

# VALUING DERIVATIVE SUITS IN MERGERS OF FOOD AND NATURAL RESOURCE CORPORATIONS THROUGH ANALYZING THE MASSEY AND ALPHA NATURAL RESOURCES MERGER: METHODS OF ENSURING CORPORATE ACCOUNTABILITY AND MAXIMIZING SHAREHOLDER VALUE

ROBERT PROUDFOOT<sup>\*</sup>

## I. INTRODUCTION

On April 5, 2010, twenty-nine Massey Energy miners<sup>1</sup> were killed by a massive methane and coal dust explosion in the Upper Big Branch coal mine disaster in West Virginia.<sup>2</sup> This disaster was the result of multiple preventable safety failures.<sup>3</sup> Not only was this the largest coal mining disaster in recent memory,<sup>4</sup> but the incident raised questions about corporate accountability,<sup>5</sup> the effectiveness of federal regulatory standards,<sup>6</sup>

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<sup>\*</sup> Senior Staff, KENTUCKY JOURNAL OF EQUINE, AGRICULTURE, AND NATURAL RESOURCES LAW, 2012-2013; B.A. 2006, Vanderbilt University; J.D. expected May 2013, University of Kentucky.

<sup>1</sup> See J. DAVITT MCATEER ET AL., UPPER BIG BRANCH: THE APRIL 5, 2010, EXPLOSION: A FAILURE OF BASIC COAL MINE SAFETY PRACTICES 4-5 (2011), available at <http://www.nttc.edu/programs&projects/minesafety/disasterinvestigations/upperbigbranch/UpperBigBranchReport.pdf> (explaining that the miners were technically employed by Performance Coal Company, a subsidiary of Massey Energy). See generally, e.g., *In re Massey Energy Co.*, No. 5430-VCS, 2011 WL 2176479 (Del. Ch. May 31, 2011) (holding that the Mine Safety and Health Administration, West Virginia Governor's Independent Investigation Report, derivative suits, and merger agreements refer to these miners and the incident as part of Massey and its responsibility).

<sup>2</sup> Ian Urbina, *No Survivors Found After West Virginia Mine Disaster*, N.Y. TIMES (Apr. 9, 2010), <http://www.nytimes.com/2010/04/10/us/10westvirginia.html>.

<sup>3</sup> *Upper Big Branch Report*, NAT'L TECH. TRANSFER CTR., <http://www.nttc.edu/programs&projects/minesafety/disasterinvestigations/upperbigbranch/conclusion.asp> (last visited Oct. 9, 2012) ("The story of Upper Big Branch is a cautionary tale of hubris. A company that was a towering presence in the Appalachian coalfields operated its mines in a profoundly reckless manner, and 29 coal miners paid with their lives for the corporate risk-taking. The April 5, 2010, explosion was not something that happened out of the blue, an event that could not have been anticipated or prevented. It was, to the contrary, a completely predictable result for a company that ignored basic safety standards and put too much faith in its own mythology.").

<sup>4</sup> Mine Safety & Health Admin., *Historical Data on Mine Disasters in the United States*, U.S. DEP'T LABOR, <http://www.msha.gov/MSHAINFO/FactSheets/MSHAFACT8.HTM> (last visited Oct. 9, 2012).

<sup>5</sup> See Ken Ward Jr., *Taking Big Coal to Task is Difficult*, CHARLESTON GAZETTE (Apr. 2, 2011), <http://wvgazette.com/News/montcoal/201104020982> ("'Enforcement doesn't reach into the boardroom,' said Davitt McAteer, a longtime mine safety advocate who ran the U.S. Mine Safety and Health Administration during the Clinton administration and is conducting an independent investigation of the Upper Big Branch disaster.").

<sup>6</sup> See MCATEER ET AL., *supra* note 1, at 77, 88-89.

and the impact of a merger<sup>7</sup> when a corporation is in a crisis. Accusations of negligence and criminal wrongdoing led to federal regulatory scrutiny, wrongful death tort claims on behalf of the victims, and derivative shareholder suits against the directors and officers.<sup>8</sup> As a reaction to the disaster and its fallout, Massey Energy's (Massey) stock price plummeted and Alpha Natural Resources (Alpha) opportunistically offered to take over the beleaguered company in a part cash and part share merger.<sup>9</sup> Shareholders, concerned that the merger would alter their status as shareholders and thus impede their derivative actions due to loss of standing under Delaware General Corporation Law § 259(a),<sup>10</sup> sued for injunctive relief in the Delaware Court of Chancery to block the merger.<sup>11</sup> After reviewing the shareholders' request to block the merger, Judge Strine declined to issue the injunction and allowed the merger to continue,<sup>12</sup> thus rendering the Massey shareholder suit against its corporate managers moot.<sup>13</sup> In December 2011, Alpha settled pending litigation regarding the deceased miners and federal regulators for \$209 million.<sup>14</sup> Each deceased miner's family received \$1.5 million,<sup>15</sup> and the Mine Safety and Health Administration (MSHA) issued a fine of \$10.8 million, its largest fine ever against a coal mining company.<sup>16</sup> Don Blankenship, CEO of Massey since 2000,<sup>17</sup> stepped down the month following the disaster and left the company with a \$12 million severance package.<sup>18</sup> In summary, Massey had one of the largest coal mining accidents in history, and Alpha's subsequent purchase of Massey effectively removed Massey shareholder standing for derivative claims against Massey corporate management.

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<sup>7</sup> See Kevin LaCroix, *In a Must-Read Opinion, Delaware Court Rejects Bid to Block Massey Merger*, D & O DIARY (June 2, 2011), <http://www.dandodiary.com/2011/06/articles/shareholders-derivative-litiga/in-a-mustread-opinion-delaware-court-rejects-bid-to-block-massey-merger/>.

<sup>8</sup> *In re Massey Energy Co.*, No. 5430-VCS, 2011 WL 2176479, at \*1 (Del. Ch. May 31, 2011).

<sup>9</sup> *Id.*

<sup>10</sup> DEL. CODE ANN. tit. 8, § 259(a) (West 2012).

<sup>11</sup> *In re Massey*, 2011 WL 2176479, at \*2.

<sup>12</sup> *Id.* at \*31.

<sup>13</sup> See *id.* at \*2 (explaining that a double derivative suit would still be available to Alpha shareholders, which will be discussed later).

<sup>14</sup> Sabrina Tavernise & Clifford Kraus, *Mine Owner Will Pay \$209 Million in Blast That Killed 29 Workers*, N.Y. TIMES (Dec. 6, 2011), [http://www.nytimes.com/2011/12/07/us/mine-owner-to-pay-200-million-in-west-virginia-explosion.html?\\_r=2&pagewanted=all](http://www.nytimes.com/2011/12/07/us/mine-owner-to-pay-200-million-in-west-virginia-explosion.html?_r=2&pagewanted=all).

<sup>15</sup> *Id.*

<sup>16</sup> Steven Allen Adams, *Alpha to Pay 209 Million over Coal Mine Disaster*, BEAVERTON POST (Dec. 6, 2011), <http://beavertonpost.com/news/story.cfm?bid=5910721>.

<sup>17</sup> Brian K. Sullivan, Karen Freifeld & Margaret Cronin Fisk, *Massey Energy: The Accountant of Coal*, BUS. WK. (Apr. 15, 2010), [http://www.businessweek.com/magazine/content/10\\_17/b4175048798671.htm](http://www.businessweek.com/magazine/content/10_17/b4175048798671.htm) ("[Blankenship] has been chairman and CEO of Massey Energy since 2000 and head of A.T. Massey Coal, a wholly owned subsidiary, since 1992.").

