
80. CSX, 562 F. Supp. 2d at 517.
81. Id.
82. Id. (emphasis added).
83. Id.
Exchange Act mandatory disclosures, like the *NACCO* case, they should be hesitant to overstep clearly established federal principles regarding remedies available under said Act.

E. **Effect on the Market for Corporate Takeovers**

Ignoring the possible burden this holding puts on the federal regulatory scheme encompassed in the Williams Act, this holding could also upset the balance of power in the takeover market in Delaware. Central to this case, and every other merger agreement for that matter, is the fact that a termination fee is negotiated in advance in the event that a merger agreement is broken. Termination fees are a vital part of the negotiating process as they serve as important deal-protection mechanisms.84 In Delaware, the importance of negotiating deal protection provisions is amplified because such provisions are automatically scrutinized by Delaware Courts under fiduciary duty cases such as *Unocal Corp. v. Mesa Petroleum Co.*,85 *Unitrin, Inc. v. American General Corp.*,86 *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*,87 etc.

In essence, the termination fee, along with other deal protections, serves as a form of liquidated damages that gets internalized in the dealmaking process by both the acquirer and the target. If Delaware allows a disgruntled acquirer to plead common law fraud after the fact, this marginalizes the importance of deal protections such as the termination fee and thus disrupts the traditional negotiating process in the corporate takeover market. In effect, all of the litigation risk is borne by the target in the event that the target board pursues a better offer and breaks a current agreement. The marginalization of the termination fee as a result of the possibility of ex-post litigation (1) creates uncertainty in the deal-making process, (2) shifts the balance of negotiating power in favor of the acquirer, and (3) hampers the target board’s ability to satisfy their fiduciary duty and rationally seek out the best offer for their shareholders.88 After this holding, a target board cannot fully rely on the fact that the termination fee is the opportunity cost to taking a more attractive offer. If anything, this holding will marginalize the value and reliability of deal protections, thus hampering prospective deals going forward.

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84. See HOUHIAN LOKEY, 2009 TRANSACTION TERMINATION FEE STUDY (June 2010), http://www.hl.com/email/pdf/2009_transaction_termination_fee_study.pdf (“Protective devices used by acquirers are heavily negotiated and may include termination fees, 'lockup' agreements and 'no-shop' provisions.”).
85. 493 A.2d 946 (Del. 1985).
86. 651 A.2d 1361 (Del. 1995).
87. 506 A.2d 173 (Del. 1986).
88. *Id.* at 182 (holding that when a corporate board decides to put itself up for sale, its duty is to maximize the company’s value for the stockholders’ benefit).
As part of NACCO and Applica’s original merger agreement, Applica paid NACCO a $4 million termination fee and a $2 million expense reimbursement.\(^{89}\) Furthermore, “[i]n consideration for the increased bid, Applica nearly doubled Harbinger’s termination fee—from $4 million to $7 million—and increased Harbinger’s expense reimbursement from $2 million to $3.3 million.”\(^{90}\) It is hard to see why NACCO asked for a monetary remedy when they already received their self-negotiated opportunity cost of not participating in the deal.

F. Delaware Courts Should be Cautious in Allowing a Common Law Remedy Where Federal Securities Law and Subsequent Supreme Court Interpretation Prohibits One

Taking a closer look at the actual tender offer contest in the NACCO case, we can possibly reach the conclusion that allowing the common law fraud action undermines the doctrine established by the Delaware Supreme Court in Revlon: The maximization of the sale price for the target stockholders’ benefit when a target company decides to sell itself.\(^{91}\) Upon further examination, it is arguable that there is limited deterrent effect in allowing a damages action; therefore, any justification must lie in the retributive nature regarding the possible unfair bargaining position of one potential acquirer over another.

Harbinger’s original offer on September 14, 2006 was to acquire all of the outstanding shares of Applica that it did not already own for $6.00 per share.\(^{92}\) In conjunction with this topping bid, Applica paid NACCO liquidated damages in the form of a “$4 million termination fee and $2 million in expense reimbursement that the Hamilton Beach Merger Agreement called for in the event the agreement was validly terminated to accept a topping bid.”\(^{93}\) It was not until November 2, 2006 when Applica filed a preliminary proxy that NACCO became aware of possible fraud in Harbinger’s Schedule 13Ds.\(^{94}\) Therefore, injunctive relief in the pre-contest stage of the case was not available to NACCO.\(^{95}\) NACCO could not have filed an injunction barring or seeking correction of the faulty

