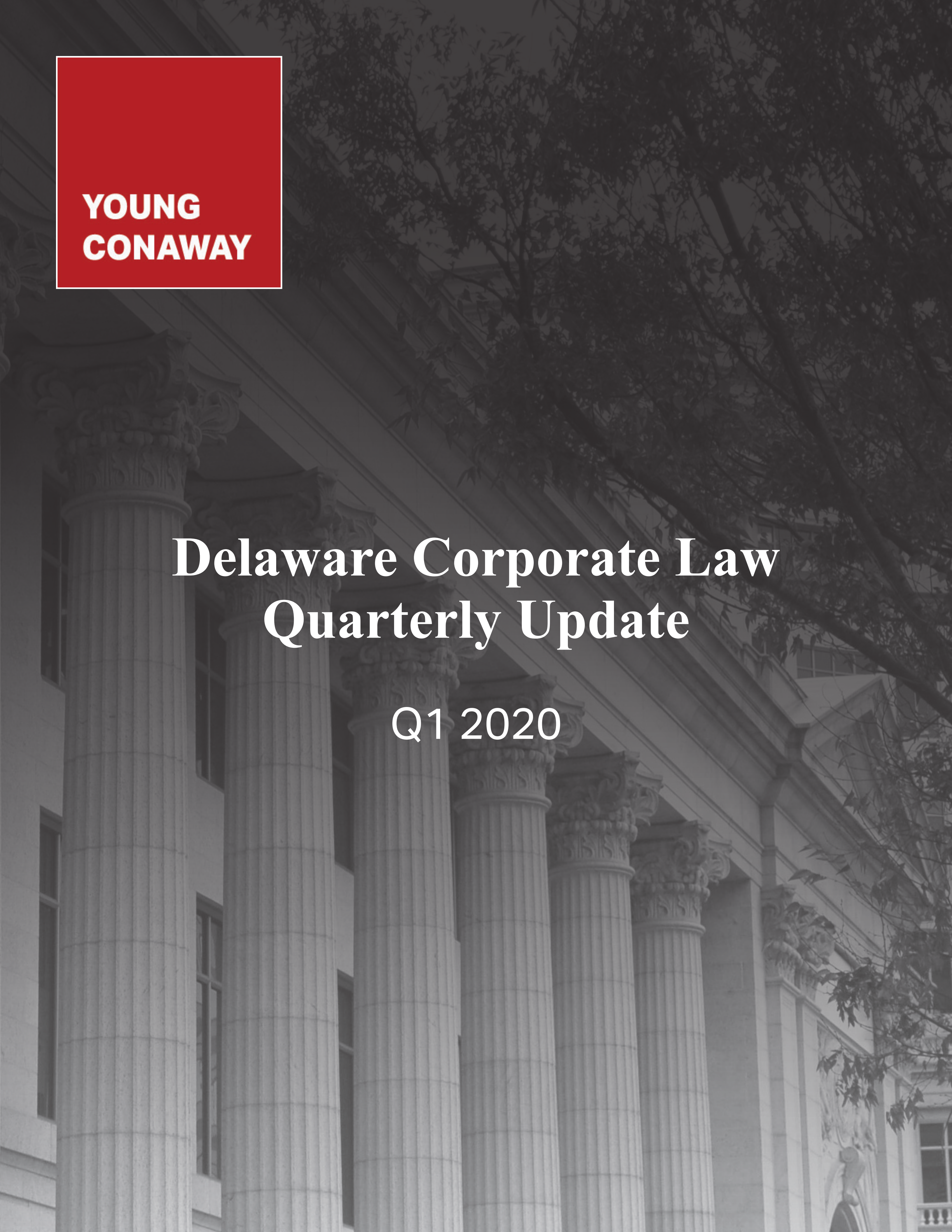

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Delaware Corporate Law Quarterly Update

Q1 2020

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Q1 2020

This publication, which summarizes notable corporate and alternative entity cases decided by the Delaware Court of Chancery and Delaware Supreme Court during the first quarter of 2020, is provided compliments of Young Conaway's Corporate Counseling and Litigation Section.

Young Conaway's Corporate Counseling and Litigation Section provides representation and advice to Delaware entities, including corporations and alternative entities, the individuals and entities that manage them, their equity holders, and other law firms. Young Conaway's practice ranges from advising on the structure and negotiation of corporate and commercial transactions to defending (or challenging) transactions in the courtroom.

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Actions Involving Breach of Fiduciary Duty Claims

McElrath v. Kalanick, 224 A.3d 982 (Del. Jan. 13, 2020)

In *McElrath v. Kalanick*,[1] the Delaware Supreme Court upheld the dismissal of claims asserted derivatively on behalf of Uber Technologies, Inc. ("Uber"), agreeing with the Court of Chancery that demand was not futile because a majority of the board was disinterested as a result of Uber's exculpatory charter provision and the plaintiff had failed to show that a majority of Uber's eleven directors lacked independence from its one interested director.

The plaintiff's claims arose from Uber's efforts to accelerate its autonomous vehicle program by acquiring Ottomotto, LLC ("Otto") in December 2016. The plaintiff alleged that Otto had been formed by Anthony Levandowski while he was still an employee of Google and that Levandowski had used Otto to recruit Google employees until Otto's acquisition by Uber.

After Uber's negotiations to acquire Otto began, Uber hired an outside firm, Stroz Friedberg, LLC ("Stroz"), to investigate whether Otto employees, including Levandowski, had transferred intellectual property from Google. The complaint alleged that the Uber board approved the acquisition of Otto without reviewing the Stroz reports. Before the transaction closed, the board met to discuss the final Stroz report, which found that several Otto employees had retained confidential Google information but found that none of the information was transferred from Otto to Uber. After the transaction closed, Google sued Uber for misappropriation of proprietary information, and that lawsuit eventually settled.

[1] 224 A.3d 982 (Del. Jan. 13, 2020).

After Uber settled the lawsuit with Google, the plaintiff, an Uber stockholder, brought the derivative action in the Court of Chancery but did not make a pre-litigation demand on the Uber board. The defendants moved to dismiss under Court of Chancery Rule 23.1 for failure to make a demand. The Court of Chancery granted the motion to dismiss, finding that a majority of the board could have reasonably considered a demand, and the plaintiff appealed.

Because a majority of the board that approved the transaction had been replaced as of the time the complaint was filed, the Supreme Court examined the demand futility claim under *Rales v. Blasband*[2] to determine whether a majority of the directors were interested and whether they lacked independence from interested directors.

On appeal, it was not disputed that Travis Kalanick, Uber's CEO, was interested. The plaintiff argued that the rest of the board also was interested because they faced a "substantial likelihood of personal liability for wrongdoing."[3] The defendants argued that they were exculpated from liability by an exculpatory provision in Uber's certificate of incorporation. Due to the exculpatory provision, the Supreme Court explained that the plaintiff would have to show the directors acted with scienter, meaning the directors knew they were acting in breach of their fiduciary duties. The plaintiff argued on appeal that the allegations that the board knew Kalanick had a history of ignoring the law in similar transactions, Uber agreed to indemnify Otto employees for pre-signing misconduct, and the board

[2] 634 A.2d 927, 934 (Del. 1993).

[3] *McElrath*, 224 A.3d at 991.

never read the Stroz reports were sufficient to show a substantial likelihood of personal liability.

The Supreme Court found that the plaintiff failed to meet his burden of alleging that the board acted in bad faith. The Supreme Court noted that the board had met to discuss the Otto transaction, reviewed the risk of litigation with Google, hired Stroz to assist with due diligence, discussed due diligence, and asked questions, which showed that the board did not merely rubber stamp the transaction.[4] The Supreme Court explained that while Kalanick may have had a history of ignoring the law, he did not have a history of lying to the board. The Supreme Court also noted that the indemnification provisions did not support a finding of bad faith because they were clearly explained to the board during negotiations and they did not indemnify Levandowski or others for conduct that was not disclosed to Uber. Additionally, the Supreme Court held the board was not required to read the final Stroz report because the board otherwise participated in due diligence and reviewed the risk of litigation. Accordingly, the Supreme Court held that the plaintiff failed to allege the board acted in bad faith and therefore failed to allege that any of the other directors, apart from Kalanick, were interested.

With regard to independence, the plaintiff conceded that five of the eleven directors were independent of Kalanick. As a result, the Supreme Court needed only to find that one more director was independent to find that a majority of the Uber board was independent. The plaintiff challenged director John Thain's independence because Kalanick had appointed Thain when Kalanick was in a power struggle with the board. The Supreme Court found that argument unpersuasive, noting that appointment to a board is insufficient to challenge a director's independence, and appointment during a power struggle, without more, was insufficient to infer that Thain's and Kalanick's relationship was of a "bias-producing nature."[5] The Supreme Court therefore concluded that the plaintiff failed to show that Thain was not independent of Kalanick. Accordingly, the Court concluded that the plaintiff's complaint was properly dismissed for failure to make a demand on the board because a majority of the board was disinterested and independent.

Coster v. UIP Cos., Inc., 2020 WL 429906 (Del. Ch. Jan. 28, 2020) (McCormick, V.C.)

In a post-trial opinion in *Coster v. UIP Companies, Inc.*,[6] the Court of Chancery applied entire fairness review to a board-approved stock sale and ultimately concluded that the challenged stock sale was entirely fair. The Court's opinion emphasizes the maxim that the entire fairness inquiry is not a bifurcated of process and price. The opinion demonstrates that although a challenged process may be imperfect, that is not determinative of the entire inquiry because the fairness of the price may outweigh other features of the challenged transaction.

Coster arose out of a dispute regarding the control and ownership of UIP Companies, Inc. ("UIP"), a real estate investment services company. Marion Coster, the plaintiff, and Steven Schwat, a defendant, each owned a 50% interest in UIP. The UIP board consisted of three directors—Schwat and the other two individual defendants, Peter Bonnell and Stephen Cox.[7] After Schwat and Coster could not agree on director nominees to fill vacant board seats, Coster filed an action in the Court of Chancery seeking the appointment of a custodian to break the deadlock pursuant to Section 226(a)(1) of the Delaware General Corporation Law.

After Coster initiated the Section 226 action, the UIP board approved a stock sale in which UIP sold unissued shares to Bonnell. The stock sale made Bonnell a one-third owner of UIP, along with Schwat and Coster. Therefore, if valid, the stock sale would have had the immediate effect of mooting the pending Section 226 action. Coster then filed a new action, challenging the stock sale as a breach of the directors' fiduciary duties, and sought to cancel the stock sale. The new action was consolidated with the Section 226 action, and the Court rendered its opinion in the consolidated action following trial.

[4] The Supreme Court noted that these factors distigiushed the case at hand from *In re Walt Disney Co. Derivative Litigation,* 825 A.2d 275, 289 (Del. Ch. 2003), where the Court of Chancery held that the plaintiff sufficiently pleaded bad faith where "the board approved a high profile hiring decision before the details were negotiated and assigned the responsibility to the CEO to negotiate the employment contract with the new hire who was his friend of many years." *McElrath,* 224 A.3d at 994.

[5] *Id.* at 995 (quoting *Beam ex rel. Martha Stewart Living Omnimedia, Inc. v. Stewart,* 845 A.2d 1040, 1050 (Del. 2004)).

[6] 2020 WL 429906 (Del. Ch. Jan. 28, 2020).

[7] UIP formally had a five-member board, but two seats were vacant, and UIP had not had an election of directors since 2007.

Coster argued that a majority of the board was interested in the stock sale and that entire fairness was the appropriate standard of review for the transaction. Because the defendants conceded that Bonnell, as the recipient of the stock sale, was interested, Coster only had to show that one other director—either Schwat or Cox—was also interested in the transaction to establish that a majority of the board was interested in the transaction.

The defendants argued that entire fairness was not the appropriate standard of review because Schwat did not personally benefit from the stock sale, as it "diluted Schwat's own holdings, harmed his financial interests, and weakened his ability to block stockholder action."[8] The Court was unpersuaded and concluded that Schwat was interested in the challenged stock sale as a consequence of his personal relationship with Bonnell and because the stock sale had the effect of mooting the pending custodian action, benefitting Schwat. The Court viewed Schwat's facilitation of the stock sale as an election of the lesser of two evils—"placing stock in Bonnell's friendly hands" (though diluting Schwat's economic and voting power) rather than "risk surrendering power over UIP to an unknown custodian."[9] The Court found that "[t]he Stock Sale most effectively served [Schwat's] personal interest" and deemed Schwat interested in the transaction.[10]

The Court emphasized the nuance of its assessment of Schwat's self-interest: "The concept of 'interestedness' encompasses a wide variety of personal motivations" and "the concept . . . is not limited to financial considerations. . . . . 'Human relations and motivations are complex,' or to use a millennial generation catch phrase, 'it's complicated.'"[11]

Because a majority of the board was deemed to be interested in the stock sale, the Court concluded that the challenged transaction was subject to entire fairness review.

The Court's entire fairness analysis focused on a valuation of UIP commissioned by the defendant directors in conjunction with the stock sale. Coster attacked the process of the sale on multiple fronts, but focused centrally on the credibility of the valuator, as well as the abbreviated time period in which the valuation was performed. The Court acknowledged that "[a]lthough the procedural process was by no means optimal, Plaintiff's fair dealing arguments standing alone do not prove that the price reached was unfair."[12] The Court emphasized that the "'test for fairness is not a bifurcated one' and 'price may be the preponderant consideration outweighing other features of the [transaction].'"[13]

Coster did not put forth a valuation of her own, choosing instead to offer an expert to discredit the valuation commissioned by the defendants. The Court was unmoved by Coster's expert, writing that parts of his testimony amounted to "a theoretical dart throwing exercise that seemed untethered to any real world considerations, including the practical effect of these criticisms on the fairness of the price."[14] The Court accepted the result of the defendant's capitalized cash flow method, finding, after a detailed, technical analysis of the expert's testimony, that it provided "the most reliable indicator of the fair value of UIP as of the date of the Stock Sale."[15]

The Court concluded that the defendants met their burden to demonstrate that the stock sale was entirely fair and that the defendants did not commit a fiduciary breach. Thus, the Court did not invalidate the stock sale. And because the stock sale was not invalid, the Court further declined to appoint a custodian because the stock sale had alleviated the board deadlock that could have supported the appointment of a custodian. The Court entered judgment in favor of the defendants.

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8 *Id.* at *16.

9 *Id.*

10 *Id.*

11 *Id.* at *15 (first internal quotation quoting *In re S. Peru Copper Corp. S'holder Deriv. Litig.*, 52 A.3d 761, 778 (Del Ch. 2011)).

12 *Id.*

13 *Id.* at *20 (quoting *Weinberger v. UIP, Inc.*, 457 A.2d 701, 711 (Del. 1983)).

14 *Id.* at *25.

15 *Id.* at *26.

***In re Tesla Motors, Inc. S'holder Litig.*, 2020 WL 553902 (Del. Ch. Feb. 4, 2020) (Slights, V.C.)**

In *In re Tesla Motors, Inc. Shareholder Litigation*,[16] the Court of Chancery denied cross motions for summary judgment and in doing so held that a controlling stockholder transaction is subject to entire fairness review even where a transaction is approved by an informed vote of the disinterested stockholders and where there is no evidence that the controlling stockholder coerced the vote. Thus, the only way to avoid entire fairness review of a controlling stockholder transaction, even where a plaintiff has failed to develop any evidence that the controlling stockholder in fact coerced the minority stockholders into voting in favor of the transaction, continues to be by complying with the dual requirements of *In re MFW Shareholders Litigation ("MFW")*[17] and its progeny: approval by *both* a well-functioning, independent special committee of the board *and* an informed, uncoerced majority-of-the-minority stockholder vote.

The litigation arose from the acquisition of SolarCity Corporation ("SolarCity") by Tesla Motors, Inc. ("Tesla"), a transaction approved by a majority of Tesla's disinterested stockholders. The plaintiffs, Tesla stockholders, challenged the transaction, alleging that Tesla's board and Elon Musk, as Tesla's controlling stockholder, breached their fiduciary duties in connection with the transaction. Musk was Tesla's largest stockholder, owning approximately 22.1% of Tesla's common stock, and served as Chairman of Tesla's board and as Tesla's CEO and Chief Product Architect. Musk was also SolarCity's largest stockholder, owning approximately 21.9% of SolarCity's common stock, and served as Chairman of SolarCity's board. The defendants had previously filed a motion to dismiss on the basis that Musk was not a controlling stockholder at the time of the merger, the merger was approved by a fully-informed, uncoerced vote of a majority of Tesla's disinterested stockholders, and therefore business judgment was the appropriate standard of review under *Corwin v. KKR Financial Holdings LLC ("Corwin")*.[18] The Court denied the motion to dismiss, holding that the plaintiffs pled sufficient facts to support a reasonable inference that Musk was Tesla's controlling stockholder and that the transaction should be reviewed under the entire fairness standard of review, thereby rendering defendants' stockholder ratification defense, based on *Corwin*, inapplicable.