<sup>18</sup> Erich Schwartzel, *Massey's Blankenship Back in Business?*, PITTSBURGH POST-GAZETTE (Nov. 30, 2011), <http://www.post-gazette.com/stories/business/news/masseys-blankenship-back-in-business-224032/>.

Using the Massey merger with Alpha as a guidepost, this Note reviews the impact of mergers on derivative actions for natural resource and agricultural companies and proposes that derivative actions are valuable assets of corporations and should be explicitly and appropriately priced in mergers.<sup>19</sup> Additionally, a potential conflict of interest is present when a merger occurs during a pending derivative action because a merger dissolves pending derivative claims against corporate management and the board of directors.<sup>20</sup> While the Delaware Court did not find evidence of fraud in the Massey merger, such a risk of fraud exists, and corporations should take action to mitigate directors' conflicts of interest and mispricing of derivative claim assets.<sup>21</sup> Prior case law states that all corporate assets should be considered in a merger<sup>22</sup> and a derivative suit on behalf of the corporation can have real monetary value.<sup>23</sup> The logical combination of these two concepts yields the focus of this Note. To minimize potential breaches of fiduciary duties during mergers and to maximize shareholder value, successfully pleaded but pending derivative actions should be specifically valued into the purchase price when a corporation merges to compensate existing shareholders for the transfer of control of the derivative action.<sup>24</sup> Without including pending derivative actions when pricing assets, there is a reduced incentive for the purchasing party to continue valid shareholder derivative suits as part of recouping its purchase costs.

## II. THE MASSEY DISASTER AND MERGER

To understand the importance of the shareholder derivative suit, this Note will review the circumstances of the Massey coal mine disaster, its merger with Alpha, and subsequent investigations regarding Massey's corporate culture. During its own investigation, MSHA determined that the

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<sup>19</sup> J. Travis Laster, *Goodbye to the Contemporaneous Ownership Requirement*, 33 DEL. J. CORP. L. 673, 686 n.62 (2008).

<sup>20</sup> See *In re Walt Disney Co.*, 731 A.2d 342, 354 (Del. Ch. 1998) (stating if a director receives a material benefit not shared by shareholders, then there is a potential claim for breach of the duty of loyalty), *aff'd in part, rev'd in part sub nom.* Brehm v. Eisner, 746 A.2d 244 (Del. 2000); see also *Aronson v. Lewis*, 473 A.2d 805, 814 (Del. 1984) ("[I]n determining demand futility the Court of Chancery in the proper exercise of its discretion must decide whether, under the particularized facts alleged, a reasonable doubt is created that: (1) the directors are disinterested and independent and (2) the challenged transaction was otherwise the product of a valid exercise of business judgment."), *overruled sub nom.* Brehm v. Eisner, 746 A.2d 244 (Del. 2000).

<sup>21</sup> See *In re Massey Energy Co.*, No. 5430-VCS, 2011 WL 2176479, at\*2 (Del. Ch. May 31, 2011) (explaining that the disposition of the case would be different had fraud been present).

<sup>22</sup> See *id.* at \*15-16.

<sup>23</sup> See *id.*; see also *Bomarko, Inc. v. Int'l Telecharge, Inc.*, No. 13052, 1994 WL 198726, at \*3 (Del. Ch. May 16, 1994).

<sup>24</sup> See *In re Massey*, 2011 WL 2176479, at \*21-25 (applying the underlying theory of Judge Strine's analysis for the Massey merger, however, the Delaware court should have required the derivative suit to be priced as an asset).

massive coal and methane dust explosion that caused the catastrophic Upper Big Branch disaster was “the result of a series of basic safety violations at [the mine] and [was] entirely preventable.”<sup>25</sup> On April 5, 2010, lapses in safety procedures allowed an unsafe and unlawful buildup of methane gas within the mine.<sup>26</sup> The longwall shearer, a machine used in coal extraction, was in disrepair, operating “with worn bits and missing water sprays, creating an ignition source for methane on the longwall.”<sup>27</sup> Massey allowed significant amounts of float coal dust, coal dust, and loose coal to accumulate in the mine.<sup>28</sup> This coal dust became the fuel for a massive blast throughout the mine after the coal shearer’s sparks ignited a small amount of methane.<sup>29</sup>

As a result, MSHA found that Massey’s corporate management failed to perform mine examinations and remedy known safety violations; kept two sets of books to conceal hazardous conditions from regulators; intimidated miners to prevent the reporting of safety hazards; failed to provide adequate safety training to workers; and established a regular practice of providing advance notice of inspections to hide safety violations.<sup>30</sup> Upper Big Branch’s head of security, Hughie Stover, was convicted in federal court for lying to federal investigators and giving advance warning of safety inspections.<sup>31</sup> As of the writing of this Note, the Justice Department has successfully reached a plea bargain with at least one mid-level executive, Gary May, and is still investigating criminal charges against other members of Massey’s management.<sup>32</sup>

Even before the Upper Big Branch disaster, Massey’s corporate culture under CEO Don Blankenship maintained an antagonistic relationship with federal mine safety regulators because the corporation continuously appealed their most serious violations.<sup>33</sup> In 2009 alone, Massey appealed thirty-seven of fifty violations as a strategy to delay stricter federal law enforcement that began in 2006.<sup>34</sup> From 2000 to 2009, MSHA cited Massey for 62,923 violations with 25,612 labeled “significant

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<sup>25</sup> NORMAN G. PAGE ET AL., U.S. DEP’T OF LABOR, MINE SAFETY & HEALTH ADMIN., REPORT OF INVESTIGATION: FATAL UNDERGROUND MINE EXPLOSION 2 (2010), available at <http://www.msha.gov/Fatals/2010/UBB/FTL10c0331noappx.pdf>.

<sup>26</sup> *Id.* at 3.

<sup>28</sup> *Id.*

<sup>29</sup> *Id.*

<sup>29</sup> *Id.*

<sup>30</sup> *Id.* at 4-6.

<sup>31</sup> Ken Ward Jr., *Ex-Upper Big Branch Security Director Found Guilty*, CHARLESTON GAZETTE (Oct. 26, 2011), <http://www.wvgazette.com/News/201110260060>.

<sup>32</sup> Howard Berkes, *Massey Mine Boss Pleads Guilty as Feds Target Execs*, NPR (Mar. 29, 2012), <http://www.npr.org/blogs/thetwo-way/2012/03/29/149639345/massey-mine-boss-pleads-guilty-as-feds-target-execs>.

<sup>33</sup> Gardiner Harris & Erik Eckholm, *Mines Fight Strict Laws by Filing More Appeals*, N.Y. TIMES (Apr. 6, 2010), [http://www.nytimes.com/2010/04/07/us/07company.html?\\_r=1](http://www.nytimes.com/2010/04/07/us/07company.html?_r=1).

