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UNCOVERING THE ROOTS: A BRIEF DISCUSSION OF THE HISTORY, POLICY AND PURPOSES OF DELAWARE'S WORKERS' COMPENSATION ACT

Christopher F. Baum*

A learned treatise on the law of workers' compensation has observed that:

[a] correctly balanced underlying concept of the nature of workers' compensation is indispensable to an understanding of current cases and to a proper drafting and interpretation of compensation acts. Almost every major error that can be observed in the development of compensation law, whether judicial or legislative, can be traced either to the importation of tort ideas, or, less frequently, to the assumption that the right to compensation resembles the right to the proceeds of a personal insurance policy.¹

The purpose of this article is to explain the basis, nature and development of Delaware's workers' compensation law so that practitioners may avoid such pitfalls.

I. CORE PHILOSOPHY

In the nineteenth century, before the first workers' compensation law was enacted in Delaware, an injured worker could only receive compensation for injuries received at the workplace through a personal injury action at common law. Under the "fellow-servant exception," however, an employer would not be liable to an injured worker if the injury was the result of a co-worker's negligence.² In addition, in cases when the employee could apprehend the possible danger of the employment, that employee, when injured, could not successfully sue the employer because he or she had "assumed the risk" of injury.³ On top of this, at the time the harsh rule of contributory negligence applied; therefore, an injured worker could not be compensated for an accident if the injured worker was negligent to any degree.⁴ Because the employer could only be found responsible if the employer itself was negligent, recovery could not be had in cases where a worker was injured as the result of an "Act of God," or when no party was found to be negligent.

As if the deck were not stacked enough against the injured worker, it must be kept in mind that the injured worker might easily be out of work because of the workplace injury. With no income, the worker would likely lack the financial

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1. ARTHUR LARSON & LEX K. LARSON, LARSON'S WORKERS' COMPENSATION LAW, DESK EDITION, § 1.02 (2014).
2. *Id.*, § 2.03. The injured worker could, in theory, bring a cause of action in tort against the coworker, but a fellow employee was unlikely to have great financial resources. Thus, even if the injured worker won, the recovery would, as a practical matter, be small and inadequate.
3. *Id.*
4. *Id.*

resources for a prolonged court battle even in those rare cases when recovery might theoretically be had against the employer.⁵ This situation could easily put the injured worker and the worker's family into the poor house and/or dependent on State hospitals for medical care—in other words, becoming a charge upon the taxpayers rather than remaining productive members of society. It is little wonder that state governments sought a different approach to the problem of injured workers.

Like legislatures elsewhere in the United States, in the early twentieth century the Delaware General Assembly worked to rectify the situation. In 1917, the General Assembly enacted the original Delaware Workmen's Compensation Act ("the Act").⁶ The original Act provided for compensation to injured workers regardless of the question of negligence, but limited the amount and types of compensation an injured worker could receive and prohibited the injured worker from suing a co-worker.

The Act removed workplace injuries from traditional personal injury law. An employee has "no rights to workers' compensation except for those granted by the Act."⁷

Workers' compensation is fundamentally different from strict tort liability in its basic test of liability, which is work connection rather than fault; in its underlying philosophy of social protection rather than righting a wrong; in the nature of the injuries compensated; in the elements of damage; in the defenses available; in the amount of compensation; in the ownership of the award; and in the significance of insurance.⁸

The original version of the 1917 Act was "elective" in nature; however, both employer and employee were presumed to have elected to be bound by the provisions of the law unless, prior to the employee's injury or death, either party gave proper notice to the other that it did not intend to be bound. The purpose of this approach was to ensure the Act's constitutionality.⁹ Eventually, court decisions across the country established the constitutionality of a compulsory act as a proper exercise of a state's inherent police powers to protect the citizenry.¹⁰ The General Assembly made the Act compulsory in 1941.¹¹ Since then, with only a few narrow exceptions, every employer and employee is bound "to pay and to accept compensation for personal injury or death by accident arising out of and in the course of employment, *regardless of the question of negligence and to the exclusion of all other rights and remedies.*"¹² This exclusivity provision "precludes a suit for negligence

5. "One need only add that the usual witnesses of the accident, being co-employees, would naturally be reluctant to testify against the employer, to complete the picture of helplessness which characterized the position of the injured worker of the precompensation era." *Id.*, § 2.03.

6. 29 Del. Laws 233 (1917).

7. *Ruddy v. I.D. Griffith & Co.*, 237 A.2d 700, 705 (Del. 1968).

8. LARSON, *SUPRA* NOTE 1, CHAPTER 1 "SCOPE."

9. *See* LARSON, *SUPRA* NOTE 1, § 2.07; *HILL v. MOSKIN STORES, INC.*, 165 A.2D 447, 449 (DEL. 1960).

10. *Cf. Hill*, 165 A.2d at 449 (stating that the Act was "obviously" grounded in an exercise of the police powers).

11. 43 Del. Laws 269 § 2 (1941).

12. DEL. CODE ANN. tit. 19, § 2304 (2005) (emphasis added). Under certain circumstances, however, an employee may forfeit the right to benefits granted under the Act. For example, the Delaware Supreme Court held:

Upon the basis of public policy, the authorities above discussed, and the principles of fairness and justice, we hold that an employee forfeits his right to benefits under the Delaware Workmen's Compensation Act if, in applying

under the common law, even if the injury was caused by the gross, wanton, wilful, deliberate, reckless, culpable or malicious negligence, or other misconduct of the employer.”¹³ By the same token, compensation was available even if the injury was caused by the negligence of the injured employee or by a co-employee, and even if the injured employee had either expressly or impliedly assumed the risk of being injured.¹⁴

Thus, the core principle of Delaware’s Workers’ Compensation Act is “to eliminate questions of negligence and fault in industrial accidents, and to substitute a reasonable scale of compensation for the common-law remedies, which experience had shown to be, generally speaking, inadequate to protect the interest of those who had become casualties of industry.”¹⁵ As such, an employer would be required to pay benefits to an employee who was injured at work even though the employee’s own negligence may have caused the injury, and even though the employer was in no way “at fault” for the injury. Clearly, this placed an additional burden on the employer. As a trade-off, the legislature restricted the benefits available to the employee. On the whole, the injured worker enjoyed the greatest benefit of the Act in that he or she was relieved of the expense and hazard of maintaining a lawsuit.

Of course, in some cases, . . . a recovery might be had at law exceeding the compensation payable under the act. But the policy of the law is to take the whole subject out of the field of negligence. The overall benefit to the employee is clear. For that benefit, he gives up the right to sue at law.¹⁶

Instead of a suit at law, an administrative board—the Industrial Accident Board (“IAB”)—was created to have jurisdiction over cases arising under the Act and to hear disputes as to the compensation to be paid to an injured worker.¹⁷

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for employment, the employee (1) knowingly and wilfully made a false representation as to his physical condition; and (2) the employer relied upon the false representation and such reliance was a substantial factor in the hiring; and (3) there was a causal connection between the false representation and the injury.

Air Mod Corp. v. Newton, 215 A.2d 434, 440 (Del. 1965) (citations omitted). All three elements must be present before benefits are forfeited. *Mountaire of Delmarva, Inc. v. Glacken*, 487 A.2d 1137, 1140 (Del. 1984). Other bases for forfeiture are listed in title 19, section 2353 of the Delaware Code.

13. *Rafferty v. Hartman Walsh Painting Co.*, 760 A.2d 157, 159 (Del. 2000). The exclusivity provision pertains to the relationship between the employer, the employee and co-employees. The Act does not, however, prevent an injured worker from bringing a traditional tort action against a third party. “Although the exclusivity provision prevents an injured employee from suing the employer for the employer’s negligence, it does nothing to alter the injured party’s right to bring a negligence action against a third-party tortfeasor.” *Stayton v. Clariant Corp.*, 10 A.3d 597, 600 (Del. 2010).

14. DEL. CODE ANN. TIT. 19, § 2314 (2005).

15. *Hill*, 165 A.2d at 451 (citation omitted).

16. *Hill*, 165 A.2d at 451.

17. DEL. CODE ANN. tit. 19, § 2301A(i) (2005). The current phrasing of the statute has caused some confusion. It states that the Board “shall have jurisdiction over cases arising under Part II of this title and shall hear disputes as to compensation to be paid under Part II of this title.” DEL. CODE ANN. tit. 19, § 2301A(i). Some have assumed that the phrase “Part II of this title” refers only to subchapter II of chapter 23, namely sections 2321 to 2334, inclusive. This is a mistaken assumption. “Subchapter II of chapter 23” is not the same thing as “Part II of this title” as that phrase is used in section 2301A. In fact, the phrase means exactly what it says: Part II of this title, not “of this chapter.” The “title” in question is title 19 of the Delaware Code. That title (“Labor”) consists of four parts. Part I contains “General Provisions” (chapters 1 through 17 of the title). Part II pertains to Workers’ Compensation and comprises

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II. THE EXPANSION OF BENEFITS TO INJURED WORKERS

The Delaware courts have acknowledged that the provisions of the Act should be construed liberally to fulfill the “twin purposes of providing a scheme of assured compensation for work related injuries without regard to fault and to relieve employers and employees of the expenses and uncertainties of civil litigation.”¹⁸ The first of these “twin purposes” is assured compensation to injured workers. “Workmen’s compensation law is grounded in a public policy strongly in favor of employers making restitution to employees who are injured while working. Unlike tort claims acts, the point of workmen’s compensation is to protect workers, not to shield employers.”¹⁹ Because the purpose of the Act is to benefit the injured worker, the courts have held that the Act is to be construed liberally and, in interpreting the statutory provisions, reasonable doubts are to be resolved in favor of the injured worker.²⁰

It is also important to understand that the Act is not “based on eleemosynary principles, but upon the fundamentals of injury or death arising out of and in the course of employment, and reliance upon the employee’s earnings for support. Indiscriminate awards of compensation, based on uncertain evidence, or on sympathy, are not in the public interest.”²¹ In other words, the Act is not an act of charity. It also should not be read so broadly that the Act is “transformed into a health insurance statute.”²² It is not intended to compensate an employee for every ailment that the employee may have, but only those that can fairly be said to have been caused by the employment. In addition, because the point of compensation is to replace periodic wages, an injured worker is generally not to be compensated with a lump sum payment for lost wages. Rather, wage replacement benefits are intended to be made periodically, as wages were payable prior to the accident.²³ The purpose of these periodic payments is to “preclude any possibility of an imprudent employee or dependent wasting the means provided for his [or her] support and thereby becoming a charge on society.”²⁴

The employer also gains from the compromise that resulted in the Act. The trade-off for removing workers’ compensation from the field of negligence (and thus creating essentially a no-fault law) was to impose a “reasonable scale

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chapters 21, 23 and 26 (although currently there are no active provisions in chapters 21 and 26, so “Part II” is really just chapter 23 of title 19). Part III of title 19 pertains to Unemployment Compensation (chapters 31, 33 and 34). Part IV is the Workplace Fraud Act (chapter 35). In short, section 2301A’s reference that the Board has jurisdiction over cases arising under “Part II of this title” means that the Board has jurisdiction over any action arising under all of the Workers’ Compensation Act (chapter 23 of title 19), including all its subchapters.

18. *New Castle County v. Goodman*, 461 A.2d 1012, 1014 (Del. 1983); *see Duvall v. Charles Connell Roofing*, 564 A.2d 1132, 1133 (Del. 1989) (noting the “two primary purposes of [the Act] are to assure prompt compensation of injured employees without regard to fault and to obviate the need for litigation”).

19. *Barnard v. State*, 642 A.2d 808, 819-20 (Del. Super. 1992).

20. *Estate of Watts v. Blue Hen Insulation*, 902 A.2d 1079, 1081 (Del. 2006) (citing *Hirneisen v. Champlain Cable Corp.*, 892 A.2d 1056, 1059 (Del. 2006)).

21. *Children’s Bureau of Delaware v. Nissen*, 29 A.2d 603, 609 (Del. Super. 1942).

22. *Air Mod Corp.*, 215 A.2d at 442.

23. *See DEL. CODE ANN. TIT. 19, § 2360.*

24. *See Molitor v. Wilder*, 195 A.2d 549, 551-52 (Del. Super. 1963).

of compensation” rather than permitting the compensation potentially available in common law tort.²⁵ “[T]here are no rights to workmen’s compensation except those granted by the Act.”²⁶ As such, the benefits that are available to an injured employee are only those expressly provided for in the Act and “the benefits of th[e] Act are intended to benefit the employee primarily.”²⁷ Further, the Board is not a court of equity; it cannot create or fashion whatever “fair” remedy a litigant may wish. Unlike a tort recovery, benefits under workers’ compensation were never meant to make the injured party whole.²⁸ In short, while the Act is to be interpreted broadly in favor of the injured worker, the trade-off for this is that the available benefits are deliberately limited in scope.

Over time, however, the benefits available to injured workers have steadily expanded. A few examples illustrate this trend.

A. Example: Occupational Disease

When it was enacted in 1917, the Act defined “personal injury” as only one that involved “violence to the physical structure of the body and such disease or infection as naturally results directly therefrom when reasonably treated.”²⁹ Occupational “diseases not entailing direct physical damage to a bodily structure were not covered.”³⁰ In 1937, this very restricted definition of “personal injury” was expanded to include twelve *specified* occupational diseases provided that the culpable exposure occurred during the period of employment and the disability manifested itself (“commenced”) within five months after the termination of the exposure.³¹ In 1949, the legislature removed the list of twelve specific diseases to allow recovery for “all occupational diseases arising out of and in the course of employment.”³² Finally, in 1974, the legislature removed the five-month-commencement requirement.³³ As the Delaware Supreme Court has observed, this evolution of coverage for occupational diseases parallels the development of workers’ compensation laws elsewhere.³⁴ “[T]his evolution of statutory treatment of compensable occupational diseases—from no coverage, to schedule coverage, to general coverage—is not unusual.”³⁵

25. See *Hill*, 165 A.2d at 451.

26. *Ruddy*, 237 A.2d at 705.

27. *Magness Construction Co. v. Waller*, 269 A.2d 554, 555 (Del. 1970).

28. See *Hill*, 165 A.2d at 451 (recognizing that a greater recovery might have been had by an injured worker in a personal injury action at law than is available under the Act); *Witt v. Georgia-Pacific Corporation*, No. 95A-08-002, 1996 WL 30250, at *7 (Del. Super. Jan. 24, 1996) (finding that a ruling under the Act may seem inequitable, but there are no additional rights to compensation except for those found in the Act).

29. 29 Del. Laws 233 (1917).

30. *Champlain Cable v. Employers Mutual Liability Ins. Co.*, 479 A.2d 835, 839 (Del. 1984).

31. 41 Del. Laws 241 § 1 (1937).

32. 47 Del. Laws 270 § 1 (1949).

33. 59 Del. Laws 454 § 8 (1974).

34. *Air Mod Corp.*, 215 at 441.

35. *Id.*

B. Example: The Three-Day Rule

At one time, the Workers' Compensation Act provided:

No compensation shall be paid for any injury which does not incapacitate the employee for a period of 3 days from earning full wages, and compensation shall begin on the fourth day of incapacity after the injury, unless the incapacity extends to 7 days, including the day of injury, or unless the incapacity results in hospitalization of the employee. In the case of incapacity for a 7 day period, amputation or hospitalization, the employee shall not be excluded from receiving compensation for the first 3 days of incapacity.³⁶

This became known as the “three-day rule.” The intent was to limit the payment of workers’ compensation so that compensation was not paid for minor or transient injuries. As written, the three-day rule affected the payment of medical expenses: if an employee was hurt but could continue working (for example, if the employee was already working in a sedentary capacity), then medical expenses for treatment of the injury would not be paid unless that employee was actually hospitalized. This led both the Board and the courts to interpret the statute to avoid its occasionally harsh literal effect.

For example, in *M & M Hunting Lodge v. DiMaio*,³⁷ the employee injured his shoulder and was unable to perform his normal duties, but he returned to work “in a limited capacity driving a tractor.”³⁸ He was paid his full wages. The employer argued that, because the employee had not lost wages, it was not required to pay his medical bills. The Board decided that the employer had paid the full wages as a gratuity (having given claimant a “specially created position”) and that such a job could not serve to deprive the claimant of benefits. The Superior Court agreed, holding, “[i]f a claimant is truly incapacitated from earning full wages due to a work related injury and returns to work in a gratuitous situation, this should not effect [sic] his workmen’s compensation benefits.”³⁹

Likewise, in *Streett v. State*,⁴⁰ the employee was incapacitated for seven days, which happened to coincide with a previously planned vacation. At the time, section 2321 stated that benefits were only paid if the injured worker was incapacitated from “earning full wages.”⁴¹ In this case, because the employee was on vacation, she received full vacation pay and lost no wages. As such, the employer argued that it was not required to pay the medical bills.⁴² The Delaware

36. DEL. CODE ANN. tit. 19, § 2321 (1985). An even earlier version of this provision was more draconian, not only requiring three days of incapacity from earning full wages, but also limiting the payment of medical expenses to “the first thirty (30) days of the injury” and limiting the total cost of such treatment to no more than \$200.00. See 43 Del. Laws 269 §6 (1941). Even acknowledging that two hundred dollars went further in those days, this was an extremely limited amount of compensation available for medical expenses. While the current version of the Act provides for a fee schedule to control medical expenses, there is no flat limit on those costs. See generally DEL. CODE ANN. tit. 19, § 2322B.

37. No. 90A-JL-81991, 1991 WL 89802 (Del. Super. May 10, 1991).

38. *DiMaio*, 1991 WL 89802, at *2.

39. *Id.* at *2, 3.

40. 669 A.2d 9 (Del. 1995).

41. *Id.* at 12 (citing DEL. CODE ANN. TIT. 19, §2321 (1995)).

42. In fact, the employer *had* paid the medical expenses, but argued that it had done so “voluntarily” rather than because they were compensable under the Act. See *Streett*, 669 A.2d at 11.

Supreme Court found that an employee should not be penalized for the timing of the injury and should not be required to cancel a scheduled vacation just so she could “not go to work” because of her injury.⁴³ The Court therefore concluded that “vacation days may be used to satisfy the three-day waiting period.”⁴⁴

Finally, in *Aiken v. General Motors Corporation*,⁴⁵ the employee sought disfigurement benefits although she “did not lose any time from work, nor any wages as a result of [her] injury.”⁴⁶ The Delaware Supreme Court held that the specific wording of section 2321 reflected the General Assembly’s determination that the recovery of “lost earnings” required incapacity for at least three days.⁴⁷ Compensation for permanent injuries under the Act (including both permanent impairment and disfigurement), however, was specifically paid “regardless of the earning power of the employee.”⁴⁸ The Court held that such permanent injuries were compensable *per se*.⁴⁹ Accordingly, the Court concluded that the three-day rule, which was a condition on recovery of “lost earnings,” was inapplicable to a claim for disfigurement.⁵⁰

As these cases made their way through the courts, the legislature changed the statutory language. The General Assembly, deciding that medical expenses for work injuries should be paid even if “minor” in the sense of not resulting in any wage loss, re-wrote the three-day rule of section 2321, effective July 10, 1995, to provide:

Surgical, medical and hospital services, medicines and supplies, and funeral benefits shall be paid from the first day of injury. Beginning with the fourth day of incapacity, all compensation otherwise provided by law shall be paid. If the incapacity extends to 7 days or more, including the day of injury, the employee shall receive all compensation otherwise provided by law from the first day of injury.⁵¹

This change allowed a claimant to receive compensation for medical treatment without the necessity of being incapacitated for three days. In other words, an injury that was so “minor” that it did not cause an employee to lose any time from work could still be deemed compensable under the Act for the reasonable and necessary medical expenses involved in treating the injury.

The legislature amended section 2321 once again in 1996, before *Aiken* was decided. The 1996 version, which remains in effect today, provides:

Permanent injury relating to hearing or vision loss, surgical, medical and hospital services, medicines and supplies, and funeral benefits shall be paid from the first day of injury. Beginning with the fourth

43. *Id.* at 13.

44. *Id.*

45. 687 A.2d 186 (Del. 1997).

46. *Aiken*, 687 A.2d at 188.

47. *Id.* (citing *Smith v Feralloy Corp.*, 460 A.2d 516, 518 (Del. 1983)).

48. *Aiken*, 687 A.2d at 189 (quoting *Ernest DiSabatino & Sons, Inc. v. Apostolico*, 269 A.2d 552, 553 (Del. 1970)).

49. *Aiken*, 687 A.2d at 189.

50. *Id.* Presumably, the same rationale would also have applied to claims for permanent impairment under section 2326 of Title 19.

51. DEL. CODE ANN. TIT. 19, § 2321 (1995).

day of incapacity, all compensation otherwise provided by law shall be paid. If the incapacity extends to 7 days or more, including the day of injury, the employee shall receive all compensation otherwise provided by law from the first day of injury.⁵²

Not knowing how the Delaware Supreme Court would decide *Aiken*, the General Assembly included a statement that “[p]ermanent injury relating to hearing or vision loss” was to be paid from the first day of injury, thus statutorily excluding such permanent injuries from the effect of the three-day rule.⁵³

Another change that further weakened section 2321’s three-day rule and increased the benefits to injured workers addressed situations where an employee continued to work, but at less than full capacity. The original version of the three-day rule provided that no compensation was to be paid for any injury “which does not incapacitate the employee for a period of 3 days *from earning full wages*.”⁵⁴ The 1995 revision quoted above (which stands today), deleted the phrase “from earning full wages” and merely noted that “all compensation otherwise provided by law shall be paid” beginning with “the fourth day of incapacity.”⁵⁵ The term “incapacity” historically had been defined as an incapacity to work, i.e., loss of earning power.⁵⁶ With respect to the three-day rule, though, it can no longer be read as meaning an inability to earn full wages. The General Assembly deleted those specific words from the statute.⁵⁷ Because “[t]he courts may not engraft

52. DEL. CODE ANN. TIT. 19, § 2331.

53. Ironically, by amending the statute before the decision issued in *Aiken*, the General Assembly ended up limiting the effect of the Court’s decision. The current version of section 2321 arose from Senate Bill 289 (“SB 289”), introduced on January 24, 1996. As originally proposed, SB 289 only added the words “permanent injury” to the beginning of section 2321, thereby exempting all permanent impairments from the scope of the three-day rule—exactly what the Supreme Court would decide was how the original section should have been read. That this was the original intent of the legislature is confirmed by the stated purpose of the legislation, which noted that SB 289:

would permit injured workers to receive benefits for permanent injury such as hearing loss or other cumulative non-incident loss even though they were not incapacitated for three days.

The three day rule is a device to exclude minor injuries from the chapter and should not be used to avoid paying benefits for a permanent loss.

SB 289, “Synopsis.” However, in May 1996, an amendment to the legislation (“SA 1 to SB 289”) was drafted which added the specific phrase “relating to hearing or vision loss.” According to its stated purpose, this amendment “clarifies the scope of the legislation.” SA 1 to SB 289, “Synopsis.” By specifically limiting the permanent impairments excluded from the operation of the three-day rule to those impairments “relating to hearing or vision loss,” the implication is that the General Assembly intended for all other permanent impairment to be subject to the three-day rule. No other explanation of SA 1 to SB 289 is possible. As the General Assembly noted, the limiting language does clarify the scope of the legislation. Thus, although the Supreme Court stated in *Aiken* that section 2326 “is a legislative recognition that certain permanent specifically ‘scheduled injuries’ . . . are compensable *per se*,” *Aiken*, 687 A.2d at 189, the enactment of SB 289 as amended evinces a specific legislative intent that permanent injury (with the exception of those relating to hearing and vision loss) are to be covered by the three-day rule. Any other reading of the statute would render the clause “[p]ermanent injury relating to hearing or vision loss” meaningless.

54. DEL. CODE ANN. tit. 19, § 2321 (1985) (emphasis added).

55. DEL. CODE ANN. TIT. 19, § 2331.

56. See, e.g., *Wilmington Housing Authority v. Gonzalez*, 333 A.2d 172, 175 (Del. Super. 1975) (noting that, while the term “incapacity” is not defined in the statute, it “is generally held to mean ‘incapacity to work.’”) (quotation omitted).

57. See 70 Del. Laws 205 § 1 (1995).

upon a statute language which has been clearly excluded therefrom by the Legislature,”⁵⁸ presumably the General Assembly intended that the three-day rule would no longer be conditioned solely on a loss of earnings—merely on “incapacity.” The Board concluded therefore that “incapacity” for purposes of the three-day rule, while it must be an incapacity *from work* (in accordance with the historical reading of the term in workers’ compensation law), did not need to be an incapacity that led to a loss of earning capacity; if an employee injured in a compensable accident is restricted to *less than full duty work*, such as being limited to light duty, that is an “incapacity” for purposes of the three-day rule even though that employee has suffered no loss of earnings.⁵⁹

C. Example: Abatement After Death

Over time, dependent benefits following the death of a claimant also have expanded. The original 1917 version of the Act specified that, if an injured worker died as a result of the work injury, the benefits payable to the injured worker’s dependents would be reduced based on the amount of benefits paid to the injured worker during the worker’s lifetime, although no reduction was to be made based on the amounts that “may have been paid for medical, surgical and hospital services and medicines nor for the expenses of last sickness and burial.”⁶⁰ This was in accord with the original intention of the Act to benefit the employee specifically, not his or her dependents.⁶¹ This reduction of benefits based on what had been paid to the injured worker was eliminated in 1941.⁶² Now section 2332 provides:

Should the employee die as a result of the injury, no reduction shall be made for the amount paid for medical, surgical, dental, optometric, chiropractic or hospital services and medicines nor for the expense of last sickness and burial as provided in this chapter. Should the employee die from some other cause than the injury as herein defined, the claim for compensation shall not abate, but the personal representative of the deceased may be substituted for the employee and prosecute the claim for the benefit of the deceased’s dependent or dependents only, but in the event an agreement for compensation or an award has theretofore been made, the full unpaid amount thereof shall be payable to the deceased employee’s nearest dependent as indicated by § 2330 of this title and such payments may be made directly to a dependent of full age and on behalf of an infant to the statutory or testamentary guardian of any such

58. *Giuricich v. Emtrol Corp.*, 449 A.2d 232, 238 (Del. 1982) (*en banc*).

59. *Marra v. Raytheon*, No. 1120439, at 9 (Del. I.A.B., July 7, 1998).

60. *See* 29 Del. Laws 233 § 103(d) (1917) (setting forth new section 3193(j) of “Chapter 90 of the Revised Code of the State of Delaware”).

61. *See Magness Construction Co. v. Waller*, 269 A.2d 554, 555 (Del. 1970).

62. *See Estate of Watts v. Blue Hen Insulation*, 902 A.2d 1079, 1082 (Del. 2006) (“When the statute was amended in 1941, the General Assembly eliminated the reduction for prior payments to workers who died from the industrial injury, but continued to deny benefits to workers who died of other causes...”). This statutory amendment, although removing the provision allowing for reduction of benefits to dependents, still continued to provide that “[s]hould the employee die as a result of the injury, no reduction shall be made for the amount which may have been paid for medical, surgical, and hospital services, and medicines, nor for the expense of last sickness and burial.” 43 Del. Laws. 269 §8 (1941). Because the whole concept of any reduction was being removed from the statute, it is unclear why it was considered necessary to retain this provision. It seems to serve no useful purpose. Nevertheless, the language has remained in section 2322 to the present day. *See* DEL. CODE ANN. TIT. 19, § 2332.

infant provided, however, that no payment or award under § 2324 [compensation for total disability] or § 2325 [compensation for partial disability] of this title shall continue or be ordered beyond the date of such injured employee's death.⁶³

Prior to 1964, section 2332 was divided into subsections (a) and (b).⁶⁴ Subsection (a) provided, in language similar to the current section, that, if the death was related to the work injury, “no reduction shall be made for the amount paid for medical, surgical, dental, optometric or hospital services and medicines nor for the expense of last sickness and burial,” but that, if death was *unrelated* to the work injury, then “liability for compensation, expense of last sickness, and burial of such employee, shall cease.”⁶⁵ Section 2332 (b), on the other hand, provided that “[c]ompensation agreed upon or awarded to an injured employee who has died and which has not been paid at the time of his death, shall be paid to his nearest dependent as indicated by section 2330 of this title.”⁶⁶ Unlike subsection (a), subsection (b) did not specify the cause of death—whether death was related to the work injury or not, agreements and awards that had been established prior to death were to be paid to the “nearest dependent” as defined by section 2330 (“section 2330 dependents”).⁶⁷

In *Moore v. Chrysler Corporation*,⁶⁸ the Delaware Supreme Court applied this pre-1964 version of section 2332 to a deceased employee's permanent impairment claim. In that case, the employee was injured in June 1962 and, as a result of this injury, his left leg was amputated in October 1962, and he died from causes unrelated to his injury in August 1963.⁶⁹ The employee made no claim for permanent impairment benefits prior to his death. “Accordingly, no compensation was ‘agreed upon’ by the parties or ‘awarded’ by the Board for such scheduled loss.”⁷⁰ The employee left a surviving spouse, who filed a claim for permanency benefits. The Delaware Supreme Court held that the right to compensation for

63. DEL. CODE ANN. tit. 19, § 2332. It should be noted that this section does not affect the award of death benefits (provided under DEL. CODE ANN. tit. 19, § 2330), and burial expenses (provided under section DEL. CODE ANN. tit. 19, § 2331). It only addresses the abatement or non-abatement of benefits that would otherwise have been payable if the injured worker was alive.

64. See DEL. CODE ANN. tit. 19, § 2332 (1953).

65. DEL. CODE ANN. tit. 19, § 2332(a) (1953). In 1955, “chiropractic” was added to the list of amounts paid for which there would be no reduction. See 50 DEL. LAWS 267 § 3 (1955).

