Massachusetts: A Compelling Alternative for Public Companies Considering DExit

Background

Delaware is the most common jurisdiction for public corporations and benefits from well-developed case law and a legislature that annually revises the corporate statute. The Delaware Chancery Court, however, often appears to view plaintiff firms as a constituency. A company may spend considerable time and money bogged down in frivolous litigation related to a transaction that is clearly in shareholder interest or may settle weak claims to avoid the cost of defense. Furthermore, a few recent Delaware decisions have included impractical or questionable substantive conclusions. Several corporations have migrated out of Delaware, and a number of others are evaluating that step. Many companies evaluate Nevada or Texas, although case law in their business courts is relatively limited. This memorandum outlines factors relevant to considering Massachusetts as a potential jurisdiction. Massachusetts lacks a reputation as a "zero liability" regime. Such a reputation, whether or not valid, informs some stockholder antipathy toward Nevada and Texas.

In comparison to Delaware, fewer public corporations are organized in Massachusetts, the case law is less well-developed, and historically the legislature has revised the corporate statute infrequently. Massachusetts, however, has a favorable regime for public company directors. Its courts, which include a dedicated business litigation session, are deferential to decisions by unconflicted directors, and the takeover regime is protective, including by allowing a public company to have "investor favored" provisions unless and until the board responds to an unwelcome takeover proposal. The Massachusetts courts have been unwilling to reward the plaintiffs' bar for attempting to hold up transactions or for bringing "creative" claims. Vertex, Analog Devices, Revvity, TransMedics, Cyclerion, State Street, and Mercury Systems are examples of entities organized in Massachusetts. ImmunoGen, Genzyme and EMC were Massachusetts corporations prior to sales. Biogen was a Massachusetts corporation prior to its merger with Idec.

Fiduciary Duties

Unlike Delaware, where fiduciary obligations are established by courts, the fiduciary duties of directors of a Massachusetts corporation are defined by statute. Section 8.30 of the Massachusetts Business Corporation Act (MBCA) requires a director to act:

(1) in good faith;

(2) with reasonable care; and

(3) in a manner the director believes is in the best interests of the corporation.

In determining the corporation's best interests, the statute explicitly permits consideration of constituencies in addition to shareholders.

Massachusetts has not adopted Delaware's sliding scale of scrutiny that depends on context. So long as a majority of the directors of a Massachusetts corporation do not have disabling conflicts, a stockholder plaintiff must prove the directors' decisions were not made in good faith, and with reasonable care, in a manner the directors believed was in the corporation's best interests. In the absence of such proof, the MBCA specifically provides that a director who acts in accordance with those standards "is not liable."

Universal Demand with Derivative Claims

Massachusetts has a universal demand requirement, which means that prior to bringing a derivative claim (a claim framed as brought by the corporation against the directors), a shareholder must make a demand on the directors and generally wait at least 90 days prior to initiating a suit. Furthermore, if a majority of disinterested directors refuse the demand, the statute provides that a court "shall dismiss" the suit unless the plaintiff shows that those directors were not disinterested or did not act upon reasonable inquiry. The universal demand requirement avoids the litigation common in Delaware around demand futility and demand refusal. The Massachusetts regime accords substantial deference to demand refusal by independent directors and generally avoids discovery into their deliberations.

These procedural requirements substantially hinder the plaintiffs' bar state law M&A playbook. (Federal securities law claims against public company M&A deals, however, are unaffected.)

Narrower Inspection Rights

Shareholder rights of inspection under MBCA Section 16.02 are more limited than those under Delaware General Corporation Law Section 220. In Delaware, inspection rights are available to obtain books, records, financial information, board materials, and other documents. The Delaware courts encourage stockholder litigants to use Section 220 as an

essential "toolkit" to uncover information prior to filing litigation. The set of materials a corporation must provide under Section 16.02 is much more limited. *See Chitwood v. Vertex*, 476 Mas. 667 (March 2017).

M&A Litigation

In Delaware, a stockholder can bring as a direct claim an allegation that directors approved a transaction at an inadequate price. The stockholder can bring it as that stockholder's claim or as a claim on behalf of similarly situated stockholders.