<sup>34</sup> *Id.*

and substantial.”<sup>35</sup> Massey also had the highest proposed fines for safety violations, \$49.9 million; \$15 million more than any other coal operator.<sup>36</sup> An American University School of Communication study found that “no U.S. coal company had a worse fatality record than Massey Energy Co., even before an explosion at its Upper Big Branch mine in West Virginia killed 29 on April 5 . . . .”<sup>37</sup> The hazards that caused the explosion at the mine were not isolated, but part of a string of safety violations that shaped Massey’s corporate culture. After former governor of West Virginia Joe Manchin requested an independent report of the incident,<sup>38</sup> it was discovered that many of Massey’s employees believed that Massey’s stated company policy of putting safety first was just a slogan, and that Massey’s true priority was coal production.<sup>39</sup> Even Alpha had concerns about Massey’s focus on production rather than miner safety and regulatory compliance when it was considering a merger.<sup>40</sup>

### III. MASSEY SHAREHOLDERS SUE DIRECTORS AND EXECUTIVES FOR BREACH OF FIDUCIARY DUTIES

With twenty-nine miners dead, a forty-percent decline in Massey stock, and the general public and federal regulators in an uproar over negligent safety standards, shareholders believed they had good cause for bringing a shareholder derivative suit against Massey’s upper management.<sup>41</sup> The shareholder plaintiffs sued directors and executives to recoup losses from delayed coal production, wrongful death suits, and for loss of shareholder value.<sup>42</sup> In his opinion, Judge Strine explained why shareholders would want to bring a derivative suit, stating, “[t]he Derivative Claims are at best a way for Massey to offset some of the Disaster Fall-Out

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<sup>35</sup> Giovanni Russonello, *The Coal Truth: Massey Had Worst Mine Fatality Record Even Before April Disaster*, INVESTIGATIVE REPORTING WORKSHOP (Nov.23, 2010), <http://investigativereportingworkshop.org/investigations/coal-truth/story/massey-had-worst-mine-fatality-record-even-april-d/>.

<sup>36</sup> *Id.*

<sup>37</sup> *Id.*

<sup>38</sup> MCATEER ET AL., *supra* note 1, at 96.

<sup>39</sup> *Id.* at 94-95.

<sup>40</sup> Howard Berkes, *Court Papers Signal Concern Over W. Va. Mining Company’s Safety Record*, NPR (May 25, 2011, 9:38 AM), <http://www.npr.org/blogs/thetwo-way/2011/05/25/136641113/court-papers-signal-concern-over-w-va-mine-companys-safety-record>. See generally Answering Brief of Defendants Alpha Natural Resources, Inc. & Mountain Merger Sub, Inc. in Opposition to Plaintiffs’ Motion for a Preliminary Injunction, *In re Massey Energy Co.*, No. 5430-VCS, 2011 WL 2176479 (Del. Ch. May 31, 2011) (No. 5430-VCS), 2011 WL 2138264 (highlighting that Alpha did not counter these allegations in its answer).

<sup>41</sup> Verified Shareholder Third Amended Derivative and Class Action Complaint at pt. 2, *In re Massey Energy Co.*, No. 5430-VCS, 2011 WL 2176479 (Del. Ch. May 31, 2011) (No. 5430-VCS), 2011 WL 2028545.

<sup>42</sup> *In re Massey Energy Co.*, No. 5430-VCS, 2011 WL 2176479, at\*1-2 (Del. Ch. May 31, 2011).

by requiring Massey's directors and officers to indemnify the company."<sup>43</sup> Taking these factors into consideration, the plaintiffs' expert witness estimated the value of the derivative action to be between \$900 million and \$1.4 billion dollars.<sup>44</sup> The defendants had available up to \$95 million in director and officer insurance (D & O insurance) to cover potential shareholder derivative claims.<sup>45</sup>

In his opinion declining to block the merger, Judge Strine relied on the reasoning in *In re Caremark International Inc.*, which described the conditions necessary for director oversight liability.<sup>46</sup> He admitted that there was sufficient evidence in Massey's case to show a breach of fiduciary duties under *Caremark*.<sup>47</sup> Although acknowledging the merit of the shareholder derivative suit, he explained his limited role in reviewing the plaintiffs' attempt for an injunction stating, "I cannot order affirmative relief at this stage. I can only grant a preliminary injunction against the Merger."<sup>48</sup> Citing his concern that the injunction could cause even more shareholder harm, Judge Strine opted not to issue the injunction, and the Massey shareholders voted the next day to approve the proposed merger with Alpha.<sup>49</sup>

#### IV. CORPORATE ACCOUNTABILITY AND SHAREHOLDER MAXIMIZATION: THE NATURE AND PURPOSE OF A DERIVATIVE ACTION

In a shareholder derivative suit, the corporation itself is the real party of interest and shareholders simply function as representatives of the corporation and its interests.<sup>50</sup> Derivative actions are typically brought against directors, officers, or controlling shareholders on behalf of the corporation to recoup losses attributed to a breach of fiduciary duty that later caused the corporation to lose value.<sup>51</sup> Successful suits make the directors and officers personally liable to the corporation for their actions.<sup>52</sup>

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<sup>43</sup> *Id.* at \*22.

<sup>44</sup> *Id.*

<sup>45</sup> *Id.* at \*28.

<sup>46</sup> *Id.* at n.154 ("[O]nly a sustained or systematic failure of the board to exercise oversight—such as an utter failure to attempt to assure a reasonable information and reporting system exists—will establish the lack of good faith that is a necessary condition to [director oversight] liability.") (quoting *In Re Caremark Int'l Inc.*, 698 A.2d 959, 967 (Del. Ch. 1996)).

<sup>47</sup> *Id.* at \*21.

<sup>48</sup> *Id.* at n. 205.

<sup>49</sup> Clifford Krauss, *Shareholders Approve Massey Energy Sale to Alpha*, N.Y. TIMES (June 1, 2011), <http://www.nytimes.com/2011/06/02/business/02coal.html>.

<sup>50</sup> 13 WILLIAM MEADE FLETCHER ET AL., FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 5941.10 (perm. ed., rev. vol. 2012).

<sup>51</sup> Seth Aronson et al., *Shareholder Derivative Actions: From Cradle to Grave*, in SECURITIES LITIGATION & ENFORCEMENT INSTITUTE 2011, at 325 (PLI Corp. Law & Practice, Course Handbook Ser. No. 28249, 2011).

<sup>52</sup> *Id.*

Such liability is usually covered by D & O insurance with some exceptions carved out for actions acted on with scienter.<sup>53</sup>

Shareholder derivative suits serve two equally valuable purposes for society. First, derivative suits return to the corporation wrongfully lost corporate funds from the parties answerable for breaching their fiduciary duties, which almost always includes management and directors.<sup>54</sup> Second, shareholder derivative suits hold CEOs, controlling shareholders, and directors accountable.<sup>55</sup> Outside of criminal prosecution, a derivative claim is an effective tool for holding a corporation's management accountable to its shareholders and, tangentially, to society.<sup>56</sup> Meeting the standard for proving criminal prosecutions is difficult and some of the available charges could only result in misdemeanor counts against Massey officials.<sup>57</sup> The threat of personal liability for derivative damages creates a potent tool "to redress the conduct of a torpid or unfaithful management."<sup>58</sup> When a corporation merges with another during a pending derivative action, this primary vehicle used to return shareholder value and hold corporate managers accountable is circumvented.