66. DEL. CODE ANN. tit. 19, § 2332(b) (1953).

67. Such dependents are primarily the surviving spouse and children. Section 2330 currently provides that, if there are no surviving spouse or children, then the surviving parent(s) can be the section 2330 dependent(s) provided that they were “actually dependent” on the employee for at least fifty percent of their support. If there was also no surviving parent, then the surviving sibling(s) could be the section 2330 dependent(s) provided again that they were “actually dependent” on the employee for at least fifty percent of their support. See DEL. CODE ANN. tit. 19, § 2330(a). This provision is an example of a situation where the availability of benefits has been restricted since 1917. The original 1917 version of the Act allowed some compensation to a surviving parent or sibling (if there were no surviving spouse or children) if the parent or sibling was “dependent to *any* extent” upon the deceased employee for support. See 29 DEL. LAWS 233 § 104 (1917) (setting forth new section 3193(k) of “Chapter 90 of the Revised Code of the State of Delaware”) (emphasis added). The requirement of fifty percent of support was not added to the statute until 1974 (which took effect on July 1, 1975). See 59 DEL. LAWS 454 § 14 (1974).

68. 233 A.2d 53 (Del. 1967)

69. *Id.* at 54.

70. *Id.*

the loss of the leg did *not* survive the employee's death.⁷¹ The Court opined that the statute clearly stated that "liability for compensation ended if the employee died from a cause other than the industrial accident, except when compensation had been agreed upon or awarded to the employee prior to his death."⁷² No such agreement or award had been reached; therefore, the right to compensation for the impairment ceased with the employee's death.

In 1964, section 2332 was amended to delete subsection (b).⁷³ The new section 2330, substantially as it exists today, was created.⁷⁴ Specific new "non-abatement" language was added to provide that "[s]hould the employee die from some other cause than the injury as herein defined, the claim for compensation shall not abate, but the personal representative of the deceased may be substituted for the employee and prosecute the claim for the benefit of the deceased's dependent or dependents only."⁷⁵ This provision was in addition to the "agreement or award" provision, which was carried over into the new section.

The Delaware Superior Court reviewed this non-abatement clause in *Witt v. Georgia-Pacific Corporation*.⁷⁶ In *Witt*, the injured employee filed a petition to determine permanent impairment and disfigurement benefits related to two separate work-related injuries.⁷⁷ Five days after he filed the petition, the employee died from causes unrelated to the work injury, leaving no surviving spouse or children.⁷⁸ His father, who survived him, acting as the deceased employee's personal representative, desired to pursue the claim filed by the deceased.⁷⁹ The primary issue for the case was whether there was a "dependency threshold" requiring the existence of section 2330 dependents in order to pursue benefits under the non-abatement clause.⁸⁰ In ruling that there was, the *Witt* Court indicated that the legislature intended to limit benefits available after an employee's death, finding that "[t]he purpose of Workers' Compensation is to compensate victims While parents suffer emotionally from the death of their child, the purpose of the statute is to compensate those who suffer *economically* from the employee's death."⁸¹ This opinion followed the Delaware Supreme Court's view that "the benefits of this Act are intended to benefit the employee primarily."⁸²

71. *Id.* at 55.

72. *Id.*

73. 54 Del. Laws 280 § 4 (1964).

74. 54 Del. Laws 280 § 3 (1964).

75. *Id.*

76. 1996 WL 30250.

77. *Id.*, at *1.

78. *Id.*

79. *Id.*

80. *Id.* The Court specified that the issue before it was not the factual question of whether the surviving parents fit the definition of "dependent," but rather the legal question of whether the Act required the presence of a dependent. *Id.*

81. *Id.*, at *4 (citation omitted; emphasis in original).

82. *Magness Construction Co.*, 269 A.2d at 555. Although the case did not involve a death, the Delaware Supreme Court in *Magness* observed that if the employee did not receive section 2326 permanent impairment benefits during his lifetime and the

If the injured worker dies from the work-related injury itself, however, benefits can be paid to one who is not even a dependent of the deceased. The Delaware Supreme Court reached this conclusion in *Estate of Watts v. Blue Hen Insulation*.⁸³ In its analysis, the Court acknowledged the general application of title 10, section 3707 of the Delaware Code, which provides that a “statutory right of action or remedy against any officer or person, in favor of any person, shall survive to, or against the executor or administrator of such officer or person, unless it be specially restricted in the statute.”⁸⁴ Workers’ compensation benefits, of course, are purely statutory in nature.⁸⁵ The question in *Watts*, therefore, was whether the statute allows a permanent impairment claim to survive the death of a claimant.⁸⁶ Reviewing section 2332, the Court found that, in the case where a claimant dies *from the work accident*, nothing in section 2332 expressly abrogates a claim for permanency benefits.⁸⁷ The Court held that “[s]ince there is no express restriction on a post-death claim for permanent injuries by the estate of a worker who dies from his injuries, . . . the worker’s statutory right of action survives.”⁸⁸

III. CURRENT STATE OF THE LAW

Although the Act originally focused on compensating only injured employees and those who suffer economically from an injured employee’s injury,⁸⁹ now the Act allows payment of permanent impairment benefits to a deceased worker’s estate even if there was *nobody* who was economically dependent on that worker.⁹⁰ Taking this extension one step further, the Court has held that *the estate of* a claimant’s “surviving spouse” was entitled to a full 400 weeks of “surviving spouse” benefits.⁹¹

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employee died without leaving a section 2330 dependent, then the employee “would lose all benefits under § 2326.” *Id.* The Court did not specify that it was only talking about a situation where the employee’s death was unrelated to the work accident; however, under the hypothetical that the Court was considering it is reasonable to assume that that was what the Court had in mind.

83. 902 A.2d 1079 (Del. 2006).

84. DEL. CODE ANN. TIT. 10, § 3707.

85. See *Ruddy*, 237 A.2d at 705 (“[T]here are no rights to workmen’s compensation except those granted by the Act.”).

86. *Watts*, 902 A.2d at 1081.

87. *Id.* at 1082.

88. *Id.* at 1083.

89. *Witt*, 1996 WL 30250 at *4.

90. The Board’s decision on Charles Watt’s claim provided additional background facts. See *Estate of Charles Watts v. Blue Hen Insulation*, No. 1209205, 1-2 (Del. I.A.B. Nov. 15, 2004). Charles Watts died at the age of 63. His surviving spouse, Verna Watts, was his sole beneficiary. Verna, on behalf of the Estate of Charles of Watts, filed the petition seeking permanent impairment benefits. She then died suddenly. The employer filed a petition to terminate the ongoing receipt of death benefits to Verna (or, rather, her estate). Verna’s estate consisted only of *her* adult child and adult stepchildren, and it appears that none of these adult children were economically dependent on either Charles or Verna. See *Id.*

91. *Watts*, 902 A.2d at 1083-84. The Court found that the statute provided a surviving spouse benefits for a *minimum* of 400 weeks and not merely until the spouse dies or remarries. *Id.* at 1083 (“If the 400 weeks is not a minimum, then the statute need

Thus, an Act that originally was enacted primarily to compensate an injured worker, rather than that worker's dependents, has evolved to the point where benefits can be paid to a deceased worker's estate even though there are no dependents to benefit from the award, and to a surviving spouse's estate even though the surviving spouse died leaving no dependents. This is truly an expansion of compensation under the Act far beyond the Act's original purpose. It also suggests, as Larson suggested in the excerpt cited at the beginning of this article, that considerations more properly associated with personal injury tort recovery have mistakenly influenced some legislative changes to workers' compensation.

Although the influence of common law tort recovery has increased workers' compensation benefits over time, the original concept that injured workers gave up their common law benefits has not been totally abandoned.⁹² This is most clearly seen in the case of a worker who is employed in multiple jobs. With certain very limited exceptions, the Act does not recognize that a work injury incurred at one job might disable a claimant from multiple jobs.⁹³ Compensation for a work injury is based *solely on the wage loss from the job where the injury happened*.⁹⁴ If a claimant was working both full-time and part-time, compensation would only be based on the job where the injury happened, even if the consequence of the injury was that the claimant was unable to work both jobs.⁹⁵ Thus, a worker earning full-time wages at one job of \$900 per week and earning part-time wages at another job of \$350 per week would, if totally disabled as a result of an injury at the part-time job, only be compensated based on the wages received at the part-time job. In other words, the worker's weekly compensation would be two-thirds of \$350, or \$233.33 per week, quite a reduction for an injured worker who had

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not make any reference to time. . . . Thus, to give full effect to all of the language in the statute, the requirement that a surviving spouse be paid for 400 weeks should be interpreted as a minimum amount that must be paid regardless of the spouse's subsequent death.")

92. Other states have also addressed this balance between giving up common law rights in exchange for receiving statutory benefits. Recently, in Florida, a trend that was the opposite of Delaware's trend for expanding benefits was discussed. A judge from the Eleventh Circuit Court determined that Florida's version of workers' compensation had become an unconstitutional deprivation of due process because the workers' compensation benefits available under Florida law had been reduced to the point that the Florida law was no longer considered a "reasonable alternative remedy to the tort remedy it supplanted." *Florida Workers' Advocates v. State of Florida*, C.A. No. 11-13661, at 19 (Fla. Cir. Ct. Aug. 13, 2014). In other words, the court concluded that injured workers were giving up their rights to common law benefits but not getting adequate benefits in return. This decision is currently on appeal.

93. One notable exception is for a volunteer firefighter who, if injured working as a volunteer firefighter, is treated as if the firefighter were a State employee with compensation based on that firefighter's "wage received in regular employment." DEL. CODE ANN. tit. 19, § 2312. There are also special provisions for an employee who is in the "joint service" of two or more employers. *See* DEL. CODE ANN. tit. 19, § 2354(a). In such cases, the joint employers contribute to the employee's compensation in proportion to their wage liability to such employee, regardless of for whom the employee was actually working at the time of injury. *Id.* However, an employee is only deemed to be under "joint service" when the employee is (a) under the simultaneous control of both employers, (b) performs services simultaneously for both employers, and (c) the services performed for each are the same or closely related. *See* *A. Mazzetti & Sons, Inc. v. Ruffin*, 437 A.2d 1120, 1123 (Del. 1981). If an employee is under contract with two employers but (a) the employers act independently of each other, (b) a specific portion of the work time is separately allocated to each employer, (c) the services performed for each employer are clearly separable and independent, and (d) the employee does not perform simultaneously for both employers, then that is not "joint service" but is, rather "dual" or "concurrent" employment. *Id.* at 1123-24.

94. Compensation for an injury, such as for total disability, is based on a percentage of the injured employee's average weekly wage. *See* DEL. CODE ANN. tit. 19, § 2324. The term "average weekly wage" is defined in the Act to mean "the weekly wage earned by the employee at the time of the employee's injury *at the job in which the employee was injured*." DEL. CODE ANN. TIT. 19, § 2302(A) (EMPHASIS ADDED).

95. *See* *Howard v. Peninsula United Methodist Homes, Inc.*, No. 03A-04-002RRC, 1996 WL 30250 (Del. Super. Nov. 17, 2003) (citing *Peterman v. L.D. Caulk*, Nos. 72, 1992, 82, 1992, 1992 WL 219072 (Del. Aug. 19, 1992)).

been making (from both jobs) \$1,250 per week.⁹⁶ While this may seem unfair or harsh, it follows from the central point: that the only benefits available to an injured worker are those provided for in the Act.⁹⁷

IV. SECOND PURPOSE OF THE ACT

The second of the twin purposes of the Act—to “relieve employers and employees of the expenses and uncertainties of civil litigation”—is just as important as the first.⁹⁸ Both parties gain from this second purpose, which has two related parts: cost saving and certainty.

A. Cost Savings

As compared to personal injury litigation in Superior Court, the litigation cost savings before and during a Board hearing are substantial. Formal pleadings are not required, which saves the expense of preparing a formal complaint or formal answer to a complaint.⁹⁹ While expert witness depositions may be taken to obtain testimony to be used at a hearing, “in lieu of personal appearance before the Board,” the use and expense of “discovery depositions” is not provided for in the *Board Rules*.¹⁰⁰ The primary discovery method contemplated by the *Board Rules* is the Request for Production.¹⁰¹

96. See DEL. CODE ANN. tit. 19, § 2324, providing that compensation for total disability is paid at 66 2/3% (or two-thirds) of the injured employee’s wages. The Act further provides that compensation cannot exceed two-thirds of the statewide “average weekly wage” that is announced on an annual basis by the Secretary of the Department of Labor (the “DOL rate”). *Id.* On the other hand, a minimum compensation rate is set at 22 2/9% of that DOL rate. *Id.* If an injured employee’s weekly wage at the time of injury was less than 22 2/9% of the DOL rate, then the employee receives the employee’s full amount of wages as compensation. *Id.*

97. While it may seem harsh to the injured part-time worker who loses both the employee’s part-time and full-time wage because of an injury at the part-time job, it would be a bizarre result indeed if a part-time employer had to pay an injured worker a higher weekly wage when injured than that employee would have received if healthy and working. It is “unrealistic to turn a part-time able-bodied worker into a full-time disabled worker.” *Spicer v. State*, No. 91A-03-3, 1991 WL 190334, *2 (Del. Super. Aug. 23, 1991). In any event, as a practical matter it should be remembered that the part-time employer’s insurance rates were likely calculated based on the actual wages paid to that employer’s employees. It would be equally unfair (and financially crippling) for a small part-time employer to have to pay insurance premiums that are based on what some other full-time employer might be paying its employees. Nobody benefits if workers’ compensation premiums are so high as to drive an employer out of business. As such, the Act intentionally limits benefits based on the wages that the employer was actually paying the injured worker.

98. *New Castle County v. Goodman*, 461 A.2d 1012, 1014 (Del. 1983).

99. See *Rules of the Industrial Accident Board for the State of Delaware* (“*Board Rules*”), Rule 6. The Board Rules are available at <http://dia.delawareworks.com/workers-comp/documents/Rules%20of%20the%20Industrial%20Accident%20Board.pdf>. Rule 6(A) states:

No formal pleading or formal statement of claim or formal answer shall be required of any party to any action before the Board. However, each person making written request for a hearing shall file with the Department on forms to be promulgated by the Department ... a statement giving substantially the information requested on said forms.

100. See *Board Rules*, Rule 10 (“Depositions Upon Oral Examination”). Rule 10(C) states, “The taking of fact witness depositions may not proceed without Board approval.” *Id.*

101. See *Board Rules*, Rule 11 (“Requests for the Production and Inspection of Documents And Other Evidence; Healthcare Authorizations And Copying or Photocopying”).

In general, the parties are relieved of the expense of preparing and responding to burdensome interrogatories. In most cases, the Board even makes the pre-trial conference cost effective by allowing the scheduling conferences to be done telephonically or by e-mail, while the pre-trial memorandum can be prepared without the need for the attorneys to appear at the Department of Labor.¹⁰²

Flexibility in the application of the rules of evidence also reduces the costs of litigation for the Board hearing itself. The Board is permitted to consider such evidence “which, in its opinion, possesses any probative value commonly accepted by reasonably prudent persons in the conduct of their affairs.”¹⁰³ By allowing flexibility in applying the customary rules of evidence, such as with regard to hearsay testimony, the Board also saves the parties the time and expense of procuring witnesses to testify on the sort of tangential matters for which the Board customarily accepts hearsay testimony.¹⁰⁴ For example, the Board may properly consider information contained in medical records prepared by medical personnel and referenced in the testimony of other medical experts appearing before the Board. It has been held that the Board may properly conclude that such evidence has probative value that “reasonably prudent persons” would accept. Indeed, doctors normally do rely on such records supplied to them by hospitals or other doctors when treating a patient.¹⁰⁵ Thus, the parties do not need to go through the cost of bringing in to the case every medical expert who prepared a relevant medical record.

However flexible the rules of evidence, the Board must still conduct a fair hearing.¹⁰⁶ Trial by surprise is not favored in Delaware and is not endorsed by the Board. Litigants are required to deal fairly with each other and not engage in “unhandsome dealing.”¹⁰⁷ In litigation before the Board, each side must be given a fair opportunity to question the factual reliability of evidence presented. In exercising its flexibility in these matters, the Board recognizes that fundamental principles of justice, such as due process, need to be observed.¹⁰⁸ Thus, while parties are spared the expenses that attach

102. See *Board Rules*, Rule 9 (“Pre-Trial Scheduling Conference and Pre-Trial Memorandum”).

103. *Board Rules*, Rule 14(C). In full, Rule 14(C) states:

The rules of evidence applicable to the Superior Court of the State of Delaware shall be followed insofar as practicable; however, that evidence will be considered by the Board which, in its opinion, possesses any probative value commonly accepted by reasonably prudent persons in the conduct of their affairs. The Board may, in its discretion, disregard any customary rules of evidence and legal procedures so long as such a disregard does not amount to an abuse of its discretion.

104. See *id.*; *Thomas v. Christiana Excavating Co.*, No. 94A-03-009, 1994 WL 750325, *5-, his per. 1994 WL 750325, *5-e? If not, pleasarch to make them all consistent.6 (November 15, 1994), *aff’d sub nom.* *Thoma v. Christiana Excavating Co.*, 655 A.2d 309 (Del. 1995) (“Indeed, administrative boards ought not to be constrained by the rigid evidentiary rules which govern jury trial. On the contrary, all evidence which could conceivably throw light on the controversy should be heard.”) (citation omitted).

105. See *id.* at *5-6.

106. See DEL. CODE ANN. tit. 19, § 2301A(i), which states (with emphasis added):

The Board shall have jurisdiction over cases arising under Part II of [Title 19] and shall hear disputes as to compensation to be paid under Part II of [Title 19]. The Board may promulgate its own rules of procedure for carrying out its duties consistent with Part II of [Title 19] and the provisions of the Administrative Procedures Act [§ 10101 et seq. of Title 29]. Such rules shall be for the purpose of securing the just, speedy and inexpensive determination of every petition pursuant to Part II of [Title 19]. *The rules shall not abridge, enlarge or modify any substantive right of any party and they shall preserve the rights of parties* as declared by Part II of [Title 19].

107. See *Delaware Home & Hospital v. Martin*, No. K11A-07-001RBV, 2012 WL 1414083, at *2 (Del. Super. February 21, 2012).

108. See *General Chemical Div., Allied Chemical & Dye Corp. v. Fasano*, 94 A.2d 600, 601 (Del. Super. 1953).

to more formal litigation, this comes with an associated duty on the part of the litigants to deal fairly and above-board with each other.

B. Reducing Uncertainty

In addition to cost savings, the Act's second mutual benefit is avoiding the "uncertainties of litigation." There is a great benefit to all parties in having matters considered by an experienced administrative board rather than by an untrained jury. The United States Supreme Court recognized this benefit of administrative proceedings in connection with the Social Security Act:

There emerges an emphasis upon the informal, rather than the formal. This, we think, is as it should be, for this administrative procedure, and these hearings, should be understandable to the layman claimant, should not necessarily be stiff and comfortable only for the trained attorney, be liberal and not strict in tone and operation. This is the obvious intent of Congress so long as the procedures are fundamentally fair.¹⁰⁹

The reason this approach works is that an administrative board necessarily develops experience and skill within its sphere of operation:

[A]dministrative boards have been developed to allow individuals who have expertise and knowledge in the board's unique area of jurisdiction to initially attempt to resolve disputes. This unique setting is different than a courtroom where jurors, who are usually not trained in the area, need to be educated on the basic grounds of the litigation.¹¹⁰

Having such expertise and knowledge allows the Board to give more predictable results than could be obtained from a less trained jury such as would be faced in tort actions. This leads to greater certainty as to the application of the statutes of the Act and the regulations promulgated by the Board. When the parties have greater certainty as to the consistent application of the provisions of the Act and the regulations, it is easier for them to reach agreement as to the application of the law to their set of facts, thereby avoiding the cost of unnecessary litigation.

It is precisely because the Board is experienced in considering matters that arise under the Act that proceedings can be less formal.¹¹¹ For example, the purpose of "the rule against hearsay ... is to keep from an untrained trier of fact material whose reliability is untrustworthy ... [but] the Board, with its background and expertise, is able to evaluate evidence without the restrictions and safeguards imparted by the formal rules of evidence."¹¹²

On appeal, "when factual determinations are at issue," an appellate court "shall take due account of the experience and specialized competence of the agency and of the purposes of the basic law under which the agency has acted."¹¹³ It

109. *Richardson v. Perales*, 402 U.S. 389, 400-01 (1971).

110. *Irish Hunt Farms, Inc. v. Stafford*, 2000 WL 972656, *6 (Del. Super. Apr. 28, 2000).

111. *See Torres v. Allen Family Foods*, 672 A.2d 26, 31 (Del. 1995); *Standard Distributing Co. v. Nally*, 630 A.2d 640, 647 (Del. 1993).

112. *Torres*, 672 A.2d at 31 (citation omitted).

113. DEL. CODE ANN. TIT. 29, § 10142(D).

is, of course, the courts that ultimately determine the proper interpretation or construction of the workers' compensation statutes and regulations.

Statutory interpretation is ultimately the responsibility of the courts. A reviewing court may accord due weight, but not defer, to an agency interpretation of a statute administered by it. A reviewing court will not defer to such an interpretation as correct merely because it is rational or not clearly erroneous.¹¹⁴

Respect should be given, however, to an administrative board's interpretation of its own statutes, regulations, rules and procedures. It is no more anomalous to give such respect and weight to an administrative tribunal's legal rulings than it would be to give respect and weight to the opinion of a medical specialist over that of a general practitioner on a matter within the specialist's field. Administrative tribunals are specialists within their field, dealing with the day-to-day application of the statutes and regulations under their charge. If an administrative board renders an opinion about the application of the law within the scope of its specialization and that opinion is rational and not clearly erroneous, then, while an appellate court certainly is not bound by and need not defer to that interpretation, the court should respect that interpretation and only overturn it with great caution and reluctance.

V. CONCLUSION

This brings us back once again to Larson's point cited at the beginning of this paper: that almost every major error in the development of workers' compensation law can be traced to the importation of concepts from other areas of law. It is only by truly understanding and remembering the guiding policies and purposes underlying workers' compensation that the proper interpretation and application of the Workers' Compensation Act can be achieved.

114. *Public Water Supply Co. v. DiPasquale*, 735 A.2d 378, 382-83 (Del. 1999) (footnotes omitted).

DELAWARE'S FIDUCIARY ACCESS TO DIGITAL ASSETS AND DIGITAL ACCOUNTS ACT

Trisha W. Hall*

On August 12, 2014, Delaware became the first state in the United States to enact comprehensive legislation authorizing personal fiduciaries to have access to the digital assets and accounts of those they serve. As new Chapter 50 to Title 12, the Fiduciary Access to Digital Assets and Digital Accounts Act (the "Act") will make it easier, less time-consuming and less expensive for personal representatives, guardians, trustees, and agents to perform their duties on behalf of estates, disabled persons, trusts, and principals, respectively. As ultimately enacted, the Act is considered to be a version of the Uniform Fiduciary Access to Digital Assets Act passed by The National Conference of Commissioners on Uniform State Laws.¹

BACKGROUND

Since 1997 to 2014, the percentage of households in the United States with access to the Internet grew from approximately 18% to 87%.² Today, 76% of Internet users report going online on a typical day, compared to 29% reporting the same in 2000.³ Along with this growth in the number and frequency of people accessing the Internet has been an exponential growth in the way people use it: corresponding⁴, purchasing⁵, banking and bill paying⁶, socializing⁷, and

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1. See *Fiduciary Access to Digital Assets*, (Dec. 31, 2014), at <http://www.uniformlawcommission.com/Act.aspx?title=Fiduciary%20Access%20to%20Digital%20Assets>.

2. See U.S. Department of Commerce, U.S. Census Bureau, *Computer and Internet Use in the United States*, issued May 2013, available at <http://www.census.gov/prod/2013pubs/p20-569.pdf>. See Fox, Susannah and Lee Raine, *The Web at 25 in the U.S.: Summary of Findings*, Pew Research Internet Project, Feb. 27, 2014 available at <http://www.pewinternet.org/2014/02/27/summary-of-findings-3/>.

3. *Id.*

4. See Molly Wilkens, *Privacy and Security During Life, Access After Death: Are They Mutually Exclusive?*, 62 *Hastings L. J.*, Vol. 1037 at 1055 (2011).

5. See Cooper Smith, *US E-Commerce Growth is Now Far Outpacing Overall Retail Sales*, BUSINESS INSIDER, APR. 2, 2014, AVAILABLE AT [HTTP://WWW.BUSINESSINSIDER.COM/US-E-COMMERCE-GROWTH-IS-NOW-FAR-OUTPACING-OVERALL-RETAIL-SALES-2014-4](http://www.businessinsider.com/us-e-commerce-growth-is-now-far-outpacing-overall-retail-sales-2014-4).

6. See Andrea McKenna, *More Consumers Embracing Online Banking, Bill Pay*, AMERICAN BANKER, JUNE, 2010, AVAILABLE AT [HTTP://WWW.AMERICANBANKER.COM/BULLETINS/-1020520-1.HTML](http://www.americanbanker.com/bulletins/-1020520-1.html).

7. Duggan, Maeve and Aaron Smith, *Social Media Update 2013*, Pew Research Internet Project, Dec. 30, 2013, available at <http://www.pewinternet.org/2013/12/30/social-media-update-2013/>.

listening to music⁸ are just a few of the personal pursuits people now conduct online, in many cases, more than or instead of in their traditional forms. In fact, these trends will continue in ways we are only now beginning to use or imagine. A survey of technology experts conducted in 2014 found that the majority believe that the use of embedded and wearable devices will be widespread by 2025 and will possibly include “subcutaneous sensors or chips [to] provide patients’ real-time vital signs to self-trackers and medical providers” and “remote control apps [to] allow users’ phones to monitor and adjust household activities”.⁹

Beginning in 2005, estate planning attorneys slowly began taking note of the impact this growing trend in internet usage could have in an estate administration with the reports of a legal battle fought by a father for access to his deceased son’s email account. John Ellsworth sought the emails his son Justin kept in his Yahoo!, Inc. (“Yahoo”) account to make copies for a scrapbook documenting Justin’s service as a Marine serving in Iraq. Because Mr. Ellsworth did not know and was unable to guess the password to Justin’s email account, he requested such access from Yahoo which it denied. Yahoo’s terms of service agreement required deletion of the account after 120 days of inactivity.¹⁰ After taking the issue to court, a probate judge for Oakland County, Michigan granted an order requiring Yahoo to provide Mr. Ellsworth access. After the court’s order, Yahoo “gave the family a CD containing more than 10,000 pages” of emails sent to Justin, but nothing he had written. It was reported that Yahoo intended to provide paper copies of the remaining emails sent by Justin.¹¹

Generally, fiduciaries are responsible for managing the affairs of a disabled person or decedent’s estate. This entails identifying, gathering and maintaining assets for the benefit of the disabled person, or for distribution to an estate’s creditors and beneficiaries. To carry out their responsibilities, fiduciaries are typically authorized by state law, federal law, or governing instruments to buy and sell property, enter into binding contracts, make gifts of property, sign income tax returns, review medical information, collect income, pay expenses, and so forth. The work of a fiduciary necessarily entails access to personal, private and sensitive information. Without this access, the critical work of a fiduciary would not get done.

Fiduciaries carry out their responsibilities subject to duties to those they serve, including the duties of impartiality, loyalty and care.^{12, 13} Failing to locate, gather or protect the assets of a disabled person or an estate may subject a fiduciary to liability for breach of duty. Further, after a fiduciary has gained control over an asset, they must manage that asset for the benefit of the person served.

8. *Digital Music Review in the United States from 2008 to 2013, by type (in million U.S. Dollars)* at <http://www.statista.com/statistics/186710/digital-music-revenue-in-the-us-since-2008/>.

9. See Anderson, Janna and Lee Rainie, *The Internet of Things Will Thrive by 2025*, Pew Research Internet Project, May 14, 2014, at <http://www.pewinternet.org/2014/05/14/internet-of-things/>.

10. See *Yahoo to Preserve E-mail of Marine Killed in Iraq*, USA TODAY, MAR. 1, 2005, AVAILABLE AT [HTTP://USATODAY30.USATODAY.COM/TECH/NEWS/2005-03-01-YAHOO-EMAIL-SAVE_X.HTM](http://USATODAY30.USATODAY.COM/TECH/NEWS/2005-03-01-YAHOO-EMAIL-SAVE_X.HTM)).

11. See *Yahoo Gives Dead Marine’s Family Email Info*, Associated Press, Apr. 21, 2005, available at http://www.nbcnews.com/id/7581686/ns/world_news-mideast_n_africa/t/yahoo-gives-dead-marines-family-e-mail-info/#.VKMthivF_4Y.

12. See *Law v. Law*, C.A. No. 14352 (Del. Ch. Sept. 30, 1997), *aff’d in part and rev’d in part*, 753 A.2d 443 (Del. 2000); *Nash v. Schock*, 732 A.2d 217 (Del. 1999); *Stegemeier v. Magness*, 728 A.2d 557 (Del. 1999).

13. See also DEL. CODE ANN. TIT. 12 DEL. C. § 1509 (every personal representative shall take and subscribe an oath to perform its duties with fidelity); DEL. CODE ANN. TIT. 12 DEL. C. § 49A-105(c) (an agent under a personal power of attorney may not act unless and until she has executed a certification acknowledging to act in the principal’s best interest, in good faith, and only as authorized).