On their motion for summary judgment, defendants argued that the business judgment standard of review should apply to the transaction, based on *Corwin*, because plaintiffs failed to present any evidence that Musk actually coerced Tesla's stockholders into approving the transaction and the stockholder vote was fully informed. While acknowledging that the defendants raised a "provocative argument" that found support from some of Delaware's leading jurists, the Court found that the defendants' argument was not supported by Delaware Supreme Court precedent, stating that the Court "decline[d] to accept [the defendants'] position that the notion of inherent coercion, as relates to controlling stockholders, evaporates when the case moves beyond the pleading stage."[19]

The Court explained that due to the inherently coercive nature of a controlling stockholder, Delaware courts focus on a controlling stockholder's "ability to control, rather than the actual exercise of control,"[20] and that courts apply entire fairness review to mitigate this threat of inherent coercion. Based on this, and because the Tesla board "elected not to implement the dual protections endorsed by" *MFW* by forming an independent special committee to negotiate and approve the transaction,[21] the Court held that if it ultimately determined Musk to be a controlling stockholder, entire fairness would be the proper standard of review regardless of whether Musk actually coerced the stockholder vote. The Court concluded: "[I]f Plaintiffs prove that Musk was a controlling stockholder at the time of the Merger, his inherently coercive influence over the other Tesla decision-makers, including the disinterested stockholders, justifies and, indeed, mandates entire fairness review of the Merger."[22] And because there were genuine disputes of material fact regarding whether Musk was Tesla's controlling stockholder, the Court denied the defendants' ratification defense.

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16 2020 WL 553902 (Del. Ch. Feb. 4, 2020).

17 67 A.3d 496, 502 (Del. Ch. 2013).

18 125 A.3d 304 (Del. 2015).

19 *Tesla*, 2020 WL 553902, at *2.

20 *Id.* at *5.

21 *Id.* at *7 n. 54 & n. 55.

22 *Id.* at *4.

***Voigt v. Metcalf*, 2020 WL 614999 (Del. Ch. Feb. 10, 2020) (Laster, V.C.)**

In *Voigt v. Metcalf*,[23] the Court of Chancery held that it was reasonably conceivable that a private equity firm that controlled 34.8% of a corporation's voting power controlled the corporation and, because the private equity firm stood on both sides of a merger, the merger was subject to entire fairness review. This case adds to a number of decisions in which Delaware courts have held that a stockholder that controls less than a majority of a corporation's voting stock was a controlling stockholder because the stockholder *de facto* "'exercise[d] control over the business affairs of the corporation.'"[24]

NCI Building Systems, Inc. ("NCI") acquired Ply Gem Parent LLC ("Ply Gem") at a valuation of $1.236 billion approximately three months after Clayton, Dubilier & Rice ("CD&R") acquired New Ply Gem at a valuation of $638 million. CD&R was a private equity firm that owned approximately 34.8% of NCI's equity and approximately 70% of Ply Gem's equity at the time NCI acquired Ply Gem. The plaintiff, a stockholder of NCI, brought claims for breach of fiduciary duty against NCI's board of directors and CD&R. The defendants filed motions to dismiss the complaint pursuant to Court of Chancery Rule 12(b)(6) for failure to state a claim.[25]

The Court denied CD&R's motion to dismiss, finding that it was reasonably conceivable that CD&R controlled NCI. Therefore, because CD&R stood on both sides of the transaction, entire fairness was the proper standard of review for purposes of the motion to dismiss. A number of factors in addition to CD&R's 34.8% voting interest contributed to the Court's determination that it was reasonably conceivable that CD&R controlled NCI. The Court first explained that the nature of the relationships between CD&R and a majority of NCI's board of directors supported a reasonable inference of control. Under a stockholders agreement between CD&R and NCI, CD&R had the right to nominate four of NCI's twelve directors,[26] and NCI filled those seats with four individuals who the Court held NCI controlled. The Court held who the complaint's allegations concerning four of the eight directors who were not CD&R's nominees led to a reasonable pleading stage inference that they were subject to CD&R's influence and control, and that the four remaining directors were independent and disinterested for pleading-stage purposes.

The Court found that CD&R had "longstanding ties" with two of the directors.[27] Those directors were originally appointed to NCI's board by CD&R when CD&R owned a majority of NCI's stock. One of those directors worked for CD&R portfolio companies and served on CD&R boards for twenty-seven years and received most, if not all, of her income since she retired in 2003 from entities affiliated with CD&R. The other director that the Court found had "longstanding ties" with CD&R worked for years at a company where the president and vice chairman was one of the directors who CD&R appointed to the NCI board and who the Court held CD&R controlled. The Court also found that the complaint raised a reasonable pleading stage inference that a material portion of the director's income since his retirement in 2007 came from serving on the NCI board.

The Court found that the complaint raised a reasonable inference that the other two directors were controlled by CD&R due to their positions or expected positions with NCI. One of the directors was NCI's CEO, who was hired by NCI at a time when CD&R owned 57% of NCI's stock and controlled a majority of NCI's board seats. And because it could be reasonably inferred that his compensation from NCI constituted most of his income, the Court held that it was reasonable to infer that he "would feel a sense of owing-ness to CD&R."[28] With respect to the other director, the Court found that the complaint raised a reasonable inference that the prospect of serving as Chairman and CEO of the combined company encouraged that director to support the transaction.

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23 2020 WL 614999 (Del. Ch. Feb. 10, 2020).

24 *Id.* at *11 (quoting *Kahn v. Lynch Commc'n Sys., Inc.*, 638 A.2d 1110, 1113 (Del. 1994)).

25 The defendants also moved to dismiss under Court of Chancery Rule 23.1 for failure to allege demand futility, but the Court found that the defendants waived those arguments because they did not meaningfully argue them in their briefs.

26 The stockholders agreement provided that CD&R could nominate a proportionate number of directors to the board, rounded to the nearest whole number, as long as CD&R controlled at least 10% of the company's voting power. At the time of the transaction, that provsion allowed CD&R to nominate four directors.

27 *Id.* at *14.

28 *Id.* at *16.

The stockholders agreement also provided CD&R with "a lengthy list of consent rights," including over "significant corporate and financing transactions, as well as more basic corporate governance issues like increasing the size of the Board or amending the bylaws," as well as board-level rights, including the right to proportionate representation on the board and on key committees.[29] The Court found that these rights, along with the other factors of control, supported a pleading stage inference of control.

Finally, the Court found that another source of influence was CD&R's relationships with NCI's CEO and the special committee's financial advisor and determined that these relationships supported a reasonable inference of control at the time of the transaction.

Because it was reasonably conceivable that CD&R controlled NCI and because CD&R stood on both sides of the transaction, the Court denied CD&R's motion to dismiss and held that CD&R was required to establish that the transaction was entirely fair. The Court found that the allegations in the complaint supported a pleading stage inference of unfairness because, among other things, of the "valuation gap" between the $638 million valuation in connection with CD&R's acquisition of Ply Gem (which the proxy statement did not disclose) and the $1.236 billion valuation in connection with NCI's acquisition of Ply Gem three months later and the fact that the special committee that evaluated the transaction had opted to use the financial advisor that was already advising another CD&R portfolio company.

For the same reasons that the Court denied CD&R's motion to dismiss, the Court also denied motions to dismiss filed by the directors with respect to whom the Court found there to be reasonable inferences of control by CD&R. The Court found that there was a reasonable inference at the pleadings stage that they acted disloyally or with bad faith and, therefore, they could not rely on the protections of the Section 102(b)(7) exculpatory provision in NCI's certificate of incorporation. On the other hand, as to four directors who the Court found were independent and disinterested, the Court found that "there is not any plead basis to infer that these defendants acted disloyally or in bad faith" and therefore found they were entitled to dismissal under *In re Cornerstone Therapeutics Inc, Stockholder Litigation* [30] because of the Section 102(b)(7) exculpatory provision.[31]

The four CD&R appointees to the NCI board who the Court held were controlled by CD&R also argued that the claims against them should be dismissed because they abstained from voting on the transaction. The Court found that the "cookie-cutter step" of recusing oneself from the final vote on the transaction, rather than "absent[ing] themselves from the process entirely," was not sufficient to establish an abstention defense at the pleadings stage and that the Court would have to conduct a fact-specific analysis that was not appropriate on a motion to dismiss.[32]

***Davidow v. LRN Corp.*, 2020 WL 898097 (Del. Ch. Feb. 25, 2020) (Zurn, V.C.)**

In *Davidow v. LRN Corp.*,[33] the Court of Chancery denied a motion to dismiss claims against a board of directors for breaches of fiduciary duty in connection with a self-tender offer. The Court concluded that the plaintiff had adequately alleged that the disclosures made in connection with the self-tender offer were misleading and incomplete and that the tender offer was coercive and unfair to the corporation's stockholders.

On May 31, 2017, approximately four months before the launch of the self-tender offer, LRN Corporation ("LRN") issued spring-loaded stock options to LRN's three directors—Dov Seidman, Lee Feldman and Mats Lederhausen—and other insiders. The options were issued based off of an appraisal that valued LRN's stock at $1.35 per share. The appraisal intentionally excluded a $20 million cash payment the company expected to receive for "non-recurring events outside the ordinary course of business," which the plaintiff alleged was excluded to reduce the option price.[34] The options grant was not disclosed to stockholders until it was disclosed in connection with the tender offer a few months later.

The self-tender offer was launched on October 6, 2017, at a price of $1.35 per share, and closed on November

29 *Id.* at *19.

30 115 A.3d 1173 (Del. 2015).

31 *Voigt*, 2020 WL 614999 at *26.

32 *Id.* at *28.

33 2020 WL 898097 (Del. Ch. Feb. 25, 2020).

34 *Id.* at *3.

17, 2017, with stockholders tendering approximately 23% of LRN's issued and outstanding shares. None of LRN's three directors tendered any shares in the tender offer. Rather, the consummation of the tender offer had the effect of materially increasing the individual defendants' equity holdings in LRN and resulted in Seidman—LRN's founder and chairman of the board—beneficially owning more than 50% of LRN's voting stock.

In connection with the tender offer, an offer to purchase was sent to LRN's stockholders. The offer to purchase stated that if more than 7,407,407 shares were tendered, the company would purchase the first 25,000 shares tendered by each stockholder and all excess shares would be purchased on a proration basis. However, the offer to purchase also stated that the company reserved the right to purchase more than 7,407,407 shares.

The offer to purchase stated that the purpose of the tender offer was to provide stockholders with liquidity. The offer to purchase explained that the company had "received certain one-time lump sum payments of over $20 million in the aggregate as the result of certain non-recurring events outside the ordinary course of business" and that LRN had "no strategic or operational need to retain the cash within LRN."[35] However, it did not disclose any information about how or why LRN received the $20 million or how it was outside the ordinary course of business.

The offer to purchase stated that it was possible that stockholders who did not participate in the tender offer would have to hold their shares for a long period of time without receiving any payment for them and that it was possible that they would never receive payment for their shares if they did not participate in the tender offer. Although the plaintiff alleged that the defendants had already started to discuss a process to sell the company at a higher price when the tender offer was initiated, the offer to purchase did not disclose information about a sales process to stockholders. The offer to purchase stated that the $1.35 per share price was based on the appraisal that was done in connection with the May 31 stock option grant and that the $20 million received by the company was excluded from the appraisal. But it did not disclose any other information about the appraisal, such as the valuation methodology, inputs to the methodology, or the bases for any inputs. The offer to purchase further disclosed that if the tender offer was successful, it would cause Seidman to own in excess of 50% of LRN's stock and that the directors may pursue transactions in the future under which the directors and the stockholders would have diverging interests.

One year following the tender offer, the individual defendants approved a merger transaction in which LRN was acquired by a third party for $7.00 per share. Seidman, who held a majority voting control of LRN in the wake of the tender offer, approved the merger by written consent. Seidman received approximately $128 million in the follow-on merger transaction, along with certain other personal benefits.

After the follow-on transaction closed, a former LRN stockholder who tendered all of his LRN shares in the tender offer filed suit in the Court of Chancery. The plaintiff alleged that Seidman and the two other LRN directors breached their fiduciary duties by issuing materially misleading and incomplete information in connection with the tender offer and by approving the transaction despite the fact that it was coercive and unfair.

The Court first held that the plaintiff sufficiently pled that the individual defendants breached their fiduciary duties of disclosure in connection with the tender offer. The Court emphasized that a board's disclosure obligation in the context of a self-tender offer is heightened because the board faces an inherent conflict of interest, stating that "self-tenders have 'built-in conflicts of interest between the fiduciaries responsible for conducting the offer and the stockholder to whom the offer is directed.'"[36] The court explained that the "'interest of the corporate offeror (*qua* buyer) is to pay the lowest price possible; the interest of the stockholders (*qua* sellers) is to receive as high a price as possible.'"[37]

The Court concluded that the plaintiff had adequately alleged three separate disclosure deficiencies in connection with the tender offer. First, the Court held that the plaintiff adequately alleged that the stated purpose of the tender offer—to provide liquidity to stockholders—"served not to enlighten but to obscure the real reasons motivating the Offer."[38] The plaintiff adequately alleged that the directors' true motivation

[35] *Id.*

[36] *Id.* at *7 (quoting *Eisenberg v. Chi. Milwakee Corp.*, 537 A.2d 1051, 1056 (Del. Ch. 1987)).

[37] *Id.* (quoting Eisenberg, 537 A.2d at 1057).

[38] *Id.* at *9.

in pursuing the tender offer was to squeeze out LRN's stockholders and facilitate a follow-on cash-out transaction to benefit the directors.

Second, the Court held that the plaintiff adequately alleged that the disclosures relating to the price of the tender offer "were intended to, and did, obscure" the fact that the offer price was unfair.[39] The defendants "failed to disclose material facts to explain" the statement in the offer to purchase that it was the defendants' belief that the offer price was "reasonable and appropriate" or the decision not to provide a recommendation to stockholders on whether stockholders should tender.[40] The Court also noted that the offer to purchase "did not disclose the basis or methodology for the valuation other than the exclusion of the $20 million lump sum," which $20 million infusion also "went unexplained."[41]

Third, the Court found that the offer to purchase did not disclose that the directors were interested in the tender offer. Although the offer to purchase disclosed that the tender offer would provide Seidman a controlling interest in the company, that the company's directors and officers were not tendering their shares, and that the board might pursue transactions in the future where the interests of the directors may diverge from the interests of the other stockholders, those disclosures were misleading and incomplete "in light of Plaintiff's theory of the case."[42] The Court found that the offer to purchase "failed to disclose the number of shares and options held by the Individual Defendants, and most importantly failed to disclose that they would not tender in the offer because they planned to sell in the [follow-on transaction] at a much higher price."[43]

In addition to finding that the plaintiff had sufficiently pled disclosure claims against the individual defendants, the Court concluded that the plaintiff had adequately alleged that the self-tender offer was coercive. The Court found that the well-pled disclosure claims were sufficient to support a claim of coercion, stating that "'actionable coercion may inhere in either the disclosures or in the terms of the offer itself.'"[44]

The Court also found that the transaction was structurally coercive. The Court first explained that the "Court has found actionable coercion where the plaintiff 'is forced into a choice between a new position and a compromised position,' and where, under the circumstances, stockholders may have perceived, 'not unreasonably, that unless they tender, they may not realize any return on or value for their investment in the foreseeable future.'"[45]

The Court found that four aspects of the self-tender offer "contributed to Plaintiff's reasonable belief that he would receive little or no return on his LRN investment unless he tendered," rendering the tender offer structurally coercive.[46] First, the company's past dealings with its stockholders rendered the tender offer coercive. The past dealings included a history of consummating transactions with inadequate disclosures at arbitrary prices, failing to hold stockholder meetings, providing stockholders with stale financial information, and failing to provide stockholders with notice of potentially conflicted transactions.