#### V. MASSEY AND ALPHA NATURAL RESOURCES MERGE

As a result of the disaster and its related fallout, Massey's share price plunged almost forty-percent during a month long period, reaching \$33.47 on May 6, 2010.<sup>59</sup> Alpha first contacted Massey to gauge merger interest on April 26, 2010, and there were on-and-off discussions until the merger was publicly announced on January 29, 2011.<sup>60</sup> Alpha would acquire Massey through exchanging \$10 in cash and 1.025 shares of Alpha stock for each share of Massey stock, in total \$69.33 per share, which was a 25% premium over the then market price.<sup>61</sup> Additionally, this price was 25% higher than Massey's stock price before the mine disaster on April 5, 2010.<sup>62</sup> Massey shareholders approved the merger on June 1, 2011; one day after Judge Strine issued his decision declining to block the merger.<sup>63</sup>

At the time of the proposed merger, both Alpha and Massey were aware of pending shareholder derivative claims and discussed them in the

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<sup>53</sup> *Id.* at 424.

<sup>54</sup> *Rales v. Blasband*, 634 A.2d 927, 933-34 (Del. 1993).

<sup>55</sup> *Aronson v. Lewis*, 473 A.2d 805, 811 (Del. 1984) *overruled by* *Brehm v. Eisner*, 746 A.2d 244 (Del. 2000).

<sup>56</sup> *Rales*, 634 A.2d at 933.

<sup>57</sup> *Tavernise & Krauss*, *supra* note 14.

<sup>58</sup> *Aronson*, 473 A.2d at 811.

<sup>59</sup> Massey Energy Co., Proxy Statement (Sch. 14A) (Apr. 29, 2011).

<sup>60</sup> *Id.*

<sup>61</sup> *Id.* at 83.

<sup>62</sup> *Id.*

<sup>63</sup> *Tavernise & Krauss*, *supra* note 14.

definitive merger agreement.<sup>64</sup> Massey did not assign a value to the derivative claim, and its legal counsel, Cravath, Swaine & Moore LLP, advised that the derivative suit would survive the merger.<sup>65</sup> Massey shareholders were given this information in the definitive merger agreement to decide whether to merge with Alpha:

In response to a question from a director, Cravath advised the board of directors that it was unclear whether a business combination would affect any of Massey's pending derivative claims and that the board should assume that the derivative claims would survive the proposed business combination. Cravath also advised the board of directors of Massey that it should not consider the pending derivative claims in any decision regarding any potential business combination.<sup>66</sup>

Judge Strine described two problems with Cravath's opinion.<sup>67</sup> First, the board of directors should have retained independent counsel to value the pending shareholder claims as an asset in the merger.<sup>68</sup> Cravath could not function as independent counsel since Massey's board of directors had already retained him to defend the directors and executives against the shareholder derivative suit.<sup>69</sup> Second, shareholder derivative suits transfer as property to the acquiring corporation, but they do not automatically survive as an ongoing lawsuit because the shareholders no longer have Massey shares and cannot maintain standing.<sup>70</sup>

## VI. LOSS OF SHAREHOLDER STANDING IN MERGERS: DELAWARE'S CONTINUOUS OWNERSHIP RULE

The general standard in Delaware and other states is that shareholders, as representative plaintiffs, lose standing in shareholder derivative suits because they no longer own shares of the acquired corporation when it is merged with a new corporation.<sup>71</sup> The shareholder must own stock at the time of the suit and continue owning the stock without interruption throughout the proceedings in order to maintain the

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<sup>64</sup> Massey Energy Co., *supra* note 59, at 124.

<sup>65</sup> *Id.* at 78.

<sup>66</sup> *Id.*

<sup>67</sup> *In re Massey Energy Co.*, No. 5430-VCS, 2011 WL 2176479, at\*15 (Del. Ch. May 31, 2011).

<sup>68</sup> See Massey Energy Co., *supra* note 59, at 15.

<sup>69</sup> *In re Massey*, 2011 WL 2176479, at \*15.

<sup>70</sup> *Id.*

<sup>71</sup> 13 WILLIAM MEADE FLETCHER ET AL., FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 5981.30 (perm. ed., rev. vol. 2012).



suit.<sup>72</sup> This is sometimes referred to as the continuous ownership rule.<sup>73</sup> There are two exceptions to this rule outlined in *Lewis v. Anderson*: “(1) where the merger itself is the subject of a claim of fraud; and (2) where the merger is in reality a reorganization which does not affect plaintiff’s ownership of the business enterprise.”<sup>74</sup> This precedent was cited with approval in *Lewis v. Ward*.<sup>75</sup> More recently, the continuous ownership rule was reexamined in *Lambrech v. O’Neal*, where a similar situation occurred when Merrill Lynch shareholders lost standing for a derivative action when Bank of America bought Merrill Lynch.<sup>76</sup> Most federal and state courts have adopted the continuous ownership rule.<sup>77</sup> Part of the rule’s rationale is derived from the Federal Rules of Civil Procedure, and similar state laws, requiring plaintiffs in a derivative action “fairly and adequately represent the interests of the shareholders.”<sup>78</sup>

In *In re Massey*, plaintiffs attempted to invoke the fraud exception of the continuous ownership rule, alleging that the proposed merger would cause plaintiff shareholders to lose standing necessary to maintain the derivative action.<sup>79</sup> The fraud exception outlined in *Lewis v. Anderson* and restated in *Lewis v. Ward* requires that the merger be “perpetrated merely to deprive the plaintiff of derivative standing.”<sup>80</sup> This fraud exception is narrow and basically calls for a proverbial smoking gun to prove the merger was conducted solely to avoid personal liability from derivative suits.<sup>81</sup> Judge Strine ruled that it was “highly doubtful” that Massey’s directors’ decision to merge with Alpha was merely to avoid personal liability, thus removing the shareholders’ ability to rely on the fraud exception to the continuous ownership rule.<sup>82</sup> Massey’s directors were aware of the potential liability the mine disaster caused and attempted to have Alpha indemnify them “to the fullest extent permitted by the law.”<sup>83</sup> This would have expanded the board of directors’ liability coverage to include intentional

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<sup>72</sup> *Id.*

<sup>73</sup> *Id.*

<sup>74</sup> *Lewis v. Anderson*, 477 A.2d 1040, 1046 n.10 (Del. 1984).

<sup>75</sup> *Lewis v. Ward*, 852 A.2d 896, 899 (Del. 2004).

<sup>76</sup> *Lambrech v. O’Neal*, 3 A.3d 277, 284 (Del. 2010).

<sup>77</sup> Malaika M. Eaton et al., *The Continuous Ownership Requirement in Shareholder Derivative Litigation: Endorsing a Common Sense Application of Sense and Choice-of-Law Principles*, 47 WILLAMETTE L. REV. 1, 3 (2010) (discussing in length the rationale and application of continuous ownership rule).

<sup>78</sup> *Id.* (quoting FED. R. CIV. P. 23.1).

<sup>79</sup> Opening Brief in Support of Co-Lead Plaintiffs’ Motion for Preliminary Injunction at 43, *In re Massey Energy Co.*, No. 5430-VCS, 2011 WL 2176479 (Del. Ch. May 31, 2011) (No. 5430-VCS), 2011 WL 2138265.

<sup>80</sup> *Lewis v. Ward*, 852 A.2d 896, 899 (Del. 2004) (citing *Lewis v. Anderson*, 477 A.2d 1040 (Del. 1984)).

<sup>81</sup> See *id.* at 903.

<sup>82</sup> *In re Massey Energy Co.*, No. 5430-VCS, 2011 WL 2176479, at\*2 (Del. Ch. May 31, 2011).