Because an increasing number of people are shifting more of the content of their lives online from the traditional tangible realm, fiduciaries may face a host of potential issues involving access to a person's online assets and accounts. These issues will likely become more commonplace and also more burdensome. Some of the issues that could be encountered by a fiduciary are:

Ensuring privacy. Without the Act, it is up to the discretion of technology companies whether and to what extent a fiduciary will have access to a decedent or disabled person's account. Often, this access is denied and the account may be left open or memorialized. This will result in information about a deceased or disabled person remaining in cyberspace to be accessed by third parties and continuing to be used by technology companies for profit.

Valuing and collecting assets. In some cases, an asset may only exist digitally (e.g., Bitcoin, video or audio files, photographs) or may only be accessed through digital means (e.g., emailed account statements). Without the Act, an agent or guardian for a disabled person may not be able to discover or obtain the use of an asset for the benefit of a disabled person, and a personal representative of an estate may not be able to discover or liquidate an asset for distribution to the beneficiaries and creditors of an estate.

Securing property. Fraud and theft routinely occur online. Without the ability to access and monitor a disabled person's accounts or close the accounts of a deceased person, property will be at risk to hackers and fraudsters.

Protecting people. Disabled persons are often more vulnerable to the influence of others. The ability of an agent under a power of attorney or guardian to be able to close or monitor social media and email accounts may prevent luring or other instances of taking advantage.

Many estate planning attorneys have attempted to account for the trends in Internet usage and the possible need for a fiduciary to access a person's online presence when drafting estate planning documents by including a specific authorization for a fiduciary to access and control a person's digital assets and accounts. This is only helpful, however, for the minority of adults who have basic estate planning documents in place¹⁴

The need for state legislation in this area is primarily driven by the fact that the federal law regulating access to online accounts is not clear about fiduciary access. The Electronic Communications Privacy Act / Stored Communications Act (the "ECPA/SCA") was enacted in 1986 to address government access to private information stored online and to prevent hacking.¹⁵ Because this law was enacted at a time when email was in its infancy and used primarily by businesses for business purposes, and social media and cloud computing did not yet exist, it was not written with the extensive personal use of online technologies in mind. Therefore, it does not contain the clear authorizations to fiduciary access that other federal laws do.¹⁶ Further, each state has laws criminalizing unauthorized access to a computer system or network¹⁷

14. See *In a New Era of Estate Planning Rocket Lawyer Survey Shows that Only Half of Adults Have a Will*, Rocket Lawyer News, Mar. 28, 2012, available at <https://www.rocketlawyer.com/news/article-Make-a-Will-Month-2012.aspx>.

15. 18 U.S.C. § 2701, et. seq. "The purpose of the legislation is to amend title 18 of the United States Code to prohibit the interception of certain electronic communications; to provide procedures for interception of electronic communications by federal law enforcement officers; to provide procedures for access to communications records by federal law enforcement officers; to provide procedures for federal law enforcement access to electronically stored communications; and to ease certain procedural requirements for interception of wire communications by federal law enforcement officers." House Report 99-647 (1986).

16. For example, bank records (15 U.S.C. §§ 6801 and 6802); medical records (45 C.F.R. §§ 164.502(a) and 164.510(b)); tax records (26 U.S.C. § 6103(c) and (e)(2) and (3)); other records, including mail (5 U.S. Code § 552a(b) and (h)).

17. See, e.g., DEL. CODE ANN. TIT. 11 DEL. C. § 932.

Because of the lack of clarity at the federal level, technology companies largely have been able to write their own rules for fiduciary access, if any.¹⁸ Through end user license agreements, these companies establish their own requirements for granting access to fiduciaries or other third parties, resulting in a patchwork of such requirements fiduciaries are obligated to meet before a technology company even considers granting access. The decision whether to grant access to a fiduciary, and if so, to what extent, is entirely in the discretion of the technology companies.

This means that, absent a state law or governing instrument that authorizes a fiduciary to have access to a digital asset or account, fiduciaries may be in breach of their duties to the disabled person or beneficiaries of an estate if they do not access an account, but if they do access an account, may be violating an agreement with the service provider or state and federal law restricting access. In fact, many fiduciaries have no doubt unknowingly violated these rules by accessing the digital assets or accounts of a disabled or deceased person without that person's express authorization by discovering or guessing login and password information.

Some states have passed or introduced legislation to authorize fiduciaries access to online accounts, but all are severally limited. Either the legislation only authorizes personal representatives to the exclusion of other types of fiduciaries¹⁹, or it only permits access to social media and email accounts, or both²⁰. Rhode Island's law only grants access to personal representatives of estates over email accounts, and then only with an order of the probate court.²¹ The Act is now the only state law comprehensive in terms of both the types of fiduciaries authorized and the types of digital assets and digital accounts covered.

THE ACT

The ECPA/SCA prohibits providers of "electronic communication service" and "remote computing service" from disclosing the contents or record of electronic communications to third parties with certain exceptions.²² These exceptions include disclosure to the addressee or recipient of a communication or his or her agent and with the lawful consent of the originator or addressee or recipient of such communication.²³ The Act is drafted to fall directly within these exceptions. In addition, no federal court that has examined the issue has held that the ECPA/SCA was intended to completely preempt state law.²⁴ In fact, the civil liability section of the ECPA/SCA includes as a defense a good faith reliance of a provider on "a legislative authorization, or a statutory authorization" without any indication that this was to be restricted to federal law.²⁵

18. See, e.g., Facebook will memorialize the account of a deceased person upon notice, meaning that people may continue to post to the account, but no posts or messages can emanate from the account. Facebook will not allow third parties to access any account for any reason. An account may be deleted after proof of death and authority of the person requesting deletion, in its discretion. <https://www.facebook.com/help/359046244166395/>. Yahoo provides "*No Right of Survivorship and Non-Transferability*. You agree that your Yahoo account is non-transferable and any rights to your Yahoo ID or contents within your account terminate upon your death. Upon receipt of a copy of a death certificate, your account may be terminated and all contents therein permanently deleted." <https://info.yahoo.com/legal/us/yahoo/utos/en-us/>.

19. See Louisiana S.B. 461 became Act No. 758 and Indiana Code § 29-1-13-1.1.

20. See Oklahoma § 58-269; Idaho Code §§ 15-5-424 and 15-3-715; and Conn. St. § 45a-334a.

21. R.I. Code §§ 33-27-1 – 33-27-5.

22. See 18 U.S.C. § 2702(a).

23. See 18 U.S.C. § 2702(b).

24. See *Sheppard v. Google, Inc.*, 2012 WL 6086867 (W.D. Ark. Dec. 6, 2012).

25. See 18 U.S.C. § 2702(e).

The Act authorizes fiduciaries to have access to the digital assets or digital accounts of the person, trust or estate they are entrusted to serve.²⁶ An individual may opt out of the Act by not including a specific authorization for an agent to have access to digital assets and accounts,²⁷ or by denying such access in a will or trust.²⁸ In a guardianship proceeding, a court may limit the powers of the guardian to prevent access to digital assets or accounts.²⁹ The Act requires that a fiduciary provide the same proof of authority to act and to gain access to digital assets and digital accounts that is required to act with respect to bank accounts, taxes, medical information, etc.³⁰

Section 5002 sets forth several definitions key to the Act. First, an “account holder” includes a decedent, a disabled person under the guardianship provisions of Title 12 Chapter 39, a principal of a personal power of attorney under Title 12 Chapter 49A, the settlor of a revocable trust, or a trust itself. The definitions of “digital asset”, “digital account” and “digital device” are broad and although they include specific examples of each (email accounts, social media accounts, computer source codes, software, laptop, tablet), they cover those “which currently exist or may exist as technology develops or such comparable items as technology develops.” This was in recognition of the relative speed at which technology develops compared to the rate at which the law changes. Further, “digital asset” explicitly excludes an “underlying asset or liability that is governed under other provisions of this title”, taking traditional bank accounts, life insurance policies and similar assets out of the purview of the Act. The term “fiduciary” extends to personal representatives (which itself includes executors, administrators, and others³¹), guardian, agent under a personal power of attorney, a trustee, or an adviser under 12 *Del. C.* § 3313.

The Act grants a broad power over the digital assets and digital accounts of an account holder that may be restricted or limited in a governing instrument or court order.³² It excludes the digital assets and digital accounts of an employer used by an employee or contractor for business purposes.³³ A fiduciary cannot be authorized beyond what the account holder him or herself could do under state or federal law, including copyright law.³⁴ The Act does not, therefore, grant rights of inheritance to digital assets or digital accounts where none would otherwise exist.

To fall within the exception to ECPA/SCA and to address Delaware’s criminal statute regarding unauthorized access to computer systems, the Act deems a fiduciary to have the lawful consent of an account holder to access a digital account or digital asset and to be an authorized agent or user under state and federal laws and end user license agreements.³⁵

26. DEL. CODE ANN. TIT. 12, § 5003.

27. DEL. CODE ANN. TIT. 12, § 5005(c)(3) AND 12, § 49A-201(B)(8).

28. DEL. CODE ANN. TIT. 12, § 5004.

29. DEL. CODE ANN. TIT. 12, § 5005(c)(2) AND 12, § 3923(d)(14).

30. DEL. CODE ANN. TIT. 12, § 5005(c).

31. DEL. CODE ANN. TIT. 12, § 101(6).

32. DEL. CODE ANN. TIT. 12, §§ 5003 AND 5004(A).

33. DEL. CODE ANN. TIT. 12, § 5003.

34. DEL. CODE ANN. TIT. 12, § 5004(A).

35. DEL. CODE ANN. TIT. 12, § 5005(A).

To further satisfy the requirements of the ECPA/SCA, the Act includes specific authorization to disclose to a fiduciary the “content of an electronic communication” if the custodian would be permitted to disclose such under the ECPA/SCA and the “catalogue of electronic communications”.³⁶ The content and the catalogue of electronic communications are defined in the Act³⁷, and are intended to track the permitted disclosure provisions of the ECPA/SCA itself.³⁸

To gain access to a digital asset or digital account, a fiduciary must present to a custodian a “valid written request” accompanied by evidence of their authority to act on behalf of the disabled person or estate, for example, letters testamentary, guardianship order or personal power of attorney.³⁹ Following receipt of a valid written request, a custodian has sixty days to comply unless the custodian would not be required to respond to a similar request made by the account holder, would be a violation of state or federal law, or when it has actual knowledge that the fiduciary does not have the authority to access the account or asset.⁴⁰ Failure to comply could result in a court order requiring the custodian to provide the requested access and liability for damages, including attorney’s fees and costs incurred in confirming a fiduciary’s authority or compelling access.⁴¹ Including a provision for attorney’s fees and costs to be paid as damages should allow fiduciaries of even modest estates the ability to force a custodian to permit the fiduciary access when authorized and in compliance with the Act, thus putting proverbial teeth on such a request.

To balance technology companies’ genuine interests in users’ privacy and their own legal rights as found in their end user license agreements with the needs of fiduciaries and the interest of the State in fiduciary affairs, the Act renders void any provision of an end user license agreement that attempts to restrict or limit a fiduciary’s otherwise valid authority to access a digital asset or digital account.⁴² However, an agreement between an account holder and a custodian regarding fiduciary access will be honored if it is separate from an end user license agreement.⁴³

CONCLUSION

The Act provides some certainty to fiduciaries of disabled persons, estates and trusts who are faced with a conflict between their duties to those they serve and a lack of legal clarity regarding the extent of their authority over digital assets and digital accounts. Technologies will only continue to develop and people’s reliance on technologies will surely increase

36. DEL. CODE ANN. TIT. 12, § 5005(B)(1) AND (2).

37. DEL. CODE ANN. TIT. 12, § 5002(2) AND (3).

38. DEL. CODE ANN. TIT. 18, § 2510 AND 2702.

39. DEL. CODE ANN. TIT. 12, § 5005(C).

40. DEL. CODE ANN. TIT. 12, §§ 5005(D) AND 5006(B).

41. DEL. CODE ANN. TIT. 12, § 5006(E).

42. DEL. CODE ANN. TIT. 12, § 5004(B).

43. *Id.* For an example of such an agreement, see Google’s Inactive Account Manager service at <https://support.google.com/accounts/answer/3036546?hl=en>.

as a result. Therefore, these conflicts would continue to mount, possibility burdening our court system, in the absence of legislation. The Act seeks to prevent fiduciaries from having to face legal battles to gain access to assets and accounts that they would have clear authority to access if they were not online. In the matter of digital assets and digital accounts, David now has a larger stone to use against Goliath⁴⁴ — at least in Delaware.

44. *See Samuel 1:17.*

RECENT DEVELOPMENTS IN CRIMINAL LAW: 2014 DELAWARE SUPREME COURT DECISIONS

Michael F. McTaggart*

In 2014, the Delaware Supreme Court issued a number of decisions that covered a wide variety of criminal law issues. This article briefly summarizes some of those evidentiary decisions and decisions in areas of significance. Readers are directed to the Court's opinions for the complete statement of the facts and legal analysis of the Court.

I. EVIDENCE DECISIONS

A. Proof Of Bad Acts By Third Party To Support Misidentification Defense-*Norwood V. State*

In *Norwood v. State*¹, Defendant Norwood was tried for a robbery at a Family Dollar store in Dover on September 4, 2012. At trial, Norwood claimed that he was not one of the three men who committed the crime, but instead that the perpetrator was someone who had been involved in prior robberies of the store.² The Court held that a defendant could offer "reverse 404(b) evidence" about another person to support his defense of misidentification.³

Within two weeks before Norwood's alleged crime, thieves robbed or attempted to rob the store twice. On August 18, at around 9:00 p.m., two men wearing masks over their faces, armed with a handgun and a large knife, obtained \$1,451.11 from the register. On August 27, just before 9 p.m., a 5'3" tall, thin man wearing a handkerchief over his face, waving a handgun, tried to get into the store, but failed because the clerks had locked the door early, and refused to open it.⁴

Norwood's alleged crime occurred on September 4th, just before 7 p.m. This time, three men entered the store. One man wore a mask on his face and held a gun. A second man wore a green shirt and camouflage shorts. The third man wore a black ski mask. The robbers took money, cigarettes, and cigars from the store.

On hearing a dispatch about the robbery, an officer responded to a nearby path. He observed three or four men on the path, one of which had on a green shirt and camouflage shorts. That man ran, however, the officer was able to arrest Norwood. As Norwood was getting down on the ground, he threw away a black ski mask, which police recovered. They also found a black long sleeve t-shirt along the path. Police returned to the store with Norwood, and a store employee identified the ski mask Norwood had as the one used in the robbery.

During the trial, Norwood attempted to offer evidence that the third man involved in the September 4th robbery was Khalil Dixon. The other two suspects in the September robbery had implicated Dixon as being their accomplice in the earlier August 18, 2012 robbery of the same store. Dixon's physical build more closely matched the description of the third

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1. 95 A.3d 588 (Del. 2014).

2. *Id.* at 590-91.

3. *Id.* at 598-99.

4. *Id.* at 591.

man, whom store employees described as being between 5'4" and 5'8," while Norwood was closer to 5'11". Norwood was also wearing a white tank top when arrested, while the third man was wearing a dark short sleeve shirt during the robbery. Norwood argued that the evidence of Dixon's involvement in the August 18, 2012 and August 27, 2012 was relevant to prove that Dixon committed the robbery on September 4, 2012. The Superior Court sustained the State's objection to this evidence, and Norwood was convicted.⁵

On appeal, the Delaware Supreme Court found that the use of the reverse 404(b) evidence to prove identity is a proper purpose under the Rule.⁶ The Court addressed how similar the prior crimes must be to the crimes in question, and noted a split among courts regarding whether a defendant offering reverse 404(b) evidence must meet the same strict test for admissibility under the Rule or a lower standard of similarity.⁷ In considering this question of first impression, the Court adopted the position of the Second and Third Circuits which applied a reduced standard for admissibility, "because prejudice to the defendant is not a factor."⁸ The Supreme Court stated that:

in a situation involving so-called reverse 404(b) evidence, the trial judge should examine: (1) whether the evidence is being offered for a purpose permitted by Rule 404(b); (2) whether the evidence is relevant under Rule 402; and (3) any argument by a party that the probative value of the evidence is substantially outweighed by potential prejudice, undue delay, or confusion of the issue under Rule 403.⁹

The Court further held that unless there is a specific request, no limiting instruction is needed.¹⁰

Applying this test to the evidence proffered by Norwood, the Court ruled that the evidence of the other robbery and attempted robbery was probative to the defense of misidentification.¹¹ The robberies were unusually similar and the evidence was highly probative and material to the defense raised by Norwood. Under Rule 403, there was no risk of unfair prejudice to Norwood as he was the one seeking to introduce the evidence and there was no serious risk of delay or confusion to the jury. The Court concluded that the evidence should have been admitted at trial, reversed the conviction, and remanded for a new trial.¹²

5. *Id.* at 591-92.

6. 95 A.3d at 595.

7. 95 A.3d at 596 (*comparing* United States v. Stevens, 935 F.2d 1380, 1404-05 (3d Cir. 1991) and United States v. Aboumoussallem, 726 F.2d 906, 911 (2d Cir. 1984) ("We believe the standard of admissibility when a criminal defendant offers similar acts evidence as a shield need not be as restrictive as when a prosecutor uses such evidence as a sword.") *with* United States v. Lucas, 357 F.3d 599 (6th Cir. 2004)); Agushi v. Duerr, 196 F.3d 754 (7th Cir. 1999).

8. 95 A.3d at 596-7 (quoting United States v. Stevens, 935 F.2d 1380, 1404-05 (3d Cir. 1991)).

9. *Id.* at 598.

10. *Id.*

11. *Id.* at 598-99 (citing *Kiser v. State*, 769 A.2d 736, 740 (Del. 2001)).

12. *Id.* at 600.

B. Unrelated Bad Acts Evidence Of Victim Of Domestic Assault-*Banks V. State*

In *Banks v. State*,¹³ the Delaware Supreme Court denied a defendant's attempt to introduce prior bad acts by the victim of a domestic assault, finding that alleged statements made by the victim to others did not show any bias or motive to testify falsely.¹⁴

The defendant Banks was involved in a romantic relationship with the victim Saunders for about a year.¹⁵ Banks returned from a weekend trip out of state, and Saunders confronted him about alleged infidelities. During the conversation, Banks became agitated and pointed his finger in Saunders' face in a threatening manner. When Saunders told Banks to leave immediately, he then threatened her with a knife, and then punched her in the forehead multiple times. Saunders' son came into the room and screamed at Banks, who then pushed the boy and exited the house. Saunders suffered injuries to her lip, forehead, the back of her neck, and the loss of hair from the left side of her head.¹⁶

At trial, Banks claimed that he only pushed Saunders against a door or wall in self-defense.¹⁷ Banks sought to introduce evidence that Saunders had several threatening conversations regarding Banks, both before and after the incident at issue.¹⁸ First, the defense sought to introduce evidence that, one month prior to the incident, Saunders had a conversation with Marjorie Westcott, during which Saunders purportedly said that she had access to Banks' Facebook password, email and photographs. Second, the defense moved to admit an alleged statement that Saunders made to Shalontay Fewes one month prior to the incident, in which Saunders threatened her and told her to stay away from Banks. The trial court allowed Fewes to testify to a conversation with Saunders but not to the content of any threats.¹⁹ Finally, the defense also sought to introduce evidence of a conversation that occurred one or two months after the incident, during which Saunders allegedly told Westcott that Banks "was going to get what he deserved or whatever." The trial court excluded that statement.²⁰

Banks was convicted at trial of Assault in the Third Degree, Carrying a Concealed Deadly Weapon, and two counts of Endangering the Welfare of a Child. Banks appealed.²¹

On appeal, the Supreme Court affirmed, ruling that the character evidence pertaining to the victim was properly excluded. The evidence that Saunders had threatened Fewes and told her to stay away from Banks did not support the defendant's claim of proper bias evidence under DRE 608(b).²² The Court reasoned that Saunders' anger toward the other

13. 93 A.2d 643 (Del. 2014).

14. *Id.* at 649-51.

15. *Id.* at 645.

16. *Id.* at 646.

17. *Id.*

18. *Id.* at 647.

19. *Id.* at 647-48.

20. *Id.* at 647-48.

21. *Id.* at 644, 646.

22. *Id.* at 649 (citing *Weber v. State*, 457 A.2d 674 (Del. 1983)).

women on other occasions did not make it more likely that she caused the attack on Banks on the night in question. The evidence was being offered by the defendant for propensity purposes to attempt to prove that Saunders had made threats in the past, and acted in the same manner with regard to Banks. The Court found that the evidence was not admissible under Rule 608(b) to establish that the witness had a motive to testify falsely, as the evidence was not probative of Saunders' bias against Banks or her motive to testify falsely.²³

The Court also rejected defendant's argument that the exclusion of the bad acts evidence violated his Sixth Amendment rights under *Holmes v. South Carolina*²⁴ for two reasons. First, Banks never raised this argument in the trial court, and the Court noted its general practice to decline to address constitutional arguments not raised at trial.²⁵ Second, the claim had no merit because the record demonstrated that Banks was permitted to present evidence in support of his self-defense claim at trial.²⁶

C. Wiretap Evidence—*Ayers V. State*

In *Ayers v. State*,²⁷ the Court held that wiretap statements from police drug investigation were not testimonial under *Crawford v. Washington*,²⁸ and were properly admitted as co-conspirator statements.²⁹

Defendants Ayers and Demby, along with several other defendants, were indicted on a number of drug charges resulting from a multi-agency investigation in Kent County that targeted Galen Brooks, using wiretaps to gather evidence.³⁰ On May 26, 2012, the police heard a conversation between Brooks and Demby which tipped them to a drug sale that would take place at McKee Crossing Shopping Center. The police followed Demby to the shopping center and watched an exchange with defendant Ayers, who drove off and later evaded police. Later calls from Demby to Brooks indicated that the deal had gone well and that Demby was to be rewarded both financially and with a cut of cocaine.³¹ The defendants were convicted of various drug offenses.

On appeal, the defendants, challenged the State's use of the wiretap evidence under several theories. First, the defendants alleged that the wiretap evidence violated their Sixth Amendment confrontation rights. The Court found that the wiretap statements were not testimonial under *Crawford v. Washington*³² or *Jones v. State*.³³ The admission of the

23. *Id.* at 649-50. The Court found the decision in *Weber* was not controlling where the trial judge in that case excluded evidence that prosecution witnesses had received money directly from the murder victim's family and the evidence bore directly on the credibility of the witnesses. *Id.* (citing *Weber*, 457 A.2d at 678-84).

24. 547 U.S. 319, 326 (2006).

25. 93 A.3d at 651 (citing *Turner v. State*, 5 A.3d 612, 615 (Del. 2010); DEL. SUPR. CT. R. 8)).

26. 97 A.3d 1037 (Del. 2014).

27. 97 A.3d 1037 (Del. 2014).

28. 541 U.S. 36 (2004).

29. 97 A.3d at 1040-41.

30. *Id.* at 1038.

31. *Id.* at 1038-39.

32. 541 U.S. 36 (2004).

33. 940 A.2d 1 (Del. 2007). In *Jones*, the Court held that:[A] statement is testimonial and implicates the Confrontation

wiretap statements at trial did not violate the Sixth Amendment because “the declarants obviously did not expect their statements to be used against them, and because the statements were made in furtherance of a conspiracy.”³⁴ The fact that a Special Agent interpreted some of the phrases on the wiretap did not make the statement testimonial. The agent’s testimony was subject to attack during cross-examination and Ayers could have called his own witnesses to challenge the agent’s interpretations.³⁵

Second, the Court rejected the argument that DEL. CONST. ART. I, § 7 required that the defendants have the right to confront each witness “face to face.” The Court had considered and rejected this same argument in *McGriff v. State*,³⁶ noting that a literal reading of “face to face” would virtually eliminate the State’s ability to admit hearsay testimony at trial.³⁷

The Court similarly rejected a challenge to the admission of the wiretap evidence under the co-conspirator exception in DRE 801(d)(2)(e). The State established the conspiracy through *voir dire* testimony regarding the content of the wiretaps, the police surveillance, and circumstantial evidence of the drug transactions. The trial court properly found the existence of a conspiracy based on this evidence by a preponderance of the evidence³⁸

D. Admission Of Public Records—*Ozdemir V. State*

In *Ozdemir v. State*,³⁹ the Court ruled that it was error to admit unredacted Family Court orders in a Superior Court case alleging felony interference with custody, where the orders contained hearsay and inflammatory statements that were not relevant to the elements of the charged offenses.⁴⁰

Ozdemir started a relationship with Douglas Riley in 2005, and the couple had two children.⁴¹ Ozdemir moved from New York to Delaware during their time together. In June, 2009, Ozdemir told Riley that she was going to New York for two weeks with the children. They never returned. In dual New York and Delaware Family Court proceedings, Delaware accepted jurisdiction over custody and awarded Ozdemir sole legal custody and primary residency of the children. Riley was awarded limited visitation rights, and the Family Court held Ozdemir in contempt for failing to bring the children to scheduled visits. A guardian *ad litem* was eventually appointed to represent the children, as Ozdemir refused

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Clause where it is given in non-emergency circumstances and the declarant would recognize that his statements could be used against him in subsequent formal proceedings. By contrast, a casual remark to an acquaintance is a nontestimonial statement. Similarly, ... statements made in furtherance of a conspiracy are nontestimonial. *Id.*

34. 97 A.3d at 1040.

35. *Id.* The agent testified that the phrase “Take three germs and put it on the scizzy” referred to “three grams of cutting material that is added to the cocaine before sale, and that a ‘scizzy’ is a scale.” *Id.*

36. 781 A.2d 534 (Del. 2001).

37. 97 A.3d at 1040-41 (quoting *McGriff*, 781 A.2d at 541-42).

38. *Id.* at 1040 (citing *Harris v. State*, 695 A.2d 34, 42 (Del. 1997); D.R.E. 801(d)(2)(e)).

39. 96 A.3d 672 (Del. 2014).

40. *Id.* at 675-76.

41. *Id.* at 673.

to cooperate with any Family Court orders. In February, 2013, Family Court issued a warrant for Ozdemir's arrest after she failed to appear with her two children. Federal Marshals took Ozdemir into custody and brought her to Delaware, where she was indicted on two counts of felony interference with custody.⁴²

At trial, the State introduced five Family Court orders to establish that Riley was entitled to custody of the children, and that Ozdemir had intentionally interfered with his rights to custody.⁴³ The unredacted orders contained factual findings by the Family Court and the guardian *ad litem* and other statements that were very prejudicial to the defendant. Ozdemir was convicted on both counts.

On appeal, Ozdemir claimed the admission of the Family Court orders was prejudicial error.⁴⁴ The Court first noted that D.R.E. 803(8) does contain an exception for "records, reports, statements, or data compilation in any form" of a public agency recording "activities or matters observed pursuant to duty imposed by law."⁴⁵ The Court found that the orders included double hearsay that was not independently admissible. Examples included hearsay statements of the guardian *ad litem* in the orders. Although the orders were public records, the Court found that the trial court erred in either not excluding them completely or redacting the inadmissible evidence.

Ozdemir also argued, for the first time on appeal, that the orders should have been excluded because they contained irrelevant and inflammatory factual findings. The Court addressed this claim under a plain error standard.⁴⁶ The orders did contain prejudicial statements about Ozdemir's lack of cooperation with the Family Court and general disregard for the judicial system. The Supreme Court found these statements had no probative value and were inflammatory as they were made by a Family Court judge and would carry significant weight.⁴⁷ The Court held that this information in the orders should have been excluded under D.R.E. 403, and reversed Ozdemir's conviction.⁴⁸

II. OTHER SIGNIFICANT DECISIONS

A. Defendant's Outburst In Presence Of Jury-*Copper V. State*

In *Copper v. State*,⁴⁹ the Court held that defendant's outburst during jury selection did not warrant new trial where the outburst was comprised of a single comment, and the trial court gave a timely curative instruction and conducted individual *voir dire*.⁵⁰

42. *Id.* at 674-75.

43. *Id.* at 674.

44. *Id.*

45. *Id.* at 675 (citing D.R.E. 803(8)). The trial court had relied on *Trawick v. State*, 845 A.2d 505 (Del. 2004), but the *Ozdemir* Court found that *Trawick* did not permit the admission of a public record outside the rules of evidence. 96 A.3d at 675.

46. *Id.* at 676 (citing *Bullock v. State*, 775 A.2d 1043, 1046-47 (Del. 2001)).

47. *Id.* at 677.

48. *Id.*.

49. 85 A.3d 689 (Del. 2014).

50. *Id.* at 694-96.

The Wilmington police arrested Copper after observing him discard a gun and baggies of cocaine as he walked down the street.⁵¹ Copper went to trial on a number of drug-related charges. During jury selection, his attorney twice stated that she was content with the jury. Copper disagreed with his lawyer and, in front of the jury, stated that he did not like the jury panel. After the alternates were picked and the sworn jury was leaving the courtroom, the trial judge asked Copper about his issue with the jury. Copper then said that “you can just give me the deal for three years, I’ll sign it now.” The trial judge later denied a defense motion for a mistrial, but did provide a curative instruction to the jury. On the second day of the trial, the trial court conducted individual *voir dire* with all of the jurors about the defendant’s comments and two jurors were excused after stating that they could not fairly decide the case in light of the outburst. The jury found Copper guilty of several drug and weapon offenses.⁵²

On appeal, Copper claimed that the trial judge violated his constitutional right to an impartial jury by denying the motion for a mistrial. The Supreme Court first noted that the trial court does not abuse its discretion in denying a mistrial due to a defendant’s own outburst.⁵³ The Court applied the four factor test of *Taylor v. State*,⁵⁴ namely: “(1) ‘the nature, persistency, and frequency of the witness’s outburst’; (2) ‘whether the witness’s outburst created a likelihood that the jury would be misled or prejudiced’; (3) ‘the closeness of the case’; and (4) ‘the curative or mitigating action taken by the trial judge.’”⁵⁵ On the first factor, the Court noted that the defendant’s outburst was not frequent nor persistent, and occurred only one time prior to the start of the trial.⁵⁶ Second, the Court found the defendant’s comments to be “relatively benign” and did not highlight any particular juror.⁵⁷ The comment about the plea agreement was prejudicial but was cured by the acts of the trial judge. Third, the Court also found that the case was not close as the defendant was “caught red-handed with crack cocaine and a fully-loaded gun.”⁵⁸ Finally, the Court weighed the actions of the trial judge in issuing a timely curative instruction and conducting individual *voir dire* that eliminated any prejudice to the plaintiff.⁵⁹ After analyzing all of the *Taylor* factors, the Supreme Court found that the trial judge did not err in denying the mistrial motion and did not violate the defendant’s right to a fair trial.⁶⁰

51. *Id.* at 690.