Second, the offer to purchase "framed" the tender offer "as the last opportunity for stockholders to avoid a total loss on their investment."[47] The Court explained that the offer to purchase was presented as a "fleeting liquidity event" that was made possible by a $20 million cash infusion outside the ordinary course of business and that the offer to purchase warned stockholders that they might never receive money for their stock if they did not participate in the tender offer.[48]

Third, the tender offer was structured so that the stock of those who did not participate would be worth less on account of Seidman having "near total control over LRN" following the tender offer.[49] That, coupled with the statements in the offer to purchase that the interests of the directors and officers may cause their interests to diverge with the interests of the remaining stockholders, "forced stockholders to face a coercive choice: either

39 *Id.*

40 *Id.*

41 *Id.* at *10.

42 *Id.*

43 *Id.*

44 *Id.* at *12. (quoting *Eisenberg v. Chi. Milwaukee Corp.*, 537 A.2d 1051, 1056 n.7 (Del. Ch. 1987)).

45 *Id.* (quoting *Gradient OC Master, Ltd. v. NBC Univ., Inc.*, 930 A.2d 104, 119 (Del. Ch. 2007) and Eisenberg, 537 A.2d at 1061).

46 *Id.*

47 *Id.* at *12.

48 *Id.*

49 *Id.* at *13.

tender at an unexplained price, or risk retaining their interest in a company controlled by a self-interested fiduciary."[50]

Fourth, the plaintiff had adequately alleged that the tender offer's proration plan was coercive because it forced stockholders to tender more shares than they would have because if the proration plan was implemented, it could have reduced the number of shares purchased. The Court stated that while it may be a valid exercise of business judgment to proration the repurchase of shares in ordinary circumstances, the plaintiff's allegations rendered the tender offer's "proration term suspicious."[51] By accepting all of the tendered shares, rather than prorating, the individual defendants "were able to buy out a greater percentage of LRN's outstanding shares, bolstering Seidman's control and increasing the Individual Defendants' equity in the Company."[52]

Thus, the Court concluded that the plaintiff had adequately alleged that the tender offer was subject to entire fairness review. Having found that the tender offer was subject to entire fairness review, the Court found that the plaintiff adequately alleged that the tender offer "was the product of an unfair process and resulted in an unfair price."[53] The Court accepted the plaintiff's challenge to the fairness of the process due to the inadequate disclosures and the timing of the transaction relative to the follow-on merger. The Court similarly accepted the plaintiff's challenge to the fairness of the $1.35 per share tender offer price, on account of, among other things, LNR's history of arbitrary pricing and the eventual $7.00 per share price in the follow-on transaction.

In re AmTrust Fin. Servs., Inc. S'holder Litig., 2020 WL 914563 (Del. Ch. Feb. 26, 2020) (Bouchard, C.)

In *In re AmTrust Financial Services, Inc. Shareholder Litigation*,[54] the Court of Chancery held that a squeeze-out merger by a corporation's controlling stockholders was not entitled to business judgment review at the pleading stage under *Kahn v. M & F Worldwide Corp.* (*"MFW"*)[55] because the complaint pled a "reasonably conceivable set of facts that three of the four members of the special committee" formed to negotiate the transaction were materially self-interested given that the transaction "was expected to extinguish viable derivative claims exposing each of them to significant personal liability."[56] This case expands on *MFW* to make clear that to be afforded the protections under *MFW*, the members of a special committee formed to negotiate a transaction not only must be independent from the controlling stockholder but also must not have a material self-interest in the transaction.

In the fall of 2017, the controlling stockholders of AmTrust Financial Services, Inc. ("AmTrust") informed AmTrust's board that they were considering a potential transaction whereby the controlling stockholders would team up with a private equity firm to take AmTrust private. In early January 2018, the controlling stockholders made an offer to the AmTrust board to acquire the corporation at a price of $12.25 per share, and the offer was conditioned on approval by an independent special committee and a fully informed vote of the majority of AmTrust's minority stockholders. That same day, the AmTrust board formed a four-member special committee in connection with the potential transaction. Thereafter, the special committee and the controlling stockholders engaged in negotiations. On February 28, 2018, the special committee recommended that the board approve the transaction at a price of $13.50 per share, and, on the following day, AmTrust announced that it had entered into a merger agreement with the controlling stockholders.

A number of significant stockholders of AmTrust, including Carl Icahn, opposed the merger at the $13.50 per share price. When it became apparent to AmTrust that a majority of the minority stockholders would not vote in favor of the merger, AmTrust cancelled the stockholder meeting that was scheduled for stockholders to vote on the transaction. Thereafter, the controlling stockholders engaged in discussions with Ichan and reached an agreement with him that they would pay $14.75 per share in return for Ichan entering into a settlement agreement pursuant to which he would support the transaction, forgo appraisal rights,

50 *Id.*

51 *Id.*

52 *Id.*

53 *Id.* at *15.

54 2020 WL 914563 (Del. Ch. Feb. 26, 2020).

55 88 A.3d 635 (Del. 2014).

56 *In re AmTrust Fin. Servs.*, 2020 WL 914563, at *1.

and dismiss a fiduciary duty action he filed challenging the $13.50 per share merger agreement. The merger agreement was amended after the special committee and the board approved the transaction at the $14.75 per share price. The stockholder meeting was reconvened and stockholders holding 67.4% of the minority shares voted to approve the merger. Several stockholders then filed suit, and the defendants filed motions to dismiss.

The Court first rejected the defendants' *MFW* defense. Under *MFW*, six conditions must be satisfied in order to receive business judgment review of a squeeze-out merger by a controlling stockholder: (1) the controller conditions the transaction on the approval of both a special committee and a majority of the minority; (2) the special committee is independent; (3) the special committee is empowered to freely select its own advisors and to say no definitively; (4) the special committee meets its duty of care in negotiating a fair price; (5) the vote of the minority is informed; and (6) there is no coercion of the minority.

The Court stated that although the second *MFW* condition "speaks in terms of the 'independence' of members of a special committee," it was the Court's "opinion" that the "condition—and the overall *MFW* framework—was intended to ensure not only that members of a special committee must be independent in the sense of not being beholden to a controlling stockholder, but also that the committee members must have no disabling personal interest in the transaction at issue."[57]

The Court held that three of the four members of the special committee were materially self-interested in the transaction because, when they were considering whether to approve the transaction, they faced viable claims that would impose personal liability, material to each of them, in derivative actions that would be extinguished by the merger. Those three members of the special committee were each named as defendants in a derivative action that was filed in April 2015 (and was pending as of the time of the special committee's approval of the transaction) by an AmTrust stockholder for breaches of their fiduciary duties of loyalty in connection with the alleged usurpation of a corporate opportunity from AmTrust by the controlling stockholders. Each of them filed an answer to the derivative complaint rather than filing a motion to dismiss, which the Court characterized as a tacit concession of "the viability of the claims against them."[58]

The Court also held that the plaintiff had sufficiently pled that the extinguishment of the derivative action was material to the three directors. The Court noted that the plaintiff's expert in the derivative action valued the claim to be worth more than $300 million and the special committee's financial advisor informed the special committee that the estimated settlement value of the derivative action was "between $15 million and $25 million."[59] The Court stated that it "certainly is reasonably conceivable that the prospect of joint and several liability for a claim with a settlement value in this range—from which it is reasonable to infer the amount of the exposure was much higher—would be material to [the three directors] personally."[60]

Because a majority of the special committee had a material self-interest in the transaction, the second condition of *MFW* was not satisfied, and the Court denied the motions to dismiss that were based on *MFW*. Given that "the failure to comply with a single condition is sufficient to defeat reliance on the MFW standard," the Court did not address whether other *MFW* conditions were satisfied.[61]

The members of the special committee also argued that they were entitled to dismissal because AmTrust's certificate of incorporation contained a Section 102(b)(7) exculpatory provision and the complaint failed to alleged a non-exculpated breach against them. In *In re Cornerstone Therapeutics Inc, Stockholder Litigation*,[62] the Delaware Supreme Court held that independent directors of a Delaware corporation with a Section 102(b)(7) exculpatory charter provision are entitled to dismissal of a case challenging a controlling stockholder transaction unless the complaint pleads a non-exculpated claim for breach of fiduciary against the directors. However, "[w]hen a director is protected by an exculpatory charter provision, a plaintiff can survive a motion to dismiss by that director defendant by pleading facts supporting a rational inference that the director harbored self-interest adverse to the

57 *Id.* at *10.

58 *Id.* at *11.

59 *Id.*

60 *Id.*

61 *Id.* at *10.

62 115 A.3d 1173 (Del. 2015).

stockholders' interest, acted to advance the self-interest of an interested party from whom they could not be presumed to act independently, or acted in bad faith."[63]

The Court of Chancery denied the motion to dismiss with respect to the three members of the special committee who were defendants in the derivative action, holding that the complaint supported a "rational inference that [they] harbored self-interest adverse to the interests of Amtrust's minority stockholders when they approved the Transaction because, as a practical matter, it would have extinguished viable claims against each of them for which they faced significant potential liability."[64]

On the other hand, the Court granted the motion to dismiss filed by the fourth member of the special committee, who was not a defendant in the derivative action and did not join the board until almost two years after the transaction at issue in the derivative action closed. Because the plaintiff did not allege that the director had a material self-interest in the transaction or was not independent of individuals who did, the plaintiff was required to "plead facts demonstrating that [he] 'intentionally fail[ed] to act in the face of a known duty to act, demonstrating a conscious disregard for [his] duties.'"[65] Because the plaintiff failed to do so, the Court granted the director's motion to dismiss.

***Salladay v. Lev*, 2020 WL 954032 (Del. Ch. Feb. 27, 2020) (Glasscock, V.C.)**

In *Salladay v. Lev*,[66] the Court of Chancery denied a motion to dismiss claims relating to a going-private transaction in which a majority of the target corporation's board of directors were conflicted. The Court held that the entire fairness standard of review would apply – despite the use of a special committee and approval by a majority of the disinterested stockholders – because the company failed to form the special committee before substantive economic discussions took place and the proxy statement issued in connection with the transaction contained materially misleading information.

[63] *In re AmTrust Fin. Servs.*, 2020 WL 914563, at *13 (quoting *Cornerstone*, 115 A.3d at 1179-80).

[64] *Id.*

[65] *Id.* (quoting *Lyondell Chem. Co. v. Ryan*, 970 A.2d 235, 243 (Del. 2009)).

[66] 2020 WL 954032 (Del. Ch. Feb. 27, 2020).

The claims arose from the actions taken by the directors of Intersections, Inc. ("Intersections") in taking the company private. In early 2018, Intersections began to look for additional investors and formed a special committee to explore potential financing. This initial search proved fruitless, and the special committee was abandoned. In September 2018, iSubscribed Investor Group ("iSubscribed") expressed interest in acquiring Intersections through iSubscribed's acquisition vehicle, WC SACD. Intersections' CEO, Michael Stanfield, met with a WC SACD representative and indicated that Intersections would be receptive of an offer in the $3.50 to $4.00 per share range. The parties then engaged in due diligence.

Intersections reconstituted the special committee on October 5 to consider a transaction with WC SACD. The special committee engaged a "nationally recognized" financial advisor, but the advisor terminated its engagement after reviewing the proposed deal.[67] The special committee subsequently retained North Point Advisors ("North Point"), which provided a fairness opinion endorsing the deal. On October 29, Intersections' board approved the sale of the company to WC SACD at $3.68 per share. On November 29, 2018, Intersections filed a Schedule 14D-9 Proxy to solicit stockholder approval. The 14D-9 did not disclose the abrupt departure of the special committee's initial financial advisor and represented that if the merger agreement was terminated, WC SACD would (pursuant to a note purchase agreement) have the right to appoint a majority of the Intersections' board, subject to NASDAQ listing requirements.

A stockholder brought claims challenging the fairness of the transaction on January 22, 2019. The defendants moved to dismiss, arguing that the transaction should receive business judgment review because it was approved by an independent committee as well as a majority of disinterested stockholders.

The Court found that the complaint adequately pled that a majority of the directors were interested in the merger because they had rolled over substantial portions of their equity into the post-merger entity. Thus, the merger could only receive business judgment review if it was approved by (i) a fully empowered, independent special committee (pursuant to *In re Trados Inc. Shareholder*

[67] *Id.* at *4.

Litigation (Trados II)),[68] or (ii) a fully informed, uncoerced vote of disinterested stockholders (pursuant to *Corwin v. KKR Financial Holdings LLC (Corwin)*).[69]

The Court found that the merger was not cleansed by an independent special committee because the special committee was formed after "substantive economic negotiations" had taken place.[70] Drawing from the Supreme Court's controlling stockholder precedent, the Court held it was important for the special committee to be constituted *ab initio*, or "from the beginning," such that, "[f]rom inception, the controlling stockholder knows that it cannot bypass the special committee's ability to say no."[71] The Court held that similar concerns applied in a conflicted board context – even where the transaction did not involve a controlling stockholder – because "[e]ven in a non-control setting, commencing negotiations prior to the special committee's constitution may begin to shape the transaction in a way that even a fully-empowered committee will later struggle to overcome."[72]

The Court noted that, for purposes of when a special committee must be constituted, *ab initio* means before "substantive economic negotiations" take place.[73] Although not a "bright-line rule," the Court noted that the Supreme Court's recent decision in *Olenik v. Lodzinski*[74] held that "substantive economic discussions" began to take place once the parties engaged in joint valuation exercises that formed a price collar for the transaction.[75]

The Court noted that the previously constituted special committee had been abandoned by the time iSubscribed and Intersections began a detailed due diligence process. Additionally, when Stanfield met with WC SACD in September, Stanfield communicated that Intersections' board would be receptive of an offer of $3.50 to $4.00 per share. Only after those discussions did the board reconstitute the special committee. Drawing all inferences in favor of the plaintiff, the Court held it was reasonable to infer the pre-committee discussions were "substantive economic negotiations" that formed a price collar and "set the field of play for the economic negotiations to come."[76] Accordingly, the Court held the special committee did not cleanse the merger in accordance with *Trados II*.

Likewise, the Court held that the merger was not cleansed by the stockholder vote because it was reasonable to infer that Intersections' 14D-9 materially misled stockholders regarding the possible transfer of control to WC SACD and omitted material facts regarding the departure of the special committee's initial financial adviser.

In examining the transfer-of-control disclosures, the Court explained that the "buried facts" doctrine provides that "[d]isclosure is inadequate if the disclosed information is 'buried' in the proxy materials" requiring the stockholder to go on a "scavenger hunt" to dig up the material information.[77] The Court acknowledged that the 14D-9 disclosed that (i) a rejection of the merger agreement would result in a change in control in favor of WC SACD, and (ii) this change in control would be subject to NASDAQ Rule 5640's requirement that the right to appoint a majority of the board must be commensurate with WC SACD's ownership. The Court found, however, that these disclosures were misleading because they would require a stockholder to go through the multiple steps of calculating WC SACD's ownership in the company before realizing a "no" vote would not result in a change in control. Accordingly, the Court held that it was reasonably conceivable that the 14D-9 change-in-control provisions were "presented in an ambiguous, incomplete, or misleading manner, [and] [were] not sufficient to meet a fiduciary's disclosure obligations."[78]

Similarly, the Court held that the 14D-9 omitted material information regarding the abrupt exit of the first financial advisor engaged by the reconstituted special committee to evaluate the merger. The Court held that the compressed time frame in which the merger took place made the departure of the financial advisor "plausibly material."[79] Here, the newly hired financial

68 73 A.3d 17 (Del. Ch. 2013).

69 125 A.3d 304 (Del. 2015).

70 *Salladay*, 2020 WL 954032, at *11.

71 *Id.* at *10 (quoting *Kahn v. M & F Worldwide Corp.*, 88 A.3d 635, 644 (Del. 2014)).

72 *Id.*

73 *Id.*

74 208 A.3d 704 (Del. 2019).

75 *Salladay*, 2020 WL 954032, at *11.

76 *Id.* The Court noted the plaintiff's allegations were strengthened by the fact that the merger price offer was raised to $3.68, just under the middle of the range offered by Stanfield. *Id.*

77 *Id.* at *13 (quoting Vento v. Curry, 2017 WL 1076725, at *3 (Del. Ch. Mar. 22, 2017)).

78 *Id.* at *16 (quoting *Appel v. Berkman*, 180 A.3d 1055, 1064 (Del. 2018)).

