

Delaware Chancery Court Finds a ~27% Founding Stockholder Is Not a Controller



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On July 2, 2024, the Delaware Chancery Court in *Sciannella v. AstraZeneca* dismissed stockholder claims in connection with the \$3 billion merger of Viela Bio and Horizon Therapeutics in 2021. The merger was approved by Viela's stockholders at a share price of \$53.00 per share, a 52.8% premium over Viela's share price at the time. The plaintiff alleged that AstraZeneca, by virtue of its 26.72% ownership stake, de facto blocking rights over certain actions and contractual support arrangements with Viela, was a controlling stockholder of Viela, and that AstraZeneca breached its fiduciary duties to Viela and Viela's stockholders by "launching Viela into a rushed, single-bidder sale process" so that AstraZeneca could more easily complete the acquisition of a competitor to Viela.

The main question for the Chancery Court was whether AstraZeneca, as a 26.72% holder of Viela, had significant control over the company and therefore whether the merger should be subject to the more stringent entire fairness standard as opposed to the highly deferential business judgment rule. The Chancery Court analyzed multiple factors, including (1) the factual background and relationship of the parties, (2) the size of AstraZeneca's equity stake, (3) board composition, (4) AstraZeneca's de facto blocking rights and (5) other contractual arrangements between AstraZeneca and Viela.

AstraZeneca created Viela through a spin-off in 2018 and that AstraZeneca maintained a nearly 27% ownership position in Viela. AstraZeneca had appointed two directors to Viela's eight member board, although one of the two had resigned prior to merger talks with Horizon. The plaintiff stockholder alleged that Viela's other directors were susceptible to AstraZeneca's pressure, even if they were not appointed by AstraZeneca, because they were former members of AstraZeneca's management team or "executives or founders of investment funds that were early investors in AstraZeneca's spin-off of" Viela. Additionally, by virtue of Viela's organizational documents, which required a 75% stockholder vote for certain matters, AstraZeneca's 26.72% allowed it to veto certain actions, including: (i) removal of a director; and (ii) stockholder-proposed bylaw amendments that were not supported by the board. Since the spin-off, AstraZeneca provided certain services to Viela through support agreements, including clinical operations, laboratory services and overhead financial, procurement and other functions, which the plaintiff argued gave AstraZeneca "absolute" control over Viela's operations and were the "lifeblood of Viela's business."

The Chancery Court found that the "prior designation of two directors on an eight-member board— only one of whom remained at the time the Board approved the Merger" was not a persuasive allegation of control, noting that plaintiff failed to "plead facts that allow for a reasonable inference that AstraZeneca 'dominate[d] the corporate decision-making process.'" With respect to the other directors on the board, the court reminded the parties that the plaintiff must plead facts to show that such directors are "either beholden to [AstraZeneca] or so under its influence that [the director's] discretion is sterilized." Taking guidance from *Kahn v. M&F Worldwide Corp.*, the court agreed that allegations of "prior employment or business relationships, without more, are insufficient to show control" or to rebut the presumption of independence.

With respect to Viela's charter provisions, the Chancery Court highlighted the fact that, while AstraZeneca had technical blocking rights "over limited corporate actions", AstraZeneca never exercised these rights and, even if it had, the rights "did not give AstraZeneca power to wield control over the Board or "operate[] the decision-making machinery of" Viela. The court also distinguished the bylaw amendment veto right from other potential blocking rights that may affect board action, noting that the control provision in the charter applied only if the board opposed the relevant bylaw amendment.

Lastly, although the support agreements gave AstraZeneca control over daily operations, the court ruled that the plaintiff did not plead that AstraZeneca "had the ability to dominate the Board's decision-making process as a result of the support agreements or operational dependence on AstraZeneca." Viela's prior SEC filings stated that Viela was "substantially reliant" on AstraZeneca. Despite the fact that the Chancery Court agreed that Viela was, at least in part, contractually dependent upon AstraZeneca, similar to its assessment of the blocking rights, the Chancery Court stressed that AstraZeneca never exercised the potential power that it arguably had. The court also distinguished the statements in Viela's SEC filings from prior decisions based on a public admission of control, stating that Viela's SEC disclosure was a "far cry" from [an] outright admission" and that Viela was not necessarily without other potential alternatives.

Overall, the Chancery Court focused on the fact that the plaintiff's assertions in the case were "not nearly as formidable as...in other cases" and were not sufficient to successfully argue AstraZeneca was a controller of Viela.

The plaintiff also argued that even if AstraZeneca was not a controller of Viela, it exercised transaction-specific control and attempted to exert influence over the sale process, including through a January 8, 2021 letter that proposed a path to a "full separation of Viela from AstraZeneca." As with plaintiff's other claims, this was not a persuasive argument for the Chancery Court. Similar to its analysis on plaintiff's other arguments, the Chancery Court focused on the fact that AstraZeneca did not actually exert influence or exercise the power it allegedly had. Of note for the court, unrelated to the merger AstraZeneca could terminate the support agreements for convenience and had been in discussions with Viela on a separation since Viela's IPO.

Holding that AstraZeneca was not a controlling stockholder, the Chancery Court expressed the position held in *Corwin v. KKR Financial Holdings LLC*, that the business judgment rule would apply absent a showing that the company's stockholders "were interested, coerced, or not fully informed." The court determined that the merger disclosures were sufficient and therefore that stockholders were adequately informed. Among other items, although neither the January 8 letter nor earlier more optimistic projections that pre-dated the merger were disclosed to stockholders, such information was not material and its omission was not sufficient to plead that stockholder action was not fully informed.

The case highlights the Chancery Court's view that when determining whether a minority stockholder exercises control over a company, the totality of the circumstances should be analyzed. Although the court found AstraZeneca not to be a controller, its decision was heavily influenced by the absence of an actual show of power. Going forward, companies in a similar situation to Viela should be careful not to rely on ownership size alone, as smaller beneficial ownership has lead Delaware courts to find the presence of a controlling relationship, especially when combined with a more tangible exertion of influence in the boardroom.

It is also worth noting that, as evidenced in another recent Delaware case, even when entire fairness applies, effective disclosure can avoid an adverse judgment for defendant boards. In a recent case involving a "Multiplan Claim" (i.e., a breach of fiduciary duties claim against directors, officers, or controllers of SPAC, alleging that such fiduciaries impaired the redemption rights of the SPAC equityholders), the Chancery Court found entire fairness to be the correct standard of review but still dismissed the matter at the pleading stage. In *In Re Hennessy Capital Acquisition Corp. IV Stockholder Litigation*, the SPAC sponsors and other defendants were interested in the transaction, in part because they held founder

shares (a structure commonly employed in SPACs), and therefore the court held the plaintiff's claims should be reviewed under the lens of entire fairness. Nevertheless, the court noted that "pleading requirements exist even where entire fairness applies," and that the plaintiff stockholder failed to plead "material facts that were known or knowable by the defendants" prior to the closing of the merger. The plaintiff stockholder brought litigation claiming that the SPAC directors and sponsors violated their fiduciary duty by failing to make adequate disclosures in the company's proxy statement related to the de-SPAC target's business plan. Specifically, the court stated that the plaintiff claimed a breach of fiduciary duty because the directors "tout[ed] an outdated business model that the target had decided to scrap." The court recognized that sufficient facts were pled to warrant entire fairness but that conflicts themselves are not a cause of action and poor performance is not indicative of a breach of fiduciary duty. The decision will likely reverse course on numerous potential copycat suits and shows that even if the Delaware courts determine that entire fairness is appropriate, it may not be a "game over" for defendants.