52. *Id.* at 690-92.

53. *Id.* at 693 (citing *Alomari v. State*, 1991 WL 22374 (Del. Feb. 14, 1991); *Verdijo v. State*, 1990 WL 109885 (Del. June 29, 1990)).

54. 690 A.2d 933 (Del. 1997).

55. 85 A.3d at 694 (quoting *Taylor*, 690 A.2d at 935).

56. *Id.* at 694.

57. *Id.*

58. *Id.*

59. 85 A.3d at 695-96 (citing *Revel v. State*, 956 A.2d 23, 27 (Del. 2008); *Lynch v. State*, 588 A.2d 1138, 1140 (Del. 1991); *Hughes v. State*, 490 A.2d 1034, 1041 (Del. 1985)).

60. *Id.* at 696.

B. Amendment To DUI Statute Requiring Sentencing As Felony For Third Offense Did Not Violate *Ex Post Facto Clause-Chambers V. State*

In *Chambers v. State*,⁶¹ the Court ruled that defendant could be sentenced as a third offense felon under the current DUI statute, even if the conduct would not have qualified as felonious under the statute as it existed at the time the defendant committed his two prior offenses.⁶²

Chambers had prior DUI convictions in 1989 and 2008. On April 26, 2013, Chambers was arrested again after his blood alcohol test result was more than twice the legal limit.⁶³ The State noticed Chambers for sentencing as a third offense DUI, subject to the felony provisions of 21 *Del. C.* § 4177(d)(3).

Chambers contended that any sentencing under § 4177(d)(3) was barred by the *ex post facto* clause of the United States Constitution. Chambers argued that this section did not go into effect until July 1, 2012, after the date of his two prior offenses. Before that date, enhanced DUI sentencing was governed by 21 *Del. C.* § 4177B(e)(2)(b) which required that the two prior DUIs be within five years of the third offense for the third offense to be sentenced as a felony.⁶⁴

The Supreme Court found that the amendment to section 4177(d)(3) was not “an unconstitutional retrospective criminalization of Chambers’ conduct.”⁶⁵ Relying on United States Supreme Court precedent, the Delaware Supreme Court noted that “[a]n enhanced sentence imposed on a persistent offender ... ‘is not to be viewed as [an] additional penalty for the earlier crimes’ but as a ‘stiffened penalty for the latest crime, which is considered to be an aggravated offense because [it is] a repetitive one.’”⁶⁶ The Court noted that its prior decisions in *Roberts v. State*⁶⁷ and *Felix v. State*⁶⁸ also rejected claims that amendments to enhanced sentencing provisions of the DUI laws violated the *ex post facto* provision.⁶⁹ In both *Roberts* and *Felix*, the defendants had committed their predicate DUI before the passage of the enhanced sentencing statute and both were punished with an enhanced sentence.⁷⁰ The Court noted that the analysis is consistent with other state precedent and found that the enhanced felony sentencing for Chambers did not violate the *ex post facto* clause.⁷¹

61. 93 A.3d 1233 (Del. 2014).

62. *Id.* at 1235-36.

63. *Id.* at 1234.

64. *Id.* at 1234-35.

65. *Id.* at 1235.

66. *Id.* at 1235 (quoting *Monge v. California*, 524 U.S. 721, 728 (1998)).

67. 494 A.2d 156, 157 (Del. 1985).

68. 905 A.2d 746 (Del. 2006).

69. 93 A.3d at 1236.

70. *Id.*

71. *Id.* at 1236 n.13 (citing *State v. Lamb*, 206 P.3d 497 (Idaho 2009); *State v. Stoen*, 596 N.W.2d 504 (Iowa 1999); *City of Norton v. Hurt*, 66 P.3d 870 (Kan. 2003); *State v. Hall*, 648 So.2d 1 (La. Ct. App. 2d Cir. 1994); *State v. Chapman*, 685 A.2d 423 (Me. 1996); *State v. Hansen*, 605 N.W.2d 461 (Neb. 2000); *Com. v. McCoy*, 895 A.2d 18, 34 (Pa. Super. Ct. 2006), *aff’d*, 975 A.2d 586 (Pa. 2009)).

C. Terroristic Threatening Charge Did Not Require Proof That Defendant Intended To Carry Out The Threat-*Lowther V. State*

In *Lowther v. State*,⁷² the Court held that to prove the crime of terroristic threatening, the State only needed to prove that the defendant uttered the threatening words; the State did not have to prove that the defendant intended to carry out the threat.⁷³

Defendant Erin Lowther assaulted both her brother and sister-in-law at their home. She was arrested and transported to the hospital for treatment of reported injuries. During the ride, Lowther told the police officer that if she saw her sister-in-law at the hospital she was going to “F*** kill her,” and repeatedly told the police officer to “go f*** yourself.”⁷⁴ The jury found Lowther guilty of multiple charges, including terroristic threatening. The Superior Court denied Lowther’s motion for judgment of acquittal

On appeal, Lowther claimed there was insufficient evidence to support her conviction for Terroristic Threatening, raising three main arguments. The Court noted the three elements needed for a conviction of Terroristic Threatening under 11 *Del. C.* § 621: “(1) a threat, (2) to commit a crime, (3) likely to result in death or ‘serious injury’ to person or property.”⁷⁵ Lowther first argued that she was handcuffed in the police car when she made the statements and it was impossible for her to have any contact with her sister-in-law or try to kill her. The Court rejected this argument, finding that the defendant does not need to have an intent to carry out the threat in order to be convicted of Terroristic Threatening. Section 621 “punishes mere words, because the statute is meant to protect against the fear threats engender.” As such, the proof needed is the “intent to utter the words and the intent to threaten the victim.”⁷⁶ Lowther’s argument was also contrary to the language of section 621, which makes an ability to carry out the threat immaterial.⁷⁷

Second, Lowther claimed that her statement was not the type that could be penalized under section 621, relying on. Lowther relied on a Pennsylvania’s terroristic threatening statute. The Court found that, unlike Delaware law, the Pennsylvania law specifically exempts “spur-of-the-moment threats.”⁷⁸ The Court concluded there was sufficient evidence from which the jury could infer that Lowther had the subjective intent to threaten her relative.

72. 104 A.3d 840 (Del. 2014).

73. *Id.* at 844-47.

74. *Id.* at 842.

75. *Id.* at 843 (citing *Andrews v. State*, 930 A.2d 846, 853 (Del. 2007)).

76. *Id.* at 844 (citing *Andrews*, 930 A.2d at 852-53)

77. *Id.* at 44 (citing DEL. CODE ANN. TIT. 11, § 621 (A)(1)).

78. *Id.* at 845. The Pennsylvania statute provides: “A person commits the crime of terroristic threats if the person communicates, either directly or indirectly, a threat to: (1) commit any crime of violence with intent to terrorize another.” PA. C.S.A. TIT. 18 § 2706(A)(1). The official comment to the statute provides:

The purpose of [§ 2706] is to impose criminal liability on persons who make threats which seriously impair personal security or public convenience. It is not intended by this section to penalize mere spur-of-the-moment threats which result from anger.

Finally, Lowther argued that the conviction was invalid because there was insufficient evidence to show that she intended to threaten her sister-in-law, because her sister-in-law was not present at the time she made the threat, and there was no evidence that she knew her sister-in-law also was going to the hospital. The Court rejected this argument, finding sufficient intent from the evidence that Lowther likely knew the police officer would tell Lowther's sister-in-law about the threat; and because there was evidence that Lowther was aware that her sister-in-law was being transported to the hospital for treatment of her injuries.⁷⁹ The Court affirmed the Superior Court's decision denying Lowther's motion for judgment of acquittal.⁸⁰

D Leaving The Scene Of Property Damage Accident On Private Property-*Zhurbin V. State*

In *Zhurbin v. State*,⁸¹ the Court held that a driver could be convicted for leaving the scene of a property damage accident even when the accident took place on private property.⁸²

The defendant Zhurbin was asked to leave Delaware Park Casino because of his disorderly conduct.⁸³ The casino security guard did not want Zhurbin to drive because Zhurbin appeared to be intoxicated. Another patron agreed to drive Zhurbin home in his own car. A short time later, however, in the casino's parking lot, another patron saw Zhurbin's car hit median guards and spin into a ditch. That patron followed Zhurbin's car to a local Denny's on Route 273. When police arrived, Zhurbin first denied that the car was his, then later said that his friend was driving. Zhurbin suffered injuries consistent with the accident. Zhurbin was convicted of leaving the scene of an accident and removal of a vehicle from the accident scene.⁸⁴

On appeal, Zhurbin contended that he could not be convicted of leaving the scene of an accident under section 4201 of title 21, since the accident occurred on private property. Zhurbin had not raised this argument at trial and the Supreme Court considered the claim under a plain error standard of review.⁸⁵ Zhurbin argued that section 4201 was modified by section 4101(a) which limits the provisions of title 21 to "the operation of vehicles upon highways except ... [w]here a different place is specifically referred to in a given section." The Court noted that the language of section 4201(a) establishes the duty of a driver in a collision to immediately stop the vehicle when the collision results in property damage or injury, and it is not limited to collisions on public roadways.⁸⁶ The Court found that section 4201, and the language of Chapter 42 generally, supports an interpretation of the statute that "the driver of any vehicle involved in an accident"

79. *Id.* at 844.

80. *Id.* at 845.

81. 104 A.3d 108 (Del. 2014).

82. *Id.* at 113-14.

83. *Id.* at 109.

84. *Id.* at 109-10.

85. *Id.* at 113-14 (citing *Turner v. State*, 5 A.3d 612, 614 (Del. 2010)).

86. *Id.* at 110 (quoting 21 DEL. CODE ANN TIT 21 § 4201(a)).

means any vehicle and is not limited to public highways.⁸⁷ The Court noted that the previous version of section 4201 was amended in 1988 to eliminate language that required the accident “on the public highways” be immediately reported, and that the synopsis to the bill amending the statute stated that drivers of “all accidents” would be required to stop and report property damage accidents.⁸⁸ The Court concluded that the obvious intent of the amendment was to eliminate the requirement that the collision be on a public highway. The Court therefore found that Zhurbin was properly convicted of the leaving the scene charge.⁸⁹

In addition, the Court addressed an error in the jury instructions which added an element to the crime of leaving the scene of an accident. The trial court instructed the jury that to convict the defendant of the charge, the State was required to prove that the defendant was driving on a public roadway. Because the trial court added an element that was not part of the offense, the Supreme Court found the error to be harmless and affirmed the conviction.⁹⁰

In *McKinney v. State*,⁹¹ the Court held that there was no probable cause to issue a search warrant where a tip from a confidential informant (“CI”) was not sufficiently corroborated to prove that existence of criminal activity.⁹²

A CI contacted the police and stated that he had just purchased marijuana from a specific apartment in the Fenwick Park Apartments from a white female with dark hair and blue eyes, wearing sweatpants and a tank top.⁹³ The CI paid \$20 for a gram of marijuana, wrapped in foil. The CI also told the police that he had purchased marijuana at the same apartment on prior occasions from a black male. The assigned officer knew that defendant McKinney, a black male, lived at that address. A Delaware Criminal Justice Information System search confirmed that both McKinney and his girlfriend King lived at the apartment. The CI identified King from a photo lineup as the person who sold her the drugs. Based on this information, the police obtained a search warrant and seized money, a firearm, and drugs including marijuana. After the trial court denied a motion to suppress, the defendant was found guilty of Possession of a Firearm by a Person Prohibited and was sentenced as a habitual offender.⁹⁴

On appeal, McKinney claimed that the warrant lacked probable cause. The Supreme Court relied on *LeGrande v. State*⁹⁵ in which it had ruled that:

An accurate description of a subject’s readily observable location and appearance is of course reliable in this limited sense: It will help the police correctly identify the person whom the tipster means to accuse.

87. *Id.* at 111. The Court noted that § 4201 refers to the duty of a driver to report, as set forth in 21 *Del. C.* § 4203(a). Section 4203(a) addresses reporting provisions for collisions resulting in death or injury to person and provides: (1) When the collision results in injury or death to any person [i.e., when section 4202 applies]; (2) When the collision *occurs on a public highway* and results in property damage to an apparent extent of \$500 or more; or (3) When it appears that any collision involving a driver whose physical ability is impaired as a result of the use of alcohol or drugs or any combination thereof. 21 *Del. C.* § 4203(a) (emphasis added).

88. 104 A.3d at 111. Section 4201 was amended in 1988 by 66 *Del. Laws* 238 § 1 (1988).

89. *Id.* at 113.

90. *Id.* at 114.

91. 107 A.3d 1045 (Del. 2014).

92. *Id.* at 1048-49.

93. *Id.* at 1046-47.

94. *Id.* at 1046-47.

95. 947 A.2d 1103 (Del. 2008).

Such a tip, however, does not show that the tipster has knowledge of concealed criminal activity. *The reasonable suspicion here at issue requires that a tip be reliable in its assertion of illegality, not just in its tendency to identify a determinate person.*⁹⁶

Examining the totality of the circumstances, the Court noted that the police did corroborate the identity of the accused but did not corroborate the CI's knowledge of the criminal activity, i.e., that someone was selling drugs from that apartment.⁹⁷ The affidavit of probable cause also did not state whether the CI was past proven reliable or whether he had contacted police face-to-face.. The Court found no precedent where a tip from a CI without any independent corroboration was sufficient to establish probable cause, and reversed the conviction.⁹⁸

E. Bill Of Particulars-*Luttrell V. State*

In *Luttrell v. State*,⁹⁹ the Court held that defendant on trial for several counts of alleged sexual contact and rape was entitled to a bill of particulars where neither the arrest warrant nor the indictment provided sufficient notice of the charged offenses for which he was on trial.¹⁰⁰

A ten year old reported to his grandmother that Luttrell, a friend of his grandmother, had touched him inappropriately over the weekend of July 14, 2012.¹⁰¹ That weekend the grandmother had allowed Luttrell to sleep on the sofa in her home, while the grandmother and her husband and dog slept in the bedroom with the door open. During his interview at the Child Advocacy Center, the boy stated that he slept on the couch one night when Luttrell came home drunk and unsuccessfully had sexual contact with him, and then forced him to perform oral sex. The boy stated that similar acts occurred on the following night when Luttrell climbed through an open window. On that night, Luttrell reportedly removed the boy's pants and anally penetrated him. When arrested, Luttrell denied any sexual misconduct with the boy, but did have trouble remembering where he was on particular days. Luttrell was indicted on three counts of Unlawful Sexual Contact and two counts of Indecent Exposure. The Unlawful Sexual Contact charges tracked the language of the statute, section 761(f) of Title 11. The Indecent Exposure counts contained the same language with different dates for the offenses.

The trial judge declined a defense request for a bill of particulars, finding that the probable cause affidavit provided sufficient notice of the charges. There were differences between the complainant's CAC interview which listed the dates of the assault as the weekend of July 14, 2012, and the indictment which listed the dates of offenses as July 20 and 21st. The jury acquitted Luttrell on two charges of Rape First Degree, but he was convicted on the remaining charges of Attempted Rape First Degree, Unlawful Sexual Contact (3 counts), Attempted Unlawful Sexual Contact, and Indecent Exposure

96. *McKinney*, 107 A.3d at 1048 (quoting *LeGrande*, 947 A.2d at 1111 (quotation omitted)).

97. 107 A.3d at 1049.

98. 107 A.3d at 1047 n.18 (citing *Brown v. State*, 897 A.2d 748, 751 (Del. 2006); *Bailey v. State*, 440 A.2d 997, 1000 (Del. 1982)).

99. 97 A.3d 70 (Del. 2014).

100. *Id.* at 77-78.

101. *Id.* at 72.

(2 counts). The trial court again denied a post-trial motion challenging the indictment, finding that the arrest warrant, probable cause affidavit, police reports, and discovery had placed Luttrell on notice of the charges.¹⁰²

On appeal, the Supreme Court ruled that the Superior Court should have granted Luttrell's request for a bill of particulars. The Court cited to *Dobson v. State*¹⁰³ a similar case where a defendant received ineffective assistance counsel when his trial attorney failed to request a bill of particulars. In *Dobson*, the Court ruled that a bill of particulars would have clarified which specific acts alleged by the juvenile complainant corresponded with the specific counts in the indictment.¹⁰⁴ The Court stated that the bill of particulars "is intended to supplement the information set forth in the indictment, and in so doing, it both 'protect[s] the defendant against surprise during the trial, and [precludes] subsequent prosecution for an inadequately described offense."¹⁰⁵

The Court found that the affidavit of probable cause only contained a summary of the allegations and it did not match up with the counts charged in the indictment¹⁰⁶ In addition, the complaining witness alleged more acts in his interview than were in the indictment, which led to uncharged evidence being admitted in the State's case, contrary to *Getz v. State*.¹⁰⁷ The Court ruled that the defendant and the jury were both entitled to know what the specific charges were at the trial. The Court also stated that the trial judge should have *sua sponte* given a jury unanimity instruction under the facts of this case.¹⁰⁸

III. APPENDIX

DELAWARE SUPREME COURT 2014 CRIMINAL LAW OPINIONS

Ashley v. State, 85 A.3d 81, 85 (Del. 2014) (trial court did not err in denying severance of bribery charge from rape charge where the charges were based on the same acts or transaction).

Ayres v. State, 97 A.3d 1037, 1040 (Del. 2014) (defendants' statements on wiretap recordings were not testimonial under the Sixth Amendment).

Banks v. State, 93 A.3d 643, 647-51 (Del. 2014) (evidence that victim of domestic assault may have threatened others who were romantically involved with the defendant was inadmissible under D.R.E. 404(b)).

Benge v. State, 101 A.3d 973, 977 (Del. 2014) (Superior Court did not act unreasonably in denying defendant's requests for reduction in his probation level).

102. *Id.* at 71-75.

103. 2013 WL 5918409 (Del. Oct. 31, 2013).

104. *Id.* at *2-3.

105. 97 A.3d at 76 (quoting *Lovett v. State*, 516 A.2d 455, 467 (Del. 1986)).

106. *Id.* at 77-78.

107. 538 A.2d 726 (Del. 1988).

108. *Id.* at 78 n.17 (citing *Probst v. State*, 547 A.2d 114, 120-22 (Del. 1988)). The Court also ruled that statements made by the detective interviewing Luttrell were improper references to the credibility of the complaining witness and should not have been played for the jury. *Id.* at 78-79.

Benson v. State, 105 A.3d 979, 984 (Del. 2014) (prosecutor's reference in closing argument to the size of defendant's gun was related to issue of intent and related to a fact in evidence).

Butler v. State, 95 A.3d 21, 38-40 (Del. 2014) (actions of trial court caused mistrial after jury was sworn and subsequent convictions were barred by double jeopardy).

Chambers v. State, 93 A.3d 1233, 1234-36 (Del. 2014) (*ex post facto* clause of United States Constitution did not bar defendant's prosecution for felony third offense DUI even though his two prior offense occurred under former statute that required the third offense be committed within five years of the first two DUIs).

Cooke v. State, 97 A.3d 513, 527, 530, 536, 541-42, 544-45, 546, 548-56, 556 (Del. 2014) (State of Delaware did not violate defendant's right to have access to counsel or his files for pretrial preparation; trial counsel did not abuse discretion in denying defendant's request for continuance; defendant forfeited his right to represent himself because of his inappropriate behavior at trial; defendant did not unequivocally waive his right to present mitigating evidence and the trial court's order that standby counsel present the mitigation case was harmless; trial court properly excluded evidence of victim's prior sexual conduct; lay witness was allowed to testify at trial to identify defendant's voice on 911 calls; trial court's ruling during jury selection and trial did not violate defendant's right to an impartial jury; imposition of death penalty was not disproportionate).

Cooper v. State, 85 A.3d 689, 693-96 (Del. 2014) (defendant's own outburst in front of the jury, including comment about taking a plea, did not warrant a mistrial where trial judge gave a curative instruction and conducted additional *voir dire*).

Fuller v. State, 104 A.3d 817, 818 (Del. 2014) ("subsequent adult conviction" for purposes of the Family Court expungement statute is a later conviction under Del. Code titles 4, 7, 11, 16, or 23, but excludes title 21).

Hoskins v. State, 102 A.3d 724, 732-33 (Del. 2014) (trial counsel's failure to request an accomplice instruction was not ineffective assistance at the time of the trial in 2009).

Lowther v. State, 104 A.3d 840, 843-44 (Del. 2014) (crime of terroristic threatening requires proof of intent to utter the words and threaten the victim, but does not require actual intent to carry out the threat).

Lum v. State, 101 A.3d 970, 971-72 (Del. 2014) (State presented sufficient evidence to support charge that defendant constructively possessed ammunition and brass knuckles recovered in his vehicle).

Luttrell v. State, 97 A.3d 70, 77 (Del. 2014) (defendant was entitled to a bill of particulars in case where the factual allegations in affidavit of probable cause did not align with the counts in the indictment, and the jury instructions did not explain what facts corresponded with each charged crime).

McKinny v. State, 107 A.3d 1045, 1048-49 (Del. 2014) (search warrant affidavit lacked probable cause where police failed to corroborate an informant's claim that drugs were sold from the defendant's apartment or that the informant was past proven reliable).

Norwood v. State, 95 A.3d 588, 595-99 (Del. 2014) (defendant should have been permitted to admit bad acts evidence that a third party committed other crimes to support his defense of misidentification).

Ozdemir v. State, 96 A.3d 672, 676-77 (Del. 2014) (Family Court records, admitted to prove charge of interference with custody, contained irrelevant and inflammatory factual findings that were hearsay and inadmissible under D.R.E. 403).

Parker v. State, 85 A.3d 682, 687-88 (Del. 2014) (social media evidence was properly admitted at trial under D.R.E. 901(b) for the jury to make the ultimate ruling on its authenticity).

Purnell v. State, 106 A.3d 337, 347-48 (Del. 2014) (trial counsel's failure to request a *Bland* instruction was deficient, but was not prejudicial where other evidence presented at trial included three witnesses who saw to defendant commit the shooting).

Williams v. State, 98 A.3d 917, 922-23 (Del. 2014) (statements by dispatcher describing suspect wanted in relation to another burglary were harmless in light of physical evidence linking defendant to the charged burglary).

Wright v. State, 91 A.3d 972, 989-94 (Del. 2014) (cumulative *Brady* evidence not disclosed at trial was material and caused violation of defendant's fair trial right).

Wynn v. State, 93 A.3d 638, 641-42 (Del. 2014) (prosecutor's statements in closing based on legitimate inferences from the evidence did not constitute misconduct).

Zhurbin v. State, 104 A.3d 108, 111-14 (Del. 2014) (defendant could be convicted for leaving the scene of an accident on private property under 21 *Del. C.* § 4201(a)).

KEY DECISIONS OF 2014 IN DELAWARE CORPORATE AND ALTERNATIVE ENTITY LAW

Kathaleen S. McCormick, Tammy L. Mercer, and Daniel M. Kirshenbaum*

I. CORPORATE LAW

A. Clarifying Controlling Stockholder Issues

1. *MFW* Defines The Legal Standard Applicable To Negotiated Mergers With Controlling Stockholders

In *Kahn v. M&F Worldwide Corp.*,¹ the Delaware Supreme Court considered the standard of review applicable to a going-private merger with a controlling stockholder, holding that the business judgment standard can apply to transactions preconditioned on the approval of an independent and well-functioning special committee and the affirmative vote of a majority of the minority stockholders.

MFW involved a public offer by a 43% stockholder, MacAndrews & Forbes (“MacAndrews”), to acquire the remaining shares of M&F Worldwide (“MFW”) for \$24 per share. MacAndrews’ proposal was contingent upon the conditions that: (1) the “Merger be negotiated and approved by a special committee of independent MFW directors”; and (2) the “Merger be approved by a majority of stockholders unaffiliated with” MacAndrews.² MFW’s board of directors empowered a special committee of independent directors to review and evaluate the proposal, negotiate with MacAndrews, report its recommendation on the fairness of the proposal to the board, and/or elect not to pursue the offer.³ The special committee retained its own independent legal counsel and financial advisor, and met eight times over the course of three months to negotiate with MacAndrews.⁴ The special committee ultimately succeeded in raising the per-share deal price by \$1, to \$25 per share.⁵

The plaintiffs initially sought to enjoin the transaction in the Court of Chancery, but withdrew the request after taking expedited discovery.⁶ The defendants then moved for summary judgment. The Court of Chancery held that

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1. 88 A.3d 635 (Del. 2014).
2. *Id.* at 638.
3. *Id.* at 641.
4. *Id.* at 650-51.
5. *Id.* at 652.
6. *Id.* at 638.

business judgment review, rather than entire fairness, applied to its evaluation of the transaction because MacAndrews had, as a practical matter, relinquished its control by conditioning its offer on the special committee and stockholder approval processes.⁷ The Court of Chancery granted summary judgment to the defendants, and the plaintiffs appealed.⁸

In affirming the Court of Chancery's decision, the Supreme Court acknowledged that, in the typical transaction between a corporation and its controlling stockholder, the applicable standard of judicial review is entire fairness, with defendants bearing the burden of proving that the transaction was entirely fair to the corporation and its minority stockholders.⁹ The Court further recognized that, even where the transaction is approved by a well-functioning committee of independent directors *or* by an informed vote of a majority of the minority stockholders, entire fairness still applies, although the burden of persuasion shifts to the plaintiff.¹⁰

The Supreme Court concluded, however, that where *both* procedural protections are in place, business judgment review is appropriate. More specifically, the Court found that business judgment review applies if, and only if, the following six factors are satisfied:

- (i) the controller conditions the procession of the transaction on the approval of both a Special Committee and a majority of the minority stockholders; (ii) the Special Committee is independent; (iii) the Special Committee is empowered to freely select its own advisors and to say no definitively; (iv) the Special Committee meets its duty of care in negotiating a fair price; (v) the vote of the minority is informed; and (vi) there is no coercion of the minority.¹¹

The Court explained that the “simultaneous deployment of the[se] procedural protections . . . create a countervailing, offsetting influence of equal – if not greater – force” than the threat of entire fairness.¹² In other words, “where the controller irrevocably and publicly disables itself from using its control to dictate the outcome of the negotiations and the shareholder vote, the controlled merger then acquires the shareholder-protective characteristics of third-party, arm’s-length mergers, which are reviewed under the business judgment standard.”¹³ The Court noted that business judgment scrutiny of such transactions also was justified because, among other things, it “optimally protects the minority stockholders” and is consistent with the traditional notion of Delaware law that courts should respect the informed decisions of directors and stockholders.¹⁴

The Court warned, however, that if a plaintiff could “plead a reasonably conceivable set of facts showing that any or all of these enumerated conditions did not exist,” the complaint would state a claim for relief and would entitle the

7. *Id.* at 639.

8. *Id.*

9. *Id.* at 642.

10. *Id.*

11. *Id.* at 645.

12. *Id.* at 644.

13. *Id.*

14. *Id.* at 644-45.

plaintiff to discovery.¹⁵ If triable issues of fact about either dual procedural protections remained after discovery, the Court continued, the “case will proceed to a trial in which the court will conduct an entire fairness review.”¹⁶

The Supreme Court then reviewed the record before it and affirmed the Court of Chancery’s conclusions that MFW’s special committee was independent and fully empowered and had acted with due care, and that the majority-of-the-minority vote was fully informed and uncoerced.¹⁷ Because it could not “be credibly argued (let alone concluded) that no rational person would find the Merger favorable to MFW’s minority stockholders[,]” the Supreme Court concluded that summary judgment had been appropriately granted in the defendants’ favor.¹⁸

Two unreported 2014 bench rulings issued subsequent to *MFW* applied its holdings: *Swomley v. Schlecht*¹⁹ and *ACP Master, LTD v. Sprint Corporation*.²⁰

In the first, *Swomley*, the Court dismissed a complaint challenging a cash-out merger of a privately-held company by a 46-percent stockholder where the merger met the six-factor *MFW* test. As a threshold matter, the Court determined that the *MFW* test may be applied in the “private company context.”²¹ The Court reasoned that, historically, Delaware courts have not made distinctions between public companies and private companies. Then, the Court held that the stockholder-plaintiffs failed to plead facts sufficient to question the satisfaction of any of the six factors and granted the defendants’ motion to dismiss the plaintiffs’ complaint.

In the second, *Sprint*, the Court of Chancery denied a motion to dismiss claims challenging a controlling-stockholder buyout conditioned on the approval of both a special committee and a majority of the minority stockholders pursuant to *MFW*. Because the plaintiffs had adequately pled allegations that the majority-of-the-minority vote in favor of the merger had been coerced, the Court determined that it could not apply the business judgment standard of review. In light of the heightened scrutiny to be applied under the entire fairness standard, the Court denied the defendants’ motions to dismiss the stockholder-plaintiffs’ complaint alleging breach of loyalty claims against the acquirer and the target’s board of directors, among others.