79 *Id.*

firm "mysteriously terminated [its] engagement" after a few days of reviewing a fully formed transaction.[80] The Court found that a reasonable stockholder would want to know why a well-known financial advisor walked away from a fully formed transaction, and that it therefore was reasonably conceivable that the 14D-9 omitted material information. Accordingly, the Court held the transaction was not cleansed by a well-informed stockholder vote under *Corwin*.

Because the merger was approved by a conflicted board, and neither the special committee nor the stockholder vote cleansed the conflict, the Court concluded that the merger was subject to entire fairness. Because the Court found that the plaintiff adequately alleged the merger was not entirely fair, the Court denied the motion to dismiss.

***Buckley Family Tr. v. McCleary*, 2020 WL 1522549 (Del. Ch. Mar. 31, 2020) (Bouchard, C.)**

In *Buckley Family Trust v. McCleary*,[81] the Court of Chancery dismissed claims against a board of directors for failure to issue dividends, holding that the plaintiff failed to overcome business judgment review of the board's refusal to declare dividends because the plaintiff did not plead facts making it reasonably conceivable that the board's failure to declare a dividend was explicable only as an oppressive or fraudulent abuse of discretion. The Court also dismissed a derivative claim that the plaintiff asserted against the directors for breach of the duty of care because the plaintiff failed to make a demand on the company's board before filing suit.

The Buckley Family Trust (the "Trust"), which owned 16.4% of the outstanding common stock of McCleary, Inc. ("McCleary"), filed suit against the directors of McCleary, who together owned the remaining 83.6% of the outstanding common stock, to compel the company to pay a dividend, alleging that the board's failure to declare a dividend was "an oppressive abuse of discretion."[82] The Trust alleged that McCleary "had a surplus from which it could pay dividends of approximately $18.2 million" and that the board had refused to declare a dividend in order to coerce the Trust into selling its stock to the defendants at a substantial discount.[83] The Trust was a party to a purchase and restriction agreement that restricted the Trust from selling or transferring any of its shares in McCleary "without first offering to sell them to [McCleary] and, if [McCleary] does not elect to purchase the shares, to [the defendants]."[84] The purchase and restriction agreement also set the purchase price for the shares at the "greater of the book value of the shares or their appraised value, less a 30% discount for 'lack of marketability and control.'"[85] Thus, the Trust argued, the board's failure to pay dividends was an attempt to coerce the Trust into selling its shares to McCleary or the defendants at a 30% discount.

The Court granted the defendants' motion to dismiss the dividend claim. The Court first noted that the Delaware Supreme Court has endorsed Chancellor Wolcott's statement in the "seminal decision" of *Eshleman v. Keenan*[86] that "although courts have the power to compel the declaration of a dividend, courts will do so only when the withholding of a dividend 'is explicable *only* on theory of an oppressive or fraudulent abuse of discretion.'"[87]

The Court then distinguished two cases relied upon by the Trust where the court denied motions to dismiss claims challenging a board's failure to pay dividends. The Court distinguished *Rubin v. Great Western United Corp.*[88] on the basis that in *Rubin*, the plaintiff was a preferred stockholder with a contractual right to receive dividends and the plaintiff alleged that the directors owned common stock and failed to pay dividends in order to "divert value from the preferred stockholders to benefit themselves as common stockholders."[89] The Court stated that, unlike in *Rubin*, the Trust held "common stock and would share equally with the [defendants] on a *pro rata* basis in any dividend that the Company issues since they each own only common stock of the Company."[90]

The Court distinguished *Litle v. Waters*[91] on the basis that while the S-corporation in *Litle* did not declare dividends in order to cover personal tax liabilities

80 *Id.* at *17.

81 2020 WL 1522549 (Del. Ch. Mar. 31, 2020).

82 *Id.* at *5.

83 *Id.* at *4

84 *Id.* at *2.

85 Id.

86 194 A. 40, 43 (Del. Ch. 1937).

87 *Buckley Family Tr.*, 2020 WL 1522549, at *5.

88 1975 WL 1261 (Del. Ch. Apr. 29, 1975).

89 *Buckley Family Tr.*, 2020 WL 1522549, at *6.

90 *Id.*

91 1992 WL 25758 (Del. Ch. Feb. 11, 1992).

passed through the corporation to its stockholders, the Trust's complaint acknowledged that "'in years when the Company was profitable, the Company issued a dividend equal to the amount necessary for stockholders to pay their related tax obligations' and, beyond that, the Company declared a special dividend to all common stockholders totaling $3 million in 2012."[92] The Court stated that "this case does not have the coercive dynamic of the 'squeeze out situation' in *Litle*, where the plaintiff had to go out-of-pocket to pay taxes just to hold his shares."[93] The Court rejected the Trust's argument that the combination of the lack of dividends and the transfer restrictions set forth in the purchase and restriction agreement amounted to coercion because it forced the Trust to sell at a 30% discount. The Court stated that it was "not coercion for the Trust—which has been under no compulsion to pay a tax liability in order to keep its shares—to honor this contractual obligation if it wishes to sell any of its shares of the Company."[94]

Finally, the Court noted that the Trust's complaint failed to allege facts demonstrating that the defendants' failure to declare dividends was motivated by self-interest. The Court rejected the implication that the defendants improperly diverted profits to themselves through excessive compensation rather than pay dividends. The Court noted that the complaint provided no compensation figures in support of the Trust's contention, and the defendants submitted compensation information to the Court that was previously produced to the Trust in connection with a Section 220 demand that showed that the five defendants collectively received annual board fees totaling between $76,000 and $84,000, and one of the defendants received between $145,718 and $167,328 per year for compensation as CEO. The Court stated that the "figures hardly seem excessive for a Company with revenues ranging between $45 million and $50 million during this period."[95]

The Trust also alleged that the defendants, as directors and officers of the company, breached their duty of care in connection with "various decisions they made and various matters they allegedly failed to manage or address properly."[96] Among other things, the Trust argued that the directors breached their duty of care in connection with the board's decision to transition away from a customer that accounted for the largest amount of the company's sales and focus its attention on a new customer.

McCleary did not have a Section 102(b)(7) exculpatory provision in its certificate of incorporation. Therefore, the defendants could be liable for monetary damages for breaches of the duty of care. However, in order to assert the derivative claims, because the Trust did not make a demand on the board, the Trust was required to establish that demand was futile. The Trust did not argue that any member of the board had a financial interest in an underlying transaction and did not challenge the independence of any of the board members. Thus, the determinative question was whether the Trust pled with particularity that the directors faced a substantial likelihood of liability. The Court found that because the Trust had "failed to demonstrate that the Board's actions or inactions were recklessly indifferent or without the bounds of reason such that the directors would face a substantial likelihood of liability," demand was not futile, and, therefore, the Court dismissed the derivative claims.[97] For example, with respect to the claim in connection with the board's decision to transition away from one customer and focus on a new customer, the Court noted that the board was advised that the customer wanted McCleary to offer it lower prices and it was the opinion of management that if McCleary matched the lower prices, McCleary would be placed in a "downward spiral."[98] The Court stated that "the Trust has failed to allege facts suggesting that the directors relied on management's opinions or reports in bad faith and the internal documents attached to the Complaint, viewed in their totality, do not demonstrate that the directors failed to be informed about moving away from [the customer] such that they could be said to have acted with reckless indifference or without the bounds of reason in making the decision."[99]

92 *Buckley Family Tr.*, 2020 WL 1522549, at *6.

93 *Id.*

94 *Id.* at *7.

95 *Id.*

96 *Id.* at *1.

97 *Id.* at *10.

98 *Id.* at *3.

99 *Id.* at *11.

Alternative Entity Litigation

***In re CVR Refining, LP Unitholder Litig.*, 2020 WL 506680 (Del. Ch. Jan. 31, 2020) (McCormick, V.C.)**

In *In re CVR Refining, LP Unitholder Litigation*,[1] the Court of Chancery held that allegations of a multi-step scheme to lower the cost of a unitholder buyout through an exchange offer leading to a call right sufficiently stated a claim for breach of a partnership agreement.

In May 2018, representatives of CVR Refining, L.P. ("Refining LP") and CVR Energy, Inc. ("CVR Energy"), the indirect owner of Refining LP's general partner, CVR Refining GP, LLP ("Refining GP"), discussed a partial exchange offer that would give CVR Energy enough equity to exercise a call right pursuant to the terms of Refining GP's partnership agreement. The partnership agreement granted Refining GP or its assignee the right to purchase common units held by unaffiliated limited partners if Refining GP and its affiliates either (i) held more than 95% of a class of units or (ii) increased their holdings from less than 70% of Refining LP's units to more than 80% of Refining LP's units. The partnership agreement "provide[d] limited partners with two price-setting provisions."[2] First, the call price could not be lower than what Refining GP or its affiliates had paid for units in the prior 90 days. Second, the formula to calculate the call price was the average closing price of the units over the prior 20 trading days.

Refining GP's board of directors issued a public filing expressing "no opinion" on whether limited partners should accept the offer.[3] On May 29, 2018, CVR Energy initiated the exchange offer at a price of $27.63. The exchange offer expired on July 27, 2018, and enough unitholders participated to increase Refining GP and its affiliates' holdings from 69.99% of Refining LP's units to 84.5% of Refining LP's units, thus satisfying the second ownership condition under the partnership agreement call option.

CVR Energy and other entities controlling Refining LP made public statements contemporaneously with the exchange offer (and in the months thereafter) that disclaimed any intent to exercise the call right after the exchange offer. Analysts nevertheless predicted CVR Energy would exercise its call right, and the stock price plummeted.

On November 29, 2018, four months after closing the exchange offer, CVR Energy disclosed that it was "now contemplating" exercising the call right.[4] The trading price of Refining LP's unit's fell significantly. On January 17, 2019, Refining LP and CVR Energy announced that Refining GP had assigned the call right to CVR Energy and that it would be exercised.

The call price, based on the 20-day formula, was set at $10.50 per unit, which was $17.13 less than the exchange offer price. Notably, two months earlier, a vice-president of CVR Energy and the General Partner purchased units for $16.72 per unit.

Several plaintiffs challenged the transactions and the Court consolidated the separate actions. The plaintiffs alleged that the defendants breached the partnership agreement, the implied covenant of good faith and fair dealing, and/or tortiously interfered in the partnership agreement by engaging in a multi-step scheme designed

[1] 2020 WL 506680 (Del. Ch. Jan. 31, 2020).

[2] *Id.* at *4.

[3] *Id.* at *5.

[4] *Id.* at *7.

to lower the cost of the buyout through the exchange offer, the announcement that the call right might be exercised, and the eventual exercise of the call option.

The partnership agreement eliminated all traditional fiduciary duties owed by Refining GP. Therefore, "the primary question before th[e] court [was] whether the defendants' alleged scheme . . . breache[d] any express or implied provision of the partnership agreement."[5] The partnership agreement required Refining GP to act in good faith, but only when acting in its capacity as general partner.

The Court found, among other things, that the plaintiffs stated a claim for breach of the good-faith requirement of partnership agreement against Refining GP and its board, but not against CVR Energy, because CVR Energy was not bound by the terms of the partnership agreement until later, when Refining GP assigned the call right to CVR Energy. In part, the Court relied on *Bandera Master Fund LP v. Boardwalk Pipeline Partners, LP*,[6] which evaluated a similar alleged scheme and that was decided while this matter was under advisement.

Specifically, the Court determined that the plaintiffs had alleged "a reasonably conceivable basis from which the Court can infer that the [Refining GP] non-recommendation [concerning the exchange offer] breached the partnership agreement's express requirement that [Refining GP] act in good faith" because the non-recommendation was made in Refining GP's official capacity, purportedly with the knowledge that it was adverse to the limited partners' interests.[7] The Court explained that the plaintiffs sufficiently pleaded that the defendants' actions were taken to lower the unit price so that CVR Energy could buy out the minority unitholders at a lower price.

The Court found that the plaintiffs also stated a claim for breach of the partnership agreement relating to the exercise price because that price was lower than what an alleged affiliate (the vice president) had paid for the units within the 90 days prior to the exercise of the call option, in contradiction of the price protections in the partnership agreement.

The Court also held that the plaintiffs had stated a cognizable claim against Refining GP and Refining LP for breach of the implied covenant of good faith and fair dealing based upon the actions taken to lower the price of the units. Again, the Court relied in part on the *Boardwalk* decision, and determined that it was "reasonably conceivable that the General Partner worked with CVR Energy to frustrate the [c]all [r]ight's price protections."[8]

The Court similarly concluded that the plaintiffs sufficiently pleaded a claim for tortious interference with contract against CVR Energy and the other entities that controlled Refining LP. However, the Court dismissed the tortious interference claims against the individual defendants (except for Carl Icahn, who was alleged to have used his control over Refining LP and Refining GP to effectuate the alleged scheme) who served on the board up until the day before the exchange offer. The Court dismissed them because, as directors acting within their scope of agency, they were agents of the corporation and could not tortuously interfere with the contract. The Court rejected the absolute stranger-rule defense – that is, "that only strangers to a contract can tortiously interfere with that contract" – made by CVR Energy and the other entities controlling Refining LP because the argument ignored Delaware's recognition of parents and subsidiaries as separate legal entities.[9]

***Inter-Marketing Grp. USA, Inc. v. Armstrong*, 2020 WL 756965 (Del. Ch. Jan. 31, 2020) (Montgomery-Reeves, J.)**

In *Inter-Marketing Group USA, Inc. v. Armstrong*,[10] the Court of Chancery denied a Rule 23.1 motion to dismiss filed by a master limited partnership's general partner, holding that the plaintiff's failure to make pre-suit demand was excused where the plaintiff sufficiently alleged that the general partner had not exercised sufficient oversight of the integrity of the partnership's oil pipelines. Similar to recent decisions where a plaintiff successfully defeated a motion to dismiss an oversight claim under *In re Caremark International Derivative*

[5] *Id.* at *2.

[6] 2019 WL 4927053 (Del. Ch. Oct. 7, 2019).

[7] *CVR Refining*, 2020 WL 506680, at *2, *9.

[8] *Id.* at *16.

[9] *Id.* at *16-17.

[10] 2020 WL 756965 (Del. Ch. Jan. 31, 2020).

Litigation,[11] this case involved a monoline company where externally imposed regulations governed its "mission-critical"[12] operations. Although *Caremark* claims are likely to continue to be "among the hardest to plead and prove"[13] under Delaware law, this is the most recent Delaware case to illustrate that *Caremark* "'does require that a board make a good faith effort to put in place a reasonable system of monitoring and reporting about the corporation's central compliance risks.'"[14]

Plains All American Pipeline, L.P. ("Plains"), a publicly traded Delaware master limited partnership, owns thousands of miles of oil pipelines in North America. In May 2015, Plains' oil pipelines in Santa Barbara, California, spilled approximately 3,400 barrels of oil. The consequences to Plains were extensive, including a decline in revenue, a drop in stock price, and a cost of $257 million to clean up the spill. In May 2016, Plains was indicted in California for criminal charges related to the oil spill. In 2018, a jury found Plains guilty of eight misdemeanors and one felony.

The plaintiff, a Plains unitholder, brought derivative claims on behalf of Plains against Plains' general partner, a number of entities that controlled the general partner, and several directors and officers of the entity defendants. The plaintiff's amended complaint alleged breaches of contract against the defendants for duties owed to Plains under the partnership agreement and, alternatively, breaches of the implied covenant of good faith and fair dealing. The defendants moved to dismiss the action for failure to make demand or plead demand futility and for failure to state a claim.

The Court first dismissed the breach of contract claims against all of the defendants other than the general partner.[15] The plaintiff argued that three provisions in the partnership agreement imposed contractual duties on the defendants. The Court found that one of the three provisions only mentioned the general partner and therefore only imposed contractual duties on the general partner and not the other defendants. The Court found that the other two provisions, an indemnification provision and an exculpation provision, imposed no duties. The Court explained that the provisions "make entitlement to indemnification and freedom from liability conditional on the Indemnitee acting in good faith" but they do "not imply a mandatory duty."[16]

The plaintiff also argued that the defendants breached the implied covenant of good faith and fair dealing because the implied covenant arises from the defendants' contractual duty to ensure that "they neither cause nor preside over Plains' participation in criminal activities."[17] The Court, however, concluded that the partnership agreement addressed such criminal activity and did not leave any gap for the implied covenant to fill. The partnership agreement's provisions addressed both the conduct of the general partner and the rights and obligations of the other defendants. Because the partnership agreement was not silent on any matter that could not have been reasonably anticipated at the time of contracting, the implied covenant did not apply. The Court dismissed the plaintiff's implied covenant claim against all of the defendants, including the general partner.