<sup>83</sup> *Id.* at \*16.

acts, which were not included in their current indemnification agreement with Massey.<sup>84</sup> Alpha described the proposal as “obnoxious” and declined to adopt it in the merger agreement.<sup>85</sup> In the end, Alpha agreed to extend the same D & O insurance coverage, which provides some personal liability protection against pending suits, to Massey’s board of directors for an additional six years.<sup>86</sup>

Plaintiffs attempted to apply *Arkansas Teacher Retirement System v. Caiafa (Countrywide)*, where plaintiffs argued that the fraud exception of the continuous ownership rule had been modified.<sup>87</sup> Although the court found that Countrywide had not merged merely to fraudulently circumvent the derivative suit, the court suggested a more complex method of applying the fraud exception.<sup>88</sup> The court stated that fraudulent actions performed prior to a merger could be taken into account in determining if the fraud exception of the continuous ownership rule applied:

As [Bank of America] amassed its Countrywide stockholdings, these directors might have seen [Bank of America] as a potential fiduciary White Knight. That is, after allegedly intentionally engaging in fraudulent conduct that caused the stock price to plummet near bankruptcy, Countrywide directors would understandably seek an acquirer to effect a merger that would extinguish potential derivative claims during such a period of upheaval that they would have few alternatives. Whether this plausible scenario reflects this board's single, cohesive plan or merely ties together, like patchwork, a snowballing pattern of fraudulent conduct and conscious neglect, the result is the same and would not fairly constitute a proper discharge of the fiduciary duties of directors of a Delaware corporation.<sup>89</sup>

Stating the continuous ownership rule and its two exceptions were settled Delaware law, *Lambrecht v. O’Neal* foreclosed the expanded application of this exception shortly after the *Countrywide* opinion was issued.<sup>90</sup> The fraud exception to the continuous ownership rule should be strictly interpreted

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<sup>84</sup> *Id.*

<sup>85</sup> *Id.*

<sup>86</sup> Massey Energy Co., *supra* note 59, at 16.

<sup>87</sup> *In re Massey*, 2011 WL 2176479, at \*30 n.199.

<sup>88</sup> See Ark. Teacher Ret. Sys. v. Caiafa, 996 A.2d 321, 333 (Del. 2010).

<sup>89</sup> *Id.* at 323.

<sup>90</sup> *Lambrecht v. O’Neal*, 3 A.3d 277, 293 n.36 (Del. 2010).

and not consider any tangential but material personal benefit for directors who do not conduct a merger merely to eliminate derivative claims.<sup>91</sup>

Alternatively, other states have interpreted the standing requirement for derivative suits differently than the continuous ownership rule.<sup>92</sup> The Alabama Supreme Court allows a derivative action to continue on the grounds that lack of standing should not be applied to abolish an existing substantive right of action.<sup>93</sup> In *Shelton v. Thompson*, the court stated: “By their blind adherence to the absolutism of the ‘stockholder status’ prerequisite, these cases use ‘lack of standing’ to abolish the remedy. We refuse to adopt such a rule.”<sup>94</sup> Over twenty years ago, California relaxed the continuous ownership rule, creating the contemporaneous ownership rule.<sup>95</sup> Contemporaneous ownership allows a shareholder who brings a derivative suit against a corporation to continue that suit after the shareholder’s corporation merges with another corporation.<sup>96</sup> However, this rule was overruled in favor of the more strict bright line rule of continuous ownership.<sup>97</sup> In *Alford v. Shaw*, the North Carolina Supreme Court allowed a shareholder who did not maintain continuous ownership throughout the suit to proceed with a derivative claim on the basis that the defendants’ actions deprived the plaintiff of standing.<sup>98</sup> Pennsylvania’s *Drain v. Covenant Life Insurance Co.* allowed a shareholder to maintain standing after a merger.<sup>99</sup> The *Drain* court ruled that the shareholders “did not lose standing to maintain their derivative action where the involuntary disposition of their interests . . . was allegedly the result of the defendants’ wrongdoing in the challenged merger.”<sup>100</sup>

The United States Supreme Court relaxed the rule in *Gollust v. Mendell* and allowed shareholders to ignore the continuous ownership rule for claims based on short-swing profits that violated § 16(b) of the Securities Exchange Act of 1934.<sup>101</sup> The Supreme Court stated that shareholders are not required to have ownership when a violation occurs, but ownership must be maintained throughout the suit.<sup>102</sup> Claims would be allowed even if the shareholder’s interest was exchanged for shares in the

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<sup>91</sup> See *id.* at 288; see also *In re Massey*, 2011 WL 2176479, at \*18.

<sup>92</sup> Eaton et al., *supra* note 77, at 5.

<sup>93</sup> *Shelton v. Thompson*, 544 So. 2d 845, 848 (Ala. 1989).

<sup>94</sup> *Id.* at 849.

<sup>95</sup> CAL. CORP. CODE § 800(b).

<sup>96</sup> *Gaillard v. Natomas Co.*, 173 Cal. App. 3d 410, 414 (Cal. Ct. App. 1985).

<sup>97</sup> *Grosset v. Wenaas*, 72 Cal. Rptr. 3d 129, 145 (Cal. 2008); see also Eaton et al., *supra* note 77, at 9-10 (discussing the rationale and application of the continuous ownership rule generally and for derivative suits).

<sup>98</sup> *Alford v. Shaw*, 398 S.E.2d 445, 451-52 (N.C. 1990).

<sup>99</sup> *Drain v. Covenant Life Ins. Co.*, 685 A.2d 119, 126-27 (Pa. 1996).

<sup>100</sup> *Id.*

<sup>101</sup> *Gollust v. Mendell*, 501 U.S. 115, 123 (1991).

<sup>102</sup> *Id.* at 126-27.

acquiring corporation during a merger.<sup>103</sup> While these outliers do exist, the continuous ownership rule and its exceptions are the general black letter law for Delaware corporations and most other jurisdictions.<sup>104</sup>

## VII. IMPACT OF MERGERS ON OTHER DERIVATIVE SUITS

The loss of standing for the Massey shareholders as a result of the merger with Alpha is not the first time a derivative suit has been dismissed. In the food and natural resource fields, multiple cases have yielded similar results. Recent mergers demonstrate the important impact of a merger on derivative actions, for example: Bank of America's purchase of Countrywide;<sup>105</sup> Bank of America's purchase of Merrill Lynch,<sup>106</sup> and JP Morgan's buyout of Bear Stearns.<sup>107</sup> Each shareholder with current or potential derivative claims lost standing as a result of these mergers.<sup>108</sup>

Using the Massey disaster as a springboard, there are many reasons shareholder derivative actions during mergers are important to natural resource and agricultural corporations. First, natural resource companies can have corporate governance problems with a very high risk of catastrophic societal losses, including the loss of life, health, monetary value, and an environment that can trigger large company losses.<sup>109</sup> If a breach of fiduciary duty caused these losses, the shareholder derivative suit claims have the potential to be large. Examples of past corporate governance failures within natural resources and agriculture companies include the Fukushima nuclear power plant meltdown in Japan,<sup>110</sup> Archer Daniels Midland's price-fixing scandal,<sup>111</sup> the Enron scandal,<sup>112</sup> Tyson Foods' option back dating scandal,<sup>113</sup> Diamond Foods' walnut crop payments scandal,<sup>114</sup> and the BP gulf oil spill.<sup>115</sup> The risk of high loss raises

<sup>103</sup> *Id.* at 118.