\(^{89}\) NACCO Indus., Inc. v. Applica Inc., 997 A.2d 1, 13 (Del. Ch. 2009).
\(^{90}\) Id.
\(^{91}\) Revlon, 506 A.2d at 182; see also William W. Bratton, Hedge Funds and Governance Targets, 95 Geo. L.J. 1375, 1424 (2007) (“The corporate law of mergers and acquisitions devotes itself to assuring that the selling shareholders get a fair price . . . .”).
\(^{92}\) NACCO, 997 A.2d at 11.
\(^{93}\) Id. at 12.
\(^{94}\) Id.
\(^{95}\) See Elec. Specialty Co. v. Int’l Controls Corp., 409 F. 2d 937, 947 (2d Cir. 1969) (stating that the application for preliminary injunction is the most effective time for courts to grant equitable relief).
statements prior to the transaction because it was not until after Applica jilted them for the Harbinger agreement that the fraud became known.\textsuperscript{96} It is arguable that, just as Congress intended a balance of legal positions between an offeror and target management so too should there be a balance of legal positions between competing offerors.\textsuperscript{97} As NACCO correctly points out, they were disadvantaged in a pure bidding war because Harbinger “had the benefit of owning a nearly 40% block that it had acquired for much lower prices at a time when NACCO was limited by a standstill agreement.”\textsuperscript{98}

Despite the possible fairness justifications discussed above, an examination of Supreme Court precedent, albeit in a different context than in the current case, supports the argument that Vice Chancellor Laster’s decision to permit ex-post common law fraud scrutiny of federal disclosures in a tender offer scenario undermines the underlying goals of the Williams Act and therefore should not be binding precedent. As explained in Section H of this article, Delaware has a policy and financial interest in preventing the federalization of corporate law. Accordingly, Delaware Courts should proceed cautiously in fashioning remedies where the federal government has explicitly prohibited them.

The Supreme Court of the United States in \textit{Schreiber v. Burlington Northern, Inc.},\textsuperscript{99} albeit in a different context, clearly stated that application by judges of “their own sense of what constitutes unfair or artificial conduct would inject uncertainty into the tender offer process.”\textsuperscript{100} The Supreme Court in \textit{Schreiber} explained that:

\begin{quote}
An essential piece of information—whether the court would deem the fully disclosed actions of one side or the other to be “manipulative”—would not be available until after the tender offer had closed. This uncertainty would directly contradict the expressed congressional desire to give investors full information.
\end{quote}

Congress’ consistent emphasis on disclosure persuades us that it intended takeover contests to be addressed to shareholders. In pursuit of this goal, Congress, consistent with the core mechanism of the Securities Exchange Act, created sweeping disclosure requirements and narrow substantive safeguards. The same Congress that placed such emphasis on shareholder choice

\textsuperscript{96} NACCO, 997 A.2d at 12.
\textsuperscript{97} See Aranow, supra note 69, at 1761 (arguing that Congress did not intend for courts to tip the balance of interests in favor of target management by denying standing to tender offerors seeking injunction under the Williams Act).
\textsuperscript{98} NACCO, 997 A.2d at 13 (explaining that, for every $1 Harbinger increased its bid, Harbinger’s cost was only increased by 60 cents).
\textsuperscript{100} Id. at 12.
would not at the same time have required judges to oversee tender offers for substantive fairness.\textsuperscript{101}

The above principle can be applied to \textit{NACCO}. Because (1) the damages award would not be determined until after Applica (target) shareholders approved the merger, and (2) the cost of any damages award would be borne by Applica (target) shareholders, the Applica (target) shareholders would not be fully informed of the ultimate price for which they were selling their shares at the time they decided to tender. It is irrelevant that the damages emanate from state law rather than federal law as in \textit{Schreiber} since tendering shareholders are completely indifferent to the source.\textsuperscript{102} Unfortunately, in some rare cases perceived inequities may occur between bidders. However, this is no excuse to allow state law the opportunity to undermine the goals of the Securities Exchange Act.

As previously discussed by the \textit{Piper} court,\textsuperscript{103} a damages award in this type of case would simply be a wealth transfer from innocent shareholders of Applica to the losing tender offeror. Furthermore, this unfairness in bidding most likely had little effect on the final price from the target shareholders’ perspective but rather only affected which competing offeror was ultimately successful.\textsuperscript{104} From a shareholder’s perspective, the bidding war was successful in raising Harbinger’s initial bid of $6.00 by more than 40\% up to $8.25.\textsuperscript{105} If Delaware’s goal in assigning damages is shareholder protection (wealth maximization), then a damages remedy in \textit{NACCO} does not seem to be justified.