Having dismissed all of the defendants except the general partner for failure to state a claim under Rule 12(b)(6), the Court next considered the general partner's motion to dismiss under Rule 23.1 based on the plaintiff's failure to make pre-suit demand. The Court first explained that when a plaintiff in a derivative action on behalf of a limited partnership fails to make pre-suit demand on the general partner, the complaint will be dismissed unless the plaintiff alleges particularized facts showing that demand would have been futile. Because the plaintiff's claims related to the general partner's failure to take action, the Court analyzed demand futility under *Rales v. Blasband*.[18] And because the plaintiff focused its allegations against the general partner on showing that the general partner had a disabling interest, the

[11] 698 A.2d 959 (Del. Ch. 1996). In *Marchand v. Barnhill*, 212 A.3d 805 (Del. 2019), the Delaware Supreme Court reversed the Court of Chancery's dismissal of a *Caremark* claim in connection with a listeria outbreak in the facilities of Blue Bell Creameries USA, Inc. A few months later, in *In re Clovis Oncology, Inc. Derivative Litigation*, 2019 WL 4850188 (Del. Ch. Oct. 1, 2019) the Court of Chancery denied a motion to dismiss a *Caremark* claim in connection with a company's the failure to comply with trial testing requirements in the development of a lung cancer drug.

[12] *Inter-Marketing Grp. USA, Inc.*, 2020 WL 756965, at *15.

[13] *Clovis*, 2019 WL 4850188, at *12.

[14] *Inter-Marketing Grp. USA, Inc.*, 2020 WL 756965, at *15 (quoting *Marchand*, 212 A.3d at 824).

[15] The Court had previously ruled that that the partnership agreement eliminated common law fiduciary duties.

[16] *Id.* at *6.

[17] *Id.* at *9.

[18] 634 A.2d 927, 934 (Del. 1993).

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Court focused the demand futility inquiry on whether it was "substantially likely that Plaintiff's claims would subject the General Partner to liability and thus disable it from considering demand."[19]

In assessing whether the general partner was substantially likely to be subjected to liability for failing to appropriately monitor the integrity of Plains' oil pipelines, the Court applied the framework set forth in *Caremark* to the plaintiff's claim of oversight liability. The Court stated it was applying *Caremark* because the parties applied *Caremark* in briefing and oral argument, but the Court noted that the "opinion does not rule that a general partner's contractual requirement to act in 'the best interests of the [p]artnership' imposes duties identical to those identified in *Caremark*."[20] And to succeed on a *Caremark* claim, the plaintiff must adequately plead that the general partner "utterly failed to implement any reporting or information system or controls" or "having implemented such a system or controls, consciously failed to monitor or oversee its operations thus disabling [itself] from being informed of risks or problems requiring [its] attention."[21]

The plaintiff here alleged that the general partner failed to create any board-level pipeline integrity reporting system. Plains' CEO and chairman of the board had testified in the criminal case against Plains, and the plaintiff relied on that testimony to support its claims. According to the plaintiff, the CEO's testimony showed the general partner's sustained and systematic failure to exercise pipeline integrity oversight. In response, the general partner argued that an audit committee monitored pipeline maintenance. The defendants, however, were unable to point to anything in the record showing that the audit committee performed its charge of pipeline integrity oversight.

The Court held that the plaintiff was entitled to the inference that the audit committee never assumed its reporting role with respect to pipeline integrity. The plaintiff also sufficiently alleged that Plains' board did not receive or review reports on pipeline activity that included information concerning pipeline integrity. The Court denied the Rule 23.1 motion to dismiss, concluding that the amended complaint "alleges particularized facts that the General Partner, acting through the Board, violated its contractual duty to Plains by consciously failing to oversee its mission-critical objective of maintaining pipeline integrity."[22]

***Skye Mineral Inv'rs, LLC v. DXS Capital (U.S.) Ltd.*, 2020 WL 881544 (Del. Ch. Feb. 24, 2020) (Slights, V.C.)**

In *Skye Mineral Investors, LLC v. DXS Capital (U.S) Ltd.*,[23] the Court of Chancery held, among other things, that the plaintiffs adequately alleged that a Delaware LLC's minority members' exercise of contractual blocking rights constituted actual control such that the minority members owed fiduciary duties to the LLC and its members. The Court found that the plaintiffs, the LLC and its majority members, adequately pled breach of fiduciary duty claims against the LLC's minority members arising out of an alleged scheme to purposefully drive the LLC's subsidiary into bankruptcy to allow the minority members to purchase its assets at a discount.

The LLC at the center of the dispute, Skye Mineral Partners, LLC ("SMP"), had one asset, its operating subsidiary, CS Mining, LLC ("CSM"). SMP's LLC agreement granted SMP's members the right to give, withhold, condition, or delay their "votes, approvals, or consents in their sole and absolute discretion."[24] The LLC agreement also required approval of 75% of SMP interest holders for certain actions, including the granting or pledging of any security interest. Given that the minority member defendants held approximately 28% of SMP's membership interests, they, "even as minority members, possessed significant control rights under the SMP Agreement."[25] The minority members also appointed one of the three managers on SMP's board of managers.

In June 2016, CSM entered bankruptcy. In August 2017, pursuant to a bankruptcy sale order, all of CSM's assets were sold to an affiliate of the minority members.

19 *Inter-Marketing Grp. USA, Inc.*, 2020 WL 756965, at *10.

20 *Id.* at *10.

21 *Id.* at *11 (alterations in original) (quoting *Stone v. Ritter*, 911 A.2d 362, 372 (Del. 2006)).

22 *Id.* at *15.

23 2020 WL 881544 (Del. Ch. Feb. 24, 2020).

24 *Id.* at *4.

25 *Id.*

In January 2018, the LLC and its majority members filed a complaint alleging, among other claims, breaches of fiduciary duty against the minority members. The minority members moved to dismiss pursuant to Rule 12(b)(6), among other grounds.

The plaintiffs alleged that the bankruptcy was the result of a scheme that the minority members devised in 2014. Among other things, the plaintiffs alleged that the minority members' appointee to the board had learned that CSM's mineral deposits were "world class" and worth at least $600 million, and shared this information only with the minority members.[26] Soon thereafter, the minority members began "to block 'reasonable financing proposals' for SMP" and CSM began "withering on the vine," as SMP was unable to obtain the capital it needed to fund CSM's debt.[27] A minority member's affiliate purchased CSM's debt at a discount and eventually caused CSM to enter bankruptcy in 2016, allowing another minority member's affiliate to purchase CSM's assets on the cheap in 2017.

The plaintiffs alleged that the minority members were controllers and owed fiduciary duties to SMP and its members "even though they were neither SMP's managers nor holders of a majority of its outstanding membership units."[28] The minority members argued that the section of the LLC agreement that granted members the right to vote, approve, or consent in their "sole and absolute discretion" constituted an unambiguous waiver of any member-level fiduciary duties.[29] The Court disagreed with the minority members, reasoning that the allegation that the defendants took bad faith action to injure SMP for their own personal advantage implicated the "core aspect of the duty of loyalty" which could not be eliminated by the "sole and absolute discretion" language. Rather, "[t]o the extent that an Agreement purports to insulate a [fiduciary] from liability even for acts of bad faith . . . it should do so in the most painstakingly clear terms."[30]

Having determined that the LLC agreement did not eliminate the LLC's members' duty of loyalty, the Court considered whether the minority members were controlling members who would owe such fiduciary duties. Because the defendants held less than 50% of SMP's membership units, the question turned on whether the plaintiffs pled facts allowing a reasonable inference that the defendants "exercise[d] such formidable voting and managerial power that, as a practical matter, [they were] no differently situated than if [they] had majority voting control."[31] The Court found that although a contractual blocking right, by itself, is unlikely to support a finding of control, the plaintiffs alleged that the minority members had "participated in a concerted effort to place SMP in a precarious financial condition (i.e. a conspiracy to harm . . . .), and then exercised their leverage with the Blocking Rights to steer CSM off the cliff into the bankruptcy ravine below."[32] The plaintiffs further alleged that "the Blocking Rights allowed [the minority members] to block *all* of SMP's efforts to finance *any* of its ongoing operations—with either debt or equity."[33] The Court noted that an inference of control is warranted when blocking rights empower a minority investor "to channel the corporation into a particular outcome"[34] and that the plaintiffs alleged "an even stronger case" because the blocking rights gave the minority members "the unilateral power to shut SMP down—full stop."[35] The Court further found that the complaint adequately pled that the minority members "*did* exercise the Blocking Rights to prevent capital contributions . . . which, predictably, bankrupted SMP's sole asset."[36] Thus, the Court concluded that the plaintiffs adequately alleged that the minority member defendants exercised control over SMP and owed fiduciary duties to SMP and its members. The Court then concluded that the complaint supported a reasonable inference that the minority members "breached their duties by exercising their Blocking Rights in bad faith intending to harm SMP."[37]

26 *Id.* at *4.

27 *Id.* at *5-6.

28 *Id.* at *24.

29 *Id.* at *25.

30 *Id.* at *26 (quoting *Miller v. Am. Real Estate P'rs, L.P.,* 2001 WL 1045643, at *11 (Del. Ch. Sept. 6, 2001)).

31 *Id.* (alterations in original) (quotation marks and citations omitted).

32 *Id.*

33 *Id.* (emphasis in original).

34 *Id.*

35 *Id.*

36 *Id.* (emphasis in original).

37 *Id.*

***United States of America v. Sanofi Aventis U.S. LLC*, 2020 WL 1270486 (Del. Mar. 17, 2020)**

In *United States of America v. Sanofi Aventis U.S. LLC*,[38] the Delaware Supreme Court answered certified questions of law regarding whether a limited liability partnership dissolves when it undergoes a change in membership, where the partnership's formational documents state that the partnership is not a distinct legal entity from its members. The Delaware Supreme Court held that in such a situation, a change in membership causes the dissolution of the old partnership and creates a new partnership.

Two doctors and a Sanofi sales representative formed a Delaware limited liability partnership ("JKJ Partnership") "to file and prosecute"[39] a *qui tam* action under the False Claims Act (the "FCA") against Sanofi-Aventis U.S. Services, Inc., Bristol-Myers Squibb Company, and related entities for their failure to disclose certain information regarding Plavix,® an antiplatelet drug used to prevent heart attacks and strokes. After filing the original *qui tam* complaint in the District Court of New Jersey, one of the partners withdrew from JKJ Partnership and was replaced. The new JKJ Partnership (consisting of two of its original members and the new member) then filed an amended *qui tam* complaint. The defendants moved to dismiss the amended complaint, arguing that the membership change caused the old partnership to dissolve and that the new partnership lacked standing under the FCA's first-to-file rule, which provides that, once a *qui tam* action has been brought, no person other than the government may intervene or bring a related action based on the facts underlying the pending action. The District Court granted the defendants' motion to dismiss. JKJ Partnership appealed to the United States Court of Appeals for the Third Circuit, arguing that the membership change did not cause the old partnership to dissolve, and that even if it did, the three original members would remain relators in the case and, therefore, could continue to pursue the litigation.

The governing partnership agreement contained conflicting language regarding whether JKJ Partnership was legally distinct from its three members. One section of the partnership agreement stated that "the Partnership shall not be a separate legal entity distinct from its Partners[,]"[40] while another section of the partnership agreement provided that the "withdrawal of a Partner shall not cause a dissolution of the Partnership."[41]

To settle this issue, the Third Circuit certified three questions to the Delaware Supreme Court: (1) whether a limited liability partnership dissolves when it undergoes a change in membership, where the partnership's formational documents contain conflicting language regarding whether the partnership is a distinct legal entity from its members; (2) whether, if the old partnership dissolved as a result of the membership change, it terminated immediately upon dissolution or must first undergo a "winding up" process; and (3) whether, if the old partnership must first undergo a "winding up" process before terminating, the original members may continue to pursue the *qui tam* action during the old partnership's "winding up" process.

With respect to the first certified question, the Delaware Supreme Court began its analysis by examining the nature of partnerships under both the Delaware Uniform Partnership Act (the "DUPA") and the current Delaware Revised Uniform Partnership Act (the "DRUPA"). The Supreme Court noted that while the DUPA embraced the "aggregate theory" of partnerships, *i.e.*, that a partnership is an aggregate of its members and does not constitute a distinct legal entity, the DRUPA embraces the "entity theory" of partnerships, *i.e.*, that a partnership is legally distinct from its members. However, the Supreme Court explained that the DRUPA also gives maximum effect to the freedom of contract and provides that, with the exception of certain mandatory provisions under DRUPA, the partnership agreement controls in most circumstances. Of particular relevance to the questions before the Supreme Court, Section 15-201 of the DRUPA provides that a partnership is an entity that is distinct from its partners "unless otherwise provided in a statement of partnership existence or a statement of qualification and in a partnership agreement."[42] Thus, the Supreme Court looked to the plain language of the partnership agreement to determine whether the original members intended for JKJ Partnership to be a legally distinct entity. Section 1.03 of the partnership aggreement explicitly provided that "the Partnership shall not be a separate legal entity distinct from its Partners" and that "[i]n the event of any

38 2020 WL 1270486 (Del. Mar. 17, 2020).

39 *Id.* at *3.

40 *Id.* at *9 (quoting 3d Cir. Order of Certification).

41 *Id.* at *10 (quoting 3d Cir. Order of Certification).

42 *Id.* at *8.

conflict between the terms of Section 1.03 and terms of any other Section of this Agreement, the terms of this Section 1.03 shall control."[43] The Supreme Court held that the plain language of Section 1.03 controlled over Section 8.01 of the partnership agreement, which provided that the "withdrawal of a Partner shall not cause a dissolution of the Partnership."[44] The Supreme Court thus held that the old JKJ Partnership dissolved upon the withdrawal of one of its members and a new partnership was created upon the substitution of that member for a new member.

With respect to the second and third certified questions, the Supreme Court held that, under the DRUPA, a partnership undergoes a "winding up" process upon its dissolution before terminating, although the Supreme Court noted that it did not have sufficient facts to determine whether JKJ Partnership had completed its "winding up" process. Assuming that it did not yet complete that process, the Supreme Court held that the old partnership could not continue to pursue the *qui tam* action during its "winding up" phase. In reaching this conclusion, the Supreme Court relied on the partnership agreement, which required the partnership to be "liquidated promptly or distributed in-kind" upon dissolution.[45] The Supreme Court explained that because the sole purpose of JKJ Partnership was to pursue the *qui tam* action, doing so during the "winding up" phase would be inconsistent with the concept of "liquidating" the partnership. The Supreme Court stated that the "concept of 'liquidating' Partnership property is inconsistent with continuing with carrying on the business for which the Partnership was established."[46] However, "[b]ecause of the dearth of case law in this area," the Supreme Court explicitly confined this particular holding "to the limited facts presented" to it.[47]

43 *Id.* at *9 (quoting the partnership agreement).

44 *Id.* at *11.

45 *Id.* at *13.

46 *Id.* at *14.

47 *Id.* at *15.

***Walsh v. White House Post Prods., LLC*, 2020 WL 1492543 (Del. Ch. Mar. 25, 2020) (McCormick, V.C.)**

In *Walsh v. White House Post Productions*,[48] the Court of Chancery found that a buyout provision in an LLC agreement constituted a call option and concluded it was reasonably conceivable that the defendant LLC had exercised the option and could not withdraw from the buyout process that was triggered by the exercise of the call option. This decision serves as a reminder for those drafting or entering into LLC agreements that for certain contractual rights to be revocable, the agreement should use clear and explicit terms permitting revocation.

The plaintiffs were members of Carbon Visual Effects, LLC ("Carbon"). Carbon's LLC agreement included a buyout provision that gave Carbon the right to purchase a member's units upon the end of that member's employment with the company. The buyout provision also included a triple-appraisal process to determine the value of the member's units. Under this process, the company would first retain an appraiser and obtain a valuation. If the member was dissatisfied with the outcome of this first appraisal, the member, at the member's own cost, could retain a second appraiser. Should the second appraisal value be more than 10% higher than the first, the buyout provision obligated the parties to jointly retain a third appraiser to determine the value of the member's units.