<sup>104</sup> Eaton et al., *supra* note 77, at 23.

<sup>105</sup> Ark. Teacher Ret. Sys. v. Caiafa, 996 A.2d 321, 322-23 (Del. 2010).

<sup>106</sup> *In re Merrill Lynch & Co.*, 597 F. Supp. 2d 427, 429 (S.D.N.Y. 2009).

<sup>107</sup> *In re Bear Stearns Cos.*, 763 F. Supp. 2d 423, 535 (S.D.N.Y. 2011).

<sup>108</sup> *Id.* at 535; *In re Merrill Lynch & Co.*, 597 F. Supp. 2d at 429; Ark. Teacher Ret. Sys., 996 A.2d at 322-23.

<sup>109</sup> See *supra* part III.

<sup>110</sup> Mail Foreign Service, *Exclusion Zone Around Stricken Japanese Nuclear Plant Widen Over Fears Reactor Core May be Cracked*, MAIL ONLINE (Mar. 25, 2011, 1:28 PM), <http://www.dailymail.co.uk/news/article-1369993/Japan-nuclear-meltdown-Fukushima-plant-exclusion-zone-widened-reactor-fears.html>.

<sup>111</sup> JAMES B. LIEBER, RATS IN THE GRAIN: THE DIRTY TRICKS AND TRIALS OF ARCHER DANIELS MIDLAND, 27-29 (2000).

<sup>112</sup> Ramona Schindelman, *Enron Faces Bankruptcy After Merger Nixed*, ABC NEWS (Nov. 28, 2001), <http://abcnews.go.com/Business/story?id=87524&page=1>.

<sup>113</sup> LaCroix, *supra* note 7.

<sup>114</sup> Nanette Byrnes, P.J. Huffstutter & Mihir Dalal, *Insight: Seeds of Trouble Sown at Diamond Foods Years Ago*, REUTERS (Mar. 19, 2012, 1:07 PM), <http://www.reuters.com/article/2012/03/19/us-diamond-tax-idUSBRE82I0AQ20120319>.

the potential value of shareholders' derivative claims. Second, shareholders should be aware of the risk a merger presents to maintaining shareholder derivative suits and should understand suits are valuable assets that should be priced into a merger.

#### VIII. TRANSFERRING CONTROL TO THE SUCCESSOR ENTITY AND DOUBLE DERIVATIVE CLAIMS

Under Delaware corporate law, a shareholder derivative suit is the property of the corporation and is transferred as an asset to the newly merged corporate entity.<sup>116</sup> Only the acquiring corporation's board of directors, which in this Note is Alpha, can continue to pursue a derivative action against the acquired corporation's board of directors and executives.<sup>117</sup> While the derivative action technically survives, the board of directors of the successor corporation must first approve the continued action against the merged company.<sup>118</sup> From a practical standpoint, it is not likely that an acquiring corporation like Alpha would work extensively with an acquired corporation's board of directors to negotiate a merger and then immediately sue the very same board of directors in a derivative suit.<sup>119</sup>

As Judge Strine characterized in the conclusion of his opinion, Massey shareholders could have prevented the merger and preserved shareholder standing for the derivative suit by voting against the proposed merger.<sup>120</sup> The proxy statements for the definitive merger agreement lay bare the financial impact of the merger on the derivative suit.<sup>121</sup> The definitive merger agreement states that plaintiffs would lose standing in the derivative suits because of the merger; Alpha's board of directors would decide whether or not to pursue the claims; the value of the derivative claims may be lost as a result of the merger; the newly merged entity would share in any subsequent recovery; and a resulting 46% dilution of Massey shareholder ownership in the suit.<sup>122</sup> It also states: "Since the Massey board of directors assumed that the derivative claims would survive the merger, the Massey board of directors did not consider this potential interest in evaluating and negotiating the merger agreement and the merger, and in recommending to the Massey stockholders that the merger agreement be

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<sup>115</sup> Adam Martin, *BP Mostly, But Not Entirely, to Blame for Gulf Spill*, ATLANTIC WIRE (Sept. 14, 2011), <http://www.theatlanticwire.com/national/2011/09/bp-mostly-not-entirely-blame-gulf-spill/42470/>.

<sup>116</sup> DEL. CODE ANN. tit. 8, § 259(a) (West 2012).

<sup>117</sup> *Lambrech v. O'Neal*, 3 A.3d 277, 282 (Del. 2010).

<sup>118</sup> *Id.*

<sup>119</sup> *In re Massey Energy Co.*, No. 5430-VCS, 2011 WL 2176479, at \*26 n.173 (Del. Ch. May 31, 2011).

<sup>120</sup> *Id.* at \*32.

<sup>121</sup> *Massey Energy Co.*, *supra* note 59, at 50.

<sup>122</sup> *Id.*

adopted.”<sup>123</sup> This transfer of control is precisely why Massey should have fully considered all of the possibilities surrounding the derivative claims, including that the Massey shareholders could lose standing in these suits.<sup>124</sup> Because of this, these shareholder derivative claims have value but can no longer benefit Massey shareholders because the asset changed hands.<sup>125</sup> A similar analogy would be ignoring the value of a barn when purchasing a farm (which includes both the barn and land) because it will be transferred with the land. While they are not separate prices, the value of barn is certainly factored into the farm’s final sale price.

The last and final option available to hold Massey directors and executives accountable and maximize shareholder value is a double derivative action. In *Lambrecht*, the Delaware Supreme Court explained the two types of derivative actions:

Double derivative actions generally fall into two distinct categories. The first are lawsuits that are brought originally as double-derivative actions on behalf of a parent corporation that has a pre-existing, wholly owned subsidiary at the time of the alleged wrongful conduct at the subsidiary level. In this category, no intervening merger takes place. The second category involves cases, such as this, where the action is brought originally as a standard derivative action on behalf of a corporation that thereafter is acquired by another corporation in an intervening stock-for-stock merger.<sup>126</sup>

For purposes of this Note, only double derivative suits during mergers are discussed. After a merger, the shareholder derivative suit is transferred along with all other assets to the acquiring corporation.<sup>127</sup> The board of directors then can determine whether it should continue the derivative suit against the acquired company’s directors and executives.<sup>128</sup> Should the board decide not to continue the suit, current shareholders of the successor company can sue their own board in a derivative suit to force them to continue the suit against the now subsidiary.<sup>129</sup>

Courts have pointed to the double derivative action as an appropriate remedy when standing is lost.<sup>130</sup> However, relying on double

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<sup>123</sup> *Id.* at 16.

<sup>124</sup> *See id.* at 50.

<sup>125</sup> *In re Massey*, 2011 WL 2176479, at \*24-25.

<sup>126</sup> *Lambrecht v. O’Neal*, 3 A.3d 277, 282 (Del. 2010).

<sup>127</sup> DEL. CODE ANN. tit. 8, §259(a) (West 2012).

<sup>128</sup> *Lambrecht*, 3 A.3d at 282.