Ultimately, because misstatements and omissions in a Schedule 13D can give rise to federal criminal convictions and other penalties, hedge funds typically take their Schedule 13D filing obligations very seriously.\textsuperscript{106} Thus the deterrent effect of the possibility of a common law damages award is overshadowed by the deterrent effect of federal penalties under the Exchange Act.

As Vice Chancellor Laster makes clear, this is a case-specific ruling at the motion to dismiss stage, and thus the precedential value of this holding

\textsuperscript{101} \textit{Id}.

\textsuperscript{102} Simply stated, federally-imposed damages have the same effect on tendering shareholders as state-imposed damages.

\textsuperscript{103} \textit{Piper v. Chris-Craft Indus., Inc.}, 430 U.S. 1, 39 (1977).

\textsuperscript{104} This assumes that Applica would have committed the same amount of out-of-pocket money to the bid. Thus, had they owned a lesser percentage of the shares, the price per share they would have been willing to pay for all of Applica would have been lower than $8.05 and therefore NACCO would have been the likely winner in the bidding war.

\textsuperscript{105} \textit{NACCO Indus., Inc. v. Applica Inc.}, 997 A.2d 1, 13 (Del. Ch. 2009).

with respect to future scrutiny of federal securities disclosures is arguably limited.\textsuperscript{107}

\textbf{G. The Reliance Element of a Common Law Fraud Claim is Questionable}

A broad reading of Vice Chancellor Laster’s opinion is that any federal disclosure is now open to the possibility of a state common law fraud action. A narrow reading is that Delaware will only intervene in actions between competing bidders where federal securities law leaves a void for the possibility of a damages award. Regardless, as Vice Chancellor Laster made perfectly clear,\textsuperscript{108} \textit{NACCO} is only at the motion to dismiss stage and therefore it is not certain that NACCO would have succeed at trial.\textsuperscript{109}

One of the factors in a Delaware common law fraud case is reliance.\textsuperscript{110} However, unlike federal securities law, which permits the fraud-on-the-market theory that implies reliance based on the materiality of the misstatement,\textsuperscript{111} Delaware common law requires that a plaintiff show actual reliance.\textsuperscript{112} Even Vice Chancellor Laster conceded that he was “troubled by the reliance inquiry” and “[e]ven based on the unusual and extreme facts pled in the Complaint, [he] view[ed] it as a close call.”\textsuperscript{113} I find most persuasive Vice Chancellor’s statement that at “some point it became unreasonably naive for NACCO to trust that a hedge fund engaging in conduct resembling a creeping takeover wanted only to receive its ratable share of the benefits of the existing deal.”\textsuperscript{114} However, the changing landscape of activist hedge funds makes this line even harder to draw ex post.

Hedge funds have taken a more moderate role in the market for corporate control than during the 1980s era of corporate raiders and greenmailers.\textsuperscript{115} “Engagements in the 1980s tended to have all or nothing outcomes—either the activist took over the firm, the firm went private or otherwise paid off its shareholders with the proceeds of a leveraged

\textsuperscript{107} \textit{NACCO}, 997 A.2d at 32.
\textsuperscript{108} \textit{Id.} at 18.
\textsuperscript{109} This case has since settled out of court.
\textsuperscript{110} \textit{NACCO}, 997 A.2d at 29.
\textsuperscript{111} Basic Inc. v. Levinson, 485 U.S. 224, 247 (U.S. 1988) (“An investor who buys or sells stock at the price set by the market does so in reliance on the integrity of that price. Because most publicly available information is reflected in market price, an investor’s reliance on any public material misrepresentations, therefore, may be presumed . . . .”).
\textsuperscript{112} \textit{NACCO}, 997 A.2d at 29 (citing Gaffin v. Teledyne, Inc., 611 A.2d 467, 474 (Del. 1992)).
\textsuperscript{113} \textit{Id.}
\textsuperscript{114} \textit{See id.} at 32 (stating that “the line when NACCO’s reliance became unreasonable is difficult to draw and is not something [he would] address on a motion to dismiss”).
\textsuperscript{115} Bratton, \textit{supra} note 91, at 1424; Bork & Ashley, \textit{supra} note 106, at 61.
restructuring, or the firm stayed independent, perhaps after making a greenmail payment.\textsuperscript{116} In the current environment, hedge fund activism rarely triggers changes in control; rather, activists often use their power to acquire board seats.\textsuperscript{117} This might support Vice Chancellor Laster’s decision to allow the suit because it makes NACCO’s reliance on Harbinger’s statement that they only had “investment” purposes more reasonable.