In 2018, Carbon notified the plaintiffs that it would not renew their employment with the company and the company would purchase their membership units. Carbon obtained an appraisal of the plaintiffs' units. After the plaintiffs informed Carbon that they would seek a second appraisal, Carbon decided not to purchase the plaintiffs' units. The plaintiffs' appraisal valuation was more than 10% higher than the first valuation, and the plaintiffs consequently contacted Carbon to obtain a third appraisal in accordance with the buyout provision. After Carbon did not respond to the plaintiffs, the plaintiffs filed suit seeking specific performance of the buyout provision, and Carbon moved to dismiss the action for failure to state a claim.

The plaintiffs argued that the buyout provision is similar to an option contract, whereby the plaintiffs hold open an offer to sell their units to the company and the

48 2020 WL 1492543 (Del. Ch. Mar. 25, 2020).

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company, after it accepts the offer, is prevented from revoking its acceptance. Carbon argued that its notice of intent to purchase the plaintiffs' units constituted an offer and, under common law contract principles, the company has the right to revoke that offer prior to the plaintiffs' acceptance.

The Court concluded that the buyout provision is a common law call option, consisting of two parts: (1) an underlying offer for the sale of membership units and (2) a collateral promise to hold that offer open. The terms of the buyout provision gave Carbon discretion whether to buy the membership units. But once Carbon exercised that discretion and accepted the offer, the buyout provision obligated the company to purchase the plaintiffs' units. The LLC agreement did not specify how Carbon must accept the offer. Under Delaware law, a party's acceptance of an offer may be expressed by words or symbols of assent, or implied by conduct. The Court held that Carbon's notice to the plaintiffs of its intent to purchase the units and undertaking of the first appraisal constituted a reasonably conceivable form of acceptance. The Court therefore denied Carbon's motion to dismiss the plaintiffs' claim for breach of contract and held that the plaintiffs stated a claim for specific performance because nothing in the complaint indicated that the plaintiffs were unwilling or unable to perform their contractual obligations.

Proceedings to Interpret, Apply, Enforce, or Determine the Validity of Corporate Instruments

***BlackRock Credit Allocation Income Tr. v. Saba Capital Master Fund, Ltd.*, 224 A.3d 964 (Del. Jan. 13, 2020)**

In *BlackRock Credit Allocation Income Trust v. Saba Capital Master Fund, Ltd.*,[1] the Delaware Supreme Court upheld a strict deadline contained in an advance notice bylaw for providing information to the board about a potential board nominee's qualifications, holding that a stockholder's nominees were properly excluded from an election when the stockholder failed to comply with the deadline. The Supreme Court reversed the Court of Chancery's holding that the board could not exclude the stockholder's nominees from the election on the basis that at least one-third of the information that the board required for nominations was not related to the qualifications for nominees as set forth in the bylaws.

The bylaws of BlackRock Credit Allocation Income Trust and BlackRock New York Municipal Bond Trust (together, "BlackRock") included advance notice provisions that required stockholders, in order to submit a nominee for a position on the boards, to submit timely nomination notices that included information sufficient to establish the nominee's qualifications as enumerated in the bylaws. The bylaws also included a provision that required stockholders to provide any supplemental information "reasonably requested" by the boards regarding a nominee's qualifications within five business days of the boards' request.[2]

Saba Capital Master Fund, Ltd. ("Saba"), a stockholder of each trust, submitted nomination notices for four nominees to BlackRock's boards. Three weeks later, the boards sent Saba a supplementation request containing the lengthy questionnaire. Saba did not respond within the five business day deadline. Seven days after the boards sent the request for supplementation, counsel for the boards informed Saba that its nominees were ineligible for election. Saba responded by providing the completed questionnaire and disputing that the response was late and that the information sought was within the scope permitted under the bylaws. A proxy contest ensued, leading to Saba filing an action in the Court of Chancery seeking a preliminary mandatory injunction requiring that BlackRock include Saba's nominees at the election and to count votes for such nominees. The Court of Chancery held that BlackRock could not require Saba to comply with the five business day deadline for submitting supplemental information because the questionnaire exceeded the bylaws' scope regarding nominee qualifications.

The Supreme Court reversed the Court of Chancery's decision, holding that "Saba had an obligation to respond to the request before the expiration of the deadline."[3] In response to Saba's arguments (and the Court of Chancery's decision) regarding the improper over-breadth of the questionnaire, the Supreme Court stated that "the record does not suggest that the Questionnaire's over-breadth precluded a timely response."[4] And the Supreme Court noted that although there were questions in the questionnaire that were not relevant to the qualifications for prospective board members pursuant to the bylaws, it was undisputed that at least one-third of the questions were directly relevant,

1 224 A.3d 964 (Del. 2020).

2 *Id.* at 968.

3 *Id.* at 978.

4 *Id.* at 979.

and, therefore: "If, after reviewing the Questionnaire, Saba believed that the Questionnaire exceeded the limits [of the bylaws], it should have raised the concern with the Trusts before the expiration of the deadline. What it could not do, without risking disqualification of its nominees, was to stay silent, do nothing, and let the deadline pass."[5]

The Supreme Court also stated that a rule permitting stockholders to ignore a clear advance notice bylaw deadline "and then, without having raised any objection, proffer after-the-fact reasons for their non-compliance with it, would create uncertainty in the electoral setting" and that "encouraging such after-the-fact factual inquiries into missed deadlines could potentially frustrate the purpose of advance-notice bylaws, which are designed and function to permit orderly meetings and election contests and to provide fair warning to the corporation so that it may have sufficient time to respond to shareholder nominations."[6]

***Claros Diagnostics, Inc. Shareholders Representative Committee v. Opko Health, Inc.*, 2020 WL 829361 (Del. Ch. Feb. 19, 2020) (Glasscock, V.C.)**

In *Claros Diagnostics, Inc. Shareholders Representative Committee v. Opko Health, Inc.*,[7] a case filed against an acquirer for payment under a merger agreement's earn-out provision, the Court of Chancery granted a motion to strike the acquirer's affirmative defenses for fraudulent inducement and breaches of representations on the basis that the affirmative defenses were time-barred. The Court addressed the doctrine of recoupment, emphasizing that this exception, permitting otherwise time-barred claims to be brought as affirmative defenses, is very narrowly tailored and interpreted by Delaware courts to require a strict "transactional nexus" with the plaintiff's claims.

In October 2011, OPKO Health, Inc. ("OPKO") purchased non-party Claros Diagnostics, Inc. ("Claros"), a company developing rapid blood testing technology. The purchase was carried out through a merger agreement whereby Claros merged into a subsidiary of OPKO ("New Claros"). Pursuant to an earn-out provision, OPKO would pay former equity holders of Claros in the form of equity in New Claros upon the achievement of certain milestones. The first milestone provided that upon "[r]eceipt of approval or clearance by the FDA to market" New Claros' testing technology, OPKO was required to pay the sellers $2.375 million in OPKO common stock.[8] The parties contemplated that between 2012 and 2018, the technology would generate more than $250 million in profit.

New Claros met the first milestone in January 2019, but OPKO refused to make payment. In response, on behalf of the former equity holders of Claros, the Claros Diagnostics, Inc. Shareholder Representative Committee filed suit in the Court of Chancery, seeking specific performance of the milestone payment, repudiation of the merger agreement, and breach of the implied covenant of good faith and fair dealing.

OPKO responded to the complaint by asserting, among other things, affirmative defenses including that (1) Claros' principals fraudulently induced OPKO to enter into the merger agreement by making false representations about the Claros' technology and (2) Claros breached the merger agreement by making false representations. Primarily, OPKO alleged that Claros misrepresented that its technology had no defects. According to OPKO, between the 2011 merger and the 2019 FDA approval, OPKO was forced to invest over $95 million in the technology due to significant defects. The parties did not dispute that OPKO was aware of these alleged significant defects as early as 2012.

The committee filed a motion to dismiss or strike OPKO's affirmative defenses as time-barred. OPKO argued in response that the defenses should be permitted as recoupment claims. Recoupment allows a defendant to "'resuscitate a time-barred claim and reduce the amount of damages that a plaintiff recovers.'"[9] But, a recoupment claim must "have a close *transactional nexus*" to the plaintiff's claims.[10]

Building upon the precedent of Delaware courts, Vice Chancellor Glasscock clarified the "transactional nexus" requirement. The Court explained that "the fact

5 *Id.*

6 *Id.* at 980.

7 2020 WL 829361 (Del. Ch. Feb. 19, 2020).

8 *Id.* at *2.

9 *Id.* (quoting *Terramar Retail Centers, LLC v. Marion #2-Seaport Tr.*, 2019 WL 2208465, at *20 (Del. Ch. May 22, 2019)).

10 *Id.* at *9 (internal quotation omitted) (emphasis added).

that a defense arises from the same relationship as does a plaintiff's claim is insufficient to permit the defense under a recoupment theory."[11] And "the 'transaction' for the transactional nexus inquiry focuses on the plaintiff's claim—and only the plaintiff's claim."[12] Furthermore, a claim that alleges breach of a portion of an agreement different than plaintiff's claim is not "transactionally related" to the plaintiff's claim: the claims must share a "factual core" such that the plaintiff's claim will require development of facts necessary to support the defendant's recoupment claim.[13]

Applying this framework, the Court granted the motion to strike OPKO's affirmative defenses of fraudulent inducement and breach of the merger agreement, reasoning that the committee's claims and OPKO's claims did not require development of the same facts, despite arising out of the same agreement. OPKO did not dispute that the first milestone was met and, instead, disputed the historic conduct of Claros' principals. As the Court noted, "[w]hether Claros' principals engaged in fraud or made misrepresentations [at the time of entering into the merger agreement] has no effect on—nor does it share a factual core with—the Committee's contractual claim to receive Milestone Payments upon the achievement of Milestones" or the committee's repudiation and implied covenant claims which depended on *recent* conduct.[14] The Court also noted that to permit OPKO's time-barred affirmative defense claims, where OPKO was aware of the alleged defects for years but chose to ignore them, would be "an application of the doctrine of recoupment . . . repugnant to equity."[15]

The Court also briefly addressed an unclean hands affirmative defense raised by OPKO. Although the Court did not strike that defense, reasoning that it required further factual development, the Court noted that an analysis of an unclean hands defense "employs a relational requirement akin to the transactional nexus requirement of recoupment," in that it "only applies where there exists a close nexus between the wrongdoing of the plaintiff and the relief he seeks," distinguishing it from an analysis of the plaintiff's conduct in general.[16]

[11] *Id.* at *10.

[12] *Id.*

[13] *Id.* at *10.

[14] *Id.*

[15] *Id.* at *11-12.

[16] *Id.* at *13.

Claros Diagnostics, therefore, makes clear that acquirers that have potential claims against sellers for fraudulent inducement or for breach of representations should not sit on such claims with the hope or expectation that they will be able to avoid making earn-out payments. If the statute of limitations runs on an acquirer's fraudulent inducement and breach of representation claims, and therefore the acquirer's right to set setoff[17] expires, the acquirer may be stuck having to make payment under the earn-out provision without the benefit of recoupment.

***Salzberg v. Schiabacucci*, --- A.3d ---, 2020 WL 1280785 (Del. Mar. 18, 2020)**

In *Salzberg v. Schiabacucci*,[18] the Delaware Supreme Court addressed the issue of whether Delaware law permits a corporate charter provision that requires the exclusive forum for any lawsuit asserting claims under the Securities Act of 1933—which by statute may be brought in either a federal or state court—to be the federal courts. The Supreme Court unanimously held that such charter provisions prohibiting 1933 Act lawsuits from being prosecuted in Delaware state courts ("Federal Forum Provisions") are not facially invalid, thereby reversing a contrary holding by the Court of Chancery. Although the Supreme Court decision answers a question of temporal importance to publicly held Delaware corporations, it raises novel questions that will likely require further litigation to resolve.

Federal Forum Provisions are a recent development that were intended to reduce the cost of litigating 1933 Act cases by locating them exclusively in the federal courts that are claimed to have greater expertise in these cases and therefore can process them more efficiently. Three Silicon Valley companies, incorporated in Delaware, adopted Federal Forum Provisions in their post-IPO charters. An action was filed in the Delaware Court of Chancery, claiming that those charter provisions were facially invalid as a matter of Delaware law.

[17] The Delaware Supreme Court explained the difference between setoff and recoupment in *Finger Lakes Capital Partners, LLC v. Honeoye Lake Acquisition, LLC*, 151 A.3d 450 (Del. 2016). Setoff is subject to a three year statute of limitations and "arises out of an independent transaction," whereas "time-barred claims can be considered for recoupment when they arise out of the same factually-related transaction as the plaintiff's claim." *Id.* at 454.

[18] --- A.3d ---, 2020 WL 1280785 (Del. Mar. 18, 2020).

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In a decision granting summary judgment to the plaintiff, the Court of Chancery ruled that the charter provisions were facially invalid. The Court of Chancery reasoned that: (1) the Delaware General Corporation Law ("DGCL") empowers Delaware corporations to provide in their charters for the management of the business and the corporation's affairs, and for defining and limiting the powers of the corporation and its directors and stockholders; (2) although this statutory power is broad, its scope is necessarily limited to matters that are internal to the corporation, *i.e.*, that would fall within the category of "internal affairs" as defined in Delaware jurisprudence;[19] (3) litigation involving the "internal affairs" of the corporation, such as stockholder actions brought to enforce statutory and fiduciary duties, would be "internal" matters regulatable by charter, but litigation falling outside this category ("external affairs"), such as tort and contract actions by third parties against the corporation, would not be; that is, such lawsuits would fall outside the corporation's statutory power to regulate by charter provision.[20]

Under this reasoning, litigation involving the corporation exists solely within a binary structure: the litigation implicates either the corporation's internal affairs or its external affairs. If the former, the litigation may lawfully be regulated by charter provision; if the latter, it may not be. That binary analytical framework framed the question before the trial court: does 1933 Act litigation implicate matters that are internal or external to the corporation? The Court of Chancery held that 1933 Act litigation, involving lawsuits by investors who became stockholders in a public offering of the corporation's securities, were external. The 1933 Act plaintiffs, although stockholders at the time of the lawsuit, were not stockholders at the time of the claimed wrongdoing (typically, improper prospectus disclosures). As such, those plaintiffs were indistinguishable from third parties filing a commercial tort or contract action against the company. Therefore, the Federal Forum Provisions at issue were invalid on their face.

On appeal, the Supreme Court reversed, holding that it was error to conclude that the Federal Forum Provisions were invalid on their face. For that to be true, the plaintiffs would have to show that the Federal Forum Provisions "cannot operate lawfully or equitably under any circumstances."[21] The plaintiffs failed to meet that burden, because the Federal Forum Provisions would fall within the purview of DGCL Section 102(b)(1), which authorizes charter provisions for the management of the business and the conduct of the affairs of the corporation, and that create, define, limit, and regulate the powers of the corporation, its directors, and its stockholders. The broad enabling language of Section 102 must be broadly construed, so long as those provisions do not violate Delaware law or public policy.

Turning to the Court of Chancery's reasoning, the Supreme Court held that nothing in Section 102 or the DGCL expressly limits the corporation's power to regulate litigation by charter provision to "internal affairs," nor was such a narrow construction mandated by public policy. The trial court's interpretation of Section 102 was too narrow, because litigation involving the corporation is not limited to a binary framework comprising only "internal" and "external" affairs. Rather, there is a continuum that comprises three categories of claims: (1) "internal corporate claims [or affairs]") (2) "intra-corporate claims [or affairs]" and (3) "external claims [or affairs]").[22]

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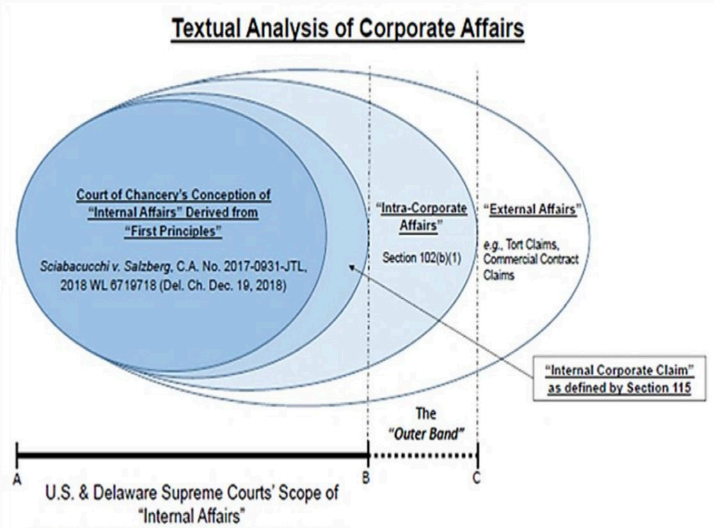
19 *Sciabacucchi v. Salzberg*, 2018 WL 6719718, at *14-15 (Del. Ch. Dec. 19, 2018).