<sup>129</sup> *Id.*

<sup>130</sup> *Id.* at 286.

derivative actions to continue derivative suits after mergers is plagued with “a thicket of procedures that even expert litigators struggle to understand.”<sup>131</sup> The process for determining standing in a double derivative action can be complex and dependent on the structure of the merger.<sup>132</sup> It also reduces the potential recovery to existing shareholders.<sup>133</sup> In a cash only merger, the acquired shareholders will not receive any part of the suit’s recovery and the shareholders of the merged company will receive the full benefit.<sup>134</sup> In a share for share merger, the combination of both companies’ shareholders in the successor corporation dilutes the potential recovery of the suit.<sup>135</sup> There is also a potential risk the board of directors will not be impartial when deciding to proceed with the derivative suit.<sup>136</sup> It is up to the newly merged corporation to bring its own suit against the former directors who negotiated the merger in the first place, a situation ripe for potential conflicts of interest.<sup>137</sup> While the double derivative approach provides a last resort to shareholders who have lost standing from a merger, it is by no means perfect; it is riddled with complicated procedures, dilution of shareholder value, and a delayed timeline for recovery.

## IX. METHODS OF VALUING DERIVATIVE CLAIMS

For most mergers, a derivative action does not rise to the level of a material asset that would affect the transaction because it is of relatively small value compared to the rest of the assets.<sup>138</sup> However, derivative claims can be quite large and can possibly impact fair valuation of merged assets when a breach of fiduciary duties at natural resource and agricultural corporations causes catastrophic losses.<sup>139</sup> For example, the potential losses from the Massey coal mine disaster, or of a nuclear power plant similar to Fukushima, create large potential shareholder derivative claims to recoup large losses. In Judge Strine’s analysis considering whether the derivative suit is of material value in *In Re Massey*, he focuses on Alpha’s characterizing it as a material asset or as potential for “loss-offsetting” the

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<sup>131</sup> Steven M. Davidoff, *The Logic in Refusing to Block Massey’s Sale*, DEALB%K (June 3, 2011, 10:30 AM), <http://dealbook.nytimes.com/2011/06/03/the-logic-in-refusing-to-block-masseys-sale/>.

<sup>132</sup> Mary Elizabeth Anderson, Commentary, *Shareholder Litigation*, TRANSACTIONS: TENN. J. BUS. L. 223, 224-25 (2011).

<sup>133</sup> *In re Massey Energy Co.*, No. 5430-VCS, 2011 WL 2176479, at \*30 (Del. Ch. May 31, 2011).

<sup>134</sup> *See id.*

<sup>135</sup> *Id.*

<sup>136</sup> *Lambrecht v. O’Neal*, 3 A.3d 277, 282 (Del. 2010).

<sup>137</sup> *Id.* at 282.

<sup>138</sup> *In re Massey*, 2011 WL 2176479, at \*28.

<sup>139</sup> *See generally id.* (detailing derivative suits in aftermath of Upper Big Branch coal mine explosion and Massey’s failure to value derivative suits).

Upper Big Branch fallout.<sup>140</sup> Judge Strine states that “[a]ny board negotiating the sale of a corporation should attempt to value and get full consideration for all of the corporation’s material assets.”<sup>141</sup> The crux of the issue is whether a shareholder derivative suit is a material asset in the eyes of the board of directors of Massey or Alpha. Although Judge Strine discusses whether Alpha would consider the derivative suit an asset, one should consider whether Massey itself would value the suit as a material asset when it negotiates its own sale.<sup>142</sup> As a stand-alone entity, Massey would likely consider the suit a material asset for recouping shareholder losses as a result of the mining catastrophe.<sup>143</sup> Alpha, when considering the other assets gained from the merger, would have less incentive to value the claim as a material asset because of other, larger assets gained in the merger.<sup>144</sup> Even though Judge Strine found that Alpha could use the derivative suit to regain value lost, he was hesitant to label the derivative claim as an asset because it was directly tied to the fallout liability of the disaster.<sup>145</sup> While this ensures there are assets for miners’ wrongful death claims, the fact that it can be used to recoup losses implies that it is an asset with value.<sup>146</sup>

In the definitive merger agreement, Massey and Alpha submitted a pro forma statement breaking down the estimated value of Massey’s assets combined in the merger.<sup>147</sup> This assignment of value to Massey’s assets helped shareholders to better understand if the merger properly valued the corporation’s assets.<sup>148</sup> Massey’s board of directors “did not engage in a valuation of the Derivative Claims individually, and at most assumed either that their value was baked into the total purchase price to be paid by an acquiror, or that the Derivative Claims had no independent value to an acquiror.”<sup>149</sup> Had the Massey board of directors attached a value to the shareholder derivative suit in the proxy statement, Massey shareholders would be better able to understand the claim’s potential value. The merger agreement did explain, however, the impact of the merger on the derivative suit in detail.<sup>150</sup>

It is possible to attach value to pending derivative claims, and a number of methodologies have been used to evaluate the worth of such a

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<sup>140</sup> *In re Massey*, 2011 WL 2176479, at \*3.

<sup>141</sup> *Id.*

<sup>142</sup> *Id.*

<sup>143</sup> *Id.* at \*22.

<sup>144</sup> *See id.* (explaining that the value one would place on a derivative claim would be immaterial when compared to the value being paid in the merger).

<sup>145</sup> *Id.* at \*23.

<sup>146</sup> *Id.*

<sup>147</sup> *Massey Energy Co.*, *supra* note 59, at 179.

<sup>148</sup> *See id.*

<sup>149</sup> *In re Massey*, 2011 WL 2176479, at \*15.

<sup>150</sup> *Massey Energy Co.*, *supra* note 59, at 50.



corporate asset in a merger.<sup>151</sup> The Delaware court stated in *Kohls v. Duthie* that “[w]hile plaintiffs will likely lose standing to maintain the derivative claim once the merger is effected, it will be possible to value that claim in the context of an appraisal action.”<sup>152</sup> Vice Chancellor Lamb performed a valuation analysis that calculated the value of the claim through multiplying the probability of success on the merits by the likely amount of a favorable recovery, and subtracting from that result the reasonable costs incurred in prosecuting the claim.<sup>153</sup> Shareholders may apply this valuation analysis in determining the value of a derivative claim where there is a breach of fiduciary duties.<sup>154</sup> Certainly, as Judge Strine noted, this simplistic valuation model can become rife with uncertainties that hamper a court’s ability to value the claims.<sup>155</sup> However, this method is much better than the Massey board of directors stating that the claim’s value is “baked into” the merger proposal or, concurrently and illogically, that the claim has no value.<sup>156</sup> In *In re Massey*, Judge Strine suggested another method of valuing shareholder derivative suits; the board of directors should seek to obtain independent counsel to determine what consideration should be given for pending derivative claims.<sup>157</sup> Soon to be acquired corporations could also ask investment firms or legal experts to evaluate the derivative claims to decide whether the claim has value, and whether it was properly valued in the merger.<sup>158</sup>

#### X. CONFLICTS OF INTEREST & BOARD OF DIRECTORS’ PERSONAL LIABILITY

Even though Massey’s board of directors knew about the shareholder derivative suit and specifically asked how the merger would impact the suit, Judge Strine ruled that the board did not have a strong enough conflict of interest to invoke Delaware’s alternative standards of review for corporate business decisions.<sup>159</sup> In Delaware, and most other states, corporate actors are protected under the business judgment rule when there are no conflicts of interest present.<sup>160</sup> *Aronson v. Lewis* defined how a director could be conflicted: “From the standpoint of interest, this means that directors can neither appear on both sides of a transaction nor expect to

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<sup>151</sup> See *In re Massey*, 2011 WL 2176478, at \*15; *Kohls v. Duthie*, 765 A.2d 1274, 1289 (Del. Ch. 2000); *Bomarko, Inc. v. Int’l Telecharge, Inc.*, 794 A.2d 1161, 1189 (Del. Ch. 1999).