On the contrary, it is arguable that the magnitude of Harbinger’s accumulation of Applica stock (a nearly forty percent block) significantly increases the likelihood that Harbinger sought a change in control and therefore negates any legitimate claim of reliance by a sophisticated party like in NACCO.\textsuperscript{118} Furthermore, based on the facts of the case it appears that any unfairness in the transaction was already attempted to be compensated for by the termination and expense fees, which Applica even increased following the bidding contest.\textsuperscript{119}

As Vice Chancellor Laster states, not allowing a damages claim even where reliance is questionable would allow “some market players [to] insulate themselves at the pleadings stage from claims based on false disclosures by arguing that others should know how close to the line they like to play and that their disclosures really should never be believed.”\textsuperscript{120}

The idea of “insulating wrongdoers and penalizing victims” is not compatible with Delaware law, or federal securities law for that matter. However, situations like the one in \textit{NACCO} seem to be fairly unique, and in balancing the harms between (1) a sophisticated losing bidder who in almost all circumstances has a termination fee\textsuperscript{122} as liquidated damages, and (2) innocent shareholders of the target corporation, courts, especially those in Delaware, should lean towards the latter.

\textbf{H. Will Delaware be Used as a “Vehicle for Fraud”?}

One final justification Vice Chancellor Laster offers in favor of allowing Delaware common law fraud actions stemming from statements filed in accordance with federal securities law is that “Delaware has a powerful interest of its own in preventing the entities that it charters from

\begin{itemize}
\item \textsuperscript{116} Bratton, \textit{supra} note 91, at 1427.
\item \textsuperscript{117} \textit{Id.} at 1427–28.
\item \textsuperscript{118} \textit{NACCO}, 997 A.2d at 13.
\item \textsuperscript{119} \textit{Id.} (“In consideration for the increased bid, Applica nearly doubled Harbinger’s termination fee—from $ 4 million to $ 7 million—and increased Harbinger’s expense reimbursement from $ 2 million to $ 3.3 million.”).
\item \textsuperscript{120} \textit{Id.} at 32.
\item \textsuperscript{121} \textit{Id.}
\item \textsuperscript{122} Edith Hotchkiss et al., \textit{Holdups, Renegotiation, and Termination Fees in Mergers} (May 2010), \url{https://www2.bc.edu/~qianju/Deal-protection-25May2010.pdf}. 
\end{itemize}
being used as vehicles for fraud” and that “Delaware’s legitimacy as a chartering jurisdiction depends on it.”\textsuperscript{123} Specifically, he is concerned that Delaware might suffer the same fate that West Virginia did at the turn of the twentieth century when it utterly failed to attract incorporations as a result of offering the “loosest, most liberal law of any state in the union.”\textsuperscript{124}

First, the notion of inter-jurisdictional competition between the fifty states for incorporation has long fizzled since the time of the swashbuckling West Virginians to which Vice Chancellor Laster refers us.\textsuperscript{125} More recent academics are less inclined to believe that substantial inter-jurisdictional competition exists.\textsuperscript{126} Therefore, it is questionable that “Delaware’s legitimacy as a chartering jurisdiction depends” on its ability to allow a common law fraud action for damages by a disgruntled tender offeror.\textsuperscript{127}

It is undisputed that Delaware has a substantial interest in maintaining its presence as the state with the highest incidence of incorporation. Delaware is already home to over 60 percent of the Fortune 500 companies\textsuperscript{128} and half of all U.S. firms traded on the New York Stock Exchange and NASDAQ.\textsuperscript{129} As of the end of the 2009 fiscal year, the Delaware Division of Corporations had collected a record high of $767 million in incorporations’ revenue, accounting for 25% of the State’s general fund.\textsuperscript{130} A Delaware shift from being the premier place to incorporate would have a substantial negative effect on the state. However, any threat from other states as Vice Chancellor Laster is concerned with in \textit{NACCO}\textsuperscript{131} seems to be minimal at best.\textsuperscript{132} Rather the real threat to