In Massachusetts, such a claim is derivative. In addition to the universal demand requirement noted above, Massachusetts law imposes other parameters around derivative litigation that create risk for plaintiff attorneys, including the possibility that plaintiffs are required to pay defendants' legal fees.

Defensive Profile

The cornerstone of a strong defensive profile is the combination of (1) a staggered board and (2) either (a) a rights plan or (b) application of a robust business combination statute.

Institutional investors generally oppose staggered boards of directors. While many companies go public with staggered boards, investor pressure often leads to declassification as equity market capitalization increases. In Massachusetts, a company can avoid staggered board provisions in its charter, while retaining the ability to stagger the board at a later date. Every Massachusetts public corporation has a staggered board by default. A company, however, can opt out. If the board opts out, then the board can unilaterally opt back in. In other words, (1) a public Massachusetts corporation could have annual election of directors, which institutional investors prefer, but (2) the board could maintain the ability, without shareholder approval, to stagger terms if and when a situation warrants such action. Opting back into the statutory default also automatically would result in the board having sole authority to fill director vacancies and directors being removable only for cause.

A plaintiff may challenge a decision to restagger, asserting the directors breached their fiduciary duties. Advance disclosure of the possibility along with a strong record demonstrating the basis for the maneuver would support defense of such a claim. Incremental pressure on bidders to negotiate with the board results from the ability to restagger.

Having a rights plan in effect is not common. From a defensive standpoint, the key is the ability to adopt a rights plan in short order. If a company has blank check preferred stock, the company can quickly adopt a rights plan (unless it has committed to restrictions). The Massachusetts statute explicitly contemplates rights plans, and Massachusetts courts have not adopted heightened scrutiny for evaluating a decision to adopt a plan.

In addition, the Massachusetts business combination statute, which has an impact similar to that of a rights plan, is more protective than the Delaware business combination statute. The Massachusetts statute uses thresholds of 5% and 90% of a company's outstanding voting shares, rather than Delaware's 15% and 85%. Most bidders would condition their acceptance of shares in a tender offer on the restrictions under Chapter 110F of the Massachusetts General Laws not applying. It would not apply if either (a) the board approved the acquisition for purposes of Chapter 110F, or (b) the bidder acquired 90% or more in a tender offer. Board approval is within the company's control. At least one prominent academic has argued that the 85% threshold used in DGCL 203 represents an insurmountable challenge. Ninety percent, obviously, represents a higher bar. Delaware moved its short-form threshold in two-step transactions from 90% of the target company's outstanding shares to a majority because friendly deals frequently had difficulty reaching 90%. A bidder could waive a Chapter 110F condition, but a board could adopt a rights plan at such time. The three-year restricted period contemplated under Chapter 110F (absent approval of two-thirds of the disinterested shares) usually would be unacceptable to a bidder.

Appraisal Rights

Appraisal claims in Delaware had increased substantially a few years ago. More recent Delaware decisions have decreased the percentage of transactions resulting in appraisal claims, but "appraisal rights arbitrage" in Delaware remains a strategy of some hedge funds; the funds buy shares after a deal is announced in order to seek, in an appraisal proceeding, a "fair value" determination that exceeds the deal price. In Massachusetts, appraisal rights are not available at all in several types of public company M&A transactions, and Massachusetts courts do not have a history of making high "fair value" determinations.

Filing Fees

Filing fees in Massachusetts based on authorized stock typically are substantially higher than in Delaware. That may argue for lower initial "headroom"—authorized but unissued stock—in initial Massachusetts articles of organization. The annual fee typically is substantially lower, however, so the corporation recoups the incremental cost, and the aggregate cost should be lower, over time.

Tender Threshold

Delaware employs a 50% threshold for a back-end merger following a tender offer. Massachusetts still uses a 90% threshold for most short-form mergers. Delaware, consequently, has a more favorable regime for a friendly two-step merger. Structuring technology exists to mitigate, but not eliminate, the difference. We anticipate that, in light of the new HSR filing requirements, in the near term, mergers will be favored over tender offers. Mergers also are favored when regulatory impediments will determine the closing timeline. In addition, we and other practitioners are engaged in efforts to revise this aspect of the Massachusetts statute.