<sup>152</sup> *Kohls*, 765 A.2d at 1289.

<sup>153</sup> *Bomarko*, 794 A.2d at 1189.

<sup>154</sup> *Id.*

<sup>155</sup> *In re Massey*, 2011 WL 2176479, at \*31.

<sup>156</sup> *Id.* at \*15.

<sup>157</sup> *Id.*

<sup>158</sup> *Massey Energy Co.*, *supra* note 59, at C-1, D-1.

<sup>159</sup> *In re Massey*, 2011 WL 2176479, at \*16.

<sup>160</sup> *Weinberger v. UOP, Inc.*, 457 A.2d 701, 711 (Del. 1983).

derive any personal financial benefit from it in the sense of self-dealing, as opposed to a benefit which devolves upon the corporation or all stockholders generally.”<sup>161</sup> When considering the merger as a whole, it is much more difficult to determine if there is a clear personal conflict of interest for directors related to the derivative suit losing standing.<sup>162</sup>

Massey directors attempted to have Alpha completely indemnify their personal liability for derivative actions in the draft merger documents.<sup>163</sup> Alpha rebuffed the proposal to completely indemnify the directors, opting to provide the same D & O insurance to the extent previously agreed.<sup>164</sup> The fact that the personal liability of the directors was negotiated during the merger demonstrates that both parties understood its value to Massey and its directors.<sup>165</sup> Even though there were negotiations regarding liability, the asset was not priced into the merger.<sup>166</sup> This raises the risk of a breach of fiduciary duty for directors receiving a personal benefit of reduced liability as a result of the merger. The main argument plaintiffs used in these shareholder derivative suits is that the directors are willing to agree to a lower price in order to minimize their own personal liability in the derivative action.<sup>167</sup> The finding of a proverbial smoking gun for the narrow fraud exception during mergers is difficult and usually inoperable in court.<sup>168</sup>

While the minimization of personal liability usually is not the main purpose of a merger, it certainly provides some potential benefit to directors.<sup>169</sup> Instead of requiring that the directors who seek a merger do so “merely to deprive shareholders of standing to bring a derivative action,”<sup>170</sup> courts should recognize that the conflict of interest related to derivative claims losing standing, while not controlling, could impair director decision-making. Therefore, good corporate governance should either price the derivative claim into the merger by valuing the derivative suit or expanding the exception to the continuous ownership rule. Past litigators unsuccessfully sought to expand the fraud exception in *Countrywide* and

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<sup>161</sup> *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984), *overruled by Brehm v. Eisner*, 746 A.2d 244, 254 (Del. 2000); *see also* DEL. CODE ANN. tit. 8, § 102(b)(7)(iv) (West 2011) (explaining that there may be provisions in a certificate of incorporation that limit the personal liability of a director for breach of a fiduciary duty, but such provision shall not limit liability for any transaction where the director derives an improper personal benefit).

<sup>162</sup> *In re Massey*, 2011 WL 2176479, at \*2.

<sup>163</sup> *Id.* at \*16.

<sup>164</sup> *Id.* at \*17.

<sup>165</sup> Davidoff, *supra* note 131.

<sup>166</sup> *In re Massey*, 2011 WL 2176479, at \*24.

<sup>167</sup> *See In re Massey*, 2011 WL 2176479; Davidoff, *supra* note 131.

<sup>168</sup> *In re Massey*, 2011 WL 2176479, at \*17.

<sup>169</sup> *Id.*

<sup>170</sup> *Lewis v. Ward*, 852 A.2d 896, 899, 902.

there is no indication that this black letter standard will change.<sup>171</sup> Therefore, the only current way to ensure maximum shareholder value and to potentially prevent board of director conflicts of interest is to force such institutions to affirmatively value the derivative claim in a merger. Currently, to pursue a double derivative action, a shareholder must prove that the successor corporation is not maximizing shareholder value in continuing the derivative action against the acquired directors and executives.<sup>172</sup> Through assigning a value to the claim in the merger, it is easier to make a double derivative claim because the successor corporation paid value for the derivative claim in the merger and, therefore, has a fiduciary duty to reclaim that capital outlay or disclose it as a loss.

#### XI. CONCLUSION: MAPPING A BETTER WAY TO VALUE SHAREHOLDER SUITS IN MERGERS

The continuous ownership rule for derivative actions during mergers, while arguably unfair to shareholders of acquired companies, has been almost uniformly enforced to remove shareholder standing in derivative actions. Instead of attempting to rectify this potential unfairness through modifying the strict fraud exception or reducing the continuous ownership requirement, acquired corporations should proactively price and evaluate derivative actions as an asset to be purchased in a merger. This is much simpler than creating a “litigation trust” as the *In re Massey* plaintiffs proposed, and the acquiring company remains able to gain ownership of the suit in the merger to loss-offset fallout liabilities.<sup>173</sup> It also is less risky than bringing a double derivative suit against the successor corporation.

Derivative actions should be priced into the merger to mitigate the risk of the breach of fiduciary duties related to asset mispricing, as well as reducing conflicts of interest impacting decision-making, and to ensure full disclosure to shareholders regarding the proper value of their assets. As in the Massey-Alpha merger, there is a high likelihood that the derivative action will not be priced into the merger and shareholders will, at minimum, not be fully apprised of the value of their assets, or at a maximum, receive less than market value for their shares. Even a double derivative action, which is usually recommended as a last resort remedy, dilutes existing shareholders’ value. Additionally, the second social goal of shareholder derivative actions as a method of corporate accountability is diminished through mergers. Without a fair valuation of the claim, the acquiring corporation has a reduced incentive to continue the suit as a double

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<sup>171</sup> Ark. Teacher Ret. Sys. v. Caiafa, 996 A.2d 321, 323 (Del. 2010). (referencing the snowball effect or a cohesive plan to initiate a merger to personally benefit from lost standing of derivative suits).

<sup>172</sup> Rales v. Blasband, 634 A.2d 927, 932 (Del. 1991).

<sup>173</sup> *In re Massey*, 2011 WL 2176479, at \*31-32.

derivative action against the acquired company's corporate management. This analysis is important to food and natural resource companies because corporate disasters in those industries have large potential losses. At the time of the definitive merger agreement in January 2011, the combined value of the companies would have been \$8.5 billion.<sup>174</sup> A year and a half later in August 2012, the combined value of the companies plummeted to \$1.5 billion.<sup>175</sup> As Alpha stock continues to decline, there is increasing attractiveness of continuing the shareholder derivative claim against Massey's directors and executives to compensate for the liabilities of the Upper Big Branch fallout. Only time will tell if Alpha, or its shareholders in a double derivative suit, will continue the suit against Massey's former directors and executives, but Massey's original shareholders will never recoup the entire recovery of such a claim.

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<sup>174</sup> Press Release, Alpha Natural Resources, Alpha Natural Resources and Massey Energy Agree To \$8.5 Billion Combination (Jan. 29, 2011) *available at* <http://alnr.client.shareholder.com/releasedetail.cfm?ReleaseID=546291>.

<sup>175</sup> Historical Prices: Alpha Natural Resources, Inc., GOOGLE FINANCE <https://www.google.com/finance/historical?q=NYSE:ANR> (last visited Oct. 9, 2012) (considering stock price of \$6.84 at end of August 14, 2012 and 220.28 Million shares outstanding).