\textsuperscript{123} \textit{NACCO}, 997 A.2d at 26.
\textsuperscript{124} See id. (quoting Charles M. Yablon, \textit{The Historical Race Competition for Corporate Charters and the Rise and Decline of New Jersey: 1880–1910}, 32 J. CORP. L. 323, 365 (2007)).
\textsuperscript{125} Mark J. Roe, \textit{Delaware and Washington as Corporate Lawmakers}, 34 DEL. J. CORP. L. 1, 5 (2009) (“recent thinking is skeptical that interjurisdictional competition is intense”).
\textsuperscript{126} Id.
\textsuperscript{127} \textit{NACCO}, 997 A.2d at 26.
\textsuperscript{128} DELAWARE DEPARTMENT OF STATE, DIVISION OF CORPORATIONS 2009 ANNUAL REPORT 1 (2009).
\textsuperscript{129} DELAWARE DEPARTMENT OF STATE, DIVISION OF CORPORATIONS 2005 ANNUAL REPORT 1 (2005).
\textsuperscript{130} Id. at 2.
\textsuperscript{131} See \textit{NACCO}, 997 A.2d at 26 (revealing Vice Chancellor Laster’s concern that if Delaware develops a reputation for permitting fraudulent schemes, it will lose its attraction to incorporations just as West Virginia and South Dakota did in the early 1900s).
\textsuperscript{132} Roe, \textit{supra} note 125, at 5 (Most states have not invested in developing good business courts, they do not try to make the corporate law that managers and shareholders want, and their per-firm rate card for franchise fees does not have them charging enough to strongly motivate themselves to attract more incorporations. Delaware is alone in competing day-to-day for corporate charters and franchise fees.)
Delaware’s “cash cow” is the threat of federalization of corporate law from Washington.\textsuperscript{133} For this reason it is clear that “Delaware does seem to formulate policy with an eye on Washington.”\textsuperscript{134} As Mark Roe further explained: “Delaware players are not oblivious to the possibility that federal authorities can act. When the issue is big enough that it could attract Washington’s attention, they have reason to consider what Washington would do, and they often have reason not to instigate Washington to displace them . . . .”\textsuperscript{135} Keeping this principle in mind, it is arguable that Delaware Courts should be hesitant to provide a remedy that has the possibility of meddling with the (1) the Williams Act and (2) the Supreme Court’s subsequent interpretation\textsuperscript{136} of said act. By allowing a common law damages award to a losing tender offeror, where such remedy is prohibited under federal securities law, the Delaware Chancery Court is possibly instigating Washington to intervene.

IV. CONCLUSION

In examining whether Delaware should offer a common law fraud action, thus opening up the availability of a damages award, stemming from alleged misstatements in federally mandated disclosure, I come to the opposite conclusion of Vice Chancellor Laster in the \textit{NACCO} case. Specifically, (1) an ex-post award like this has the potential to disrupt the market for corporate takeovers by marginalizing ex-ante negotiated deal protections; (2) tender offerors are not part of the protected class which Congress sought to protect with the Williams Act; (3) the Supreme Court has already spoken as to the availability of a damages award; (4) allowing a state damages award in this context contravenes said Congressional intent and Supreme Court precedent; and (5) offering such remedy would contradict Delaware’s interest in delaying/preventing the federalization of corporate law. As previously noted, Vice Chancellor Laster was correctly applying binding Delaware Supreme Court precedent of \textit{Rossdeutscher v. Viacom}. For the aforementioned reasons, it might be prudent for Delaware to reexamine this case.\textsuperscript{137}

\textsuperscript{133}. \textit{Id.} at 6–7 (explaining that a “very large portion of the law governing the corporation is not made in a jurisdictional race but by a national political authority, such as Congress, the SEC, or the federal courts”).

\textsuperscript{134}. \textit{Id.}

\textsuperscript{135}. \textit{Id.} at 8.

\textsuperscript{136}. \textit{See}, e.g., \textit{Piper v. Chris-Craft Indus., Inc.}, 430 U.S. 1, 28 (1977) (“Congress was intent upon regulating takeover bidders . . . . in order to protect the shareholders of target companies . . . . [T]ender offerors were not the intended beneficiaries of the bill . . . .”).

\textsuperscript{137}. \textit{Rossdeutscher v. Viacom}, 768 A.2d 8, 8 (Del. 2001).