20 *Id.* at *21.

21 *Salzberg*, --- A.3d ---, 2020 WL 1280785, at *4.

22 "Internal claims" (the "inner band" of the continuum) are as defined by the United States and the Delaware Supreme Court in decisions cited in the opinion, as well as DGCL Section 115 ("Claims . . . (i) based on a violation of a duty by a current or former director or officer or stockholder in such capacity, or (ii) as to which this title confers jurisdiction on the Court of Chancery."). *Id.* at *7. The "external claims" category falls into the "outer band" of the continuum. The "inter-corporate claims" category falls within the inner and outer bands and was coined in *ATP Tour, Inc. v. Deutscher Tennis Bund*, 91 A.3d 554 (Del. 2014), which involved the validity of a fee-shifting provision in the bylaws of a non-stock Delaware corporation. That provision applied where a member sued the corporation and lost. The Supreme Court described this scenario as "inter-corporate litigation" and ultimately held that 1933 Act litigation falls into this category, which may validly be regulated under Section 102(b)(1).

To illustrate that continuum, the Supreme Court provided in its opinion a Venn diagram that is reproduced below:



The Supreme Court held that 1933 Act litigation properly fell within the intermediate category of "intra-corporate claims," which were neither "internal corporate affairs" claims or "external claims," but which fell within the broad enabling provisions of Section 102. Therefore, it was error to hold that the Federal Forum Provisions were facially invalid under Delaware law. Conceivably, such a charter provision could be challenged as invalid "as applied" but such a challenge would need to occur in a specific factual context. If such a provision were found to be unreasonable or inequitable in specific circumstances, the court could grant appropriate relief.

The Supreme Court also found that the Federal Forum Provision did not violate public policy, because in *Rodriguez de Quijas v. Shearson/American Express, Inc.*,[23] the United States Supreme Court permitted a narrowing of the fora available under the 1933 Act, by upholding an arbitration provision in a brokerage firm's standard customer agreement that precluded state court litigation of 1933 Act claims. Because the Federal Forum Provisions similarly narrow forum alternatives available under the 1933 Act, they do not violate public policy.

Manifestly, the Delaware Supreme Court decision carves out new conceptual ground that unavoidably will raise new issues that will be the fodder for further litigation. We raise only two of them here.

First, will other state courts enforce the Federal Forum Provisions if a 1933 Act case is brought against a Delaware corporation in a non-Delaware state court? The Delaware Supreme Court decision acknowledged this question and attempted to address it in its opinion. The Supreme Court urged that many of the same reasons requiring application of the internal affairs doctrine support enforcing the Federal Forum Provisions. Courts must protect constitutional rights of officers, directors, and stockholders to know what law will be applied when their actions are challenged. Moreover, Federal Forum Provisions are procedural, not substantive: they govern only where a plaintiff may file suit, not whether a plaintiff may file suit. And, other state courts have respected Delaware forum selection provisions, which are more restrictive than the Federal Forum Provisions. Although these arguments for enforcing Federal Forum Provisions are compelling, only time will tell if other state courts will agree.

Second, the big unknown is the scope and content of the "intra-corporate affairs" category. Can a Delaware corporation validly adopt a charter provision that requires "internal affairs" litigation (or specific categories thereof) be arbitrated? What other types of litigation will be claimed as analogous to 1933 Act litigation or to the litigation involved in *ATP*? Conceptual breakthroughs, although created at the 30,000-foot level, must at some point be implemented at the ground level. We anticipate that attempts to do that will happen sooner rather than later.

The Chemours Co. v. DowDuPoint Inc., 2020 WL 1527783 (Del. Ch. Mar. 30, 2020) (Glasscock, V.C.)

In *The Chemours Company v. DowDuPont Inc.*,[24] the Delaware Court of Chancery dismissed an action for lack of subject matter jurisdiction, pursuant to Rule 12(b)(1), finding that a separation agreement that was entered in connection with a spin-off of a subsidiary from its parent required that the question of arbitrability be decided by an arbitration panel. In doing so, the Court held that where a subsidiary's board approves a spinoff and an officer of the subsidiary executes a separation agreement, the requirement of consent for a binding contract is satisfied, even if the terms of the separation agreement are dictated by the parent and the

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[23] 490 U.S. 477 (1989).

[24] 2020 WL 1527783 (Del. Ch. Mar. 30, 2020).

subsidiary has no opportunity to negotiate the terms of the agreement.

The Chemours Company ("Chemours") was created as a wholly-owned subsidiary of E.I. du Pont de Nemours and Company ("DuPont") in 2015. Shortly after its creation, Chemours was spun off as an independent corporation and its shares were distributed to DuPont's stockholders. Chemours also assumed $4 billion in debt in connection with the spin-off and used the proceeds to distribute a $3.91 billon dividend to DuPont.

During the course of structuring the spin-off, DuPont engaged Houlihan Lokey to prepare a financial analysis and an opinion that Chemours would be solvent as of the date of the spin-off. To conduct its valuation, Houlihan Lokey relied on "high end" estimates of environmental liabilities that Chemours would be assuming in connection with the spin-off, which estimates were provided and certified by DuPont. Houlihan Lokey provided its opinion "that it was appropriate, desirable, and in the best interests of DuPont and its stockholders to conduct [the spin-off], including the assignment of the liabilities to Chemours."[25]

The terms of the spin-off were set forth in a separation agreement. The separation agreement provided for the assignment of certain historical liabilities to Chemours, including a duty to indemnify DuPont for certain environmental related damages that DuPont incurred. The separation agreement also provided that any dispute between Chemours and DuPont "arising out of, in connection with, or in relation to the interpretation, performance, nonperformance, validity or breach" of the separation agreement that cannot be resolved by the parties "shall be submitted to final and binding arbitration. . . ."[26] Additionally, Section 8.2(c) of the separation agreement—the delegation clause—provided that "the Parties expressly agree that all issues of arbitrability, including all issues concerning the propriety and timeliness of the commencement of the arbitration . . . , the jurisdiction of the Arbitral Tribunal, and the procedural conditions for arbitration, shall be finally and solely determined by the Arbitral Tribunal."[27] And the separation agreement contained a Delaware choice-of-law provision.

Chemours filed suit against DuPont and alleged that had DuPont disclosed the "true maximum potential liabilities" that were assigned to Chemours, Houlihan Lokey "would have arrived at a valuation of Chemours' total liabilities that rendered the $3.91 billion dividend unlawful under" Sections 170, 173, and 174 of the Delaware General Corporation Law.[28] Chemours sought a declaration that the separation agreement's indemnification provisions were not enforceable or that they cannot not apply to liabilities in excess of the "high end" estimates of environmental liabilities that DuPont certified in connection with the spin-off. Alternatively, Chemours sought to be compensated for environmental liabilities in excess of the certified estimates or all or a portion of the $3.91 billion dividend Chemours issued to DuPont.

DuPont filed a motion to dismiss the action in favor of arbitration pursuant to Rule 12(b)(1), contending that the delegation clause mandated dismissal and required the parties to arbitrate the threshold issue of arbitrability.

In response, Chemours argued that it was not bound by the separation agreement's arbitration provisions because Chemours did not consent to arbitration and the Federal Arbitration Act ("FAA") does not require parties to arbitrate claims when they have not consented to doing so. Chemours argued that it did not consent to arbitration because its management did not have any ability to negotiate the terms of the separation agreement with DuPoint and all of the arbitration provisions "were conceived, drafted, and executed by DuPont alone."[29] According to Chemours, the separation agreement was not really a contract but rather "a form of quasi-constitutional corporation document" and that such agreements are generally enforced "not because they reflect the consented-to agreement that is fundamental to offer and acceptance but because, as a matter of sound administration of the corporate law and public policy, they will generally be enforceable."[30]

The Court rejected Chemours' argument that it was not bound by the separation agreement's arbitration provisions because it did not consent to them. The Court held that "[u]nder Delaware contract law, Chemours' board resolution and [officer's] signature on the Separation Agreement evidence Chemours' overt

25 *Id.* at *3.

26 *Id.* at *6.

27 *Id.* at *8.

28 *Id.* at *7.

29 *Id.* at *10.

30 *Id.* at *11.

manifestation of assent—and, therefore, Chemours' consent—to the Separation Agreement."[31] The Court stated: "Simply because the parent dictates terms to its wholly-owned subsidiary is *not* grounds under Delaware law to infer lack of consent such that the contract would not be enforceable."[32]

Chemours also argued that, even if the separation agreement was a binding contract meeting the consent requirements of the FAA, the Court should still decline to enforce the arbitration provision as unconscionable. Chemours argued that the arbitration provisions, including the delegation clause, were procedurally unconscionable because they were not consented to by Chemours. Chemours argued that the delegation clause was substantively unconscionable because Chemours had pled that certain provisions of the separation agreement were invalid or unenforceable, but the separation agreement provided that the arbitral tribunal could not "limit, expand, alter, amend, modify, revoke, or suspend any condition or provision" of the separation agreement.[33] Thus, Chemours argued, "if the arbitrators determine arbitrability, Chemours must make its arguments regarding the invalidity or unenforceability of the substantive provisions of the Separation Agreement 'to the arbitrators—who cannot hear it, because it would involve invalidating, modifying or suspending the arbitration provisions.'"[34]

The Court disagreed and held that Chemours failed to show that the delegation clause was unconscionable. The Court first noted that "an attack on a delegation clause must refer to the unconscionability of that clause and not the broader contractual provisions regarding arbitration."[35]

The Court then held that the delegation clause was not substantively unconscionable. The Court stated, that "[i]n order to properly challenge the Delegation Clause . . . , Chemours would have to argue that the limitation of the Arbitral Tribunal's powers causes the arbitration *over the arbitrability of Chemours' claim* that the Separation Agreement is invalid or unenforceable to be unconscionable."[36] The Court stated that the separation agreement did not prevent Chemours from arguing to the arbitral tribunal that the arbitration provisions were unconscionable under Delaware law and the arbitral tribunal would be required to apply Delaware law. Therefore, the Court found that Chemours' substantive unconscionability challenge was to the separation agreement's arbitration provisions in general, and was not specially a challenge to the delegation provision. The Court concluded that "contrary to Chemours' argument that the Delegation Clause operates as an unenforceable waiver of unconscionability, the Delegation Clause *does not* waive Chemours' ability to argue unconscionability. What the Delegation Clause does require is for Chemours to make that argument to the Arbitral Panel, not this Court."[37]

Finally, the Court concluded that the delegation clause was not procedurally unconscionable. The Court stated that "[e]ven if the Delaware Clause was the product of procedural unfairness, it cannot be procedurally unconscionable because such a finding cannot be squared with settled Delaware law that '[w]holly-owned subsidiary corporations are expected to operate for the benefit of their parent corporations; that is why they are created.'"[38]

***Conduent Bus. Servs., LLC v. Skyview Capital LLC*, C.A. No. 2020-0232-JTL (Del. Ch. Mar. 30, 2020) (TRANSCRIPT) (Laster, V.C.)**

In *Conduent Business Services, LLC v. Skyview Capital LLC*,[39] the Court of Chancery considered whether a Delaware court could assert jurisdiction over claims subject to a New York forum selection clause, where the New York courts' current operating procedures precluded litigation of the case on a schedule that might avert irreparable harm faced by the plaintiff. The Court held, in a transcript ruling, that the Court of Chancery is an appropriate venue and can assert jurisdiction over claims that functionally cannot be litigated in the contractually agreed upon venue due to the COVID-19 pandemic, provided that the Court otherwise has personal and subject matter jurisdiction with respect

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31 *Id.* at *10.

32 *Id.*

33 *Id.* at *13.

34 *Id.*

35 *Id.* at *12.

36 *Id.* at *14 (emphasis in opinion).

37 *Id.* (emphasis in opinion).

38 *Id.* (quoting Trenwick Am. Litig. Tr. v. Ernst & Young, L.L.P., 906 A.2d 168, 173 (Del. Ch. 2006), aff'd sub nom. Trenwick Am. Litig. Tr. v. Billett, 931 A.2d 438 (Del. 2007)).

39 C.A. No. 2020-0232-JTL (Del. Ch. Mar. 30, 2020) (TRANSCRIPT).

to the dispute. A party faced with irreparable harm should consider whether Delaware is an option if the contractually specified forum is unavailable by reason of the current COVID-19 crisis.

Conduent Business Services, LLC ("Conduent"), a Delaware entity, faced an anticipatory breach of an asset purchase agreement with a transfer date of April 30, 2020. The agreement included a New York forum selection clause. Due to the COVID-19 crisis, however, New York courts were indefinitely closed to "non-essential" matters, which include all new commercial filings. As a result, Conduent sought declaratory and injunctive relief in the Delaware Court of Chancery.

With respect to venue, the Court of Chancery observed that the New York courts, which are "among the finest in the world," had halted all civil litigation in response to the COVID-19 crisis:

> "The reality is that they face an extraordinary situation right now, and so it's understandable that they'd be in a position where they can't handle disputes. That doesn't thrust parties back into a state of nature where people can simply use self-help against each other. It means that people can go to other courts, if the jurisdictional bases are met, and seek relief in those courts. So in terms of the availability of potential relief in this Court, I think it exists."[40]

The Court ruled that, due to the current COVID-19 crisis and closure of New York's courts to commercial disputes, the chosen forum was "unavailable" for Conduent to seek the expedited relief needed to avert irreparable harm.[41] As a result, the Court of Chancery could exercise jurisdiction over this claim despite the contract's forum selection provision.

Ultimately, however, the Court denied expedition of Conduent's claims based upon the balance of the equities: the Court observed that it would need to resolve factual disputes to reach a resolution, which would be unduly difficult in the time available, taking into account the effects of the COVID-19 crisis.

The Court's ruling is consistent with precedent, which holds that where parties have agreed to a forum, and that forum later becomes unavailable, an alternative forum able to afford relief can appropriately exercise jurisdiction.[42] Thus, the Court's ruling highlights that there may be an alternate forum for parties to litigate their disputes where the parties' choice of forum is unavailable due to the COVID-19 crisis and that the crisis will be taken into account in the Court's consideration of whether to permit expedition.

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40 *Id.* at 34.

41 *Id.* at 10.

42 *See, e.g., Troy v. Schoon Corp.*, 2007 WL 949441, at *4 (Del. Ch. Mar. 26, 2007); *see also Kemper Mortg., Inc. v. Russell,* 2006 WL 355613, at *3 (S.D. Ohio Feb. 16, 2006) (holding court could exercise jurisdiction over claims where forum selection provision designated non-existent forum as exclusive forum); *McDonnell Douglas Corp. v. Islamic Republic of Iran,* 758 F.2d 341, 346 (8th Cir. 1985) (holding court could exercise jurisdiction where Islamic revolution rendered Iranian courts unavailable to hear claims).

Special Proceedings Under the Delaware General Corporation Law

***Lebanon Cty. Empls.' Ret. Fund v. AmerisourceBergen Corp.*, 2020 WL 132752 (Del. Ch. Jan. 13, 2020) (Laster, V.C.)**

In *Lebanon County Employees' Retirement Fund v. AmerisourceBergen Corp.*,[1] the Court of Chancery determined that stockholder plaintiffs established that they had a proper purpose to conduct an inspection of the books and records of AmerisourceBergen Corp. ("AmerisourceBergen") under Section 220 of the Delaware General Corporation Law. In doing so, the Court rejected a line of authority from the Court of Chancery requiring stockholders seeking books and records in order to investigate mismanagement to "state up-front what they planned to do with the fruits of the inspection."[2] The Court explained that the general application of a "purpose-plus-an-end" test "goes beyond what Section 220 and the Delaware Supreme Court precedent require" and that "Section 220 only requires that a stockholder state a proper purpose."[3]

AmerisourceBergen is "one of the world's largest wholesale distributors of opioid pain medication" and has been a subject of several state and federal investigations and lawsuits focused on the pharmaceutical industry's role in the national opioid epidemic.[4] The plaintiffs served a Section 220 demand for books and records on AmerisourceBergen, identifying the following as purposes for the inspection: (i) to investigate possible breaches of fiduciary duty, mismanagement, or violations of law by AmerisourceBergen directors and officers in connection to the distribution of opioids; (ii) to consider any remedies to be sought in connection with any breaches of fiduciary duty, mismanagement, or violations of law; (iii) to evaluate the independence and disinterestedness of AmerisourceBergen's directors; and (iv) to "evaluate possible litigation or other corrective measures."[5] AmerisourceBergen rejected the demand entirely, contending the plaintiffs did not have a proper purpose or a credible basis to suspect wrongdoing. The plaintiffs then filed a Section 220 action.