Further, because the Court determined that it was reasonably conceivable that *MFW* would not apply, and that the merger would be subject to entire fairness review, the Court declined to grant the dismissal motions of the company and the director defendants. The Court also declined to grant the acquirer’s motion to dismiss for lack of personal jurisdiction and on the merits. In so doing, the Court held that the plaintiffs had adequately pled that the Court of Chancery had personal jurisdiction over SoftBank with respect to Clearwire’s acquisition, because SoftBank’s “jurisdictional act of forming Delaware subsidiaries for the purpose of acquiring Sprint” was “part of a single plan on behalf of Softbank

15. *Id.* at 646.

16. *Id.*

17. *Id.* at 647-54.

18. *Id.* at 654.

19. C.A. No. 8355-VCL (Del. Ch. Sept. 10, 2014) (TRANSCRIPT) (applying *MFW* in the private company context), *aff’d*, No. 180, 2015 (Del. Nov. 19, 2015).

20. C.A. No. 8508-VCL (Del. Ch. Jul. 23, 2014) (TRANSCRIPT) (denying defendants’ motion to dismiss under *MFW* where the plaintiffs argued that the majority-of-the-minority vote had been coerced).

21. *Id.* at 66.

to acquire Sprint and acquire Clearwire.”²² The Court further held that the plaintiffs had adequately pled that SoftBank aided and abetted Sprint “to squeeze out the stockholders of Clearwire for a below-market price.”²³ The Court based this holding on its finding that the plaintiffs’ allegations that SoftBank, among other things, participated in merger negotiations “create[d] an inference that SoftBank knowingly participated in that ongoing course of conduct.”²⁴

2. Dismissal Decisions Lend Guidance On Allegations Sufficient To Support A Finding Of Control

In several cases in 2014, the Court of Chancery discussed the circumstances under which a stockholder owning less than 50% of a corporation’s outstanding shares can be considered a controlling stockholder. In three of these cases, the Court of Chancery dismissed complaints where allegations of control were insufficient, making clear that a non-majority stockholder will only be considered a controller if the stockholder controls the corporation’s board of directors with respect to the challenged transaction.²⁵

In *KKR*, the Court of Chancery considered on a motion to dismiss whether a stockholder who owned only 1% of a corporation’s outstanding shares, but managed the corporation’s day-to-day operations, was a controlling stockholder.²⁶ *KKR* involved the acquisition of KKR Financial Holdings LLC (“Holdings”) by KKR & Co. L.P.’s (“KKR”) in a stock-for-stock merger.²⁷ The merger was valued at \$2.6 billion and represented a 35% premium to Holdings’ trading price on the day of closing.²⁸ It was the product of a sound process, having been negotiated for Holdings by an independent transaction committee, which was advised by independent financial advisors and legal counsel, effective in raising the exchange ratio, and informed by a fairness opinion.²⁹ Also, the merger was conditioned on the approval of a majority of Holdings’ stockholders other than KKR and its affiliates, which was obtained.³⁰

Nevertheless, stockholder plaintiffs filed suit challenging the merger, alleging, among other things, that KKR was a controlling stockholder of Holdings and that it breached its duty of loyalty to other Holdings stockholders by causing Holdings to enter into the merger agreement. Although KKR owned less than 1% of Holdings’ shares, the plaintiffs argued

22. *Id.* at 107.

23. *Id.* at 108.

24. *Id.* at 109.

25. See *In re KKR Fin. Hldgs. LLC S’holder Litig.*, 101 A.3d 980 (Del. Ch. 2014), *aff’d*, No. 629, 2015 (Del. Oct. 2, 2015); *In re Crimson Exploration Inc. S’holder Litig.*, 2014 Del. Ch. LEXIS 213 (Del. Ch. Oct. 24, 2014); and *In re Sanchez Energy Deriv. Litig.*, 2014 Del. Ch. LEXIS 239 (Del. Ch. Nov. 25, 2014). *But see In re Zhongpin S’holders Litig.*, 2014 Del. Ch. LEXIS 252 (Del. Ch. Nov. 26, 2014), *rev’d on other grounds* 115 A.3d 1173 (Del. 2015).

26. 101 A.3d 980.

27. *Id.* at 983.

28. *Id.* at 988.

29. *Id.* at 987-88.

30. *Id.* at 988-89.

that KKR held actual control of Holdings' corporate conduct through a management agreement between Holdings and an affiliate of KKR, KKR Financial Advisors LLC ("Advisors").³¹ The management agreement "delegated responsibility for its day-to-day operations," including, among other things, the power to implement and execute Holdings' business, investments, and risk management practices.³² The management agreement also explicitly subjected Advisors to the supervision of the Holdings' board and limited the Advisors' "functions and authority" as Holdings delegated to it.³³

The Court rejected the plaintiffs' argument that KKR was a controlling stockholder of Holdings with concomitant fiduciary duties. The Court explained that "[t]o survive a motion to dismiss ... plaintiffs must allege facts demonstrating actual control with regard to the particular transaction that is being challenged."³⁴ Relying on its prior decisions in *Superior Vision Services, Inc. v. ReliaStar Life Insurance Co.*³⁵ and *In re Morton's Restaurant Group, Inc. Stockholders Litigation*,³⁶ the Court held that a minority stockholder will not be considered a controlling stockholder that owes a duty of loyalty to the other stockholders "unless it exercises such formidable voting and managerial power that it, as a practical matter, is no differently situated than if it had majority voting control."³⁷ The Court concluded that although the management agreement demonstrated that KKR controlled the day-to-day operations of Holdings, the complaint did not contain sufficient facts to support a reasonable inference that KKR controlled the Holdings board and was able to prevent the Holdings board from exercising its independent judgment when deciding whether or not to approve the merger agreement.³⁸ Specifically, the Court reasoned that the plaintiffs' claim was "devoid of any allegation that KKR had a contractual right to appoint any (much less a majority) of the members of the Holdings board, to dictate any action by the board, to veto any action of the board or to prevent the board from hiring advisors and gathering information in order to be fully-informed."³⁹ The Court also noted that there was nothing in the pleaded facts to suggest that the Holdings directors had reason to fear being replaced if they voted against the merger.⁴⁰

On appeal, the Delaware Supreme Court affirmed and commended the Court of Chancery's "well-reasoned opinion,"⁴¹ observing that "the Chancellor correctly applied the law and we see no reason to repeat his lucid analysis of the question."⁴²

31. *Id.* at 993.

32. *Id.* at 985.

33. *Id.*

34. *Id.* at 991.

35. 2006 Del. Ch. LEXIS 160 (Del. Ch. Aug. 25, 2006).

36. 74 A.3d 656 (Del. Ch. 2013).

37. *In re KKR*, 101 A.3d at 992 (citing *In re Morton's*, 74 A.3d at 664-65).

38. *Id.* at 993.

39. *Id.* at 994.

40. *Id.*

41. *Corwin v. KKR Fin. Hldgs. LLC*, No. 629, 2015, at 2 (Del. Oct. 2, 2015).

42. *Id.* at 4.

Next, in *Crimson*,⁴³ the Court of Chancery considered on a motion to dismiss whether a stockholder who owned 33.7% of a corporation's outstanding shares was a controlling stockholder. *Crimson* involved a stock-for-stock merger of Crimson Exploration, Inc. ("Crimson") and Contango Oil & Gas Co. ("Contango") in which Contango acquired Crimson in consideration for 0.08288 shares of Contango for each share of Crimson.⁴⁴ The exchange ratio represented a 7.7% premium to the trading price of Contango and Crimson common stock on the day prior to the announcement of the Merger.⁴⁵ The merger contained several deal protection devices, including a \$7 million termination fee, which represented approximately 1.8% of Crimson's enterprise value, an expense fee, a no-solicitation provision and a matching-rights provision.⁴⁶

Stockholder plaintiffs alleged that the merger undervalued Crimson. They further alleged that Oaktree Capital Management L.P. ("Oaktree"), the owner of 33.7% of Crimson's common stock, was a controlling stockholder that caused Crimson to be sold for an inadequate price in exchange for benefits not shared with the minority common stockholders.⁴⁷ The plaintiffs also alleged that both Crimson management and its board lacked independence because they were interested in the merger and were also dominated by Oaktree.⁴⁸ The plaintiffs thus argued that entire fairness was the proper standard of review and that defendants could not satisfy this standard.⁴⁹ The defendants moved to dismiss the complaint, arguing that Oaktree was not a controlling stockholder and that the plaintiffs had not pled sufficient facts to rebut the business judgment rule.⁵⁰

The Court began its analysis by discussing the "two different contested issues related to the law of controlling stockholders": "(1) when is a stockholder a controlling stockholder?; and (2) which transactions involving a controlling stockholder implicate entire fairness?"⁵¹ The Court first addressed the issue of when a stockholder will be considered a controlling stockholder. The Court explained that even a stockholder owning less than 50% of a corporation's shares can be considered a controlling stockholder if it is determined that the stockholder "exercises control over the business affairs of the corporation."⁵² The Court proceeded to make a "non-exhaustive list of significant cases" where there was a dispute about whether a non-majority stockholder satisfied the "control" test and noted the lack of correlation in those cases between the percentage of shares owned by the non-majority stockholder and the likelihood of the Court to find the stockholder to be a controlling stockholder.⁵³ After examining several of the listed cases, the Court concluded that "a

43. 2014 Del. Ch. LEXIS 213 (Del. Ch. Oct. 24, 2014).

44. *Id.* at *19.

45. *Id.*

46. *Id.* at *20.

47. *Id.* at *23-24.

48. *Id.* at *24.

49. *Id.* at *23.

50. *Id.* at *25.

51. *Id.* at *31.

52. *Id.* at *32.

53. *Id.* at *34.

large blockholder will not be considered a controlling stockholder unless they actually control the board's decisions about the challenged transaction."⁵⁴

The Court then addressed the second issue—which transactions involving a controlling stockholder implicate entire fairness review—holding that entire fairness review will be implicated in the following two categories of cases: “(a) transactions where the controller stands on both sides; and (b) transactions where the controller competes with the common stockholders for consideration.”⁵⁵ The Court explained that in the latter category, entire fairness is deemed appropriate because the controller is presumed to be competing with the minority stockholders for a larger portion of the total consideration the acquirer is willing to pay.⁵⁶ The Court identified three cases in which the controlling stockholder will be considered to be competing with the minority stockholders: “(1) the controller receives disparate consideration, which the board approves; (2) the controller receives a continuing stake in the surviving entity, whereas the minority is cashed out; and (3) the controller receives a unique benefit, despite nominal pro rata treatment of all stockholders.”⁵⁷

In applying these standards, the Court found that while the plaintiffs did not plead any facts from which the Court could reasonably infer that Oaktree actually controlled the Crimson board, the Court was “hesitant to conclude that [p]laintiffs could not conceivably make that showing,” which would be sufficient to survive a motion to dismiss.⁵⁸ Nevertheless, the Court held that entire fairness review was inappropriate because the plaintiffs did not plead sufficient facts from which they could conceivably show that Oaktree stood on both sides of the Merger or that it received some benefit not shared with the minority stockholders.⁵⁹

The third case, *Sanchez*,⁶⁰ involved two family members whose collective ownership of 21.5% of the corporation's stock and control of two of five board seats were deemed insufficient to constitute control.⁶¹ *Sanchez* involved a transaction in which Sanchez Energy Corporation (“Sanchez Energy”) purchased a partial working interest in 40,000 acres of undeveloped land from Sanchez Resources, LLC (“Sanchez Resources”).⁶² A third-party, Altpoint Capital Partners (“Altpoint”), held a stake in the acreage.⁶³ When Altpoint refused to make any additional investments to fund development, Sanchez Energy acquired Altpoint's interest in the acreage.⁶⁴ Sanchez Energy paid approximately \$77 million in cash and stock—\$62 million to Altpoint and \$15 million to Sanchez Resources.⁶⁵

54. *Id.* at *38.

55. *Id.* at *40.

56. *Id.* at *46-47.

57. *Id.* at *47.

58. *Id.* at *56.

59. *Id.* at *57-68.

60. 2014 Del. Ch. LEXIS 239 (Del. Ch. Nov. 25, 2014) *rev'd* 2015 Del. LEXIS 472 (Del. 2015).

61. *Id.* at *32.

62. *Id.* at *6.

63. *Id.* at *5.

64. *Id.*

65. *Id.* at *6.

Members of the Sanchez family stood on both sides of the transaction—owning Sanchez Resources outright, and having a significant 21.5% stake in Sanchez Energy. Two Sanchez family members also sat on the Sanchez Energy board.⁶⁶ The other three board members acted as the audit committee, which was created for the purpose of evaluating and approving interested-party transactions between Sanchez Energy and Sanchez family members.⁶⁷ The independent audit committee members, assisted by a financial advisor, approved the transaction with Sanchez Resources.⁶⁸

Stockholder plaintiffs filed a derivative action alleging a breach of fiduciary duty claim against all of the directors for approving the transaction. The plaintiffs did not make a pre-suit demand, arguing that such a demand was futile under the test set forth in *Aronson v. Lewis*⁶⁹ and was therefore excused.⁷⁰ In *Aronson*, the Supreme Court held that a plaintiff who has not made a demand on the board must plead allegations raising a reasonable doubt that “(1) the directors are disinterested and independent [or] (2) the challenged transaction was otherwise the product of a valid exercise of business judgment.”⁷¹

Relevant to the control analysis, the Court rejected the plaintiffs’ argument under the second prong of *Aronson*: that even if the audit committee was found to be disinterested and independent, demand was futile under the second prong of the *Aronson* test because the Sanchez family were controlling stockholders, thereby triggering entire fairness standard of review.⁷² The Court explained that “to establish that a defendant is a controlling stockholder when that stockholder owns less than 50% of the corporation’s outstanding stock, a plaintiff must allege domination by a minority shareholder through actual control of corporate conduct,” which the Court held means actual control over the board of directors.⁷³ According to the Court, “Vice Chancellor Parson’s survey [in *Crimson*] confirms that, while the controller analysis is highly fact specific, actual board control is undoubtedly the defining and necessary feature of a minority controlling stockholder.”⁷⁴ The Court held that the plaintiffs failed to plead facts to support a reasonable inference that the Sanchez family actually controlled Sanchez Energy’s board.⁷⁵ In so concluding, the Court relied in part on the plaintiffs’ own admission at oral argument that the Sanchez family could not exert power to remove a dissenting director.⁷⁶

66. *Id.* at *3.

67. *Id.* at *7.

68. *Id.*

69. 473 A.2d 805 (Del. 1984).

70. *Sanchez*, 2014 Del. Ch. LEXIS 239, at *2-3.

71. 473 A.2d at 814.

72. *Sanchez*, 2014 Del. Ch. LEXIS 239, at *21-22.

73. *Id.* at *25.

74. *Id.* at *27.

75. *Id.* at *31-32.

76. *Id.* at *32.

The Court also rejected the plaintiffs' argument that demand was futile under the first prong of the *Aronson* test because two of the three members of the audit committee lacked independence from the Sanchez family.⁷⁷ The plaintiffs based this argument on allegations that one of the audit committee members, Jackson, had donated to a Sanchez family member's political campaign and maintained a close friendship with the Sanchez patriarch "for more than five decades."⁷⁸ The other board member, Garcia, was also alleged to have personal ties to the Sanchez family that were "conceded at oral argument" to be "even weaker," than those alleged about Jackson.⁷⁹ The plaintiffs further pointed to long-term business relationships between Garcia and the Sanchez family, but failed to explain in briefing or at argument "the significance of these business relationships" or how they would cause Garcia to "abandon his fiduciary duties."⁸⁰ The Court found the plaintiffs' allegations wholly insufficient bases upon which to reasonably infer that either Jackson or Garcia lacked independence from the Sanchez family.⁸¹

One 2014 decision deemed allegations of a non-majority stockholders' control sufficient to support a finding of control if true. In *Zhongpin*,⁸² the Court considered on a motion to dismiss whether a CEO and chairman of the board who owned 17.3% of a corporation's common stock was considered a controlling stockholder. *Zhongpin* involved a going-private merger in which Xianfu Zhu ("Zhu"), the CEO and chairman of the board of Zhongpin Inc. ("Zhongpin") and the owner of 17.3% of Zhongpin's common stock, purchased Zhongpin's outstanding shares for \$13.50 per share. In March 2012, Zhu submitted a preliminary, non-binding proposal to purchase all of Zhongpin's outstanding shares for \$13.50 per share.⁸³ In response to Zhu's proposal, Zhongpin's board established a three-member special committee comprising three directors from Zhongpin's board.⁸⁴ The special committee was charged to evaluate and negotiate, and recommend to the board whether to accept or reject, the terms of Zhu's proposal or any alternative transaction.⁸⁵

The special committee engaged Barclays Bank PLC ("Barclays") as its independent financial advisor in connection with evaluating Zhu's proposal and any alternative transaction.⁸⁶ Although Barclays attempted to negotiate with Zhu to raise his \$13.50 bid, Zhu remained steadfast in his price.⁸⁷ On November 21, 2012, Zhu informed the special committee that any further delay in signing a merger agreement would jeopardize his financing.⁸⁸ Shortly thereafter, Barclays informed

77. *Id.* at *8.

78. *Id.* at *16.

79. *Id.* at *19.

80. *Id.* at *20.

81. *Id.* at *21.

82. 2014 Del. Ch. LEXIS 252 (Del. Ch. Nov. 26, 2014).

83. *Id.* at *3.

84. *Id.* at *4.

85. *Id.*

86. *Id.* at *7.

87. *Id.* at *9.

88. *Id.* at *10.

the special committee that it could not render a fairness opinion on Zhu's proposal and terminated its engagement as the special committee's financial advisor.⁸⁹ Fearing that Zhu would lose his financing, the special committee determined at its November 23, 2012 meeting that Zhu's proposal was fair to Zhongpin's stockholders and advised the board to approve the transaction and recommend it to Zhongpin's stockholders, notwithstanding Barclays' refusal to render a fairness opinion.⁹⁰ In reaching this conclusion, the special committee noted the favorable deal provisions, including (i) a non-waivable "majority of the minority" voting requirement, (ii) a 60-day go-shop provision that allowed Zhongpin to actively solicit proposals from third parties after entering into the Merger Agreement, and (iii) Zhongpin's right to terminate the merger agreement at any time and for any reason during the go-shop period with no termination fee.⁹¹

Zhongpin received no superior offers during the go-shop period.⁹² On February 8, 2013, the special committee's new financial advisor rendered a fairness opinion on Zhu's proposal, concluding that it was fair from a financial standpoint.⁹³ On the same date, Zhongpin's special committee and board approved certain amendments to the merger agreement, including the removal of both the go-shop provision and Zhongpin's right to terminate the merger agreement for any reason and a reduction of Zhongpin's termination fee.⁹⁴ On June 27, 2013, a slim majority—51.3%—of Zhongpin's unaffiliated stockholders approved the merger agreement.⁹⁵

Stockholder plaintiffs asserted fiduciary claims against both Zhongpin's board, for engaging in a sales process that advantaged Zhu at the expense of the other stockholders, and Zhu, for completing a self-dealing transaction at the expense of the other stockholders. The plaintiffs argued that Zhu was a controlling stockholder and thus the Court should apply the entire fairness standard.⁹⁶ The plaintiffs claimed that the merger was not entirely fair to the other stockholders because the special committee was beholden to Zhu, its process was flawed, and the merger consideration was inadequate.⁹⁷ Defendants moved to dismiss the complaint, arguing that the business judgment rule applied and that the plaintiffs could not rebut the business judgment rule's presumptions.⁹⁸

The Court concluded that the complaint asserted facts that, if accepted as true, established that Zhu was a controlling stockholder. To reach this result, the Court concluded that the complaint supported inferences that Zhu possessed both latent control—the ability to exercise significant influence over stockholder votes on the election of directors, mergers and acquisitions, and amendments to Zhongpin's bylaws—and active control—the ability to materially impact

89. *Id.* at *11.

90. *Id.*

91. *Id.* at *12.

92. *Id.* at *13-14.

93. *Id.* at 14.

94. *Id.*

95. *Id.*

96. *Id.* at *16.

97. *Id.*

98. *Id.* at *15.

Zhongpin's day-to-day operations.⁹⁹ With respect to the "active control" issues, the Court noted that Zhongpin's 10-K explicitly stated that Zhu had "significant influence over [Zhongpin's] management and affairs," and that the loss of Zhu "would have a material adverse effect on [Zhongpin's] business and operations."¹⁰⁰ While the Court acknowledged that the 10-K did not "conclusively demonstrate Zhu's status as a controller under Delaware law," it did "along with the other allegations in the Complaint, support the inference that Zhu exercised significantly more power than would be expected of a CEO and 17% stockholder."¹⁰¹

Because Zhu was a controlling stockholder who stood on both sides of the transaction, the Court held that entire fairness review was appropriate. In so holding, the Court explained that because Zhu did not condition his proposal at the outset on the approval of a majority of the minority and that provision was only included at the "tail-end of the sales process" after the parties had already negotiated and agreed to the \$13.50 per share price, the transactional structure did not satisfy the criteria set forth in *Kahn v. M & F Worldwide Corp.* to warrant the application of the business judgment standard of review.¹⁰² The Court concluded that the plaintiffs adequately alleged facts that the merger "was not characterized by fair dealing and fair price" to meet the "reasonably conceivable" standard necessary to survive a motion to dismiss.¹⁰³

3. *Nine Systems* Applies The Entire Fairness Standard To Find That A Control Group Breached Its Fiduciary Duties

In *In re Nine Systems Corp. Stockholders Litig.*, the Court held that defendants breached their duties of loyalty by engaging in a self-interested transaction through an unfair process, but at a fair price, awarding no damages, but inviting a petition for attorneys' fees.¹⁰⁴

This entire fairness action arose from a 2002 recapitalization of Streaming Media Corporation, which later changed its name to Nine Systems Corporation ("Nine Systems").¹⁰⁵ The recapitalization caused the equity stake of defendants—three entities known as "Wren," "Javva," and "Catalyst," that collectively held 90% of Nine Systems' secured debt—to increase significantly, while the equity stake of plaintiffs, who were minority stockholders, was correspondingly diluted.¹⁰⁶ Four years later, in 2006, after marked improvement in Nine Systems' financial health, Nine Systems sold itself

99. *Id.* at *25-26.

100. *Id.* at *22-23.

101. *Id.* at *24.

102. *Id.* at *28-31.

103. *Id.* at *32-33.

104. 2014 Del. Ch. LEXIS 171 (Del. Ch. Sept. 4, 2014).

105. *Id.* at *3.

106. The first step in the recapitalization involved the conversion of the Nine Systems' secured debt to newly issued Preferred A stock. That conversion increased Nine Systems' total equity outstanding by 23%. Nine Systems then issued new Preferred B-1 stock, representing 51% of Nine Systems's total equity, to Wren and Javva. As a result of the recapitalization, Wren, Javva, and Catalyst together increased their ownership interest from 54% to 80% of the Company's stock, and the plaintiff-stockholders' ownership was diluted from approximately 26% to 2% of the Company's stock. *Id.* at 49.

to Akamai Technologies (“Akamai”) for \$175 million.¹⁰⁷ The plaintiffs, who received \$3 million in the merger,¹⁰⁸ sued and argued, *inter alia*, that the recapitalization: (1) was a conflicted transaction that was not entirely fair to the minority; and (2) resulted in the minority receiving far less than their fair share of the consideration from the Akamai merger.¹⁰⁹ The overarching theory behind the plaintiffs’ claims was that, “through the Recapitalization, the Defendants unfairly expropriated the economic and voting rights of the Company’s stockholders who did not participate in it.”¹¹⁰

The Court rejected the defendants’ argument that the Akamai merger extinguished plaintiffs’ standing to pursue a derivative claim, finding that the plaintiffs could pursue their claims as direct claims against the defendants under *Gentile v. Rossette*,¹¹¹ because the defendants constituted a control group and “use[d] the levers of corporate control to benefit themselves” to the minority’s detriment.¹¹² The Court reached this conclusion, in part, based on an internal Catalyst memo reflecting Catalyst’s plan to “control the purse strings” of the Company to give “Catalyst (and to a lesser extent, [Wren] and Javva) control over the Company.”¹¹³ The Court also placed weight upon evidence that Catalyst was provided an option to invest that was not extended to other stockholders.¹¹⁴

The Court further concluded that the plaintiffs had standing to challenge the recapitalization directly because the majority of the board was conflicted with respect to the challenged transactions. The Court reasoned that:

it makes little sense to hold a controlling stockholder to account to the minority for improper expropriation after a merger but to deny standing for stockholders to challenge a similar expropriation by a board of directors after a merger. After all, Delaware law endows the board—not a controller—with the exclusive authority to manage and direct the corporation’s business affairs, the foremost example of which is the power to issue stock. Why, then, should Delaware law hold a controlling stockholder to a higher standard than the board of directors?¹¹⁵

The Court then undertook the fair dealing/fair price inquiry and found that the defendant directors had engaged in unfair dealing because, *inter alia*, they: (1) utterly failed to understand the nature of their fiduciary relationships to the Nine Systems minority stockholders; (2) were not adequately informed about the Company’s valuation in connection with the recapitalization; (3) failed to adequately disclose material information about the recapitalization’s terms and participants; and (4) inexplicably changed the terms of the recapitalization (after board approval had occurred) to increase the benefit to Wren and Javva, thereby increasing the harm to the minority stockholders.¹¹⁶

107. *Id.*

108. *Id.* at *59.

109. *Id.* at *60.

110. *Id.* at *59.

111. 906 A.2d 91 (Del. 2006).

112. 2014 Del. Ch. LEXIS 171, at *85.

113. *Id.* at *72.

114. *Id.* at *74.

115. *Id.* at *82 (internal footnotes omitted).

116. *Id.* at *108-14.

Despite the finding of unfair dealing, the Court found that the plaintiffs received a more than fair price in the Akamai merger because, as of the recapitalization, the Company had a negative implied equity value and thus the value of the plaintiffs' shares as of the recapitalization was zero.¹¹⁷ "[B]ecause their common stock had no value that could have been diluted, the Plaintiffs necessarily received the substantial equivalent in value of what they had before."¹¹⁸ In what the Court labeled its "unitary conclusion on entire fairness," the Court held that "a grossly unfair process can render an otherwise fair price, even when a company's common stock has no value, not entirely fair."¹¹⁹ Because the defendants' process in connection with the recapitalization was grossly unfair, the Court found that the defendants had breached their fiduciary duties.¹²⁰ Although the Court declined to award damages, it stated its willingness to exercise its "inherent equitable power to shift attorneys' fees and its statutory authority to shift costs," and invited the plaintiffs to "petition the Court for an award of attorneys' fees and costs if they so choose."¹²¹

B. Imposing Liability Against Financial Advisors

In *In re Rural/Metro Corp. Stockholders Litigation*,¹²² the Court of Chancery held an acquired corporation's primary financial advisor liable for \$74 million for aiding and abetting breaches of fiduciary duty by the corporation's directors, even though the directors' loyalty was not challenged and they were exculpated from monetary liability for breaches of the duty of care.

Rural/Metro Corporation ("Rural") merged with an affiliate of Warburg Pincus LLC ("Warburg") in June 2011.¹²³ Warburg paid \$17.25 per share.¹²⁴ Dissenting stockholders of Rural sued, alleging that the Rural board breached its fiduciary duties by (i) failing to conduct a reasonable sales process (the "Sales Process Claim"), and (ii) failing to disclose material information in the Company's definitive proxy statement (the "Disclosure Claim").¹²⁵ The plaintiffs also alleged that the Rural board's financial advisors, RBC Capital Markets, LLC ("RBC"), and Moelis & Company LLC ("Moelis"), aided and abetted the Rural board's breaches of fiduciary duties. Both the Rural directors and Moelis settled before trial.¹²⁶ A trial was held solely against RBC on the aiding and abetting claims.¹²⁷

117. *Id.* at *141.

118. *Id.* (internal quotation marks omitted).

119. *Id.* at *145-46.

120. *Id.* at *147.

121. *Id.* at *161 (internal footnote omitted).

122. 88 A.3d 54 (Del. Ch. 2014) (post-trial opinion concerning liability), 102 A.3d 205 (Del. Ch. 2014) (damages opinion), *aff'd sub nom.*, RBC Cap. Mkts., LLC v. Jervis, No. 140, 2015 (Del. Nov. 30, 2015).

123. 88 A.3d at 64.

124. *Id.*

125. *Id.*

126. *Id.*

127. *Id.*

At trial, the plaintiffs proved the following: In December 2010, RBC was aware that both Rural and Emergency Medical Services Corporation (“EMS”), Rural’s largest competitor, were interested in being acquired.¹²⁸ RBC saw an opportunity whereby, “if Rural engaged in a sale process led by RBC, then RBC could use its position as sell-side advisor to secure buy-side roles with the private equity firms bidding for EMS.”¹²⁹ RBC pursued this opportunity and became Rural’s sell-side financial advisor, but “RBC did not disclose that it planned to use its engagement as Rural’s advisor to capture financing work from the bidders for EMS.”¹³⁰

RBC commenced the sales process on the instructions of one Rural director and without the full Rural board’s approval.¹³¹ Soon after the sales process began, it ran into “readily foreseeable problems.”¹³² Because RBC had timed the Rural sales process to run in parallel with the EMS sales process, many of the “financial sponsors who participated in the EMS process [were] limited in their ability to consider Rural simultaneously because they [were] constrained by confidentiality agreements they signed as part of the EMS process and because EMS would fear that any participants in both processes would share EMS’s confidential information with its closest competitor,” Rural.¹³³ The confidentiality concerns ultimately resulted in Warburg being the only bidder for Rural.¹³⁴ RBC lobbied hard to convince Warburg to include RBC on its buy-side “financing tree” for the Rural merger, but Warburg refused.¹³⁵

The Court of Chancery issued two primary post-trial opinions. The first, addressing RBC’s liability for aiding and abetting the Rural directors’ breaches of fiduciary duties, was issued on March 7, 2014 (the “Liability Opinion”).¹³⁶ The second, quantifying the amount of damages for which RBC was responsible, was issued on October 10, 2014 (the “Damages Opinion”).¹³⁷

In its Liability Opinion, the Court of Chancery applied Delaware’s intermediate standard of review, “enhanced scrutiny,”¹³⁸ to the Rural directors’ decisions regarding the sale process.¹³⁹ The Court explained that the intermediate standard “applies to ‘specific, recurring, and readily identifiable situations involving potential conflicts of interest where the realities of the decisionmaking context can subtly undermine the decisions of even independent and disinterested directors.’”¹⁴⁰

128. *Id.* at 66.