AmerisourceBergen argued that the plaintiffs failed to state a proper purpose to inspect books and records because, among other reasons, (i) the plaintiffs failed to prove a credible basis to suspect wrongdoing that would warrant further investigation; (ii) even if the plaintiffs had proven a credible basis to suspect wrongdoing, the plaintiffs' purpose in investigating wrongdoing was "confined to investigating a *Caremark* claim with the sole objective of bringing litigation," which according to AmerisourceBergen was not a viable claim;[6] and (iii) the plaintiffs failed to "present evidence demonstrating a credible basis to suspect actionable wrongdoing on the part of the Board."[7]

1 2020 WL 132752 (Del. Ch. Jan. 13, 2020).

2 *Id.* at *12.

3 *Id.* at *13.

4 *Id.* at *1.

5 *Id.* at *7.

6 *Id.* at *11 (ellipsis omitted). *Caremark* claims implicate a board's fiduciary duty of loyalty to oversee a corporation's operations. Boards of directors breach this duty of oversight only if "(a) [they] utterly failed to implement any reporting or information system or controls; or (b) having implemented such a system or controls, [they] consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention." *Stone v. Ritter*, 911 A.2d 362, 370 (Del. 2006) (discussing *In re Caremark Int'l Inc. Deriv. Litig.*, 698 A.2d 959 (Del. Ch. 1996)).

7 *Id.* at *14.

The Court rejected all of AmerisourceBergen's arguments. First, the Court found that the plaintiffs had shown there was a credible basis to infer that AmerisourceBergen possibly violated the Controlled Substances Act based on the numerous state and federal investigations and lawsuits against AmerisourceBergen in connection with the opioid crisis. The Court explained that a stockholder seeking books and records "need only establish by a preponderance of the evidence that there is a credible basis from which the court can infer a possibility of wrongdoing" and that a stockholder does not have to "prove by a preponderance of the evidence that [wrongdoing] and mismanagement are actually occurring."[8]

Second, the Court found AmerisourceBergen's assertion that the plaintiffs were confined to a specific use for the books and records as contrary to Delaware Supreme Court precedent.[9] Specifically, the Court rejected AmerisourceBergen's argument that stockholders must state in their demand their intended use of documents, other than litigation, to properly investigate wrongdoing.[10] The Court stated that "a stockholder need not both articulate a proper purpose for inspection and commit in advance to the ends to which it will put the books and records."[11] The Court also rejected AmerisourceBergen's argument that the plaintiffs' demand was limited to pursuing litigation. The Court stated that, while the plaintiffs' demand mentioned the evaluation of possible litigation as a possible use, the plaintiffs reserved the right to pursue all possible courses of action as a result of their investigation.

In holding that stockholders are not required to state the intended use of documents received in connection with a Section 220 demand, the Court pushed back against a line of Court of Chancery cases that applied the "purpose-plus-an-end test" by requiring stockholders to "state up-front what they planned to do with the fruits of the inspection."[12] The Court explained that the first two cases to apply the "purpose-plus-an-end test" did so in limited circumstances where stockholders had already filed merits-related cases and it was clear that the stockholders were seeking the books and records to aid the stockholders in connection with the claims asserted in the merits-related actions. However, the Court noted that, more recently, the Court of Chancery "has framed the purpose-plus-an-end test as a general requirement under Section 220" by applying it "to hold that a stockholder who fails to cite ends other than litigation when making a demand cannot use the fruits of the investigation for any purpose other than litigation."[13] The Court found that those cases "turn the purpose-plus-an-end concept into a requirement that goes beyond what Section 220 and Delaware Supreme Court precedent require."[14]

Third, the Court rejected AmerisourceBergen's argument that the plaintiffs must present evidence to support "actionable wrongdoing," akin to the standard required to survive a motion to dismiss under Court of Chancery Rule 23.1, and failed to do so. As an initial matter, the Court found that AmerisourceBergen's argument failed because the plaintiffs were "not seeking books and records for the sole purpose of investigating a potential *Caremark* claim."[15] Beyond that, the Court found that AmerisourceBergen's position imposed a heavy burden on stockholders that went beyond the standard established in *Seinfeld v. Verizon Communications, Inc*.[16] The Court explained that the "*Seinfeld* test only requires that a stockholder establish, by a preponderance of the evidence, that there is a credible basis to infer possible corporate wrongdoing or mismanagement."[17] Thus, the Court held that the plaintiffs had stated a credible basis to infer wrongdoing and had a proper purpose.

8 *Id.* at *8.

9 *Id.* at *11.

10 *Id.*

11 *Id.* at *11, *13.

12 *Id.* at *12.

13 *Id.* at *13.

14 *Id.*

15 *Id.* at *14. The Court stated that AmerisourceBergen's contention that the plaintiffs confined their demand to investigate *Caremark* claims with the goal of bringing litigation was an attempt by AmerisourceBergen to "lay the cornerstone" for its merits-based defenses against the Section 220 action. *Id.* at *11. The Court rejected AmerisourceBergen's merits-related defenses, including a Section 102(b)(7) defense and a statute of limitations defense, in part because the plaintiffs' demand was not limited to pursuing litigation and the plaintiffs' rights did "not turn on the existence of an actionable claim against the directors." *Id.* at *23. "The plaintiffs need only establish a credible basis to infer possible corporate mismanagement or wrongdoing, which they have done." *Id.*

16 909 A.2d 117 (Del. 2006).

17 *AmerisourceBergen Corp.*, 2020 WL 132752, at *15.

Finally, the Court found that that it was "straightforward" that the plaintiffs' stated purpose of investigating director independence and disinterestedness was a proper purpose.[18] The Court stated that the Delaware Supreme Court has held that it is within a stockholder's power to investigate such matters and has "criticized a plaintiff 'who sought books and records to plead his complaint' because he 'somehow only asked for records relating to the transaction he sought to redress and did not seek any books and records bearing on the independence of the board.'"[19]

With respect to the scope of the inspection, the Court held that the plaintiffs were entitled to formal board materials and that, after reviewing the formal board materials, they could take a Rule 30(b)(6) deposition of AmerisourceBergen on the issues of what types of books and records exist and where they are located.

***In re Appraisal of Panera Bread Co.*, 2020 WL 506684 (Del. Ch. Jan. 31, 2020) (Zurn, V.C.)**

In *In re Appraisal of Panera Bread Co.*,[20] the Court of Chancery found after trial in a statutory appraisal proceeding that the fair value of respondent Panera Bread Co.'s stock was the deal price minus synergies, rejecting the petitioners' fifteen-percent-higher proposed value and ascribing "no weight to other valuation metrics" such as discounted cash flow ("DCF"), comparable companies, and precedent transactions analyses.[21] *Panera* continues the Delaware courts' trend in appraisal proceedings to give weight to deal price where, despite imperfections, the process contains "indicia of reliability" such as arms'-length negotiations, an unconflicted board, multiple rounds of price increases, and the absence of topping bids in the post-signing period.[22]

The petitioners sought appraisal of their Panera stock after JAB holdings, B.V. purchased Panera for $315 per share. The petitioners argued that Panera's fair value was $361 per share, based primarily on their expert's DCF analysis.[23] In support of their argument that the Court should adopt their expert's analyses and disregard the deal price as an indicator of fair value, the petitioners pointed to three primary alleged problems in Panera's sale process: (1) the Panera board's "apathy, ignorance, and flat-footed[ness]," (2) the Panera CEO's desire to exit his position and retire, which incentivized him to sell Panera for less than fair value, and (3) Panera's financial advisor's conflicts of interest.[24]

The Court rejected the petitioners' arguments and found that, although the transaction had flaws, those "flaws d[id] not undermine its numerous indicia of reliability," which included "an arm's length negotiation, a disinterested and independent board, numerous price increases, no emerging [topping] bidders . . . , and outreach to all logical buyers."[25]

First, the deal process was not undermined by what the petitioners characterized as the board's "apathy, ignorance, and flat-footed[ness]."[26] While the Court found it problematic that the board "gave early guidance" to the would-be acquirer on a potential

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[18] *Id.* at *24.

[19] *Id.* (quoting *Sandys v. Pincus*, 152 A.3d 124, 128-29 (Del. 2016)).

[20] 2020 WL 506684. (Del. Ch. Jan. 31, 2020.)

[21] *Id.* at *1.

[22] *Id.* at *19 (citing *In re Appraisal of Stillwater Mining Co.*, 2019 WL 3943851, at *22 (Del. Ch. Aug. 21, 2019)). In contrast, in *Manichaean Capital, LLC v. SourceHOV Holdings, Inc.*, 2020 WL 496606 (Del. Ch. Jan. 30, 2020), the Court of Chancery held that the deal price was not entitled to any weight. The Court did not consider deal price as an indicator of fair value—and neither party argued for its use—because there was no real effort to "run a 'sale process' in advance" of the transaction at issue: there was not a single board meeting to consider the transaction and there was no solicitation of bids from third parties after the initial overture. *Id.* at *1, *18 n.243. Likewise,the market price was not reliable as the seller was a private company whose "equity was not traded in an efficient market." *Id.* at *18. Instead, the Court ultimately determined fair value by adopting the discounted cash flow analysis of petitioner's expert "*in toto*, except for my adjustment to the applicable size premium." *Id.* at *27.

[23] Panera, 2020 WL 506684, at *17. Specifically, the petitioners' gave 60% weight to their expert's DCF analysis, 30% weight to his comprable companies analysis, and 10% weight to his precedent transactions analysis. *Id.*

[24] *Id.* at *24-35.

[25] *Id.* at *24.

[26] *Id.*

price range that may have been too low, the Court reasoned that "this pricing guidance was not a potentially binding counteroffer, and did not set a ceiling on the price."[27] The petitioners also criticized Panera's board for moving too quickly in compliance with the acquirer's proposed timeline, but the Court found that the acquirer's "desire for speed benefitted" Panera because it minimized managerial distraction and potential disruption of Panera's operations.[28] The Court also found that Panera's board negotiated "less restrictive deal protections," including a no-shop with a fiduciary out, matching rights, and a 3.0% termination fee (negotiated down from 4.0%)—all standard deal terms that provided flexibility to Panera.[29] Finally, the Court rejected the petitioners' argument that the board's decision to pursue a "logical buyer universe" of only two buyers was "absurd," holding that the board "possessed a robust body of evidence that it used to determine the universe of logical buyers" and "the absence of a wider canvass or go-shop d[id] not change the reliability of Panera's outreach."[30] In sum, "[t]he board's performance d[id] not render Panera's pre-signing process unreliable."[31]

Second, even though Panera's CEO, Ronald Shaich, "led the negotiations" and "wanted to exit Panera," his "desire to retire did not undermine the deal process or diminish Panera's standalone value."[32] Rather, the Court found that Shaich was "intent on driving the price upwards" and credited testimony that he was "supremely focused on finding a good home for the company and preserving [Panera's] legacy."[33]

Third, the Court rejected the petitioners' arguments that Panera's financial advisor, Morgan Stanley, undermined the deal process. Although Morgan Stanley had previously done work for the acquirer, this was disclosed to the Panera board, and the petitioners presented no evidence that Morgan Stanley preferred the acquirer's interests. Moreover, Morgan Stanley provided competent advice that informed Panera's negotiating strategy. Finally, the fact that "the board had very little time with Morgan Stanley's valuation" before approving the merger did not undermine the sale process.[34]

The Court also affirmatively concluded that the deal process bore several objective indicia of reliability, including that (1) the board was independent and unconflicted, (2) the acquirer conducted robust diligence based on both public and confidential information, (3) the board extracted two price increases from the acquirer during negotiations, (4) no post-signing bidders emerged, despite the fact that the deal leaked during negotiations and thus provided numerous market actors with notice and an opportunity to bid, and (5) Panera solicited all logical buyers.

After finding that the deal process was not undermined and contained numerous indicia of reliability, the Court conducted a synergies analysis and deducted $11.56 from the deal price to arrive at a "deal price minus synergies valuation method" that yielded a price of $303.44 per share.[35] The Court further reasoned that, "in the context of a persuasive deal price," the petitioners' expert's alternative valuation methodologies (DCF, comparable companies, and precedent transactions) were unreliable and deserved no weight.[36]

Although the Court held that the deal price minus synergies was Panera's fair value, the Court noted that Panera had chosen to pre-pay the petitioners the deal price of $315 per share.[37] The Court rejected Panera's request that the Court require the petitioners to refund the difference between the $315-per-share payment and the Court's fair value determination of $303.44 per share, finding that such request had no basis in the appraisal statute and that the respondent had provided no other grounds on which the difference would be recoverable. This holding serves as a warning to appraisal respondents that, if they decide to pre-pay the deal consideration to petitioners, they will not be entitled to a refund of any difference between that deal price and a lower fair value determination (absent contractual agreement otherwise).

27 *Id.* at *27.
28 *Id.* at *28.
29 *Id.* at *29.
30 *Id.* at *24.
31 *Id.* at *29.
32 *Id.* at *31.
33 *Id.* at *30.
34 *Id.* at *35.
35 *Id.* at *35-40.
36 *Id.* at *40-43.
37 *Id.* at *43.

Members of the Corporate Counseling and Litigation Section

Martin S. Lessner
Partner and Chair of Section
mlessner@ycst.com
302.571.6698

Elena C. Norman
Partner and Vice Chair of Section
enorman@ycst.com
302.571.5029

Rolin P. Bissell
Partner
rbissell@ycst.com
302.571.6560

Emily V. Burton
Partner
eburton@ycst.com
302.571.6747

C. Barr Flinn
Partner
bflinn@ycst.com
302.571.6692

William D. Johnston
Partner
wjohnston@ycst.com
302.571.6679

Paul J. Loughman
Partner
ploughman@ycst.com
302.576.3598

David C. McBride
Partner
dmcbride@ycst.com
302.571.6639

Tammy L. Mercer
Partner
tmercer@ycst.com
302.571.6556

James M. Yoch, Jr.
Partner
jyoch@ycst.com
302.576.3584

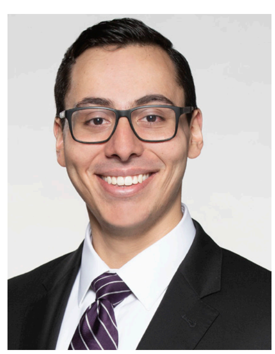
Jack B. Jacobs
Senior Counsel
jjacobs@ycst.com
302.571.6626

Nicholas J. Rohrer
Counsel
nrohrer@ycst.com
302.571.6713

Richard J. Thomas
Counsel
rjthomas@ycst.com
302.571.6739

Peter J. Artese
Associate
partese@ycst.com
302.571.6651

Elisabeth S. Bradley
Associate
ebradley@ycst.com
302.571.5010



Alberto E. Chávez
Associate
achavez@ycst.com
302.571.6729

Lauren Dunkle Fortunato
Associate
lfortunato@ycst.com
302.571.6624

Caleb G. Johnson
Associate
cjohnson@ycst.com
302.571.5011

Daniel M. Kirshenbaum
Associate
dkirshenbaum@ycst.com
302.571.5025

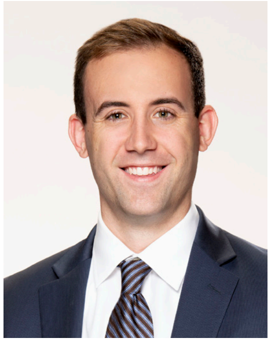
Michael A. Laukaitis, II
Associate
mlaukaitis@ycst.com
302.571.5031

Lakshmi A. Muthu
Associate
lmuthu@ycst.com
302.576.3248

Michael E. Neminski
Associate
mneminski@ycst.com
302.571.6696

Mae Oberste
Associate
moberste@ycst.com
302.571.6691

Benjamin M. Potts
Associate
bpotts@ycst.com
302.571.5027



Kevin P. Rickert
Associate
krickert@ycst.com
302.571.6743

M. Paige Valeski
Associate
pvaleski@ycst.com
302.571.6702

YOUNG
CONAWAY

Rodney Square
1000 North King Street
Wilmington, Delaware 19801
P: 302.571.6600
F: 302.571.1253
YoungConaway.com