129. *Id.*

130. *Id.* at 68.

131. *Id.* at 67.

132. *Id.* at 70.

133. *Id.*

134. *Id.* at 74.

135. *Id.* at 77-78.

136. 88 A.3d 54.

137. 102 A.3d 205 (Del. Ch. 2014).

138. In the context of a challenged merger, this standard is sometimes referred to as the *Revlon* standard in reference to *Revlon, Inc. v. MacAndrews & Forbes Hldgs., Inc.*, 506 A.2d 173, 182 (Del. 1986).

139. 88 A.3d at 81.

140. *Id.* at 82 (quoting *In re Tradco Inc. S’holder Litig.*, 73 A.3d 17, 43 (Del. Ch. 2013)).

On the burden of proof, the Court observed that had the Rural directors not settled with the plaintiffs, they would have been required to “establish both (i) the reasonableness of the decision making process ... including the information on which the directors based their decision, and (ii) the reasonableness of the directors’ action in light of the circumstances then existing.”¹⁴¹ But, since the plaintiffs settled with the defendant directors, the plaintiffs “took up the burden of proof on each of the elements of aiding and abetting, including the existence of a fiduciary breach.”¹⁴²

The Court then found that the plaintiffs had carried their burden on the sales process claims demonstrating the unreasonableness of several aspects of the defendant directors’ decision-making process, including: (i) the decision to run the Rural sales process in parallel with the EMS process; (ii) the decision to maintain the parallel process despite its preventing many potential acquirers from considering Rural; and (iii) the decision to approve Warburg’s \$17.25 bid without adequate information.¹⁴³

The Court also found that RBC aided and abetted the directors’ breaches of duties because “RBC *created* the unreasonable process and informational gaps that led to the Board’s breach of duty.”¹⁴⁴ Thus, RBC’s conduct easily satisfied the “knowing participation” prong of the standard for aiding and abetting a breach of fiduciary duty.¹⁴⁵

Concerning the disclosure claims, the Court found that RBC provided false information to the Rural board in connection with its precedent transaction analyses. “RBC told the directors that it used ‘Wall Street research analyst consensus projections’ to derive Rural’s EBITDA for 2010,” but those data “were neither analyst projections, nor did they represent a Wall Street consensus.”¹⁴⁶ The inclusion of that false information in Rural’s proxy statement was a breach of duty in which RBC knowingly participated. Moreover, the proxy statement failed to disclose “how RBC used the initiation of the Rural sales process to seek a role in the EMS acquisition financing,” and it also omitted “RBC’s receipt of more than \$10 million for its part in financing the acquisition of EMS.”¹⁴⁷ Because “RBC knowingly participated in both of the disclosure violations,” the Court held RBC liable for aiding and abetting the breaches of fiduciary duties in connection with those violations.¹⁴⁸

In the subsequent Damages Opinion, the Court of Chancery engaged in a lengthy analysis to conclude that RBC was responsible for 83% of the total damages suffered by the plaintiffs.¹⁴⁹ The Court began by analyzing the Delaware Uniform Contribution Among Tortfeasors Act (“DUCATA”) and concluded that DUCATA did not bar RBC from claiming a settlement credit or from seeking contribution from the settling defendants as joint tortfeasors.¹⁵⁰ But the Court also

141. 88 A.3d at 83 (internal quotation marks omitted).

142. *Id.* at 85.

143. *Id.* at 89-96.

144. *Id.* at 99 (emphasis in original).

145. *Id.* at 96-97.

146. *Id.* at 104.

147. *Id.* at 106.

148. *Id.* at 107.

149. 102 A.3d 205.

150. *Id.* at 222-224.

held that the equitable doctrine of unclean hands barred RBC from claiming either a settlement credit or contribution “to the extent that the breaches of duty [were] related to the Board’s final approval of the Merger” because RBC “forfeited its right to have a Court consider contribution for these matters by committing fraud against the very directors from whom RBC would seek contribution.”¹⁵¹ Where breaches of duty were *not* related to the board’s final approval of the merger, the Court apportioned liability between RBC and those director defendants who had committed non-exculpated breaches—i.e., breaches of the duty of loyalty—and thus would have been liable to plaintiffs but for the settlement.¹⁵²

The Court weighted equally the damages associated with each of the two sets of claims—i.e., the (i) Sales Process Claim, and (ii) the Disclosure Claim. The Court then found that RBC was “solely responsible for the Disclosure Claim” and thus apportioned 50% of total damages to RBC based on that claim.¹⁵³ Next, the Court found that 50% of the fault for the Sales Process Claim related to the Rural board’s final approval of the merger, and thus apportioned 50% of the damages for the Sales Process Claim (25% of the total damages) to RBC based on the “unclean hands” analysis. Lastly, the Court apportioned the final 50% of the fault for the Sales Process Claim (*i.e.*, the remaining 25% of total damages) between RBC and the two directors who had breached their duties of loyalty, assigning 8% of the remaining total damages to RBC.¹⁵⁴ In sum, RBC was liable for 83% of the total damages suffered by the plaintiff class.¹⁵⁵ The Court entered judgment against RBC in accordance with that conclusion.¹⁵⁶

C. Proscribing Stockholder Litigation: Unenforceable Fee-Shifting Bylaws And Enforceable Delaware Forum Selection Clauses

In 2015, Delaware law-makers amended the Delaware General Corporation Law to prohibit certificates of incorporation and bylaws from including fee-shifting provisions for internal governance disputes, and to permit certificates of incorporation and bylaws to include provisions requiring that internal corporate claims be brought exclusively in Delaware courts.¹⁵⁷ The amendments, codified at 8 *Del. C.* §§ 102(f), 109(b), and 115, were signed into law by Delaware Governor Jack Markell on June 24, 2015, and became effective on August 1, 2015.

These amendments effectively prohibit the extension of the 2014 decision in *ATP Tour, Inc. v. Deutscher Tennis Bund* to stock corporations. In *ATP*, the Delaware Supreme Court held that fee-shifting bylaws were both theoretically permissible and enforceable under Delaware law, but the corporation at issue in the case was a non-stock membership corporation.¹⁵⁸ The amendments also codified the 2013 ruling in *Boilermakers Local 154 Retirement Fund v. Chevron*

151. *Id.* at 237, 239.

152. *Id.* at 239.

153. *Id.* at 262.

154. *Id.* at 263.

155. *Id.*

156. *Id.*

157. Del. S. Res. 75, 148th Gen. Assem. (2015).

158. 91 A.3d 554 (Del. 2014).

Corporation,¹⁵⁹ which deemed enforceable a bylaw amendment unilaterally adopted by a board that selected Delaware as an exclusive forum for lawsuits brought by stockholders, either directly or on behalf of the corporation derivatively, to obtain redress for fiduciary breach.

The 2015 amendments, however, made clear that the Court of Chancery's 2014 decision in *City of Providence v. First Citizens BancShares, Inc.*,¹⁶⁰ in which the Court of Chancery held that forum selection bylaws were permissible even if they designated an exclusive forum other than Delaware, is no longer good law.

D. Clarifying Stockholder Inspection Rights

1. Scope Of Inspection: Ability To Inspect Privileged Information

In *Wal-Mart Stores, Inc. v. Ind. Elec. Workers Pension Trust Fund IBEW*,¹⁶¹ the Supreme Court considered on appeal the scope of production ordered by the Court of Chancery, which included the production of e-mails. The Supreme Court also considered whether the Court of Chancery properly applied the Fifth Circuit's holding in *Garner v. Wolfinbarger*¹⁶² in ruling that certain attorney-client privileged documents should be produced. The Supreme Court affirmed both the scope of production ordered and the Court of Chancery's adoption and application of *Garner*.

Wal-Mart involved a request by Indiana Electrical Workers Pension Trust Fund IBEW ("IBEW") to inspect a broad category of documents of Wal-Mart Stores, Inc. ("Wal-Mart") pursuant to 8 *Del. C.* § 220. The request was in response to allegations that Wal-Mart de Mexico ("WalMex"), a Wal-Mart subsidiary, engaged in a scheme of illegal bribery payments to Mexican officials at the direction of WalMex's CEO in exchange for benefits ranging from zoning changes to rapid and favorable processing of permits and licenses for new stores.¹⁶³ IBEW's stated purpose in requesting the documents was "to investigate: (1) mismanagement in connection with the WalMex Allegations; (2) the possibility of breaches of fiduciary duty by Wal-Mart or WalMex executives in connection with the bribery allegations; and (3) whether a pre-suit demand on the board would be futile as part of a derivative suit."¹⁶⁴ Although Wal-Mart produced certain documents, IBEW believed that the document production was deficient and too narrow in scope.¹⁶⁵ Wal-Mart also declined to produce to IBEW documents that were protected by the attorney-client privilege and attorney work-product doctrine.¹⁶⁶ As a result, IBEW brought an action in the Court of Chancery pursuant to Section 220.

IBEW also noticed depositions of certain Wal-Mart records custodians to gain information about documents that it believed should have been disclosed.¹⁶⁷ In response, Walmart moved for a protective order, arguing that the deposition

159. 73 A.3d 934 (Del. Ch. 2013).

160. 99 A.3d 229 (Del. Ch. 2014).

161. 95 A.3d 1264 (Del. 2014).

162. 430 F.2d 1093 (5th Cir.1970).

163. *Wal-Mart*, 95 A.3d at 1268.

164. *Id.*

165. *Id.* at 1269.

166. *Id.*

167. *Id.*

notices were overly broad.¹⁶⁸ After an October 2012 Court of Chancery hearing failed to resolve the parties' issues, the parties agreed to conduct a Section 220 trial on the basis of a paper record to determine whether Wal-Mart had produced all of the documents that were responsive to IBEW's demand.¹⁶⁹

On October 15, 2013, the Court of Chancery entered a Final Order and Judgment ordering Wal-Mart to produce: "(1) officer (and lower)-level documents regardless of whether they were ever provided to Wal-Mart's Board of Directors or any committee thereof; (2) documents spanning a seven-year period and extending well after the timeframe at issue; (3) documents from disaster recovery tapes; and (4) any additional responsive documents 'known to exist' by the undefined 'Office of the General Counsel.'"¹⁷⁰

Additionally, the Court of Chancery ordered Wal-Mart to produce documents protected by the attorney-client privilege. In doing so, the Court of Chancery relied on *Garner v. Wolfenbarger*, in which the Fifth Circuit recognized a stockholder's right to inspect attorney-client privileged documents in order to prove fiduciary breaches by those in control of the corporation upon showing good cause.¹⁷¹ The Court of Chancery also ordered Wal-Mart to produce documents protected by the attorney work-product doctrine.¹⁷²

Wal-Mart appealed the Court of Chancery's final order, arguing that it was ordered to produce documents that "far exceed the proper scope of a Section 220 action," and that IBEW failed to meet its burden of showing that the scope of production was "necessary and essential" to its proper purposes.¹⁷³ Wal-Mart also argued that the *Garner* doctrine had never been accepted by the Supreme Court in any plenary proceeding, much less in the context of a Section 220 action.¹⁷⁴ Finally, Wal-Mart argued that the Court of Chancery erroneously relied on the *Garner* doctrine in requiring Wal-Mart to produce work-product documents because the *Garner* doctrine is only applicable to attorney-client privileged documents.¹⁷⁵

The Supreme Court first affirmed the scope of the production ordered by the Court of Chancery. The Supreme Court explained that the plain language of Section 220(c) gives the Court of Chancery discretion to determine the scope of any document production and it thus only reviews the Court of Chancery's determinations for abuse of discretion.¹⁷⁶ The Supreme Court concluded that the Court of Chancery properly used its discretion in concluding that the documents ordered to be produced were "necessary and essential" to IBEW's proper purposes.¹⁷⁷

168. *Id.*

169. *Id.*

170. *Id.* at 1270.

171. *Id.*

172. *Id.*

173. *Id.* at 1270-71.

174. *Id.* at 1271.

175. *Id.*

176. *Id.* at 1271-72.

177. *Id.* at 1272.

Next, the Supreme Court affirmed the Court of Chancery's ruling that IBEW was entitled to certain attorney-client privileged documents. In doing so, the Supreme Court concluded that the Court of Chancery properly adopted the *Garner* doctrine in a Section 220 action. The Supreme Court explained that the *Garner* doctrine "is narrow, exacting, and intended to be very difficult to satisfy," and that the doctrine "achieves a proper balance between legitimate competing interests."¹⁷⁸ The Court made clear, however, that "the necessary and essential inquiry must precede any privilege inquiry because the necessary and essential inquiry is dispositive of the threshold question—the scope of document production to which the plaintiff is entitled under Section 220."¹⁷⁹

The Supreme Court also affirmed the Court of Chancery's application of the *Garner* doctrine. The Supreme Court relied on the following factors in determining that IBEW had satisfied the "good cause" standard required by *Garner*: (1) IBEW had a colorable claim; (2) the information sought was unavailable from non-privileged sources; (3) the information sought was particularized and not just "a broad fishing expedition"; (4) disclosure of the material would not risk the revelation of trade secrets; (5) the allegations at issue implicated criminal conduct under the Foreign Corrupt Practices Act; and (6) IBEW was a legitimate stockholder as a pension fund.¹⁸⁰

Finally, the Supreme Court affirmed the Court of Chancery's ruling that IBEW was entitled to certain work-product documents. The Supreme Court rejected Wal-Mart's contention that the Court of Chancery improperly conflated these two standards, explaining that "[a] careful reading of the *Garner* factors demonstrates that they overlap with the required showing under the Rule 26(b)(3) work-product doctrine" and that the Court of Chancery "only referred to the privilege rationale of *Garner* as overlapping with its own separate work product analysis."¹⁸¹

2. Conditions On Inspection: Agreements To Forum Selection And Trading Restrictions

In *United Technologies Corp. v. Treppel*,¹⁸² the Supreme Court considered on appeal whether the Court of Chancery had authority under 8 *Del. C.* § 220 to impose a restriction requiring a stockholder to bring any legal action resulting from a books and records inspection in Delaware. At the time Treppel brought his lawsuit, United Technologies did not have a forum selection clause in its bylaws requiring all litigation to be brought in Delaware courts.¹⁸³ However, the board adopted such a provision while the lawsuit was pending.¹⁸⁴ The Supreme Court reversed the Court of Chancery's ruling, holding that the Court of Chancery does have such authority under the broad powers of Section 220.¹⁸⁵ The Supreme

178. *Id.* at 1278.

179. *Id.*

180. *Id.* at 1279-80.

181. *Id.* at 1281.

182. 109 A.3d 553 (Del. 2014).

183. *Id.* at 556.

184. *Id.*

185. *Id.* at 559.

Court remanded the action so the Court of Chancery could consider in the first instance whether it should exercise its authority and impose this restriction based on the specific facts of the case.¹⁸⁶

Conversely, in *Ravenswood Inv. Co., L.P. v. Winmill & Co. Inc.*,¹⁸⁷ the Court of Chancery held that a corporation could not condition a production in response to a books and records demand on an agreement to indemnify the corporation against any legal claims arising as a result of the stockholder's use of the information received.

Ravenswood involved a demand by Ravenswood Investment Company, L.P. ("Ravenswood") to inspect the books and records of Winmill & Company Incorporated ("Winmill") pursuant to Section 220 for the purpose of "determining the value of its investment in and the economic performance of Winmill."¹⁸⁸ Winmill provided Ravenswood with all of its requested documents except for Winmill's financial statements.¹⁸⁹ Winmill had concerns regarding potential "tipper liability" under the federal securities law for disclosing material, nonpublic information to a recipient who then trades on that information.¹⁹⁰ Winmill also argued that Ravenswood's true purpose for requesting the financial statements could only have been to trade on the non-public, material information that it would learn from the financial statements, which did not qualify as a "proper purpose" under Section 220(b).¹⁹¹ Thus, Winmill refused to provide Ravenswood with its financial statements unless Ravenswood agreed to be bound by a restriction forbidding it to trade in Winmill's stock for one year after receiving the financial statements.¹⁹²

The Court began its analysis by noting that "Delaware law has long recognized that valuing stock is a proper purpose to support a stockholder's request for financial information from a corporation under 8 *Del. C.* § 220."¹⁹³ The Court thus concluded that Ravenswood's purpose for requesting Winmill's financial statements was "clearly proper," and that "any secondary purpose or ulterior motive of the stockholder becomes irrelevant."¹⁹⁴

Having determined the purpose of Ravenswood's request to be proper, the Court next addressed the restriction that Winmill sought to impose on Ravenswood as a condition to producing the financial statements. The Court held that such a restriction "would inappropriately frustrate" the "fundamental stockholder right" of valuing stock.¹⁹⁵ The Court explained that "the whole point of valuing stock is so that a stockholder can determine what to do with it: to buy, to sell, or to use the value for some other appropriate purpose."¹⁹⁶ The Court was thus "unwilling to incorporate such an inequitable notion into Delaware's Section 220 jurisprudence," concluding that such a restriction "is contrary to Delaware law."¹⁹⁷

186. *Id.* at 560.

187. 2014 Del. Ch. LEXIS 93 (Del. Ch. May 30, 2014) (Noble, V.C.).

188. *Id.* at *7.

189. *Id.*

190. *Id.*

191. *Id.*

192. *Id.*

193. *Id.* at *11.

194. *Id.* at *12.

195. *Id.*

196. *Id.* at *12-13.

197. *Id.* at *13.

3. Proper Purpose For Inspection: Ulterior Purposes And Desire To Investigate Time-Barred Claims

In *Caspian Select Credit Master Fund Ltd. v. Key Plastics Corp.*,¹⁹⁸ the Court of Chancery considered whether a stockholder had improper ulterior motives in requesting to inspect a corporation's books and records other than its stated purpose, which the Court had determined was a "proper purpose" under 8 *Del. C.* § 220(b). The Court granted the stockholder's request to inspect the corporation's books and records, holding that the corporation could not prove that the stockholder's stated purpose for inspecting the books and records was not genuine and that the potential existence of an ulterior motive was not a basis to reject the stockholder's request.

Caspian involved a request by Caspian Select Credit Master Fund Ltd. ("Caspian"), the owner of approximately 8.5% of Key Plastics Corporation's ("Key Plastics") outstanding shares, to inspect Key Plastics' books and records pursuant to Section 220. Key Plastics had filed a prepackaged bankruptcy plan under Chapter 11. Caspian served a demand letter upon Key Plastics requesting to inspect Key Plastics' books and records.¹⁹⁹ The letter explained that Caspian wished to inspect Key Plastics' books and records for the purpose of, among other things, (i) investigating potential waste and mismanagement with respect to a loan provided to Key Plastics by Wayzata Investment Partners LLC, the manager of two funds that together owned the other 91.5% of Key Plastics outstanding shares; (ii) investigating whether the controlling stockholders engaged in any self-dealing; and (iii) valuing Caspian's equity stake.²⁰⁰ Key Plastics agreed to allow Caspian to inspect a limited number of documents on condition that Caspian sign a confidentiality agreement.²⁰¹ Caspian refused to sign the confidentiality agreement and instead brought a books and records action.

The parties disagreed about whether Caspian's purpose for inspecting the books and records was proper. Caspian argued that both its desire to investigate potential waste and mismanagement and its desire to value its equity stake were proper purposes under Section 220(b).²⁰² Key Plastics argued that Caspian's true purpose for requesting to inspect the books and records was to use the litigation as a means to force Key Plastics to buy Caspian's equity stake.²⁰³

The Court began its analysis by noting that the valuation of one's equity stake and the investigation of potential waste, mismanagement, self-dealing or other improper transactions are proper purposes under Section 220(b).²⁰⁴ Accordingly, the Court explained that "[b]ecause the analysis of a stockholder's secondary purpose or ulterior motive is unnecessary once a proper primary purpose is established, the Court's analysis is limited to determining whether the alleged secondary purposes are the stockholder's primary purposes and the stated primary purpose is false."²⁰⁵ In other words, the Court held

198. 2014 Del. Ch. LEXIS 26 (Del. Ch. Feb. 24, 2014) (Noble, V.C.).

199. *Id.* at *5.

200. *Id.*

201. *Id.* at *6.

202. *Id.* at *7.

203. *Id.*

204. *Id.* at *9-11.

205. *Id.* at *9.

that for a defendant to rebut an established proper primary purpose “[t]he defendant must demonstrate that the plaintiff’s stated purpose was offered under false pretenses and thus the primary purpose is improper.”²⁰⁶

The Court found no evidence that Caspian’s stated purposes were offered under false pretenses. The Court explained that Caspian had demonstrated an interest in selling its equity stake, which justified Caspian’s desire to value that stake, and produced sufficient evidence to support a credible basis for its concerns regarding waste, mismanagement and self-dealing, etc.²⁰⁷ The Court rejected Key Plastics’ assertions that the evidence did not support a credible basis to infer wrongdoing as “attempts to engage in a merits defense,” explaining that “a stockholder need not prove actual wrongdoing as a Section 220 action is not a full trial on the merits.”²⁰⁸

In *Wolst v. Monster Beverage Corp.*,²⁰⁹ the Court of Chancery considered whether a stockholder seeking to inspect a corporation’s books and records to evaluate the corporation’s rejection of the stockholder’s litigation demand can demonstrate a “proper purpose” under Section 220(b) when the claims the stockholder sought to bring are now time-barred. The Court held that, in such a case, the inspection request would be improper.

Wolst involved a request by Anastasia Wolst, a stockholder of Monster Beverage Corporation (“Monster”), to inspect Monster’s books and records pursuant to Section 220. In 2012, Wolst made a demand on Monster’s board to bring litigation related to potential federal securities violations by certain Monster insiders.²¹⁰ In response, Monster’s board appointed a special committee, which rejected Wolst’s demand.²¹¹ In 2013, Wolst requested from Monster to inspect certain of its books and records for the purpose of evaluating the board’s refusal to act on her litigation demand and the process by which the board decided to reject her demand.²¹² Wolst conceded that her ultimate goal was “to determine whether there is a basis to bring a derivative suit based on the wrongs alleged in the earlier derivative action.”²¹³ Monster thus argued that Wolst’s request was not for a “proper purpose,” as required by Section 220(b), because the derivative suit that Wolst wanted to bring was time-barred.²¹⁴

The Court began its analysis by noting that while the derivative suit that Wolst wanted to bring was time-barred, it is possible that “conduct that cannot be challenged because of a time-bar defense can, nevertheless, inform consideration of other potentially wrongful conduct that is not yet time-barred.”²¹⁵ Nevertheless, the Court acknowledged “the possibility that, in a specific factual setting, a time bar defense ... would eviscerate any showing that might otherwise

206. *Id.* at *12-13.

207. *Id.* at *9-12.

208. *Id.* at *12.

209. 2014 Del. Ch. LEXIS 198 (Del. Ch. Oct. 3, 2014) (Noble, V.C.).

210. *Id.* at *2.

211. *Id.*

212. *Id.*

213. *Id.*

214. *Id.*

215. *Id.* at *4.

be made in an effort to establish a proper shareholder purpose.”²¹⁶ The Court explained that in this case, the challenged trading activities occurred in 2006 and 2007 and Wolst had not identified any more recent wrongful conduct that could serve as a basis for litigation. The Court thus concluded that “[w]ithout some elaboration upon what [Wolst] would do with the requested books and records in her capacity as a stockholder, the burden of producing books and records that Section 220 imposes upon the corporation should be avoided in this instance.”²¹⁷ The Court emphasized, however, that its holding was limited to “this specific factual setting.”²¹⁸

E. Dismissing Directors Pre-Trial On The Basis Of Exculpatory Charter Provisions

In *In re Cornerstone Therapeutics, Inc. S’holder Litig.*, the Supreme Court put an end to a long-standing debate concerning the procedural implications of exculpatory charter provisions.²¹⁹ Overruling the Court of Chancery,²²⁰ the Supreme Court held that even when the challenged transaction is subject to entire fairness review, exculpated claims against directors protected by exculpatory charter provisions may be resolved before trial, saving the directors the burden of litigation.²²¹

In February 2013, Chiesi Farmaceutici S.p.A. (“Chiesi”), a privately-held Italian drug manufacturer and holder of 65.4% of the stock in Cornerstone Therapeutics Inc. (“Cornerstone”) sent a letter to Cornerstone’s board offering to acquire all of Cornerstone’s remaining stock for between \$6.40 and \$6.70 per share.²²² At the time, Cornerstone’s board consisted of nine directors, including two who were current Chiesi employees.²²³ Cornerstone formed a special committee to consider Chiesi’s offer. The special committee consisted of five Cornerstone directors, all of whom were unaffiliated with Chiesi.²²⁴ The special committee hired Clifford Chance U.S. LLP as its legal advisor and Lazard as its financial advisor.²²⁵

Upon reviewing management’s forecasts and Lazard’s financial analysis, the special committee concluded that the fair value of Cornerstone’s stock was in the range of \$11.00 to \$12.00 per share. The special committee communicated to Chiesi that it would consider a deal at \$12.00 per share.

216. *Id.*

217. *Id.*

218. *Id.*

219. 115 A.3d 1173 (Del. 2015).

220. 2014 Del. Ch. LEXIS 170 (Del. Ch. Sept. 10, 2014) (Glasscock, V.C.).

221. *Cornerstone*, 115 A.3d at 1176.

222. *Cornerstone*, 2014 Del. Ch. LEXIS 170, at *3-4.

223. A third director was a former Chiesi employee. *Id.*

224. Plaintiffs, however, questioned the special committee’s independence, noting that some of its members were involved in a company that had previously done a deal with Chiesi and that the other members were handpicked by Cornerstone’s CEO, who had previously sold Cornerstone stock to Chiesi. *Id.* at *6.

225. *Id.* at *4-6.

In May 2013, Cornerstone released first quarter financial results that fell below its projections. Based on management's updated financial forecast and certain negative adjustments that the special committee instructed Lazard to make to its financial analysis, the special committee informed Chiesi that it would accept a deal at \$10.25 per share.²²⁶

A few weeks later, Cornerstone received a letter from one of its competitors advising that it was seeking regulatory approval for a new drug that would compete directly with one of Cornerstone's products; but, the competitor claimed, that would not infringe on any of Cornerstone's patents. In light of this threat, the special committee further revised its demand to Chiesi downward, to \$9.75 per share.²²⁷

The special committee ultimately recommended to the board a merger at \$9.50 per share, conditioned upon the approval of the majority of Cornerstone's minority stockholders. The Cornerstone board approved the merger and filed its definitive proxy in December 2013. The merger was approved by more than 80% of Cornerstone's minority stockholders at a special stockholder meeting in February 2014.²²⁸

The plaintiffs filed suit to challenge the merger, asserting a breach of fiduciary duty claim against members of the special committee and the other four Cornerstone directors, a breach of fiduciary duty claim against Chiesi as the controlling stockholder, and an aiding and abetting a breach of fiduciary duty claim against Cornerstone.²²⁹

All defendants moved to dismiss the claims against them. Both plaintiffs and defendants agreed that entire fairness was the appropriate standard of review for the claims against Chiesi as the controlling stockholder and against the two interested directors employed by Chiesi. The seven director defendants who were not employed by Chiesi at the time of the merger, however, contended that they were entitled to dismissal of plaintiffs' claims because they were disinterested in the merger and plaintiffs had failed to allege with specificity that the director defendants breached a non-exculpated fiduciary duty.²³⁰

Plaintiffs opposed dismissal. Relying on *Emerald Partners v. Berlin*,²³¹ plaintiffs argued that in a case governed by *Kahn v. Lynch*,²³² the Court may not dismiss claims against disinterested and independent directors at the pre-trial stage, even where a plaintiff fails to allege a breach of non-exculpated fiduciary duty with specificity. Plaintiffs reasoned that one of the purposes of entire fairness review is to allow for thorough discovery and fact-finding at trial to uncover possible breaches of the duty of loyalty by disinterested directors who might have been influenced by a controlling stockholder.²³³

On the motion to dismiss, the Court of Chancery noted the advantages of both plaintiffs' and the independent directors' arguments regarding the appropriate pleading standard to be applied to claims against disinterested directors in a transaction involving a controlling stockholder. According to the Court, plaintiffs' proposed standard would "undoubtedly

226. *Id.* at *9-10. Plaintiffs asserted that the special committee's decision was partially motivated by the fear that Chiesi would terminate discussions unless the special committee lowered its proposal.

227. *Id.* at *10-11.

228. *Id.* at *11-12.

229. *Id.* at *12-13.

230. *Id.* at *14-16.

231. 787 A.2d 85 (Del. 2001).

232. 638 A.2d 1110 (Del. 1994).

233. *Cornerstone*, 2014 Del. Ch. LEXIS 170, at *16-17.

result in justice being done in cases where, under the [Director] Defendants' pleading rule, faithless directors would not be called to account."²³⁴ Conversely, the Court noted, the disinterested and independent director defendants' proposed standard "is consistent with our treatment of directors alleged to have breached duties in non-controller-dominated transactions," "allows management of the corporation to proceed unaffected by frivolous litigation [,] and protects the directors' ability to pursue appropriate levels of risk without fear of liability, so long as their actions are consistent with the duty of loyalty."²³⁵ In the end, however, the Court of Chancery concluded that it was bound by controlling precedent to deny the motion to dismiss.

On appeal, the Supreme Court reversed the Court of Chancery's decision, but acknowledged that "the body of law relevant to these disputes presents a debate between two competing but colorable views of the law."²³⁶ The Supreme Court observed, however, that denying dismissal to independent directors that had not committed duty of loyalty or good faith violations incentivizes such directors to avoid serving on special committees altogether or to reject transactions simply from fear of litigation.²³⁷

The Supreme Court further observed that to deny dismissal to directors with only exculpatory claims pled against them would undermine a purpose of 102(b)(7),²³⁸—to allow directors to take business risks without fear of personal liability.²³⁹

In reaching this result, the Supreme Court cabined its ruling in *Emerald Partners*, instructing that it should be read only in its "case-specific context."²⁴⁰

The Supreme Court also mentioned previous Court of Chancery opinions that supported its *Cornerstone* holding. In *In re Southern Peru Copper Corp. Shareholder Derivative Litigation*,²⁴¹ the Court of Chancery granted—albeit in a bench ruling²⁴²—summary judgment for special committee defendants prior to trial based upon an exculpatory charter provision. Likewise, in *Dirienzo v. Lichtenstein*,²⁴³ the Court of Chancery granted special committee defendants' motion

234. *Id.* at *40.

235. *Id.* at *35.

236. *Cornerstone*, 115 A.3d at 1179.

237. *Id.* at 1184.

238. *Id.* at 1185.

239. *Id.*

240. *Id.* at 1185.

241. *In re S. Peru Copper Corp. S'holder Deriv. Litig.*, C.A. No. 961-VCS, Transcript of Oral Argument at 40, 43, (Del. Ch. Dec. 21, 2010) (Strine, V.C.) ("[F]or about seven to ten good and sufficient reasons, . . . [it] really couldn't be the law" that "pre-trial dismissal on 102(b)(7) grounds in an entire fairness case is not appropriate," because "the whole idea of the 102(b)(7) clause is if all you can fault [directors] for is some lapse in care, then they are out.").

242. Note, however, that the Delaware Court of Chancery has cautioned practitioners about relying on transcripts of bench rulings as precedent. *In re NYSE Euronext S'holders Litig.*, C.A. No. 8236-CS, Transcript at 4-6, (Del. Ch. May 10, 2013) (Strine, C.).

243. 2013 Del. Ch. LEXIS 242, at *34-60 (Del. Ch. Sept. 30, 2013) ("[The plaintiff] seeks to bootstrap his entire fairness claim against Lichtenstein into an entire fairness claim against the Special Committee. This he cannot do. To burden the Special Committee with proving entire fairness, [the plaintiff] must allege sufficient that the committee members breached a non-exculpated fiduciary duty.").

to dismiss prior to discovery pursuant to a § 102(b)(7) provision. In both cases, the challenged transactions were subject to entire fairness review. The *Cornerstone* Court discussed *DiRienzo* at length and approved *DiRienzo*'s interpretation that *Emerald Partners* stood only "for the mundane proposition that a defendant cannot obtain dismissal on the basis of an exculpatory provision when there is evidence that he committed a non-exculpated breach of fiduciary duty."²⁴⁴

F. Adopting And Applying Section 204 And 205 Of The DGCL

Sections 204 and 205 of the Delaware General Corporation Law became effective on April 1, 2014.²⁴⁵ Section 204 creates a statutory method of retroactively ratifying any void or voidable corporate act that is within the power of the corporation under subchapter II of the DGCL. Section 205 establishes a new type of proceeding in the Delaware Court of Chancery to determine or affect the validity of corporate acts.

Two 2014 cases gave rise to decisions applying Section 205: *In re Trupanion, Inc.*,²⁴⁶ and *In re Cheniere Energy, Inc. Stockholders Litigation*.²⁴⁷

The petitioners in *Trupanion* sought to cure uncertainty arising from a series of invalid corporate conversions of Trupanion, Inc. ("Trupanion"). Specifically, in 2008, a Trupanion employee filed documents purportedly effecting a conversion of Trupanion from a Delaware corporation to an Arizona corporation with the Delaware Secretary of State and the Arizona Corporation Commission.²⁴⁸ The employee filed these documents without first obtaining the necessary approval from either Trupanion's board or stockholders.²⁴⁹ Three months later, the same employee filed documents purportedly undoing the prior transaction, converting Trupanion from an Arizona corporation to a Delaware corporation.²⁵⁰ Thereafter, Trupanion purported to issue additional stock, amend its certificate of incorporation, and hold annual meetings to elect new directors.²⁵¹ By 2014, due to the purported conversions in 2008, it was unclear whether Trupanion existed as a Delaware corporation, what of its outstanding stock was valid, and whether its board was validly elected.²⁵²

Because Trupanion could not identify its directors or stockholders with certainty, it was unable to ratify its defective conversions and subsequent corporate acts through Section 204. Nonetheless, Trupanion sent each of its stockholders and putative stockholders, with the exception of one former stockholder running a competing business, an information sheet, which informed them of the defective corporate acts and asked each stockholder or putative stockholder to indicate

244. *Cornerstone*, 115 A.3d at 1186.

245. 8 Del. C. §§ 204, 205.

246. C.A. No. 9496-VCP (Del. Ch. Apr. 28, 2014) (ORDER and TRANSCRIPT) (Parsons, V.C.).

247. C.A. No. 9710-VCL (Del. Ch. Jul. 10, 2014) (TRANSCRIPT) (Laster, V.C.).

248. Verified Petition for Relief Under 8 Del. C. § 205, C.A. No. 9496-VCP, at ¶¶ 1-2 (Del. Ch. Apr. 28, 2014).

249. *Id.* at ¶ 2.

250. *Id.*

251. *Id.*

252. *Id.* at ¶ 3.

whether they supported ratification of each defective corporate act.²⁵³ Stockholders representing 99.26% of Trupanion's valid stock responded in support of ratification.²⁵⁴

Trupanion then filed a petition under Section 205 in the Delaware Court of Chancery, detailing the events leading to the defects in its corporate structure as well as its efforts to confirm its stockholders' approval of ratification. Along with the significant issues caused by the purported conversions, Trupanion also noted other potentially defective corporate acts in its history.²⁵⁵ Finally Trupanion noted that it could not ratify the defects in its corporate structure through Section 204 with confidence.²⁵⁶

Less than a month after Trupanion's petition under Section 205 was filed, the Court held a hearing on Trupanion's petition.²⁵⁷ At the start of the hearing, the Court confirmed that there were no objectors to Trupanion's petition at the hearing.²⁵⁸ The Court also confirmed that Section 204 was not a viable alternative for Trupanion.²⁵⁹ Nonetheless, the Court noted that the course that Trupanion had followed was akin to a Section 204 action, in that it had provided notice and sought stockholder approval.²⁶⁰ The Court then clarified that although it was willing to confirm the validity of Trupanion's stock and stock options, it was only doing so with respect to the defects identified in the information statement sent to Trupanion's stockholders and putative stockholders: "I don't mean for this to be, you know, sanitizing everything that possibly ever could have been challenged about any of those transactions."²⁶¹

At the hearing, the Court granted Trupanion's proposed form of order ratifying the defective corporate acts for which Trupanion sought ratification. The Court noted that in granting the proposed order, it was important that "we, through this order, not be granting something more than you would have gotten if you went through the procedures of 204."²⁶² The Court directed Trupanion to file multiple certificates of validation with the Secretary of State to address the multiple potentially invalid actions taken by Trupanion and the Court directed the Secretary of State to accept the Certificates.²⁶³ The Court also validated Trupanion's proposed stock ledger, a statement of outstanding options, and a roster for Trupanion's board, each as set forth in an exhibit provided by Trupanion.²⁶⁴

253. *Id.* at ¶ 79.

254. C.A. No. 9496-VCP, at 29 (Del. Ch. Apr. 28, 2014) (TRANSCRIPT) (Parsons, V.C.).

255. Verified Petition for Relief Under 8 Del. C. § 205, C.A. No. 9496-VCP, at ¶¶ 44-48 (Del. Ch. Apr. 28, 2014).

256. *Id.* at ¶ 53.

257. C.A. No. 9496-VCP (Del. Ch. Apr. 28, 2014) (TRANSCRIPT) (Parsons, V.C.).

258. *Id.*

259. *Id.* at 6.

260. *Id.* at 21-22.

261. *Id.* at 21, 38.

262. *Id.* at 37.

263. *Id.* at 23.

264. 2014 Del. Ch. LEXIS 176 (Del. Ch. Apr. 28, 2014) (Parsons, V.C.).

The second Section 205 decision of 2014, *In re Cheniere Energy, Inc. Stockholders Litigation*,²⁶⁵ addressed the procedural interplay between Section 205 actions and traditional stockholder litigation challenging corporate acts.

At its 2013 stockholders' meeting, Cheniere held a stockholder vote to approve an amendment (the "Amendment") to a plan that governed the issuance of stock options to Cheniere's directors, officers, and employees, to permit the issuance of additional options.²⁶⁶ The NYSE, on which Cheniere's stock trades, required a stockholder vote to approve the Amendment.²⁶⁷ In counting the stockholder vote on the Amendment, Cheniere omitted abstentions, as Cheniere contended was permitted by the NYSE rules, and determined that the stockholders had approved the Amendment.²⁶⁸

Cheniere stockholders brought multiple derivative and direct lawsuits alleging, *inter alia*, that the Amendment was not validly approved because stockholder abstentions from the vote to approve the Amendment should have been treated as "no" votes under Delaware law.²⁶⁹ Shortly thereafter, Cheniere filed an action pursuant to Section 205 seeking: (1) a determination that the Amendment was validly approved as a matter of law and (2) if the Amendment was not validly approved, judicial ratification of the Amendment (the "Section 205 Action").²⁷⁰

At oral argument on the schedule for the Section 205 Action and the stockholder actions, Cheniere argued that the Section 205 Action should proceed first because the Section 205 Action afforded the Court more flexibility with respect to remedies.²⁷¹ Cheniere further argued that the Court should bifurcate the Section 205 Action to address the question of validity first as a matter of law, and then, if necessary, to permit the plaintiff stockholders to take discovery in advance of a trial on ratification.²⁷² The stockholders argued, among other things, that it was improper for Cheniere to bring the Section 205 Action in response to the stockholder actions and that the Section 205 Action should be viewed as "a tag-along case," to be addressed if anything remained after a resolution of the stockholder actions.²⁷³

The Court agreed with Cheniere that, in the scheduling context, "the Section 205 action logically takes precedence and is designed to take precedence. The idea of fixing things through ratification and the idea that you could moot challenges by engaging in ratification is something that is long-standing."²⁷⁴ The Court also noted that equity acts where there is no other remedy, but Section 205 provided a remedy at law to many of the issues raised by the plaintiffs.²⁷⁵ The

265. C.A. No. 9710-VCL (Del. Ch. Jul. 10, 2014) (TRANSCRIPT) (Laster, V.C.).

266. Verified Application Pursuant to 8 Del. C. § 205, C.A. No. 9710-VCL, at ¶¶ 32-49 (Del. Ch. July 10, 2014).

267. *Id.*

268. *Id.* at ¶¶ 5-6.

269. *Jones v. Souki*, C.A. No. 9710-VCL (Del. Ch. filed May 29, 2014), *Macguire v. Souki*, C.A. No. 9746-VCL (Del. Ch. filed June 6, 2014), and *Shenker v. Souki*, C.A. No. 9763 (Del. Ch. filed June 13, 2014).

270. Verified Application Pursuant to 8 Del. C. § 205, C.A. No. 9710-VCL, at ¶¶ 81-90 (Del. Ch. July 10, 2014) (Laster, V.C.)

271. C.A. No. 9710-VCL, at 6-7 (Del. Ch. July 10, 2014) (TRANSCRIPT) (Laster, V.C.).

272. *Id.* at 16-17.

273. *Id.* at 28.

274. *Id.* at 38-39.

275. *Id.* at 39.

Court further observed that the stockholders were not worse off as a result of the stay of the consolidated action, because the consolidated action was also subject to a motion for judgment on the pleadings as to the validity of the Amendment, which would have a similar effect to the stay in favor of the Section 205 Action. Finally, the Court held that Cheniere's proposed bifurcated approach was sensible. Thus, the Court ordered the parties to submit briefing on the validity of the Amendment and stayed discovery pending a ruling on validity.

While addressing scheduling, the Court observed that the Section 205 Action would not necessarily resolve the consolidated action:

What is clear from 205 and what is clear from 204 is that it addresses legal validity Let's assume that these shares are validated, but they're validated at great expense and cost to the company. There is still a potential wrong out there. It doesn't necessarily mean that that wrong is moot. That wrong might be *de minimis*, such that nobody feels that it's worth pursuing, but it may or may not be that there is, nevertheless, a claim against the humans who caused the corporation to engage in particular behavior or who acted contrary, it is alleged, to potential contract rights as part of the constitutive agreement between the corporation and stockholders. That would still remain live.²⁷⁶

In the course of ruling on the litigation schedule, the Court made several helpful observations about Section 205 actions generally. First, the Court observed that "it seems to me that if a company is going to come forward and say, 'Court, bless this,' you have something of an obligation to come forward and inform the Court about everything that one is blessing."²⁷⁷ Second, the Court noted that the grant of validation can be "conditioned on things[.]" in order to balance the equities where ratification is sought in a context in which the board was found to have engaged in misconduct but third-parties would be harmed in the absence of ratification.²⁷⁸

G. Challenging A Sales Process Under *Revlon*

The Delaware Supreme Court in *C&J Energy Services, Inc. v. City of Miami General Employees and Sanitation Employees' Retirement Trust*,²⁷⁹ reversed the Court of Chancery's November 24, 2014 bench ruling enjoining a business combination for 30 days to permit the target company to shop itself during that period.

In *C&J*, the stockholder plaintiffs sued to enjoin a merger between C&J and a division of a competitor, Nabors Industries Ltd. ("Nabors").²⁸⁰ Through the proposed merger, C&J, a U.S. corporation, would acquire a subsidiary of Nabors, domiciled in Bermuda.²⁸¹ The merger was structured to effect a "corporate inversion" whereby the combined entity would be re-domiciled as a Bermuda entity to obtain significant corporate tax savings.²⁸² Importantly, Nabors would retain

276. *Id.* at 40-41.

277. *Id.* at 12.

278. *Id.* at 48.

279. 107 A.3d 1049 (Del. 2014).

280. *Id.* at 1052.

281. *Id.*

282. *Id.* at 1057.

the majority of the equity of the surviving entity.²⁸³ The merger was negotiated by C&J's chairman and founder, Joshua Comstock, who held a 10% stake in C&J.²⁸⁴

In light of the proposed restructuring (and corresponding transfer of majority control to Nabors), the seven-member board of C&J considered whether to actively shop C&J to potential buyers, but it elected not to do so.²⁸⁵ To temper Nabors' majority voting control of the surviving entity, C&J's board negotiated certain protections for C&J's stockholders, including a by-law guaranteeing that all stockholders would share *pro rata* in any future sale of the new entity.²⁸⁶ The board also bargained for a "fiduciary out" if a superior proposal emerged during a lengthy market check, but the merger agreement prohibited C&J from soliciting competing bids.²⁸⁷ As part of the final deal, Comstock would receive a more generous compensation package from the new entity than the compensation he would receive in his current position at C&J.²⁸⁸

The Court of Chancery faulted the board for failing to actively shop C&J and determined that there was a plausible violation of the board's *Revlon* duties. The Court of Chancery enjoined the stockholder vote for 30 days and required C&J to shop itself.²⁸⁹ To address the fact that this mandatory injunction otherwise conflicted with the terms of the merger agreement, the Court of Chancery ruled that "[t]he solicitation of proposals consistent with this Order and any subsequent negotiations of any alternative proposal that emerges will not constitute a breach of the Merger Agreement in any respect."²⁹⁰ The defendants filed an expedited appeal.

In reversing this decision, the Delaware Supreme Court described the Court of Chancery's ruling as "an unusual preliminary injunction."²⁹¹ The Supreme Court agreed with the Court of Chancery's determination that "*Revlon* made clear that when a board engages in a change of control transaction, it must not take actions inconsistent with achieving the highest immediate value reasonably attainable."²⁹² But the Supreme Court clarified that *Revlon* did not require the board to conduct an active solicitation process in order to satisfy its contextual fiduciary duties:

Revlon does not require a board to set aside its own view of what is best for the corporation's stockholders and run an auction whenever the board approves a change of control transaction "[T]here is no single blueprint that a board must follow to fulfill its duties," and a court applying *Revlon's* enhanced scrutiny must decide "whether the directors made a *reasonable* decision, not a *perfect* decision."²⁹³

283. *Id.* at 1052.

284. *Id.* at 1055.

285. *Id.* at 1061.

286. *Id.* at 1062.

287. *Id.*

288. *Id.* at 1064.

289. *Id.* at 1052.

290. *C&J Energy Servs.*, C.A. No. 9980-VCN, Order Granting Preliminary Injunction, Certifying Interlocutory Appeal, & Staying the Injunction Pending Appeal, (Del. Ch. Nov. 26, 2014) (Noble, V.C.).

291. 107 A.3d at 1052.

292. *Id.* at 1067 (citation omitted).

293. *Id.* (quoting *Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361, 1385-86 (Del. 1995)).

The Court clarified that an “effective” market check need not be an “active” one, but rather, a process through which “interested bidders have a fair opportunity to present a higher-value alternative, and the board has the flexibility to eschew the original transaction and accept the higher-value deal.”²⁹⁴ Thus, the Supreme Court held that the Court of Chancery had misapplied the *Revlon* standard by requiring an active solicitation process.²⁹⁵

The Supreme Court also ruled that the Court of Chancery erred by entering a mandatory injunction based on a preliminary record.²⁹⁶ The Supreme Court first noted that the traditional use of a preliminary injunction is to preserve “the status quo,” not to require a party to take affirmative action.²⁹⁷ The standard of review for a preliminary injunction requires a plaintiff to demonstrate (1) a reasonable probability of success on the merits, (2) that they will suffer irreparable injury without an injunction, and (3) that its harm without an injunction outweighs the harm to defendant that will result from the injunction.²⁹⁸ The Supreme Court determined that the Court of Chancery misapplied the first factor:

In this case, although the Court of Chancery correctly identified the standard of review for a preliminary injunction, it misapplied that standard when it found that there was “a *plausible* showing of a likelihood of success on the merits as to a breach of the duty of care, and that goes to an absence of an effort to sell.” ... A party showing a “reasonable probability” of success must demonstrate “that it will prove that it is more likely than not entitled to relief.”²⁹⁹

Further, the Court observed that “[t]o issue a mandatory injunction requiring a party to take affirmative action—such as to engage in the go-shop process the Court of Chancery required—the Court of Chancery must either hold a trial and make findings of fact, or base an injunction solely on undisputed facts.”³⁰⁰ The Supreme Court observed that here, “the Court of Chancery issued a mandatory injunction on a paper record that surfaced a number of important factual disputes and that was only sufficient to convince the Court of Chancery that the plaintiffs had a plausible merits case. This was error.”³⁰¹ The Supreme Court concluded by noting that “[a]lthough the equitable authority of our Court [of Chancery] is broad, it is not uncabined and must be exercised with care and respect for the rights of litigants.”³⁰²

In addition, the Court observed that where, as in C&J, there is no finding that the acquirer aided and abetted in any fiduciary breach, it is inappropriate to “blue-pencil” a contract through a mandatory injunction and thereby “strip an innocent third part of its contractual rights while simultaneously binding that party to consummate the transaction.”³⁰³

294. 107 A.3d. at 1068.

295. *Id.* at 1071.

296. *Id.*

297. *Id.* at 1072.

298. *Id.* at 1066.

299. *Id.* (quoting *C&J Energy Services, C.A. No. 9980-VCN* (Del. Ch. Nov. 24, 2014) and *Mitchell Lan Publishers, Inc. v. Rasemas*, 2014 Del. Ch. LEXIS 194 (Del. Ch. 2014)).

300. *Id.* at 1071.

301. *Id.*

302. *Id.*

303. *Id.* at 1054.

H. Endorsement Of Lower Poison Pill Threshold To Activist Stockholder Under *Unocal*

In *Third Point LLC v. Ruprecht*,³⁰⁴ the Court held that activist stockholders may constitute a threat justifying the imposition of a poison pill with a lower trigger level (10%) than that applicable to passive investors (20%).

Third Point involved Sotheby's, a publicly traded Delaware corporation, led by an independent, non-staggered board.³⁰⁵ Between May and July of 2013, three hedge funds—Triam Fund Management, L.P. (“Triam”), Third Point, LLC (“Third Point”) and Marcato Capital Management LLC (“Marcato”)—disclosed stockholdings in Sotheby's.³⁰⁶ Sotheby's board became concerned about the possibility of a proxy contest being mounted by the hedge funds either separately or as a group.³⁰⁷ The board met repeatedly with its legal advisor, Wachtell, Lipton, Rosen & Katz (“Wachtell”) and financial advisor, Goldman Sachs Group, Inc. (“Goldman”) to discuss both a possible proxy contest and a project to return capital to stockholders.³⁰⁸

By October 2, 2013, Third Point filed an amended Schedule 13D, revealing that it had increased its stake in Sotheby's to 9.4%, making it Sotheby's largest stockholder.³⁰⁹ Third Point included a letter with its Schedule 13D filing criticizing Sotheby's management, board, and competitive position.³¹⁰ The next day, the board met with Wachtell and Goldman.³¹¹ Wachtell recommended that the board adopt a poison pill to ensure the board's involvement in the timing and outcome of a takeover or creeping accumulation of control.³¹² The board tabled the poison pill proposal at the close of the October 3 meeting, but met again on October 4 and approved the poison pill.³¹³ At the October 4 board meeting at which the board approved the poison pill, the board did not make any explicit finding that the hedge funds presented a threat to Sotheby's.³¹⁴

By its terms, the poison pill expired in one year unless approved by a stockholder vote, did not apply to certain “any-and-all” shares offers for 100% of the company, and had a two-tier structure.³¹⁵ Under the poison pill, a stockholder

304. 2014 Del. Ch. LEXIS 64 (Del. Ch. May 2, 2014) (Parsons, V.C.).

305. *Id.* at *8-9.

306. *Id.* at *9-12.

307. *Id.* at *15-17.

308. *Id.* at *10.

309. *Id.* at *28.

310. *Id.*

311. *Id.*

312. *Id.* at *30-31.

313. *Id.* at *31-32.

314. *Id.* at *32.

315. *Id.* at *32-33.

who reported its ownership pursuant to Schedule 13G, indicating its status as a passive investor, was able to acquire up to a 20% interest in Sotheby's, but all other stockholders, including Third Point, were limited to 10% ownership.³¹⁶

Throughout late 2013 and early 2014, the board attempted unsuccessfully to negotiate an agreement with Third Point's CEO Daniel Loeb to forestall a proxy fight.³¹⁷ Third Point also continued to increase its stockholdings.³¹⁸ Then, in March 2014, in advance of Sotheby's annual meeting, Third Point requested a waiver of the poison pill to allow it to buy up to 20% of Sotheby's stock. Sotheby's board refused.³¹⁹

Third Point then sought a preliminary injunction to delay Sotheby's upcoming annual meeting until the Court had an opportunity to rule on the validity of the poison pill.³²⁰

Applying *Unocal's* two prong analysis, the Court first assessed whether the board reasonably perceived a threat to corporate effectiveness. The Court found a *prima facie* showing of reasonableness based on the board's composition of a majority of outside, independent directors and reliance on the advice of legal counsel.³²¹ Thereafter, the Court noted that, when Sotheby's adopted the poison pill, several hedge funds were increasing their Sotheby's holdings and Third Point was doing so rapidly.³²² Thus, the Court concluded that

Based on these facts and the profiles of Third Point and Marcato, presented to the Board in materials prepared by its financial and legal advisors, I cannot conclude that there is a reasonable probability that the Board did not make an objectively reasonable determination that Third Point posed a threat of forming a control block for Sotheby's with other hedge funds without paying a control premium.³²³

Third Point argued that the Court should apply the stringent *Blasius* standard when reviewing the poison pill because (1) the record showed that the board was concerned about the upcoming proxy contest when it adopted the poison pill and (2) certain emails showed animus towards Loeb.³²⁴ The Court rejected this argument on the grounds that (1) the board was composed of independent, outside directors, with the sole exception of its CEO, (2) the board had a reasonable basis to believe that Third Point was trying to acquire control without paying a control premium, (3) the record was nearly devoid of any evidence of an entrenchment motive by any director, and (4) the emails referring to Loeb pejoratively came primarily from Sotheby's CEO and followed public statements by Loeb disparaging the CEO.³²⁵ As such, the Court

316. *Id.* at *33.

317. *Id.* at *36-37.

318. *Id.* at *39-40.

319. *Id.* at *40-45.

320. *Id.* at *45.

321. *Id.* at *57.

322. *Id.* at *58.

323. *Id.* at *58-59.

324. *Id.* at *60-62.

325. *Id.* at *61-63.

found that Third Point was unlikely to be able to show that the poison pill was adopted either for the primary purpose of interfering with the stockholder franchise or out of animus toward Third Point.³²⁶

In the course of reaching this conclusion, the Court noted that Delaware law is somewhat unresolved with respect to the role of the *Blasius* standard, without attempting to clarify the issue.³²⁷

With respect to the second prong of *Unocal*, whether the poison pill was a proportionate response, the Court found that the board would likely prevail. In support of that holding, the Court noted that the entire board owned less than 1% of Sotheby's stock collectively, that a 10% threshold allows activist investors to accumulate a substantial stake in the company, that Third Point was Sotheby's largest stockholder, and that "[a] trigger level much higher than 10% could make it easier for a relatively small group of activist investors to achieve control, without paying a premium, through conscious parallelism."³²⁸

With respect to the trigger, which limited activist stockholders that filed the Schedule 13D to 10% ownership while allowing passive Schedule 13G-filers to accumulate 20% ownership, the Court first noted that the discriminatory trigger was arguably more tailored to the threat identified than a flat 10% trigger would be.³²⁹ Then, the Court held:

In this case, Third Point is the Company's largest stockholder meaning that there are no Schedule 13G filers who own more than 10% of Sotheby's stock. Thus, while the question of whether Schedule 13G filers should be permitted under a rights plan to buy a larger interest in a company than activist stockholders is important in a general sense, I am not persuaded it can or should serve as a basis to enjoin the Sotheby's annual meeting when, as a practical matter, it is a complete non-issue in terms of the current composition of Sotheby's stockholders.³³⁰

The Court also analyzed Third Point's request that the board waive the 10% trigger under *Unocal*.³³¹ For the purposes of that analysis, the Court observed that the "wolf pack" concern was not as pressing.³³² Nonetheless, the Court found that

The evidence currently available indicates that Sotheby's may have had legitimate real-world concerns that enabling individuals or entities, such as Loeb and Third Point, to obtain 20% as opposed to 10% ownership interests in the Company could effectively allow those persons to exercise disproportionate control and influence over major corporate decisions, even if they do not have an explicit veto power.³³³

The Court held that this threat could satisfy the first prong of *Unocal*.³³⁴

326. *Id.* at *64.

327. *Id.* at *59.

328. *Id.* at *68.

329. *Id.* at *70.

330. *Id.* at *71-72.

331. *Id.* at *72-76.

332. *Id.* at *74.

333. *Id.* at *74-75.

334. *Id.*

I. Creditor Standing To Pursue Derivative Claims

The Court of Chancery, in *Quadrant Structured Products Co. v. Verim*,³³⁵ clarified, on a motion to dismiss, creditor standing to bring derivative litigation and the standards applicable to the decisions of the board of a controlled and insolvent company.

The plaintiff, Quadrant Structured Products Company, Ltd. (“Quadrant”), was a creditor of Athilon Capital Corp. (“Athilon”).³³⁶ Athilon was controlled by EBF & Associates (“EBF”), which employed its affiliate Athilon Structured Investment Advisors, LLC (“ASIA”) to manage Athilon’s investments.³³⁷ Athilon allegedly became insolvent sometime in 2008 due to its heavy investment in credit swaps for residential mortgage-backed securities.³³⁸ Though insolvent, Athilon (1) continued to pay interest on the subordinated debt held by EBF, although it allegedly had a contractual right to discontinue such interest payments, and (2) also allegedly overpaid ASIA for management services, which Quadrant offered to perform for Athilon at substantially lower cost.³³⁹ Athilon’s board also adopted a riskier business strategy after May 2011.³⁴⁰ Quadrant filed derivative claims for fiduciary breach against Athilon’s board, EBF, and ASIA, for the payments made to EBF and ASIA, as well as the board’s decision to embark on a riskier investment strategy.³⁴¹ Quadrant also alleged fraudulent transfer claims against EBF and ASIA.³⁴²

The defendants moved to dismiss Quadrant’s complaint on the grounds that Quadrant was not a creditor of Athilon at the time of each of the challenged decisions and thus lacked standing under 8 *Del. C.* § 327 or analogous principals.³⁴³ The Court rejected this argument.

The Court began its opinion on the defendants’ dismissal motion with a summary of Delaware law concerning the fiduciary duties owed by directors of troubled or insolvent corporations.³⁴⁴ The Court noted that under Delaware law, directors owe fiduciary duties to the corporation.³⁴⁵ As the residual claimants in a solvent corporation, stockholders have standing to assert derivative claims to enforce the directors’ fiduciary duties.³⁴⁶ But when a corporation becomes insolvent,

335. 102 A.3d 155 (Del. Ch. 2014).

336. *Id.* at 166.

337. *Id.* at 168.

338. *Id.* at 168-169.

339. *Id.* at 169.

340. *Id.* at 167-168.

341. *Id.* at 166.

342. *Id.*

343. *Id.*

344. *Id.* at 171-76.

345. *Id.*

346. *Id.*

creditors gain standing to assert derivative claims.³⁴⁷ The Court then elaborated that in order to plead derivative standing, a creditor must plead facts supporting a reasonable inference that the corporation was insolvent—either through the “balance sheet” test or the “cash flow” test.³⁴⁸ The Court further held that Quadrant’s complaint establishes a reasonable inference that Athilon was insolvent as of 2008.

The Court further analyzed whether statutory standing requirements applicable to stockholders pleading derivative claims apply to creditors by analogy.³⁴⁹ Specifically, Section 327 requires a stockholder to hold stock at the time of the wrongs complained of (the contemporaneous ownership requirement) and courts have required that stockholders hold stock continuously since that time (the continuous ownership requirement) to maintain standing to bring a derivative action.³⁵⁰

The Court rejected the defendants’ arguments that the contemporaneous and continuous ownership requirements apply to creditors, explaining that both creditors’ and stockholders’ standing to bring derivative litigation arose at common law.³⁵¹ The common law did not include either a contemporaneous or a continuous ownership requirement.³⁵² The Court noted that Section 327 was a statutory limitation on these common law principals.³⁵³ Because “[b]y its terms, Section 327 applies only to stockholders[,]” the Court concluded that Section 327’s contemporaneous ownership requirement does not apply to a creditor’s standing to bring derivative litigation.³⁵⁴ Moreover, the Court held that Court of Chancery Rule 23.1 cannot impose a contemporaneous standing requirement on creditors, because the Court’s rules are not permitted to modify substantive law.³⁵⁵

The Court also held, following the rationale in *Production Resources Group, L.L.C. v. NCT Group, Inc.*,³⁵⁶ that creditors of an insolvent corporation have standing to bring derivative actions challenging fiduciary conduct that occurred before the corporation became insolvent. The Court noted that “[i]t is entirely possible, perhaps even likely, that breaches of fiduciary duty that cause, hasten, or otherwise contribute to insolvency will have occurred before the point of insolvency in fact.³⁵⁷ If creditors lack standing to assert claims that pre-dated the point of insolvency, then the number of potential plaintiffs will be few: stockholders will lack the incentive, and creditors will lack the ability.”³⁵⁸

347. *Id.*

348. *Id.* at 176 (citations omitted).

349. *Id.* at 177-182.

350. *Id.* at 177-178.

351. *Id.* at 178.

352. *Id.*

353. *Id.* at 178-179.

354. *Id.* at 179.

355. *Id.* at 178.

356. 863 A.2d 727 (Del. Ch. 2004).

357. *Quadrant*, 102 A.3d at 180.

358. *Id.*

The Court further accepted Quadrant's arguments that the challenged payments to EBF and ASIA should be reviewed under the entire fairness standard, because each decision allegedly benefited Athilon's controlling stockholder to the detriment of Athilon's residual interest holders.³⁵⁹ Although the board was permitted to manage Athilon (a wholly owned subsidiary) solely for the benefit of its parent corporation when Athilon was solvent, the Court held that the board of an insolvent corporation cannot sacrifice the interests of the corporation for the benefit of its parent.³⁶⁰

The Court, however, dismissed Quadrant's claims challenging the board's adoption of a riskier investment strategy, holding that such a decision would be subject to review under the business judgment standard.³⁶¹ The Court reasoned that

“Even when the firm is insolvent, directors are free to pursue value maximizing strategies, while recognizing that the firm's creditors have become its residual claimants.” ... If a creditor-plaintiff could sue derivatively and establish a lack of director independence and disinterestedness by alleging that the director who owned equity or who owed duties to a large stockholder adopted a risky business strategy to benefit the common stock, the directors of an insolvent corporation would face precisely the same type of fiduciary conflict that *Gheewalla* sought to avoid.³⁶²

Consequently, the Court held that where a board of an insolvent corporation acts to the benefit of all stockholders, its decision remains protected by the business judgment rule.

II. ALTERNATIVE ENTITY LAW

In 2014, the concept of good faith and the scope of the implied covenant of good faith and fair dealing played an important role in the decisions concerning alternative entities. In two opinions involving the same master limited partnership, the Court of Chancery refused to find any breach of the contractual standard of good faith and refused to use the implied covenant of good faith and fair dealing to sustain claims that were specifically precluded by the terms of the parties' negotiated agreements, even though such claims would have been viable under a traditional fiduciary duty analysis. In a post-trial opinion involving a limited liability company, the Court of Chancery held that the defendants had not eliminated or modified the traditional default fiduciary duties and that the defendants had breached those duties. Finally, in a rare post-trial opinion, the Court held that a defendant had breached the implied covenant of good faith and fair dealing.

A. *El Paso* MLP Decisions

In two separate opinions, the Court of Chancery addressed the concept of contractual good faith and the implied covenant of good faith and fair dealing in the context of transactions undertaken by a publicly traded master limited partnership. These opinions all involved so called “drop down transactions,” *i.e.*, transactions in which a parent entity or an affiliated entity sells certain assets to the publicly traded limited partnership. These transactions typically involve

359. *Id.* at 182-184, 185.

360. *Id.* at 184-185.

361. 102 A.3d at 192.

362. *Id.* at 186 (quoting *Trenwick Am. Litig. Trust v. Ernst & Young, L.L.P.*, 906 A.2d 168, (Del. Ch. 2006)).

conflicts of interest because the parent or the affiliate holds an interest in the limited partnership. The limited partnership agreement for the master limited partnership (the “LP Agreement”) in these cases followed a typical form. The LP Agreement eliminated all fiduciary duties and replaced those duties with a contractually defined duty of good faith. The LP Agreement also created a conclusive presumption of good faith if certain procedural devices were used (*e.g.* special approval by a conflicts committee). In each case, on a summary judgment record, the Court refused to allow the plaintiffs’ claims to proceed.

1. *El Paso I*

In the first opinion, *In re El Paso Pipeline Partners, L.P. Derivative Litigation* (“*El Paso I*”),³⁶³ the Court decided on summary judgment that the general partner had not breached its implied duty of good faith and fair dealing by failing to disclose certain information to a conflicts committee and that the conflicts committee’s failure to consider such information did not result in an ineffective special approval process.

In *El Paso I*, the plaintiffs challenged two separate transactions.³⁶⁴ The first involved the sale of a 51% interest in Southern LNG (“Southern LNG”) and a 51% interest in El Paso Elba Express Company, LLC (“Elba Express”) by El Paso Corporation (“El Paso Parent”) to El Paso Pipeline Partners, L.P. (“El Paso MLP”) in March 2010 (the “March Transaction”).³⁶⁵ The second involved the sale of the remaining 49% interest in Southern LNG and Elba Express by El Paso Parent to El Paso MLP in November 2010 (the “November Transaction” and with the March Transaction the “Transactions”).³⁶⁶ Southern LNG and Elba Express each owned facilities for the storage and transport of liquid natural gas (“LNG”).³⁶⁷ Between 2006 and 2010 the demand for LNG was strong. In 2010, however, about the time El Paso Parent proposed the Transactions, demand for LNG was much lower due to higher levels of domestic production and lower gas prices.³⁶⁸

Because the March Transaction involved a conflict, the general partner sought to obtain Special Approval, as defined by the LP Agreement.³⁶⁹ It created a conflicts committee to consider and approve the Transactions.³⁷⁰ The conflicts committee hired Tudor, Pickering, Holt & Co. (“Tudor”) to act as its financial advisor and Akin Gump Strauss Hauer &

363. 2014 Del. Ch. LEXIS 101 (Del. Ch. June 12, 2014) (Laster, V.C.), *aff’d sub nom.*, *Allen v. El Paso Pipeline GP Co., L.L.C.*, 2015 Del. LEXIS 107 (Del. Feb. 26, 2015).

364. 2014 Del. Ch. LEXIS 101, at *1-2.

365. *Id.* at *1.

366. *Id.* at *1-2. Only the March Transaction is the subject of *El Paso I*. The November Transaction is the subject of a separate post-trial opinion dated April 20, 2015. In that opinion, the Court of Chancery held that the Conflicts Committee had not acted with subjective good faith in connection with approving the November Transaction. Accordingly, the Court awarded the plaintiffs \$171 million in damages.

367. *Id.* at *6-7.

368. *Id.* at *7.

369. *Id.* at *9-10.

370. *Id.* at *10.

Feld LLP (“Akin Gump”) to act as its legal advisor.³⁷¹ The conflicts committee met five times over a one and a half month time period and approved the March Transaction.³⁷² At the same time that the conflicts committee was deciding whether to approve the March Transaction, El Paso Parent was considering whether to purchase additional LNG assets for itself.³⁷³ El Paso Parent had a right of first refusal as to certain other LNG assets.³⁷⁴ El Paso Parent refused to exercise the right of first refusal at a price that represented a lower implied EBITDA multiple than was being applied to the Southern LNG and Elba Express assets being sold by El Paso Parent to El Paso MLP.³⁷⁵ Certain directors were involved in El Paso Parent’s decision not to purchase additional LNG assets, but did not disclose those negotiations to the conflicts committee.³⁷⁶

The plaintiffs alleged that the failure by El Paso Parent and the directors involved with El Paso Parent’s decision not to purchase LNG assets to disclose this information to the conflicts committee created an inference of bad faith.³⁷⁷ The plaintiffs further alleged that because the conflicts committee did not know this information, the Special Approval was ineffective.³⁷⁸

As to the contractual good faith inquiry, the plaintiffs argued that Special Approval was not properly obtained because the conflicts committee could not have approved the March Transaction in good faith.³⁷⁹ Plaintiffs argued that the conflicts committee lacked information about El Paso Parent’s decision not to acquire LNG assets.³⁸⁰ The Court rejected this argument and held that subjective good faith is determined solely based on the information possessed by the conflicts committee at the time they made the decision to approve the March Transaction.³⁸¹ If the conflicts committee had known about the LNG assets offered to El Paso Parent at the time they were considering the March Transaction, the pricing disparity between the two might have supported an inference of bad faith. However, because the plaintiffs admitted that the conflicts committee lacked this knowledge, there could be no such inference.³⁸² The Court also observed that any claim that the Special Approval was ineffective as a result of El Paso Parent’s decision to withhold information from the conflicts committee would arise under an implied covenant analysis because the LP Agreement was silent on the issue.³⁸³

371. *Id.* at *12.

372. *Id.* at *14.

373. *Id.* at *20.

374. *Id.* at *21.

375. *Id.*

376. *Id.*

377. *Id.* at *22.

378. *Id.*

379. *Id.* at *46.

380. *Id.*

381. *Id.*

382. *Id.* at *47.

383. *Id.* at *46.

As to the implied covenant of good faith and fair dealing, the plaintiffs argued that the implied covenant of good faith and fair dealing required that El Paso Parent disclose to the conflicts committee the fact that it was considering purchasing LNG assets at the time it was selling Southern LNG and Elba Express to El Paso MLP.³⁸⁴ On this claim, the Court held that a contractual gap existed because the LP Agreement was silent on whether, absent a request from the conflicts committee, El Paso Parent was required to disclose this information.³⁸⁵ The Court observed that if the LP Agreement had not eliminated all default fiduciary duties, Delaware law would require El Paso Pipeline GP Company (“El Paso GP”) and El Paso Parent to voluntarily disclose to the conflicts committee the material information they possessed.³⁸⁶ Because the LP Agreement eliminated all such duties, however, no such disclosure requirement existed.³⁸⁷

In so holding, the Court rejected the notion that the Delaware Supreme Court in *Gerber v. Enterprise Products Holdings, LLC*³⁸⁸ held otherwise.³⁸⁹ The Court noted that while the Delaware Supreme Court in *Gerber* observed that the intentional concealment of material information by a controller from a financial advisor would be an act that would breach the implied covenant of good faith and fair dealing, these comments were dictum because they did not impact the outcome of the case.³⁹⁰ The Court refused to read *Gerber* as holding that the failure of a controller to volunteer information is always a breach of the implied covenant of good faith and fair dealing.³⁹¹

Instead, the Court looked at the LP Agreement to discern what the parties would have agreed had they considered the disclosure issue.³⁹² The Court held that the parties would not have required El Paso Parent to voluntarily disclose the details of its refusal to purchase the LNG assets and thus there was no breach of the implied covenant of good faith and fair dealing by failing to do so.³⁹³ The Court found five facts important: (1) the parties general approach to the LP Agreement was to use the freedom of contract granted to them to provide El Paso GP with broad freedom to act; (2) the LP Agreement eliminated all fiduciary duties and, instead, left the parties with their contractual relationship—a relationship in which counterparties typically have no duty to disclose private information to the other; (3) because the LP Agreement eliminated all fiduciary duties, including the duty of disclosure, it seems unlikely the drafters would impose an implicit contractual obligation of disclosure; (4) the LP Agreement eliminated El Paso Parent’s and El Paso GP’s common law obligation to disclose business opportunities to El Paso MLP; and (5) other agreements in precedent cases show that where parties sought to impose a duty to disclose information to a conflicts committee, specific language (absent here) was used to require such disclosure.³⁹⁴

384. *Id.* at *57.

385. *Id.* at *63-64.

386. *Id.*

387. *Id.*

388. 67 A.3d 400 (Del. 2013).

389. 2014 Del. Ch. LEXIS 101, at *69-70.

390. *Id.* at *69.

391. *Id.* at *69-70.

392. *Id.* at *70.

393. *Id.* at *76-77.

394. *Id.* at *70-76.

2. *El Paso II*

In a later opinion involving the same El Paso entity and another drop-down transaction, *Allen v. El Paso Pipeline GP Co.* (“*El Paso II*”),³⁹⁵ the Court again granted summary judgment to the defendants and in doing so held that the general partner had not breached any contractual duties or the implied covenant of good faith and fair dealing.

In *El Paso II*, the general partner sought to obtain Special Approval of another drop-down transaction.³⁹⁶ Again the conflicts committee hired Tudor to act as its financial advisor and Akin Gump to act as its legal advisor.³⁹⁷ The conflicts committee met six times over a period of almost two months and conducted due diligence.³⁹⁸ At the sixth and final meeting Tudor formally opined that the transaction was “fair from a financial point of view to holders of El Paso MLP common units other than the holders affiliated with El Paso Parent.”³⁹⁹ Based on this opinion, the conflicts committee approved the Transaction and the board of the general partner followed suit.⁴⁰⁰ The transaction closed thereafter.⁴⁰¹

The plaintiffs argued that the defendants had breached the LP Agreement because the transaction was not approved by the conflicts committee in good faith.⁴⁰² They asserted that the conflicts committee could not have acted in good faith in approving the transaction because it failed to consider the impact of the IDRs (incentive distribution rights held by the general partner) on the partnership.⁴⁰³

As to the express breach claim, the Court observed that the general partner chose to comply with the Special Approval provision.⁴⁰⁴ As such, the relevant contractual standard required that the transaction be approved by a majority of the members of the conflicts committee acting in “good faith.”⁴⁰⁵ Good faith was defined as a belief that the conflict-of-interest transaction was in the “best interests of El Paso MLP.”⁴⁰⁶ The Court observed that “[t]wo aspects of the resulting contractual test warrant emphasis: (i) subjective belief and (ii) best interests of the Partnership.”⁴⁰⁷ The Court observed that this contractual standard “departs from the fiduciary standard of conduct that applies in the corporate arena” as follows:

395. 113 A.3d 167 (Del. Ch. 2014), *aff’d*, 2015 Del. LEXIS 107 (Del. Feb. 26, 2015).

396. 113 A.3d at 174.

397. *Id.* at 175.

398. *Id.* at 175-76.

399. *Id.* at 176.

400. *Id.*

401. *Id.*

402. *Id.*

403. *Id.*

404. *Id.* at 178.

405. *Id.*

406. *Id.*

407. *Id.*

When considering that issue the Conflicts Committee has discretion to consider the full range of entity constituencies, including but not limited to employees, creditors, suppliers, customers, the general partner, the IDR holders ... and of course limited partners. In place of a single beneficiary of fiduciary duties, the LP Agreement confers contractual discretion on the Conflicts Committee to balance the competing interests of the Partnership's various entity constituencies when determining whether a conflict-of-interest transaction is in the best interests of the Partnership.⁴⁰⁸

Applying this standard, the Court held that certain facts were fatal to the plaintiff's claim.⁴⁰⁹ The plaintiff had made no claim that the partnership had paid an excessive price for the assets and no claim that the transaction harmed the partnership.⁴¹⁰ Moreover, the conflicts committee members testified that they believed the transaction benefitted the partnership.⁴¹¹ It was not enough to assert that the transaction was more beneficial to the general partner than to the unaffiliated limited partners.⁴¹² Such a claim might have survived summary judgment under a traditional fiduciary duty analysis, but did not survive summary judgment under the pertinent contract standard.⁴¹³

Finally, as to the implied covenant claim, the plaintiff asserted a *Gerber*-type claim, *i.e.* that the financial advisor opinion failed to address some element of the transaction in its opinion—in this case the dilution the limited partners would suffer as a result of the transaction.⁴¹⁴ The Court refused to read the Special Approval provision of the LP Agreement as to require the conflicts committee to obtain any opinion from a financial advisor, let alone one that addressed the effects of the transaction on the limited partners.⁴¹⁵ The Court held that it would:

[C]onflict fundamentally with the plain language and structure of Section 7.9(a) to invoke the implied covenant to require that the Conflicts Committee follow a particular course by obtaining an opinion from a financial advisor that addressed the fairness of the [Transaction] to the limited partners in a judicially proscribed manner. Deploying the implied covenant in this fashion would rewrite Section 7.9(a) by changing both the nature of the Conflicts Committee inquiry (from the best interests of the Partnership to fairness to the limited partners) and the scope of judicial review (from the subjective good faith of a majority of the committee to compliance with an obligation to obtain an opinion that analyzed the fairness with a sufficient level of methodological rigor to satisfy a court after the fact).⁴¹⁶

408. *Id.* at 181.

409. *Id.*

410. *Id.*

411. *Id.*

412. *Id.*

413. *Id.*

414. *Id.* at 182.

415. *Id.* at 190.

416. *Id.* at 191.

Interestingly, the Court limited *Gerber*.⁴¹⁷ The Court held that the plaintiff could not rely on *Gerber* to state an implied covenant claim because “that decision turned on the Conclusive Presumption Provision and its gaps.”⁴¹⁸ Because the Court’s decision focused on the Special Approval provision, *Gerber* did not apply.⁴¹⁹

Finally, as to the aiding and abetting claims, the Court held that because the parties had eliminated all fiduciary duties and replaced them with contractual duties, an aiding and abetting theory was not available.⁴²⁰ “Because the LP Agreement establishes a purely contractual relationship, a theory of aiding and abetting a breach of contract claim is unavailable in this case.”⁴²¹ The Court distinguished between contractual “fiduciary duties” and a contractual standard that turned on a “requisite mental state” such as subjective good faith.⁴²² The former could support an aiding and abetting claim while the latter could not.⁴²³

B. Consequence Of Failing To Eliminate Default Fiduciary Duties

In *Ross Holding & Management Co. v. Advance Realty Group, LLC*,⁴²⁴ the Court of Chancery held that the operative limited liability company agreement had not eliminated default fiduciary duties and that defendants had breached the fiduciary duties they owed to the company’s minority unitholders by agreeing to a reorganization without adequately considering the impact it would have on the minority unitholders. However, because the plaintiffs failed to show how they had been harmed, the Court could not award damages.

Plaintiffs, minority unitholders of Advance Realty Group, LLC (“ARG”), brought an action against the members of ARG’s Board of Managers (the “Board”) claiming that the Board breached its fiduciary duties to the minority unitholders by agreeing to a reorganization (the “Reorganization”).⁴²⁵ The plaintiffs claimed that the Reorganization caused a diminution in value of their ARG units.⁴²⁶

In 2001, ARG was looking for an infusion of capital to grow its business and, as a result, partnered with Five Arrows Realty Securities, III (“FARS”), an investor that provided growth capital to private and public real estate operating companies in return for both a steady return and the opportunity to participate in the increase in the companies’ equity value.⁴²⁷ Pursuant to a credit agreement, FARS gave ARG a \$60 million loan with a maturity date of August 6, 2008

417. *Id.* at 190.

418. *Id.*

419. *Id.*

420. *Id.* at 194.

421. *Id.*

422. *Id.*

423. *Id.*

424. 2014 Del. Ch. LEXIS 173 (Del. Ch. Sept. 4, 2014) (Noble, V.C.).

425. *Id.* at *2-3.

426. *Id.* at *3.

427. *Id.* at *5.

(the “Maturity Date”).⁴²⁸ The interest on the loan was 6%, but would increase to 15% if ARG did not repay the loan by the Maturity Date.⁴²⁹ The promissory note FARS received also allowed it to convert all or a portion of its debt into ARG Class A units at a conversion price of \$16.65 per unit.⁴³⁰

ARG also amended its operating agreement and expanded the Board from two members to four members, with ARG’s majority owner Advance Capital Partners (“ACP”) being granted two designees and FARS being granted two designees.⁴³¹ Additionally, according to the terms of the loan, if ARG defaulted on the loan the Board would expand to add a fifth FARS-controlled board seat.⁴³²

Beginning in 2005, ARG began exploring options to assist FARS in liquidating its investment in ARG. The Board explored several possibilities, including a Rule 144A private placement, a recapitalization, and a sale of its operating portfolio.⁴³³ Ultimately, ARG decided against any of these transactions and instead pursued the Reorganization.⁴³⁴ The purpose of the Reorganization was to create one easily-capitalized and readily-saleable company while allowing FARS to satisfy its investment.⁴³⁵ To accomplish this, ARG spun off its development subsidiary, Advance Realty Development (“ARD”), to ACP, allowing it to own and develop \$45 million worth of capital-intensive properties.⁴³⁶ FARS also converted approximately \$10 million of its debt at a strike price of \$16.65 into approximately 600,000 units of ARG thereby giving FARS a majority equity interest in the reorganized ARG, which would keep its revenue-generating properties in order to sell them to satisfy FARS’ investment.⁴³⁷ After the conversion of \$10 million of its debt into Class A units, the remaining balance of FARS’ \$60 million debt was converted into \$80 million worth of notes in the reorganized ARG.⁴³⁸ FARS was also given the right to be paid before the minority unitholders.⁴³⁹ The minority unitholders were offered two options: (1) to exchange their Class A Units for common units in ARD on the same terms as those accepted by ACP, or (2) to receive \$21.68 per unit payable in \$5.84 in cash and a promissory note of \$15.84 with an interest rate of 6%.⁴⁴⁰ The plaintiffs refused both options and instead retained their units.⁴⁴¹

428. *Id.* at *6.

429. *Id.* at *6-7.

430. *Id.* at *7.

431. *Id.* at *7-8.

432. *Id.* at *8.

433. *Id.* at *14-18.

434. *Id.* at *24.

435. *Id.*

436. *Id.* at *25.

437. *Id.*

438. *Id.*

439. *Id.* at *26.

440. *Id.* at *37.

441. *Id.* at *38.

Ultimately, ARG defaulted on its Class A unitholders' notes and many other of its loans.⁴⁴² The plaintiffs' units thus became valueless.⁴⁴³ The plaintiffs brought a claim against members of the Board for breach of fiduciary duty.⁴⁴⁴

The Court began its analysis by assessing what duties were owed by defendants. To make this determination, the Court began with ARG's operating agreement.⁴⁴⁵ The Court held that traditional fiduciary duties apply to limited liability companies unless those duties "have been clearly supplanted or modified" by the operating agreement.⁴⁴⁶ After analyzing ARG's operating agreement, the Court concluded that the operating agreement did not eliminate or modify the default fiduciary duties the Board owed to the minority unitholders.⁴⁴⁷ Moreover, the Court held that the Reorganization was an interested transaction and the entire fairness standard of review applied.⁴⁴⁸

The Court then examined the Reorganization under the entire fairness standard. In applying the standard, the Court held that while the price that the minority received for redeeming their units was fair, the Reorganization was procedurally unfair.⁴⁴⁹ Specifically, the Court held that,

The process employed by ARG's board left much to be desired and was motivated by its members' self-interest. The process did not empower ARG's minority to negotiate with the Board, to seek interim injunctive relief, or to ratify the transaction. The Board failed to provide information to the minority which could help them in evaluating the value of their units and sent inadequate notice only after the Reorganization was complete. No fairness opinion guided the Board's valuation efforts. In sum, the Court was not convinced that the Board was adequately representing the minority interests.⁴⁵⁰

Thus, the Court concluded that the poor process prevented a finding that "the price *and* process, assessed as a unitary standard was fair."⁴⁵¹ The Court discussed the various types of damages awards that might have been available, but concluded that because the plaintiffs had failed to explain how they were harmed it had no basis to make a "responsible estimate of damages."⁴⁵²

442. *Id.* at *39.

443. *Id.*

444. *Id.*

445. *Id.* at *41.

446. *Id.* at *42.

447. *Id.* at *46.

448. *Id.* at *59.

449. *Id.* at *72.

450. *Id.* at *114-15.

451. *Id.* at *119.

452. *Id.* at *121.

C. Post-Trial Damages Awarded As Result Of A Breach Of The Implied Covenant Of Good Faith And Fair Dealing

Finally, in *NAMA Holdings, LLC v. Related WMC LLC*,⁴⁵³ the Court of Chancery held, after trial, that that an escrow agent had breached the implied covenant of good faith and fair dealing by failing to remain neutral in its role. The facts showed that the escrow agent held monies in escrow. Following a dispute in 2006 regarding those monies, the Court approved an order outlining the escrow agent's duties related to the escrow pending an arbitration of the parties' disputes (the "Segregation Order").⁴⁵⁴ The Segregation Order required the escrow agent to hold any disputed amounts in a segregated, interest-bearing account until either (i) the parties to the disputes authorized the release of the disputed amounts by joint written instructions or (ii) the escrow agent received a copy of the decision of the one arbitrating the disputes.⁴⁵⁵ Following arbitration, the escrow agent refused to release certain disputed amounts pursuant to the ruling of the arbitral panel.⁴⁵⁶ Instead, the escrow agent released the funds to another related party who distributed the amounts in a manner not contemplated by the arbitrators' decision.⁴⁵⁷ As a result, the plaintiff filed an action against the escrow agent and its parent company for breach of the implied covenant of good faith and fair dealing.⁴⁵⁸ The parties proceeded to trial and the Court issued its post-trial opinion finding that the escrow agent had breached the implied covenant of good faith and fair dealing.⁴⁵⁹ In so holding the Court provided a roadmap for analyzing such claims.

The Court began its analysis by noting that the implied covenant will only "fill gaps" in a contract and will not apply to issues that the language of the contract expressly covers.⁴⁶⁰ Furthermore, the Court explained that even if it determines that a contractual gap exists, the Court will only "fill the gap" when "it is clear from what was expressly agreed upon that the parties who negotiated the express terms of the contract would have agreed to proscribe the act later complained of as a breach of the implied covenant of good faith—had they thought to negotiate with respect to that matter."⁴⁶¹

The Court next discussed how it should go about determining how to fill the gaps. To do so, the Court observed that it does not "introduce its own notions of what would be fair or reasonable under the circumstances" because the implied covenant of good faith and fair dealing is not a "free-floating requirement that a party act in some morally commendable sense." Likewise, to find a breach of the implied covenant the court need not determine that a party acted in bad faith.

453. 2014 Del. Ch. LEXIS 232 (Del. Ch. Nov. 17, 2014) (Laster, V.C.).

454. *Id.* at *18.

455. *Id.*

456. *Id.* at *31.

457. *Id.* at *33.

458. *Id.* at *43.

459. *Id.* at *45.

460. *Id.* at *47.

461. *Id.* at *51.

Instead, the implied covenant contemplates “faithfulness to the scope, purpose and terms of the parties’ contract.”⁴⁶² This determination is based on whether the party’s actions comport with the contract itself and what the parties would have agreed upon had the issue arisen when they were bargaining originally.⁴⁶³

Applying this test, the Court assessed the language of the Segregation Order, which reflected the most recent stipulation between the parties.⁴⁶⁴ The Court held that while the Segregation Order did not contain any language requiring the escrow agent to act as a neutral custodian for the funds, “this expectation was so fundamental that [the parties] did not need to negotiate about [it].”⁴⁶⁵ According to the Court, “[i]t was a core term that the parties would have agreed to themselves and made explicit if they had considered the issue in their original bargaining positions at the time of contracting.”⁴⁶⁶ The Court relied on what it considered to be the widely-held proposition that a custodian for property in dispute is expected to act neutrally with respect to the parties in dispute.⁴⁶⁷ The Court concluded that the escrow agent did not act neutrally when it refused to release the amount after the arbitrator’s decision.⁴⁶⁸ The Court awarded damages in the amount of \$5,894,391, which represented the amount the plaintiff was unable to recover as a result of the escrow agent’s conduct.⁴⁶⁹

462. *Id.* at *50 (citation omitted).

463. *Id.* at *51.

464. *Id.* at *53.

465. *Id.* (citation omitted).

466. *Id.* at *53-54.

467. *Id.*

468. *Id.* at *65.

469. *Id.* at *78.